

ESSA Bancorp, Inc.  
Form 10-Q  
August 08, 2014  
Table of Contents

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

**FORM 10-Q**

x **Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**For the quarterly period ended June 30, 2014**

**OR**

.. **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No. 001-33384**

**ESSA Bancorp, Inc.**

**(Exact name of registrant as specified in its charter)**

**Pennsylvania**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**20-8023072**  
**(I.R.S. Employer**  
**Identification Number)**

**200 Palmer Street, Stroudsburg, Pennsylvania**  
**(Address of Principal Executive Offices)**

**18360**  
**(Zip Code)**

**(570) 421-0531**

**(Registrant's telephone number)**

N/A

**(Former name or former address, if changed since last report)**

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 (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such 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 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" and "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  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

As of August 1, 2014 there were 11,758,278 shares of the Registrant's common stock, par value \$0.01 per share, outstanding.

**Table of Contents**

**ESSA Bancorp, Inc.**

**FORM 10-Q**

**Table of Contents**

	Page
<b><u>Part I. Financial Information</u></b>	
Item 1. <u>Financial Statements (unaudited)</u>	1
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	34
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	43
Item 4. <u>Controls and Procedures</u>	43
<b><u>Part II. Other Information</u></b>	
Item 1. <u>Legal Proceedings</u>	45
Item 1A. <u>Risk Factors</u>	45
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	45
Item 3. <u>Defaults Upon Senior Securities</u>	45
Item 4. <u>Mine Safety Disclosures</u>	45
Item 5. <u>Other Information</u>	45
Item 6. <u>Exhibits</u>	46
<u>Signature Page</u>	47

**Table of Contents****Part I. Financial Information****Item 1. Financial Statements**

## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEET

(UNAUDITED)

	<b>June 30, 2014</b>	<b>September 30, 2013</b>
	<b>(dollars in thousands)</b>	
Cash and due from banks	\$ 18,600	\$ 22,393
Interest-bearing deposits with other institutions	4,880	4,255
<b>Total cash and cash equivalents</b>	<b>23,480</b>	<b>26,648</b>
Certificates of deposit	1,767	1,767
Investment securities available for sale, at fair value	375,024	315,622
Loans receivable (net of allowance for loan losses of \$8,836 and \$8,064)	1,050,125	928,230
Regulatory stock, at cost	12,757	9,415
Premises and equipment, net	17,121	15,747
Bank-owned life insurance	29,484	28,797
Foreclosed real estate	2,967	2,111
Intangible assets, net	2,599	2,466
Goodwill	10,259	8,817
Deferred income taxes	10,971	11,183
Other assets	22,624	21,512
<b>TOTAL ASSETS</b>	<b>\$ 1,559,178</b>	<b>\$ 1,372,315</b>
<b>LIABILITIES</b>		
Deposits	\$ 1,143,095	\$ 1,041,059
Short-term borrowings	78,749	23,000
Other borrowings	145,550	129,260
Advances by borrowers for taxes and insurance	11,924	4,962
Other liabilities	8,563	7,588
<b>TOTAL LIABILITIES</b>	<b>1,387,881</b>	<b>1,205,869</b>
<b>STOCKHOLDERS EQUITY</b>		
Preferred Stock (\$.01 par value; 10,000,000 shares authorized, none issued)		
Common stock (\$.01 par value; 40,000,000 shares authorized, 18,133,095 issued;	181	181

Edgar Filing: ESSA Bancorp, Inc. - Form 10-Q

11,823,878 and 11,945,564 outstanding at June 30, 2014 and September 30, 2013)		
Additional paid in capital	182,642	182,440
Unallocated common stock held by the Employee Stock Ownership Plan (ESOP)	(10,193)	(10,532)
Retained earnings	75,781	71,709
Treasury stock, at cost; 6,309,217 and 6,187,531 shares outstanding at June 30, 2014 and September 30, 2013, respectively	(77,445)	(76,117)
Accumulated other comprehensive income (loss)	331	(1,235)
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>171,297</b>	<b>166,446</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 1,559,178</b>	<b>\$ 1,372,315</b>

See accompanying notes to the unaudited consolidated financial statements.

**Table of Contents**

ESSA BANCORP, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENT OF INCOME  
(UNAUDITED)

	For the Three Months Ended		For the Nine Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
	(dollars in thousands, except per share data)			
<b>INTEREST INCOME</b>				
Loans receivable, including fees	\$ 11,807	\$ 11,032	\$ 32,173	\$ 34,310
Investment securities:				
Taxable	1,632	1,370	4,682	4,558
Exempt from federal income tax	173	73	318	200
Other investment income	173	16	317	63
<b>Total interest income</b>	<b>13,785</b>	<b>12,491</b>	<b>37,490</b>	<b>39,131</b>
<b>INTEREST EXPENSE</b>				
Deposits	2,015	1,757	5,909	5,576
Short-term borrowings	54	27	104	109
Other borrowings	619	858	1,951	2,994
<b>Total interest expense</b>	<b>2,688</b>	<b>2,642</b>	<b>7,964</b>	<b>8,679</b>
<b>NET INTEREST INCOME</b>	<b>11,097</b>	<b>9,849</b>	<b>29,526</b>	<b>30,452</b>
Provision for loan losses	500	1,100	2,000	2,950
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>10,597</b>	<b>8,749</b>	<b>27,526</b>	<b>27,502</b>
<b>NONINTEREST INCOME</b>				
Service fees on deposit accounts	828	797	2,342	2,315
Services charges and fees on loans	283	277	572	774
Trust and investment fees	260	230	701	641
Gain (loss) on sale of investments, net	(10)	11	226	749
Gain on sale of loans, net		11		426
Earnings on Bank-owned life insurance	234	235	687	709
Insurance commissions	205	231	625	638
Gain on acquisition	241		241	
Other	59	8	85	32

Edgar Filing: ESSA Bancorp, Inc. - Form 10-Q

Total noninterest income	2,100	1,800	5,479	6,284
<b>NONINTEREST EXPENSE</b>				
Compensation and employee benefits	4,912	4,690	13,577	14,314
Occupancy and equipment	1,051	956	3,034	2,935
Professional fees	441	549	1,348	1,453
Data processing	977	687	2,426	2,155
Advertising	243	170	463	425
Federal Deposit Insurance Corporation (FDIC) premiums	266	261	730	739
Gain on foreclosed real estate	(65)	(100)	(116)	(498)
Merger related costs	176		522	
Amortization of intangible assets	282	250	756	749
Other	812	691	1,987	2,177
Total noninterest expense	9,095	8,154	24,727	24,449
Income before income taxes	3,602	2,395	8,278	9,337
Income taxes	976	519	2,146	2,542
<b>NET INCOME</b>	<b>\$ 2,626</b>	<b>1,876</b>	<b>\$ 6,132</b>	<b>\$ 6,795</b>
Earnings per share				
Basic	\$ 0.24	0.16	\$ 0.56	\$ 0.58
Diluted	\$ 0.24	0.16	\$ 0.56	\$ 0.58
Dividends per share	\$ 0.07	0.05	\$ 0.19	\$ 0.15

See accompanying notes to the unaudited consolidated financial statements.

**Table of Contents**

ESSA BANCORP, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME  
(UNAUDITED)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(dollars in thousands)</b>			
Net income	\$ 2,626	\$ 1,876	\$ 6,132	\$ 6,795
Other comprehensive income (loss):				
Investment securities available for sale:				
Unrealized holding gain (loss)	3,281	(6,354)	2,578	(8,229)
Tax effect	(1,116)	2,160	(877)	2,798
Reclassification of (gains) loss recognized in net income	10	(11)	(226)	(749)
Tax effect	(3)	4	77	255
Net of tax amount	2,172	(4,201)	1,552	(5,925)
Pension plan adjustment:				
Related to actuarial losses and prior service cost	7	98	21	294
Tax effect	(2)	(33)	(7)	(100)
Net of tax amount	5	65	14	194
Total other comprehensive income (loss)	2,177	(4,136)	1,566	(5,731)
Comprehensive income (loss)	\$ 4,803	\$ (2,260)	\$ 7,698	\$ 1,064

See accompanying notes to the unaudited consolidated financial statements.



**Table of Contents**

ESSA BANCORP, INC. AND SUBSIDIARY  
 CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
 (UNAUDITED)

	<b>Common Stock</b>		<b>Unallocated Common Stock Held by</b>		<b>Retained</b>	<b>Treasury</b>	<b>Accumulated Other Comprehensive</b>	<b>Total</b>
	<b>Number of Shares</b>	<b>Amount</b>	<b>Paid In Capital</b>	<b>the ESOP</b>	<b>Earnings</b>	<b>Stock</b>	<b>Income(Loss)</b>	<b>Stockholders Equity</b>
	(dollars in thousands)							
Balance, September 30, 2013	11,945,564	\$ 181	\$ 182,440	\$ (10,532)	\$ 71,709	\$ (76,117)	\$ (1,235)	\$ 166,446
Net income					6,132			6,132
Other comprehensive income							1,566	1,566
Cash dividends declared (\$0.19 per share)					(2,060)			(2,060)
Stock based compensation			170					170
Allocation of ESOP stock			32	339				371
Treasury shares purchased	(121,686)					(1,328)		(1,328)
Balance, June 30, 2014	11,823,878	\$ 181	\$ 182,642	\$ (10,193)	\$ 75,781	\$ (77,445)	\$ 331	\$ 171,297

See accompanying notes to the unaudited consolidated financial statements.

**Table of Contents**

ESSA BANCORP, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(UNAUDITED)

	<b>For the Nine Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>
	<b>(dollars in thousands)</b>	
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 6,132	\$ 6,795
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,000	2,950
Provision for depreciation and amortization	948	860
Amortization and accretion of discounts and premiums, net	829	1,205
Net gain on sale of investment securities	(226)	(749)
Gain on sale of loans, net		(426)
Origination of mortgage loans sold		(19,184)
Proceeds from sale of mortgage loans originated for sale		19,956
Compensation expense on ESOP	371	361
Stock based compensation	170	1,461
(Increase) decrease in accrued interest receivable	(629)	307
Increase (decrease) in accrued interest payable	202	(156)
Earnings on bank-owned life insurance	(687)	(709)
Deferred federal income taxes	(738)	1,646
Decrease in prepaid FDIC premiums		1,934
(Decrease) increase in accrued pension liability	(412)	312
Gain on foreclosed real estate, net	(116)	(498)
Amortization of identifiable intangible assets	756	750
Other, net	2,113	2,568
Net cash provided by operating activities	\$ 10,713	\$ 19,383
<b>INVESTING ACTIVITIES</b>		
Purchase of certificates of deposit	\$	\$ (500)
Investment securities available for sale:		
Proceeds from sale of investment securities	8,065	39,212
Proceeds from principal repayments and maturities	27,863	80,111
Purchases	(37,720)	(109,764)
Decrease in loans receivable, net	27,025	3,285
Redemption of regulatory stock	2,431	9,556
Purchase of regulatory stock	(4,204)	
Investment in limited partnership		(451)

Edgar Filing: ESSA Bancorp, Inc. - Form 10-Q

Investment in insurance subsidiary		(276)
Proceeds from sale of foreclosed real estate	2,038	2,841
Acquisition, including cash acquired	(15,415)	
Capital improvements to foreclosed real estate		(86)
Purchase of premises, equipment, and software	(498)	(723)

Net cash provided by investing activities	\$ 9,585	\$ 23,205
---	----------	-----------

**FINANCING ACTIVITIES**

(Decrease) increase in deposits, net	\$ (68,902)	\$ 22,863
Net increase (decrease) in short-term borrowings	55,749	(11,069)
Proceeds from other borrowings	42,500	19,800
Repayment of other borrowings	(56,387)	(66,100)
Increase in advances by borrowers for taxes and insurance	6,962	9,875
Purchase of treasury stock shares	(1,328)	(11,430)
Dividends on common stock	\$ (2,060)	\$ (1,751)

Net cash used for financing activities	(23,466)	(37,812)
--	----------	----------

Increase in cash and cash equivalents	(3,168)	4,776
---------------------------------------	---------	-------

<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>26,648</b>	<b>15,550</b>
---	---------------	---------------

<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 23,480</b>	<b>\$ 20,326</b>
---	------------------	------------------

**SUPPLEMENTAL CASH FLOW DISCLOSURES**

Cash Paid:

Interest	\$ 7,762	\$ 8,835
----------	----------	----------

Income taxes	2	662
--------------	---	-----

Noncash items:

Transfers from loans to foreclosed real estate	2,342	952
--	-------	-----

Treasury stock payable		66
------------------------	--	----

Non cash asset received and liabilities assumed:

Goodwill		276
----------	--	-----

Acquisition of FNCB:

Cash received	4,640	
---------------	-------	--

Noncash assets acquired

Loans receivable and accrued interest receivable	1,033	
--	-------	--

Premises and equipment	1,626	
------------------------	-------	--

Goodwill	1,442	
----------	-------	--

4,101

Liabilities assumed:

Certificates of deposit	3,069	
-------------------------	-------	--

Deposits other than certificates of deposit	5,683	
---	-------	--

8,752

Net noncash assets acquired		(4,651)	
Cash acquired	\$	11	\$
Acquisition of Franklin Security Bank assets and liabilities:			
Noncash assets acquired			
Investment securities, available for sale	\$	55,901	\$
Loans receivable		152,188	
Federal Home Loan Bank stock		1,569	
Premises and equipment		176	
Foreclosed real estate		436	
Intangible assets, net		889	
Deferred income taxes		1,031	
Other assets		2,504	
	\$	214,694	\$
Liabilities assumed:			
Certificates of deposits		90,869	
Deposits other than certificates of deposits		71,317	
Other borrowings		30,177	
Other liabilities		2,265	
		194,628	
Net noncash assets acquired		20,066	
Cash acquired	\$	(19,825)	\$

See accompanying notes to the unaudited consolidated financial statements.

**Table of Contents**

ESSA BANCORP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(unaudited)

**1. Nature of Operations and Basis of Presentation**

The consolidated financial statements include the accounts of ESSA Bancorp, Inc. (the Company), and its wholly owned subsidiary, ESSA Bank & Trust (the Bank), and the Bank's wholly owned subsidiaries, ESSACOR, Inc.; Pocono Investments Company; ESSA Advisory Services, LLC; Integrated Financial Corporation; and Integrated Abstract Incorporated, a wholly owned subsidiary of Integrated Financial Corporation. The primary purpose of the Company is to act as a holding company for the Bank. The Company is subject to regulation and supervision as a savings and loan holding company by the Federal Reserve Board. The Bank is a Pennsylvania-chartered savings bank located in Stroudsburg, Pennsylvania. The Bank's primary business consists of the taking of deposits and granting of loans to customers generally in Monroe, Northampton, Lehigh, Lackawanna and Luzerne counties, Pennsylvania. The Bank is subject to regulation and supervision by the Pennsylvania Banking Department and the Federal Deposit Insurance Corporation. The investment in subsidiary on the parent company's financial statements is carried at the parent company's equity in the underlying net assets.

ESSACOR, Inc. is a Pennsylvania corporation that has been used to purchase properties at tax sales that represent collateral for delinquent loans of the Bank. Pocono Investment Company is a Delaware corporation formed as an investment company subsidiary to hold and manage certain investments, including certain intellectual property. ESSA Advisory Services, LLC is a Pennsylvania limited liability company owned 100 percent by ESSA Bank & Trust. ESSA Advisory Services, LLC is a full-service insurance benefits consulting company offering group services such as health insurance, life insurance, short-term and long-term disability, dental, vision, and 401(k) retirement planning as well as individual health products. Integrated Financial Corporation is a Pennsylvania Corporation that provided investment advisory services to the general public as a former subsidiary of First Star Bank. The Company acquired First Star Bank in a transaction that closed on July 31, 2012. Integrated Financial Corporation is currently inactive. Integrated Abstract Incorporated is a Pennsylvania Corporation that provides title insurance services. All significant intercompany accounts and transactions have been eliminated in consolidation.

The unaudited consolidated financial statements reflect all adjustments, which in the opinion of management, are necessary for a fair presentation of the results of the interim periods and are of a normal and recurring nature. Operating results for the nine month period ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending September 30, 2014.

**2. Earnings per Share**

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation for the three and nine month periods ended June 30, 2014 and 2013.

**Three months ended**

**Nine months ended**

Edgar Filing: ESSA Bancorp, Inc. - Form 10-Q

	<b>June 30, 2014</b>	<b>June 30, 2013</b>	<b>June 30, 2014</b>	<b>June 30, 2013</b>
Weighted-average common shares outstanding	18,133,095	18,162,764	18,133,095	18,142,984
Average treasury stock shares	(6,272,961)	(5,645,336)	(6,233,349)	(5,269,686)
Average unearned ESOP shares	(1,012,790)	(1,058,066)	(1,024,151)	(1,069,427)
Average unearned non-vested shares	(9,752)	(49,571)	(11,233)	(38,970)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	10,837,592	11,409,791	10,864,362	11,764,901
Additional common stock equivalents (non-vested stock) used to calculate diluted earnings per share				
Additional common stock equivalents (stock options) used to calculate diluted earnings per share				
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	10,837,592	11,409,791	10,864,362	11,764,901

---

**Table of Contents**

At June 30, 2014 and 2013 there were options to purchase 1,458,379 shares of common stock outstanding at a price of \$12.35 per share that were not included in the computation of diluted EPS because to do so would have been anti-dilutive. At June 30, 2014 and 2013 there were 4,440 and 24,999 shares, respectively, of nonvested stock outstanding at prices of \$10.94 and \$12.35 per share, respectively that were not included in the computation of diluted EPS because to do so would have been anti-dilutive.

**3. Use of Estimates in the Preparation of Financial Statements**

The accounting principles followed by the Company and its subsidiaries and the methods of applying these principles conform to U.S. generally accepted accounting principles ( GAAP ) and to general practice within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the Consolidated Balance Sheet date and related revenues and expenses for the period. Actual results could differ significantly from those estimates.

**4. Recent Accounting Pronouncements:**

In June 2013, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2013-08, *Financial Services – Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*. The amendments in this Update affect the scope, measurement, and disclosure requirements for investment companies under U.S. GAAP. The amendments do all of the following: (1) change the approach to the investment company assessment in Topic 946, clarify the characteristics of an investment company, and provide comprehensive guidance for assessing whether an entity is an investment company; (2) require an investment company to measure noncontrolling ownership interests in other investment companies at fair value rather than using the equity method of accounting; and (3) require the following additional disclosures: (a) the fact that the entity is an investment company and is applying the guidance in Topic 946, (b) information about changes, if any, in an entity's status as an investment company, and (c) information about financial support provided or contractually required to be provided by an investment company to any of its investees. The amendments in this Update are effective for an entity's interim and annual reporting periods in fiscal years that begin after December 15, 2013. Earlier application is prohibited. This Update is not expected to have a significant impact on the Company's financial statements.

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. This Update is not expected to have a significant impact on the Company's financial

statements.

In January 2014, the FASB issued ASU 2014-01, *Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects*. The amendments in this Update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this Update should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In January 2014, the FASB issued ASU 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan



---

**Table of Contents**

through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (a new revenue recognition standard). The Update's core principle is that a company will recognize revenue to depict the transfer of 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 addition, this update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. This update is not expected to have a significant impact on the Company's financial statements.

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*. The amendments in this Update change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. For repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. The amendments also require enhanced disclosures. The accounting changes in this Update are effective for the first interim or annual period beginning after December 15, 2014. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Earlier application is prohibited. The disclosure for certain transactions accounted for as a sale is required to be presented for interim and annual periods beginning after December 15, 2014, and the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. The disclosures are not required to be presented for comparative periods before the effective date. This Update is not expected to have a significant impact on the Company's financial statements.

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*. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments in this Update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this Update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. Additionally, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. This Update is not expected to have a significant impact on the Company's financial statements.



**Table of Contents****5. Investment Securities**

The amortized cost and fair value of investment securities available for sale are summarized as follows (in thousands):

	<b>June 30, 2014</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>Available for Sale</b>				
Fannie Mae	\$ 141,678	\$ 1,991	\$ (1,230)	\$ 142,439
Freddie Mac	80,805	813	(1,017)	80,601
Governmental National Mortgage Association	31,709	170	(170)	31,709
Other mortgage-backed securities	2,839		(7)	2,832
<b>Total mortgage-backed securities</b>	<b>257,031</b>	<b>2,974</b>	<b>(2,424)</b>	<b>257,581</b>
Obligations of states and political subdivisions	42,067	1,390	(294)	43,163
U.S. government agency securities	48,037	240	(372)	47,905
Corporate obligations	13,169	262	(26)	13,405
Trust-preferred securities	5,003	688		5,691
Other debt securities	5,233	40	(19)	5,254
<b>Total debt securities</b>	<b>370,540</b>	<b>5,594</b>	<b>(3,135)</b>	<b>372,999</b>
Equity securities - financial services	2,025			2,025
<b>Total</b>	<b>\$ 372,565</b>	<b>\$ 5,594</b>	<b>\$ (3,135)</b>	<b>\$ 375,024</b>

	<b>September 30, 2013</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>Available for Sale</b>				
Fannie Mae	\$ 114,927	\$ 1,691	\$ (1,595)	\$ 115,023
Freddie Mac	60,111	838	(1,252)	59,697
Governmental National Mortgage Association	39,692	289	(230)	39,751
Other mortgage-backed securities	3,385		(19)	3,366
<b>Total mortgage-backed securities</b>	<b>218,115</b>	<b>2,818</b>	<b>(3,096)</b>	<b>217,837</b>
Obligations of states and political subdivisions	23,754	654	(499)	23,909
U.S. government agency securities	52,775	225	(480)	52,520
Corporate obligations	12,756	186	(169)	12,773
Trust-preferred securities	4,943	471		5,414
Other debt securities	1,147	7		1,154

Edgar Filing: ESSA Bancorp, Inc. - Form 10-Q

Total debt securities	313,490	4,361	(4,244)	313,607
Equity securities - financial services	2,025		(10)	2,015
Total	\$ 315,515	\$ 4,361	\$ (4,254)	\$ 315,622

**Table of Contents**

The amortized cost and fair value of debt securities at June 30, 2014, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

	<b>Available For Sale</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>
Due in one year or less	\$ 2,130	\$ 2,144
Due after one year through five years	47,511	47,901
Due after five years through ten years	63,011	63,750
Due after ten years	257,888	259,204
<b>Total</b>	<b>\$ 370,540</b>	<b>\$ 372,999</b>

For the three months ended June 30, 2014, the Company realized gross losses of \$10,000 on proceeds from the sale of investment securities of \$100. For the nine months ended June 30, 2014, the Company realized gross gains of \$247,000 and gross losses of \$21,000 on proceeds from the sale of investment securities of \$8.1 million. For the three months ended June 30, 2013, the Company realized gross gains of \$11,000 on proceeds from the sale of investment securities of \$23,000. For the nine months ended June 30, 2013, the Company realized gross gains of \$767,000 and gross losses of \$18,000 on proceeds from the sale of investment securities of \$39.2 million.

**6. Unrealized Losses on Securities**

The following table shows the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position (in thousands):

	<b>Number of Securities</b>	<b>Less than Twelve Months</b>		<b>June 30, 2014 Twelve Months or Greater</b>		<b>Total</b>	
		<b>Gross</b>		<b>Gross</b>		<b>Gross</b>	
		<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
Fannie Mae	24	\$ 6,381	\$ (28)	\$ 33,971	\$ (1,202)	\$ 40,352	\$ (1,230)
Freddie Mac	23	9,551	(49)	30,409	(968)	39,960	(1,017)
Governmental National Mortgage Association	6	3,453	(11)	6,245	(159)	9,698	(170)
Other mortgage-backed securities	3	547	(1)	2,286	(6)	2,833	(7)
Obligations of states and political subdivisions	5			7,186	(294)	7,186	(294)
U.S. government agency securities	10	4,004	(6)	23,470	(366)	27,474	(372)
Corporate obligations	5	1,990	(10)	2,319	(16)	4,309	(26)

Edgar Filing: ESSA Bancorp, Inc. - Form 10-Q

Other debt securities	2	2,102	(19)			2,102	(19)
<b>Total</b>	<b>78</b>	<b>\$ 28,028</b>	<b>\$ (124)</b>	<b>\$ 105,886</b>	<b>\$ (3,011)</b>	<b>\$ 133,914</b>	<b>\$ (3,135)</b>

	Number of Securities	September 30, 2013					
		Less than Twelve Months		Twelve Months or Greater		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fannie Mae	30	\$ 47,814	\$ (1,589)	\$ 1,057	\$ (6)	\$ 48,871	\$ (1,595)
Freddie Mac	20	32,781	(1,252)			32,781	(1,252)
Governmental National Mortgage Association	6	10,301	(230)			10,301	(230)
Other mortgage-backed securities	3	3,366	(19)			3,366	(19)
Obligations of states and political subdivisions	7	8,064	(499)			8,064	(499)
U.S. government agency securities	10	30,084	(479)	999	(1)	31,083	(480)
Corporate obligations	5	5,042	(169)			5,042	(169)
Equity securities-financial services	1	1,990	(10)			1,990	(10)
<b>Total</b>	<b>82</b>	<b>\$ 139,442</b>	<b>\$ (4,247)</b>	<b>\$ 2,056</b>	<b>\$ (7)</b>	<b>\$ 141,498</b>	<b>\$ (4,254)</b>

**Table of Contents**

The Company's investment securities portfolio contains unrealized losses on securities, including mortgage-related instruments issued or backed by the full faith and credit of the United States government, or generally viewed as having the implied guarantee of the U.S. government, debt obligations of a U.S. state or political subdivision and corporate debt obligations.

The Company reviews its position quarterly and has asserted that at June 30, 2014, the declines outlined in the above table represent temporary declines and the Company would not be required to sell the security before its anticipated recovery in market value.

The Company has concluded that any impairment of its investment securities portfolio is not other than temporary but is the result of interest rate changes that are not expected to result in the non-collection of principal and interest during the period.

**7. Loans Receivable, Net and Allowance for Loan Losses**

Loans receivable consist of the following (in thousands):

	June 30, 2014	September 30, 2013
<b>Held for investment:</b>		
Real Estate Loans:		
Residential	\$ 667,316	\$ 686,651
Construction	1,800	2,288
Commercial	188,343	159,469
Commercial	23,331	10,125
Obligations of states and political subdivisions	50,096	33,445
Home equity loans and lines of credit	40,866	41,923
Auto Loans	83,619	61
Other	3,590	2,332
	1,058,961	936,294
Less allowance for loan losses	8,836	8,064
Net loans	\$ 1,050,125	\$ 928,230

Included in the June 30, 2014 balances are loans acquired from FNCB, as of the acquisition date of January 24, 2014 as follows:

Real Estate Loans:	
Residential	\$ 933
Home equity loans and lines of credit	77
Other	20

Total loans	\$ 1,030
-------------	----------

Included in the June 30, 2014 balances are loans acquired from Franklin Security Bank, as of the acquisition date of April 4, 2014 as follows:

Real Estate Loans:	
Residential	\$ 17,151
Commercial	38,247
Commercial	9,308
Obligations of states and political subdivisions	7,309
Home equity loans and lines of credit	16
Auto loans	78,794
Other	1,363
Total loans	\$ 152,188



**Table of Contents**

	Total Loans	Individually Evaluated for Impairment	Acquired with Deteriorated Credit Quality	Collectively Evaluated for Impairment
<b>June 30, 2014</b>				
Real Estate Loans:				
Residential	\$ 667,316	\$ 13,093	\$ 109	\$ 654,114
Construction	1,800			1,800
Commercial	188,343	17,912	5,151	165,280
Commercial	23,331	536	293	22,502
Obligations of states and political subdivisions	50,096			50,096
Home Equity loans and lines of credit	40,866	220		40,646
Auto Loans	83,619			83,619
Other	3,590			3,590
<b>Total</b>	<b>\$ 1,058,961</b>	<b>\$ 31,761</b>	<b>\$ 5,553</b>	<b>\$ 1,021,647</b>

	Total Loans	Individually Evaluated for Impairment	Acquired with Deteriorated Credit Quality	Collectively Evaluated for Impairment
<b>September 30, 2013</b>				
Real Estate Loans:				
Residential	\$ 686,651	\$ 14,018	\$ 271	\$ 672,362
Construction	2,288			2,288
Commercial	159,469	15,478	6,355	137,636
Commercial	10,125	220	502	9,403
Obligations of states and political subdivisions	33,445			33,445
Home Equity loans and lines of credit	41,923	379	3	41,541
Auto Loans	61			61
Other	2,332			2,332
<b>Total</b>	<b>\$ 936,294</b>	<b>\$ 30,095</b>	<b>\$ 7,131</b>	<b>\$ 899,068</b>

We maintain a loan review system that allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Impairment is measured on a loan-by-loan basis for commercial and construction loans by the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral-dependent.



**Table of Contents**

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential mortgage loans for impairment disclosures, unless such loans are part of a larger relationship that is impaired, or are classified as a troubled debt restructuring.

A loan is considered to be a troubled debt restructuring ( TDR ) loan when the Company grants a concession to the borrower because of the borrower s financial condition that it would not otherwise consider. Such concessions include the reduction of interest rates, forgiveness of principal or interest, or other modifications of interest rates that are less than the current market rate for new obligations with similar risk. TDR loans that are in compliance with their modified terms and that yield a market rate may be removed from the TDR status after a period of performance.

**Table of Contents**

The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable. Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized during the time within the period that the impaired loans were impaired.

	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Associated Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
<b>June 30, 2014</b>					
<b>With no specific allowance recorded:</b>					
Real Estate Loans					
Residential	\$ 8,512	\$ 10,603	\$	\$ 9,566	\$ 242
Construction					
Commercial	22,252	23,205		20,241	553
Commercial	829	834		1,764	49
Obligations of states and political subdivisions					
Home equity loans and lines of credit	183	458		285	4
Auto Loans					
Other					
Total	31,776	35,100		31,856	848
<b>With an allowance recorded:</b>					
Real Estate Loans					
Residential	4,690	5,258	531	3,425	79
Construction					
Commercial	811	847	96	1,896	
Commercial					
Obligations of states and political subdivisions					
Home equity loans and lines of credit	37	45	37	17	
Auto Loans					
Other					
Total	5,538	6,150	664	5,338	79
<b>Total:</b>					
Real Estate Loans					
Residential	13,202	15,861	531	12,991	321
Construction					
Commercial	23,063	24,052	96	22,137	553
Commercial	829	834		1,764	49
Obligations of states and political subdivisions					

Edgar Filing: ESSA Bancorp, Inc. - Form 10-Q

Home equity loans and lines of credit	220	503	37	302	4
Auto Loans					
Other					
Total Impaired Loans	\$ 37,314	\$ 41,250	\$ 664	\$ 37,194	\$ 927

**Table of Contents**

	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Associated Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
<b>September 30, 2013</b>					
<b>With no specific allowance recorded:</b>					
Real Estate Loans					
Residential	\$ 11,251	\$ 13,013	\$	\$ 9,716	\$ 159
Construction					
Commercial	18,711	20,258		20,751	615
Commercial	722	731		1,034	9
Obligations of states and political subdivisions					
Home equity loans and lines of credit	382	683		373	3
Other				18	
<b>Total</b>	<b>31,066</b>	<b>34,685</b>		<b>31,892</b>	<b>786</b>
<b>With an allowance recorded:</b>					
Real Estate Loans					
Residential	3,038	3,221	518	2,655	74
Construction					
Commercial	3,122	3,178	301	2,839	
Commercial					
Obligations of states and political subdivisions					
Home equity loans and lines of credit					
Other					
<b>Total</b>	<b>6,160</b>	<b>6,399</b>	<b>819</b>	<b>5,494</b>	<b>74</b>
<b>Total:</b>					
Real Estate Loans					
Residential	14,289	16,234	518	12,371	233
Construction					
Commercial	21,833	23,436	301	23,590	615
Commercial	722	731		1,034	9
Obligations of states and political subdivisions					
Home equity loans and lines of credit	382	683		373	3
Other				18	
<b>Total Impaired Loans</b>	<b>\$ 37,226</b>	<b>\$ 41,084</b>	<b>\$ 819</b>	<b>\$ 37,386</b>	<b>\$ 860</b>

Management uses a ten point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as Pass rated. The criticized rating categories

utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. The portion of any loan that represents a specific allocation of the allowance for loan losses is placed in the Doubtful category. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. The Bank's Commercial Loan Officers perform an annual review of all commercial relationships \$250,000 or greater. Confirmation of the appropriate risk grade is included in the review on an ongoing basis. The Bank engages an external consultant to conduct loan reviews on at least a semi-annual basis. Generally, the external consultant reviews commercial relationships greater than \$500,000 and/or all criticized relationships. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

**Table of Contents**

The following tables present the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system as of June 30, 2014 and September 30, 2013 (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
<b>June 30, 2014</b>					
Commercial real estate loans	\$ 157,359	\$ 8,576	\$ 22,106	\$ 302	\$ 188,343
Commercial	22,295	375	661		23,331
Obligations of states and political subdivisions	50,096				50,096
<b>Total</b>	<b>\$ 229,750</b>	<b>\$ 8,951</b>	<b>\$ 22,767</b>	<b>\$ 302</b>	<b>\$ 261,770</b>

	Pass	Special Mention	Substandard	Doubtful	Total
<b>September 30, 2013</b>					
Commercial real estate loans	\$ 129,799	\$ 9,440	\$ 20,230	\$	\$ 159,469
Commercial	9,466	436	223		10,125
Obligations of states and political subdivisions	33,445				33,445
<b>Total</b>	<b>\$ 172,710</b>	<b>\$ 9,876</b>	<b>\$ 20,453</b>	<b>\$</b>	<b>\$ 203,039</b>

All other loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or non-performing. The following tables present the risk ratings in the consumer categories of performing and non-performing loans at June 30, 2014 and September 30, 2013 (in thousands):

	Performing	Non-performing	Total
<b>June 30, 2014</b>			
Real estate loans:			
Residential	\$ 656,893	\$ 10,423	\$ 667,316
Construction	1,800		1,800
Home Equity loans and lines of credit	40,613	253	40,866
Auto Loans	83,594	25	83,619
Other	3,577	13	3,590
<b>Total</b>	<b>\$ 786,477</b>	<b>\$ 10,714</b>	<b>\$ 797,191</b>



	<b>Performing</b>	<b>Non-performing</b>	<b>Total</b>
<b>September 30, 2013</b>			
Real estate loans:			
Residential	\$ 675,706	\$ 10,945	\$ 686,651
Construction	2,288		2,288
Home Equity loans and lines of credit	41,584	339	41,923
Auto loans	61		61
Other	2,332		2,332
Total	\$ 721,971	\$ 11,284	\$ 733,255

**Table of Contents**

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of June 30, 2014 and September 30, 2013 (in thousands):

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non- Accrual	Total Loans
<b>June 30, 2014</b>							
Real estate loans							
Residential	\$ 652,247	\$ 3,857	\$ 789	\$	\$ 10,423	\$ 15,069	\$ 667,316
Construction	1,800						1,800
Commercial	177,162	283			10,898	11,181	188,343
Commercial	21,682	204	127		1,318	1,649	23,331
Obligations of states and political subdivisions	50,077	19				19	50,096
Home equity loans and lines of credit	40,514	69	30		253	352	40,866
Auto Loans	83,312	282			25	307	83,619
Other	3,517	51	9		13	73	3,590
<b>Total</b>	<b>\$ 1,030,311</b>	<b>\$ 4,765</b>	<b>\$ 955</b>	<b>\$</b>	<b>\$ 22,930</b>	<b>\$ 28,650</b>	<b>\$ 1,058,961</b>

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non- Accrual	Total Loans
<b>September 30, 2013</b>							
Real estate loans							
Residential	\$ 671,850	\$ 2,866	\$ 990	\$	\$ 10,945	\$ 14,801	\$ 686,651
Construction	2,288						2,288
Commercial	146,062	2,589			10,818	13,407	159,469
Commercial	8,948				1,177	1,177	10,125
Obligations of states and political subdivisions	33,445						33,445
Home equity loans and lines of credit	41,380	127	77		339	543	41,923
Auto loans	61						61
Other	2,275	57				57	2,332

Total	\$ 906,309	\$ 5,639	\$ 1,067	\$ 23,279	\$ 29,985	\$ 936,294
-------	------------	----------	----------	-----------	-----------	------------

Our allowance for loan losses is maintained at a level necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. Our allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an allocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management's judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary, based on changing economic conditions. Payments received on impaired loans generally are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. The allowance for loan losses as of June 30, 2014 is maintained at a level that represents management's best estimate of losses inherent in the loan portfolio, and such losses were both probable and reasonably estimable.

In addition, the FDIC and the Pennsylvania Department of Banking, as an integral part of their examination process, have periodically reviewed our allowance for loan losses. The banking regulators may require that we recognize additions to the allowance based on its analysis and review of information available to it at the time of its examination.

**Table of Contents**

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

**Table of Contents**

The following tables summarize changes in the primary segments of the ALL for the three and nine month periods ending June 30, 2014 and 2013:

	Real Estate Loans				Home Obligations of States Loans and and Lines Commercial Political of Auto Loans			Other Loans	Unallocated	Total
	Residential	Construction	Commercial	Loans	Subdivision	Credit	Loans	Other	Unallocated	Total
ALL balance at March 31, 2014	5,920	26	1,003	369	106	500	26	712		8,662
Charge-offs	(332)		(23)			(10)				(365)
Recoveries	34			2				3		39
Provision	312	(2)	(399)	222	10	(17)	56	(3)	321	500
ALL balance at June 30, 2014	5,934	24	581	593	116	473	56	26	1,033	8,836
March 31, 2013	5,791	28	837	350	106	496		19	44	7,671
Charge-offs	(509)		(74)	(16)						(599)
Recoveries	9					3				12
Provision	676	16	262	27	7	97		1	14	1,100
ALL balance at June 30, 2013	5,967	44	1,025	361	113	596		20	58	8,184
ALL balance at September 30, 2013	5,787	20	946	337	130	430		21	393	8,064
Charge-offs	(1,255)		(73)	(48)		(73)				(1,449)
Recoveries	112		83	14				12		221
Provision	1,290	4	(375)	290	(14)	116	56	(7)	640	2,000
ALL balance at June 30, 2014	5,934	24	581	593	116	473	56	26	1,033	8,836
September 30, 2012	5,401	29	699	474	127	499		22	51	7,302
Charge-offs	(1,752)		(288)	(16)		(67)		(6)		(2,129)
Recoveries	50		2			9				61
Provision	2,268	15	612	(97)	(14)	155		4	7	2,950
ALL balance at June 30, 2013	5,967	44	1,025	361	113	596		20	58	8,184

Acquired loans are recorded at fair value on their purchase date without a carryover of the related allowance for loan losses.

**Table of Contents**

The following table summarizes the primary segments of the ALL, segregated into amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of June 30, 2014 (in thousands):

	Real Estate Loans			Home Obligations of Equity States and Loans and Commercial Political Lines of Auto				Other Loans		Unallocated	Total
	Residential	Construction	Commercial	Loans	Subdivisions	Credit	Loans	Other	Loans	Unallocated	Total
Individually evaluated for impairment	531		96			37					664
Collectively evaluated for impairment	5,403	24	485	593	116	436	56	26	1,033	8,172	
ALL Balance at June 30, 2014	5,934	24	581	593	116	473	56	26	1,033	8,836	
Individually evaluated for impairment	518		301							819	
Collectively evaluated for impairment	5,269	20	645	337	130	430		21	393	7,245	
ALL balance at September 30, 2013	5,787	20	946	337	130	430		21	393	8,064	

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date. The Company allocated increased provisions to the residential real estate, commercial loans, home equity loans and lines of credit segments for the nine month period ending June 30, 2014 due to increased charge off activity and impairment evaluations in those segments. Despite the above allocations, the allowance for loan losses is general in nature and is available to absorb losses from any loan segment.

**Table of Contents**

The following is a summary of troubled debt restructuring granted during the three and nine months ended June 30, 2014 and 2013.

	<b>For the Three Months Ended June 30, 2014</b>		
	<b>Number of Contracts</b>	<b>Pre-Modification Outstanding Recorded Investment</b>	<b>Post-Modification Outstanding Recorded Investment</b>
<b><u>Troubled Debt Restructurings</u></b>			
Real estate loans:			
Residential	2	\$ 236	\$ 236
Construction			
Commercial			
Commercial			
Obligations of states and political subdivisions			
Home equity loans and lines of credit			
Auto Loans			
Other			
<b>Total</b>	<b>2</b>	<b>\$ 236</b>	<b>\$ 236</b>

Of the two new troubled debt restructurings granted for the three months ended June 30, 2014, one loan totaling \$208,000 was granted terms and rate concessions and one loan totaling \$28,000 was granted terms concessions.

	<b>For the Three Months Ended June 30, 2013</b>		
	<b>Number of Contracts</b>	<b>Pre-Modification Outstanding Recorded Investment</b>	<b>Post-Modification Outstanding Recorded Investment</b>
<b><u>Troubled Debt Restructurings</u></b>			
Real estate loans:			
Residential	8	\$ 989	\$ 989
Construction			
Commercial			
Commercial			
Obligations of states and political subdivisions			
Home equity loans and lines of credit	1	98	98
Auto Loans			
Other			
<b>Total</b>	<b>9</b>	<b>\$ 1,087</b>	<b>\$ 1,087</b>



Of the nine new troubled debt restructurings granted for the three months ended June 30, 2013, six loans totaling \$751,000 were granted terms and rate concessions and three loans totaling \$336,000 were granted terms concessions.

	<b>For the Nine Months Ended June 30, 2014</b>		
	<b>Pre-Modification</b>	<b>Post-Modification</b>	
	<b>Outstanding</b>	<b>Outstanding</b>	
	<b>Number of</b>	<b>Recorded</b>	<b>Recorded</b>
	<b>Contracts</b>	<b>Investment</b>	<b>Investment</b>
<b><u>Troubled Debt Restructurings</u></b>			
Real estate loans:			
Residential	9	\$ 1,293	\$ 1,293
Construction			
Commercial	1	197	197
Commercial			
Obligations of states and political subdivisions			
Home equity loans and lines of credit			
Auto Loans			
Other			
<b>Total</b>	<b>10</b>	<b>\$ 1,490</b>	<b>\$ 1,490</b>

**Table of Contents**

Of the ten new troubled debt restructurings granted for the nine months ended June 30, 2014, six loans totaling \$883,000 were granted terms and rate concessions and four loans totaling \$607,000 were granted terms concessions.

	For the Nine Months Ended June 30, 2013	
	Pre-Modification Outstanding Number of Contracts	Post-Modification Outstanding Recorded Investment
<b>Troubled Debt Restructurings</b>		
Real estate loans:		
Residential	12	\$ 1,589
Construction		
Commercial		
Commercial		
Obligations of states and political subdivisions		
Home equity loans and lines of credit	1	98
Auto Loans		
Other		
<b>Total</b>	<b>13</b>	<b>\$ 1,687</b>

Of the 13 new troubled debt restructurings granted for the nine months ended June 30, 2013, eight loans totaling \$1.3 million were granted terms and rate concessions and five loans totaling \$410,000 were granted terms concessions. There were no troubled debt restructurings that have subsequently defaulted within one year of modification for the three and nine months ended June 30, 2014 and 2013.

**Table of Contents****8. Deposits**

Deposits consist of the following major classifications (in thousands):

	<b>June 30, 2014</b>	<b>September 30, 2013</b>
Non-interest bearing demand accounts	\$ 70,980	\$ 58,795
NOW accounts	120,939	99,857
Money market accounts	178,263	138,049
Savings and club accounts	124,812	110,189
Certificates of deposit	648,101	634,169
 Total	 \$ 1,143,095	 \$ 1,041,059

**9. Net Periodic Benefit Cost-Defined Benefit Plan**

For a detailed disclosure on the Bank's pension and employee benefits plans, please refer to Note 13 of the Company's Consolidated Financial Statements for the year ended September 30, 2013 included in the Company's Form 10-K.

The following table comprises the components of net periodic benefit cost for the periods ended (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Nine Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Service Cost	\$ 144	\$ 175	\$ 433	\$ 526
Interest Cost	191	179	572	537
Expected return on plan assets	(290)	(259)	(871)	(776)
Amortization of unrecognized loss	7	98	21	294
 Net periodic benefit cost	 \$ 52	 \$ 193	 \$ 155	 \$ 581

The Bank contributed \$550,000 to its pension plan in May 2014.

**10. Equity Incentive Plan**

The Company maintains the ESSA Bancorp, Inc. 2007 Equity Incentive Plan (the "Plan"). The Plan provides for a total of 2,377,326 shares of common stock for issuance upon the grant or exercise of awards. Of the shares available under the Plan, 1,698,090 may be issued in connection with the exercise of stock options and 679,236 may be issued as restricted stock. The Plan allows for the granting of non-qualified stock options ( "NSOs" ), incentive stock options ( "ISOs" ), and restricted stock. Options are granted at no less than the fair value of the Company's common stock on the date of the grant.

Certain officers, employees and outside directors were granted in aggregate 1,140,469 NSOs; 317,910 ISOs; and 590,320 shares of restricted stock on May 23, 2008. Certain officers were granted in aggregate 30,000 shares of restricted stock on April 1, 2013. In accordance with generally accepted accounting principles, the Company expenses the fair value of all share-based compensation grants over the requisite service periods.

The Company classifies share-based compensation for employees and outside directors within Compensation and employee benefits in the consolidated statement of income to correspond with the same line item as compensation paid. Additionally, generally accepted accounting principles require the Company to report: (1) the expense associated with the grants as an adjustment to operating cash flows and (2) any benefits of realized tax deductions in excess of previously recognized tax benefits on compensation expense as a financing cash flow.

Stock options vest over a five-year service period and expire ten years after grant date. The Company recognizes compensation expense for the fair values of these awards, which vest on a straight-line basis over the requisite service period of the awards.

The 2008 restricted shares vest over a five-year service period. The 2013 restricted stock shares vest over an 18-month service period. The product of the number of shares granted and the grant date market price of the Company's common stock determines the fair value of restricted shares under the Company's restricted stock plan. The Company recognizes compensation expense for the fair value of restricted shares on a straight-line basis over the requisite service period for the entire award.

**Table of Contents**

For the nine months ended June 30, 2014 and 2013, the Company recorded \$170,000 and \$1.5 million of share-based compensation expense, respectively, comprised of restricted stock expense of \$170,000 for the June 30, 2014 period and stock option expense of \$458,000 and restricted stock expense of \$1.0 million for the June 30, 2013 period. Expected future compensation expense relating to the 13,334 restricted shares at June 30, 2014, is \$49,000 over the remaining vesting period of 0.25 years.

The following is a summary of the Company's stock option activity and related information for its option grants for the six month period ended June 30, 2014.

	<b>Number of Stock Options</b>	<b>Weighted- average Exercise Price</b>	<b>Weighted- average Remaining Contractual Term (in years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Outstanding, September 30, 2013	1,458,379	\$ 12.35	4.67	\$
Granted				
Exercised				
Forfeited				
Outstanding, June 30, 2014	1,458,379	\$ 12.35	3.9	\$
Exercisable at June 30, 2014	1,458,379	\$ 12.35	3.9	\$

The following is a summary of the status of the Company's restricted stock as of June 30, 2014, and changes therein during the six month period then ended:

	<b>Number of Restricted Stock</b>	<b>Weighted- average Grant Date Fair Value</b>
Nonvested at September 30, 2013	14,995	\$ 10.94
Granted		
Vested	1,661	10.94
Forfeited		
Nonvested at June 30, 2014	13,334	\$ 10.94

**11. Fair Value Measurement**

The following disclosures show the hierarchical disclosure framework associated within the level of pricing observations utilized in measuring assets and liabilities at fair value. The definition of fair value maintains the

exchange price notion in earlier definitions of fair value but focuses on the exit price of the asset or liability. The exit price is the price that would be received to sell the asset or paid to transfer the liability adjusted for certain inherent risks and restrictions. Expanded disclosures are also required about the use of fair value to measure assets and liabilities.

**Table of Contents**

The following table presents information about the Company's securities, other real estate owned and impaired loans measured at fair value as of June 30, 2014 and September 30, 2013 and indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value:

Fair Value Measurements Utilized for the Company's Financial Assets (in thousands):	Fair Value Measurement at June 30, 2014			Balances as of September 30, 2013
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Securities available-for-sale measured on a recurring basis				
Mortgage backed securities	\$	\$ 257,581	\$	\$ 257,581
Obligations of states and political subdivisions		43,163		43,163
U.S. government agencies		47,905		47,905
Corporate obligations		13,405		13,405
Trust-preferred securities		3,861	1,830	5,691
Other debt securities		5,254		5,254
Equity securities-financial services	2,025			2,025
<b>Total debt and equity securities</b>	<b>\$ 2,025</b>	<b>\$ 371,169</b>	<b>\$ 1,830</b>	<b>\$ 375,024</b>
Foreclosed real estate owned measured on a non-recurring basis	\$	\$	\$ 2,967	\$ 2,967
Impaired loans measured on a non-recurring basis	\$	\$	\$ 36,650	\$ 36,650

Fair Value Measurements Utilized for the Company's Financial Assets (in thousands):	Fair Value Measurement at September 30, 2013			Balances as of September 30, 2013
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Securities available-for-sale measured on a recurring basis				
Mortgage backed securities	\$	\$ 217,837	\$	\$ 217,837
Obligations of states and political subdivisions		23,909		23,909
U.S. government agencies		52,520		52,520
Corporate obligations		12,773		12,773
Trust-preferred securities		3,614	1,800	5,414
Other debt securities		1,154		1,154
Equity securities-financial services	2,015			2,015
<b>Total debt and equity securities</b>	<b>\$ 2,015</b>	<b>\$ 311,807</b>	<b>\$ 1,800</b>	<b>\$ 315,622</b>
	\$	\$	\$ 2,111	\$ 2,111

Foreclosed real estate owned measured on a non-recurring basis

Impaired loans measured on a non-recurring basis	\$	\$	\$ 36,407	\$ 36,407
--	----	----	-----------	-----------



**Table of Contents**

The following table presents a summary of changes in the fair value of the Company's Level III investments for the periods ended June 30, 2014 and June 30, 2013.

	Fair Value Measurement Using Significant Unobservable Inputs (Level III)	
	Three months ended	
	June 30, 2014	June 30, 2013
Beginning balance	\$ 1,830	\$ 1,760
Purchases, sales, issuances, settlements, net		
Total unrealized gain:		
Included in earnings		
Included in other comprehensive income		20
Transfers in and/or out of Level III		
	\$ 1,830	\$ 1,780

	Fair Value Measurement Using Significant Unobservable Inputs (Level III)	
	Nine months ended	
	June 30, 2014	June 30, 2013
Beginning balance	\$ 1,800	\$ 1,740
Purchases, sales, issuances, settlements, net		
Total unrealized gain:		
Included in earnings		
Included in other comprehensive income	30	40
Transfers in and/or out of Level III		
	\$ 1,830	\$ 1,780

Each financial asset and liability is identified as having been valued according to a specified level of input, 1, 2 or 3. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank has the ability to access at the measurement date. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset, either directly or indirectly. Level 2 inputs include quoted prices for similar assets in active markets, and inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy, within which the fair value measurement in

its entirety falls, has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset.

The measurement of fair value should be consistent with one of the following valuation techniques: market approach, income approach, and/or cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering factors specific to the measurement (qualitative and quantitative). Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on a security's relationship to other benchmark quoted securities. Most of the securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Securities reported at fair

**Table of Contents**

value utilizing Level 1 inputs are limited to actively traded equity securities whose market price is readily available from the New York Stock Exchange or the NASDAQ exchange. Foreclosed real estate is measured at fair value, less cost to sell at the date of foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value, less cost to sell. Income and expenses from operations and changes in valuation allowance are included in the net expenses from foreclosed real estate. Impaired loans are reported at fair value utilizing level three inputs. For these loans, a review of the collateral is conducted and an appropriate allowance for loan losses is allocated to the loan. At June 30, 2014, 249 impaired loans with a carrying value of \$37.3 million were reduced by specific valuation allowance totaling \$664,000 resulting in a net fair value of \$36.7 million based on Level 3 inputs. At September 30, 2013, 233 impaired loans with a carrying value of \$37.2 million were reduced by a specific valuation totaling \$819,000 resulting in a net fair value of \$36.4 million based on Level 3 inputs.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

<i>(unaudited, in thousands)</i>	<b>Quantitative Information about Level 3 Fair Value Measurements</b>			
	<b>Fair Value Estimate</b>	<b>Valuation Techniques</b>	<b>Unobservable Input</b>	<b>Range</b>
<b>June 30, 2014:</b>				
Impaired loans	36,650	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to 30% (23.0%)
Foreclosed real estate owned	2,967	Appraisal of collateral (1), (3)	Appraisal adjustments (2)	20% to 40% (21.4%)

<i>(unaudited, in thousands)</i>	<b>Quantitative Information about Level 3 Fair Value Measurements</b>			
	<b>Fair Value Estimate</b>	<b>Valuation Techniques</b>	<b>Unobservable Input</b>	<b>Range</b>
<b>September 30, 2013:</b>				
Impaired loans	36,407	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to 30% (23.5%)
Foreclosed real estate owned	2,111	Appraisal of collateral (1), (3)	Appraisal adjustments (2)	0% to 30% (20.4%)

- (1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.
  - (2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.
  - (3) Includes qualitative adjustments by management and estimated liquidation expenses.
- The fair values presented represent the Company's best estimate of fair value using the methodologies discussed below.

**Table of Contents****Disclosures about Fair Value of Financial Instruments**

The fair values presented represent the Company's best estimate of fair value using the methodologies discussed below.

	<b>June 30, 2014</b>				<b>Total Fair Value</b>
	<b>Carrying Value</b>	<b>Level I</b>	<b>Level II</b>	<b>Level III</b>	
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 23,480	\$ 23,480	\$	\$	\$ 23,480
Certificates of deposit	1,767		1,767		1,767
Investment and mortgage backed securities available for sale	375,024	2,025	371,169	1,830	375,024
Loans receivable, net	1,050,125			1,078,683	1,078,683
Accrued interest receivable	5,042	5,042			5,042
FHLB stock	12,757	12,757			12,757
Mortgage servicing rights	799			799	799
Bank owned life insurance	29,484	29,484			29,484
<b>Financial liabilities:</b>					
Deposits	\$ 1,143,095	\$ 494,994	\$	\$ 651,908	1,146,902
Short-term borrowings	78,749	78,749			78,749
Other borrowings	145,260			146,398	146,398
Advances by borrowers for taxes and insurance	11,924	11,924			11,924
Accrued interest payable	1,035	1,035			1,035

	<b>September 30, 2013</b>				<b>Total Fair Value</b>
	<b>Carrying Value</b>	<b>Level I</b>	<b>Level II</b>	<b>Level III</b>	
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 26,648	\$ 26,648	\$	\$	\$ 26,648
Certificates of deposit	1,767		1,767		1,767
Investment and mortgage backed securities available for sale	315,622	2,015	311,807	1,800	315,622
Loans receivable, net	928,230			951,120	951,120
Accrued interest receivable	4,413	4,413			4,413
FHLB stock	9,415	9,415			9,415
Mortgage servicing rights	382			382	382
Bank owned life insurance	28,797	28,797			28,797
<b>Financial liabilities:</b>					
Deposits	\$ 1,041,059	\$ 406,890	\$	\$ 638,510	1,045,400
Short-term borrowings	23,000	23,000			23,000
Other borrowings	129,260			124,504	124,504
Advances by borrowers for taxes and insurance	4,962	4,962			4,962
Accrued interest payable	833	833			833



## **Table of Contents**

Financial instruments are defined as cash, evidence of an ownership interest in an entity, or a contract which creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. If a quoted market price is available for a financial instrument, the fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas or simulation modeling.

As many of these assumptions result from judgments made by management based upon estimates which are inherently uncertain, the resulting values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in the assumptions on which the values are based may have a significant impact on the resulting estimated values.

As certain assets and liabilities, such as deferred tax assets, premises and equipment, and many other operational elements of the Bank, are not considered financial instruments but have value, this fair value of financial instruments would not represent the full market value of the Company.

The Company employed simulation modeling in determining the fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

### **Cash and Cash Equivalents, Accrued Interest Receivable, Short-Term Borrowings, Advances by Borrowers for Taxes and Insurance, and Accrued Interest Payable**

The fair value approximates the current book value.

### **Bank-Owned Life Insurance**

The fair value is equal to the cash surrender value of the Bank-owned life insurance.

### **Investment and Mortgage-Backed Securities Available for Sale and FHLB Stock**

The fair value of investment and mortgage-backed securities available for sale is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Since the FHLB stock is not actively traded on a secondary market and held exclusively by member financial institutions, the fair market value approximates the carrying amount.

### **Loans Receivable**

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

### **Mortgage Servicing Rights**

The Company utilizes a third party provider to estimate the fair value of certain loan servicing rights. Fair value for the purpose of this measurement is defined as the amount at which the asset could be exchanged in a current transaction between willing parties, other than in a forced liquidation.

**Deposit Liabilities**

The fair values disclosed for demand, savings, and money market deposit accounts are valued at the amount payable on demand as of quarter-end. Fair values for time deposits are estimated using a discounted cash flow calculation that applies contractual costs currently being offered in the existing portfolio to current market rates being offered for deposits of similar remaining maturities.

**Other Borrowings**

Fair values for other borrowings are estimated using a discounted cash flow calculation that applies contractual costs currently being offered in the existing portfolio to current market rates being offered for other borrowings of similar remaining maturities.

**Table of Contents****Commitments to Extend Credit**

These financial instruments are generally not subject to sale, and fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure.

**12. Accumulated Other Comprehensive Income**

The activity in accumulated other comprehensive income for the three and nine months ended June 30, 2014 and 2013 is as follows:

	<b>Accumulated Other Comprehensive Income/(Loss) Unrealized Gains Defined Benefits on Securities Pension Available for Plan Sale Total</b>		
Balance at March 31, 2014	\$ (1,297)	\$ (549)	\$ (1,846)
Other comprehensive income before reclassifications		2,165	2,165
Amounts reclassified from accumulated other comprehensive income	5	7	12
Period change	5	2,172	2,177
Balance at June 30, 2014	\$ (1,292)	\$ 1,623	\$ 331
Balance at March 31, 2013	\$ (4,318)	\$ 4,481	\$ 163
Other comprehensive loss before reclassifications		(4,194)	(4,194)
Amounts reclassified from accumulated other comprehensive income	65	(7)	58
Period change	65	(4,201)	(4,136)
Balance at June 30, 2013	\$ (4,253)	\$ 280	\$ (3,973)

	<b>Accumulated Other Comprehensive Income/(Loss) Unrealized Gains Defined Benefits on Securities Pension Available for Plan Sale Total</b>		
--	--	--	--



Edgar Filing: ESSA Bancorp, Inc. - Form 10-Q

Balance at September 30, 2013	\$ (1,306)	\$	71	\$ (1,235)
Other comprehensive income before reclassifications			1,701	1,701
Amounts reclassified from accumulated other comprehensive income	14		(149)	(135)
Period change	14		1,552	1,566
Balance at June 30, 2014	\$ (1,292)	\$	1,623	\$ 331
Balance at September 30, 2012	\$ (4,450)	\$	6,208	\$ 1,758
Other comprehensive loss before reclassifications			(5,431)	(5,431)
Amounts reclassified from accumulated other comprehensive income	194		(494)	(300)
Period change	194		(5,925)	(5,731)
Balance at June 30, 2013	\$ (4,256)	\$	283	\$ (3,973)

**Table of Contents**

	<b>Amount Reclassified from Accumulated Other Comprehensive Income Accumulated Other Comprehensive Income for the Three Months Ended June 30, 2014      2013</b>			<b>Affected Line Item in the Consolidated Statement of Income</b>
<b>Securities available for sale:</b>				
Net securities gains reclassified into earnings	\$ 10	\$ (11)		Gain on sale of investments, net
Related income tax expense	(3)	4		Provision for income taxes
Net effect on accumulated other comprehensive income for the period	7	(7)		Net of tax
<b>Defined benefit pension plan:</b>				
Amortization of net loss and prior service costs	7	98		Compensation and employee benefits
Related income tax expense	\$ (2)	\$ (33)		Provision for income taxes
Net effect on accumulated other	5	65		Net of tax
<b>Total reclassification for the period</b>	<b>\$ 12</b>	<b>\$ 58</b>		<b>Net of tax</b>

	<b>Amount Reclassified from Accumulated Other Comprehensive Income Accumulated Other Comprehensive Income for the Nine months Ended June 30, 2014      2013</b>			<b>Affected Line Item in the Consolidated Statement of Income</b>
<b>Securities available for sale:</b>				
Net securities gains reclassified into earnings	\$ (226)	\$ (749)		Gain on sale of investments, net
Related income tax expense	77	255		Provision for income taxes
Net effect on accumulated other comprehensive income for the period	(149)	(494)		Net of tax

Defined benefit pension plan:			
Amortization of net loss and prior service costs	21	294	Compensation and employee benefits
Related income tax expense	\$ (7)	\$ (100)	Provision for income taxes
Net effect on accumulated other	14	194	Net of tax
Total reclassification for the period	\$ (135)	\$ (300)	Net of tax

### 13. Acquisitions

#### Acquisition of FNCB Branch

On January 24, 2014, the Company closed on a purchase transaction pursuant to which ESSA Bancorp, Inc. acquired a branch facility, customer deposits, and loans of First National Community Bank (FNCB), the subsidiary of First National Community Bancorp, Inc., in a cash transaction. The acquired branch is located in the Monroe County, Pennsylvania market. Under the terms of the agreement, the Company acquired all of the branch facilities, customer deposits and loans of FNCB and received net cash of \$4.6 million.

The acquired assets and assumed liabilities were measured at fair values. Management made significant estimates and exercised significant judgment in accounting for the acquisition. Management measured loan fair values based on loan file reviews (including borrower financial statements or tax returns), appraised collateral values, expected cash flows and historical loss factors of FNCB. Real estate acquired through foreclosure was primarily value based on appraised collateral values.

**Table of Contents**

The business combination resulted in the acquisition of loans without evidence of credit quality deterioration. FNCB's loans were fair valued by discounting both expected principal and interest cash flows using an observable discount rate for similar instruments that a market participant would consider in determining fair value. Additionally, consideration was given to management's best estimates of default rates and payment speeds. At acquisition, FNCB's loan portfolio without evidence of deterioration totaled \$1.0 million and was recorded at a fair value of \$1.0 million.

The following condensed statement reflects the values assigned to FNCB's net assets as of the acquisitions date:

Total purchase price	\$ 4,460
Net assets acquired:	
Cash	\$ 11
Loans receivable and accrued interest receivable	1,033
Premises and equipment, net	1,626
Certificates of deposits	(3,069)
Deposits other than certificates of deposits	(5,683)
	6,082
Goodwill resulting from FNCB purchase	\$ 1,442

Supplemental pro forma financial information related to the FNCB acquisition has not been provided as it would be impracticable to do so. Historical financial information regarding the acquired branch is not accessible and thus the amounts would require estimates so significant as to render the disclosure irrelevant.

**Acquisition of Franklin Security Bancorp, Inc.**

On April 4, 2014, the Company closed on a merger transaction pursuant to which ESSA Bancorp, Inc. acquired Franklin Security Bancorp, Inc., the parent company of Franklin Security Bank, in a cash transaction. The acquisition added two branch locations in the Scranton-Wilkes Barre, Pennsylvania market, establishing ESSA's presence in that market.

Under the terms of the merger agreement, the Company acquired all of the outstanding shares of Franklin Security Bancorp, Inc. for a total cash purchase price of approximately \$15.7 million. Franklin Security Bank has been merged into ESSA Bank & Trust, with ESSA Bank & Trust as the surviving entity.

The acquired assets and assumed liabilities were measured at estimated fair values. Management made significant estimates and exercised significant judgment in accounting for the acquisition. Management measured loan fair values based on loan file reviews (including borrower financial statements or tax returns), appraised collateral values, expected cash flows and historical loss factors of Franklin Security Bank. Real estate acquired through foreclosure was primarily valued based on appraised collateral values. The Company also recorded an identifiable intangible asset representing the core deposit base of Franklin Security Bank based on management's evaluation of the cost of such deposits relative to alternative funding sources. Management used market quotations to measure the fair value of investment securities and FHLB advances. The business combination resulted in the acquisition of loans without evidence of credit quality deterioration. At the acquisition date, the Company determined that there were no purchased impaired loans. The method of measuring carrying value of purchased loans differs from loans originated by the

Company (originated loans), and as such, the Company identifies purchased loans and purchased loans with a credit quality discount and originated loans at amortized cost.

Franklin Security Bank's loans without evidence of credit deterioration were measured to fair value by discounting both expected principal and interest cash flows using an observable discount rate for similar instruments that a market participant would consider in determining fair value. Additionally, consideration was given to management's best estimates of default rates and payment speeds. At acquisition, Franklin Security Bank's loan portfolio without evidence of deterioration totaled \$155.3 million and was recorded at a fair value of \$152.2 million.

**Table of Contents**

The following condensed statement reflects the values assigned to Franklin Security Bancorp, Inc.'s net assets as of the acquisitions date:

Total purchase price	\$ 15,698
Net assets acquired:	
Cash	\$ (19,825)
Investments available for sale	55,901
Loans receivable	152,188
Regulatory stock	1,569
Premises and equipment, net	176
Foreclosed real estate	436
Intangible assets	889
Deferred tax assets	1,031
Other assets	2,504
Certificates of deposits	(90,869)
Deposits other than certificates of deposits	(71,317)
Borrowings	(30,177)
Other liabilities	(2,265)
Gain resulting from Franklin Security Bancorp, Inc. acquisition	\$ 241

Results of operations for Franklin prior to the acquisition date are not included in the Consolidated Statement of Income for the three and nine-month periods ended June 30, 2014. The following table presents financial information regarding the former Franklin operations included in the Consolidated Statement of Income from the date of acquisition through June 30, 2014 under column Actual from acquisition date through June 30, 2014. In addition, the following table presents unaudited pro forma information as if the acquisition of Franklin had occurred on October 1, 2012 under the Pro Forma columns. The table below has been prepared for comparative purposes only and is not necessarily indicative of the actual results that would have been attained had the acquisition occurred as of the beginning of the periods presented, nor is it indicative of future results. Furthermore, the unaudited pro forma information does not reflect management's estimate of any revenue-enhancing opportunities nor anticipated cost savings as a result of the integration and consolidation of the acquisition. Merger and acquisition integration costs and amortization of fair value adjustments net of the related income tax effects are included in the amounts below, but any purchase gain has been excluded.

	Actual From Acquisition Date
	Through June 30, 2014 (in thousands)
Net interest income	\$ 1,902
Non interest income	107

Edgar Filing: ESSA Bancorp, Inc. - Form 10-Q

Net income	\$	641
------------	----	-----

	Pro Formas			
	Three months ended June 30,		Nine months ended June 30,	
	2014	2013	2014	2013
	(in thousands, except per share data)			
Net interest income	\$ 11,097	\$ 11,267	\$ 32,534	\$ 34,791
Non interest income	2,100	1,915	5,605	6,850
Net income	2,385	2,036	4,471	7,184
Pro forma earnings per share:				
Basic	\$ 0.22	\$ 0.18	\$ 0.41	\$ 0.61
Diluted	\$ 0.22	\$ 0.18	\$ 0.41	\$ 0.61

**Table of Contents**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations  
Forward Looking Statements**

This quarterly report contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These forward-looking statements include:

statements of our goals, intentions and expectations;

statements regarding our business plans and prospects and growth and operating strategies;

statements regarding the asset quality of our loan and investment portfolios; and

estimates of our risks and future costs and benefits.

By identifying these forward-looking statements for you in this manner, we are alerting you to the possibility that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. Important factors that could cause our actual results and financial condition to differ from those indicated in the forward-looking statements include, among others, those discussed under "Risk Factors" in Part I, Item 1A of the Company's Annual Report on Form 10-K and Part II, Item 1A of this Report on Form 10-Q, as well as the following factors:

significantly increased competition among depository and other financial institutions;

inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;

general economic conditions, either nationally or in our market areas, that are worse than expected;

adverse changes in the securities markets;

legislative or regulatory changes that adversely affect our business;

our ability to enter new markets successfully and take advantage of growth opportunities, and the possible short-term dilutive effect of potential acquisitions or *de novo* branches, if any;



changes in consumer spending, borrowing and savings habits;

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies and the Financial Accounting Standards Board; and

changes in our organization, compensation and benefit plans.

**Table of Contents**

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

**Comparison of Financial Condition at June 30, 2014 and September 30, 2013**

**Total Assets.** Total assets increased by \$186.9 million, or 13.62%, to \$1,559.2 million at June 30, 2014 from \$1,372.3 million at September 30, 2013. The acquisition of Franklin Security Bancorp, Inc. accounted for the majority of the increase. The Company completed its acquisition of Franklin Security Bancorp on April 4, 2014, adding approximately \$219.5 million in total assets, \$152.2 million in loans and \$162.2 million in deposits.

**Total Cash and Cash Equivalents.** Total cash and cash equivalents decreased \$3.1 million, or 11.65%, to \$23.5 million at June 30, 2014 from \$26.6 million at September 30, 2013. This decrease was primarily the result of the cash used for the acquisition of Franklin Security Bancorp, Inc. offset by cash generated from the repayment of loans receivable from September 30, 2013 through June 30, 2014.

**Net Loans.** Net loans increased \$121.9 million, or 13.13%, to \$1,050.1 million at June 30, 2014 from \$928.2 million at September 30, 2013. During this period, commercial real estate loans increased \$28.9 million to \$183.3 million, commercial loans increased \$13.2 million to \$23.3 million, obligations of states and political subdivisions increased \$16.7 million to \$50.1 million, auto loans increased \$83.6 million to \$83.6 million and other loans increased \$1.3 million to \$3.6 million. These increases were partially offset by decreases in residential loans of \$19.3 million to \$667.3 million, construction loans outstanding of \$488,000 to \$1.8 million, home equity loans and lines of credit of \$1.0 million to \$40.9 million.

**Investment Securities Available for Sale.** Investment securities available for sale increased \$59.4 million, or 18.82%, to \$375.0 million at June 30, 2014 from \$315.6 million at September 30, 2013. The increase was due primarily to increases in mortgage backed securities of \$39.8 million and obligations of states and political subdivisions of \$19.3 million, offset in part by a decrease in U.S. government securities of \$4.6 million.

**Deposits.** Deposits increased \$102.0 million, or 9.8%, to \$1,143.1 million at June 30, 2014 from \$1,041.1 million at September 30, 2013, primarily as a result of the acquisition of Franklin Security Bancorp, Inc. At June 30, 2014 compared to September 30, 2013, certificate of deposit accounts increased \$13.9 million to \$648.1 million, NOW accounts increased \$21.1 million to \$120.9 million, non-interest bearing demand accounts increased \$12.2 million to \$71.0 million, money market accounts increased \$40.2 million to \$178.3 million and savings and club accounts increased \$14.6 million to \$124.8 million. Included in the certificates of deposit at June 30, 2014 was an increase in brokered certificates of \$12.2 million to \$245.5 million.

**Borrowed Funds.** Borrowed funds increased by \$72.0 million, or 47.31%, to \$224.3 million at June 30, 2014, from \$152.3 million at September 30, 2013. The increase in borrowed funds was primarily due to increases in short term borrowings of \$55.8 million and other borrowings of \$16.3 million.

**Stockholders Equity.** Stockholders equity increased by \$4.9 million, or 2.91%, to \$171.3 million at June 30, 2014 from \$166.5 million at September 30, 2013.

**Table of Contents****Average Balance Sheets for the Three and Nine Months Ended June 30, 2014 and 2013**

The following tables set forth average balance sheets, average yields and costs, and certain other information for the periods indicated. All average balances are daily average balances, the yields set forth below include the effect of deferred fees and discounts and premiums that are amortized or accreted to interest income.

	For the Three Months Ended June 30, 2014			2013		
	Average Balance	Interest Income/ Expenses	Yield/Cost	Average Balance	Interest Income/ Expenses	Yield/Cost
<b>(dollars in thousands)</b>						
<b>Interest-earning assets:</b>						
Loans <sup>(1)</sup>	\$ 1,054,409	\$ 11,807	4.49%	\$ 947,107	\$ 11,032	4.67%
<b>Investment Securities</b>						
Taxable <sup>(2)</sup>	81,064	411	2.03%	87,100	376	1.73%
Exempt from federal income tax <sup>(2)(3)</sup>	32,298	173	3.26%	14,192	73	3.13%
Total investment securities	113,362	584	2.38%	101,292	449	1.93%
Mortgage-backed securities	244,722	1,221	2.00%	217,162	994	1.84%
Regulatory stock	12,153	167	5.51%	13,553	13	0.38%
Other	17,589	6	0.14%	11,904	3	0.10%
Total interest-earning assets	1,442,235	13,785	3.86%	1,291,018	12,491	3.89%
Allowance for loan losses	(8,697)			(7,841)		
Noninterest-earning assets	113,084			101,755		
Total assets	\$ 1,546,622			\$ 1,384,932		
<b>Interest-bearing liabilities:</b>						
NOW accounts	\$ 121,934	\$ 20	0.07%	\$ 88,045	\$ 13	0.06%
Money market accounts	178,056	92	0.21%	137,908	67	0.19%
Savings and club accounts	122,691	17	0.06%	105,857	12	0.05%
Certificates of deposit	652,488	1,886	1.16%	606,584	1,665	1.10%
Borrowed funds	215,097	673	1.26%	191,981	885	1.85%
Total interest-bearing liabilities	1,290,266	2,688	0.84%	1,130,375	2,642	0.94%
Non-interest-bearing NOW accounts	67,056			60,570		
Non-interest-bearing liabilities	19,035			21,886		
Total liabilities	1,376,357			1,212,831		
Equity	170,265			172,101		
Total liabilities and equity	\$ 1,546,622			\$ 1,384,932		

Edgar Filing: ESSA Bancorp, Inc. - Form 10-Q

Net interest income		\$ 11,097		\$ 9,849
<b>Interest rate spread</b>				
Net interest-earning assets	\$ 151,969	3.02%	\$ 160,643	2.95%
<b>Net interest margin</b>				
Average interest-earning assets to average interest-bearing liabilities		111.78%		114.21%

36

**Table of Contents**

- (1) Non-accruing loans are included in the outstanding loan balances.
- (2) Available for sale securities are reported at fair value.
- (3) Yields on tax exempt securities have been calculated on a fully tax equivalent basis assuming a tax rate of 34%.
- (4) Represents the difference between interest earned and interest paid, divided by average total interest earning assets.

**Table of Contents**

**For the Nine Months Ended June 30,**  
**2014** **2013**  
**Interest Income/** **Interest Income/**  
**Average Balance** **Expenses** **Yield/Cost** **Average Balance** **Expenses** **Yield/Cost**  
**(dollars in thousands)**

**Interest-earning assets:**

Loans <sup>(1)</sup>	\$ 968,243	\$ 32,173	4.44%	\$ 948,040	\$ 34,310	4.84%
<b>Investment Securities</b>						
Taxable <sup>(2)</sup>	83,408	1,250	2.00%	90,205	1,211	1.79%
Exempt from federal income tax <sup>(2)(3)</sup>	19,896	318	3.24%	12,825	200	3.16%
Total investment securities	103,304	1,568	2.24%	103,030	1,411	1.96%
Mortgage-backed securities	227,106	3,432	2.02%	220,895	3,347	2.03%
Regulatory stock	10,687	303	3.79%	17,098	53	0.41%
Other	11,802	14	0.16%	9,403	10	0.14%
Total interest-earning assets	1,321,142	37,490	3.81%	1,298,466	39,131	4.04%
Allowance for loan losses	(8,342)			(7,607)		
Noninterest-earning assets	108,291			101,364		
Total assets	\$ 1,421,091			\$ 1,392,223		

**Interest-bearing liabilities:**

NOW accounts	\$ 100,849	42	0.06%	\$ 90,000	38	0.06%
Money market accounts	151,834	225	0.20%	144,618	258	0.24%
Savings and club accounts	113,959	45	0.05%	102,940	37	0.05%
Certificates of deposit	619,283	5,597	1.21%	592,035	5,243	1.18%
Borrowed funds	187,720	2,055	1.46%	213,548	3,103	1.94%
Total interest-bearing liabilities	1,173,645	7,964	0.90%	1,143,141	8,679	1.01%
Non-interest-bearing NOW accounts	62,026			55,162		
Non-interest-bearing liabilities	16,443			18,875		
Total liabilities	1,252,114			1,217,178		
Equity	168,977			175,045		
Total liabilities and equity	\$ 1,421,091			\$ 1,392,223		

Net interest income \$ 29,526 \$ 30,452

Interest rate spread 2.91% 3.03%  
Net interest-earning assets \$ 147,497 \$ 155,325

Net interest margin 2.99% 3.14%  
Average interest-earning assets to average  
interest-bearing liabilities 112.57% 113.59%



**Table of Contents**

- (1) Non-accruing loans are included in the outstanding loan balances.
- (2) Available for sale securities are reported at fair value.
- (3) Yields on tax exempt securities have been calculated on a fully tax equivalent basis assuming a tax rate of 34%.
- (4) Represents the difference between interest earned and interest paid, divided by average total interest earning assets.

**Comparison of Operating Results for the Three Months Ended June 30, 2014 and June 30, 2013**

**Net Income.** Net income increased \$750,000, or 39.98%, to \$2.6 million for the three months ended June 30, 2014 compared to net income of \$1.9 million for the comparable period in 2013. The increase was due primarily to increases in net interest income and noninterest income, offset in part by an increase in noninterest expenses.

**Net Interest Income.** Net interest income increased \$1.3 million, or 12.67%, to \$11.1 million for the three months ended June 30, 2014 from \$9.8 million for the comparable period in 2013. The increase was primarily attributable to an increase in the Company's interest rate spread to 3.02% for the three months ended June 30, 2014, from 2.95% for the comparable period in 2013, offset by a decrease of \$8.7 million in the Company's average net earnings assets.

**Interest Income.** Interest income increased \$1.3 million, or 10.36%, to \$13.8 million for the three months ended June 30, 2014 from \$12.5 million for the comparable 2013 period. The increase resulted primarily from an increase in interest earning assets of \$151.2 million offset in part by a decline in the yield on interest earning assets of 3 basis points. The average yield on interest earning assets was 3.86% for the three months ended June 30, 2014, as compared to 3.89% for the comparable 2013 period. Loans increased on average \$107.3 million between the two periods. In addition, average investment securities increased \$12.1 million, mortgage-backed securities increased \$27.6 million, regulatory stock decreased \$1.4 million and other interest earning assets increased \$5.7 million. Interest income for the three months ended June 30, 2014 included approximately \$462,000 of net accretion of fair market value adjustments for credit and yield applied to purchased loans compared to \$371,000 of accretion and recapture for the comparable 2013 period.

**Interest Expense.** Interest expense increased \$46,000, or 1.74%, to \$2.7 million for the three months ended June 30, 2014 from \$2.6 million for the comparable 2013 period. The increase resulted from a \$159.9 million increase in average interest bearing liabilities for the three months ended June 30, 2014, offset in part by a 10 basis point decrease in the overall cost of interest bearing liabilities to 0.84% for the three months ended June 30, 2014 from 0.94% for the comparable 2013 period. Increases in all interest bearing accounts as a result of the Franklin Security Bancorp merger was the primary reason for the increased interest expense.

**Provision for Loan Losses.** In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are subject to interpretation and revision as more information becomes available or as future events occur. After an evaluation of these factors, management made a provision for loan losses of \$500,000 for the three month period ended June 30, 2014 as compared to \$1.1 million for the three month period ended June 30, 2013. The allowance for loan losses was \$8.8 million, or 0.83% of loans outstanding, at June 30, 2014, compared to \$8.1 million, or 0.86% of loans outstanding at September 30, 2013. During the three month period ending June 30, 2014 the Company acquired Franklin Security Bancorp's loan portfolio. The portfolio was recorded at a fair value of \$152.2 million and included a credit quality discount which incorporates an adjustment for possible loan losses.



**Non-interest Income.** Non-interest income increased \$300,000, or 16.67%, to \$2.1 million for the three months ended June 30, 2014 from \$1.8 million for the comparable period in 2013. The primary reason for the increase was a gain on acquisition of \$241,000 during the 2014 period.

**Non-interest Expense.** Non-interest expense increased \$941,000, or 11.54%, to \$9.1 million for the three months ended June 30, 2014 from \$8.2 million for the comparable period in 2013. The primary reasons for the increase were increases in compensation and employee benefits of \$222,000, data processing expense of \$290,000, merger related costs of \$176,000 and other expenses of \$121,000. The primary reason for the increases were expenses related to the Franklin acquisition.

**Income Taxes.** Income tax expense increased \$457,000 to \$976,000 for the three months ended June 30, 2014 from \$519,000 for the comparable 2013 period. The increase was primarily a result of the increase in income before taxes of \$1.2 million for the three months ended June 30, 2014. The effective tax rate was 27.10% for the three months ended June 30, 2014, compared to 21.67% for the 2013 period.

### **Comparison of Operating Results for the Nine Months Ended June 30, 2014 and June 30, 2013**

**Net Income.** Net income decreased \$663,000, or 9.76%, to \$6.1 million for the nine months ended June 30, 2014 compared to net income of \$6.8 million for the comparable period in 2013. The decrease was due primarily to decreases in net interest income and noninterest income and an increase in noninterest expenses.

---

**Table of Contents**

**Net Interest Income.** Net interest income decreased \$926,000, or 3.04%, to \$29.5 million for the nine months ended June 30, 2014 from \$30.5 million for the comparable period in 2013. The decrease was primarily attributable to a decrease in the Company's interest rate spread to 2.91% for the nine months ended June 30, 2014, from 3.03% for the comparable period in 2013, along with a decrease of \$7.8 million in the Company's average net earnings assets.

**Interest Income.** Interest income decreased \$1.6 million, or 4.19%, to \$37.5 million for the nine months ended June 30, 2014 from \$39.1 million for the comparable 2013 period. The decrease resulted primarily from a decline in the yield on interest earning assets, offset in part by an increase in interest earning assets. Average interest earning assets increased \$26.7 million and the average yield on interest earning assets decreased 23 basis points. The average yield on interest earning assets was 3.81% for the nine months ended June 30, 2014, as compared to 4.04% for the comparable 2013 period. Loans increased on average \$20.2 million between the two periods. In addition, average investment securities increased \$274,000, mortgage-backed securities increased \$6.2 million, regulatory stock decreased \$6.4 million and other interest earning assets increased \$2.4 million. Interest income for the nine months ended June 30, 2014 included approximately \$1.3 million of net accretion of fair market value adjustments for credit and yield applied to purchased loans compared to \$2.7 million of accretion and recapture for the comparable 2013 period.

**Interest Expense.** Interest expense decreased \$715,000, or 8.24%, to \$8.0 million for the nine months ended June 30, 2014 from \$8.7 million for the comparable 2013 period. The decrease resulted from an 11 basis point decrease in the overall cost of interest bearing liabilities to 0.90% for the nine months ended June 30, 2014 from 1.01% for the comparable 2013 period, offset by a \$30.5 million increase in average interest-bearing liabilities. Average interest bearing liabilities increased primarily from additional liabilities acquired from Franklin.

**Provision for Loan Losses.** In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are subject to interpretation and revision as more information becomes available or as future events occur. After an evaluation of these factors, management made a provision for loan losses of \$2.0 million for the nine month period ended June 30, 2014 as compared to \$3.0 million for the nine month period ended June 30, 2013. The allowance for loan losses was \$8.8 million, or 0.83% of loans outstanding, at June 30, 2014, compared to \$8.2 million, or 0.86% of loans outstanding at September 30, 2013.

**Non-interest Income.** Non-interest income decreased \$805,000, or 12.81%, to \$5.5 million for the nine months ended June 30, 2014 from \$6.3 million for the comparable period in 2013. The primary reasons for the decrease were decreases in gain on sale of loans, net of \$426,000, gains on sale of investments net of \$523,000 and service fees, charges and fees on loans of \$202,000, offset by a gain on acquisition of \$241,000 during the 2014 period.

**Non-interest Expense.** Non-interest expense increased \$278,000, or 1.14%, to \$24.7 million for the nine months ended June 30, 2014 from \$24.4 million for the comparable period in 2013. The primary reasons for the increase were increases in data processing of \$271,000, cost to liquidate foreclosed real estate of \$382,000 and merger related expenses of \$522,000. These increases were partially offset by decreases in compensation and employee benefits of \$737,000 and professional fees of \$105,000. Compensation and employee benefits declined due to decreases in the cost of the Company's stock based incentive plan.

**Income Taxes.** Income tax expense decreased \$396,000 to \$2.1 million for the nine months ended June 30, 2014 from \$2.5 million for the comparable 2013 period. The decrease was primarily a result of the decrease in income before taxes of \$1.1 million for the nine months ended June 30, 2014. The effective tax rate was 25.92% for the nine months

ended June 30, 2014, compared to 27.23% for the 2013 period.

**Table of Contents****Non-Performing Assets**

The following table provides information with respect to the Bank's non-performing assets at the dates indicated. (Dollars in thousands)

	<b>June 30, 2014</b>	<b>September 30, 2013</b>
Non-performing assets:		
Non-accruing loans	\$ 22,930	\$ 23,279
Troubled debt restructures	263	585
Total non-performing loans	23,193	23,864
Foreclosed real estate	2,967	2,111
Other repossessed assets	69	
Total non-performing assets	\$ 26,229	\$ 25,975
Ratio of non-performing loans to total loans	2.19%	2.55%
Ratio of non-performing loans to total assets	1.49%	1.74%
Ratio of non-performing assets to total assets	1.68%	1.89%
Ratio of allowance for loan losses to total loans	0.83%	0.86%

Loans are reviewed on a regular basis and are placed on non-accrual status when they become more than 90 days delinquent. When loans are placed on non-accrual status, unpaid accrued interest is fully reserved, and further income is recognized only to the extent received. Non-performing assets increased \$227,000 to \$26.2 million at June 30, 2014 from \$26.0 million at September 30, 2013. Non-performing loans decreased \$698,000 to \$23.2 million at June 30, 2014 from \$23.9 million at September 30, 2013. The year to date decrease was primarily due to a decrease of \$522,000 in nonperforming residential loans and a \$322,000 decrease in troubled debt restructures offset by a \$222,000 increase in nonperforming commercial loans. The number of nonperforming residential loans increased to 99 at June 30, 2014, from 89 at September 30, 2013. The \$22.9 million of non-accruing loans at June 30, 2014 included 99 residential loans with an aggregate outstanding balance of \$10.4 million that were past due 90 or more days at June 30, 2014, 76 commercial and commercial real estate loans with aggregate outstanding balances of \$12.2 million and 15 consumer loans with aggregate balances of \$291,000. Within the residential loan balance are \$2.4 million of loans less than 90 days past due. In the quarter ended June 30, 2014, the Company identified 15 residential loans which, although paying as agreed, have a high probability of default. Foreclosed real estate increased \$856,000 to \$3.0 million at June 30, 2014 from \$2.1 million at September 30, 2013. Foreclosed real estate consists of 25 residential properties, two building lots and four commercial properties. During the three month period ending June 30, 2014, the Company acquired Franklin Security Bancorp's loan portfolio, which was recorded at a fair value of \$152.2 million. Balances and ratios as of June 30, 2014 reflect the addition of the former Franklin Security non-performing assets.

Foreclosed real estate increased \$856,000 to \$3.0 million at June 30, 2014 from \$2.1 million at September 30, 2013. The balance of foreclosed real estate acquired from Franklin Security Bancorp at June 30, 2014 was \$185,000. The Company also acquired other repossessed assets from Franklin (principally mobile homes) which totaled \$69,000 at June 30, 2014.

At June 30, 2014, the principal balance of troubled debt restructures was \$7.3 million as compared to \$7.8 million at September 30, 2013. Of the \$7.3 million of troubled debt restructures at June 30, 2014, \$3.5 million are performing loans and \$3.8 million are non-accrual loans. An additional \$263,000 of performing troubled debt restructures are classified as non-performing assets because they were non-performing assets at the time they were restructured.

Of the 53 loans that comprise our troubled debt restructures at June 30, 2014, no loans were granted a rate concession at a below market interest rate. Nineteen loans with balances totaling \$2.6 million were granted market rate and terms concessions, ten totaling \$849,000 loans were granted an interest rate concession and 31 loans with balances totaling \$3.9 million were granted term concessions.

As of June 30, 2014, troubled debt restructures were comprised of 48 residential loans totaling \$5.8 million, 10 commercial and commercial real estate loans totaling \$1.5 million, and two consumer (home equity loans, home equity lines and credit, and other) totaling \$103,000.

For the three month period ended June 30, 2014, six loans totaling \$851,000 were removed from non-performing TDR status. Three loans for \$415,000 were transferred to foreclosed real estate, and two loans totaling \$396,000 completed 12 months of consecutive on time payments and one loan totaling \$140,000 was paid off.

We have modified terms of loans that do not meet the definition of a TDR. The vast majority of such loans were rate modifications of residential first mortgage loans in lieu of refinancing. The non-TDR rate modifications were all performing loans when the rates were reset to current market rates. For the three months ended June 30, 2014, we modified eight loans (\$1.4 million) in this fashion. With regard to commercial loans, including commercial real estate loans, various non-troubled loans were modified, either for the purpose of a rate reduction to reflect

---

**Table of Contents**

current market rates (in lieu of a refinance) or the extension of a loan's maturity date. In total, there were six such loans in the three months ended June 30, 2014 with an aggregate balance of approximately \$762,000. For the nine months ended June 30, 2014, we modified 24 loans (\$3.0 million) residential first mortgage loans. With regard to commercial loans, including commercial real estate loans, there were 21 such loans in the nine months ended June 30, 2014 with an aggregate balance of approximately \$12.8 million.

**Liquidity and Capital Resources**

We maintain liquid assets at levels we consider adequate to meet both our short-term and long-term liquidity needs. We adjust our liquidity levels to fund deposit outflows, repay our borrowings and to fund loan commitments. We also adjust liquidity as appropriate to meet asset and liability management objectives.

Our primary sources of liquidity are deposits, prepayment and repayment of loans and mortgage-backed securities, maturities of investment securities and other short-term investments, and earnings and funds provided from operations, as well as access to FHLBank advances and other borrowing sources. While scheduled principal repayments on loans and mortgage-backed securities are a relatively predictable source of funds, deposit flows and loan prepayments are greatly influenced by market interest rates, economic conditions, and rates offered by our competition. We set the interest rates on our deposits to maintain a desired level of total deposits.

A portion of our liquidity consists of cash and cash equivalents and borrowings, which are a product of our operating, investing and financing activities. At June 30, 2014, \$23.5 million of our assets were invested in cash and cash equivalents. Our primary sources of cash are principal repayments on loans, proceeds from the maturities of investment securities, principal repayments of mortgage-backed securities and increases in deposit accounts. Short-term investment securities (maturing in one year or less) totaled \$2.1 million at June 30, 2014. As of June 30, 2014, we had \$224.3 million in borrowings outstanding from FHLBank Pittsburgh. We have access to total FHLBank advances of up to approximately \$596.3 million.

At June 30, 2014, we had \$92.0 million in loan commitments outstanding, which included, in part, \$5.7 million in undisbursed construction loans and land development loans, \$31.6 million in unused home equity lines of credit, \$35.8 million in commercial lines of credit and commitments to originate commercial loans, \$5.6 million in performance standby letters of credit and \$524,000 in other unused commitments which are primarily to originate residential mortgage loans and multifamily loans. Certificates of deposit due within one year of June 30, 2014 totaled \$299.6 million, or 46.2% of certificates of deposit. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before June 30, 2015. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

As reported in the Consolidated Statements of Cash Flows, our cash flows are classified for financial reporting purposes as operating, investing or financing cash flows. Net cash provided by operating activities was \$10.7 million and \$19.4 million for the nine months ended June 30, 2014 and 2013, respectively. These amounts differ from our net income because of a variety of cash receipts and disbursements that did not affect net income for the respective periods. Net cash provided in investing activities was \$9.6 million and \$23.2 million for the three months ended June 30, 2014 and 2013, respectively, principally reflecting our loan and investment security activities. Deposit and borrowing cash flows have comprised most of our financing activities which resulted in net cash used of \$23.5 million and \$37.8 million for the nine months ended June 30, 2014 and 2013, respectively.

## Critical Accounting Policies

We consider accounting policies that require management to exercise significant judgment or discretion or make significant assumptions that have, or could have, a material impact on the carrying value of certain assets or on income, to be critical accounting policies. We consider the following to be our critical accounting policies:

***Allowance for Loan Losses.*** The allowance for loan losses is the estimated amount considered necessary to cover credit losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses which is charged against income. In determining the allowance for loan losses, management makes significant estimates and has identified this policy as one of our most critical. The methodology for determining the allowance for loan losses is considered a critical accounting policy by management due to the high degree of judgment involved, the subjectivity of the assumptions utilized and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans and discounted cash flow valuations of properties are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisals and discounted cash flow valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly impact the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals and discounted cash flow valuations are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans.

## **Table of Contents**

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. Consideration is given to a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic and industry concentrations, the adequacy of the underlying collateral, the financial strength of the borrower, results of internal and external loan reviews and other relevant factors. This evaluation is inherently subjective, as it requires material estimates that may be susceptible to significant revision based on changes in economic and real estate market conditions.

The analysis of the allowance for loan losses has two components: specific and general allocations. Specific allocations are made for loans that are determined to be impaired. Impairment is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The general allocation is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. We also analyze historical loss experience, delinquency trends, general economic conditions and geographic and industry concentrations. This analysis establishes factors that are applied to the loan groups to determine the amount of the general allocations. Actual loan losses may be significantly more than the allowance for loan losses we have established which could have a material negative effect on our financial results.

***Other-than-Temporary Investment Security Impairment.*** Securities are evaluated periodically to determine whether a decline in their value is other-than-temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other-than-temporary. The term other-than-temporary is not intended to indicate that the decline is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

***Deferred Income Taxes.*** We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. We consider the determination of this valuation allowance to be a critical accounting policy because of the need to exercise significant judgment in evaluating the amount and timing of recognition of deferred tax liabilities and assets, including projections of future taxable income. These judgments and estimates are reviewed on a continual basis as regulatory and business factors change. A valuation allowance for deferred tax assets may be required if the amount of taxes recoverable through loss carryback declines, or if we project lower levels of future taxable income. Such a valuation allowance would be established through a charge to income tax expense which would adversely affect our operating results.

## **Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements (as such term is defined in applicable Securities and Exchange Commission rules) that are reasonably likely to have a current or future material effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

## **Contractual Obligations**



During the first nine months of fiscal 2014, the Company's contractual obligations did not change materially from those discussed in the Company's Financial Statements for the year ended September 30, 2013.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits and borrowings. As a result, a principal part of our business strategy is to manage interest rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly, our Board of Directors has approved guidelines for managing the interest rate risk inherent in our assets and liabilities, given our business strategy, operating environment, capital, liquidity and performance objectives. Senior management monitors the level of interest rate risk on a regular basis and the asset/liability committee meets quarterly to review our asset/liability policies and interest rate risk position.

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. The net proceeds from the Company's stock offering increased our capital and provided management with greater flexibility to manage our interest rate risk. In particular, management used the majority of the capital we received to increase our interest-earning assets. There have been no material changes in our interest rate risk since September 30, 2013.

**Item 4. Controls and Procedures**

Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and

**Table of Contents**

15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

There were no changes made in the Company's internal controls over financial reporting (as defined by rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) or in other factors that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting during the period covered by this report.

**Table of Contents****Part II Other Information****Item 1. Legal Proceedings**

The Company and its subsidiaries are subject to various legal actions arising in the normal course of business. In the opinion of management, the resolution of these legal actions is not expected to have a material adverse effect on the Company's financial condition or results of operations.

**Item 1A. Risk Factors**

There have been no material changes in the Risk Factors as disclosed in the Company's response to Item 1A to Part 1 of Form 10-K for the year ended September 30, 2013 filed on December 16, 2013.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table presents a summary of the company's share repurchases during the quarter ended June 30, 2014.

**Company Purchases of Common Stock**

<b>Month Ending</b>	<b>Total number of shares purchased</b>	<b>Average price paid per share</b>	<b>Total number of shares purchased as part of publicly announced plans or programs</b>	<b>Maximum number of shares that may yet be purchased under the plans or programs</b>
April 30, 2014	7,600	\$ 10.42	7,600	
May 31, 2014	30,900	10.48	30,900	
June 30, 2014	23,400	10.63	23,400	
Total	61,900	\$ 10.53	61,900	238,100

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

Not applicable.

**Table of Contents**

**Item 6. Exhibits**

The following exhibits are either filed as part of this report or are incorporated herein by reference:

- 3.1 Certificate of Incorporation of ESSA Bancorp, Inc.\*
- 3.2 Bylaws of ESSA Bancorp, Inc.\*
- 4 Form of Common Stock Certificate of ESSA Bancorp, Inc.\*
- 10.2 Amended and Restated Employment Agreement for Gary S. Olson\*\*
- 10.3 Amended and Restated Employment Agreement for Robert S. Howes\*\*
- 10.4 Amended and Restated Employment Agreement for Allan A. Muto\*\*
- 10.5 Amended and Restated Employment Agreement for Diane K. Reimer\*\*
- 10.6 Amended and Restated Employment Agreement for V. Gail Warner\*\*
- 10.7 Supplemental Executive Retirement Plan\*\*
- 10.8 Endorsement Split Dollar Life Insurance Agreement for Gary S. Olson\*\*
- 10.9 Endorsement Split Dollar Life Insurance Agreement for Robert S. Howes\*\*
- 21 Subsidiaries of Registrant\*
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101 Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statements of Condition; (ii) the Consolidated Statement of Income; (iii) the Consolidated Statement of Changes in Stockholder Equity; the Consolidated Statement of Cash Flows; and (iv) the Notes to Consolidated Financial Statements.

\* Incorporated by reference to the Registration Statement on Form S-1 of ESSA Bancorp, Inc. (file no. 333-139157), originally filed with the Securities and Exchange Commission on December 7, 2006.

\*\* Incorporated by reference to ESSA Bancorp, Inc.'s current report on Form 8-K filed with the Securities and Exchange Commission on October 6, 2008.

**Table of Contents**

**SIGNATURES**

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

**ESSA BANCORP, INC.**

Date: August 8, 2014

/s/ Gary S. Olson  
Gary S. Olson  
President and Chief Executive Officer

Date: August 8, 2014

/s/ Allan A. Muto  
Allan A. Muto  
Executive Vice President and Chief Financial Officer