

ESSA Bancorp, Inc.  
Form 10-Q  
August 09, 2011  
[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, 2011

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)

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

**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 4, 2011 there were 12,454,622 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

|  | <b>Page</b> |
|--|-------------|
| <b>Part I. Financial Information</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> | 19          |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>                            | 29          |
| Item 4. <u>Controls and Procedures</u>   | 30          |
| <b>Part II. Other Information</b>  |             |
| Item 1. <u>Legal Proceedings</u>   | 30          |
| Item 1A. <u>Risk Factors</u>   | 30          |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | 30          |
| Item 3. <u>Defaults Upon Senior Securities</u>   | 30          |
| Item 4. <u>[Removed and Reserved]</u>  | 30          |
| Item 5. <u>Other Information</u>   | 30          |
| Item 6. <u>Exhibits</u>  | 31          |
| <u>Signature Page</u>  | 32          |

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

## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEET

(UNAUDITED)

|  | June 30,<br>2011       | September 30,<br>2010 |
|--|------------------------|-----------------------|
|  | (dollars in thousands) |                       |
| Cash and due from banks  | \$ 8,604               | \$ 7,454              |
| Interest-bearing deposits with other institutions  | 13,193                 | 3,436                 |
| <b>Total cash and cash equivalents</b>   | <b>21,797</b>          | <b>10,890</b>         |
| Investment securities available for sale   | 256,166                | 252,341               |
| Investment securities held to maturity (fair value of \$9,834 and \$13,254)  | 9,479                  | 12,795                |
| Loans receivable (net of allowance for loan losses of \$8,225 and \$7,448)   | 741,764                | 730,842               |
| Federal Home Loan Bank stock   | 17,770                 | 20,727                |
| Premises and equipment, net  | 11,682                 | 12,189                |
| Bank-owned life insurance  | 23,057                 | 15,618                |
| Foreclosed real estate   | 2,039                  | 2,034                 |
| Intangible assets, net   | 1,906                  |                       |
| Goodwill   | 40                     |                       |
| Other assets   | 16,923                 | 14,561                |
| <b>TOTAL ASSETS</b>  | <b>\$ 1,102,623</b>    | <b>\$ 1,071,997</b>   |
| <b>LIABILITIES</b>   |                        |                       |
| Deposits   | \$ 655,369             | \$ 540,410            |
| Short-term borrowings  |                        | 14,719                |
| Other borrowings   | 269,657                | 335,357               |
| Advances by borrowers for taxes and insurance  | 6,550                  | 1,465                 |
| Other liabilities  | 6,448                  | 8,423                 |
| <b>TOTAL LIABILITIES</b>   | <b>938,024</b>         | <b>900,374</b>        |
| Commitment and contingencies   |                        |                       |
| <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, 16,980,900 issued; 12,645,522 and 13,482,612 outstanding at June 30, 2011 and September 30, 2010) | 170                    | 170                   |
| Additional paid in capital   | 166,208                | 164,494               |
| Unallocated common stock held by the Employee Stock Ownership Plan (ESOP)  | (11,551)               | (11,891)              |
| Retained earnings  | 65,973                 | 64,272                |
| Treasury stock, at cost; 4,335,378 and 3,498,288 shares at June 30, 2011 and September 30, 2010, respectively  | (55,436)               | (44,870)              |
| Accumulated other comprehensive loss   | (765)                  | (552)                 |
| <b>TOTAL STOCKHOLDERS EQUITY</b>   | <b>164,599</b>         | <b>171,623</b>        |

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

|  |              |              |
|--|--------------|--------------|
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 1,102,623 | \$ 1,071,997 |
|--|--------------|--------------|

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<br>Ended June 30, |               | For the Nine Months<br>Ended June 30, |               |
|--|--|---------------|---------------------------------------|---------------|
|  | 2011                                   | 2010          | 2011                                  | 2010          |
| (dollars in thousands, except per share data)              |  |               |                                       |               |
| <b>INTEREST INCOME</b>                                     |  |               |                                       |               |
| Loans receivable   | \$ 9,683                               | \$ 10,105     | \$ 29,322                             | \$ 30,612     |
| Investment securities:                                     |  |               |                                       |               |
| Taxable  | 2,092                                  | 1,925         | 6,030                                 | 6,326         |
| Exempt from federal income tax                             | 66                                     | 78            | 219                                   | 238           |
| Other investment income                                    | 1                                      | 3             | 2                                     | 5             |
| <b>Total interest income</b>                               | <b>11,842</b>                          | <b>12,111</b> | <b>35,573</b>                         | <b>37,181</b> |
| <b>INTEREST EXPENSE</b>                                    |  |               |                                       |               |
| Deposits   | 1,932                                  | 1,769         | 5,423                                 | 4,633         |
| Short-term borrowings                                      | 1                                      | 1             | 46                                    | 85            |
| Other borrowings   | 2,549                                  | 3,670         | 8,272                                 | 11,305        |
| <b>Total interest expense</b>                              | <b>4,482</b>                           | <b>5,440</b>  | <b>13,741</b>                         | <b>16,023</b> |
| <b>NET INTEREST INCOME</b>                                 | <b>7,360</b>                           | <b>6,671</b>  | <b>21,832</b>                         | <b>21,158</b> |
| Provision for loan losses                                  | 475                                    | 500           | 1,605                                 | 1,650         |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b> | <b>6,885</b>                           | <b>6,171</b>  | <b>20,227</b>                         | <b>19,508</b> |
| <b>NONINTEREST INCOME</b>                                  |  |               |                                       |               |
| Service fees on deposit accounts                           | 768                                    | 799           | 2,259                                 | 2,403         |
| Services charges and fees on loans                         | 142                                    | 126           | 497                                   | 351           |
| Trust and investment fees                                  | 190                                    | 203           | 596                                   | 635           |
| Gain on sale of investments, net                           | 56                                     | 305           | 171                                   | 613           |
| Gain on sale of loans, net                                 |  | 41            | 3                                     | 236           |
| Earnings on bank-owned life insurance                      | 170                                    | 135           | 438                                   | 410           |
| Insurance commissions                                      | 125                                    |               | 125                                   |               |
| Other  | 8                                      | 10            | 28                                    | 34            |
| <b>Total noninterest income</b>                            | <b>1,459</b>                           | <b>1,619</b>  | <b>4,117</b>                          | <b>4,682</b>  |
| <b>NONINTEREST EXPENSE</b>                                 |  |               |                                       |               |
| Compensation and employee benefits                         | 3,899                                  | 3,731         | 11,712                                | 11,068        |
| Occupancy and equipment                                    | 758                                    | 823           | 2,331                                 | 2,145         |
| Professional fees  | 411                                    | 373           | 1,260                                 | 1,136         |
| Data processing  | 477                                    | 524           | 1,407                                 | 1,441         |
| Advertising  | 165                                    | 208           | 534                                   | 472           |
| Federal Deposit Insurance Corporation (FDIC) premiums      | 196                                    | 157           | 602                                   | 638           |
| Loss on foreclosed real estate, net                        | 81                                     |               | 93                                    | 1,200         |

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

|                                   |                 |                 |                 |                 |
|-----------------------------------|-----------------|-----------------|-----------------|-----------------|
| Amortization of intangible assets | 54              |                 | 54              |                 |
| Other                             | 526             | 519             | 1,667           | 1,511           |
| Total noninterest expense         | 6,567           | 6,335           | 19,660          | 19,611          |
| Income before income taxes        | 1,777           | 1,455           | 4,684           | 4,579           |
| Income taxes                      | 536             | 387             | 1,216           | 1,114           |
| <b>NET INCOME</b>                 | <b>\$ 1,241</b> | <b>\$ 1,068</b> | <b>\$ 3,468</b> | <b>\$ 3,465</b> |
| Earnings per share                |                 |                 |                 |                 |
| Basic                             | \$ 0.11         | \$ 0.09         | \$ 0.30         | \$ 0.27         |
| Diluted                           | \$ 0.11         | \$ 0.09         | \$ 0.30         | \$ 0.27         |
| Dividends per share               | \$ 0.05         | \$ 0.05         | \$ 0.15         | \$ 0.15         |

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)

|  | Common Stock        |        | Additional<br>Paid In<br>Capital | Unallocated<br>Common<br>Stock Held by<br>the ESOP | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders<br>Equity |
|--|---------------------|--------|----------------------------------|--|----------------------|-------------------|---|---------------------------------|
|  | Number of<br>Shares | Amount |                                  |  |                      |                   |   |                                 |
| Balance, September 30, 2010  | 13,482,612          | \$ 170 | \$ 164,494                       | \$ (11,891)  | \$ 64,272            | \$ (44,870)       | \$ (552)                                      | \$ 171,623                      |
| (Dollars in thousands, except number of shares)  |                     |        |                                  |  |                      |                   |   |                                 |
| Net income   |                     |        |                                  |  | 3,468                |                   |   | 3,468                           |
| Other comprehensive loss:  |                     |        |                                  |  |                      |                   |   |                                 |
| Unrealized loss on securities<br>available for sale, net of income tax<br>benefit of \$214 |                     |        |                                  |  |                      |                   | (417)   | (417)                           |
| Change in unrecognized pension<br>cost, net of income taxes of \$105                       |                     |        |                                  |  |                      |                   | 204   | 204                             |
| Cash dividends declared (\$.15 per<br>share)   |                     |        |                                  |  | (1,767)              |                   |   | (1,767)                         |
| Stock based compensation   |                     |        | 1,628                            |  |                      |                   |   | 1,628                           |
| Allocation of ESOP stock   |                     |        | 86                               | 340  |                      |                   |   | 426                             |
| Treasury shares purchased  | (837,090)           |        |                                  |  |                      | (10,566)          |   | (10,566)                        |
| Balance, June 30, 2011   | 12,645,522          | \$ 170 | \$ 166,208                       | \$ (11,551)  | \$ 65,973            | \$ (55,436)       | \$ (765)                                      | \$ 164,599                      |

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<br/>Ended June 30,<br/>2011                      2010<br/>(dollars in thousands)</b> |          |
|---|---|----------|
| <b>OPERATING ACTIVITIES</b>   |   |          |
| Net income  | \$ 3,468  | \$ 3,465 |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |          |
| Provision for loan losses   | 1,605   | 1,650    |
| Provision for depreciation and amortization.                                      | 830   | 895      |
| Amortization of discounts and premiums, net                                       | 906   | 474      |
| Gain on sale of investment securities, net  | (171)   | (613)    |
| Gain on sale of loans, net  | (3)   | (236)    |
| Origination of mortgage loans sold  | (97)  | (9,750)  |
| Proceeds from sale of mortgage loans originated for sale                          | 100   | 9,986    |
| Compensation expense on ESOP  | 426   | 420      |
| Stock based compensation  | 1,628   | 1,604    |
| Decrease in accrued interest receivable   | 166   | 208      |
| Increase in accrued interest payable  | 103   | 191      |
| Earnings on bank-owned life insurance   | (438)   | (410)    |
| Deferred federal income taxes   | (597)   | (50)     |
| (Increase) decrease in prepaid FDIC premiums                                      | 553   | (1,455)  |
| Decrease in accrued pension liability   | (845)   | (1,196)  |
| Loss on foreclosed real estate, net   | 335   | 1,200    |
| Amortization of intangible assets   | 54  |          |
| Other, net  | (1,062)   | (1,811)  |
| Net cash provided by operating activities   | 6,961   | 4,572    |
| <b>INVESTING ACTIVITIES</b>   |   |          |
| Proceeds from repayments of certificates of deposit                               |   | 3,385    |
| Investment securities available for sale:   |   |          |
| Proceeds from sale of investment securities                                       | 7,660   | 28,105   |
| Proceeds from principal repayments and maturities                                 | 67,885  | 47,113   |
| Purchases   | (80,748)  | (88,275) |
| Investment securities held to maturity:   |   |          |
| Proceeds from sale of investment securities                                       | 643   |          |
| Proceeds from principal repayments and maturities                                 | 2,673   | 3,024    |
| Purchases   |   | (10,163) |
| (Increase) decrease in loans receivable, net                                      | (14,687)  | 1,127    |
| Redemption of FHLB stock  | 2,957   |          |
| Purchase of bank owned life insurance   | (7,001)   |          |
| Proceeds from sale of other real estate   | 1,889   |          |
| Investment in limited partnership   | (2,170)   |          |
| Capital improvements to foreclosed real estate                                    | (46)  | (63)     |
| Purchase of insurance subsidiary  | (2,025)   |          |
| Purchase of premises, equipment, and software                                     | (297)   | (2,859)  |
| Net cash used for investing activities  | (23,267)  | (18,606) |

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

FINANCING ACTIVITIES

|   |          |          |
|---|----------|----------|
| Increase in deposits, net                                 | 114,959  | 107,018  |
| Net decrease in short-term borrowings                     | (14,719) | (48,091) |
| Proceeds from other borrowings                            | 8,300    | 17,250   |
| Repayment of other borrowings                             | (74,000) | (45,500) |
| Increase in advances by borrowers for taxes and insurance | 5,085    | 4,847    |
| Purchase of treasury stock.                               | (10,645) | (12,421) |
| Dividends on common stock                                 | (1,767)  | (1,958)  |

|   |        |        |
|---|--------|--------|
| Net cash provided by financing activities | 27,213 | 21,145 |
|---|--------|--------|

|                                       |        |       |
|---------------------------------------|--------|-------|
| Increase in cash and cash equivalents | 10,907 | 7,111 |
|---------------------------------------|--------|-------|

|  |        |        |
|--|--------|--------|
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 10,890 | 18,593 |
|--|--------|--------|

|  |           |           |
|--|-----------|-----------|
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 21,797 | \$ 25,704 |
|--|-----------|-----------|

SUPPLEMENTAL CASH FLOW DISCLOSURES

Cash Paid:

|          |           |           |
|----------|-----------|-----------|
| Interest | \$ 13,638 | \$ 15,832 |
|----------|-----------|-----------|

|              |       |       |
|--------------|-------|-------|
| Income taxes | 2,475 | 1,869 |
|--------------|-------|-------|

Noncash items:

|  |       |     |
|--|-------|-----|
| Transfers from loans to foreclosed real estate | 2,171 | 699 |
|--|-------|-----|

|                        |      |          |
|------------------------|------|----------|
| Treasury stock payable | (79) | \$ (159) |
|------------------------|------|----------|

Acquisition of Insurance Subsidiary:

|           |         |  |
|-----------|---------|--|
| Cash Paid | (2,025) |  |
|-----------|---------|--|

Noncash assets received and liabilities assumed:

|          |    |  |
|----------|----|--|
| Goodwill | 40 |  |
|----------|----|--|

|                   |       |  |
|-------------------|-------|--|
| Intangible assets | 1,960 |  |
|-------------------|-------|--|

|                        |    |  |
|------------------------|----|--|
| Premises and equipment | 25 |  |
|------------------------|----|--|

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 unaudited, 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 Investment Company and ESSA Advisory Services, LLC. The primary purpose of the Company is to act as a holding company for the Bank. The Company has been subject to regulation and supervision as a savings and loan holding company by the Office of Thrift Supervision (the OTS). As of July 21, 2011, the Federal Reserve Board assumed regulation and supervision of savings and loan holding companies as required by the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010. The Bank is a Pennsylvania chartered savings association 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 and Lehigh counties, Pennsylvania. The Bank has been subject to regulation and supervision by the Pennsylvania Banking Department and the OTS. Pursuant to the Dodd Frank Act referred to above, the role of the OTS was assumed by the Federal Deposit Insurance Corporation as of July 21, 2011. 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 is currently inactive. 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% 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. All significant intercompany 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 three and nine month periods ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending September 30, 2011.

**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, 2011 and 2010.

|  | Three months ended |               | Nine months ended |               |
|--|--------------------|---------------|-------------------|---------------|
|  | June 30, 2011      | June 30, 2010 | June 30, 2011     | June 30, 2010 |
| Weighted-average common shares outstanding   | 16,980,900         | 16,980,900    | 16,980,900        | 16,980,900    |
| Average treasury stock shares  | (4,226,817)        | (2,892,908)   | (3,918,021)       | (2,555,593)   |
| Average unearned ESOP shares   | (1,148,618)        | (1,193,894)   | (1,159,979)       | (1,205,255)   |
| Average unearned non-vested shares   | (254,845)          | (373,905)     | (264,070)         | (383,006)     |
| Weighted average common shares and common stock equivalents used to calculate basic earnings per share | 11,350,620         | 12,520,193    | 11,638,830        | 12,837,046    |
| 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       |                    |               |                   |               |
|  | 11,350,620         | 12,520,193    | 11,638,830        | 12,837,046    |

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

Weighted average common shares and common stock  
equivalents used to calculate diluted earnings per share

**Table of Contents**

At June 30, 2011 and 2010 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, 2011 and 2010 there were 224,566 and 342,656 shares, respectively, of nonvested 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.

**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 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. Comprehensive Income**

The components of other comprehensive income are as follows (in thousands):

|   | <b>Three Months Ended<br/>June 30</b> |             | <b>Nine Months Ended<br/>June 30</b> |             |
|---|---------------------------------------|-------------|--------------------------------------|-------------|
|   | <b>2011</b>                           | <b>2010</b> | <b>2011</b>                          | <b>2010</b> |
| Net income  | \$ 1,241                              | \$ 1,068    | \$ 3,468                             | \$ 3,465    |
| Unrealized gain/(loss) on securities available for sale | 4,178                                 | 1,683       | (460)                                | 478         |
| Realized gains included in net income                   | (56)                                  | (202)       | (171)                                | (405)       |
| Change in unrecognized pension cost                     | 103                                   | 78          | 309                                  | 234         |
| Other comprehensive income/(loss) before tax            | 4,225                                 | 1,559       | (322)                                | 307         |
| Income tax (benefit) related to comprehensive loss      | 1,437                                 | 531         | (109)                                | 105         |
| Other comprehensive income/(loss)                       | 2,788                                 | 1,028       | (213)                                | 202         |
| Comprehensive income                                    | \$ 4,029                              | \$ 2,096    | \$ 3,255                             | \$ 3,667    |

**5. Recent Accounting Pronouncements**

In January 2010, the Financial Accounting Standards Board (FASB) issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of this guidance is not expected to have a significant impact on the Company's financial statements.

In July 2010, FASB issued ASU No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU 2010-20 is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The amendments in ASU

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

2010-20 encourage, but do not require, comparative disclosures for earlier reporting periods that ended before initial adoption. However, an entity should provide comparative disclosures for those reporting periods ending after initial adoption. The Company has presented the necessary disclosures in Note 8, herein.

In September, 2010, the FASB issued ASU 2010-25, Plan Accounting *Defined Contribution Pension Plans*. The amendments in this ASU require that participant loans be classified as notes receivable from participants, which are segregated from plan investments and measured at their unpaid principal balance plus any accrued but unpaid interest. The amendments in this update are effective for fiscal years ending after December 15, 2010 and are not expected to have a significant impact on the Company's financial statements.

---

**Table of Contents**

In October 2010, the FASB issued ASU 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. This ASU addresses the diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The amendments are effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2011 and are not expected to have a significant impact on the Company's financial statements.

In December 2010, the FASB issued ASU 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*. This ASU modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating an impairment may exist. The qualitative factors are consistent with the existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For public entities, the amendments in this Update are effective for fiscal year, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Nonpublic entities may early adopt the amendments using the effective date for public entities. This ASU is not expected to have a significant impact on the Company's financial statements.

In December 2010, the FASB issued ASU 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations*. The amendments in this update specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures under Topic 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments in this Update are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

In January 2011, the FASB issued ASU 2011-01, *Receivables (Topic 310): Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20*. The amendments in this Update temporarily delay the effective date of the disclosures about troubled debt restructurings in Update 2010-20, enabling public-entity creditors to provide those disclosures after the FASB clarifies the guidance for determining what constitutes a troubled debt restructuring. The deferral in this Update will result in more consistent disclosures about troubled debt restructurings. This amendment does not defer the effective date of the other disclosure requirements in Update 2010-20. In the proposed Update for determining what constitutes a troubled debt restructuring, the FASB proposed that the clarifications would be effective for interim and annual periods ending after June 15, 2011. For the new disclosures about troubled debt restructurings in Update 2010-20, those clarifications would be applied retrospectively to the beginning of the fiscal year in which the proposal is adopted. The adoption of this guidance is not expected to have a significant impact on the Company's financial statements.

In April 2011, the FASB issued ASU 2011-02, *Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. The amendments in this Update provide additional guidance or clarification to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The amendments in this Update are effective for the first interim or annual reporting period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning annual period of adoption. As a result of applying these amendments, an entity may identify receivables that are newly considered impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments

---

**Table of Contents**

prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In April 2011, the FASB issued ASU 2011-03, *Reconsideration of Effective Control for Repurchase Agreements*. The main objective in developing this Update is to improve the accounting for repurchase agreements (repos) and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments in this Update remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this Update apply to all entities, both public and nonpublic. The amendments affect all entities that enter into agreements to transfer financial assets that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity. The guidance in this Update is effective for the first interim or annual period beginning on or after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments in this Update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. For nonpublic entities, the amendments are effective for annual periods beginning after December 15, 2011. Early application by public entities is not permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*. The amendments in this Update improve the comparability, clarity, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. GAAP and IFRS, the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. All entities that report items of comprehensive income, in any period presented, will be affected by the changes in this Update. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. The amendments in this Update should be applied retrospectively, and early adoption is permitted. This ASU is not expected to have a significant impact on the Company's financial statements.



**Table of Contents****6. Investment Securities**

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

|  | Amortized Cost | June 30, 2011          |                         | Fair Value |
|--|----------------|------------------------|-------------------------|------------|
|  |                | Gross Unrealized Gains | Gross Unrealized Losses |            |
| <b>Available for Sale</b>                        |                |                        |                         |            |
| Fannie Mae                                       | \$ 129,327     | \$ 2,705               | \$ (401)                | \$ 131,631 |
| Freddie Mac                                      | 47,634         | 1,630                  | (75)                    | 49,189     |
| Governmental National Mortgage Association       | 28,967         | 795                    | (61)                    | 29,701     |
| Total mortgage-backed securities                 | 205,928        | 5,130                  | (537)                   | 210,521    |
| Obligations of states and political subdivisions | 14,659         | 406                    | (105)                   | 14,960     |
| U.S. government agency securities                | 27,774         | 209                    |                         | 27,983     |
| Corporate obligations                            | 2,610          | 38                     | (7)                     | 2,641      |
| Total debt securities                            | 250,971        | 5,783                  | (649)                   | 256,105    |
| Equity securities financial services             | 11             | 50                     |                         | 61         |
| Total  | \$ 250,982     | \$ 5,833               | \$ (649)                | \$ 256,166 |

| <b>Held to Maturity</b> |          |        |    |          |
|-------------------------|----------|--------|----|----------|
| Fannie Mae              | \$ 1,293 | \$ 87  | \$ | \$ 1,380 |
| Freddie Mac             | 8,186    | 268    |    | 8,454    |
| Total                   | \$ 9,479 | \$ 355 | \$ | \$ 9,834 |

|  | Amortized Cost | September 30, 2010     |                         | Fair Value |
|--|----------------|------------------------|-------------------------|------------|
|  |                | Gross Unrealized Gains | Gross Unrealized Losses |            |
| <b>Available for Sale</b>                        |                |                        |                         |            |
| Fannie Mae                                       | \$ 99,142      | \$ 2,412               | \$ (9)                  | \$ 101,545 |
| Freddie Mac                                      | 47,693         | 1,895                  |                         | 49,588     |
| Governmental National Mortgage Association       | 35,211         | 1,040                  | (96)                    | 36,155     |
| Total mortgage-backed securities                 | 182,046        | 5,347                  | (105)                   | 187,288    |
| Obligations of states and political subdivisions | 10,637         | 279                    | (12)                    | 10,904     |
| U.S. government agency securities                | 52,177         | 279                    | (22)                    | 52,434     |
| Corporate obligations                            | 1,654          | 23                     |                         | 1,677      |
| Total debt securities                            | 246,514        | 5,928                  | (139)                   | 252,303    |
| Equity securities financial services             | 12             | 26                     |                         | 38         |
| Total  | \$ 246,526     | \$ 5,954               | \$ (139)                | \$ 252,341 |

| <b>Held to Maturity</b> |           |        |    |           |
|-------------------------|-----------|--------|----|-----------|
| Fannie Mae              | \$ 2,600  | \$ 140 | \$ | \$ 2,740  |
| Freddie Mac             | 10,195    | 319    |    | 10,514    |
| Total                   | \$ 12,795 | \$ 459 | \$ | \$ 13,254 |

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

The amortized cost and fair value of debt securities at June 30, 2011, 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):

|  | Available For Sale |                   | Held To Maturity  |                 |
|--|--------------------|-------------------|-------------------|-----------------|
|  | Amortized<br>Cost  | Fair Value        | Amortized<br>Cost | Fair Value      |
| Due in one year or less                | \$ 16,570          | \$ 16,639         | \$                | \$              |
| Due after one year through five years  | 12,074             | 12,304            | 706               | 750             |
| Due after five years through ten years | 46,396             | 47,704            | 957               | 1,029           |
| Due after ten years                    | 175,931            | 179,458           | 7,816             | 8,055           |
| <b>Total</b>                           | <b>\$ 250,971</b>  | <b>\$ 256,105</b> | <b>\$ 9,479</b>   | <b>\$ 9,834</b> |

For the nine months ended June 30, 2011, the Company realized gross gains of \$204,000 and gross losses of \$33,000 and proceeds from the sale of investment securities of \$8.3 million. For the nine months ended June 30, 2010, the Company realized gross gains of \$613,000 and proceeds from the sale of investment securities of \$28.1 million. Included in the gross gains realized for the nine months ended June 30, 2011 was \$18,000 from the sale of investment securities classified as held to maturity. Proceeds from the sale of these securities were \$643,000. The investment remaining in these securities at the time of sale was less than 20% of the original investment.

**Table of Contents****7. 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):

|  | Number of Securities | Less than Twelve Months |                         | June 30, 2011            |                         | Total            |                         |
|--|----------------------|-------------------------|-------------------------|--------------------------|-------------------------|------------------|-------------------------|
|  |                      | Fair Value              | Gross Unrealized Losses | Twelve Months or Greater | Gross Unrealized Losses | Fair Value       | Gross Unrealized Losses |
| Fannie Mae                                       | 14                   | \$ 35,933               | \$ (401)                | \$                       | \$                      | \$ 35,933        | \$ (401)                |
| Freddie Mac                                      | 4                    | 9,695                   | (75)                    |                          |                         | 9,695            | (75)                    |
| Governmental National Mortgage Association       | 5                    | 11,169                  | (61)                    |                          |                         | 11,169           | (61)                    |
| Obligations of states and political subdivisions | 1                    | 833                     | (105)                   |                          |                         | 833              | (105)                   |
| Corporate obligations                            | 1                    | 493                     | (7)                     |                          |                         | 493              | (7)                     |
| <b>Total</b>                                     | <b>25</b>            | <b>\$ 58,123</b>        | <b>\$ (649)</b>         | <b>\$</b>                | <b>\$</b>               | <b>\$ 58,123</b> | <b>\$ (649)</b>         |

|  | Number of Securities | Less than Twelve Months |                         | September 30, 2010       |                         | Total            |                         |
|--|----------------------|-------------------------|-------------------------|--------------------------|-------------------------|------------------|-------------------------|
|  |                      | Fair Value              | Gross Unrealized Losses | Twelve Months or Greater | Gross Unrealized Losses | Fair Value       | Gross Unrealized Losses |
| Fannie Mae                                       | 1                    | \$ 2,060                | \$ (9)                  | \$                       | \$                      | \$ 2,060         | \$ (9)                  |
| Governmental National Mortgage Association       | 2                    | 5,605                   | (96)                    |                          |                         | 5,605            | (96)                    |
| Obligations of states and political subdivisions | 1                    | 610                     | (12)                    |                          |                         | 610              | (12)                    |
| U.S. government agency securities                | 4                    | 6,484                   | (22)                    |                          |                         | 6,484            | (22)                    |
| <b>Total</b>                                     | <b>8</b>             | <b>\$ 14,759</b>        | <b>\$ (139)</b>         | <b>\$</b>                | <b>\$</b>               | <b>\$ 14,759</b> | <b>\$ (139)</b>         |

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, 2011, 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.

**Table of Contents****8. Loans Receivable, Net and Allowance for Loan Losses**

Loans receivable consist of the following (in thousands):

|                                       | June 30,<br>2011 | September 30,<br>2010 |
|---------------------------------------|------------------|-----------------------|
| Real Estate Loans:                    |                  |                       |
| Residential                           | \$ 589,204       | \$ 596,455            |
| Construction                          | 1,094            | 1,302                 |
| Commercial                            | 101,166          | 77,943                |
| Commercial                            | 15,322           | 16,545                |
| Home equity loans and lines of credit | 41,037           | 43,559                |
| Other                                 | 2,166            | 2,486                 |
|                                       | 749,989          | 738,290               |
| Less allowance for loan losses        | 8,225            | 7,448                 |
| Net loans                             | \$ 741,764       | \$ 730,842            |

|                      | Real Estate Loans |              |            | Commercial<br>Loans<br>(dollars in thousands) | Home<br>Equity and<br>Lines of<br>Credit | Other<br>Loans | Total      |
|----------------------|-------------------|--------------|------------|---|--|----------------|------------|
|                      | Residential       | Construction | Commercial |   |  |                |            |
| <b>June 30, 2011</b> |                   |              |            |   |  |                |            |
| Total Loans          | \$ 589,204        | \$ 1,094     | \$ 101,166 | \$ 15,322                                     | \$ 41,037                                | \$ 2,166       | \$ 749,989 |

|                                       |         |       |        |        |        |       |         |
|---------------------------------------|---------|-------|--------|--------|--------|-------|---------|
| Individually evaluated for impairment | 6,233   |       | 4,918  | 300    | 279    | 192   | 11,922  |
| Collectively evaluated for impairment | 582,971 | 1,094 | 96,248 | 15,022 | 40,758 | 1,974 | 738,067 |

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. 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.

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.

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.



**Table of Contents**

|   | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Associated<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|---|------------------------|--------------------------------|-------------------------|-----------------------------------|----------------------------------|
| <b>June 30, 2011</b>                        |                        |                                |                         |                                   |                                  |
| <b>With no specific allowance recorded:</b> |                        |                                |                         |                                   |                                  |
| Real Estate Loans                           |                        |                                |                         |                                   |                                  |
| Residential                                 | \$ 2,830               | \$ 2,823                       | \$                      | \$ 2,720                          | \$                               |
| Construction                                |                        |                                |                         |                                   |                                  |
| Commercial                                  | 3,657                  | 3,662                          |                         | 3,321                             |                                  |
| Commercial                                  | 267                    | 267                            |                         | 70                                |                                  |
| Home equity loans and lines of credit       | 91                     | 91                             |                         | 52                                |                                  |
| Other                                       |                        |                                |                         |                                   |                                  |
| Total                                       | 6,845                  | 6,843                          |                         | 6,163                             |                                  |
| <b>With an allowance recorded:</b>          |                        |                                |                         |                                   |                                  |
| Real Estate Loans                           |                        |                                |                         |                                   |                                  |
| Residential                                 | 3,403                  | 3,397                          | 446                     | 2,842                             |                                  |
| Construction                                |                        |                                |                         |                                   |                                  |
| Commercial                                  | 1,261                  | 1,261                          | 187                     | 608                               |                                  |
| Commercial                                  | 33                     | 33                             | 33                      | 14                                |                                  |
| Home equity loans and lines of credit       | 188                    | 188                            | 118                     | 71                                |                                  |
| Other                                       | 192                    | 192                            | 110                     | 71                                |                                  |
| Total                                       | 5,077                  | 5,071                          | 894                     | 3,606                             |                                  |
| <b>Total:</b>                               |                        |                                |                         |                                   |                                  |
| Real Estate Loans                           |                        |                                |                         |                                   |                                  |
| Residential                                 | 6,233                  | 6,220                          | 446                     | 5,562                             |                                  |
| Construction                                |                        |                                |                         |                                   |                                  |
| Commercial                                  | 4,918                  | 4,923                          | 187                     | 3,929                             |                                  |
| Commercial                                  | 300                    | 300                            | 33                      | 84                                |                                  |
| Home equity loans and lines of credit       | 279                    | 279                            | 118                     | 123                               |                                  |
| Other                                       | 192                    | 192                            | 110                     | 71                                |                                  |
| Total Impaired Loans                        | \$ 11,922              | \$ 11,914                      | \$ 894                  | \$ 9,769                          | \$                               |

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 table presents 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, 2011 (in thousands):

|                              | Pass              | Special<br>Mention | Substandard      | Doubtful      | Total             |
|------------------------------|-------------------|--------------------|------------------|---------------|-------------------|
| Commercial real estate loans | 85,649            | 1,316              | 14,014           | 187           | 101,166           |
| Commercial                   | 14,778            | 278                | 233              | 33            | 15,322            |
| <b>Total</b>                 | <b>\$ 100,427</b> | <b>\$ 1,594</b>    | <b>\$ 14,247</b> | <b>\$ 220</b> | <b>\$ 116,488</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.

|                                       | Performing        | Non-performing  | Total             |
|---------------------------------------|-------------------|-----------------|-------------------|
| <b>June 30, 2011</b>                  |                   |                 |                   |
| Real estate loans:                    |                   |                 |                   |
| Residential                           | \$ 580,598        | \$ 8,606        | \$ 589,204        |
| Construction                          | 1,094             |                 | 1,094             |
| Home Equity loans and lines of credit | 40,887            | 150             | 41,037            |
| Other                                 | 1,973             | 193             | 2,166             |
| <b>Total</b>                          | <b>\$ 624,552</b> | <b>\$ 8,949</b> | <b>\$ 633,501</b> |

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 table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of June 30, 2011 (in thousands):

|                                       | Current           | 31-60 Days<br>Past Due | 61-90 Days<br>Past Due | Greater than<br>90 Days Past<br>Due and still<br>accruing | Non-Accrual      | Total Past<br>Due and<br>Non-Accrual | Total<br>Loans    |
|---------------------------------------|-------------------|------------------------|------------------------|---|------------------|--------------------------------------|-------------------|
| <b>June 30, 2011</b>                  |                   |                        |                        |   |                  |                                      |                   |
| Real estate loans                     |                   |                        |                        |   |                  |                                      |                   |
| Residential                           | \$ 577,784        | \$ 2,944               | \$ 166                 | \$  | \$ 8,310         | \$ 11,420                            | \$ 589,204        |
| Construction                          | 1,094             |                        |                        |   |                  |                                      | 1,094             |
| Commercial                            | 98,731            |                        |                        |   | 2,435            | 2,435                                | 101,166           |
| Commercial                            | 15,056            |                        | 34                     |   | 232              | 266                                  | 15,322            |
| Home equity loans and lines of credit | 40,280            | 440                    | 166                    |   | 151              | 757                                  | 41,037            |
| Other                                 | 1,954             | 13                     | 7                      |   | 192              | 212                                  | 2,166             |
| <b>Total</b>                          | <b>\$ 734,899</b> | <b>\$ 3,397</b>        | <b>\$ 373</b>          | <b>\$</b>   | <b>\$ 11,320</b> | <b>\$ 15,090</b>                     | <b>\$ 749,989</b> |

Non-performing assets, which are composed of non-performing loans of \$11.3 million, troubled debt restructures of \$531,000, and foreclosed real estate of \$2.0 million, were \$13.9 million at June 30, 2011. Non-performing assets were \$12.9 million at September 30, 2010. The increase was due to increases of \$1.1 million in non-performing commercial loans, \$5,000 in foreclosed real estate, and \$171,000 in troubled debt restructures, offset, in part, by a decrease of \$203,000 in non-performing consumer loans and \$51,000 in non-performing residential loans. Commercial non-performing loans increased primarily as a result of the addition of two commercial real estate relationships. The number of non-performing residential loans at June 30, 2011 decreased to 47 compared to 50 at September 30, 2010. Within the non-performing loans of \$11.3 million at June 30, 2011, \$4.8 million were impaired loans. As of June 30, 2011, the Company had total impaired loans of \$11.9 million.



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

The Company has determined that \$5.1 million of the impaired total required a reserve of \$894,000. Foreclosed real estate was \$2.0 million at June 30, 2011 and September 30, 2010, respectively.

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,

**Table of Contents**

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, 2011 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 OTS and the Pennsylvania Department of Banking, as an integral part of its 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.

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.

The following table summarizes the primary segments of the ALL, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of June 30, 2011 (in thousands):

|                                       | Real Estate Loans        |            |                  |                 | Home Equity Loans and |     | Unallocated | Total |
|---------------------------------------|--------------------------|------------|------------------|-----------------|-----------------------|-----|-------------|-------|
|                                       | Residential Construction | Commercial | Commercial Loans | Lines of Credit | Other Loans           |     |             |       |
| ALL balance at September 30, 2010     | 4,462                    | 15         | 1,556            | 204             | 569                   | 22  | 620         | 7,448 |
| Charge-offs                           | (717)                    |            |                  | (132)           | (145)                 |     |             | (994) |
| Recoveries                            | 146                      |            |                  | 2               | 18                    |     |             | 166   |
| Provision                             | 1,237                    | (7)        | (69)             | 274             | 217                   | 113 | (160)       | 1,605 |
| ALL balance at June 30, 2011          | 5,128                    | 8          | 1,487            | 348             | 659                   | 135 | 460         | 8,225 |
| Individually evaluated for impairment | 446                      |            | 187              | 33              | 118                   | 110 |             | 894   |
| Collectively evaluated for impairment | 4,682                    | 8          | 1,300            | 315             | 541                   | 25  | 460         | 7,331 |

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 and home equity loans and lines of credit segments for the nine month period ending June 30, 2011 due to increased charge off activity 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 activity in the allowance for loan losses is summarized as follows (in thousands):

|                                 | Nine Months Ended<br>June 30, |          |
|---------------------------------|-------------------------------|----------|
|                                 | 2011                          | 2010     |
| Balance, beginning of period    | \$ 7,448                      | \$ 5,815 |
| Add                             |                               |          |
| Provision charged to operations | 1,605                         | 1,650    |
| Loan recoveries                 | 166                           | 29       |
|                                 | 9,219                         | 7,494    |
| Less loans charged off          | (994)                         | (472)    |
| Balance, end of period          | \$ 8,225                      | \$ 7,022 |

**9. Deposits**

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

|                                      | June 30,<br>2011 | September 30,<br>2010 |
|--------------------------------------|------------------|-----------------------|
| Non-interest bearing demand accounts | \$ 32,433        | \$ 30,448             |
| NOW accounts                         | 60,375           | 61,878                |
| Money market accounts                | 117,883          | 119,238               |
| Savings and club accounts            | 74,486           | 67,763                |
| Certificates of deposit              | 370,192          | 261,083               |
| Total                                | \$ 655,369       | \$ 540,410            |

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

For a detailed disclosure on the Bank's pension and employee benefits plans, please refer to Note 14 of the Company's Consolidated Financial Statements for the year ended September 30, 2010 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):

|                                    | Three Months Ended<br>June 30, |        | Nine Months Ended<br>June 30, |        |
|------------------------------------|--------------------------------|--------|-------------------------------|--------|
|                                    | 2011                           | 2010   | 2011                          | 2010   |
| Service Cost                       | \$ 134                         | \$ 106 | \$ 401                        | \$ 317 |
| Interest Cost                      | 175                            | 142    | 524                           | 427    |
| Expected return on plan assets     | (193)                          | (145)  | (578)                         | (435)  |
| Amortization of prior service cost | 2                              | 3      | 6                             | 9      |
| Amortization of unrecognized loss  | 101                            | 74     | 303                           | 225    |

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

|                           |        |        |        |        |
|---------------------------|--------|--------|--------|--------|
| Net periodic benefit cost | \$ 219 | \$ 180 | \$ 656 | \$ 543 |
|---------------------------|--------|--------|--------|--------|

The Bank contributed \$1.5 million to its pension plan in May 2011.

### 11. 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. In accordance with generally accepted accounting principles for *Share-Based Payments*, the Company expenses the fair value of all share-based compensation grants over the requisite service periods.

**Table of Contents**

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.

Restricted shares vest over a five-year 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.

For the nine months ended June 30, 2011 and 2010, the Company recorded \$1.6 million of share-based compensation expense, comprised of stock option expense of \$533,000 and restricted stock expense of \$1.1 million for the June 30, 2011 period and stock option expense of \$521,000 and restricted stock expense of \$1.1 million for the June 30, 2010 period. Expected future expense relating to the 574,351 non-vested options outstanding as of June 30, 2011, is \$1.3 million over the remaining vesting period of 1.92 years. Expected future compensation expense relating to the 234,425 restricted shares at June 30, 2011, is \$2.8 million over the remaining vesting period of 1.92 years.

The following is a summary of the Company's stock option activity and related information for its option grants for the three month period ended June 30, 2011.

|                                 | Number of Stock<br>Options | Weighted-<br>average<br>Exercise<br>Price | Weighted-<br>average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic<br>Value<br>(in thousands) |
|---------------------------------|----------------------------|---|---|---|
| Outstanding, September 30, 2010 | 1,458,379                  | \$ 12.35                                  | 7.67  | \$  |
| Granted                         |                            |   |   |   |
| Exercised                       |                            |   |   |   |
| Forfeited                       |                            |   |   |   |
| Outstanding, June 30, 2011      | 1,458,379                  | \$ 12.35                                  | 6.20  | \$ 102  |
| Exercisable at June 30, 2011    | 884,028                    | \$ 12.35                                  | 6.20  | \$  |

The weighted-average grant date fair value of the Company's non-vested options as of June 30, 2011 and 2010, was \$2.38.

The following is a summary of the status of the Company's restricted stock as of June 30, 2011, and changes therein during the nine month period then ended:

|                                 | Number of<br>Restricted Stock | Weighted-<br>average<br>Grant Date<br>Fair Value |
|---------------------------------|-------------------------------|--|
| Nonvested at September 30, 2010 | 352,448                       | \$ 12.35   |
| Granted                         |                               |  |
| Vested                          | 118,023                       | 12.35  |
| Forfeited                       |                               |  |
| Nonvested at June 30, 2011      | 234,425                       | \$ 12.35   |

**12. Fair Value Measurement**

The following disclosures show the hierarchal 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

**Table of Contents**

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.

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, 2011 and September 30, 2010 and indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value:

**Fair Value Measurement at June 30, 2011**

| Fair Value Measurements Utilized for the Company's Financial Assets (in thousands): | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balances as of June 30, 2011 |
|---|--|---|---|------------------------------|
| <b>Securities available-for-sale measured on a recurring basis</b>                  |  |   |   |                              |
| Mortgage backed securities  | \$   | \$ 210,521                                    | \$  | \$ 210,521                   |
| Obligations of states and political subdivisions                                    |  | 14,960  |   | 14,960                       |
| U.S. government agencies  |  | 27,983  |   | 27,983                       |
| Corporate obligations   |  | 2,641   |   | 2,641                        |
| Equity securities - financial services  | 24   | 37  |   | 61                           |
| <b>Total debt and equity securities</b>   | <b>\$ 24</b>   | <b>\$ 256,142</b>                             | <b>\$</b>                                 | <b>\$ 256,166</b>            |
| Foreclosed real estate owned measured on a non-recurring basis                      | \$   | \$  | \$ 2,039                                  | \$ 2,039                     |
| Impaired loans measured on a non-recurring basis                                    | \$   | \$  | \$ 11,028                                 | \$ 11,028                    |
| Mortgage servicing rights measured on a non-recurring basis                         | \$   | \$  | \$ 263                                    | \$ 263                       |

**Fair Value Measurement at September 30, 2010**

| Fair Value Measurements Utilized for the Company's Financial Assets (in thousands): | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balances as of June 30, 2011 |
|---|--|---|---|------------------------------|
| <b>Securities available-for-sale measured on a recurring basis</b>                  |  |   |   |                              |
| Mortgage backed securities  | \$   | \$ 187,288                                    | \$  | \$ 187,288                   |
| Obligations of states and political subdivisions                                    |  | 10,904  |   | 10,904                       |
| U.S. government agencies  |  | 52,434  |   | 52,434                       |
| Corporate obligations   |  | 1,677   |   | 1,677                        |
| Equity securities - financial services  | 38   |   |   | 38                           |
| <b>Total debt and equity securities</b>   | <b>\$ 38</b>   | <b>\$ 252,303</b>                             | <b>\$</b>                                 | <b>\$ 252,341</b>            |
| Foreclosed real estate owned measured on a non-recurring basis                      | \$   | \$ 2,034                                      | \$  | \$ 2,034                     |
| Impaired loans measured on a non-recurring basis                                    | \$   | \$ 7,646                                      | \$  | \$ 7,646                     |
| Mortgage servicing rights measured on a non-recurring basis                         | \$   | \$  | \$ 318                                    | \$ 318                       |

As required by generally accepted accounting principles, each financial asset and liability must be identified as having been valued according to 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



**Table of Contents**

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 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, 2011, 72 impaired loans with a carrying value of \$11.9 million were reduced by specific valuation allowance totaling \$894,000 resulting in a net fair value of \$11.0 million based on Level 3 inputs.

**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.

|   | June 30, 2011  |            | September 30, 2010 |            |
|---|----------------|------------|--------------------|------------|
|   | Carrying Value | Fair Value | Carrying Value     | Fair Value |
| <b>Financial assets:</b>                          |                |            |                    |            |
| Cash and cash equivalents                         | \$ 21,797      | \$ 21,797  | \$ 10,890          | \$ 10,890  |
| <b>Investment and mortgage-backed securities:</b> |                |            |                    |            |
| Available for sale                                | 256,166        | 256,166    | 252,341            | 252,341    |
| Held to maturity                                  | 9,479          | 9,834      | 12,795             | 13,254     |
| Loans receivable, net                             | 741,764        | 771,313    | 730,842            | 755,871    |
| Accrued interest receivable                       | 4,226          | 4,226      | 4,392              | 4,392      |
| FHLB stock  | 17,770         | 17,770     | 20,727             | 20,727     |
| Mortgage servicing rights                         | 263            | 263        | 318                | 318        |
| Bank owned life insurance                         | 23,057         | 23,057     | 15,618             | 15,618     |
| <b>Financial liabilities:</b>                     |                |            |                    |            |
| Deposits  | \$ 655,369     | \$ 663,801 | \$ 540,410         | \$ 548,352 |
| Short-term borrowings                             |                |            | 14,719             | 14,719     |
| Other borrowings                                  | 269,657        | 282,130    | 335,357            | 353,358    |
| Advances by borrowers for taxes and insurance     | 6,550          | 6,550      | 1,465              | 1,465      |
| Accrued interest payable                          | 1,749          | 1,749      | 1,646              | 1,646      |

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.

## **Table of Contents**

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 Held to Maturity 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, Deposits, Other Borrowings, and Mortgage Servicing Rights**

The fair values for loans and mortgage servicing rights are estimated by discounting contractual cash flows and adjusting for prepayment estimates. Discount rates are based upon market rates generally charged for such loans with similar characteristics. Demand, savings, and money market deposit accounts are valued at the amount payable on demand as of year-end. Fair values for time deposits and 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 deposits and borrowings of similar remaining maturities.

### **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.

## **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;

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

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;

## **Table of Contents**

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.

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, 2011 and September 30, 2010**

**Total Assets.** Total assets increased by \$30.6 million, or 2.9%, to \$1,102.6 million at June 30, 2011 from \$1,072.0 million at September 30, 2010. This increase was primarily due to increases in interest-bearing deposits with other institutions, net loans receivable and bank-owned life insurance.

**Interest-Bearing Deposits with Other Institutions.** Interest-bearing deposits with other institutions increased \$9.8 million to \$13.2 million at June 30, 2011 from \$3.4 million at September 30, 2010. This increase was primarily the result of the significant increase in deposits at June 30, 2011 from September 30, 2010 that was offset, in part, by loan growth, a reduction in borrowings and other uses of cash.

**Net Loans.** Net loans increased \$10.9 million, or 1.5%, to \$741.8 million at June 30, 2011 from \$730.8 million at September 30, 2010. The increase in net loans receivable was primarily attributed to an increase in commercial real estate loans. During this period, commercial real estate loans outstanding increased by \$23.2 million to \$101.2 million. This increase was partially offset by decreases in commercial loans outstanding of \$1.2 million to \$15.3 million, residential real estate loans outstanding of \$7.3 million to \$589.2 million, home equity loans and lines of credit outstanding of \$2.5 million to \$41.0 million, construction loans outstanding of \$208,000 to \$1.1 million and other loans outstanding of \$320,000 to \$2.2 million.

**Bank-Owned Life Insurance.** Bank-owned life insurance increased \$7.4 million, or 47.6%, to \$23.1 million at June 30, 2011 from \$15.6 million at September 30, 2010. In an attempt to partially offset increased health care and other employee benefits, the Bank purchased an additional \$2.0 million of Bank-owned life insurance in March, 2011 and an additional \$5.0 million in May 2011.

**Intangible Assets, Net and Goodwill.** On April 29, 2011 the Bank acquired the benefit consulting insurance businesses of William S. Harrison and David P. Lilly, two Lehigh Valley-based insurance agents who have been serving clients throughout eastern Pennsylvania for over twenty years. A new subsidiary of the Bank, ESSA Advisory Services, LLC, was formed as part of the acquisition. ESSA Advisory Services, LLC will operate as 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. The cost of the acquisition was approximately \$2.0 million, resulting in intangible assets of \$1.9 million and goodwill of \$40,000. Acquisition costs of approximately \$75,000

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

were included as professional fees during the three months ended June 30, 2011. Terms of the acquisition include a commitment by the Bank to make two additional payments to the sellers, one each on April 29, 2012 and 2013. These payments are not guaranteed and are based on achievement of certain revenue goals. These payments can be as high as 68.0% of the original acquisition price. Any additional payments to the sellers will be recorded as an increase to goodwill.

**Table of Contents**

**Deposits.** Deposits increased \$115.0 million, or 21.3%, to \$655.4 million at June 30, 2011 from \$540.4 million at September 30, 2010. At June 30, 2011 compared to September 30, 2010, certificate of deposit accounts increased \$109.1 million to \$370.2 million, savings and club accounts increased \$6.7 million to \$74.5 million and non-interest bearing demand accounts increased \$2.0 million to \$32.4 million. These increases were offset in part during the same period by decreases in NOW accounts of \$1.5 million to \$60.4 million and money market accounts of \$1.4 million to \$117.9 million. Included in the certificates of deposit at June 30, 2011 was an increase in brokered certificates of \$65.5 million to \$136.1 million. The increase in brokered certificates was the result of the Company's decision to replace maturing FHLBank Pittsburgh borrowings with lower priced brokered certificates of deposit.

**Borrowed Funds.** Borrowed funds decreased by \$80.4 million, or 23.0%, to \$269.7 million at June 30, 2011, from \$350.1 million at September 30, 2010. The decrease in borrowed funds was primarily due to maturities of FHLBank Pittsburgh borrowings.

**Stockholders' Equity.** Stockholders' equity decreased by \$7.0 million, or 4.1%, to \$164.6 million at June 30, 2011 from \$171.6 million at September 30, 2010. This decrease was primarily the result of a stock repurchase program the Company began in June 2008. In June, 2009, the Company announced that it had completed its first stock repurchase program having purchased 2,547,135 shares at a weighted average cost of \$13.14. On October 6, 2010, the Company announced that it had completed its second stock repurchase program having purchased 1,499,100 shares at a weighted average cost of \$12.36. In April 2011, the Company announced that it had completed the third repurchase program having purchased 679,900 shares at a weighted average cost of \$12.82. It was also announced that the Company's Board of Directors authorized a fourth repurchase program to purchase up to an additional 5% of its outstanding shares. During the quarter ended June 30, 2011, the Company purchased an additional 142,481 shares at a weighted average cost of \$12.15 per share.

**Average Balance Sheets for the Three and Nine Months Ended June 30, 2011 and 2010**

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 |          |                        |              |           |             |
|--|------------------------------------|----------|------------------------|--------------|-----------|-------------|
|  | 2011                               |          |                        | 2010         |           |             |
|  | Average                            | Interest |                        | Average      | Interest  |             |
|  | Balance                            | Income/  | Yield/ Cost            | Balance      | Income/   | Yield/ Cost |
|  |                                    | Expense  | (dollars in thousands) |              | Expense   |             |
| <b>Interest-earning assets:</b>        |                                    |          |                        |              |           |             |
| Loans (1)                              | \$ 751,112                         | \$ 9,683 | 5.17%                  | \$ 738,555   | \$ 10,105 | 5.49%       |
| Investment securities                  |                                    |          |                        |              |           |             |
| Taxable (2)                            | 41,132                             | 231      | 2.25%                  | 49,103       | 249       | 2.03%       |
| Exempt from federal income tax (2) (3) | 5,506                              | 66       | 7.28%                  | 6,894        | 78        | 6.88%       |
| Total investment securities            | 46,638                             | 297      | 2.85%                  | 55,997       | 327       | 2.63%       |
| Mortgage-backed securities             | 216,260                            | 1,861    | 3.45%                  | 185,144      | 1,676     | 3.63%       |
| Federal Home Loan Bank stock           | 18,061                             |          | 0.00%                  | 20,727       |           | 0.00%       |
| Other                                  | 12,914                             | 1        | 0.03%                  | 17,202       | 3         | 0.07%       |
| Total interest-earning assets          | 1,044,985                          | 11,842   | 4.56%                  | 1,017,625    | 12,111    | 4.79%       |
| Allowance for loan losses              | (8,125)                            |          |                        | (6,732)      |           |             |
| Noninterest-earning assets             | 60,461                             |          |                        | 52,758       |           |             |
| Total assets                           | \$ 1,097,321                       |          |                        | \$ 1,063,651 |           |             |
| <b>Interest-bearing liabilities:</b>   |                                    |          |                        |              |           |             |
| NOW accounts                           | \$ 58,584                          | 7        | 0.05%                  | \$ 57,585    | 11        | 0.08%       |
| Money market accounts                  | 118,208                            | 127      | 0.43%                  | 116,826      | 333       | 1.14%       |
| Savings and club accounts              | 71,961                             | 37       | 0.21%                  | 69,281       | 55        | 0.32%       |

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

|                                    |            |          |       |            |          |       |
|------------------------------------|------------|----------|-------|------------|----------|-------|
| Certificates of deposit            | 362,233    | 1,762    | 1.95% | 230,872    | 1,370    | 2.38% |
| Borrowed funds                     | 278,591    | 2,549    | 3.67% | 370,440    | 3,671    | 3.97% |
| Total interest-bearing liabilities | \$ 889,577 | \$ 4,482 | 2.02% | \$ 845,004 | \$ 5,440 | 2.58% |
| Non-interest bearing NOW accounts  | 31,116     |          |       | 27,742     |          |       |
| Noninterest-bearing liabilities    | 12,305     |          |       | 11,720     |          |       |
| Total liabilities                  | 932,998    |          |       | 884,466    |          |       |

**Table of Contents**

|   | For the Three Months Ended June 30 |  |            |                    |  |            |
|---|------------------------------------|--|------------|--------------------|--|------------|
|   | Average<br>Balance                 | 2011<br>Interest<br>Income/<br>Expense | Yield/Cost | Average<br>Balance | 2010<br>Interest<br>Income/<br>Expense | Yield/Cost |
|   | (dollars in thousands)             |  |            |                    |  |            |
| Equity  | 164,323                            |  |            | 179,185            |  |            |
| Total liabilities and equity  | \$ 1,097,321                       |  |            | \$ 1,063,651       |  |            |
| Net interest income   |                                    | \$ 7,360                               |            |                    | \$ 6,671                               |            |
| Interest rate spread  |                                    |  | 2.54%      |                    |  | 2.21%      |
| Net interest-earning assets   | \$ 155,408                         |  |            | \$ 172,621         |  |            |
| Net interest margin (4)   |                                    |  | 2.83%      |                    |  | 2.63%      |
| Average interest-earning assets to average interest-bearing liabilities |                                    | 117.47%                                |            |                    | 120.43%                                |            |

- (1) Non-accruing loans are included in the outstanding loan balances.
- (2) Held to maturity securities are reported at amortized cost. 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, |                    |             |              |                    |             |
|---|------------------------------------|--------------------|-------------|--------------|--------------------|-------------|
|   | 2011                               |                    |             | 2010         |                    |             |
|   | Average                            | Interest           | Yield/ Cost | Average      | Interest           | Yield/ Cost |
|   | Balance                            | Income/<br>Expense |             | Balance      | Income/<br>Expense |             |
|   | (dollars in thousands)             |                    |             |              |                    |             |
| <b>Interest-earning assets:</b>   |                                    |                    |             |              |                    |             |
| Loans (1)   | \$ 748,984                         | \$ 29,322          | 5.23%       | \$ 736,410   | \$ 30,612          | 5.56%       |
| Investment securities   |                                    |                    |             |              |                    |             |
| Taxable (2)   | 45,422                             | 673                | 1.98%       | 38,963       | 641                | 2.20%       |
| Exempt from federal income tax (2) (3)                                  | 6,332                              | 219                | 7.01%       | 7,078        | 238                | 6.81%       |
| Total investment securities   | 51,754                             | 892                | 2.60%       | 46,041       | 879                | 2.91%       |
| Mortgage-backed securities  | 209,819                            | 5,357              | 3.41%       | 186,746      | 5,685              | 4.07%       |
| Federal Home Loan Bank stock  | 19,118                             |                    | 0.00%       | 20,727       |                    | 0.00%       |
| Other   | 7,042                              | 2                  | 0.04%       | 10,499       | 5                  | 0.06%       |
| Total interest-earning assets   | 1,036,717                          | 35,573             | 4.60%       | 1,000,423    | 37,181             | 4.99%       |
| Allowance for loan losses   | (7,870)                            |                    |             | (6,337)      |                    |             |
| Noninterest-earning assets  | 56,428                             |                    |             | 50,078       |                    |             |
| Total assets  | \$ 1,085,275                       |                    |             | \$ 1,044,164 |                    |             |
| <b>Interest-bearing liabilities:</b>                                    |                                    |                    |             |              |                    |             |
| NOW accounts  | \$ 57,715                          | 20                 | 0.05%       | \$ 54,973    | 32                 | 0.08%       |
| Money market accounts   | 118,456                            | 448                | 0.51%       | 113,537      | 975                | 1.15%       |
| Savings and club accounts   | 68,812                             | 127                | 0.25%       | 67,189       | 163                | 0.32%       |
| Certificates of deposit   | 324,458                            | 4,828              | 1.99%       | 180,498      | 3,463              | 2.57%       |
| Borrowed funds  | 307,242                            | 8,318              | 3.62%       | 407,699      | 11,390             | 3.74%       |
| Total interest-bearing liabilities                                      | 876,683                            | 13,741             | 2.10%       | 823,896      | 16,023             | 2.60%       |
| Non-interest bearing NOW accounts                                       | 29,704                             |                    |             | 26,951       |                    |             |
| Noninterest-bearing liabilities   | 11,302                             |                    |             | 10,579       |                    |             |
| Total liabilities   | 917,689                            |                    |             | 861,426      |                    |             |
| Equity  | 167,586                            |                    |             | 182,738      |                    |             |
| Total liabilities and equity  | \$ 1,085,275                       |                    |             | \$ 1,044,164 |                    |             |
| Net interest income   |                                    | \$ 21,832          |             | \$ 21,158    |                    |             |
| Interest rate spread  |                                    |                    | 2.50%       |              |                    | 2.39%       |
| Net interest-earning assets   | \$ 160,034                         |                    |             | \$ 176,527   |                    |             |
| Net interest margin (4)   |                                    |                    | 2.82%       |              |                    | 2.83%       |
| Average interest-earning assets to average interest-bearing liabilities |                                    | 118.25%            |             |              | 121.43%            |             |

(1) Non-accruing loans are included in the outstanding loan balances.

(2) Held to maturity securities are reported at amortized cost. 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****Comparison of Operating Results for the Three Months Ended June 30, 2011 and June 30, 2010**

**Net Income.** Net income increased \$173,000, or 16.2%, to \$1.2 million for the three months ended June 30, 2011 compared to net income of \$1.1 million for the comparable period in 2010. Net income for the three months ending June 30, 2011 increased primarily due to an increase in net interest income which was offset, in part, by a decrease in noninterest income and an increase in noninterest expense.

**Net Interest Income.** Net interest income increased \$689,000 or 10.3%, to \$7.4 million for the three months ended June 30, 2011 from \$6.7 million for the comparable period in 2010. The increase was primarily attributable to an increase in the Company's interest rate spread to 2.54% for the three months ended June 30, 2011, from 2.21% for the comparable period in 2010, offset in part by a decrease of \$17.2 million in the Company's average net earnings assets.

**Interest Income.** Interest income decreased \$269,000 or 2.2%, to \$11.8 million for the three months ended June 30, 2011 from \$12.1 million for the comparable 2010 period. The decrease resulted primarily from a 23 basis point decrease in average yield on interest earning assets partially offset by a \$27.4 million increase in average interest-earning assets. The average yield on interest earning assets was 4.56% for the three months ended June 30, 2011, as compared to 4.79% for the comparable 2010 period as the Company's interest earning assets continued to re-price downward throughout the period. Loans increased on average \$12.6 million between the two periods along with increases in the average balance of mortgage backed securities of \$31.1 million. These increases were offset in part by decreases in the average balances of total investment securities of \$9.4 million, average Federal Home Loan Bank stock of \$2.7 million and average other interest earning assets of \$4.3 million. The primary reason for the increase in mortgage backed securities was the partial reinvestment of borrowing proceeds, deposit proceeds and maturing investment securities into these assets. Average FHLBank Pittsburgh stock declined \$2.7 million as a result of repurchases by the FHLB of stock. The decrease in other interest earning assets was primarily due to a decrease in the average balance of cash held at FHLBank Pittsburgh.

**Interest Expense.** Interest expense decreased \$958,000 or 17.6%, to \$4.5 million for the three months ended June 30, 2011 from \$5.4 million for the comparable 2010 period. The decrease resulted from a 56 basis point decrease in the overall cost of interest bearing liabilities to 2.02% for the three months ended June 30, 2011 from 2.58% for the comparable 2010 period, partially offset by a \$44.6 million increase in average interest-bearing liabilities. Average interest bearing deposits increased \$136.4 million and average borrowed funds decreased \$91.8 million. Average interest bearing deposits increased primarily as a result of a \$131.4 million increase in average certificates of deposit. Borrowed funds decreased primarily due to maturities of FHLBank Pittsburgh borrowings. Average certificates of deposit included an increase of \$64 million in average brokered certificates of deposit. The Company replaced maturing FHLBank Pittsburgh borrowings with brokered certificates because they were a cheaper funding source.

**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 \$475,000 for the three months ended June 30, 2011 as compared to \$500,000 for the three months ended March 31, 2010. The allowance for loan losses was \$8.2 million, or 1.10% of loans outstanding, at June 30, 2011, compared to \$7.4 million, or 1.01% of loans outstanding at September 30, 2010.

**Non-interest Income.** Non-interest income decreased \$160,000 or 9.9% to \$1.5 million from \$1.6 million for the comparable period in 2010. The primary reasons for the decrease were the declines in gains on the sale of investments of \$249,000, gains on sale of loans, net of \$41,000, and service fees and deposit accounts of \$31,000 during the 2010 period. The Company took advantage of favorable market conditions in the three months ended June 30, 2010 and recorded a gain on sale of investments of \$305,000 compared to \$56,000 for the three months ended June 30, 2011.

**Non-interest Expense.** Non-interest expense increased \$232,000, or 3.7%, to \$6.6 million for the three months ended June 30, 2011 from \$6.3 million for the comparable period in 2010. The primary reasons for the

**Table of Contents**

increase were increases in compensation and employee benefits of \$168,000 and loss on foreclosed real estate of \$81,000. Compensation and employee benefits increased primarily due to compensation paid to Executives at the Company's recently added insurance subsidiary along with an increase in the accrual expense related to the Company's incentive plans. Loss on foreclosed real estate increased due primarily to subsequent write downs in fair market value of properties already classified as foreclosed real estate as a result of updated appraisal information.

**Income Taxes.** Income tax expense increased \$149,000 to \$536,000 for the three months ended June 30, 2011 from \$387,000 for the comparable 2010 period. The increase was primarily a result of the increase in income before taxes of \$322,000 million for the three months ended June 30, 2011. The effective tax rate was 30.2% for the three months ended June 30, 2011, compared to 26.6% for the 2010 period.

**Comparison of Operating Results for the Nine Months Ended June 30, 2011 and June 30, 2010**

**Net Income.** Net income increased \$3,000 or 0.1%, to \$3.5 million for the nine months ended June 30, 2011 compared to net income of \$3.5 million for the comparable period in 2010. An increase in net interest income was offset, in part, by decreases in noninterest income and increases in noninterest expense and income taxes.

**Net Interest Income.** Net interest income increased \$674,000 or 3.2%, to \$21.8 million for the nine months ended June 30, 2011 from \$21.2 million for the comparable period in 2010. The increase was primarily attributable to an increase in the Company's interest rate spread to 2.50% for the nine months ended June 30, 2011 from 2.39% for the comparable period in 2010, offset in part by a decrease of \$16.5 million in the Company's average net earning assets.

**Interest Income.** Interest income decreased \$1.6 million or 4.3%, to \$35.6 million for the nine months ended June 30, 2011 from \$37.2 million for the comparable 2010 period. The decrease resulted primarily from a 39 basis point decrease in average yield on interest earning assets partially offset by a \$36.3 million increase in average interest-earning assets. The average yield on interest earning assets was 4.60% for the nine months ended June 30, 2011, as compared to 4.99% for the comparable 2010 period. Loans increased on average \$12.6 million between the two periods along with increases in the average balance of mortgage backed securities of \$23.1 million and total investment securities of \$5.7 million. These increases were offset in part by a decrease in the average balances of other earning assets of \$3.5 million and capital stock of FHLBank Pittsburgh of \$1.6 million. The primary reason for the increase in mortgage backed securities was the partial reinvestment of borrowing proceeds, maturing certificates of deposit and investment securities into these assets. Total investment securities increased primarily due to an increase in the Company's investment in taxable municipal securities of approximately \$7.0 million. The decrease in other interest earning assets was primarily due to a decrease in the average balance of cash held at FHLBank Pittsburgh. Average FHLBank Pittsburgh stock declined as a result of repurchases by the FHLBank of their stock.

**Interest Expense.** Interest expense decreased \$2.3 million, or 14.2%, to \$13.7 million for the nine months ended June 30, 2011 from \$16.0 million for the comparable 2010 period. The decrease resulted from a 50 basis point decrease in the overall cost of interest bearing liabilities to 2.10% for the nine months ended June 30, 2011 from 2.60% for the comparable 2010 period, partially offset by a \$52.8 million increase in average interest-bearing liabilities. Average interest bearing deposits increased \$153.2 million and average borrowed funds decreased \$100.5 million. Average interest bearing deposits increased primarily as a result of an increase of \$144.0 million in average certificates of deposit. Borrowed funds decreased primarily due to maturities of FHLBank Pittsburgh borrowings. Average certificates of deposit included an increase of \$70.2 million in average brokered certificates of deposit. The Company replaced maturing FHLBank Pittsburgh borrowings primarily with brokered certificates of deposit.

**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. Non-performing assets at June 30, 2011 were \$13.9 million compared to non-performing assets of \$11.3 million at June 30, 2010. After an evaluation of these factors, management made a provision for loan losses of \$1.6 million for the nine months ended June 30, 2011 as compared to \$1.7 million for the nine months ended June 30, 2010. The allowance for loan losses was \$8.2 million, or 1.10% of loans outstanding, at June 30, 2011, compared to \$7.0 million, or 0.95% of loans outstanding at June 30, 2010.

**Table of Contents**

**Non-interest Income.** Non-interest income decreased \$565,000 or 12.1%, to \$4.1 million for the nine months ended June 30, 2011 from \$4.7 million for the comparable period in 2010. The primary reasons for the decrease were decreases in gain on sale of investments of \$442,000, gain on sale of loans of \$233,000, and service fees on deposit accounts of \$144,000 which were partially offset by increases in service charges and fees on loans of \$146,000. The Company took advantage of favorable market conditions in the nine months ended June 30, 2010 and recorded gains on sale of investments of \$613,000 and gains on sales of loans of \$236,000 versus \$171,000 and \$3,000 for the comparable period in 2011, respectively.

**Non-interest Expense.** Non-interest expense increased \$49,000, or 0.2%, to \$19.7 million for the nine months ended June 30, 2011 from \$19.6 million for the comparable period in 2010. Comparing the nine months ended June 30, 2011 to the same period in 2010, there was a decline in loss on foreclosed real estate of \$1.1 million. This decrease was offset in part by increases in occupancy and equipment expense of \$186,000 and compensation and employee benefit expense of \$644,000. Loss on of foreclosed real estate decreased because the Company took a \$1.2 million charge off in the first fiscal quarter of 2010 related to a single property in the Bank's foreclosed real estate portfolio. Compensation and employee benefits increased primarily as a result of the hiring of additional employees to staff the Company's branch expansion which occurred during the second and third quarters of 2010.

**Income Taxes.** Income tax expense increased \$102,000 or 9.2%, to \$1.2 million for the nine months ended June 30, 2011 from \$1.1 million for the comparable 2010 period. The effective tax rate was 26.0% for the nine months ended June 30, 2011, compared to 24.3% for the 2010 period.

**Non-Performing Assets**

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

|   | June 30,<br>2011 | September 30,<br>2010 |
|---|------------------|-----------------------|
| Non-performing assets:                            |                  |                       |
| Non-accruing loans                                | \$ 11,320        | \$ 10,516             |
| Troubled debt restructures                        | 531              | 360                   |
| <br>  |                  |                       |
| Total non-performing loans                        | 11,851           | 10,876                |
| Foreclosed real estate                            | 2,039            | 2,034                 |
| <br>  |                  |                       |
| Total non-performing assets                       | \$ 13,890        | \$ 12,910             |
| <br>  |                  |                       |
| Ratio of non-performing loans to total loans      | 1.58%            | 1.47%                 |
| Ratio of non-performing loans to total assets     | 1.07%            | 1.01%                 |
| Ratio of non-performing assets to total assets    | 1.26%            | 1.20%                 |
| Ratio of allowance for loan losses to total loans | 1.10%            | 1.01%                 |

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 \$980,000 to \$13.9 million at June 30, 2011 from \$12.9 million at September 30, 2010. Non-performing loans increased \$975,000 to \$11.9 million at June 30, 2011 from \$10.9 million at September 30, 2010. The \$11.3 million of non-accruing loans included 47 residential loans with an aggregate outstanding balance of \$8.3 million that were past due 90 or more days at June 30, 2011, 19 commercial loans with aggregate outstanding balances of \$2.7 million and 6 consumer loans with aggregate balances of \$343,000. Foreclosed real estate increased \$5,000 to \$2.0 million at June 30, 2011 from \$2.0 million at September 30, 2010. Foreclosed real estate consists of 20 residential properties and one commercial building lot.

A loan is considered to be a troubled debt restructure ( 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 of 12 months.



---

## **Table of Contents**

At June 30, 2011 the principal balance of troubled debt restructures was \$9.7 million as compared to \$7.0 million at September 30, 2010. Of the \$9.7 million of troubled debt restructures at June 30, 2011, \$5.2 million are performing loans and \$4.0 million are non-accrual loans. An additional \$531,000 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 56 loans that make up our troubled debt restructures at June 30, 2011, no loans were granted a rate concession at a below market interest rate. Two loans with balances totaling \$805,000 were granted market rate and terms concessions and 54 loans with balances totaling \$8.9 million were granted terms concessions.

Residential real estate loans make up the vast majority of our troubled debt restructures. As of June 30, 2011, troubled debt restructures were comprised of 34 residential loans totaling \$6.2 million, 16 commercial and commercial real estate loans totaling \$3.3 million, and six consumer (Home equity loans, home equity lines and credit, and other) totaling \$272,000.

For the nine month period ended June 30, 2011, nine loans totaling \$1.4 million were removed from TDR status. One loan for \$148,000 was transferred to foreclosed real estate, four loans for \$1.0 million had completed 12 timely payments, and four loans totaling \$230,000 were paid off.

We have modified terms of loans that do not meet the definition of a TDR. The vast majority of such loans were simply 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 nine months ended June 30, 2011, we modified 236 loans (\$31.4 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 current market rates (in lieu of a refinance) or the extension of a loan's maturity date. In total, they numbered 38 in the nine months ended June 30, 2011 with an aggregate balance of approximately \$18.9 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, 2011, \$21.8 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 \$16.6 million at June 30, 2011. As of June 30, 2011, we had \$209.7 million in borrowings outstanding from FHLBank Pittsburgh and \$60.0 million in borrowings through repurchase agreements with other financial institutions. We have access to additional FHLBank advances of up to approximately \$243.8 million.

At June 30, 2011, we had \$55.2 million in loan commitments outstanding, which included, in part, \$8.6 million in undisbursed construction loans, \$23.3 million in unused home equity lines of credit, \$8.1 million in commercial lines of credit and \$12.3 million to originate primarily multi-family and nonresidential mortgage loans. Certificates of deposit due within one year of June 30, 2011 totaled \$116.7 million, or 31.5% 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

---

**Table of Contents**

before June 30, 2012. 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. The Company purchased \$2.2 million of low income housing tax credits during the period ending June 30 2011 as part of a total investment of \$8.0 million. These credits will be disbursed during the next two years.

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 \$7.0 million and \$4.6 million for the three months ended June 30, 2011 and 2010, 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 used in investing activities was \$(23.3) million and \$(18.6) million for the three months ended June 30, 2011 and 2010, 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 provided of \$27.2 million and \$21.1 million for the three months ended June 30, 2011 and 2010, 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.

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.





## **Table of Contents**

**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. At June 30, 2011 the Company had a \$2.8 million valuation allowance established against its deferred tax asset. The tax deduction generated by the contribution to the Foundation as part of the Company's stock offering exceeded the allowable federal income tax deduction limitations resulting in the establishment of this valuation allowance for the contribution carry forward.

## **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 2011, the Company's contractual obligations did not change materially from those discussed in the Company's Financial Statements for the year ended September 30, 2010 except, as previously noted, the Company's commitment to purchase \$8.0 million in low income housing tax credits.

## **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 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, 2010.

**Table of Contents**

**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 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 significant changes made in the Company’s internal controls over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) or in other factors that could significantly affect the Company’s internal controls over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

**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 disclosed in the Company’s Annual Report for the fiscal year ended September 30, 2010 on Form 10-K filed on December 14, 2010 except for the following:

**The Standard & Poor’s downgrade in the U.S. government’s sovereign credit rating, and in the credit ratings of instruments issued, insured or guaranteed by certain related institutions, agencies and instrumentalities, could result in risks to the Company and general economic conditions that we are not able to predict.**

On August 5, 2011, Standard & Poor’s downgraded the United States long-term debt rating from its AAA rating to AA+. On August 8, 2011, Standard & Poor’s downgraded the credit ratings of certain long-term debt instruments issued by Fannie Mae and Freddie Mac and other U.S. government agencies linked to long-term U.S. debt. Instruments of this nature are key assets on the balance sheets of financial institutions, including the Bank. These downgrades could adversely affect the market value of such instruments, and could adversely impact our ability to obtain funding that is collateralized by affected instruments, as well as affecting the pricing of that funding when it is available. We cannot predict if, when or how these changes to the credit ratings will affect economic conditions. These ratings downgrades could result in a significant adverse impact to the Company, and could exacerbate the other risks to which the Company is subject, including those described under Risk Factors in the Company’s 2010 Annual Report on Form 10-K.

**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, 2011.

| Month Ending | Company Purchases of Common Stock |                              |  | Maximum number of shares that may yet be purchased under the plans or programs |
|--------------|-----------------------------------|------------------------------|--|--|
|              | Total number of shares purchased  | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs |  |
|              |                                   |                              |  |  |

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

|                    |         |    |       |         |         |
|--------------------|---------|----|-------|---------|---------|
| April 30, 2011 (1) | 41,181  | \$ | 12.84 | 41,181  |         |
| May 31, 2011 (2)   | 31,968  |    | 11.25 |         |         |
| June 30, 2011 (3)  | 93,500  |    | 11.79 | 93,500  | 579,400 |
| Total              | 166,649 | \$ | 11.97 | 134,681 |         |

- (1) The Bank's third stock repurchase program was completed in April 2011.
- (2) In May 2011 the Bank purchased 31,968 shares at \$11.25 per share as part of a non-public program.
- (3) The Bank's fourth stock repurchase program began in June 2011.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. [Removed and Reserved]**

**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 Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements tagged as blocks of text and in detail(1)

\* 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.

(1) As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

**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 9, 2011

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

Date: August 9, 2011

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