

ESSA Bancorp, Inc.  
Form 10-Q  
August 09, 2012  
[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, 2012

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 6, 2012 there were 12,077,713 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><u>Part I. Financial Information</u></b>	
Item 1. <u>Financial Statements (unaudited)</u>	1
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	31
Item 4. <u>Controls and Procedures</u>	31
<b><u>Part II. Other Information</u></b>	
Item 1. <u>Legal Proceedings</u>	32
Item 1A. <u>Risk Factors</u>	32
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	32
Item 3. <u>Defaults Upon Senior Securities</u>	32
Item 4. <u>Mine Safety Disclosures</u>	32
Item 5. <u>Other Information</u>	32
Item 6. <u>Exhibits</u>	33
<u>Signature Page</u>	34

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

## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEET

(UNAUDITED)

	June 30, 2012	September 30, 2011
	(dollars in thousands)	
Cash and due from banks	\$ 8,624	\$ 9,801
Interest-bearing deposits with other institutions	14,160	31,893
<b>Total cash and cash equivalents</b>	<b>22,784</b>	<b>41,694</b>
Investment securities available for sale, at fair value	276,496	245,393
Loans receivable (net of allowance for loan losses of \$7,100 and \$8,170)	741,200	738,619
Federal Home Loan Bank stock, at cost	14,474	16,882
Premises and equipment, net	11,453	11,494
Bank-owned life insurance	23,844	23,256
Foreclosed real estate	1,769	2,356
Intangible assets, net	1,582	1,825
Goodwill	413	40
Other assets	19,048	15,921
<b>TOTAL ASSETS</b>	<b>\$ 1,113,063</b>	<b>\$ 1,097,480</b>
<b>LIABILITIES</b>		
Deposits	\$ 688,897	\$ 637,924
Short-term borrowings	11,000	4,000
Other borrowings	234,410	284,410
Advances by borrowers for taxes and insurance	6,942	1,381
Other liabilities	8,140	8,086
<b>TOTAL LIABILITIES</b>	<b>949,389</b>	<b>935,801</b>
<b>STOCKHOLDERS EQUITY</b>		
Preferred Stock (\$.01 par value; 10,000,000 shares authorized, none issued)		
Common stock (\$.01 par value; 40,000,000 shares authorized, 16,980,900 issued; 12,077,713 and 12,109,622 outstanding at June 30, 2012 and September 30, 2011)	170	170
Additional paid in capital	168,389	166,758
Unallocated common stock held by the Employee Stock Ownership Plan (ESOP)	(11,098)	(11,438)
Retained earnings	67,910	67,215
Treasury stock, at cost; 4,903,187 and 4,871,278 shares outstanding at June 30, 2012 and September 30, 2011, respectively	(61,944)	(61,612)
Accumulated other comprehensive income	247	586
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>163,674</b>	<b>161,679</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 1,113,063</b>	<b>\$ 1,097,480</b>

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

See accompanying notes to the unaudited consolidated financial statements.

**Table of Contents**

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

	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
	2012	2011	2012	2011
	(dollars in thousands, except per share data)			
<b>INTEREST INCOME</b>				
Loans receivable, including fees	\$ 8,880	\$ 9,683	\$ 27,366	\$ 29,322
Investment securities:				
Taxable	1,636	2,092	4,902	6,030
Exempt from federal income tax	55	66	158	219
Other investment income	5	1	13	2
<b>Total interest income</b>	<b>10,576</b>	<b>11,842</b>	<b>32,439</b>	<b>35,573</b>
<b>INTEREST EXPENSE</b>				
Deposits	1,780	1,932	5,527	5,423
Short-term borrowings	7	1	18	46
Other borrowings	2,053	2,549	6,679	8,272
<b>Total interest expense</b>	<b>3,840</b>	<b>4,482</b>	<b>12,224</b>	<b>13,741</b>
<b>NET INTEREST INCOME</b>	<b>6,736</b>	<b>7,360</b>	<b>20,215</b>	<b>21,832</b>
Provision for loan losses	600	475	1,750	1,605
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>6,136</b>	<b>6,885</b>	<b>18,465</b>	<b>20,227</b>
<b>NONINTEREST INCOME</b>				
Service fees on deposit accounts	670	768	2,058	2,259
Services charges and fees on loans	166	142	550	497
Trust and investment fees	262	190	684	596
Gain on sale of investments, net		56	147	171
Gain on sale of loans, net	19		27	3
Earnings on Bank-owned life insurance	194	170	588	438
Insurance commissions	177	125	563	125
Other	7	8	25	28
<b>Total noninterest income</b>	<b>1,495</b>	<b>1,459</b>	<b>4,642</b>	<b>4,117</b>
<b>NONINTEREST EXPENSE</b>				
Compensation and employee benefits	3,888	3,899	11,804	11,712
Occupancy and equipment	756	758	2,288	2,331
Professional fees	339	411	1,083	1,260
Data processing	523	477	1,512	1,407
Advertising	110	165	263	534
Federal Deposit Insurance Corporation (FDIC) premiums	168	196	497	602
Loss (gain) on foreclosed real estate	(17)	81	90	93

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

Merger related costs	168		544	
Amortization of intangible assets	81	54	243	54
Other	510	526	1,738	1,667
<b>Total noninterest expense</b>	<b>6,526</b>	<b>6,567</b>	<b>20,062</b>	<b>19,660</b>
Income before income taxes	1,105	1,777	3,045	4,684
Income taxes	311	536	706	1,216
<b>NET INCOME</b>	<b>\$ 794</b>	<b>\$ 1,241</b>	<b>\$ 2,339</b>	<b>\$ 3,468</b>
<b>Earnings per share</b>				
Basic	\$ 0.07	\$ 0.11	\$ 0.22	\$ 0.30
Diluted	\$ 0.07	\$ 0.11	\$ 0.22	\$ 0.30
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 Paid In Capital	Unallocated Common Stock Held by the ESOP	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total Stockholders' Equity
	Number of Shares	Amount						
Balance, September 30, 2011	12,109,622	\$ 170	\$ 166,758	\$ (11,438)	\$ 67,215	\$ (61,612)	\$ 586	\$ 161,679
Net income					2,339			2,339
Other comprehensive loss:								
Change in unrealized loss on securities available for sale, net of income tax benefit of \$296							(575)	(575)
Change in unrecognized pension cost, net of income taxes of \$122							236	236
Cash dividends declared (\$.15 per share)					(1,644)			(1,644)
Stock based compensation			1,623					1,623
Allocation of ESOP stock			8	340				348
Treasury shares purchased	(31,909)					(332)		(332)
Balance, June 30, 2012	12,077,713	\$ 170	\$ 168,389	\$ (11,098)	\$ 67,910	\$ (61,944)	\$ 247	\$ 163,674

See accompanying notes to the unaudited consolidated financial statements.



**Table of Contents**

## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

	<b>For the Nine Months Ended June 30, 2012                      2011 (dollars in thousands)</b>	
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 2,339	\$ 3,468
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,750	1,605
Provision for depreciation and amortization.	726	830
Amortization of discounts and premiums, net	1,217	906
Net gain on sale of investment securities	(147)	(171)
Gain on sale of loans, net	(27)	(3)
Origination of mortgage loans sold	(1,871)	(97)
Proceeds from sale of mortgage loans originated for sale	1,898	100
Compensation expense on ESOP	348	426
Stock based compensation	1,623	1,628
Decrease in accrued interest receivable	264	166
Increase in accrued interest payable	55	103
Earnings on bank-owned life insurance	(588)	(438)
Deferred federal income taxes	1,009	(597)
Decrease in prepaid FDIC premiums	451	553
Increase (decrease) in accrued pension liability	413	(845)
Loss on foreclosed real estate, net	90	93
Amortization of intangible assets	243	54
Other, net	(282)	(820)
 Net cash provided by operating activities	 9,511	 6,961
<b>INVESTING ACTIVITIES</b>		
Investment securities available for sale:		
Proceeds from sale of investment securities	8,072	7,660
Proceeds from principal repayments and maturities	54,746	67,885
Purchases	(95,833)	(80,748)
Investment securities held to maturity:		
Proceeds from sale of investment securities		643
Proceeds from principal repayments and maturities		2,673
Increase in loans receivable, net	(5,485)	(14,687)
Redemption of FHLB stock	2,408	2,957
Purchase of bank owned life insurance		(7,001)
Investment in limited partnership	(4,442)	(2,170)
Proceeds from sale of foreclosed real estate	1,622	1,889
Capital improvements to foreclosed real estate		(46)
Investment in insurance subsidiary	(373)	
Purchase of insurance subsidiary		(2,025)
Purchase of premises, equipment, and software	(694)	(297)
 Net cash used for investing activities	 (39,979)	 (23,267)

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

FINANCING ACTIVITIES		
Increase in deposits, net	50,973	114,959
Net increase (decrease) in short-term borrowings	7,000	(14,719)
Proceeds from other borrowings	5,150	8,300
Repayment of other borrowings	(55,150)	(74,000)
Increase in advances by borrowers for taxes and insurance	5,561	5,085
Purchase of treasury shares.	(332)	(10,645)
Dividends on common stock	(1,644)	(1,767)
<b>Net cash provided by financing activities</b>	<b>11,558</b>	<b>27,213</b>
Increase (decrease) in cash and cash equivalents	(18,910)	10,907
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>41,694</b>	<b>10,890</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 22,784</b>	<b>\$ 21,797</b>
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Cash Paid:		
Interest	\$ 12,169	\$ 13,638
Income taxes	300	2,475
Noncash items:		
Transfers from loans to foreclosed real estate	1,125	2,171
Treasury stock payable	\$	\$ (79)
Acquisition of insurance company:		
Cash paid		(2,025)
Noncash assets received and liabilities assumed:		
Intangible assets		2,000
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 is subject to regulation and supervision as a savings and loan holding company by the Federal Reserve Board. The Bank is a Pennsylvania chartered savings 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 is subject to regulation and supervision by the Pennsylvania Banking Department and the Federal Deposit Insurance Corporation. The investment in subsidiary on the parent company's financial statements is carried at the parent company's equity in the underlying net assets.

ESSACOR, Inc. is a Pennsylvania corporation that 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 percent by ESSA Bank & Trust. ESSA Advisory Services, LLC is a full-service insurance benefits consulting company offering group services such as health insurance, life insurance, short term and long term disability, dental, vision and 401(k) retirement planning as well as individual health products. All 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, 2012 are not necessarily indicative of the results that may be expected for the year ending September 30, 2012.

**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, 2012 and 2011.

	Three Months Ended		Nine Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Weighted-average common shares outstanding	16,980,900	16,980,900	16,980,900	16,980,900
Average treasury stock shares	(4,884,603)	(4,226,817)	(4,875,703)	(3,918,021)
Average unearned ESOP shares	(1,103,342)	(1,148,618)	(1,114,702)	(1,159,979)
Average unearned non-vested shares	(135,472)	(254,845)	(145,363)	(264,070)
<b>Weighted average common shares and common stock equivalents used to calculate basic earnings per share</b>	<b>10,857,483</b>	<b>11,350,620</b>	<b>10,845,132</b>	<b>11,638,830</b>
Additional common stock equivalents (nonvested stock) used to calculate diluted earnings per share				
Additional common stock equivalents (stock options) used to calculate diluted earnings per share				
<b>Weighted average common shares and common stock equivalents used to calculate diluted earnings per share</b>	<b>10,857,483</b>	<b>11,350,620</b>	<b>10,845,132</b>	<b>11,638,830</b>

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

At June 30, 2012 and 2011 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 earnings per share ( EPS ) because to do so would have

**Table of Contents**

been anti-dilutive. At June 30, 2012 and 2011 there were 105,519 and 224,566 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 ( GAAP ) and to general practice within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the Consolidated Balance Sheet date and related revenues and expenses for the period. Actual results could differ significantly from those estimates.

**4. Comprehensive Income**

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

	Three Months Ended June 30		Nine Months Ended June 30	
	2012	2011	2012	2011
Net income	\$ 794	\$ 1,241	\$ 2,339	\$ 3,468
Unrealized gain (loss) on securities available for sale	1,483	4,178	(724)	(460)
Realized gains included in net income		(56)	(147)	(171)
Change in unrecognized pension cost	121	103	358	309
Other comprehensive income (loss) before tax benefit	1,604	4,225	(513)	(322)
Income tax (benefit) related to comprehensive income (loss)	546	1,437	(174)	(109)
Other comprehensive income (loss)	1,058	2,788	(339)	(213)
Comprehensive income	\$ 1,852	\$ 4,029	\$ 2,000	\$ 3,255

**5. Recent Accounting Pronouncements:**

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): 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. The Company has presented the necessary disclosures in Note 12, herein.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): 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

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

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**

In September 2011, the FASB issued ASU 2011-08, *Intangibles – Goodwill and Other Topics (Topic 350), Testing Goodwill for Impairment*. The objective of this update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this Update apply to all entities, both public and nonpublic, that have goodwill reported in their financial statements and are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity’s financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. This ASU is not expected to have a significant impact on the Company’s financial statements.

In September 2011, the FASB issued ASU 2011-09, *Compensation-Retirement Benefits-Multiemployer Plans (Subtopic 715-80): Disclosures about an Employer’s Participation in a Multiemployer Plan*. The amendments in this Update will require additional disclosures about an employer’s participation in a multiemployer pension plan to enable users of financial statements to assess the potential cash flow implications relating to an employer’s participation in multiemployer pension plans. The disclosures also will indicate the financial health of all of the significant plans in which the employer participates and assist a financial statement user to access additional information that is available outside the financial statements. For public entities, the amendments in this Update are effective for annual periods for fiscal years ending after December 15, 2011, with early adoption permitted. For nonpublic entities, the amendments are effective for annual periods of fiscal years ending after December 15, 2012, with early adoption permitted. The amendments should be applied retrospectively for all prior periods presented. This ASU is not expected to have a significant impact on the Company’s financial statements.

In December 2011, the FASB issued ASU 2011-10, *Property, Plant, and Equipment (Topic 360): Derecognition of in Substance Real Estate-a Scope Clarification*. The amendments in this Update affect entities that cease to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary’s nonrecourse debt. Under the amendments in this Update, when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary’s nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. Generally, a reporting entity would not satisfy the requirements to derecognize the in substance real estate before the legal transfer of the real estate to the lender and the extinguishment of the related nonrecourse indebtedness. That is, even if the reporting entity ceases to have a controlling financial interest under Subtopic 810-10, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary’s operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. The amendments in this Update should be applied on a prospective basis to deconsolidation events occurring after the effective date. Prior periods should not be adjusted even if the reporting entity has continuing involvement with previously derecognized in substance real estate entities. For public entities, the amendments in this Update are effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2013, and interim and annual periods thereafter. Early adoption is permitted. This ASU is not expected to have a significant impact on the Company’s financial statements.

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. The amendments in this Update affect all entities that have financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement. The requirements amend the disclosure requirements on offsetting in Section 210-20-50. This information will enable users of an entity’s financial statements to evaluate the effect or potential effect of netting arrangements on an entity’s financial position,

**Table of Contents**

including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments in the scope of this Update. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. This ASU is not expected to have a significant impact on the Company's financial statements.

In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. In order to defer only those changes in Update 2011-05 that relate to the presentation of reclassification adjustments, the paragraphs in this Update supersede certain pending paragraphs in Update 2011-05. Entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before Update 2011-05. All other requirements in Update 2011-05 are not affected by this Update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. Nonpublic entities should begin applying these requirements for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. This ASU is not expected to have a significant impact on the Company's financial statements.

**6. Investment Securities**

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

	Amortized Cost	June 30, 2012		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
<b>Available for Sale</b>				
Fannie Mae	\$ 119,267	\$ 4,122	\$ (6)	\$ 123,383
Freddie Mac	50,724	1,738	(2)	52,460
Governmental National Mortgage Association	31,611	781	(15)	32,377
<b>Total mortgage-backed securities</b>	<b>201,602</b>	<b>6,641</b>	<b>(23)</b>	<b>208,220</b>
Obligations of states and political subdivisions	18,623	905	(4)	19,524
U.S. government agency securities	39,432	275	(14)	39,693
Corporate obligations	9,113	71	(143)	9,041
<b>Total debt securities</b>	<b>268,770</b>	<b>7,892</b>	<b>(184)</b>	<b>276,478</b>
Equity securities - financial services	11	7		18
<b>Total</b>	<b>\$ 268,781</b>	<b>\$ 7,899</b>	<b>\$ (184)</b>	<b>\$ 276,496</b>

	Amortized Cost	September 30, 2011		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
<b>Available for Sale</b>				
Fannie Mae	\$ 118,945	\$ 4,618	\$ (11)	\$ 123,552
Freddie Mac	47,449	2,207		49,656
Governmental National Mortgage Association	30,247	802	(48)	31,001
<b>Total mortgage-backed securities</b>	<b>196,641</b>	<b>7,627</b>	<b>(59)</b>	<b>204,209</b>
Obligations of states and political subdivisions	13,760	789	(50)	14,499



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

U.S. government agency securities	21,797	289	(3)	22,083
Corporate obligations	4,598	26	(40)	4,584
<b>Total debt securities</b>	<b>236,796</b>	<b>8,731</b>	<b>(152)</b>	<b>245,375</b>
Equity securities - financial services	11	7		18
<b>Total</b>	<b>\$ 236,807</b>	<b>\$ 8,738</b>	<b>\$ (152)</b>	<b>\$ 245,393</b>

**Table of Contents**

The amortized cost and fair value of debt securities at June 30, 2012, 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	
	Amortized Cost	Fair Value
Due in one year or less	\$ 1,915	\$ 1,926
Due after one year through five years	24,291	24,402
Due after five years through ten years	58,969	60,409
Due after ten years	183,595	189,741
<b>Total</b>	<b>\$ 268,770</b>	<b>\$ 276,478</b>

For the three months ended June 30, 2012, the Company did not sell any investment securities. For the nine months ended June 30, 2012, the Company realized gross gains of \$147,000 and proceeds from the sale of investment securities of \$8.1 million. For the three months ended June 30, 2011, the Company realized gross gains of \$56,000 and proceeds from the sale of investment securities of \$1.5 million. For the nine months ended June 30, 2011, the Company realized gross gains of \$204,000 and gross losses of \$33,000, respectively, and proceeds from the sale of investment securities of \$8.3 million.

**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, 2012		Twelve Months or Greater		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses		
Fannie Mae	5	\$ 9,526	\$ (6)	\$	\$	\$ 9,526	\$ (6)		
Freddie Mac	1	1,704	(2)			1,704	(2)		
Governmental National Mortgage Association	4	6,377	(15)			6,377	(15)		
Obligations of states and political subdivisions	1	1,474	(4)			1,474	(4)		
U.S. government agency securities	1	1,959	(14)			1,959	(14)		
Corporate obligations	9	3,937	(100)	457	(43)	4,394	(143)		
<b>Total</b>	<b>21</b>	<b>\$ 24,977</b>	<b>\$ (141)</b>	<b>\$ 457</b>	<b>\$ (43)</b>	<b>\$ 25,434</b>	<b>\$ (184)</b>		

	Number of Securities	Less than Twelve Months		September 30, 2011		Twelve Months or Greater		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses		

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

Fannie Mae	3	\$	5,156	\$	(11)	\$		\$	5,156	\$	(11)		
Governmental National Mortgage Association	4		2,723		(11)	4,440	(37)		7,163		(48)		
Obligations of states and political subdivisions	2		1,403		(50)				1,403		(50)		
U.S. government agency securities	2		3,045		(3)				3,045		(3)		
Corporate obligations	3		1,460		(40)				1,460		(40)		
Total	14	\$	13,787	\$	(115)	\$	4,440	\$	(37)	\$	18,227	\$	(152)

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.

**Table of Contents**

The Company reviews its position quarterly and has asserted that at June 30, 2012, 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.

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

Loans receivable consist of the following (in thousands):

	June 30, 2012	September 30, 2011
<b>Real Estate Loans:</b>		
Residential	\$ 586,339	\$ 583,599
Construction	2,143	691
Commercial	82,259	79,362
Commercial	5,190	14,766
Obligations of states and political subdivisions	33,109	25,869
Home equity loans and lines of credit	37,296	40,484
Other	1,964	2,018
	748,300	746,789
Less allowance for loan losses	7,100	8,170
<b>Net loans</b>	<b>\$ 741,200</b>	<b>\$ 738,619</b>

	Real Estate Loans				Commercial Loans	Obligations of States and Political Subdivisions	Home Equity and Lines of Credit	Other Loans	Total
	Residential	Construction	Commercial						
<b>June 30, 2012</b>									
Total Loans	\$ 586,339	\$ 2,143	\$ 82,259	\$ 5,190	\$ 33,109	\$ 37,296	\$ 1,964	\$ 748,300	
Individually evaluated for impairment	9,777		19,732	313		228		30,050	
Collectively evaluated for impairment	576,562	2,143	62,527	4,877	33,109	37,068	1,964	718,250	

	Real Estate Loans				Commercial Loans	Obligations of States and Political Subdivisions	Home Equity and Lines of Credit	Other Loans	Total
	Residential	Construction	Commercial						
<b>September 30, 2011</b>									
Total Loans	\$ 583,599	\$ 691	\$ 79,362	\$ 14,766	\$ 25,869	\$ 40,484	\$ 2,018	\$ 746,789	
	5,441		11,916	490		314	58	18,219	

Individually evaluated for impairment								
Collectively evaluated for impairment	578,158	691	67,446	14,276	25,869	40,170	1,960	728,570

We maintain a loan review system, that allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Impairment is

**Table of Contents**

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. All TDR loans are evaluated for impairment individually. 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 (in thousands). 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.

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
<b>June 30, 2012</b>					
<b>With no specific allowance recorded:</b>					
Real Estate Loans					
Residential	\$ 2,539	\$ 2,539	\$	\$ 4,333	\$
Construction					
Commercial	18,107	18,169		12,066	
Commercial	268	267		287	
Obligations of states and political subdivisions					
Home equity loans and lines of credit	215	215		230	
Other					
Total	21,129	21,190		16,916	
<b>With an allowance recorded:</b>					
Real Estate Loans					
Residential	7,238	7,214	553	1,654	
Construction					
Commercial	1,625	1,627	302	1,596	
Commercial	45	45	14	47	
Obligations of states and political subdivisions					
Home equity loans and lines of credit	13	13	13	14	
Other					
Total	8,921	8,899	882	3,311	
<b>Total:</b>					
Real Estate Loans					
Residential	9,777	9,753	553	5,987	
Construction					
Commercial	19,732	19,796	302	13,662	
Commercial	313	312	14	334	
Obligations of states and political subdivisions					
Home equity loans and lines of credit	228	228	13	244	

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

Other

Total Impaired Loans	\$ 30,050	\$ 30,089	\$ 882	\$ 20,227	\$
----------------------	-----------	-----------	--------	-----------	----

**Table of Contents**

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
<b>September 30, 2011</b>					
<b>With no specific allowance recorded:</b>					
Real Estate Loans					
Residential	\$ 2,623	\$ 2,621	\$	\$ 3,397	\$
Construction					
Commercial	9,557	9,501		3,375	60
Commercial	225	220		123	3
Obligations of states and political subdivisions					
Home equity loans and lines of credit	126	126		95	
Other	58	58		58	
Total	12,589	12,526		7,048	63
<b>With an allowance recorded:</b>					
Real Estate Loans					
Residential	2,818	2,811	475	2,257	
Construction					
Commercial	2,359	2,297	466	1,279	41
Commercial	265	263	101	36	5
Obligations of states and political subdivisions					
Home equity loans and lines of credit	188	188	118	98	
Other					
Total	5,630	5,559	1,160	3,670	46
<b>Total:</b>					
Real Estate Loans					
Residential	5,441	5,432	475	5,654	
Construction					
Commercial	11,916	11,798	466	4,654	101
Commercial	490	483	101	159	8
Obligations of states and political subdivisions					
Home equity loans and lines of credit	314	314	118	193	
Other	58	58		58	
Total Impaired Loans	\$ 18,219	\$ 18,085	\$ 1,160	\$ 10,718	\$ 109

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



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

quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

**Table of Contents**

The following tables present the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system as of June 30, 2012 and September 30, 2011 (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
<b>June 30, 2012</b>					
Commercial real estate loans	\$ 62,334	\$	\$ 19,321	\$ 604	\$ 82,259
Commercial	4,877		299	14	5,190
Obligations of states and political subdivisions	33,109				33,109
<b>Total</b>	<b>\$ 100,320</b>	<b>\$</b>	<b>\$ 19,620</b>	<b>\$ 618</b>	<b>\$ 120,558</b>

	Pass	Special Mention	Substandard	Doubtful	Total
<b>September 30, 2011</b>					
Commercial real estate loans	\$ 65,214	\$	\$ 13,682	\$ 466	\$ 79,362
Commercial	13,781	48	806	131	14,766
Obligations of states and political subdivisions	25,869				25,869
<b>Total</b>	<b>\$ 104,864</b>	<b>\$ 48</b>	<b>\$ 14,488</b>	<b>\$ 597</b>	<b>\$ 119,997</b>

All other loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or non-performing. The following tables present the risk ratings in the consumer categories of performing and non-performing loans at June 30, 2012 and September 30, 2011 (in thousands):

	Performing	Non-performing	Total
<b>June 30, 2012</b>			
Real estate loans:			
Residential	\$ 576,992	\$ 9,347	\$ 586,339
Construction	2,143		2,143
Home equity loans and lines of credit	36,946	350	37,296
Other	1,964		1,964
<b>Total</b>	<b>\$ 618,045</b>	<b>\$ 9,697</b>	<b>\$ 627,742</b>

	Performing	Non-performing	Total
<b>September 30, 2011</b>			
Real estate loans:			
Residential	\$ 576,745	\$ 6,854	\$ 583,599
Construction	691		691
Home equity loans and lines of credit	40,236	248	40,484
Other	1,957	61	2,018

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

Total	\$	619,629	\$	7,163	\$	626,792
-------	----	---------	----	-------	----	---------

**Table of Contents**

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of June 30, 2012 and September 30, 2011 (in thousands):

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non- Accrual	Total Loans
<b>June 30, 2012</b>							
Real estate loans							
Residential	\$ 574,190	\$ 2,151	\$ 1,354	\$	\$ 8,644	\$ 12,149	\$ 586,339
Construction	2,143						2,143
Commercial	75,598	149			6,512	6,661	82,259
Commercial	4,953				237	237	5,190
Obligations of states and political subdivisions	33,109						33,109
Home equity loans and lines of credit	36,599	315	32		350	697	37,296
Other	1,952	7	5			12	1,964
Total	\$ 728,544	\$ 2,622	\$ 1,391	\$	\$ 15,743	\$ 19,756	\$ 748,300

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non- Accrual	Total Loans
<b>September 30, 2011</b>							
Real estate loans							
Residential	\$ 573,229	\$ 2,588	\$ 928	\$	\$ 6,854	\$ 10,370	\$ 583,599
Construction	691						691
Commercial	75,438	422			3,502	3,924	79,362
Commercial	14,459		1		306	307	14,766
Obligations of states and political subdivisions	25,869						25,869
Home equity loans and lines of credit	39,952	97	187		248	532	40,484
Other	1,950	5	2		61	68	2,018
Total	\$ 731,588	\$ 3,112	\$ 1,118	\$	\$ 10,971	\$ 15,201	\$ 746,789

Our allowance for loan losses (ALL) is maintained at a level necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. Our allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an allocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management's judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary, based on changing economic conditions. Payments received on impaired loans generally are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. The allowance for loan losses as of June 30, 2012 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.

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

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

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

**Table of Contents**

The following 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, 2012 (in thousands):

	Real Estate Loans				Home Obligations of Equity States and Loans and			Other Loans	Unallocated	Total
	Residential	Construction	Commercial	Commercial Loans	Political Subdivisions	Lines of Credit				
ALL balance at March 31, 2012	\$ 5,619	\$ 8	\$ 1,432	\$ 343	\$ 81	\$ 469	\$ 135	\$ 11	\$ 8,098	
Charge-offs	(1,152)		(475)	(31)		(80)			(1,738)	
Recoveries	140								140	
Provision	596	(1)	(206)	82	21	(15)	(3)	126	600	
ALL balance at June 30, 2012	\$ 5,203	\$ 7	\$ 751	\$ 394	\$ 102	\$ 374	\$ 132	\$ 137	\$ 7,100	
ALL balance at March 31, 2011	5,042	8	1,421	347		634	24	653	8,129	
Charge-offs	(403)					(44)			(447)	
Recoveries	63			1		4			68	
Provision	426		66			65	111	(193)	475	
ALL balance at June 30, 2011	\$ 5,128	\$ 8	\$ 1,487	\$ 348	\$	\$ 659	\$ 135	\$ 460	\$ 8,225	
ALL balance at September 30, 2011	\$ 5,220	\$ 8	\$ 1,255	\$ 500	\$ 74	\$ 622	\$ 80	\$ 411	\$ 8,170	
Charge-offs	(1,834)		(820)	(31)		(326)	(9)		(3,020)	
Recoveries	173		5	20			2		200	
Provision	1,644	(1)	311	(95)	28	78	59	(274)	1,750	
ALL balance at June 30, 2012	\$ 5,203	\$ 7	\$ 751	\$ 394	\$ 102	\$ 374	\$ 132	\$ 137	\$ 7,100	
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	553		302	14		13			882	
Collectively evaluated for impairment	4,650	7	449	380	102	361	132	137	6,218	
ALL balance at June 30, 2012	\$ 5,203	\$ 7	\$ 751	\$ 394	\$ 102	\$ 374	\$ 132	\$ 137	\$ 7,100	
Individually evaluated for impairment	475		466	101		118			1,160	
Collectively evaluated for impairment	4,745	8	789	399	74	504	80	411	7,010	
ALL balance at September 30, 2011	\$ 5,220	\$ 8	\$ 1,255	\$ 500	\$ 74	\$ 622	\$ 80	\$ 411	\$ 8,170	

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 real estate, other loans and home equity loans and lines of credit segments for the nine month period ending June 30, 2012 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 following is a summary of troubled debt restructuring granted during the past three and nine months (in thousands).

	For the Three Months Ended June 30, 2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
<b><u>Troubled Debt Restructurings</u></b>			
Real estate loans:			
Residential	8	\$ 1,509	\$ 1,509
Construction			
Commercial	3	666	666
Commercial			
Obligations of states and political subdivisions			
Home equity loans and lines of credit	1	5	5
Other			
Total	12	\$ 2,180	\$ 2,180

	For the Nine Months Ended June 30, 2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
<b><u>Troubled Debt Restructurings</u></b>			
Real estate loans:			
Residential	14	\$ 2,569	\$ 2,563
Construction			
Commercial	9	2,427	2,396
Commercial	3	217	207
Obligations of states and political subdivisions			
Home equity loans and lines of credit	3	47	47
Other			
Total	29	\$ 5,260	\$ 5,213

The following is a summary of troubled debt restructurings that have subsequently defaulted within one year of modification (dollars in thousands).

	For the Twelve Months Ended June 30, 2012	
	Number of Contracts	Recorded Investment
<b><u>Troubled Debt Restructurings</u></b>		
Real estate loans:		
Residential	1	\$ 88
Construction		
Commercial	3	159
Commercial	1	31



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

Obligations of states and political subdivisions			
Home equity loans and lines of credit	1		36
Other			
Total	6	\$	314

**Table of Contents****9. Deposits**

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

	June 30, 2012	September 30, 2011
Non-interest bearing demand accounts	\$ 39,468	\$ 33,296
NOW accounts	65,674	65,074
Money market accounts	105,970	114,617
Savings and club accounts	81,088	73,058
Certificates of deposit	396,697	351,879
 Total	 \$ 688,897	 \$ 637,924

**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 13 of the Company's Consolidated Financial Statements for the year ended September 30, 2011 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 June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Service Cost	\$ 149	\$ 134	\$ 448	\$ 401
Interest Cost	179	175	535	524
Expected return on plan assets	(204)	(193)	(611)	(578)
Amortization of prior service cost		2		6
Amortization of unrecognized loss	119	101	356	303
 Net periodic benefit cost	 \$ 243	 \$ 219	 \$ 728	 \$ 656

The Bank contributed \$396,000 to its pension plan in May 2012.

**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.

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

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

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.

**Table of Contents**

For the nine months ended June 30, 2012 and 2011, the Company recorded \$1.6 million of share-based compensation expense, respectively, comprised of stock option expense of \$515,000 and restricted stock expense of \$1.1 million for the June 30, 2012 period and stock option expense of \$533,000 and restricted stock expense of \$1.1 million for the June 30, 2011 period. Expected future expense relating to the 288,675 non-vested options outstanding as of June 30, 2012, is \$630,000 over the remaining vesting period of 0.92 years. Expected future compensation expense relating to the 115,212 restricted shares at June 30, 2012, is \$1.7 million over the remaining vesting period of 1.17 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, 2012.

	Number of Stock Options	Weighted- average Exercise Price	Weighted- average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding, September 30, 2011	1,458,379	\$ 12.35	6.67	\$
Granted				
Exercised				
Forfeited				
Outstanding, June 30, 2012	1,458,379	\$ 12.35	5.92	\$
Exercisable at June 30, 2012	1,169,704	\$ 12.35	5.92	\$

The weighted-average grant date fair value of the Company's non-vested options as of June 30, 2012 and 2011 was \$2.38.

The following is a summary of the status of the Company's restricted stock as of June 30, 2012, and changes therein during the three month period then ended:

	Number of Restricted Stock	Weighted- average Grant Date Fair Value
Nonvested at September 30, 2011	234,425	\$ 12.35
Granted		
Vested	119,213	12.35
Forfeited		
Nonvested at June 30, 2012	115,212	\$ 12.35

**12. Fair Value Measurement**

The following disclosures show the hierarchical disclosure framework associated within the level of pricing observations utilized in measuring assets and liabilities at fair value. The definition of fair value maintains the exchange price notion in earlier definitions of fair value but focuses on the exit price of the asset or liability. The exit price is the price that would be received to sell the asset or paid to transfer the liability adjusted for certain inherent risks and restrictions. Expanded disclosures are also required about the use of fair value to measure assets and liabilities.

**Table of Contents**

The following table presents information about the Company's securities, other real estate owned and impaired loans measured at fair value as of June 30, 2012 and September 30, 2011 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

**Fair Value Measurement at June 30, 2012**

Fair Value Measurements Utilized for the Company's Financial Assets (in thousands):	Significant Other			Balances as of June 30, 2012
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Securities available-for-sale measured on a recurring basis</b>				
Mortgage backed securities	\$	\$ 208,220	\$	\$ 208,220
Obligations of states and political subdivisions		19,524		19,524
U.S. government agencies		39,693		39,693
Corporate obligations		9,041		9,041
Equity securities financial-services	18			18
<b>Total debt and equity securities</b>	\$ 18	\$ 276,478	\$	\$ 276,496
Foreclosed real estate owned measured on a non-recurring basis	\$	\$	\$ 1,769	\$ 1,769
Impaired loans measured on a non-recurring basis	\$	\$	\$ 29,168	\$ 29,168

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

Fair Value Measurements Utilized for the Company's Financial Assets (in thousands):	Significant Other			Balances as of September 30, 2011
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Securities available-for-sale measured on a recurring basis</b>				
Mortgage backed securities	\$	\$ 204,209	\$	\$ 204,209
Obligations of states and political subdivisions		14,499		14,499
U.S. government agencies		22,083		22,083
Corporate obligations		4,584		4,584
Equity securities financial-services	18			18
<b>Total debt and equity securities</b>	\$ 18	\$ 245,375	\$	\$ 245,393
Foreclosed real estate owned measured on a non-recurring basis	\$	\$	\$ 2,356	\$ 2,356
Impaired loans measured on a non-recurring basis	\$	\$	\$ 17,059	\$ 17,059

As required by GAAP, each financial asset and liability must be identified as having been valued according to a specified level of input, 1, 2 or 3. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank has the ability to access at the measurement date. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset, either directly or indirectly. Level 2 inputs include quoted prices for similar assets in active markets, and inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy, within which the fair value measurement in its entirety falls, has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset.

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

observable data that may include dealer quoted market spreads, cash flows, the U.S.

**Table of Contents**

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, 2012, 93 impaired loans with a carrying value of \$30.1 million were reduced by specific valuation allowance totaling \$882,000 resulting in a net fair value of \$29.2 million based on Level 3 inputs.

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

<i>(In thousands)</i>	<b>Quantitative Information about Level 3 Fair Value Measurements</b>			
	<b>Fair Value Estimate</b>	<b>Valuation Techniques</b>	<b>Unobservable Input</b>	<b>Range</b>
<b>June 30, 2012:</b>				
Impaired loans	29,168	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to 30%
Foreclosed real estate owned	1,769	Appraisal of collateral (1), (3)		

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

**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 (in thousands).

	<b>June 30, 2012</b>			<b>Total Fair Value</b>
	<b>Level I</b>	<b>Level II</b>	<b>Level III</b>	
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 22,784	\$	\$	\$ 22,784
Investment and mortgage backed securities Available for sale	18	276,478		276,496
Loans receivable, net			771,682	771,682
Accrued interest receivable	3,929			3,929
FHLB stock	14,474			14,474
Mortgage servicing rights			180	180
Bank owned life insurance	23,844			23,844
<b>Financial liabilities:</b>				
Deposits	\$ 286,745	\$	\$ 404,390	\$ 691,135
Short-term borrowings	11,000			11,000
Other borrowings			243,462	243,462
Advances by borrowers for taxes and insurance	6,942			6,942
Accrued interest payable	1,540			1,540

**Table of Contents**

	June 30, 2012		September 30, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 22,784	\$ 22,784	\$ 41,694	\$ 41,694
Investment securities available for sale	276,496	276,496	245,393	245,393
Loans receivable, net	741,200	771,682	738,619	773,142
Accrued interest receivable	3,929	3,929	4,193	4,193
FHLB stock	14,474	14,474	16,882	16,882
Mortgage servicing rights	180	180	248	248
Bank owned life insurance	23,844	23,844	23,256	23,256
<b>Financial liabilities:</b>				
Deposits	\$ 688,897	\$ 691,135	\$ 637,924	\$ 647,090
Short-term borrowings	11,000	11,000	4,000	4,000
Other borrowings	234,410	243,462	284,410	296,324
Advances by borrowers for taxes and insurance	6,942	6,942	1,381	1,381
Accrued interest payable	1,540	1,540	1,485	1,485

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

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

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

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

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

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

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

The fair value approximates the current book value.

**Bank-Owned Life Insurance**

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

**Investment Available for Sale and FHLB Stock**

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





## **Table of Contents**

### **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 quarter-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;

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

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

estimates of our risks and future costs and benefits.

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

significantly increased competition among depository and other financial institutions;

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

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

adverse changes in the securities markets;

legislative or regulatory changes that adversely affect our business;

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

changes in consumer spending, borrowing and savings habits;

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

changes in our organization, compensation and benefit plans.

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

---

**Table of Contents****Comparison of Financial Condition at June 30, 2012 and September 30, 2011**

**Total Assets.** Total assets increased by \$15.6 million, or 1.42%, to \$1,131.1 million at June 30, 2012 from \$1,097.5 million at September 30, 2011. Increases in investment securities available for sale, loans receivable and other assets were offset, in part, by a decrease in interest-bearing deposits with other institutions.

**Interest-Bearing Deposits with Other Institutions.** Interest-bearing deposits with other institutions decreased \$17.7 million, or 55.6%, to \$14.2 million at June 30, 2012 from \$31.9 million at September 30, 2011. This decrease was primarily the result of the increase in purchases of investment securities available for sale along with loan growth from September 30, 2011 through June 30, 2012.

**Net Loans.** Net loans increased \$2.6 million, or 0.4%, to \$741.2 million at June 30, 2012 from \$738.6 million at September 30, 2011. During this period, residential real estate loans outstanding increased by \$2.7 million to \$586.3 million. Construction loans increased \$1.5 million to \$2.1 million, commercial real estate loans increased \$2.9 million to \$82.3 million, obligations of states and political subdivisions increased \$7.2 million to \$33.1 million. These increases were partially offset by decreases in commercial loans outstanding of \$9.6 million to \$5.2 million, home equity loans and lines of credit outstanding of \$3.2 million to \$38.3 million and other loans outstanding of \$54,000 to \$2.0 million.

**Goodwill.** Goodwill increased \$373,000 to \$413,000 at June 30, 2012 from \$40,000 at September 30, 2011. The Company's previously disclosed purchase of an insurance business during the third fiscal quarter of 2011 included the potential for the Company to pay two performance based payments as part of the original purchase price. Performance would be measured on each of the first two anniversaries of the original purchase. According to these terms, a payment of \$373,000 was made during the third fiscal quarter of 2012.

**Other Assets.** Other assets increased \$3.1 million, or 19.6%, to \$19.0 million at June 30, 2012 from \$15.9 million at September 30, 2011. This increase was primarily due to the purchase of federal tax credits through an investment in a limited partnership related to a low income housing project. This investment increased \$4.4 million at June 30, 2012 compared to September 30, 2011.

**Investment Securities Available for Sale.** Investment securities available for sale increased \$31.1 million, or 12.7%, to \$276.5 million at June 30, 2012 from \$245.4 million at September 30, 2011. The increase was due primarily to increases in the Company's U.S. Government agency securities portfolio of \$17.3 million and in its mortgage-backed securities portfolio of \$6.2 million.

**Deposits.** Deposits increased \$51.0 million, or 8.0%, to \$688.9 million at June 30, 2012 from \$637.9 million at September 30, 2011. At June 30, 2012 compared to September 30, 2011, certificate of deposit accounts increased \$44.8 million to \$396.7 million, non-interest bearing demand accounts increased \$6.2 million to \$39.5 million, savings and club accounts increased \$8.0 million to \$81.1 million and NOW accounts increased \$600,000 to \$65.7 million. These increases were offset in part during the same period by a decrease in money market accounts of \$8.6 million to \$106.0 million. Included in the certificates of deposit at June 30, 2012 was an increase in brokered certificates of \$45.6 million to \$146.7 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 \$43.0 million, or 14.9%, to \$245.4 million at June 30, 2012, from \$288.4 million at September 30, 2011. The decrease in borrowed funds was primarily due to maturities of FHLBank Pittsburgh borrowings.

**Stockholders' Equity.** Stockholders' equity increased by \$2.0 million, or 1.2%, to \$163.7 million at June 30, 2012 from \$161.7 million at September 30, 2011. This increase was primarily the result of net income of \$2.3 million which was partially offset by a decrease in accumulated other comprehensive income of \$339,000 to \$247,000 at June 30, 2012 from \$586,000 at September 30, 2011.

**Table of Contents****Average Balance Sheets for the Three and Nine Months Ended June 30, 2012 and 2011**

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					
	2012			2011		
	Average Balance	Interest Income/Expense	Yield/ Cost (dollars in thousands)	Average Balance	Interest Income/Expense	Yield/ Cost
<b>Interest-earning assets:</b>						
Loans (1)	\$ 749,165	\$ 8,880	4.75%	\$ 751,112	\$ 9,683	5.17%
Investment securities						
Taxable (2)	58,654	264	1.81%	41,132	231	2.25%
Exempt from federal income tax (2) (3)	8,898	51	3.48%	5,506	66	7.28%
Total investment securities	67,552	315	2.03%	46,638	297	2.85%
Mortgage-backed securities	207,447	1,376	2.66%	216,260	1,861	3.45%
Federal Home Loan Bank stock	14,719	4	0.11%	18,061		0.00%
Other	10,891	1	0.04%	12,914	1	0.03%
Total interest-earning assets	1,049,774	10,576	4.05%	1,044,985	11,842	4.56%
Allowance for loan losses	(7,632)			(8,125)		
Noninterest-earning assets	63,558			60,461		
Total assets	\$ 1,105,700			\$ 1,097,321		
<b>Interest-bearing liabilities:</b>						
NOW accounts	\$ 61,982	4	0.03%	\$ 58,584	7	0.05%
Money market accounts	108,390	69	0.26%	118,208	127	0.43%
Savings and club accounts	77,847	15	0.08%	71,961	37	0.21%
Certificates of deposit	389,464	1,692	1.74%	362,233	1,762	1.95%
Borrowed funds	254,414	2,060	3.25%	278,591	2,549	3.67%
Total interest-bearing liabilities	\$ 892,097	\$ 3,840	1.73%	\$ 889,577	\$ 4,482	2.02%
Non-interest bearing NOW accounts	35,480			31,116		
Noninterest-bearing liabilities	14,109			12,305		
Total liabilities	941,686			932,998		
Equity	164,014			164,323		
Total liabilities and equity	\$ 1,105,700			\$ 1,097,321		
Net interest income		\$ 6,736			\$ 7,360	
Interest rate spread			2.32%			2.54%
Net interest-earning assets	\$ 157,677			\$ 155,408		
Net interest margin (4)			2.57%			2.83%
		117.67%			117.47%	

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

Average interest-earning assets to average interest-bearing liabilities

- (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,					
	Average Balance	2012 Interest Income/Expense	Yield/ Cost	Average Balance	2011 Interest Income/Expense	Yield/ Cost
(dollars in thousands)						
<b>Interest-earning assets:</b>						
Loans (1)	\$ 748,803	\$ 27,366	4.87%	\$ 748,984	\$ 29,322	5.23%
Investment securities						
Taxable (2)	46,713	728	2.08%	45,422	673	1.98%
Exempt from federal income tax (2) (3)	8,661	158	3.68%	6,332	219	7.01%
Total investment securities	55,374	886	2.33%	51,754	892	2.60%
Mortgage-backed securities	206,614	4,174	2.69%	209,819	5,357	3.41%
Federal Home Loan Bank stock	15,569	8	0.07%	19,118		
Other	16,893	5	0.04%	7,042	2	0.04%
Total interest-earning assets	1,043,253	32,439	4.15%	1,036,717	35,573	4.60%
Allowance for loan losses	(8,135)			(7,870)		
Noninterest-earning assets	62,903			56,428		
Total assets	\$ 1,098,021			\$ 1,085,275		
<b>Interest-bearing liabilities:</b>						
NOW accounts	\$ 59,647	13	0.03%	\$ 57,715	20	0.05%
Money market accounts	110,106	225	0.27%	118,456	448	0.51%
Savings and club accounts	74,103	58	0.10%	68,812	127	0.25%
Certificates of deposit	372,408	5,231	1.87%	324,458	4,828	1.99%
Borrowed funds	272,701	6,697	3.27%	307,242	8,318	3.62%
Total interest-bearing liabilities	888,965	12,224	1.83%	876,683	13,741	2.10%
Non-interest bearing NOW accounts	33,512			29,704		
Noninterest-bearing liabilities	12,596			11,302		
Total liabilities	935,073			917,689		
Equity	162,948			167,586		
Total liabilities and equity	\$ 1,098,021			\$ 1,085,275		
Net interest income		\$ 20,215			\$ 21,832	
Interest rate spread			2.32%			2.50%
Net interest-earning assets	\$ 154,288			\$ 160,034		
Net interest margin (4)			2.58%			2.82%
Average interest-earning assets to average interest-bearing liabilities		117.36%			118.25%	

(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.

**Comparison of Operating Results for the Three Months Ended June 30, 2012 and June 30, 2011**

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

**Net Income.** Net income decreased \$447,000, or 36.0%, to \$794,000 for the three months ended June 30, 2012 compared to net income of \$1.2 million for the comparable period in 2011. Net income for the three months ending June 30, 2012 decreased primarily due to a decrease in net interest income and an increase in noninterest expense offset, in part, by an increase in noninterest income.

**Net Interest Income.** Net interest income decreased \$624,000, or 8.5%, to \$6.7 million for the three months ended June 30, 2012 from \$7.4 million for the comparable period in 2011. The decrease was primarily attributable to a decrease in the Company's interest rate spread to 2.32% for the three months ended June 30, 2012, from 2.54% for the comparable period in 2011, offset in part by an increase of \$2.3 million in the Company's average net earnings assets.

**Interest Income.** Interest income decreased \$1.3 million, or 10.7%, to \$10.6 million for the three months ended June 30, 2012 from \$11.8 million for the comparable 2011 period. The decrease resulted primarily from a 51 basis point decrease in average yield on interest earning assets, partially offset by a \$4.8 million increase in average



**Table of Contents**

interest-earning assets. The average yield on interest earning assets was 4.05% for the three months ended June 30, 2012, as compared to 4.56% for the comparable 2011 period as the Company's interest earning assets continued to re-price downward throughout the period. Total investment securities increased an average \$20.9 million. This increase was offset in part by declines in average balances of loans, mortgage backed securities, Federal Home Loan Bank stock and other investments. Loans decreased on average \$2.0 million between the two periods along with decreases in the average balance of mortgage backed securities of \$8.8 million. In addition, Federal Home Loan Bank stock decreased \$3.3 million and other investments decreased \$2.0 million. The primary reasons for the decrease in average loan balances were declines in one-four family residential loans, commercial loans and home equity loans and lines of credit which were offset in part by increases in commercial real estate loans and obligations of states and political subdivisions. Average FHLBank Pittsburgh stock declined \$3.3 million as a result of repurchases by the FHLB of its 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 \$642,000, or 14.3%, to \$3.8 million for the three months ended June 30, 2012 from \$4.5 million for the comparable 2011 period. The decrease resulted from a 29 basis point decrease in the overall cost of interest bearing liabilities to 1.73% for the three months ended June 30, 2012 from 2.02% for the comparable 2011 period, partially offset by a \$2.5 million increase in average interest-bearing liabilities. Average interest bearing deposits increased \$26.7 million and average borrowed funds decreased \$24.2 million. Average interest bearing deposits increased primarily as a result of a \$27.2 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 \$23.6 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 \$600,000 for the three month period ended June 30, 2012 as compared to \$475,000 for the three month period ended June 30, 2011. The allowance for loan losses was \$7.1 million, or 0.95% of loans outstanding, at June 30, 2012, compared to \$8.2 million, or 1.09% of loans outstanding at September 30, 2011.

**Non-interest Income.** Non-interest income increased \$36,000, or 2.5%, to \$1.5 million for the three months ended June 30, 2012 from \$1.5 million for the comparable period in 2011. The primary reasons for the increase were increases in insurance commissions of \$52,000 and trust and investment fee income of \$72,000 during the 2012 period. These increases were offset in part by a decline in service fees on deposit accounts of \$98,000.

**Non-interest Expense.** Non-interest expense decreased \$41,000, or 0.6%, to \$6.5 million for the three months ended June 30, 2012 from \$6.6 million for the comparable period in 2011. The primary reasons for the decrease were decreases in professional fees of \$72,000, loss on foreclosed real estate of \$98,000 and advertising expense of \$55,000. These decreases were partially offset by increases in merger related costs of \$168,000 and data processing expense of \$46,000. Merger related costs increased primarily due to expenses related to the previously announced proposed merger between the Company and First Star Bancorp, Inc.

**Income Taxes.** Income tax expense decreased \$225,000 to \$311,000 for the three months ended June 30, 2012 from \$536,000 for the comparable 2011 period. The decrease was primarily a result of the decrease in income before taxes of \$672,000 for the three months ended June 30, 2012. The effective tax rate was 28.1% for the three months ended June 30, 2012, compared to 30.1% for the 2011 period. The decrease in the effective tax rate was primarily due to the increase in the portion of pre-tax income derived from non-taxable loan and investment income for the three months ended June 30, 2012 compared to the 2011 period.

**Comparison of Operating Results for the Nine Months Ended June 30, 2012 and June 30, 2011**

**Net Income.** Net income decreased \$1.1 million, or 32.6%, to \$2.3 million for the nine months ended June 30, 2012 compared to net income of \$3.5 million for the comparable period in 2011. A decrease in net interest income and an increase in noninterest expense were offset, in part, by an increase in noninterest income and a decrease in income taxes.

---

**Table of Contents**

**Net Interest Income.** Net interest income decreased \$1.6 million, or 7.4%, to \$20.2 million for the nine months ended June 30, 2012 from \$21.8 million for the comparable period in 2011. The decrease was primarily attributable to a decrease in the Company's interest rate spread to 2.32% for the nine months ended June 30, 2012 from 2.50% for the comparable period in 2011 and a decrease of \$5.7 million in the Company's average net earning assets.

**Interest Income.** Interest income decreased \$3.1 million, or 8.8%, to \$32.4 million for the nine months ended June 30, 2012 from \$35.6 million for the comparable 2011 period. The decrease resulted primarily from a 45 basis point decrease in average yield on interest earning assets partially offset by a \$6.5 million increase in average interest-earning assets. The average yield on interest earning assets was 4.15% for the nine months ended June 30, 2012, as compared to 4.60% for the comparable 2011 period. Total investment securities increased on average \$3.6 million between the two periods along with increases in the average balance of other investment securities of \$9.9 million. These increases were offset in part by decreases in the average balances of mortgage backed securities of \$3.2 million, capital stock of FHLBank Pittsburgh of \$3.5 million and loans of \$181,000. The primary reason for the increase in other interest earning assets was due to an increase in the average balance of cash held at the FHLBank Pittsburgh. Total investment securities increased primarily due to an increase in the average balance of U.S. government agency securities. Average FHLBank Pittsburgh stock declined as a result of repurchases by the FHLBank of its stock.

**Interest Expense.** Interest expense decreased \$1.5 million, or 11.0%, to \$12.2 million for the nine months ended June 30, 2012 from \$13.7 million for the comparable 2011 period. The decrease resulted from a 27 basis point decrease in the overall cost of interest bearing liabilities to 1.83% for the nine months ended June 30, 2012 from 2.10% for the comparable 2011 period, partially offset by a \$12.3 million increase in average interest-bearing liabilities. Average interest bearing deposits increased \$46.8 million and average borrowed funds decreased \$34.5 million. Average interest bearing deposits increased primarily as a result of an increase of \$48.0 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 \$25.3 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, 2012 were \$18.2 million compared to non-performing assets of \$13.9 million at June 30, 2011. After an evaluation of these factors, management made a provision for loan losses of \$1.8 million for the nine months ended June 30, 2012 as compared to \$1.6 million for the nine months ended June 30, 2011. The allowance for loan losses was \$7.1 million, or 0.95% of loans outstanding, at June 30, 2012, compared to \$8.1 million, or 1.08% of loans outstanding at June 30, 2011.

**Non-interest Income.** Non-interest income increased \$525,000, or 12.8%, to \$4.6 million for the nine months ended June 30, 2012 from \$4.1 million for the comparable period in 2011. The primary reasons for the increase were increases in insurance commissions of \$438,000 and earnings on bank owned life insurance of \$150,000, which were partially offset by decreases in service fees on deposit accounts of \$201,000. The Company's purchase of ESSA Advisory Services during the quarter ended June 30, 2011 is the primary reason for the increase in insurance commission income. The Company's purchase of a total of \$7.0 million in bank owned life insurance during the quarters ended March 31, 2011 and June 30, 2011 was the principle reason for the increase in bank owned life insurance income during the September 30, 2011 period. The primary reason for the decrease in service fees on deposit accounts was a decrease of \$202,000 in overdraft fee income.

**Table of Contents**

**Non-interest Expense.** Non-interest expense increased \$402,000, or 2.0%, to \$20.1 million for the nine months ended June 30, 2012 from \$19.7 million for the comparable period in 2011. Comparing the nine months ended June 30, 2012 to the same period in 2011, there were increases in merger related costs of \$544,000, amortization of intangible assets of \$189,000 and data processing expenses of \$105,000. These increases were offset in part by decreases in advertising expense of \$271,000 and FDIC premiums of \$105,000. Merger related costs increased due to expenses associated with the previously announced proposed merger with First Star Bancorp. Amortization of intangible assets increases were related to the insurance consulting subsidiary.

**Income Taxes.** Income tax expense decreased \$510,000, or 41.9%, to \$706,000 for the nine months ended June 30, 2012 from \$1.2 million for the comparable 2011 period. The effective tax rate was 23.2% for the nine months ended June 30, 2012, compared to 26.0% for the 2011 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, 2012	September 30, 2011
<b>Non-performing assets:</b>		
Non-accruing loans	\$ 15,743	\$ 10,971
Troubled debt restructures	703	529
Total non-performing loans	16,446	11,500
Foreclosed real estate	1,769	2,356
Total non-performing assets	\$ 18,215	\$ 13,856
Ratio of non-performing loans to total loans	2.20%	1.54%
Ratio of non-performing loans to total assets	1.48%	1.05%
Ratio of non-performing assets to total assets	1.64%	1.26%
Ratio of allowance for loan losses to total loans	0.95%	1.09%

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 \$4.4 million to \$18.2 million at June 30, 2012 from \$13.9 million at September 30, 2011. Non-performing loans increased \$4.9 million to \$16.4 million at June 30, 2012 from \$11.5 million at September 30, 2011. The increase was primarily due to an increase of \$3.0 million in nonperforming commercial loans and \$1.8 million in nonperforming residential loans. The increase in commercial loans was primarily due to the addition of one commercial real estate loan. This loan was added to nonperforming loans at the conclusion of the Company's most recent FDIC examination. At June 30, 2012 the outstanding balance of this loan was \$2.5 million and the loan was paying pursuant to its terms. The number of nonperforming residential loans increased to 61 at June 30, 2012, from 41 at September 30, 2011, compared to 62 at March 31, 2012. The \$15.7 million of non-accruing loans at June 30, 2012 included 61 residential loans with an aggregate outstanding balance of \$8.6 million that were past due 90 or more days at June 30, 2012, 28 commercial and commercial real estate loans with aggregate outstanding balances of \$6.7 million and 13 consumer loans with aggregate balances of \$350,000. Within the residential loan balance are \$1.5 million of loans less than 90 days past due. In the quarter ended June 30, 2012, the Company identified nine residential loans which although paying as agreed, have a high probability of default. Foreclosed real estate decreased \$587,000 to \$1.8 million at June 30, 2012 from \$2.4 million at September 30, 2011. Foreclosed real estate consists of 21 residential properties and one commercial building lot.

At June 30, 2012 the principal balance of troubled debt restructures was \$13.6 million as compared to \$7.0 million at September 30, 2011. Of the \$13.6 million of troubled debt restructures at June 30, 2012, \$9.0 million are performing loans and \$4.6 million are non-accrual loans. An additional \$703,000 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 74 loans that comprise our troubled debt restructures at June 30, 2012, no loans were granted a rate concession at a below market interest rate. Eight loans with balances totaling \$2.0 million were granted market rate and terms concessions and 66 loans with balances totaling \$11.6 million were granted terms concessions.



---

## **Table of Contents**

As of June 30, 2012, troubled debt restructures were comprised of 41 residential loans totaling \$7.3 million, 28 commercial and commercial real estate loans totaling \$6.1 million, and five consumer (home equity loans, home equity lines of credit, and other) totaling \$171,000.

For the nine month period ended June 30, 2012, four loans totaling \$172,000 were removed from TDR status. One loan for \$69,000 was paid off, one loan for \$42,000 was transferred to foreclosed real estate, and two loans totaling \$60,000 were charged off.

We have modified terms of loans that do not meet the definition of a TDR. The vast majority of such loans were rate modifications of residential first mortgage loans in lieu of refinancing. The non-TDR rate modifications were all performing loans when the rates were reset to current market rates. For the three months ended June 30, 2012, we modified 74 loans (\$9.7 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, there were eight such loans in the three months ended June 30, 2012 with an aggregate balance of approximately \$8.0 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, 2012, \$22.8 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 \$1.9 million at June 30, 2012. As of June 30, 2012, we had \$190.4 million in borrowings outstanding from FHLBank Pittsburgh and \$55.0 million in borrowings through repurchase agreements with other financial institutions. We have access to additional FHLBank advances of up to approximately \$289.5 million.

At June 30, 2012, we had \$51.4 million in loan commitments outstanding, which included, in part, \$15.9 million in undisbursed construction loans and land development loans, \$24.8 million in unused home equity lines of credit, \$4.6 million in commercial lines of credit and commitments to originate commercial loans, \$3.2 million in performance standby letters of credit and \$2.9 million in other unused commitments which are primarily to originate residential mortgage loans and multifamily loans. Certificates of deposit due within one year of June 30, 2012 totaled \$146.9 million, or 37.0% of certificates of deposit. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before June 30, 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.

As previously disclosed, during the third fiscal quarter of 2011 the Bank formed a new subsidiary, ESSA Advisory Services, LLC, as part of the acquisition of two Lehigh Valley based insurance benefit consulting insurance businesses. Terms of the acquisition included a commitment to make two additional payments to the sellers, one each during the third quarters of fiscal 2012 and 2013. These payments are not guaranteed and are based on the achievement of certain revenue goals. During the third quarter of fiscal 2012 the Bank made a payment of approximately \$373,000 according to these terms. The payment was recorded as additional goodwill.

---

## **Table of Contents**

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 \$9.5 million and \$7.0 million for the nine months ended June 30, 2012 and 2011, 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 \$40.0 million and \$23.3 million for the nine months ended June 30, 2012 and 2011, 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 \$11.6 million and \$27.2 million for the nine months ended June 30, 2012 and 2011, 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.

***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.

---

## **Table of Contents**

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, 2012 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 2012, the Company's contractual obligations did not change materially from those discussed in the Company's Financial Statements for the year ended September 30, 2011.

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

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

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. The net proceeds from the Company's stock offering increased our capital and provided management with greater flexibility to manage our interest rate risk. In particular, management used the majority of the capital we received to increase our interest-earning assets. There have been no material changes in our interest rate risk since September 30, 2011.

### **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 by rule 13a-15(f) under the Securities Exchange Act of 1934) or in other factors that could significantly affect, or are reasonably likely to materially affect, the Company's internal controls over financial reporting during the period covered by this report.

## **Table of Contents**

### **Part II Other Information**

#### **Item 1. Legal Proceedings**

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

#### **Item 1A. Risk Factors**

In addition to the risk factors relating to the Company that were disclosed in response to Item 1A to part I of Form 10-K for the year ended September 30, 2011, the following additional risk factor exists relating to the recently announced execution of a merger agreement by and among the Company and First Star Bancorp, Inc., the holding company to First Star Bank (collectively referred to herein as "First Star"):

**The merger of the Company and First Star and the integration of the companies may be more difficult, costly or time consuming than expected.** It is possible that the integration process could result in the loss of key employees or disruption of ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect the Company's ability to maintain relationships with customers and employees or achieve the anticipated benefits of the merger. As with any member of banking institutions, there may also be business disruptions that cause the Company to lose customers or cause customers to withdraw their deposits from the Company's banking subsidiaries. The success of the combined company following the merger may depend in large part on the ability to integrate the two business models and cultures. If we are not able to integrate the Company's and First Star's operations successfully and in a timely manner, the expected benefits of the merger may not be realized.

**The Company may fail to realize the cost savings estimated for the merger.** The Company estimates that it will achieve cost savings from the merger when the two companies have been fully integrated, while the Company continues to be comfortable with these expectations, it is possible that the estimates of the potential cost savings could turn out to be incorrect. The cost savings estimates also assume the ability to combine the businesses of the company and First Star in a manner that permits those cost savings to be realized. If the estimates turn out to be incorrect or the company is not able to successfully combine the two companies the anticipated cost savings may not be fully realized or realized at all, or may take longer to realize than expected.

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

- (a) None.
- (b) Not applicable.
- (c) None.

#### **Item 3. Defaults Upon Senior Securities**

Not applicable.

#### **Item 4. Mine Safety Disclosures**

Not applicable.



**Item 5. Other Information**

Not applicable.

**Table of Contents**

**Item 6. Exhibits**

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

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

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

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

\*\*\* 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, 2012

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

Date: August 9, 2012

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