

ESSA Bancorp, Inc.  
Form 10-Q  
August 10, 2015  
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**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, 2015**

**OR**

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

**Commission File No. 001-33384**

**ESSA Bancorp, Inc.**  
**(Exact name of registrant as specified in its charter)**

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

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

**200 Palmer Street, Stroudsburg, Pennsylvania**  
**(Address of Principal Executive Offices)**  
**(570) 421-0531**

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

**(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 3, 2015 there were 11,412,821 shares of the Registrant's common stock, par value \$0.01 per share, outstanding.

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**ESSA Bancorp, Inc.**

**FORM 10-Q**

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## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEET

(UNAUDITED)

|  | <b>June 30,<br/>2015</b>      | <b>September 30,<br/>2014</b> |
|--|-------------------------------|-------------------------------|
|  | <b>(dollars in thousands)</b> |                               |
| Cash and due from banks  | \$ 16,017                     | \$ 20,884                     |
| Interest-bearing deposits with other institutions  | 1,675                         | 1,417                         |
| Total cash and cash equivalents  | 17,692                        | 22,301                        |
| Certificates of deposit  | 1,750                         | 1,767                         |
| Investment securities available for sale, at fair value  | 381,375                       | 383,078                       |
| Loans receivable (net of allowance for loan losses of \$8,767 and \$8,634)   | 1,092,527                     | 1,058,267                     |
| Regulatory stock, at cost  | 14,537                        | 14,284                        |
| Premises and equipment, net  | 16,655                        | 16,957                        |
| Bank-owned life insurance  | 30,421                        | 29,720                        |
| Foreclosed real estate   | 2,595                         | 2,759                         |
| Intangible assets, net   | 1,910                         | 2,396                         |
| Goodwill   | 10,259                        | 10,259                        |
| Deferred income taxes  | 11,045                        | 12,027                        |
| Other assets   | 18,058                        | 21,000                        |
| <b>TOTAL ASSETS</b>  | <b>\$ 1,598,824</b>           | <b>\$ 1,574,815</b>           |
| <b>LIABILITIES</b>   |                               |                               |
| Deposits   | \$ 1,075,553                  | \$ 1,133,889                  |
| Short-term borrowings  | 120,856                       | 108,020                       |
| Other borrowings   | 208,805                       | 151,300                       |
| Advances by borrowers for taxes and insurance  | 11,617                        | 4,093                         |
| Other liabilities  | 10,666                        | 10,204                        |
| <b>TOTAL LIABILITIES</b>   | <b>1,427,497</b>              | <b>1,407,506</b>              |
| <b>STOCKHOLDERS' EQUITY</b>  |                               |                               |
| Preferred Stock (\$.01 par value; 10,000,000 shares authorized, none issued)   |                               |                               |
| Common stock (\$.01 par value; 40,000,000 shares authorized, 18,133,095 issued; 11,419,321 and 11,590,378 outstanding at June 30, 2015 and September 30, 2014) | 181                           | 181                           |

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|   |                         |                         |
|---|-------------------------|-------------------------|
| Additional paid in capital  | 182,358                 | 182,486                 |
| Unallocated common stock held by the Employee Stock Ownership Plan (ESOP)   | (9,740)                 | (10,079)                |
| Retained earnings   | 82,289                  | 77,413                  |
| Treasury stock, at cost; 6,713,774 and 6,542,717 shares outstanding at June 30, 2015 and September 30, 2014, respectively | (82,105)                | (80,113)                |
| Accumulated other comprehensive loss  | (1,656)                 | (2,579)                 |
| <b>TOTAL STOCKHOLDERS EQUITY</b>  | <b>171,327</b>          | <b>167,309</b>          |
| <br><b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>  | <br><b>\$ 1,598,824</b> | <br><b>\$ 1,574,815</b> |

See accompanying notes to the unaudited consolidated financial statements.

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ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF INCOME

(UNAUDITED)

|   | For the Three Months Ended                    |           | For the Nine Months Ended |           |
|---|---|-----------|---------------------------|-----------|
|   | June 30,                                      |           | June 30,                  |           |
|   | 2015  | 2014      | 2015                      | 2014      |
|   | (dollars in thousands, except per share data) |           |                           |           |
| INTEREST INCOME                                     |   |           |                           |           |
| Loans receivable, including fees                    | \$ 11,398                                     | \$ 11,807 | \$ 33,947                 | \$ 32,173 |
| Investment securities:                              |   |           |                           |           |
| Taxable   | 1,741   | 1,632     | 5,429                     | 4,682     |
| Exempt from federal income tax                      | 248   | 173       | 721                       | 318       |
| Other investment income                             | 181   | 173       | 759                       | 317       |
| Total interest income                               | 13,568  | 13,785    | 40,856                    | 37,490    |
| INTEREST EXPENSE                                    |   |           |                           |           |
| Deposits  | 1,800   | 2,015     | 5,643                     | 5,909     |
| Short-term borrowings                               | 118   | 54        | 324                       | 104       |
| Other borrowings                                    | 639   | 619       | 1,826                     | 1,951     |
| Total interest expense                              | 2,557   | 2,688     | 7,793                     | 7,964     |
| NET INTEREST INCOME                                 | 11,011  | 11,097    | 33,063                    | 29,526    |
| Provision for loan losses                           | 525   | 500       | 1,500                     | 2,000     |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 10,486  | 10,597    | 31,563                    | 27,526    |
| NONINTEREST INCOME                                  |   |           |                           |           |
| Service fees on deposit accounts                    | 842   | 828       | 2,426                     | 2,342     |
| Services charges and fees on loans                  | 274   | 283       | 863                       | 572       |
| Trust and investment fees                           | 218   | 260       | 660                       | 701       |
| Gain/(loss) on sale of investments, net             | 194   | (10)      | 398                       | 226       |
| Earnings on Bank-owned life insurance               | 231   | 234       | 701                       | 687       |
| Insurance commissions                               | 183   | 205       | 582                       | 625       |
| Gain on acquisition                                 |   | 241       |                           | 241       |
| Other   | 6   | 59        | 33                        | 85        |

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|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Total noninterest income                              | 1,948    | 2,100    | 5,663    | 5,479    |
| NONINTEREST EXPENSE                                   |          |          |          |          |
| Compensation and employee benefits                    | 5,213    | 4,912    | 15,559   | 13,577   |
| Occupancy and equipment                               | 996      | 1,051    | 3,111    | 3,034    |
| Professional fees                                     | 517      | 441      | 1,438    | 1,348    |
| Data processing                                       | 861      | 977      | 2,566    | 2,426    |
| Advertising   | 373      | 243      | 725      | 463      |
| Federal Deposit Insurance Corporation (FDIC) premiums | 269      | 266      | 850      | 730      |
| (Gain)/loss on foreclosed real estate                 | 8        | (65)     | (167)    | (116)    |
| Merger related costs                                  |          | 176      |          | 522      |
| Amortization of intangible assets                     | 157      | 282      | 486      | 756      |
| Other   | 965      | 812      | 2,855    | 1,987    |
| Total noninterest expense                             | 9,359    | 9,095    | 27,423   | 24,727   |
| Income before income taxes                            | 3,075    | 3,602    | 9,803    | 8,278    |
| Income taxes  | 618      | 976      | 2,318    | 2,146    |
| NET INCOME  | \$ 2,457 | \$ 2,626 | \$ 7,485 | \$ 6,132 |
| Earnings per share                                    |          |          |          |          |
| Basic   | \$ 0.24  | \$ 0.24  | \$ 0.72  | \$ 0.56  |
| Diluted   | \$ 0.23  | \$ 0.24  | \$ 0.71  | \$ 0.56  |
| Dividends per share                                   | \$ 0.09  | \$ 0.07  | \$ 0.25  | \$ 0.19  |

See accompanying notes to the unaudited consolidated financial statements.

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ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(UNAUDITED)

|   | Three Months Ended<br>June 30, |          | Nine Months Ended<br>June 30, |          |
|---|--------------------------------|----------|-------------------------------|----------|
|   | 2015                           | 2014     | 2015                          | 2014     |
|   | (dollars in thousands)         |          |                               |          |
| Net income  | \$ 2,457                       | \$ 2,626 | \$ 7,485                      | \$ 6,132 |
| Other comprehensive income (loss):                          |                                |          |                               |          |
| Investment securities available for sale:                   |                                |          |                               |          |
| Unrealized holding gain (loss)                              | (3,496)                        | 3,281    | 1,616                         | 2,578    |
| Tax effect  | 1,188                          | (1,116)  | (549)                         | (877)    |
| Reclassification of (gains) losses recognized in net income | (194)                          | 10       | (398)                         | (226)    |
| Tax effect  | 66                             | (3)      | 135                           | 77       |
| Net of tax amount   | (2,436)                        | 2,172    | 804                           | 1,552    |
| Pension plan adjustment:                                    |                                |          |                               |          |
| Related to actuarial losses and prior service cost          | 61                             | 7        | 181                           | 21       |
| Tax effect  | (22)                           | (2)      | (62)                          | (7)      |
| Net of tax amount   | 39                             | 5        | 119                           | 14       |
| Total other comprehensive income (loss)                     | (2,397)                        | 2,177    | 923                           | 1,566    |
| Comprehensive income  | \$ 60                          | \$ 4,803 | \$ 8,408                      | \$ 7,698 |

See accompanying notes to the unaudited consolidated financial statements.



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ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(UNAUDITED)

|   | <b>Common Stock</b>     |               | <b>Unallocated Common</b>         |  | <b>Accumulated Other Comprehensive Total</b> |                       | <b>Stockholders' Equity</b> |
|---|-------------------------|---------------|-----------------------------------|--|--|-----------------------|-----------------------------|
|   | <b>Number of Shares</b> | <b>Amount</b> | <b>Additional Paid In Capital</b> | <b>Stock Held by the ESOP (dollars in thousands)</b> | <b>Retained Earnings</b>                     | <b>Treasury Stock</b> |                             |
| Balance, September 30, 2014                     | 11,590,378              | \$ 181        | \$ 182,486                        | \$ (10,079)  | \$ 77,413                                    | \$ (80,113)           | \$ (2,579) \$ 167,309       |
| Net income                                      |                         |               |                                   |  | 7,485  |                       | 7,485                       |
| Other comprehensive income                      |                         |               |                                   |  |  |                       | 923 923                     |
| Cash dividends declared (\$.25 per share)       |                         |               |                                   |  | (2,609)                                      |                       | (2,609)                     |
| Stock based compensation                        |                         |               | 81                                |  |  |                       | 81                          |
| Allocation of ESOP stock                        |                         |               | 76                                | 339  |  |                       | 415                         |
| Allocation of treasury shares to incentive plan |                         |               | (285)                             |  |  | 285                   |                             |
| Treasury shares purchased                       | (171,057)               |               |                                   |  |  | (2,277)               | (2,277)                     |
| Balance, June 30, 2015                          | 11,419,321              | \$ 181        | \$ 182,358                        | \$ (9,740)   | \$ 82,289                                    | \$ (82,105)           | \$ (1,656) \$ 171,327       |

See accompanying notes to the unaudited consolidated financial statements.

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

|   | For the Nine Months Ended<br>June 30, |          |
|---|---------------------------------------|----------|
|   | 2015                                  | 2014     |
|   | (dollars in thousands)                |          |
| OPERATING ACTIVITIES  |                                       |          |
| Net income  | \$ 7,485                              | \$ 6,132 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                       |          |
| Provision for loan losses   | 1,500                                 | 2,000    |
| Provision for depreciation and amortization                                       | 980                                   | 948      |
| Amortization and accretion of discounts and premiums, net                         | 322                                   | 829      |
| Net gain on sale of investment securities   | (398)                                 | (226)    |
| Compensation expense on ESOP  | 415                                   | 371      |
| Stock based compensation  | 81                                    | 170      |
| Increase in accrued interest receivable   | (54)                                  | (629)    |
| Increase in accrued interest payable  | 99                                    | 202      |
| Earnings on bank-owned life insurance   | (701)                                 | (687)    |
| Deferred federal income taxes   | (507)                                 | (738)    |
| Gain on foreclosed real estate, net   | (167)                                 | (116)    |
| Amortization of identifiable intangible assets                                    | 486                                   | 756      |
| Other, net  | 4,478                                 | 1,701    |
| Net cash provided by operating activities   | 14,019                                | 10,713   |
| INVESTING ACTIVITIES  |                                       |          |
| Maturities of certificates of deposit   | 17                                    |          |
| Investment securities available for sale:   |                                       |          |
| Proceeds from sale of investment securities                                       | 5,904                                 | 8,065    |
| Proceeds from principal repayments and maturities                                 | 46,953                                | 27,863   |
| Purchases   | (50,532)                              | (37,720) |
| (Increase) decrease in loans receivable, net                                      | (37,329)                              | 27,025   |
| Redemption of regulatory stock  | 11,660                                | 2,431    |
| Purchase of regulatory stock  | (11,913)                              | (4,204)  |
| Proceeds from sale of foreclosed real estate                                      | 2,543                                 | 2,038    |
| Acquisition, including cash acquired  |                                       | (15,415) |
| Capital improvements to foreclosed real estate                                    | 30                                    |          |
| Purchase of premises, equipment, and software                                     | (604)                                 | (498)    |
| Net cash (used for) provided by investing activities                              | (33,271)                              | 9,585    |

## FINANCING ACTIVITIES

|   |          |          |
|---|----------|----------|
| Decrease in deposits, net                                 | (58,336) | (68,902) |
| Net increase in short-term borrowings                     | 12,836   | 55,749   |
| Proceeds from other borrowings                            | 66,705   | 42,500   |
| Repayment of other borrowings                             | (9,200)  | (56,387) |
| Increase in advances by borrowers for taxes and insurance | 7,524    | 6,962    |
| Purchase of treasury stock shares                         | (2,277)  | (1,328)  |
| Dividends on common stock                                 | (2,609)  | (2,060)  |

|  |        |          |
|--|--------|----------|
| Net cash provided by (used for) financing activities | 14,643 | (23,466) |
|--|--------|----------|

|                                       |         |         |
|---------------------------------------|---------|---------|
| Decrease in cash and cash equivalents | (4,609) | (3,168) |
|---------------------------------------|---------|---------|

|  |        |        |
|--|--------|--------|
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 22,301 | 26,648 |
|--|--------|--------|

|  |           |           |
|--|-----------|-----------|
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 17,692 | \$ 23,480 |
|--|-----------|-----------|

## SUPPLEMENTAL CASH FLOW DISCLOSURES

## Cash Paid:

|              |          |          |
|--------------|----------|----------|
| Interest     | \$ 7,694 | \$ 7,762 |
| Income taxes | 250      | 2        |

## Noncash items:

|  |       |       |
|--|-------|-------|
| Transfers from loans to foreclosed real estate | 2,242 | 2,342 |
|--|-------|-------|

## Acquisition of FNCB:

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

## Noncash assets acquired

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

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

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

|                       |  |          |
|-----------------------|--|----------|
| Total non cash assets |  | \$ 4,101 |
|-----------------------|--|----------|

## Liabilities assumed:

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

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

|                   |  |       |
|-------------------|--|-------|
| Total liabilities |  | 8,752 |
|-------------------|--|-------|

|                             |  |         |
|-----------------------------|--|---------|
| Net noncash assets acquired |  | (4,651) |
|-----------------------------|--|---------|

|               |    |    |
|---------------|----|----|
| Cash acquired | \$ | 11 |
|---------------|----|----|

## Acquisition of Franklin Security Bank assets and liabilities:

## Noncash assets acquired

|   |  |        |
|---|--|--------|
| Investment securities, available for sale |  | 55,901 |
|---|--|--------|

|                  |  |         |
|------------------|--|---------|
| Loans receivable |  | 152,188 |
|------------------|--|---------|

|                              |  |       |
|------------------------------|--|-------|
| Federal Home Loan Bank stock |  | 1,569 |
|------------------------------|--|-------|

|                        |  |     |
|------------------------|--|-----|
| Premises and equipment |  | 176 |
|------------------------|--|-----|

|                        |  |     |
|------------------------|--|-----|
| Foreclosed real estate |  | 436 |
|------------------------|--|-----|

|   |                    |
|---|--------------------|
| Intangible assets, net                      | 889                |
| Deferred income taxes                       | 1,031              |
| Other assets                                | 2,504              |
| <b>Total assets acquired</b>                | <b>\$ 214,694</b>  |
| Liabilities assumed:                        |                    |
| Certificates of deposit                     | 90,869             |
| Deposits other than certificates of deposit | 71,317             |
| Other borrowings                            | 30,177             |
| Other liabilities                           | 2,265              |
| <b>Total liabilities</b>                    | <b>194,628</b>     |
| Net noncash assets acquired                 | 20,066             |
| <b>Cash acquired</b>                        | <b>\$ (19,825)</b> |

See accompanying notes to the unaudited consolidated financial statements.

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## ESSA BANCORP, INC. AND SUBSIDIARY

## Notes to Consolidated Financial Statements

(unaudited)

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

The consolidated financial statements include the accounts of ESSA Bancorp, Inc. (the Company), its wholly owned subsidiary, ESSA Bank & Trust (the Bank), and the Bank's wholly owned subsidiaries, ESSACOR Inc.; Pocono Investments Company; ESSA Advisory Services, LLC; Integrated Financial Corporation; and Integrated Abstract Incorporated, a wholly owned subsidiary of Integrated Financial Corporation. The primary purpose of the Company is to act as a holding company for the Bank. On November 6, 2014, the Company converted its status from a savings and loan holding company to a bank holding company. In addition, the Bank converted from a Pennsylvania-chartered savings association to a Pennsylvania-chartered savings bank. The Bank's primary business consists of the taking of deposits and granting of loans to customers generally in Monroe, Northampton, Lehigh, Lackawanna, and Luzerne Counties, Pennsylvania. The Bank is subject to regulation and supervision by the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation. The investment in subsidiary on the parent company's financial statements is carried at the parent company's equity in the underlying net assets.

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

The unaudited consolidated financial statements reflect all adjustments, which in the opinion of management, are necessary for a fair presentation of the results of the interim periods and are of a normal and recurring nature. Operating results for the nine month period ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending September 30, 2015.

**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, 2015 and 2014.

| Three months ended |          | Nine months ended |          |
|--------------------|----------|-------------------|----------|
| June 30,           | June 30, | June 30,          | June 30, |
| 2015               | 2014     | 2015              | 2014     |

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|  |             |             |             |             |
|--|-------------|-------------|-------------|-------------|
| Weighted-average common shares outstanding | 18,133,095  | 18,133,095  | 18,133,095  | 18,133,095  |
| Average treasury stock shares              | (6,709,111) | (6,272,961) | (6,671,091) | (6,233,349) |
| Average unearned ESOP shares               | (967,514)   | (1,012,790) | (978,875)   | (1,024,151) |
| Average unearned non-vested shares         | (25,008)    | (9,752)     | (19,045)    | (11,233)    |

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Weighted average common shares and common stock equivalents used to calculate basic earnings per share | 10,431,462 | 10,837,592 | 10,464,084 | 10,864,362 |
|--|------------|------------|------------|------------|

|  |         |  |        |  |
|--|---------|--|--------|--|
| Additional common stock equivalents (non-vested stock) used to calculate earnings per share      | 627     |  |        |  |
| Additional common stock equivalents (stock options) used to calculate diluted earnings per share | 133,034 |  | 69,620 |  |

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Weighted average common shares and common stock equivalents used to calculate diluted earnings per share | 10,565,123 | 10,837,592 | 10,533,704 | 10,864,362 |
|--|------------|------------|------------|------------|

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At June 30, 2015 and 2014 there were options to purchase 317,910 shares of common stock outstanding at a price of \$12.35 per share that were not included in the computation of diluted EPS because to do so would have been anti-dilutive. At June 30, 2015 and 2014 there were 35,057 and 4,440 shares, respectively, of nonvested stock outstanding at prices of \$12.27 and \$10.94 per share, respectively that were not included in the computation of diluted EPS because to do so would have been anti-dilutive.

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

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

**4. Recent Accounting Pronouncements:**

**Recent Accounting Pronouncements:**

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

In January 2014, the FASB issued ASU 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (a new revenue recognition standard). The Update's core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is evaluating the effect of adopting this new accounting Update.

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*. The amendments in this Update change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. For repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. The amendments also require enhanced disclosures. The accounting changes in this Update are effective for the first interim or annual period beginning after December 15, 2014. An entity is required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Earlier application is prohibited. The disclosure for certain transactions accounted for as a sale is required to be presented for interim and annual



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periods beginning after December 15, 2014, and the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. The disclosures are not required to be presented for comparative periods before the effective date. This Update did not have a significant impact on the Company's financial statements.

In June 2014, the FASB issued ASU 2014-12, *Compensation-Stock Compensation (Topic 718): Accounting for Share-Based Payments when the Terms of an Award Provide that a Performance Target Could Be Achieved After the Requisite Service Period*. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments in this Update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this Update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. Additionally, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. This Update is not expected to have a significant impact on the Company's financial statements.

In August 2014, the FASB issued ASU 2014-14, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40)*. The amendments in this Update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. This Update is not expected to have a significant impact on the Company's financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements -Going Concern (Subtopic 205-40)*. The amendments in this Update provide guidance in accounting principles generally accepted in the United States of America about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In November 2014, the FASB issued ASU 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (a consensus of the FASB Emerging Issues Task Force)*. This ASU clarifies how current U.S. GAAP should be interpreted in subjectively evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Public business entities are required to implement the new requirements in fiscal years and interim periods within those fiscal years beginning after December 15, 2015. This Update is not expected to have a significant impact on the Company's financial statements.

In January 2015, the FASB issued ASU 2015-01, *Income Statement – Extraordinary and Unusual Items*, as part of its initiative to reduce complexity in accounting standards. This Update eliminates from GAAP the concept of extraordinary items. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. A reporting entity also may apply the amendments retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. This Update is not expected to have a significant impact on the Company's financial statements.

In February 2015, the FASB issued ASU 2015-02, *Consolidation (Topic 810)*. The amendments in this Update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments (1) Modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities; (2) Eliminate the presumption that a general partner should consolidate a limited partnership; (3) Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships; (4) Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this Update are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company's financial statements.

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In April 2015, the FASB issued ASU 2015-03, *Interest-Imputation of Interest (Subtopic 835-30)*, as part of its initiative to reduce complexity in accounting standards. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this Update. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. An entity should apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. This Update is not expected to have a significant impact on the Company's financial statements.

In April 2015, the FASB issued ASU 2015-04, *Compensation-Retirement Benefits (Topic 715)*, as part of its initiative to reduce complexity in accounting standards. For an entity with a fiscal year-end that does not coincide with a month-end, the amendments in this Update provide a practical expedient that permits the entity to measure defined benefit plan assets and obligations using the month-end that is closest to the entity's fiscal year-end and apply that practical expedient consistently from year to year. The practical expedient should be applied consistently to all plans if an entity has more than one plan. The amendments in this Update are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Earlier application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In April 2015, the FASB issued ASU 2015-05, *Intangible – Goodwill and Other Internal Use Software (Topic 350-40)*, as part of its initiative to reduce complexity in accounting standards. This guidance will help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement. The amendments in this Update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. For public business entities, the Board decided that the amendments will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. For all other entities, the amendments will be effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016. Early adoption is permitted for all entities. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2015, the FASB issued ASU 2015-08, *Business Combinations - Pushdown Accounting - Amendment to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115*. This ASU was issued to amend various SEC paragraphs pursuant to the issuance of Staff Accounting Bulletin No. 115. This Update did not have a significant impact on the Company's financial statements.

In May 2015, the FASB issued ASU 2015-09, *Financial Services-Insurance (Topic 944) - Disclosure about Short-Duration Contracts*. The amendments apply to all insurance entities that issue short-duration contracts as defined in Topic 944, *Financial Services-Insurance*. The amendments require insurance entities to disclose for annual reporting periods certain information about the liability for unpaid claims and claim adjustment expenses. The amendments also require insurance entities to disclose information about significant changes in methodologies and

assumptions used to calculate the liability for unpaid claims and claim adjustment expenses, including reasons for the change and the effects on the financial statements. Additionally, the amendments require insurance entities to disclose for annual and interim reporting periods a rollforward of the liability for unpaid claims and claim adjustment expenses, described in Topic 944. For health insurance claims, the amendments require the disclosure of the total of incurred-but-not-reported liabilities plus expected development on reported claims included in the liability for unpaid claims and claim adjustment expenses. For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. For all other entities, the amendments in this Update are effective for annual periods beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017. This Update is not expected to have a significant impact on the Company's financial statements.

In June 2015, the FASB issued ASU 2015-10, *Technical Corrections and Improvements*. The amendments in this Update represent changes to clarify the Codification, correct unintended application of guidance, or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. Transition guidance varies based on the amendments in this Update. The amendments in this Update that require transition guidance are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. All other amendments will be effective upon the issuance of this Update. This Update is not expected to have a significant impact on the Company's financial statements.

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

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

|  | <b>June 30, 2015</b>      |                                       |  |                       |
|--|---------------------------|---------------------------------------|--|-----------------------|
|  | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| <b>Available for Sale</b>                        |                           |                                       |  |                       |
| Fannie Mae                                       | \$ 134,184                | \$ 1,470                              | \$ (913)                               | \$ 134,741            |
| Freddie Mac                                      | 92,368                    | 738                                   | (562)                                  | 92,544                |
| Governmental National Mortgage Association       | 16,534                    | 106                                   | (77)                                   | 16,563                |
| Other mortgage-backed securities                 | 2,663                     |                                       | (12)                                   | 2,651                 |
| Total mortgage-backed securities                 | 245,749                   | 2,314                                 | (1,564)                                | 246,499               |
| Obligations of states and political subdivisions | 48,887                    | 1,293                                 | (376)                                  | 49,804                |
| U.S. government agency securities                | 44,246                    | 280                                   | (14)                                   | 44,512                |
| Corporate obligations                            | 21,493                    | 142                                   | (236)                                  | 21,399                |
| Trust-preferred securities                       | 3,194                     | 277                                   |  | 3,471                 |
| Other debt securities                            | 15,579                    | 122                                   | (36)                                   | 15,665                |
| Total debt securities                            | 379,148                   | 4,428                                 | (2,226)                                | 381,350               |
| Equity securities - financial services           | 25                        |                                       |  | 25                    |
| Total  | \$ 379,173                | \$ 4,428                              | \$ (2,226)                             | \$ 381,375            |

|  | <b>September 30, 2014</b> |                                       |  |                       |
|--|---------------------------|---------------------------------------|--|-----------------------|
|  | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| <b>Available for Sale</b>                        |                           |                                       |  |                       |
| Fannie Mae                                       | \$ 144,291                | \$ 1,327                              | \$ (1,550)                             | \$ 144,068            |
| Freddie Mac                                      | 99,556                    | 548                                   | (1,277)                                | 98,827                |
| Governmental National Mortgage Association       | 19,446                    | 92                                    | (161)                                  | 19,377                |
| Other mortgage-backed securities                 | 2,795                     |                                       | (15)                                   | 2,780                 |
| Total mortgage-backed securities                 | 266,088                   | 1,967                                 | (3,003)                                | 265,052               |
| Obligations of states and political subdivisions | 41,375                    | 1,654                                 | (258)                                  | 42,771                |
| U.S. government agency securities                | 47,821                    | 192                                   | (383)                                  | 47,630                |
| Corporate obligations                            | 13,140                    | 236                                   | (48)                                   | 13,328                |
| Trust-preferred securities                       | 5,027                     | 594                                   |  | 5,621                 |
| Other debt securities                            | 6,618                     | 51                                    | (18)                                   | 6,651                 |

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|  |            |          |            |            |
|--|------------|----------|------------|------------|
| Total debt securities                  | 380,069    | 4,694    | (3,710)    | 381,053    |
| Equity securities - financial services | 2,025      |          |            | 2,025      |
| Total                                  | \$ 382,094 | \$ 4,694 | \$ (3,710) | \$ 383,078 |

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The amortized cost and fair value of debt securities at June 30, 2015, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

|  | <b>Available For Sale</b> |                   |
|--|---------------------------|-------------------|
|  | <b>Amortized Cost</b>     | <b>Fair Value</b> |
| Due in one year or less                | \$ 6,506                  | \$ 6,516          |
| Due after one year through five years  | 49,366                    | 49,771            |
| Due after five years through ten years | 64,198                    | 64,601            |
| Due after ten years                    | 259,078                   | 260,462           |
| <b>Total</b>                           | <b>\$ 379,148</b>         | <b>\$ 381,350</b> |

For the three months ended June 30, 2015, the Company realized gross gains of \$194,000 and no gross losses on proceeds from the sale of investment securities of \$2.6 million. For the nine months ended June 30, 2015, the Company realized gross gains of \$398,000 and no gross losses on proceeds from the sale of investment securities of \$5.9 million. For the three months ended June 30, 2014, the Company realized gross losses of \$10,000 on proceeds from the sale of investment securities of \$100. For the nine months ended June 30, 2014, the Company realized gross gains of \$247,000 and gross losses of \$21,000 on proceeds from the sale of investment securities of \$8.1 million.

**6. Unrealized Losses on Securities**

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

|  | <b>Number of Securities</b> | <b>Less than Twelve Months</b> |                                | <b>June 30, 2015<br/>Twelve Months or Greater</b> |                                | <b>Total</b>      |                                |
|--|-----------------------------|--------------------------------|--------------------------------|---|--------------------------------|-------------------|--------------------------------|
|  |                             | <b>Fair Value</b>              | <b>Gross Unrealized Losses</b> | <b>Fair Value</b>                                 | <b>Gross Unrealized Losses</b> | <b>Fair Value</b> | <b>Gross Unrealized Losses</b> |
| Fannie Mae                                       | 26                          | \$ 15,652                      | \$ (129)                       | \$ 24,511   | \$ (784)                       | \$ 40,163         | \$ (913)                       |
| Freddie Mac                                      | 21                          | 15,946                         | (101)                          | 16,010  | (461)                          | 31,956            | (562)                          |
| Governmental National Mortgage Association       | 4                           | 1,244                          | (7)                            | 2,399   | (70)                           | 3,643             | (77)                           |
| Other mortgage-backed securities                 | 3                           |                                |                                | 2,651   | (12)                           | 2,651             | (12)                           |
| Obligations of states and political subdivisions | 14                          | 9,172                          | (195)                          | 4,581   | (181)                          | 13,753            | (376)                          |
| U.S. government agency securities                | 4                           | 7,986                          | (13)                           | 1,000   | (1)                            | 8,986             | (14)                           |
| Corporate obligations                            | 10                          | 9,906                          | (214)                          | 979   | (22)                           | 10,885            | (236)                          |
| Other debt securities                            | 7                           | 6,097                          | (27)                           | 1,801   | (9)                            | 7,898             | (36)                           |
| <b>Total</b>                                     | <b>89</b>                   | <b>66,003</b>                  | <b>(686)</b>                   | <b>53,932</b>                                     | <b>(1,540)</b>                 | <b>119,935</b>    | <b>(2,226)</b>                 |

September 30, 2014

|  | Number of Securities | Less than Twelve Months |                         | Twelve Months or Greater |                         | Total      |                         |
|--|----------------------|-------------------------|-------------------------|--------------------------|-------------------------|------------|-------------------------|
|  |                      | Fair Value              | Gross Unrealized Losses | Fair Value               | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Fannie Mae                                       | 39                   | \$ 34,377               | \$ (164)                | \$ 33,249                | \$ (1,386)              | \$ 67,626  | \$ (1,550)              |
| Freddie Mac                                      | 36                   | 38,210                  | (216)                   | 29,269                   | (1,061)                 | 67,479     | (1,277)                 |
| Governmental National Mortgage Association       | 5                    | 4,127                   | (22)                    | 2,981                    | (139)                   | 7,108      | (161)                   |
| Other mortgage-backed securities                 | 3                    |                         |                         | 2,780                    | (15)                    | 2,780      | (15)                    |
| Obligations of states and political subdivisions | 5                    |                         |                         | 7,207                    | (258)                   | 7,207      | (258)                   |
| U.S. government agency securities                | 11                   | 8,004                   | (25)                    | 18,629                   | (358)                   | 26,633     | (383)                   |
| Corporate obligations                            | 5                    | 3,142                   | (32)                    | 1,130                    | (16)                    | 4,272      | (48)                    |
| Other debt securities                            | 2                    | 1,980                   | (18)                    |                          |                         | 1,980      | (18)                    |
| Total  | 106                  | \$ 89,840               | \$ (477)                | \$ 95,245                | \$ (3,233)              | \$ 185,085 | \$ (3,710)              |



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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, other mortgage backed securities, debt obligations of a U.S. state or political subdivision, corporate debt obligations and equity securities.

The Company reviews its position quarterly and has asserted that at June 30, 2015, the declines outlined in the above table represent temporary declines and the Company would not be required to sell the security before its anticipated recovery in market value.

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

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

Loans receivable consist of the following (in thousands):

|  | <b>June 30,<br/>2015</b> | <b>September 30,<br/>2014</b> |
|--|--------------------------|-------------------------------|
| Real estate loans:                               |                          |                               |
| Residential                                      | \$ 618,198               | \$ 654,152                    |
| Construction                                     | 1,151                    | 1,367                         |
| Commercial                                       | 195,503                  | 190,536                       |
| Commercial                                       | 35,035                   | 25,807                        |
| Obligations of states and political subdivisions | 56,868                   | 49,177                        |
| Home equity loans and lines of credit            | 40,975                   | 41,387                        |
| Auto Loans                                       | 150,370                  | 100,571                       |
| Other  | 3,194                    | 3,904                         |
|  | 1,101,294                | 1,066,901                     |
| Less allowance for loan losses                   | 8,767                    | 8,634                         |
| Net loans  | \$ 1,092,527             | \$ 1,058,267                  |

|                      | <b>Total<br/>Loans</b> | <b>Individually<br/>Evaluated for<br/>Impairment</b> | <b>Loans Acquired<br/>with Deteriorated<br/>Credit<br/>Quality</b> | <b>Collectively<br/>Evaluated for<br/>Impairment</b> |
|----------------------|------------------------|--|--|--|
| <b>June 30, 2015</b> |                        |  |  |  |
| Real estate loans:   |                        |  |  |  |
| Residential          | \$ 618,198             | \$ 12,671  | \$   | \$ 605,527   |
| Construction         | 1,151                  |  |  | 1,151  |
| Commercial           | 195,503                | 15,627   | 4,365  | 175,511  |

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|  |              |           |          |              |
|--|--------------|-----------|----------|--------------|
| Commercial                                       | 35,035       | 219       | 74       | 34,742       |
| Obligations of states and political subdivisions | 56,868       |           |          | 56,868       |
| Home equity loans and lines of credit            | 40,975       | 607       |          | 40,368       |
| Auto loans                                       | 150,370      | 340       |          | 150,030      |
| Other  | 3,194        |           |          | 3,194        |
| Total  | \$ 1,101,294 | \$ 29,464 | \$ 4,439 | \$ 1,067,391 |

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|  | <b>Total<br/>Loans</b> | <b>Individually<br/>Evaluated for<br/>Impairment</b> | <b>Loans Acquired<br/>with Deteriorated<br/>Credit<br/>Quality</b> | <b>Collectively<br/>Evaluated for<br/>Impairment</b> |
|--|------------------------|--|--|--|
| <b>September 30, 2014</b>                        |                        |  |  |  |
| Real estate loans:                               |                        |  |  |  |
| Residential                                      | \$ 654,152             | \$ 13,528  | \$ 110   | \$ 640,514   |
| Construction                                     | 1,367                  |  |  | 1,367  |
| Commercial                                       | 190,536                | 17,517   | 4,727  | 168,292  |
| Commercial                                       | 25,807                 | 456  | 263  | 25,088   |
| Obligations of states and political subdivisions | 49,177                 |  |  | 49,177   |
| Home equity loans and lines of credit            | 41,387                 | 266  | (3)  | 41,124   |
| Auto loans                                       | 100,571                | 101  |  | 100,470  |
| Other  | 3,904                  |  |  | 3,904  |
| <b>Total</b>                                     | <b>\$ 1,066,901</b>    | <b>\$ 31,868</b>                                     | <b>\$ 5,097</b>  | <b>\$ 1,029,936</b>                                  |

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

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

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

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The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable (in thousands).

|  | <b>Recorded<br/>Investment</b> | <b>Unpaid<br/>Principal<br/>Balance</b> | <b>Associated<br/>Allowance</b> |
|--|--------------------------------|---|---------------------------------|
| <b>June 30, 2015</b>                             |                                |   |                                 |
| <b>With no specific allowance recorded:</b>      |                                |   |                                 |
| Real estate loans                                |                                |   |                                 |
| Residential                                      | \$ 9,378                       | \$ 11,231                               | \$                              |
| Construction                                     |                                |   |                                 |
| Commercial                                       | 19,847                         | 20,789                                  |                                 |
| Commercial                                       | 293                            | 305                                     |                                 |
| Obligations of states and political subdivisions |                                |   |                                 |
| Home equity loans and lines of credit            | 529                            | 533                                     |                                 |
| Auto loans                                       | 159                            | 237                                     |                                 |
| Other  |                                |   |                                 |
| <b>Total</b>                                     | <b>30,206</b>                  | <b>33,095</b>                           |                                 |
| <b>With an allowance recorded:</b>               |                                |   |                                 |
| Real estate loans                                |                                |   |                                 |
| Residential                                      | 3,293                          | 3,761                                   | 432                             |
| Construction                                     |                                |   |                                 |
| Commercial                                       | 145                            | 174                                     | 1                               |
| Commercial                                       |                                |   |                                 |
| Obligations of states and political subdivisions |                                |   |                                 |
| Home equity loans and lines of credit            | 78                             | 106                                     | 69                              |
| Auto loans                                       | 181                            | 181                                     | 76                              |
| Other  |                                |   |                                 |
| <b>Total</b>                                     | <b>3,697</b>                   | <b>4,222</b>                            | <b>578</b>                      |
| <b>Total:</b>                                    |                                |   |                                 |
| Real estate loans                                |                                |   |                                 |
| Residential                                      | 12,671                         | 14,992                                  | 432                             |
| Construction                                     |                                |   |                                 |
| Commercial                                       | 19,992                         | 20,963                                  | 1                               |
| Commercial                                       | 293                            | 305                                     |                                 |
| Obligations of states and political subdivisions |                                |   |                                 |
| Home equity loans and lines of credit            | 607                            | 639                                     | 69                              |
| Auto loans                                       | 340                            | 418                                     | 76                              |
| Other  |                                |   |                                 |

|                      |           |           |        |
|----------------------|-----------|-----------|--------|
| Total Impaired Loans | \$ 33,903 | \$ 37,317 | \$ 578 |
|----------------------|-----------|-----------|--------|

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|  | <b>Recorded<br/>Investment</b> | <b>Unpaid<br/>Principal<br/>Balance</b> | <b>Associated<br/>Allowance</b> |
|--|--------------------------------|---|---------------------------------|
| <b>September 30, 2014</b>                        |                                |   |                                 |
| <b>With no specific allowance recorded:</b>      |                                |   |                                 |
| Real Estate Loans                                |                                |   |                                 |
| Residential                                      | \$ 11,030                      | \$ 13,225                               | \$                              |
| Construction                                     |                                |   |                                 |
| Commercial                                       | 21,587                         | 22,428                                  |                                 |
| Commercial                                       | 719                            | 777                                     |                                 |
| Obligations of states and political subdivisions |                                |   |                                 |
| Home equity loans and lines of credit            | 210                            | 377                                     |                                 |
| Auto Loans                                       | 101                            | 101                                     |                                 |
| Other  |                                |   |                                 |
| <br>Total  | <br>33,647                     | <br>36,908                              |                                 |
| <b>With an allowance recorded:</b>               |                                |   |                                 |
| Real Estate Loans                                |                                |   |                                 |
| Residential                                      | 2,608                          | 2,997                                   | 334                             |
| Construction                                     |                                |   |                                 |
| Commercial                                       | 657                            | 677                                     | 84                              |
| Commercial                                       |                                |   |                                 |
| Obligations of states and political subdivisions |                                |   |                                 |
| Home equity loans and lines of credit            | 53                             | 76                                      | 50                              |
| Auto Loans                                       |                                |   |                                 |
| Other  |                                |   |                                 |
| <br>Total  | <br>3,318                      | <br>3,750                               | <br>468                         |
| <b>Total:</b>                                    |                                |   |                                 |
| Real Estate Loans                                |                                |   |                                 |
| Residential                                      | 13,638                         | 16,222                                  | 334                             |
| Construction                                     |                                |   |                                 |
| Commercial                                       | 22,244                         | 23,105                                  | 84                              |
| Commercial                                       | 719                            | 777                                     |                                 |
| Obligations of states and political subdivisions |                                |   |                                 |
| Home equity loans and lines of credit            | 263                            | 453                                     | 50                              |
| Auto Loans                                       | 101                            | 101                                     |                                 |
| Other  |                                |   |                                 |
| <br>Total Impaired Loans                         | <br>\$ 36,965                  | <br>\$ 40,658                           | <br>\$ 468                      |



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The following table represents 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 (in thousands).

|  | Three months ended<br>June 30,            |   |  |  |
|--|---|---|--|--|
|  | 2015<br>Average<br>Recorded<br>Investment | 2014<br>Average<br>Recorded<br>Investment | 2015<br>Interest<br>Income<br>Recognized | 2014<br>Interest<br>Income<br>Recognized |
| <b>With no specific allowance recorded:</b>      |   |   |  |  |
| Real estate loans                                |   |   |  |  |
| Residential                                      | \$ 9,522                                  | \$ 8,989                                  | \$ 59                                    | \$ 92                                    |
| Construction                                     |   |   |  |  |
| Commercial                                       | 20,152                                    | 20,640                                    | 222                                      | 179                                      |
| Commercial                                       | 306                                       | 3,289                                     | 2  | 43                                       |
| Obligations of states and political subdivisions |   |   |  |  |
| Home equity loans and lines of credit            | 433                                       | 215                                       | 2  | 2  |
| Auto loans                                       | 116                                       |   |  |  |
| Other  |   |   |  |  |
| Total  | 30,529                                    | 33,133                                    | 285                                      | 316                                      |
| <b>With an allowance recorded:</b>               |   |   |  |  |
| Real estate loans                                |   |   |  |  |
| Residential                                      | 2,697                                     | 3,806                                     | 3  | 21                                       |
| Construction                                     |   |   |  |  |
| Commercial                                       | 146                                       | 978                                       |  |  |
| Commercial                                       |   |   |  |  |
| Obligations of states and political subdivisions |   |   |  |  |
| Home equity loans and lines of credit            | 51  | 37  |  |  |
| Auto loans                                       | 60  |   | 2  |  |
| Other  |   |   |  |  |
| Total  | 2,954                                     | 4,821                                     | 5  | 21                                       |
| <b>Total:</b>                                    |   |   |  |  |
| Real estate loans                                |   |   |  |  |
| Residential                                      | 12,219                                    | 12,795                                    | 62                                       | 113                                      |
| Construction                                     |   |   |  |  |
| Commercial                                       | 20,298                                    | 21,618                                    | 222                                      | 179                                      |
| Commercial                                       | 306                                       | 3,289                                     | 2  | 43                                       |
| Obligations of states and political subdivisions |   |   |  |  |
| Home equity loans and lines of credit            | 484                                       | 252                                       | 2  | 2  |



|                      |           |           |        |        |
|----------------------|-----------|-----------|--------|--------|
| Auto loans           | 176       |           |        | 2      |
| Other                |           |           |        |        |
| Total Impaired Loans | \$ 33,483 | \$ 37,954 | \$ 290 | \$ 337 |

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|  | Nine months ended<br>June 30,             |   |  |  |
|--|---|---|--|--|
|  | 2015<br>Average<br>Recorded<br>Investment | 2014<br>Average<br>Recorded<br>Investment | 2015<br>Interest<br>Income<br>Recognized | 2014<br>Interest<br>Income<br>Recognized |
| <b>With no specific allowance recorded:</b>      |   |   |  |  |
| Real estate loans                                |   |   |  |  |
| Residential                                      | \$ 10,334                                 | \$ 9,556                                  | \$ 222                                   | \$ 242                                   |
| Construction                                     |   |   |  |  |
| Commercial                                       | 20,729                                    | 20,241                                    | 606                                      | 553                                      |
| Commercial                                       | 550                                       | 1,764                                     | 6  | 49                                       |
| Obligations of states and political subdivisions |   |   |  |  |
| Home equity loans and lines of credit            | 307                                       | 285                                       | 4  | 4  |
| Auto loans                                       | 74  |   | 1  |  |
| Other  |   |   |  |  |
| Total  | 31,994                                    | 31,846                                    | 839                                      | 848                                      |
| <b>With an allowance recorded:</b>               |   |   |  |  |
| Real estate loans                                |   |   |  |  |
| Residential                                      | 2,535                                     | 3,425                                     | 45                                       | 79                                       |
| Construction                                     |   |   |  |  |
| Commercial                                       | 343                                       | 1,896                                     |  |  |
| Commercial                                       |   |   |  |  |
| Obligations of states and political subdivisions |   |   |  |  |
| Home equity loans and lines of credit            | 34  | 17  |  |  |
| Auto loans                                       | 83  |   | 5  |  |
| Other  |   |   |  |  |
| Total  | 2,995                                     | 5,338                                     | 50                                       | 79                                       |
| <b>Total:</b>                                    |   |   |  |  |
| Real estate loans                                |   |   |  |  |
| Residential                                      | 12,869                                    | 12,981                                    | 267                                      | 321                                      |
| Construction                                     |   |   |  |  |
| Commercial                                       | 21,072                                    | 22,137                                    | 606                                      | 553                                      |
| Commercial                                       | 550                                       | 1,764                                     | 6  | 49                                       |
| Obligations of states and political subdivisions |   |   |  |  |
| Home equity loans and lines of credit            | 341                                       | 302                                       | 4  | 4  |
| Auto loans                                       | 157                                       |   | 6  |  |
| Other  |   |   |  |  |
| Total Impaired Loans                             | \$ 34,989                                 | \$ 37,184                                 | \$ 889                                   | \$ 927                                   |

The Company 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 fundamentally sound yet, exhibit potentially unacceptable credit risk or deteriorating trends or characteristics which if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Company's credit position at some future date. 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. Loans in the Doubtful category have all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Loans in the Loss category are considered uncollectible and of little value that their continuance as bankable assets is not warranted. Certain residential real estate loans, construction loans, home equity loans and lines of credit, auto loans and other consumer 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.

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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 \$500,000 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 \$1,000,000 and/or all criticized relationships. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

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, 2015 and September 30, 2014 (in thousands):

| <b>June 30, 2015</b>                             | <b>Pass</b>       | <b>Special<br/>Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Total</b>      |
|--|-------------------|----------------------------|--------------------|-----------------|-------------------|
| Commercial real estate loans                     | \$ 169,502        | \$ 3,382                   | \$ 22,619          | \$              | \$ 195,503        |
| Commercial                                       | 32,325            | 2,295                      | 415                |                 | 35,035            |
| Obligations of states and political subdivisions | 56,868            |                            |                    |                 | 56,868            |
| <b>Total</b>                                     | <b>\$ 258,695</b> | <b>\$ 5,677</b>            | <b>\$ 23,034</b>   | <b>\$</b>       | <b>\$ 287,406</b> |

| <b>September 30, 2014</b>                        | <b>Pass</b>       | <b>Special<br/>Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Total</b>      |
|--|-------------------|----------------------------|--------------------|-----------------|-------------------|
| Commercial real estate loans                     | \$ 160,749        | \$ 8,020                   | \$ 21,469          | \$ 298          | \$ 190,536        |
| Commercial                                       | 24,874            | 345                        | 588                |                 | 25,807            |
| Obligations of states and political subdivisions | 49,177            |                            |                    |                 | 49,177            |
| <b>Total</b>                                     | <b>\$ 234,800</b> | <b>\$ 8,365</b>            | <b>\$ 22,057</b>   | <b>\$ 298</b>   | <b>\$ 265,520</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, 2015 and September 30, 2014 (in thousands):

|                      | <b>Performing</b> | <b>Non-performing</b> | <b>Total</b> |
|----------------------|-------------------|-----------------------|--------------|
| <b>June 30, 2015</b> |                   |                       |              |
| Real estate loans:   |                   |                       |              |

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|                                       |            |           |            |
|---------------------------------------|------------|-----------|------------|
| Residential                           | \$ 608,002 | \$ 10,196 | \$ 618,198 |
| Construction                          | 1,151      |           | 1,151      |
| Home equity loans and lines of credit | 40,281     | 694       | 40,975     |
| Auto loans                            | 150,263    | 107       | 150,370    |
| Other                                 | 3,156      | 38        | 3,194      |
| Total                                 | \$ 802,853 | \$ 11,035 | \$ 813,888 |

|                                       | Performing | Non-performing | Total      |
|---------------------------------------|------------|----------------|------------|
| <b>September 30, 2014</b>             |            |                |            |
| Real estate loans:                    |            |                |            |
| Residential                           | \$ 644,374 | \$ 9,778       | \$ 654,152 |
| Construction                          | 1,367      |                | 1,367      |
| Home equity loans and lines of credit | 41,128     | 259            | 41,387     |
| Auto loans                            | 100,571    |                | 100,571    |
| Other                                 | 3,884      | 20             | 3,904      |
| Total                                 | \$ 791,324 | \$ 10,057      | \$ 801,381 |

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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, 2015 and September 30, 2014 (in thousands):

|   |                     |                           |                           | Greater than<br>90 Days Past<br>Due<br>and<br>still<br>accruing | Non-Accrual      | Total Past<br>Due and<br>Non-<br>Accrual | Total<br>Loans      |
|---|---------------------|---------------------------|---------------------------|---|------------------|--|---------------------|
|   | Current             | 31-60 Days<br>Past<br>Due | 61-90 Days<br>Past<br>Due |   |                  |  |                     |
| <b>June 30, 2015</b>                                |                     |                           |                           |   |                  |  |                     |
| Real estate loans                                   |                     |                           |                           |   |                  |  |                     |
| Residential   | \$ 604,655          | \$ 1,930                  | \$ 1,417                  | \$  | \$ 10,196        | \$ 13,543                                | \$ 618,198          |
| Construction  | 1,151               |                           |                           |   |                  |  | 1,151               |
| Commercial  | 185,696             | 300                       |                           |   | 9,507            | 9,807                                    | 195,503             |
| Commercial  | 34,496              | 370                       | 11                        |   | 158              | 539                                      | 35,035              |
| Obligations of states and<br>political subdivisions | 56,868              |                           |                           |   |                  |  | 56,868              |
| Home equity loans and<br>lines of credit            | 40,148              | 63                        | 70                        |   | 694              | 827                                      | 40,975              |
| Auto loans  | 148,588             | 1,549                     | 126                       |   | 107              | 1,782                                    | 150,370             |
| Other   | 3,147               |                           | 9                         |   | 38               | 47                                       | 3,194               |
| <b>Total</b>  | <b>\$ 1,074,749</b> | <b>\$ 4,212</b>           | <b>\$ 1,633</b>           | <b>\$</b>   | <b>\$ 20,700</b> | <b>\$ 26,545</b>                         | <b>\$ 1,101,294</b> |

|   |            |                           |                           | Greater than<br>90 Days Past<br>Due<br>and<br>still<br>accruing | Non-Accrual | Total Past<br>Due and<br>Non-<br>Accrual | Total<br>Loans |
|---|------------|---------------------------|---------------------------|---|-------------|--|----------------|
|   | Current    | 31-60 Days<br>Past<br>Due | 61-90 Days<br>Past<br>Due |   |             |  |                |
| <b>September 30, 2014</b>                           |            |                           |                           |   |             |  |                |
| Real estate loans                                   |            |                           |                           |   |             |  |                |
| Residential   | \$ 640,583 | \$ 2,398                  | \$ 1,393                  | \$  | \$ 9,778    | \$ 13,569                                | \$ 654,152     |
| Construction  | 1,367      |                           |                           |   |             |  | 1,367          |
| Commercial  | 179,319    | 516                       | 89                        |   | 10,612      | 11,217                                   | 190,536        |
| Commercial  | 24,424     | 110                       | 30                        |   | 1,243       | 1,383                                    | 25,807         |
| Obligations of states and<br>political subdivisions | 49,159     | 18                        |                           |   |             | 18                                       | 49,177         |
| Home equity loans and<br>lines of credit            | 40,870     | 225                       | 33                        |   | 259         | 517                                      | 41,387         |
| Auto loans  | 100,112    | 426                       | 33                        |   |             | 459                                      | 100,571        |
| Other   | 3,884      |                           |                           |   | 20          | 20                                       | 3,904          |

|       |              |          |          |    |           |           |              |
|-------|--------------|----------|----------|----|-----------|-----------|--------------|
| Total | \$ 1,039,718 | \$ 3,693 | \$ 1,578 | \$ | \$ 21,912 | \$ 27,183 | \$ 1,066,901 |
|-------|--------------|----------|----------|----|-----------|-----------|--------------|

Our allowance for loan losses is maintained at a level necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. Our allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an allocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management's judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary, based on changing economic conditions. Payments received on impaired loans generally are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. The allowance for loan losses as of June 30, 2015 is maintained at a level that represents management's best estimate of losses inherent in the loan portfolio, and such losses were both probable and reasonably estimable.

In addition, the FDIC and the Pennsylvania Department of Banking and Securities, 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.

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

The following tables summarize changes in the primary segments of the ALL for the three and nine month periods ending June 30, 2015 and 2014 (in thousands):

|                                  | Real Estate Loans |              |            | Home<br>Obligations of<br>States and<br>Political Lines<br>of Credit |              |        | Auto Loans |       | Other Loans |  | Unallocated | Total    |
|----------------------------------|-------------------|--------------|------------|--|--------------|--------|------------|-------|-------------|--|-------------|----------|
|                                  | Residential       | Construction | Commercial | Commercial   | Subdivisions | Credit | Auto       | Loans | Loans       |  |             |          |
| ALL balance at<br>March 31, 2015 | \$ 5,289          | \$ 17        | \$ 843     | \$ 635   | \$ 87        | \$ 468 | \$ 1,023   | \$ 30 | \$ 276      |  |             | \$ 8,668 |
| Charge-offs                      | (390)             |              |            | (3)  |              | (3)    | (136)      | (5)   |             |  |             | (537)    |
| Recoveries                       |                   |              | 54         | 11   |              |        | 40         | 6     |             |  |             | 111      |
| Provision                        | 359               | (8)          | (189)      | (2)  | 112          | 10     | 406        | (3)   | (160)       |  |             | 525      |
| ALL balance at<br>June 30, 2015  | \$ 5,258          | \$ 9         | \$ 708     | \$ 641   | \$ 199       | \$ 475 | \$ 1,333   | \$ 28 | \$ 116      |  |             | \$ 8,767 |
| March 31, 2014                   | \$ 5,920          | \$ 26        | \$ 1,003   | \$ 369   | \$ 106       | \$ 500 |            | \$ 26 | \$ 712      |  |             | \$ 8,662 |
| Charge-offs                      | (332)             |              | (23)       |  |              | (10)   |            |       |             |  |             | (365)    |
| Recoveries                       | 34                |              |            | 2  |              |        |            | 3     |             |  |             | 39       |
| Provision                        | 312               | (2)          | (399)      | 222  | 10           | (17)   | 56         | (3)   | 321         |  |             | 500      |
| ALL balance at<br>June 30, 2014  | \$ 5,934          | \$ 24        | \$ 581     | \$ 593   | \$ 116       | \$ 473 | \$ 56      | \$ 26 | \$ 1,033    |  |             | \$ 8,836 |

|                                      | Real Estate Loans |              |            | Home<br>Obligations of<br>States and<br>Political Lines<br>of Credit |              |        | Auto Loans |       | Other Loans |  | Unallocated | Total    |
|--------------------------------------|-------------------|--------------|------------|--|--------------|--------|------------|-------|-------------|--|-------------|----------|
|                                      | Residential       | Construction | Commercial | Commercial   | Subdivisions | Credit | Auto       | Loans | Loans       |  |             |          |
| ALL balance at<br>September 30, 2014 | \$ 5,573          | \$ 11        | \$ 663     | \$ 528   | \$ 163       | \$ 470 | \$ 459     | \$ 32 | \$ 735      |  |             | \$ 8,634 |
| Charge-offs                          | (1,150)           |              | (53)       | (30)   |              | (22)   | (301)      | (5)   |             |  |             | (1,561)  |
| Recoveries                           | 22                |              | 85         | 20   |              | 12     | 49         | 6     |             |  |             | 194      |
| Provision                            | 813               | (2)          | 13         | 123  | 36           | 15     | 1,126      | (5)   | (619)       |  |             | 1,500    |



|                                 |          |       |        |        |        |        |          |       |          |          |
|---------------------------------|----------|-------|--------|--------|--------|--------|----------|-------|----------|----------|
| ALL balance at<br>June 30, 2015 | \$ 5,258 | \$ 9  | \$ 708 | \$ 641 | \$ 199 | \$ 475 | \$ 1,333 | \$ 28 | \$ 116   | \$ 8,767 |
| September 30, 2013              | \$ 5,787 | \$ 20 | \$ 946 | \$ 337 | \$ 130 | \$ 430 | \$       | \$ 21 | \$ 393   | \$ 8,064 |
| Charge-offs                     | (1,255)  |       | (73)   | (48)   |        | (73)   |          |       |          | (1,449)  |
| Recoveries                      | 112      |       | 83     | 14     |        |        |          | 12    |          | 221      |
| Provision                       | 1,290    | 4     | (375)  | 290    | (14)   | 116    | 56       | (7)   | 640      | 2,000    |
| ALL balance at<br>June 30, 2014 | \$ 5,934 | \$ 24 | \$ 581 | \$ 593 | \$ 116 | \$ 473 | \$ 56    | \$ 26 | \$ 1,033 | \$ 8,836 |

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

The following table summarizes the primary segments of the ALL, segregated into amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of June 30, 2015 and September 30, 2014 (in thousands):

|                                       | Real Estate Loans |              |            | Home<br>Obligations of<br>States, Loans and<br>and Lines<br>of<br>Commercial, Political<br>Subdivisions, Credit<br>Auto Loans, Other<br>Loans |              |        | Unallocated |       |        | Total    |
|---------------------------------------|-------------------|--------------|------------|---|--------------|--------|-------------|-------|--------|----------|
|                                       | Residential       | Construction | Commercial | Loans   | Subdivisions | Credit | Auto        | Loans | Other  |          |
| Individually evaluated for impairment | \$ 432            | \$           | \$ 1       | \$  | \$           | \$ 69  | \$ 76       | \$    | \$     | \$ 578   |
| Collectively evaluated for impairment | 4,826             | 9            | 707        | 641   | 199          | 406    | 1,257       | 28    | 116    | 8,189    |
| ALL Balance at June 30, 2015          | \$ 5,258          | \$ 9         | \$ 708     | \$ 641  | \$ 199       | \$ 475 | \$ 1,333    | \$ 28 | \$ 116 | \$ 8,767 |
| Individually evaluated for impairment | \$ 334            | \$           | \$ 84      | \$  | \$           | \$ 50  | \$          | \$    | \$     | \$ 468   |
| Collectively evaluated for impairment | 5,239             | 11           | 579        | 528   | 163          | 420    | 459         | 32    | 735    | 8,166    |
| ALL balance at September 30, 2014     | \$ 5,573          | \$ 11        | \$ 663     | \$ 528  | \$ 163       | \$ 470 | \$ 459      | \$ 32 | \$ 735 | \$ 8,634 |

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 decreased provisions to residential real estate for the nine month period ending June 30, 2015 due to declining loan balances and impairment evaluations in those segments. The Company allocated increased provisions to commercial real estate, commercial loans and obligations of states and political subdivisions for the nine month period ending June 30, 2015 due primarily to increased loan balances. The Company allocated increased provisions in auto loans due to increased loan balances and increased charge off activity. Despite the above allocations, the allowance for loan losses is general in nature and is available to absorb losses from any loan segment.

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The following is a summary of troubled debt restructuring granted during the three and nine months ended June 30, 2015 and 2014 (dollars in thousands).

| For the Three Months Ended June 30, 2015         |           |                  |                   |
|--|-----------|------------------|-------------------|
| Dollars in thousands                             |           |                  |                   |
|  |           | Pre-Modification | Post-Modification |
|  |           | Outstanding      | Outstanding       |
|  | Number of | Recorded         | Recorded          |
|  | Contracts | Investment       | Investment        |
| <b>Troubled Debt Restructurings</b>              |           |                  |                   |
| Real estate loans:                               |           |                  |                   |
| Residential                                      | 3         | \$ 695           | \$ 695            |
| Construction                                     |           |                  |                   |
| Commercial                                       |           |                  |                   |
| Commercial                                       |           |                  |                   |
| Obligations of states and political subdivisions |           |                  |                   |
| Home equity loans and lines of credit            | 1         | 25               | 25                |
| Auto loans                                       |           |                  |                   |
| Other  |           |                  |                   |
| <b>Total</b>                                     | <b>4</b>  | <b>\$ 720</b>    | <b>\$ 720</b>     |

All four new troubled debt restructurings, granted for the three months ended June 30, 2015, were granted terms and rate concessions.

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

|       |   |    |     |    |     |
|-------|---|----|-----|----|-----|
| Total | 2 | \$ | 236 | \$ | 236 |
|-------|---|----|-----|----|-----|

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

**For the Nine Months Ended June 30,  
2015**

**Dollars in thousands**

|  |                                |    | <b>Pre-Modification<br/>Outstanding<br/>Recorded<br/>Investment</b> | <b>Post-Modification<br/>Outstanding<br/>Recorded<br/>Investment</b> |
|--|--------------------------------|----|---|--|
|  | <b>Number of<br/>Contracts</b> |    |   |  |
| <u>Troubled Debt Restructurings</u>              |                                |    |   |  |
| Real estate loans:                               |                                |    |   |  |
| Residential                                      | 12                             | \$ | 2,115   | \$ 2,115   |
| Construction                                     |                                |    |   |  |
| Commercial                                       |                                |    |   |  |
| Commercial                                       |                                |    |   |  |
| Obligations of states and political subdivisions |                                |    |   |  |
| Home equity loans and lines of credit            | 2                              |    | 175   | 175  |
| Auto loans                                       |                                |    |   |  |
| Other  |                                |    |   |  |
| Total  | 14                             | \$ | 2,290   | \$ 2,290   |

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Of the fourteen new troubled debt restructurings granted for the nine months ended June 30, 2015, ten loans totaling \$1.6 million were granted terms and rate concessions and four loans totaling \$607,000 were granted terms concessions.

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

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

For the three months ended June 30, 2015, one residential real estate loan totaling \$68,000 defaulted on a restructuring agreement within one year of modification. For the nine months ended June 30, 2015, five residential real estate loans totaling \$712,000 defaulted on a restructuring agreement within one year of modification. There were no troubled debt restructurings that have subsequently defaulted within one year of modification for the three and nine months ended June 30, 2014.

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

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

|                                      | <b>June 30,<br/>2015</b> | <b>September 30,<br/>2014</b> |
|--------------------------------------|--------------------------|-------------------------------|
| Non-interest bearing demand accounts | \$ 103,419               | \$ 70,048                     |
| Interest bearing demand accounts     | 98,498                   | 163,936                       |
| Money market accounts                | 155,140                  | 170,158                       |
| Savings and club accounts            | 131,295                  | 122,734                       |
| Certificates of deposit              | 587,201                  | 607,013                       |
| <br>Total                            | <br>\$ 1,075,553         | <br>\$ 1,133,889              |

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

For a detailed disclosure on the Bank's pension and employee benefits plans, please refer to Note 13 of the Company's Consolidated Financial Statements for the year ended September 30, 2014 included in the Company's Form 10-K.

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

|                                   | <b>Three Months Ended<br/>June 30,</b> |             | <b>Nine Months Ended<br/>June 30,</b> |             |
|-----------------------------------|--|-------------|---------------------------------------|-------------|
|                                   | <b>2015</b>                            | <b>2014</b> | <b>2015</b>                           | <b>2014</b> |
| Service Cost                      | \$ 219                                 | \$ 144      | \$ 655                                | \$ 433      |
| Interest Cost                     | 207                                    | 191         | 619                                   | 572         |
| Expected return on plan assets    | (309)                                  | (290)       | (925)                                 | (871)       |
| Amortization of unrecognized loss | 61                                     | 7           | 181                                   | 21          |
| <br>Net periodic benefit cost     | <br>\$ 178                             | <br>\$ 52   | <br>\$ 530                            | <br>\$ 155  |

The Bank contributed \$500,000 to its pension plan in April 2015.

**10. Equity Incentive Plan**

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

Certain officers, employees and outside directors were granted in aggregate 1,140,469 NSOs; 317,910 ISOs; and 590,320 shares of restricted stock on May 23, 2008. Certain officers were granted in aggregate 30,000 shares of restricted stock on April 1, 2013, 19,880 of restricted stock on July 22, 2014 and 21,843 shares of restricted stock on May 20, 2015. In accordance with generally accepted accounting principles, the Company expenses the fair value of all share-based compensation grants over the requisite service periods.

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

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

The 2013 restricted stock shares vested over an 18-month service period. The 2014 restricted shares vest over a 39 month service period. The 2015 restricted shares vest over a 40 month service period. The product of the number of shares granted and the grant date market price of the Company's common stock determines the fair value of restricted shares under the Company's restricted stock plan. The Company recognizes compensation expense for the fair value of restricted shares on a straight-line basis over the requisite service period for the entire award.

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For the nine months ended June 30, 2015 and 2014, the Company recorded \$171,000 and \$170,000 of share-based compensation expense, respectively, comprised of restricted stock expense. Expected future compensation expense relating to the 14,906 (2014 shares) restricted shares, at June 30, 2015 is \$152,000 over the remaining vesting period of 2.25 years. Expected future compensation expense relating to the 21,843 restricted shares (2015 shares) at June 30, 2015 is \$271,000 over the remaining vesting period of 3.25 years.

The following is a summary of the Company's stock option activity and related information for its option grants for the nine month period ended June 30, 2015.

|                                 | <b>Number of Stock<br/>Options</b> | <b>Weighted-<br/>average<br/>Exercise<br/>Price</b> | <b>Weighted-<br/>average<br/>Remaining<br/>Contractual<br/>Term (in years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(in thousands)</b> |
|---------------------------------|------------------------------------|---|--|---|
| Outstanding, September 30, 2014 | 1,443,379                          | \$ 12.35  | 3.67   | \$  |
| Granted                         |                                    |   |  |   |
| Exercised                       |                                    |   |  |   |
| Forfeited                       | (123,799)                          | 12.35   | 2.92   |   |
| Outstanding, June 30, 2015      | 1,319,580                          | \$ 12.35  | 2.92   | \$ 673,000  |
| Exercisable at June 30, 2015    | 1,319,580                          | \$ 12.35  | 2.92   | \$ 673,000  |

The following is a summary of the status of the Company's restricted stock as of June 30, 2015, and changes therein during the nine month period then ended:

|                                 | <b>Number of<br/>Restricted Stock</b> | <b>Weighted-<br/>average<br/>Grant Date<br/>Fair Value</b> |
|---------------------------------|---------------------------------------|--|
| Nonvested at September 30, 2014 | 14,906                                | \$ 11.07   |
| Granted                         | 21,843                                | 13.05  |
| Vested                          |                                       |  |
| Forfeited                       |                                       |  |
| Nonvested at June 30, 2015      | 36,749                                | \$ 12.25   |

**11. Fair Value Measurement**

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



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

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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, 2015 and September 30, 2014 and indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value:

| <b>Fair Value Measurement at<br/>June 30, 2015</b>                                     |   |   |   |                                      |
|--|---|---|---|--------------------------------------|
| Fair Value Measurements Utilized for the<br>Company's Financial Assets (in thousands): | Quoted Prices in Active<br>Markets for Identical Assets |   |   | Balances as of<br>June 30, 2015      |
|  | (Level 1)   | Significant<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |                                      |
| Securities available-for-sale measured on a recurring basis                            |   |   |   |                                      |
| Mortgage backed securities   | \$  | \$ 246,499                                    | \$  | \$ 246,499                           |
| Obligations of states and political subdivisions                                       |   | 49,804  |   | 49,804                               |
| U.S. government agencies   |   | 44,512  |   | 44,512                               |
| Corporate obligations  |   | 19,399  | 2,000   | 21,399                               |
| Trust-preferred securities   |   | 1,741   | 1,730   | 3,471                                |
| Other debt securities  |   | 15,165  | 500   | 15,665                               |
| Equity securities-financial services   | 25  |   |   | 25                                   |
| Total debt and equity securities   | \$ 25   | \$ 377,120                                    | \$ 4,230  | \$ 381,375                           |
| Foreclosed real estate owned measured on a non-recurring basis                         | \$  | \$  | \$ 2,595  | \$ 2,595                             |
| Impaired loans measured on a non-recurring basis                                       | \$  | \$  | \$ 33,325                                       | \$ 33,325                            |
| <b>Fair Value Measurement at<br/>September 30, 2014</b>                                |   |   |   |                                      |
| Fair Value Measurements Utilized for the<br>Company's Financial Assets (in thousands): | Quoted Prices in Active<br>Markets for Identical Assets |   |   | Balances as of<br>September 30, 2014 |
|  | (Level 1)   | Significant<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |                                      |
| Securities available-for-sale measured on a recurring basis                            |   |   |   |                                      |
| Mortgage backed securities   | \$  | \$ 265,052                                    | \$  | \$ 265,052                           |
| Obligations of states and political subdivisions                                       |   | 42,771  |   | 42,771                               |
| U.S. government agencies   |   | 47,630  |   | 47,630                               |
| Corporate obligations  |   | 13,328  |   | 13,328                               |
| Trust-preferred securities   |   | 3,891   | 1,730   | 5,621                                |
| Other debt securities  |   | 6,151   | 500   | 6,651                                |
| Equity securities-financial services   | 2,025   |   |   | 2,025                                |
| Total debt and equity securities   | \$ 2,025  | \$ 378,823                                    | \$ 2,230  | \$ 383,078                           |
| Foreclosed real estate owned measured on a non-recurring basis                         | \$  | \$  | \$ 2,759  | \$ 2,759                             |
| Impaired loans measured on a non-recurring basis                                       | \$  | \$  | \$ 36,497                                       | \$ 36,497                            |



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The following table presents a summary of changes in the fair value of the Company's Level III investments for the three and nine month periods ended June 30, 2015 and June 30, 2014 (in thousands).

| Fair Value Measurement Using Significant Unobservable Inputs<br>(Level III) |                    |               |
|---|--------------------|---------------|
|   | Three months ended |               |
|   | June 30, 2015      | June 30, 2014 |
| Beginning balance   | \$ 4,240           | \$ 1,830      |
| Purchases, sales, issuances, settlements, net                               |                    |               |
| Total unrealized gain:  |                    |               |
| Included in earnings  |                    |               |
| Included in other comprehensive income                                      | (10)               |               |
| Transfers in and/or out of Level III  |                    |               |
|   | \$ 4,230           | \$ 1,830      |

| Fair Value Measurement Using Significant Unobservable Inputs<br>(Level III) |                   |               |
|---|-------------------|---------------|
|   | Nine months ended |               |
|   | June 30, 2015     | June 30, 2014 |
| Beginning balance   | \$ 2,230          | \$ 1,800      |
| Purchases, sales, issuances, settlements, net                               | 2,000             |               |
| Total unrealized gain:  |                   |               |
| Included in earnings  |                   |               |
| Included in other comprehensive income                                      |                   | 30            |
| Transfers in and/or out of Level III  |                   |               |
|   | \$ 4,230          | \$ 1,830      |

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

The measurement of fair value should be consistent with one of the following valuation techniques: market approach, income approach, and/or cost approach. The market approach uses prices and other relevant information generated by

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

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measurements consider observable data that may include dealer quoted market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Securities reported at fair value utilizing Level 1 inputs are limited to actively traded equity securities whose market price is readily available from the New York Stock Exchange or the NASDAQ exchange. A few securities are valued using Level 3 inputs. 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, 2015, 246 impaired loans with a carrying value of \$33.9 million were reduced by specific valuation allowance totaling \$578,000 resulting in a net fair value of \$33.3 million based on Level 3 inputs. At September 30, 2014, 264 impaired loans with a carrying value of \$37.0 million were reduced by a specific valuation totaling \$468,000 resulting in a net fair value of \$36.5 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:

| <b>Quantitative Information about Level 3 Fair Value Measurements</b> |                            |                                  |                           |                    |
|---|----------------------------|----------------------------------|---------------------------|--------------------|
| <i>(in thousands)</i>   | <b>Fair Value Estimate</b> | <b>Valuation Techniques</b>      | <b>Unobservable Input</b> | <b>Range</b>       |
| <b><u>June 30, 2015 :</u></b>   |                            |                                  |                           |                    |
| Impaired loans  | \$ 33,325                  | Appraisal of collateral (1)      | Appraisal adjustments (2) | 0% to 50% (22.7%)  |
| Foreclosed real estate owned  | 2,595                      | Appraisal of collateral (1), (3) | Appraisal adjustments (2) | 19% to 30% (21.1%) |

| <b>Quantitative Information about Level 3 Fair Value Measurements</b> |                            |                                  |                           |                    |
|---|----------------------------|----------------------------------|---------------------------|--------------------|
| <i>(in thousands)</i>   | <b>Fair Value Estimate</b> | <b>Valuation Techniques</b>      | <b>Unobservable Input</b> | <b>Range</b>       |
| <b><u>September 30, 2014 :</u></b>                                    |                            |                                  |                           |                    |
| Impaired loans  | \$ 36,497                  | Appraisal of collateral (1)      | Appraisal adjustments (2) | 0% to 35% (23.0%)  |
| Foreclosed real estate owned  | 2,759                      | Appraisal of collateral (1), (3) | Appraisal adjustments (2) | 19% to 35% (21.2%) |

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

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



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

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

| June 30, 2015  |                |            |          |            |                  |
|--|----------------|------------|----------|------------|------------------|
|  | Carrying Value | Level I    | Level II | Level III  | Total Fair Value |
| Financial assets:  |                |            |          |            |                  |
| Cash and cash equivalents                                    | \$ 17,692      | \$ 17,692  | \$       | \$         | \$ 17,692        |
| Investment and mortgage backed securities available for sale | 381,375        | 25         | 377,120  | 4,230      | 381,375          |
| Loans receivable, net  | 1,092,527      |            |          | 1,109,147  | 1,109,147        |
| Accrued interest receivable                                  | 5,115          | 5,115      |          |            | 5,115            |
| Regulatory stock   | 14,537         | 14,537     |          |            | 14,537           |
| Mortgage servicing rights                                    | 478            |            |          | 478        | 478              |
| Bank owned life insurance                                    | 30,421         | 30,421     |          |            | 30,421           |
| Financial liabilities:                                       |                |            |          |            |                  |
| Deposits   | \$ 1,075,553   | \$ 488,352 | \$       | \$ 590,123 | \$ 1,078,475     |
| Short-term borrowings  | 120,856        | 120,856    |          |            | 120,856          |
| Other borrowings   | 208,805        |            |          | 209,841    | 209,841          |
| Advances by borrowers for taxes and insurance                | 11,617         | 11,617     |          |            | 11,617           |
| Accrued interest payable                                     | 930            | 930        |          |            | 930              |

| September 30, 2014   |                |            |          |            |                  |
|--|----------------|------------|----------|------------|------------------|
|  | Carrying Value | Level I    | Level II | Level III  | Total Fair Value |
| Financial assets:  |                |            |          |            |                  |
| Cash and cash equivalents                                    | \$ 22,301      | \$ 22,301  | \$       | \$         | \$ 22,301        |
| Investment and mortgage backed securities available for sale | 383,078        | 2,025      | 378,823  | 2,230      | 383,078          |
| Loans receivable, net  | 1,058,267      |            |          | 1,077,585  | 1,077,585        |
| Accrued interest receivable                                  | 5,061          | 5,061      |          |            | 5,061            |
| Regulatory stock   | 14,284         | 14,284     |          |            | 14,284           |
| Mortgage servicing rights                                    | 688            |            |          | 688        | 688              |
| Bank owned life insurance                                    | 29,720         | 29,720     |          |            | 29,720           |
| Financial liabilities:                                       |                |            |          |            |                  |
| Deposits   | \$ 1,133,889   | \$ 526,876 | \$       | \$ 608,936 | 1,135,812        |
| Short-term borrowings  | 108,020        | 108,020    |          |            | 108,020          |
| Other borrowings   | 151,300        |            |          | 151,617    | 151,617          |
| Advances by borrowers for taxes and insurance                | 4,093          | 4,093      |          |            | 4,093            |
| Accrued interest payable                                     | 831            | 831        |          |            | 831              |





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

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

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

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

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

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

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

The fair value approximates the current book value.

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

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

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

The fair value of investment and mortgage-backed securities available for sale is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Since the FHLB stock is not actively traded on a secondary market and held exclusively by member financial institutions, the fair market value approximates the carrying amount. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) are used to support fair values of certain Level 3 investments, if applicable.

### **Loans Receivable**

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

### **Mortgage Servicing Rights**

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

### **Deposits**

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

**Table of Contents****Other Borrowings**

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

**Commitments to Extend Credit**

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

**12. Accumulated Other Comprehensive Income/(Loss)**

The activity in accumulated other comprehensive income/(loss) for the three and nine months ended June 30, 2015 and 2014 is as follows (in thousands):

|  | <b>Accumulated Other<br/>Comprehensive Income/(Loss)<br/>Unrealized Gains<br/>Defined Benefit (Losses) on Securities</b> |                               |              |
|--|--|-------------------------------|--------------|
|  | <b>Pension<br/>Plan</b>  | <b>Available for<br/>Sale</b> | <b>Total</b> |
| Balance at March 31, 2015  | \$ (3,148)   | \$ 3,889                      | \$ 741       |
| Other comprehensive income before reclassifications                        |  | (2,308)                       | (2,308)      |
| Amounts reclassified from accumulated other comprehensive loss, net of tax | 39   | (128)                         | (89)         |
| Period change  | 39   | (2,436)                       | (2,397)      |
| Balance at June 30, 2015   | \$ (3,109)   | \$ 1,453                      | \$ (1,656)   |
| Balance at March 31, 2014  | \$ (1,297)   | \$ (549)                      | \$ (1,846)   |
| Other comprehensive loss before reclassifications                          |  | 2,165                         | 2,165        |
| Amounts reclassified from accumulated other comprehensive loss, net of tax | 5  | 7                             | 12           |
| Period change  | 5  | 2,172                         | 2,177        |
| Balance at June 30, 2014   | \$ (1,292)   | \$ 1,623                      | \$ 331       |

|   | Accumulated Other<br>Comprehensive Income/(Loss)<br>Unrealized Gains<br>Defined Benefit(Losses) on Securities |                       |            |
|---|---|-----------------------|------------|
|   | Pension<br>Plan   | Available for<br>Sale | Total      |
| Balance at September 30, 2014                                     | \$ (3,228)  | \$ 649                | \$ (2,579) |
| Other comprehensive loss before<br>reclassifications              |   | 1,067                 | 1,067      |
| Amounts reclassified from accumulated<br>other comprehensive loss | 119   | (263)                 | (144)      |
| Period change   | 119   | 804                   | 923        |
| Balance at June 30, 2015  | \$ (3,109)  | \$ 1,453              | \$ (1,656) |
| Balance at September 30, 2013                                     | \$ (1,306)  | \$ 71                 | \$ (1,235) |
| Other comprehensive loss before<br>reclassifications              |   | 1,701                 | 1,701      |
| Amounts reclassified from accumulated<br>other comprehensive loss | 14  | (149)                 | (135)      |
| Period change   | 14  | 1,552                 | 1,566      |
| Balance at June 30, 2014  | \$ (1,292)  | \$ 1,623              | \$ 331     |

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|   | Amount Reclassified from<br>Accumulated Other Comprehensive Income<br>Accumulated<br>Other<br>Comprehensive Income for<br>the Three<br>Months<br>Ended<br>June 30,<br>2015    2014 |         | Affected<br>Line Item in the Consolidated<br>Statement of Income |
|---|--|---------|--|
| <b>Securities available for sale:</b>                             |  |         |  |
| Net securities gains reclassified into earnings                   | \$ 194   | \$ (10) | Gain on sale of investments, net                                 |
| Related income tax expense  | (66)   | (3)     | Income taxes   |
| Net effect on accumulated other comprehensive loss for the period | 128  | (7)     | Net of tax   |
| <b>Defined benefit pension plan:</b>                              |  |         |  |
| Amortization of net loss and prior service costs                  | (61)   | (7)     | Compensation and employee benefits                               |
| Related income tax expense  | 22   | 2       | Income taxes   |
| Net effect on accumulated other comprehensive loss for the period | \$ (39)  | \$ (5)  | Net of tax   |
| Total reclassification for the period                             | \$ 89  | \$ (12) | Net of tax   |

|   | Amount Reclassified from<br>Accumulated Other Comprehensive Income<br>Accumulated<br>Other<br>Comprehensive Income for<br>the Nine<br>Months<br>Ended<br>June 30,<br>2015    2014 |        |                                  | Affected<br>Line Item in the Consolidated<br>Statement of Income |
|---|---|--------|----------------------------------|--|
| Securities available for sale:                                    |   |        |                                  |  |
| Net securities gains reclassified into earnings                   | \$ 398  | \$ 226 | Gain on sale of investments, net |  |
| Related income tax expense  | (135)   | (77)   | Income taxes                     |  |
| Net effect on accumulated other comprehensive loss for the period | 263   | 149    | Net of tax                       |  |
| Defined benefit pension plan:                                     |   |        |                                  |  |

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|   |          |         |                                    |
|---|----------|---------|------------------------------------|
| Amortization of net loss and prior service costs                  | (181)    | (21)    | Compensation and employee benefits |
| Related income tax expense  | 62       | 7       | Income taxes                       |
| Net effect on accumulated other comprehensive loss for the period | \$ (119) | \$ (14) | Net of tax                         |
| Total reclassification for the period                             | \$ 144   | \$ 135  | Net of tax                         |

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**13. Subsequent Events.**

On July 29, 2015, the Company announced that it and Eagle National Bancorp, Inc. ( ENB ) had executed a definitive agreement whereby the Company will acquire ENB and its wholly owned subsidiary, Eagle National Bank through an all-cash deal. Under the terms of the merger agreement, stockholders of ENB will receive \$5.80 per share or an aggregate of approximately \$24.7 million. Pending the satisfaction of customary closing conditions, including the receipt of all regulatory approvals and the approval of ENB stockholders, the transaction is expected to close in the fourth calendar quarter of 2015.

**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.

#### **Comparison of Financial Condition at June 30, 2015 and September 30, 2014**

**Total Assets.** Total assets increased by \$24.0 million, or 1.5%, to \$1.60 billion at June 30, 2015 from \$1.57 billion at September 30, 2014. An increase in loans receivable of \$34.3 million, which was partially offset by decreases in cash and due from banks of \$4.9 million, deferred income taxes of \$1.0 million, investment securities available for sale of \$1.7 million, and other assets of \$2.9 million was the primary reason for the increase.

**Total Cash and Cash Equivalents.** Total cash and cash equivalents decreased \$4.6 million, or 20.7%, to \$17.7 million at June 30, 2015 from \$22.3 million at September 30, 2014. Decreases in cash and due from banks of \$4.9 million were partially offset by an increase in interest bearing deposits with other institutions of \$258,000. The decrease in cash and due from banks was due to normal fluctuations in cash held at the Federal Reserve Bank.

**Net Loans.** Net loans increased \$34.3 million, or 3.2%, to \$1.09 billion at June 30, 2015 from \$1.06 billion at September 30, 2014. During this period, commercial real estate loans increased \$5.0 million to \$195.5 million, commercial loans increased \$9.2 million to \$35.0 million, obligations of states and political subdivisions increased \$7.7 million to \$56.9 million and auto loans increased \$49.8 million to \$150.4 million. These increases were partially offset by decreases in residential loans of \$36.0 million to \$618.2 million, construction loans of \$216,000 to \$1.2 million, home equity loans and lines of credit of \$412,000 to \$41.0 million and other loans of \$710,000 to \$3.2 million.

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***Investment Securities Available for Sale.*** Investment securities available for sale decreased \$1.7 million, or 0.4%, to \$381.4 million at June 30, 2015 from \$383.1 million at September 30, 2014. The decrease was due primarily to decreases in mortgage backed securities of \$18.6 million, U.S. government agency securities of \$3.1 million, trust preferred securities of \$2.2 million and equity securities of \$2.0 million, offset in part by increases in obligations of states and political subdivisions of \$7.0 million, corporate obligations of \$8.1 million and other debt securities of \$9.0 million.

***Deposits.*** Deposits decreased \$58.3 million, or 5.1%, to \$1.08 billion at June 30, 2015 from \$1.13 billion at September 30, 2014, primarily as a result of decreases in interest bearing demand accounts, money market accounts and certificates of deposit, offset in part by increases in non-interest bearing demand accounts and savings accounts. At June 30, 2015, compared to September 30, 2014, certificate of deposit accounts decreased \$19.8 million to \$587.2 million, interest bearing demand accounts decreased \$65.4 million to \$98.5 million, non-interest bearing demand accounts increased \$33.4 million to \$103.4 million, money market accounts decreased \$15.0 million to \$155.1 million and savings and club accounts increased \$8.6 million to \$131.3 million. Included in the certificates of deposit at June 30, 2015 was an increase in brokered certificates of \$30.7 million to \$249.0 million to help offset the decline in retail deposits.

***Borrowed Funds.*** Borrowed funds increased by \$70.3 million, or 27.1%, to \$329.7 million at June 30, 2015, from \$259.3 million at September 30, 2014. The increase in borrowed funds was due to increases in short term borrowings of \$12.8 million and other borrowings of \$57.5 million. All borrowings at June 30, 2015 represent advances from the Pittsburgh FHLB.

***Stockholders' Equity.*** Stockholders' equity increased by \$4.0 million, or 2.4% to \$171.3 million at June 30, 2015 from \$167.3 million at September 30, 2014. Increases resulting from net income and the change to accumulated other comprehensive income were partially offset by the payment of dividends and the repurchase of common stock.

**Table of Contents****Average Balance Sheets for the Three and Nine Months Ended June 30, 2015 and 2014**

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,<br>2015 |                             |                                      | 2014               |                             |            |
|---|---|-----------------------------|--------------------------------------|--------------------|-----------------------------|------------|
|   | Average<br>Balance                          | Interest Income/<br>Expense | Yield/Cost<br>(dollars in thousands) | Average<br>Balance | Interest Income/<br>Expense | Yield/Cost |
| <b>Interest-earning assets:</b>                     |   |                             |                                      |                    |                             |            |
| Loans <sup>(1)</sup>                                | \$ 1,091,356                                | \$ 11,398                   | 4.19%                                | \$ 1,054,409       | \$ 11,807                   | 4.49%      |
| <b>Investment Securities</b>                        |   |                             |                                      |                    |                             |            |
| Taxable <sup>(2)</sup>                              | 82,731                                      | 433                         | 2.10%                                | 81,064             | 411                         | 2.03%      |
| Exempt from federal income<br>tax <sup>(2)(3)</sup> | 38,382                                      | 248                         | 3.93%                                | 32,298             | 173                         | 3.26%      |
| Total investment securities                         | 121,113                                     | 681                         | 2.68%                                | 113,362            | 584                         | 2.38%      |
| Mortgage-backed securities                          | 260,522                                     | 1,308                       | 2.01%                                | 244,722            | 1,221                       | 2.00%      |
| Regulatory stock                                    | 13,670                                      | 177                         | 5.19%                                | 12,153             | 167                         | 5.51%      |
| Other   | 3,170                                       | 4                           | 0.51%                                | 17,589             | 6                           | 0.14%      |
| Total interest-earning assets                       | 1,489,831                                   | 13,568                      | 3.69%                                | 1,442,235          | 13,785                      | 3.86%      |
| Allowance for loan losses                           | (8,708)                                     |                             |                                      | (8,697)            |                             |            |
| Noninterest-earning assets                          | 106,842                                     |                             |                                      | 113,084            |                             |            |
| Total assets  | \$ 1,587,965                                |                             |                                      | \$ 1,546,622       |                             |            |
| <b>Interest-bearing liabilities:</b>                |   |                             |                                      |                    |                             |            |
| Interest bearing demand accounts                    | \$ 100,123                                  | \$ 28                       | 0.11%                                | \$ 121,934         | 20                          | 0.07%      |
| Money market accounts                               | 176,533                                     | 110                         | 0.25%                                | 178,056            | 92                          | 0.21%      |
| Savings and club accounts                           | 126,209                                     | 16                          | 0.05%                                | 122,691            | 17                          | 0.06%      |
| Certificates of deposit                             |   |                             |                                      |                    |                             |            |