

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

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

FORM 10-Q

x **Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended December 31, 2013

OR

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

Commission File No. 001-33384

ESSA Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of
incorporation or organization)

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

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

18360
(Zip Code)

(570) 421-0531

(Registrant's telephone number)

N/A

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer" and "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

As of February 3, 2014 there were 11,892,664 shares of the Registrant's common stock, par value \$0.01 per share, outstanding.

Table of Contents

ESSA Bancorp, Inc.

FORM 10-Q

Table of Contents

| | Page |
|--|-------------|
| <u>Part I. Financial Information</u> | |
| Item 1. <u>Financial Statements (unaudited)</u> | 3 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 28 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 34 |
| Item 4. <u>Controls and Procedures</u> | 34 |
| <u>Part II. Other Information</u> | |
| Item 1. <u>Legal Proceedings</u> | 35 |
| Item 1A. <u>Risk Factors</u> | 35 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 35 |
| Item 3. <u>Defaults Upon Senior Securities</u> | 35 |
| Item 4. <u>Mine Safety Disclosures</u> | 35 |
| Item 5. <u>Other Information</u> | 35 |
| Item 6. <u>Exhibits</u> | 36 |
| <u>Signature Page</u> | 37 |

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

ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEET

(UNAUDITED)

| | December 31, 2013 | September 30, 2013 |
|--|-------------------------------|-------------------------------|
| | (dollars in thousands) | |
| Cash and due from banks | \$ 11,293 | \$ 22,393 |
| Interest-bearing deposits with other institutions | 3,524 | 4,255 |
| Total cash and cash equivalents | 14,817 | 26,648 |
| Certificates of deposit | 1,767 | 1,767 |
| Investment securities available for sale, at fair value | 315,829 | 315,622 |
| Loans receivable (net of allowance for loan losses of \$8,369 and \$8,064) | 922,286 | 928,230 |
| Regulatory stock, at cost | 10,024 | 9,415 |
| Premises and equipment, net | 15,542 | 15,747 |
| Bank-owned life insurance | 29,025 | 28,797 |
| Foreclosed real estate | 2,618 | 2,111 |
| Intangible assets, net | 2,229 | 2,466 |
| Goodwill | 8,817 | 8,817 |
| Deferred income taxes | 12,024 | 11,183 |
| Other assets | 20,218 | 21,512 |
| TOTAL ASSETS | \$ 1,355,196 | \$ 1,372,315 |
| LIABILITIES | | |
| Deposits | \$ 996,391 | \$ 1,041,059 |
| Short-term borrowings | 33,000 | 23,000 |
| Other borrowings | 145,760 | 129,260 |
| Advances by borrowers for taxes and insurance | 7,360 | 4,962 |
| Other liabilities | 6,136 | 7,588 |
| TOTAL LIABILITIES | 1,188,647 | 1,205,869 |
| STOCKHOLDERS EQUITY | | |
| 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; 11,927,964 and 11,945,564 outstanding at December 31, 2013 and September 30, | 181 | 181 |

| | | |
|--|---------------------|---------------------|
| 2013) | | |
| Additional paid in capital | 182,506 | 182,440 |
| Unallocated common stock held by the Employee Stock Ownership Plan (ESOP) | (10,419) | (10,532) |
| Retained earnings | 73,169 | 71,709 |
| Treasury stock, at cost; 6,205,131 and 6,187,531 shares outstanding at December 31, 2013 and September 30, 2013, respectively | (76,313) | (76,117) |
| Accumulated other comprehensive loss | (2,575) | (1,235) |
| TOTAL STOCKHOLDERS EQUITY | 166,549 | 166,446 |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 1,355,196 | \$ 1,372,315 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

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

| | For the Three Months Ended December 31, | |
|--|--|---------------|
| | 2013 | 2012 |
| | (dollars in thousands, except per share data) | |
| INTEREST INCOME | | |
| Loans receivable, including fees | \$ 10,523 | \$ 12,237 |
| Investment securities: | | |
| Taxable | 1,527 | 1,630 |
| Exempt from federal income tax | 73 | 54 |
| Other investment income | 59 | 29 |
| Total interest income | 12,182 | 13,950 |
| INTEREST EXPENSE | | |
| Deposits | 1,988 | 1,971 |
| Short-term borrowings | 23 | 36 |
| Other borrowings | 680 | 1,224 |
| Total interest expense | 2,691 | 3,231 |
| NET INTEREST INCOME | 9,491 | 10,719 |
| Provision for loan losses | 750 | 1,000 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 8,741 | 9,719 |
| NONINTEREST INCOME | | |
| Service fees on deposit accounts | 792 | 807 |
| Services charges and fees on loans | 185 | 229 |
| Trust and investment fees | 211 | 215 |
| Gain on sale of investments, net | | 30 |
| Gain on sale of loans, net | | 334 |
| Earnings on Bank-owned life insurance | 228 | 226 |
| Insurance commissions | 193 | 175 |
| Other | 18 | 10 |

| | | |
|---|----------|----------|
| Total noninterest income | 1,627 | 2,026 |
| NONINTEREST EXPENSE | | |
| Compensation and employee benefits | 4,308 | 4,556 |
| Occupancy and equipment | 918 | 949 |
| Professional fees | 409 | 312 |
| Data processing | 680 | 663 |
| Advertising | 106 | 110 |
| Federal Deposit Insurance Corporation (FDIC) premiums | 229 | 185 |
| Loss (Gain) on foreclosed real estate | 42 | (226) |
| Merger related costs | 258 | |
| Amortization of intangible assets | 237 | 250 |
| Other | 561 | 706 |
| Total noninterest expense | 7,748 | 7,505 |
| Income before income taxes | 2,620 | 4,240 |
| Income taxes | 616 | 1,361 |
| NET INCOME | \$ 2,004 | \$ 2,879 |
| Earnings per share | | |
| Basic | \$ 0.18 | \$ 0.24 |
| Diluted | \$ 0.18 | \$ 0.24 |
| Dividends per share | \$ 0.05 | \$ 0.05 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

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

| | Three Months Ended December 31, | |
|--|--|-------------|
| | 2013 | 2012 |
| Net income | \$ 2,004 | \$ 2,879 |
| Other comprehensive loss: | | |
| Investment securities available for sale: | | |
| Unrealized holding loss | (2,036) | (932) |
| Tax effect | 691 | 318 |
| Reclassification of gains recognized in net income | | (30) |
| Tax effect | | 10 |
| Net of tax amount | (1,345) | (634) |
| Pension plan adjustment: | | |
| Related to actuarial losses and prior service cost | 7 | 97 |
| Tax effect | (2) | (33) |
| Net of tax amount | 5 | 64 |
| Total other comprehensive loss | (1,340) | (570) |
| Comprehensive income | \$ 664 | \$ 2,309 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(UNAUDITED)

| | Common Stock | | Unallocated Common Stock Held by | | Retained | Treasury | Accumulated Other Comprehensive | Total |
|--|------------------------|--------|--|-------------|-----------|-------------|---------------------------------------|------------------------|
| | Number of Shares | Amount | Additional Paid In Capital | the ESOP | Earnings | Stock | Loss | Stockholders Equity |
| | | | | | | | | |
| | (Dollars in thousands) | | | | | | | |
| Balance, September 30, 2013 | 11,945,564 | \$ 181 | \$ 182,440 | \$ (10,532) | \$ 71,709 | \$ (76,117) | \$ (1,235) | \$ 166,446 |
| Net income | | | | | 2,004 | | | 2,004 |
| Other comprehensive loss | | | | | | | (1,340) | (1,340) |
| Cash dividends declared (\$.05 per share) | | | | | (544) | | | (544) |
| Stock based compensation | | | 55 | | | | | 55 |
| Allocation of ESOP stock | | | 11 | 113 | | | | 124 |
| Treasury shares purchased | (17,600) | | | | | (196) | | (196) |
| Balance, December 31, 2013 | 11,927,964 | \$ 181 | \$ 182,506 | \$ (10,419) | \$ 73,169 | \$ (76,313) | \$ (2,575) | \$ 166,549 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

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

| | For the Three Months Ended December 31, | |
|---|--|--------------|
| | 2013 | 2012 |
| | (dollars in thousands) | |
| OPERATING ACTIVITIES | | |
| Net income | \$ 2,004 | \$ 2,879 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 750 | 1,000 |
| Provision for depreciation and amortization | 291 | 286 |
| Amortization and accretion of discounts and premiums, net | 240 | 369 |
| Net gain on sale of investment securities | | (30) |
| Gain on sale of loans, net | | (334) |
| Origination of mortgage loans sold | | (12,963) |
| Proceeds from sale of mortgage loans originated for sale | | 11,547 |
| Compensation expense on ESOP | 124 | 114 |
| Stock based compensation | 55 | 527 |
| Decrease in accrued interest receivable | 106 | 360 |
| Increase (decrease) in accrued interest payable | 309 | (13) |
| Earnings on bank-owned life insurance | (228) | (226) |
| Deferred federal income taxes | (151) | 307 |
| Decrease in prepaid FDIC premiums | | 175 |
| (Gain) loss on foreclosed real estate, net | 42 | (226) |
| Amortization of identifiable intangible assets | 237 | 250 |
| Other, net | (606) | 2,038 |
| Net cash provided by operating activities | 3,173 | 6,060 |
| INVESTING ACTIVITIES | | |
| Purchase of certificates of deposit | | (500) |
| Investment securities available for sale: | | |
| Proceeds from sale of investment securities | | 1,106 |
| Proceeds from principal repayments and maturities | 12,952 | 37,955 |
| Purchases | (15,457) | (42,306) |
| Decrease in loans receivable, net | 4,586 | 8,214 |
| Redemption of FHLB stock | 626 | 2,860 |
| Purchase of FHLB stock | (1,235) | |
| Investment in limited partnership | | (110) |
| Proceeds from sale of foreclosed real estate | 82 | 1,246 |
| Purchase of premises, equipment, and software | (48) | (245) |

| | | |
|---|-----------|-----------|
| Net cash provided by investing activities | 1,506 | 8,220 |
| FINANCING ACTIVITIES | | |
| Decrease in deposits, net | (44,668) | (21,745) |
| Net increase in short-term borrowings | 10,000 | 41,219 |
| Proceeds from other borrowings | 21,500 | 7,000 |
| Repayment of other borrowings | (5,000) | (39,000) |
| Increase in advances by borrowers for taxes and insurance | 2,398 | 3,511 |
| Purchase of treasury stock shares | (196) | (293) |
| Dividends on common stock | (544) | (605) |
| Net cash used for financing activities | (16,510) | (9,913) |
| Increase (decrease) in cash and cash equivalents | (11,831) | 4,367 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 26,648 | 15,550 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 14,817 | \$ 19,917 |
| SUPPLEMENTAL CASH FLOW DISCLOSURES | | |
| Cash Paid: | | |
| Interest | \$ 2,382 | \$ 3,244 |
| Income taxes | | 5 |
| Noncash items: | | |
| Transfers from loans to foreclosed real estate | \$ 631 | \$ 525 |
| Treasury stock payable | | 116 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

ESSA BANCORP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(unaudited)

1. Nature of Operations and Basis of Presentation

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

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

The unaudited consolidated financial statements reflect all adjustments, which in the opinion of management, are necessary for a fair presentation of the results of the interim periods and are of a normal and recurring nature. Operating results for the three month periods ended December 31, 2013 are not necessarily indicative of the results that may be expected for the year ending September 30, 2014.

2. Earnings per Share

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation for the three month period ended December 31, 2013 and 2012.

Three months ended

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

| | December 31, 2013 | December 31, 2012 |
|--|------------------------------|------------------------------|
| Weighted-average common shares outstanding | 18,133,095 | 18,133,095 |
| Average treasury stock shares | (6,190,794) | (4,906,440) |
| Average unearned ESOP shares | (1,035,427) | (1,080,703) |
| Average unearned non-vested shares | (16,718) | (57,827) |
| | | |
| Weighted average common shares and common stock equivalents used to calculate basic earnings per share | 10,890,156 | 12,088,125 |
| | | |
| Additional common stock equivalents (non-vested stock) used to calculate diluted earnings per share | | |
| Additional common stock equivalents (stock options) used to calculate diluted earnings per share | 16,073 | |
| | | |
| Weighted average common shares and common stock equivalents used to calculate diluted earnings per share | 10,906,229 | 12,088,125 |

Table of Contents

At December 31, 2013 and 2012 there were options to purchase 317,910 and 1,458,379 shares, respectively, 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 December 31, 2013 and 2012 there were 14,997 and 47,913 shares, respectively, of nonvested stock outstanding at prices of \$10.94 and \$12.35 per share, respectively, that were not included in the computation of diluted EPS because to do so would have been anti-dilutive.

3. Use of Estimates in the Preparation of Financial Statements

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

4. Recent Accounting Pronouncements:

In February 2013, the FASB issued ASU 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date*. The ASU requires the measurement of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement with its co-obligors as well as any additional amount that the entity expects to pay on behalf of its co-obligors. The new standard is effective retrospectively for fiscal years and interim periods within those years, beginning after December 15, 2013, and early adoption is permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

In April 2013, the FASB issued ASU 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting*. The amendments in this update are being issued to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. The amendments require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (a) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties or (b) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy). If a plan for liquidation was specified in the entity's governing documents from the entity's inception (for example, limited-life entities), the entity should apply the liquidation basis of accounting only if the approved plan for liquidation differs from the plan for liquidation that was specified at the entity's inception. The amendments are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted. Entities that use the liquidation basis of accounting as of the effective date in accordance with other Topics (for example, terminating employee benefit plans) are not required to apply the amendments. Instead, those entities should continue to apply the guidance in those other Topics until they have completed liquidation. This ASU is not expected to have a significant impact on the Company's financial statements.

In June 2013, the FASB issued ASU 2013-08, *Financial Services - Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*. The amendments in this update affect the scope,

measurement, and disclosure requirements for investment companies under U.S. GAAP. The amendments do all of the following: 1. Change the approach to the investment company assessment in Topic 946, clarify the characteristics of an investment company, and provide comprehensive guidance for assessing whether an entity is an investment Company. 2. Require an investment company to measure noncontrolling ownership interests in other investment companies at fair value rather than using the equity method of accounting. 3. Require the following additional disclosures: (a) the fact that the entity is an investment company and is applying the guidance in Topic 946, (b) information about changes, if any, in an entity's status as an investment company, and (c) information about financial support provided or contractually required to be provided by an investment company to any of its investees. The amendments in this update are effective for an entity's interim and annual reporting periods in fiscal years that begin after December 15, 2013. Earlier application is prohibited. This ASU is not expected to have a significant impact on the Company's financial statements.

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

Table of Contents

tax position at the reporting date. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

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

Table of Contents**5. Investment Securities**

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

| | December 31, 2013 | | | |
|--|---------------------------|---------------------------------------|--|-----------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Available for Sale | | | | |
| Fannie Mae | \$ 118,067 | \$ 1,166 | \$ (2,088) | \$ 117,145 |
| Freddie Mac | 57,856 | 760 | (1,628) | 56,988 |
| Governmental National Mortgage Association | 37,054 | 246 | (267) | 37,033 |
| Other mortgage-backed securities | 3,111 | | (16) | 3,095 |
| Total mortgage-backed securities | 216,088 | 2,172 | (3,999) | 214,261 |
| Obligations of states and political subdivisions | 24,079 | 555 | (622) | 24,012 |
| U.S. government agency securities | 52,503 | 188 | (738) | 51,953 |
| Corporate obligations | 12,727 | 187 | (180) | 12,734 |
| Trust-preferred securities | 4,967 | 500 | | 5,467 |
| Other debt securities | 5,369 | 45 | (37) | 5,377 |
| Total debt securities | 315,733 | 3,647 | (5,576) | 313,804 |
| Equity securities - financial services | 2,025 | | | 2,025 |
| Total | \$ 317,758 | \$ 3,647 | \$ (5,576) | \$ 315,829 |

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

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

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

The amortized cost and fair value of debt securities at December 31, 2013, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

| | Available For Sale | |
|--|---------------------------|--------------|
| | Amortized | Fair |
| | Cost | Value |
| Due in one year or less | \$ 2,871 | \$ 2,879 |
| Due after one year through five years | 40,356 | 40,616 |
| Due after five years through ten years | 68,652 | 68,104 |
| Due after ten years | 203,854 | 202,205 |
| Total | \$ 315,733 | \$ 313,804 |

Table of Contents

For the three months ended December 31, 2013, the Company did not sell any investment securities. For the three months ended December 31, 2012, the Company realized gross gains of \$31,000 and gross losses of \$1,000 on proceeds from the sale of investment securities of \$1.1 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 (in thousands):

| | Number of Securities | December 31, 2013 | | | | | |
|--|----------------------|-------------------------|-------------------------|--------------------------|-------------------------|-------------------|-------------------------|
| | | Less than Twelve Months | | Twelve Months or Greater | | Total | |
| | | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Fannie Mae | 42 | \$ 56,551 | \$ (1,581) | \$ 10,839 | \$ (507) | \$ 67,390 | \$ (2,088) |
| Freddie Mac | 22 | 29,338 | (1,257) | 6,704 | (371) | 36,042 | (1,628) |
| Governmental National Mortgage Association | 7 | 6,280 | (196) | 3,649 | (71) | 9,929 | (267) |
| Other mortgage backed securities | 3 | 2,245 | (11) | 850 | (5) | 3,095 | (16) |
| Obligations of states and political subdivisions | 9 | 5,393 | (288) | 3,450 | (334) | 8,843 | (622) |
| U.S. government agency securities | 13 | 33,663 | (737) | 999 | (1) | 34,662 | (738) |
| Corporate obligations | 7 | 6,002 | (180) | | | 6,002 | (180) |
| Other debt securities | 1 | 1,971 | (37) | | | 1,971 | (37) |
| Total | 104 | \$ 141,443 | \$ (4,287) | \$ 26,491 | \$ (1,289) | \$ 167,934 | \$ (5,576) |

| | Number of Securities | September 30, 2013 | | | | | |
|--|----------------------|-------------------------|-------------------------|--------------------------|-------------------------|------------|-------------------------|
| | | Less than Twelve Months | | Twelve Months or Greater | | Total | |
| | | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Fannie Mae | 30 | \$ 47,814 | \$ (1,589) | \$ 1,057 | \$ (6) | \$ 48,871 | \$ (1,595) |
| Freddie Mac | 20 | 32,781 | (1,252) | | | 32,781 | (1,252) |
| Governmental National Mortgage Association | 6 | 10,301 | (230) | | | 10,301 | (230) |
| Other mortgage-backed securities | 3 | 3,366 | (19) | | | 3,366 | (19) |

| | | | | | | | |
|--|-----------|-------------------|-------------------|-----------------|---------------|-------------------|-------------------|
| Obligations of states and political subdivisions | 7 | 8,064 | (499) | | | 8,064 | (499) |
| U.S. government agency securities | 10 | 30,084 | (479) | 999 | (1) | 31,083 | (480) |
| Corporate obligations | 5 | 5,042 | (169) | | (0) | 5,042 | (169) |
| Equity securities | 1 | 1,990 | (10) | | | 1,990 | (10) |
| Total | 82 | \$ 139,442 | \$ (4,247) | \$ 2,056 | \$ (7) | \$ 141,498 | \$ (4,254) |

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

The Company reviews its position quarterly and has asserted that at December 31, 2013, 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.

Table of Contents

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):

| | December 31, 2013 | September 30, 2013 |
|--|----------------------|-----------------------|
| Held for investment: | | |
| Real Estate Loans: | | |
| Residential | \$ 674,299 | \$ 686,651 |
| Construction | 2,895 | 2,288 |
| Commercial | 159,916 | 159,469 |
| Commercial | 9,908 | 10,125 |
| Obligations of states and political subdivisions | 40,439 | 33,445 |
| Home equity loans and lines of credit | 40,798 | 41,923 |
| Other | 2,400 | 2,393 |
| | 930,655 | 936,294 |
| Less allowance for loan losses | 8,369 | 8,064 |
| Net loans | \$ 922,286 | \$ 928,230 |

| | Total Loans | Individually Evaluated for Impairment | Loans Acquired with Deteriorated Credit Quality | Collectively Evaluated for Impairment |
|--|-------------|---|---|---|
| December 31, 2013 | | | | |
| Real Estate Loans: | | | | |
| Residential | \$ 674,299 | \$ 12,920 | \$ 159 | \$ 661,220 |
| Construction | 2,895 | | | 2,895 |
| Commercial | 159,916 | 16,716 | 6,049 | 137,151 |
| Commercial | 9,908 | 438 | 460 | 9,010 |
| Obligations of states and political subdivisions | 40,439 | | | 40,439 |
| Home equity loans and lines of credit | 40,798 | 333 | 4 | 40,461 |
| Other | 2,400 | | | 2,400 |

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

| | | | | |
|-------|------------|-----------|----------|------------|
| Total | \$ 930,655 | \$ 30,407 | \$ 6,672 | \$ 893,576 |
|-------|------------|-----------|----------|------------|

Table of Contents

| | Total Loans | Individually Evaluated for Impairment | Loans Acquired with Deteriorated Credit Quality | Collectively Evaluated for Impairment |
|--|--------------------|--|--|--|
| September 30, 2013 | | | | |
| Real Estate Loans: | | | | |
| Residential | \$ 686,651 | \$ 14,018 | \$ 271 | \$ 672,362 |
| Construction | 2,288 | | | 2,288 |
| Commercial | 159,469 | 15,478 | 6,355 | 137,636 |
| Commercial | 10,125 | 220 | 502 | 9,403 |
| Obligations of states and political subdivisions | 33,445 | | | 33,445 |
| Home equity loans and lines of credit | 41,923 | 379 | 3 | 41,541 |
| Other | 2,393 | | | 2,393 |
| Total | \$ 936,294 | \$ 30,095 | \$ 7,131 | \$ 899,068 |

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 a period of performance.

Table of Contents

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

| | Recorded Investment | Unpaid Principal Balance | Associated Allowance | Average Recorded Investment | Interest Income Recognized |
|--|--------------------------------|---|---------------------------------|--|---|
| December 31, 2013 | | | | | |
| With no specific allowance recorded: | | | | | |
| Real Estate Loans | | | | | |
| Residential | \$ 9,842 | \$ 11,417 | \$ | \$ 10,081 | \$ 56 |
| Construction | | | | | |
| Commercial | 20,286 | 21,564 | | 18,939 | 191 |
| Commercial | 898 | 929 | | 793 | 3 |
| Obligations of states and political subdivisions | | | | | |
| Home equity loans and lines of credit | 337 | 677 | | 338 | 2 |
| Other | | | | | |
| Total | 31,363 | 34,587 | | 30,151 | 252 |
| With an allowance recorded: | | | | | |
| Real Estate Loans | | | | | |
| Residential | 3,237 | 3,345 | 545 | 3,003 | 35 |
| Construction | | | | | |
| Commercial | 2,479 | 2,600 | 259 | 2,813 | |
| Commercial | | | | | |
| Obligations of states and political subdivisions | | | | | |
| Home equity loans and lines of credit | | | | | |
| Other | | | | | |
| Total | 5,716 | 5,945 | 804 | 5,816 | 35 |
| Total: | | | | | |
| Real Estate Loans | | | | | |
| Residential | 13,079 | 14,762 | 545 | 13,084 | 91 |
| Construction | | | | | |
| Commercial | 22,765 | 24,164 | 259 | 21,752 | 191 |
| Commercial | 898 | 929 | | 793 | 3 |
| Obligations of states and political subdivisions | | | | | |
| Home equity loans and lines of credit | 337 | 677 | | 338 | 2 |
| Other | | | | | |
| Total Impaired Loans | \$ 37,079 | \$ 40,532 | \$ 804 | \$ 35,967 | \$ 287 |

Table of Contents

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

Management uses a ten point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as Pass rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that

jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. The portion of any loan that represents a specific allocation of the allowance for loan losses is placed in the Doubtful category. Any portion of a loan that has been charged off is placed in the Loss category.

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

Table of Contents

The following tables present the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system as of December 31, 2013 and September 30, 2013 (in thousands):

| | Pass | Special Mention | Substandard | Doubtful | Total |
|--|-------------------|--------------------|------------------|---------------|-------------------|
| December 31, 2013 | | | | | |
| Commercial real estate loans | \$ 131,743 | \$ 6,796 | \$ 21,066 | \$ 311 | \$ 159,916 |
| Commercial | 8,945 | 407 | 556 | | 9,908 |
| Obligations of states and political subdivisions | 40,439 | | | | 40,439 |
| Total | \$ 181,127 | \$ 7,203 | \$ 21,622 | \$ 311 | \$ 210,263 |

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

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 December 31, 2013 and September 30, 2013 (in thousands):

| | Performing | Non-performing | Total |
|---------------------------------------|-------------------|------------------|-------------------|
| December 31, 2013 | | | |
| Real estate loans: | | | |
| Residential | \$ 664,454 | \$ 9,845 | \$ 674,299 |
| Construction | 2,895 | | 2,895 |
| Home equity loans and lines of credit | 40,407 | 391 | 40,798 |
| Other | 2,400 | | 2,400 |
| Total | \$ 710,156 | \$ 10,236 | \$ 720,392 |

| | Performing | Non-performing | Total |
|---------------------------------------|-------------------|-----------------------|-------------------|
| September 30, 2013 | | | |
| Real estate loans: | | | |
| Residential | \$ 675,706 | \$ 10,945 | \$ 686,651 |
| Construction | 2,288 | | 2,288 |
| Home equity loans and lines of credit | 41,584 | 339 | 41,923 |
| Other | 2,393 | | 2,393 |
| Total | \$ 721,971 | \$ 11,284 | \$ 733,255 |

Table of Contents

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of December 31, 2013 and September 30, 2013 (in thousands):

| | Current | 31-60 Days Past Due | 61-90 Days Past Due | Greater than 90 Days Past Due and still accruing | Non-Accrual | Total Past Due and Non-Accrual | Total Loans |
|---|------------|---------------------------|---------------------------|---|-------------|--------------------------------------|----------------|
| December 31, 2013 | | | | | | | |
| Real estate loans | | | | | | | |
| Residential | \$ 660,623 | \$ 2,616 | \$ 1,215 | \$ | \$ 9,845 | \$ 13,676 | \$ 674,299 |
| Construction | 2,895 | | | | | | 2,895 |
| Commercial | 147,320 | 200 | 329 | | 12,067 | 12,596 | 159,916 |
| Commercial | 8,650 | | 58 | | 1,200 | 1,258 | 9,908 |
| Obligations of states and political subdivisions | 40,439 | | | | | | 40,439 |
| Home equity loans and lines of credit | 40,189 | 201 | 17 | | 391 | 609 | 40,798 |
| Other | 2,350 | 7 | 43 | | | 50 | 2,400 |
| Total | \$ 902,466 | \$ 3,024 | \$ 1,662 | \$ | \$ 23,503 | \$ 28,189 | \$ 930,655 |

| | Current | 31-60 Days Past Due | 61-90 Days Past Due | Greater than 90 Days Past Due and still accruing | Non-Accrual | Total Past Due and Non-Accrual | Total Loans |
|---|------------|---------------------------|---------------------------|---|-------------|--------------------------------------|----------------|
| September 30, 2013 | | | | | | | |
| Real estate loans | | | | | | | |
| Residential | \$ 671,850 | \$ 2,866 | \$ 990 | \$ | \$ 10,945 | \$ 14,801 | \$ 686,651 |
| Construction | 2,288 | | | | | | 2,288 |
| Commercial | 146,062 | 2,589 | | | 10,818 | 13,407 | 159,469 |
| Commercial | 8,948 | | | | 1,177 | 1,177 | 10,125 |
| Obligations of states and political subdivisions | 33,445 | | | | | | 33,445 |

| | | | | | | |
|---------------------------------------|------------|----------|----------|-----------|-----------|------------|
| Home equity loans and lines of credit | 41,380 | 127 | 77 | 339 | 543 | 41,923 |
| Other | 2,336 | 57 | | | 57 | 2,393 |
| Total | \$ 906,309 | \$ 5,639 | \$ 1,067 | \$ 23,279 | \$ 29,985 | \$ 936,294 |

Our allowance for loan losses is maintained at a level necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. Our allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an allocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management's judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary, based on changing economic conditions. Payments received on impaired loans generally are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. The allowance for loan losses as of December 31, 2013 is maintained at a level that represents management's best estimate of losses inherent in the loan portfolio, and such losses were both probable and reasonably estimable.

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

Table of Contents

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

The following table summarizes the primary segments of the ALL, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of December 31, 2013 (in thousands):

| | Real Estate Loans | | Commercial Loans | | Political Subdivisions | | Home Obligations of Equity States Loans and Lines of Credit | Other Loans | Unallocated | Total |
|-----------------------------------|-------------------|--------------|------------------|------------|------------------------|--------------|---|-------------|-------------|-------|
| | Residential | Construction | Commercial | Commercial | Political | Subdivisions | of Credit | Loans | | |
| ALL balance at September 30, 2013 | \$ 5,787 | \$ 20 | \$ 946 | \$ 337 | \$ 130 | \$ 430 | \$ 21 | \$ 393 | \$ 8,064 | |
| Charge-offs | (387) | | (38) | (48) | | (63) | | | (536) | |
| Recoveries | 77 | | | 11 | | | 3 | | 91 | |
| Provision | 426 | 6 | 103 | 30 | (24) | 124 | (2) | 87 | 750 | |
| ALL balance at December 31, 2013 | \$ 5,903 | \$ 26 | \$ 1,011 | \$ 330 | \$ 106 | \$ 491 | \$ 22 | \$ 480 | \$ 8,369 | |

| | Real Estate Loans | | Commercial Loans | | Political Subdivisions | | Home Obligations of Equity States Loans and Lines of Credit | Other Loans | Unallocated | Total |
|-----------------------------------|-------------------|--------------|------------------|------------|------------------------|--------------|---|-------------|-------------|-------|
| | Residential | Construction | Commercial | Commercial | Political | Subdivisions | of Credit | Loans | | |
| ALL balance at September 30, 2012 | \$ 5,401 | \$ 29 | \$ 699 | \$ 474 | \$ 127 | \$ 499 | \$ 22 | \$ 51 | \$ 7,302 | |
| Charge-offs | (645) | | (106) | | | (35) | | | (786) | |
| Recoveries | 37 | | 1 | | | 1 | | | 39 | |
| Provision | 756 | (21) | 190 | (90) | (11) | (88) | 111 | 153 | 1,000 | |
| ALL balance at December 31, 2012 | \$ 5,549 | \$ 8 | \$ 784 | \$ 384 | \$ 116 | \$ 377 | \$ 133 | \$ 204 | \$ 7,555 | |

Real Estate Loans

Unallocated Total

| | Residential | | Construction | | Commercial | | Commercial Loans | Obligations of States and Political Subdivisions | Home Equity Loans and Lines of Credit | Other Loans |
|--|--------------------|-------|---------------------|--------|-------------------|--------|-----------------------------|---|--|------------------------|
| Individually evaluated for impairment | \$ 545 | \$ | \$ 259 | \$ | \$ | \$ | \$ | \$ | \$ | \$ 804 |
| Collectively evaluated for impairment | 5,358 | 26 | 752 | 330 | 106 | 491 | 22 | 480 | 7,565 | |
| ALL balance at December 31, 2013 | \$ 5,903 | \$ 26 | \$ 1,011 | \$ 330 | \$ 106 | \$ 491 | \$ 22 | \$ 480 | \$ 8,369 | |

| | Real Estate Loans | | | Commercial | Political | Home Obligations of Equity States and Loans and Lines of Credit | Other | Unallocated | Total |
|--|-------------------|--------------|------------|------------|--------------|---|-------|-------------|----------|
| | Residential | Construction | Commercial | Loans | Subdivisions | | Loans | | |
| Individually evaluated for impairment | \$ 518 | \$ | \$ 301 | \$ | \$ | \$ | \$ | \$ | \$ 819 |
| Collectively evaluated for impairment | 5,269 | 20 | 645 | 337 | 130 | 430 | 21 | 393 | 7,245 |
| ALL balance at September 30, 2013 | \$ 5,787 | \$ 20 | \$ 946 | \$ 337 | \$ 130 | \$ 430 | \$ 21 | \$ 393 | \$ 8,064 |

Table of Contents

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date. The Company allocated increased provisions to the residential real estate, commercial real estate and other loan segments for the three month period ending December 31, 2013 due to increased charge off activity and impairment evaluations in those segments. Despite the above allocations, the allowance for loan losses is general in nature and is available to absorb losses from any loan segment.

The following is a summary of troubled debt restructuring granted during the three months ended December 31, 2013 and 2012.

| | For the Three Months Ended December 31, 2013 | | |
|--|---|---|--|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| <u>Troubled Debt Restructurings</u> | | | |
| Real estate loans: | | | |
| Residential | 4 | \$ 599 | \$ 599 |
| Construction | | | |
| Commercial | | | |
| Commercial | | | |
| Obligations of states and political subdivisions | | | |
| Home equity loans and lines of credit | | | |
| Other | | | |
| Total | 4 | \$ 599 | \$ 599 |

Of the four new troubled debt restructurings granted for the three months ended December 31, 2013, two loans totaling \$469,000 were granted terms concessions and two loans totaling \$130,000 were granted terms and rate concessions.

| | For the Three Months Ended December 31, 2012 | | |
|--|---|---|--|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| <u>Troubled Debt Restructurings</u> | | | |
| Real estate loans: | | | |
| Residential | 1 | \$ 130 | \$ 130 |
| Construction | | | |
| Commercial | | | |

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

Commercial

Obligations of states and political
subdivisions

Home equity loans and lines of credit

Other

| | | | | | |
|-------|---|----|-----|----|-----|
| Total | 1 | \$ | 130 | \$ | 130 |
|-------|---|----|-----|----|-----|

One loan for \$130,000 was granted terms and rate concessions for the three months ended December 31, 2012.

Table of Contents

The following is a summary of troubled debt restructurings that have subsequently defaulted within one year of modification.

| | For the Twelve Months Ended December 31, 2013 | |
|--|--|--------------------------------|
| | Number of Contracts | Recorded Investment |
| <u>Troubled Debt Restructurings</u> | | |
| Real estate loans: | | |
| Residential | \$ | \$ |
| Construction | | |
| Commercial | | |
| Commercial | | |
| Obligations of states and political subdivisions | | |
| Home equity loans and lines of credit | 1 | 98 |
| Other | | |
| Total | \$ 1 | \$ 98 |

There were no troubled debt restructurings that defaulted within one year of modification for the twelve months ended December 31, 2012.

8. Deposits

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

| | December 31, 2013 | September 30, 2013 |
|--------------------------------------|------------------------------|-------------------------------|
| Non-interest bearing demand accounts | \$ 59,110 | \$ 58,795 |
| NOW accounts | 93,141 | 99,857 |
| Money market accounts | 137,300 | 138,049 |
| Savings and club accounts | 111,317 | 110,189 |
| Certificates of deposit | 595,523 | 634,169 |
| Total | \$ 996,391 | \$ 1,041,059 |

9. Net Periodic Benefit Cost-Defined Benefit Plan

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

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

| | Three Months Ended | |
|-----------------------------------|---------------------------|---------------|
| | December 31, | |
| | 2013 | 2012 |
| Service Cost | \$ 144 | \$ 176 |
| Interest Cost | 191 | 179 |
| Expected return on plan assets | (290) | (258) |
| Amortization of unrecognized loss | 7 | 97 |
| Net periodic benefit cost | \$ 52 | \$ 194 |

The Bank plans to contribute \$550,000 to its pension plan in 2014.

10. Equity Incentive Plan

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

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

Table of Contents

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

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

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

For the three months ended December 31, 2013 and 2012, the Company recorded \$55,000 and \$527,000 of share-based compensation expense, respectively, comprised of restricted stock expense of \$55,000 for the December 31, 2013 period and stock option expense of \$172,000 and restricted stock expense of \$356,000 for the December 31, 2012 period. Expected future compensation expense relating to the 14,995 restricted shares at December 31, 2013, is \$164,000 over the remaining vesting period of 0.75 years.

The following is a summary of the Company's stock option activity and related information for its option grants for the three month period ended December 31, 2013.

| | Number of Stock Options | Weighted- average Exercise Price | Weighted- average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (in thousands) |
|----------------------------------|----------------------------|---|---|---|
| Outstanding, September 30, 2013 | 1,458,379 | \$ 12.35 | 4.67 | \$ |
| Granted | | | | |
| Exercised | | | | |
| Forfeited | | | | |
| Outstanding, December 31, 2013 | 1,458,379 | \$ 12.35 | 4.42 | \$ |
| Exercisable at December 31, 2013 | 1,458,379 | \$ 12.35 | 4.42 | \$ |

The weighted-average grant date fair value of the Company's non-vested options as of December 31, 2013 and 2012 was \$12.35.

The following is a summary of the status of the Company's restricted stock as of December 31, 2013, and changes therein during the three month period then ended:

| | Number of Restricted Stock | Weighted- average Grant Date Fair Value |
|---------------------------------|---------------------------------------|--|
| Nonvested at September 30, 2013 | 14,995 | \$ 10.94 |
| Granted | | |
| Vested | | |
| Forfeited | | |
| Nonvested at December 31, 2013 | 14,995 | \$ 10.94 |

11. Fair Value Measurement

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

Table of Contents

The following table presents information about the Company's securities, other real estate owned and impaired loans measured at fair value as of December 31, 2013 and September 30, 2013 and indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value:

| Fair Value Measurement at December 31, 2013 | | | | |
|--|---|---|--|--|
| Fair Value Measurements Utilized for the Company's Financial Assets (in thousands): | Quoted Prices in Active Markets for Identical Assets | | | Balances as of December 31, 2013 |
| | (Level 1) | Significant Observable Inputs (Level 2) | Other Significant Observable Inputs (Level 3) | |
| Securities available-for-sale measured on a recurring basis | | | | |
| Mortgage backed securities | \$ | \$ 214,261 | \$ | \$ 214,261 |
| Obligations of states and political subdivisions | | 24,012 | | 24,012 |
| U.S. government agencies | | 51,953 | | 51,953 |
| Corporate obligations | | 12,734 | | 12,734 |
| Trust-preferred securities | | 3,627 | 1,840 | 5,467 |
| Other debt securities | | 5,377 | | 5,377 |
| Equity securities-financial services | 2,025 | | | 2,025 |
| Total debt and equity securities | \$ 2,025 | \$ 311,964 | \$ 1,840 | \$ 315,829 |
| Foreclosed real estate owned measured on a non-recurring basis | \$ | \$ | \$ 2,618 | \$ 2,618 |
| Impaired loans measured on a non-recurring basis | \$ | \$ | \$ 36,275 | \$ 36,275 |

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

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

| | | | | |
|--|----------|------------|-----------|------------|
| Equity securities-financial services | 2,015 | | | 2,015 |
| Total debt and equity securities | \$ 2,015 | \$ 311,807 | \$ 1,800 | \$ 315,622 |
| Foreclosed real estate owned measured on a non-recurring basis | \$ | \$ | \$ 2,111 | \$ 2,111 |
| Impaired loans measured on a non-recurring basis | \$ | \$ | \$ 36,407 | \$ 36,407 |

Table of Contents

The following table presents a summary of changes in the fair value of the Company's Level III investments for the periods ended December 31, 2013 and September 30, 2013.

| | Fair Value Measurement Using Significant Unobservable Inputs (Level III) | |
|--|---|-----------------------|
| | December 31, 2013 | September 30, 2013 |
| Beginning balance | \$ 1,800 | \$ 1,740 |
| Purchases, sales, issuances, settlements, net | | |
| Total unrealized gain: | | |
| Included in earnings | | |
| Included in other comprehensive income | 40 | 60 |
| Transfers in and/or out of Level III | | |
| Ending balance | \$ 1,840 | \$ 1,800 |

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

The measurement of fair value should be consistent with one of the following valuation techniques: market approach, income approach, and/or cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering factors specific to the measurement (qualitative and quantitative). Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on a security's relationship to other benchmark quoted securities. Most of the securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Securities reported at fair value utilizing Level 1 inputs are limited to

actively traded equity securities whose market price is readily available from the New York Stock Exchange or the NASDAQ exchange. Foreclosed real estate is measured at fair value, less cost to sell at the date of foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value, less cost to sell. Income and expenses from operations and changes in valuation allowance are included in the net expenses from foreclosed real estate. Impaired loans are reported at fair value utilizing level three inputs. For these loans, a review of the collateral is conducted and an appropriate allowance for loan losses is allocated to the loan. At December 31, 2013, 224 impaired loans with a carrying value of \$37.1 million were reduced by specific valuation allowance totaling \$804,000 resulting in a net fair value of \$36.3 million based on Level 3 inputs.

Table of Contents

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:

| Quantitative Information about Level 3 Fair Value Measurements | | | | |
|---|----------------------------|----------------------------------|---------------------------|---------------------------------|
| | Fair Value Estimate | Valuation Techniques | Unobservable Input | Range (Weighted Average) |
| <i>(unaudited, in thousands)</i> | | | | |
| December 31, 2013: | | | | |
| Impaired loans | | | | 0% to 30% |
| | 36,275 | Appraisal of collateral (1) | Appraisal adjustments (2) | (23.0%) |
| Foreclosed real estate owned | | | | 20% to 40% |
| | 2,618 | Appraisal of collateral (1), (3) | Appraisal adjustments (2) | (21.9%) |

| Quantitative Information about Level 3 Fair Value Measurements | | | | |
|---|----------------------------|----------------------------------|---------------------------|---------------------------------|
| | Fair Value Estimate | Valuation Techniques | Unobservable Input | Range (Weighted Average) |
| <i>(unaudited, in thousands)</i> | | | | |
| September 30, 2013: | | | | |
| Impaired loans | | | | 0% to 30% |
| | 36,407 | Appraisal of collateral (1) | Appraisal adjustments (2) | (23.5%) |
| Foreclosed real estate owned | | | | 20% to 40% |
| | 2,111 | Appraisal of collateral (1), (3) | Appraisal adjustments (2) | (20.4%) |

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

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.

December 31, 2013

| | Carrying Value | Level I | Level II | Level III | Total Fair Value |
|--|-----------------------|----------------|-----------------|------------------|-------------------------|
| Financial assets: | | | | | |
| Cash and cash equivalents | \$ 14,817 | \$ 14,817 | \$ | \$ | \$ 14,817 |
| Investment and mortgage backed securities available for sale | 315,829 | 2,025 | 311,964 | 1,840 | 315,829 |
| Loans receivable, net | 922,286 | | | 943,403 | 943,403 |
| Accrued interest receivable | 4,307 | 4,307 | | | 4,307 |
| FHLB stock | 10,024 | 10,024 | | | 10,024 |
| Mortgage servicing rights | 371 | | | 371 | 371 |
| Bank owned life insurance | 29,025 | 29,025 | | | 29,025 |
| Financial liabilities: | | | | | |
| Deposits | \$ 996,391 | \$ 377,386 | \$ | \$ 598,669 | 976,055 |
| Short-term borrowings | 33,000 | 33,000 | | | 33,000 |
| Other borrowings | 145,760 | | | 145,630 | 145,630 |
| Advances by borrowers for taxes and insurance | 7,360 | 7,360 | | | 7,360 |
| Accrued interest payable | 1,142 | 1,142 | | | 1,142 |

Table of Contents

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

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

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

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

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

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

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

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

The fair value approximates the current book value.

Bank-Owned Life Insurance

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

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

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

Loans Receivable

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

Table of Contents**Mortgage Servicing Rights**

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

Deposit Liabilities

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

Other Borrowings

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

Commitments to Extend Credit

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

12. Accumulated Other Comprehensive Income

The activity in accumulated other comprehensive income for the three months ended December 31, 2013 and 2012 is as follows:

| | Accumulated Other Comprehensive Income/(Loss) | | |
|--|--|-------------------------------|--------------|
| | (1) | | |
| | Unrealized Gains | | |
| | Defined Benefit(Losses) on Securities | | |
| | Pension Plan | Available for Sale | Total |
| Balance at September 30, 2013 | \$ (1,306) | \$ 71 | \$ (1,235) |
| Other comprehensive loss before reclassifications | | (1,345) | (1,345) |
| Amounts reclassified from accumulated other comprehensive income | 5 | | 5 |
| Period change | 5 | (1,345) | (1,340) |

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

| | | | |
|--|------------|------------|------------|
| Balance at December 31, 2013 | \$ (1,301) | \$ (1,274) | \$ (2,575) |
| Balance at September 30, 2012 | \$ (4,450) | \$ 6,208 | \$ 1,758 |
| Other comprehensive loss before reclassifications | | (614) | (614) |
| Amounts reclassified from accumulated other comprehensive income | 64 | (20) | 44 |
| Period change | 64 | (634) | (570) |
| Balance at December 31, 2012 | \$ (4,386) | \$ 5,574 | \$ 1,188 |

- (1) All amounts are net of tax. Related income tax expense or benefit is calculated using an income tax rate approximating 34%.

Table of Contents

| | Amount Reclassified from Accumulated Other Comprehensive Income (1) | | Affected Line Item in the Consolidated Statement of Income |
|---|--|----------------|--|
| | Accumulated Other Comprehensive Income for the Three Months Ended December 31, 2013 | 2012 | |
| Securities available for sale: | | | |
| Net securities gains reclassified into earnings | \$ | \$ 30 | Gain on sale of investments, net |
| Related income tax expense | | (10) | Provision for income taxes |
| Net effect on accumulated other comprehensive income for the period | | 20 | Net of tax |
| Defined benefit pension plan: | | | |
| Amortization of net loss and prior service costs | (7) | (97) | Compensation and employee benefits |
| Related income tax expense | \$ 2 | \$ 33 | Provision for income taxes |
| Net effect on accumulated other | (5) | (64) | Net of tax |
| Total reclassification for the period | \$ (5) | \$ (44) | Net of tax |

(1) Amounts in parentheses indicate debits.

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 December 31, 2013 and September 30, 2013

Total Assets. Total assets decreased by \$17.1 million, or 1.3%, to \$1,355 million at December 31, 2013 from \$1,372 million at September 30, 2013. Decreases in cash and due from banks and loans receivable were the primary reasons for the decline.

Table of Contents

Cash and Due from Banks. Cash and due from banks declined \$11.1 million to \$11.3 million at December 31, 2013 from \$22.4 million at September 30, 2013. The primary reason for the decline was a decline in the Company's Federal Reserve account of \$9.8 million.

Interest-Bearing Deposits with Other Institutions. Interest-bearing deposits with other institutions decreased \$731,000, or 17.2%, to \$3.5 million at December 31, 2013 from \$4.3 million at September 30, 2013.

Net Loans. Net loans decreased \$5.9 million, or 0.6%, to \$922.3 million at December 31, 2013 from \$928.2 million at September 30, 2013. During this period, residential real estate loans outstanding decreased by \$12.4 million to \$674.3 million. Commercial loans decreased \$217,000 to \$9.9 million, and home equity loans and lines of credit decreased \$1.1 million to \$40.8 million. These decreases were partially offset by increases in construction loans outstanding of \$607,000 to \$2.9 million, commercial real estate loans of \$447,000 to \$159.9 million, other loans of \$7,000 to \$2.4 million and obligations of states and political subdivisions of \$7.0 million to \$40.4 million.

Other Assets. Other assets decreased \$1.3 million, or 6.0%, to \$20.2 million at December 31, 2013 from \$21.5 million at September 30, 2013.

Deposits. Deposits decreased \$44.7 million, or 4.3%, to \$996.4 million at December 31, 2013 from \$1.0 billion at September 30, 2013. At December 31, 2013 compared to September 30, 2013, certificate of deposit accounts decreased \$38.6 million to \$595.5 million, NOW accounts decreased \$6.7 million to \$93.1 million, and money market accounts decreased \$749,000 million to \$137.3 million. These decreases were offset, in part, during the same period by an increase in non-interest bearing demand accounts of \$315,000 million to \$59.1 million and savings and club accounts of \$1.1 million to \$111.3 million. Included in the certificates of deposit at December 31, 2013 was a decrease in brokered certificates of \$32.5 million to \$200.9 million. Brokered certificates declined primarily because FHLBank Pittsburgh borrowings were a less costly funding alternative.

Borrowed Funds. Borrowed funds increased by \$26.5 million, or 17.4%, to \$178.8 million at December 31, 2013, from \$152.3 million at September 30, 2013. The increase in borrowed funds was primarily due to increases in short term FHLBank Pittsburgh borrowings of \$10.0 million and other borrowings of \$16.5 million.

Stockholders' Equity. Stockholders' equity increased by \$103,000, or 0.1%, to \$166.5 million at December 31, 2013 from \$166.5 million at September 30, 2013. This increase was primarily the result of net income of \$2.0 million which was partially offset by an increase in accumulated other comprehensive loss of \$1.3 million to \$2.6 million at December 31, 2013 from \$1.2 million at September 30, 2013.

Table of Contents**Average Balance Sheets for the Three Months Ended December 31, 2013 and 2012**

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 December 31, | | | | | |
|--------------------------------------|--|----------------|--------------------|-----------------|-------------|--------------------|
| | Average | 2013 | Yield/ Cost | Average | 2012 | Yield/ Cost |
| Balance | Interest | Balance | | Interest | | |
| | Income/ | Expense | Cost | Expense | Cost | |
| (dollars in thousands) | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans (1) | \$ 928,643 | \$ 10,523 | 4.50% | \$ 953,090 | \$ 12,237 | 5.09% |
| Investment securities | | | | | | |
| Taxable (2) | 87,136 | 426 | 1.94% | 96,785 | 422 | 1.73% |
| Exempt from federal income tax (2) | | | | | | |
| (3) | 13,685 | 73 | 3.21% | 10,038 | 54 | 3.23% |
| Total investment securities | 100,821 | 499 | 2.11% | 106,823 | 476 | 1.87% |
| Mortgage-backed securities | 217,736 | 1,101 | 2.01% | 218,612 | 1,208 | 2.19% |
| Federal Home Loan Bank stock | 9,729 | 55 | 2.24% | 19,914 | 24 | 0.48% |
| Other | 7,989 | 4 | 0.20% | 5,657 | 5 | 0.35% |
| Total interest-earning assets | 1,264,918 | 12,182 | 3.83% | 1,304,096 | 13,950 | 4.25% |
| Allowance for loan losses | (7,993) | | | (7,408) | | |
| Noninterest-earning assets | 104,109 | | | 102,046 | | |
| Total assets | \$ 1,361,034 | | | \$ 1,398,734 | | |
| Interest-bearing liabilities: | | | | | | |
| NOW accounts | \$ 90,559 | 11 | 0.05% | \$ 95,415 | 13 | 0.05% |
| Money market accounts | 137,745 | 70 | 0.20% | 153,302 | 116 | 0.30% |
| Savings and club accounts | 107,367 | 14 | 0.05% | 100,692 | 12 | 0.05% |
| Certificates of deposit | 614,547 | 1,893 | 1.22% | 578,902 | 1,830 | 1.25% |
| Borrowed funds | 170,358 | 703 | 1.64% | 228,709 | 1,260 | 2.19% |
| Total interest-bearing liabilities | 1,120,576 | 2,691 | 0.95% | 1,157,020 | 3,231 | 1.11% |
| Non-interest bearing NOW accounts | 58,412 | | | 48,791 | | |
| Noninterest-bearing liabilities | 13,988 | | | 15,586 | | |
| Total liabilities | 1,192,976 | | | 1,221,397 | | |
| Equity | 168,058 | | | 177,337 | | |

| | | | |
|---|--------------|----------|--------------|
| Total liabilities and equity | \$ 1,361,034 | | \$ 1,398,734 |
| Net interest income | | \$ 9,491 | \$ 10,719 |
| Interest rate spread | | 2.88% | 3.14% |
| Net interest-earning assets | \$ 144,342 | | \$ 147,076 |
| Net interest margin (4) | | 2.98% | 3.26% |
| Average interest-earning assets to average interest-bearing liabilities | | 112.88% | 112.71% |

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

Table of Contents**Comparison of Operating Results for the Three Months Ended December 31, 2013 and December 31, 2012**

Net Income. Net income decreased \$875,000, or 30.4%, to \$2.0 million for the three months ended December 31, 2013 compared to net income of \$2.9 million for the comparable period in 2012. The decrease was due primarily to decreases in net interest income and noninterest income along with an increase in noninterest expenses.

Net Interest Income. Net interest income decreased \$1.2 million, or 11.5%, to \$9.5 million for the three months ended December 31, 2013 from \$10.7 million for the comparable period in 2012. The decrease was primarily attributable to a decrease in the Company's interest rate spread to 2.88% for the three months ended December 31, 2013, from 3.14% for the comparable period in 2012, along with a decrease of \$2.7 million in the Company's average net earnings assets.

Interest Income. Interest income decreased \$1.8 million, or 12.7%, to \$12.2 million for the three months ended December 31, 2013 from \$14.0 million for the comparable 2012 period. The decrease resulted primarily from a decline in the yield on interest earning assets. Average interest earning assets decreased \$39.2 million and the average yield on interest earning assets decreased forty-two basis points. The average yield on interest earning assets was 3.83% for the three months ended December 31, 2013, as compared to 4.25% for the comparable 2012 period. Loans decreased on average \$24.4 million between the two periods. In addition, average investment securities decreased \$6.0 million, mortgage-backed securities decreased \$876,000, FHLBank Pittsburgh stock decreased \$10.2 million and other interest earning assets increased \$2.3 million. The increase in other interest earning assets was primarily due to a corresponding increase in the average balance of cash held at FHLBank Pittsburgh. Interest income for the three months ended December 31, 2013 included approximately \$77,000 of net accretion of fair market value adjustments for credit and yield applied to First Star loans at the acquisition closing date of July 31, 2012 compared to \$424,000 for the comparable 2012 period. In addition, interest income for the quarter included approximately \$541,000 of the recapture of fair value adjustments to loans acquired as part of the First Star acquisition that were either fully or partially repaid during the quarter compared to \$973,000 of similar repayments for the comparable 2012 period.

Interest Expense. Interest expense decreased \$540,000, or 16.7%, to \$2.7 million for the three months ended December 31, 2013 from \$3.2 million for the comparable 2012 period. The decrease resulted from a 16 basis point decrease in the overall cost of interest bearing liabilities to 0.95% for the three months ended December 31, 2013 from 1.11% for the comparable 2012 period, along with a \$36.4 million decrease in average interest-bearing liabilities. Average interest bearing liabilities decreased primarily as a result of declines in borrowed funds of \$58.4 million, money market accounts of \$15.6 million and NOW accounts of \$4.9 million offset, in part, by an increase in certificates of deposit of \$35.6 million and savings and club accounts of \$6.7 million.

Provision for Loan Losses. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are subject to interpretation and revision as more information becomes available or as future events occur. After an evaluation of these factors, management made a provision for loan losses of \$750,000 for the three month period ended December 31, 2013 as compared to \$1.0 million for the three month period ended December 31, 2012. The allowance for loan losses was \$8.4 million, or 0.90% of loans outstanding, at December 31, 2013, compared to \$8.1 million, or 0.86% of loans outstanding at September 30, 2013.

Non-interest Income. Non-interest income decreased \$399,000, or 19.7%, to \$1.6 million for the three months ended December 31, 2013 from \$2.0 million for the comparable period in 2012. The primary reasons for the decrease were decreases in gain on sale of loans, net of \$334,000, service fees on loans of \$44,000 and gain on sale of investments of \$30,000 during the three months ended December 31, 2013. As part of its overall interest rate risk management

strategy, the Company sold \$11.5 million of long-term, fixed-rate mortgage loans during the quarter ended December 31, 2012. There were no loans sold during the quarter ended December 31, 2013.

Non-interest Expense. Non-interest expense increased \$243,000, or 3.2%, to \$7.7 million for the three months ended December 31, 2013 from \$7.5 million for the comparable period in 2012. The primary reasons for the increase were increases in (gain) loss on foreclosed real estate of \$268,000, merger related costs of \$258,000 and professional fees of \$97,000. These increases were partially offset by decreases in compensation and employee benefits of \$248,000 and occupancy and equipment of \$31,000 and amortization of intangible assets of \$145,000.

Income Taxes. Income tax expense decreased \$745,000 to \$616,000 for the three months ended December 31, 2013 from \$1.4 million for the comparable 2012 period. The decrease was primarily a result of a decrease in income before taxes of \$1.6 million for the three months ended December 31, 2013. The effective tax rate was 23.5% for the three months ended December 31, 2013, compared to 32.1% for the 2012 period. The decrease in the effective tax rate was primarily due to the increase in low income housing tax credits for the three months ended December 31, 2013 compared to the 2012 period and to the decrease in the portion of pre-tax income derived from non-taxable loan and investment income for the 2013 period compared to the 2012 period.

Table of Contents**Non-Performing Assets**

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

| | December 31, 2013 | September 30, 2013 |
|---|------------------------------|-------------------------------|
| Non-performing assets: | | |
| Non-accruing loans | \$ 23,503 | \$ 23,279 |
| Troubled debt restructures | 713 | 585 |
| | | |
| Total non-performing loans | 24,216 | 23,864 |
| Foreclosed real estate | 2,618 | 2,111 |
| | | |
| Total non-performing assets | \$ 26,834 | \$ 25,975 |
| | | |
| Ratio of non-performing loans to total loans | 2.60% | 2.55% |
| Ratio of non-performing loans to total assets | 1.79% | 1.74% |
| Ratio of non-performing assets to total assets | 1.98% | 1.89% |
| Ratio of allowance for loan losses to total loans | 0.90% | 0.86% |

Loans are reviewed on a regular basis and are placed on non-accrual status when they become more than 90 days delinquent. When loans are placed on non-accrual status, unpaid accrued interest is fully reserved, and further income is recognized only to the extent received. Non-performing assets increased \$860,000 to \$26.8 million at December 31, 2013 from \$26.0 million at September 30, 2013. Non-performing loans increased \$352,000 to \$24.2 million at December 31, 2013 from \$23.9 million at September 30, 2013. The increase was primarily due to an increase of \$1.2 million in nonperforming commercial loans and was offset, in part, by a decline in residential mortgage loans of \$1.1 million. The increase in commercial loans was primarily due to the addition of one commercial real estate loan. At December 31, 2013 the outstanding balance of this loan was \$1.7 million. The number of nonperforming residential loans decreased to 86 at December 31, 2013, from 89 at September 30, 2013. The \$23.5 million of non-accruing loans at December 31, 2013 included 82 residential loans with an aggregate outstanding balance of \$8.9 million that were past due 90 or more days at December 31, 2013, 52 commercial and commercial real estate loans with aggregate outstanding balances of \$4.8 million and 18 consumer loans with aggregate balances of \$310,000. Within the residential loan balance are \$927,000 of loans less than 90 days past due. In the quarter ended December 31, 2013, the Company identified seven residential loans which, although paying as agreed, have a high probability of default. Foreclosed real estate increased \$507,000 to \$2.6 million at December 31, 2013 from \$2.1 million at September 30, 2013. Foreclosed real estate consists of 24 residential properties, two building lots and four commercial properties.

At December 31, 2013, the principal balance of troubled debt restructures was \$7.7 million as compared to \$7.8 million at September 30, 2013. Of the \$7.7 million of troubled debt restructures at December 31, 2013, \$4.4 million are performing loans and \$3.3 million are non-accrual loans. An additional \$713,000 of performing troubled debt restructures are classified as non-performing assets because they were non-performing assets at the time they were restructured.

Of the 59 loans that comprise our troubled debt restructures at December 31, 2013, no loans were granted a rate concession at a below market interest rate. Nineteen loans with balances totaling \$2.8 million were granted market rate and terms concessions, and 40 loans with balances totaling \$4.9 million were granted term concessions.

As of December 31, 2013, troubled debt restructures were comprised of 42 residential loans totaling \$6.0 million, 11 commercial and commercial real estate loans totaling \$1.5 million, and six consumer (home equity loans, home equity lines and credit, and other) totaling \$197,000.

For the three month period ended December 31, 2013, one loan totaling \$357,000 paid off and was removed from TDR status.

We have modified terms of loans that do not meet the definition of a TDR. The vast majority of such loans were rate modifications of residential first mortgage loans in lieu of refinancing. The non-TDR rate modifications were all performing loans when the rates were reset to current market rates. For the three months ended December 31, 2013, we modified 11 loans (\$957,000) in this fashion. With regard to commercial loans, including commercial real estate loans, various non-troubled loans were modified, either for the purpose of a rate reduction to reflect current market rates (in lieu of a refinance) or the extension of a loan's maturity date. In total, there were eight such loans in the three months ended December 31, 2013 with an aggregate balance of approximately \$7.1 million.

Liquidity and Capital Resources

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

Table of Contents

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

A portion of our liquidity consists of cash and cash equivalents and borrowings, which are a product of our operating, investing and financing activities. At December 31, 2013, \$14.8 million of our assets were invested in cash and cash equivalents. Our primary sources of cash are principal repayments on loans, proceeds from the maturities of investment securities, principal repayments of mortgage-backed securities and increases in deposit accounts. Short-term investment securities (maturing in one year or less) totaled \$2.9 million at December 31, 2013. As of December 31, 2013, we had \$168.8 million in borrowings outstanding from FHLBank Pittsburgh and \$10.0 million in borrowings through repurchase agreements with other financial institutions. We have access to additional FHLBank Pittsburgh advances of up to approximately \$592.9 million.

At December 31, 2013, we had \$59.8 million in loan commitments outstanding, which included, in part, \$19.3 million in undisbursed construction loans and land development loans, \$31.8 million in unused home equity lines of credit, \$3.5 million in commercial lines of credit and commitments to originate commercial loans, \$4.5 million in performance standby letters of credit and \$4.2 million in other unused commitments which are primarily to originate residential mortgage loans and multifamily loans. Certificates of deposit due within one year of December 31, 2013 totaled \$254.2 million, or 42.5% of certificates of deposit. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before December 31, 2014. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

As reported in the Consolidated Statements of Cash Flows, our cash flows are classified for financial reporting purposes as operating, investing or financing cash flows. Net cash provided by operating activities was \$3.2 million and \$6.1 million for the three months ended December 31, 2013 and 2012, respectively. These amounts differ from our net income because of a variety of cash receipts and disbursements that did not affect net income for the respective periods. Net cash provided in investing activities was \$1.5 million and \$8.2 million for the three months ended December 31, 2013 and 2012, respectively, principally reflecting our loan and investment security activities. Deposit and borrowing cash flows have comprised most of our financing activities which resulted in net cash used of \$16.5 million and \$9.9 million for the three months ended December 31, 2013 and 2012, respectively.

Critical Accounting Policies

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

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

judgment involved, the subjectivity of the assumptions utilized and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

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

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

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

Table of Contents

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

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

Off-Balance Sheet Arrangements

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

Contractual Obligations

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. The net proceeds from the Company's stock offering increased our capital and provided management with greater flexibility to manage our interest rate risk. In particular, management used the majority of

the capital we received to increase our interest-earning assets. There have been no material changes in our interest rate risk since September 30, 2013.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

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

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

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

Item 1A. Risk Factors

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

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

The following table presents a summary of the company's share repurchases during the quarter ended December 31, 2013.

Company Purchases of Common Stock

| Month Ending | Total number of shares purchased | Average price paid per share | Total number of shares purchased as of part of publicly announced plans or under the plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|---------------------|---|-------------------------------------|---|---|
| October 31, 2013 | | \$ | | |
| November 30, 2013 | | | | |
| December 31, 2013 | 17,600 | 11.14 | 17,600 | |
| Total | 17,600 | \$ 11.14 | 17,600 | 41,626 |

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Table of Contents

Item 6. Exhibits

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

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

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

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

Table of Contents

SIGNATURES

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

ESSA BANCORP, INC.

Date: February 10, 2014

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

Date: February 10, 2014

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