

ESSA Bancorp, Inc.
Form 10-K
December 16, 2013
Table of Contents

SECURITIES AND EXCHANGE COMMISSION

100 F Street NE

Washington, D.C. 20549

FORM 10-K

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended September 30, 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)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.01 par value	The NASDAQ Stock Market, LLC
Securities Registered Pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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

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 twelve 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 (§232.405 of this chapter) 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 the definitions of large accelerated filer, 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 December 6, 2013, there were 18,133,095 shares issued and 11,945,564 shares outstanding of the Registrant's Common Stock.

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the last sale price on March 31, 2013, was \$114,120,886.

DOCUMENTS INCORPORATED BY REFERENCE

Proxy Statement for the 2013 Annual Meeting of Stockholders of the Registrant (Part III).

Table of Contents

TABLE OF CONTENTS

PART I

Item 1.	<u>Business</u>	1
Item 1A.	<u>Risk Factors</u>	26
Item 1B.	<u>Unresolved Staff Comments</u>	30
Item 2.	<u>Properties</u>	31
Item 3.	<u>Legal Proceedings</u>	32
Item 4.	<u>Mine Safety Disclosures</u>	32

PART II

Item 5.	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	33
Item 6.	<u>Selected Financial Data</u>	36
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	37
Item 7A.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	47
Item 8.	<u>Financial Statements and Supplementary Data</u>	47
Item 9.	<u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	47
Item 9A.	<u>Controls and Procedures</u>	47
Item 9B.	<u>Other Information</u>	48

PART III

Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	48
Item 11.	<u>Executive Compensation</u>	48
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	48
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	48
Item 14.	<u>Principal Accounting Fees and Services</u>	48

PART IV

Item 15.	<u>Exhibits and Financial Statement Schedules</u>	49
----------	--	----

Table of Contents

Forward Looking Statements

This Annual Report contains certain forward-looking statements which may be identified by the use of words such as believe, expect, anticipate, should, planned, estimated and potential. Examples of forward-looking statements but are not limited to, estimates with respect to our financial condition, results of operations and business that are subject to various factors which could cause actual results to differ materially from these estimates and most other statements that are not historical in nature. These factors include, but are not limited to, general and local economic conditions, changes in interest rates, deposit flows, demand for mortgage, and other loans, real estate values, competition, changes in accounting principles, policies, or guidelines, changes in legislation or regulation, and other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and the ability to successfully complete or close transactions or to integrate acquired entities. Because of these and a wide variety of other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. Please also see Item 1A. Risk Factors.

PART I

Item 1. Business
ESSA Bancorp, Inc.

ESSA Bancorp, Inc. is the Pennsylvania-chartered stock holding company of ESSA Bank & Trust. ESSA Bancorp, Inc. owns 100% of the outstanding shares of common stock of ESSA Bank & Trust. Since being formed in 2006, ESSA Bancorp, Inc. has engaged primarily in the business of holding the common stock of ESSA Bank & Trust. Our executive offices are located at 200 Palmer Street, Stroudsburg, Pennsylvania 18360. Our telephone number at this address is (570) 421-0531. ESSA Bancorp, Inc. is subject to comprehensive regulation and examination by the Federal Reserve Board of Governors. On July 31, 2012, ESSA Bancorp, Inc. completed its acquisition of First Star Bancorp, Inc. and its wholly-owned subsidiary, First Star Bank. The total value of the consideration for the acquisition was \$24.6 million, 50% of which was paid in cash and the remainder paid in the form of ESSA Bancorp, Inc. common stock. The information presented herein includes the combined operations of both companies as of July 31, 2012. At September 30, 2013, ESSA Bancorp, Inc. had consolidated assets of \$1.4 billion, consolidated deposits of \$1.0 billion and consolidated stockholders' equity of \$166.5 million. Its consolidated net income for the fiscal year ended September 30, 2013 was \$8.8 million.

On November 15, 2013, ESSA Bancorp, Inc. entered into an Agreement and Plan of Merger (the Merger Agreement) by and among ESSA Bancorp, Inc., ESSA Acquisition Corp. (a wholly owned subsidiary of ESSA Bancorp, Inc.) and Franklin Security Bancorp, Inc. (FS Bancorp), pursuant to which (i) FS Bancorp will merge with and into ESSA Bancorp, with ESSA Bancorp as the surviving entity, and (ii) immediately thereafter, Franklin Security Bank (Franklin Bank) will be merged with and into ESSA Bank & Trust with ESSA Bank as the surviving bank (collectively, the Merger). Under the terms of the Merger Agreement, stockholders of FS Bancorp will receive a cash payment equal to nine dollars and seventy five cents (\$9.75) for each share of FS Bancorp common stock, or an aggregate of approximately \$15.7 million. The transaction has been approved by the Board of Directors of each company and is expected to close in the second quarter of 2014. Completion of the Merger is subject to customary closing conditions, including the receipt of required regulatory approvals and the approval of FS Bancorp's stockholders.

ESSA Bank & Trust

General

ESSA Bank & Trust was organized in 1916. ESSA Bank & Trust is a Pennsylvania chartered full-service, community-oriented savings and loan association. We provide financial services to individuals, families and businesses through our 26 full-service banking offices, located in Monroe, Northampton and Lehigh Counties, Pennsylvania. ESSA Bank & Trust is subject to comprehensive regulation and examination by the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation. Pursuant to changes in Pennsylvania law, ESSA Bank & Trust has applied to change its charter from a Pennsylvania savings and loan association to a Pennsylvania savings bank. The charter change is not expected to have a material effect on the operations of ESSA Bank & Trust. Additionally, ESSA Bank & Trust has previously announced that it will purchase from First National Community Bank (FNCB) the deposit and loans associated with two FNCB branches, and the FNCB branch located in Marshalls Creek, Pennsylvania. Customer deposits and loans from the FNCB Stroudsburg office will be transferred to ESSA Bank and Trust 's Stroudsburg facility. ESSA Bank & Trust plans to consolidate two of its branches, located in Bushkill, Pennsylvania and Marshalls Creek, into the newly acquired FNCB Marshalls Creek facility. Subject to regulatory approval, the transaction is expected to close in January 2014.

ESSA Bank & Trust 's business consists primarily of accepting deposits from the general public and investing those deposits, together with funds generated from operations and borrowings, in residential first mortgage loans (including construction mortgage loans), commercial real estate loans, home equity loans and lines of credit, commercial and consumer loans. We offer a

Table of Contents

variety of deposit accounts, including checking, savings and certificates of deposits. We also offer asset management and trust services. We offer investment services through our relationship with Cetera Investment Services LLC, a third party broker/dealer and investment advisor. We offer insurance benefit consulting services through our wholly owned subsidiary, ESSA Advisory Services, LLC.

ESSA Bank & Trust's executive offices are located at 200 Palmer Street, Stroudsburg, Pennsylvania 18360. Our telephone number at this address is (570) 421-0531. Our website address is www.essabank.com.

The Company is a public company, and files interim, quarterly and annual reports with the Securities and Exchange Commission (SEC). All filed SEC reports and interim filings can be obtained from the Bank's website, on the Investor Relations page, without charge from the Company.

Market Area

At September 30, 2013, our 26 full-service banking offices consisted of 13 offices in Monroe County, six offices in Lehigh County, and seven offices in Northampton County, Pennsylvania. Our primary market for deposits is currently concentrated around the areas where our full-service banking offices are located. Our primary lending area consists of the counties where our branch offices are located, and to a lesser extent, the contiguous counties in the Commonwealth of Pennsylvania.

Monroe County is located in eastern Pennsylvania, situated 90 miles north of Philadelphia, 75 miles west of New York and 116 miles northeast of Harrisburg. Monroe County is comprised of 611 square miles of mostly rural terrain. Major industries include tourism, construction and educational facilities. Northampton County is located south of Monroe County and directly borders New Jersey. Lehigh County is located southwest of Monroe County. As of September 30, 2013, we had a deposit market share of approximately 29.5% in Monroe County, which represented the largest deposit market share in Monroe County, 3.2% in Northampton County and 2.1% in Lehigh County.

Lending Activities

Historically, our principal lending activity has been the origination of first mortgage loans for the purchase, construction or refinancing of one-to-four family residential real property. In recent years, we have increased our originations of commercial loans and commercial real estate loans in an effort to increase interest income, diversify our loan portfolio, and better serve the community. Commercial real estate loans have increased from 9.2% of our total loan portfolio at September 30, 2009 to \$159.5 million, or 17.0% of our total loan portfolio at September 30, 2013. One-to-four family residential real estate mortgage loans represented \$686.7 million, or 73.3%, of our loan portfolio at September 30, 2013. Home equity loans and lines of credit totaled \$41.9 million, or 4.5% of our loan portfolio at September 30, 2013. Commercial loans totaled \$10.1 million, or 1.1% of our loan portfolio at September 30, 2013 and construction first mortgage loans totaled \$2.3 million or 0.2% of the total loan portfolio at September 30, 2013. Obligations of states and political subdivisions totaled \$33.4 million or 3.6% of our loan portfolio at September 30, 2013. We originate other consumer loans on a limited basis.

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio, by type of loan at the dates indicated, excluding loans held for sale.

	At September 30,				
2013	2012	2011	2010	2009	

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

Amount Percent Amount Percent Amount Percent Amount Percent Amount Percent
(Dollars in thousands)

Residential first mortgage loans:										
One-to-four family	\$ 686,651	73.3%	\$ 696,696	72.8%	\$ 583,599	78.1%	\$ 596,455	80.8%	\$ 604,010	81.7%
Construction	2,288	0.2	3,805	0.4	691	0.1	1,302	0.2	1,707	0.2
Commercial	10,125	1.1	12,818	1.3	14,766	2.0	16,545	2.2	16,452	2.2
Commercial real estate	159,469	17.0	160,192	16.7	79,362	10.6	77,943	10.6	67,888	9.2
Obligations of states and political subdivisions	33,445	3.6	33,736	3.5	25,869	3.5				
Home equity loans and lines of credit	41,923	4.5	47,925	5.0	40,484	5.4	43,559	5.9	46,812	6.3
Other	2,393	0.3	2,485	0.3	2,018	0.3	2,486	0.3	2,526	0.4
Total loans receivable	\$ 936,294	100.0%	\$ 957,657	100.0%	\$ 746,789	100.0%	\$ 738,290	100.0%	\$ 739,395	100.0%
Allowance for loan losses	(8,064)		(7,302)		(8,170)		(7,448)		(5,815)	
Total loans receivable, net	\$ 928,230		\$ 950,355		\$ 738,619		\$ 730,842		\$ 733,580	

Table of Contents

Loan Portfolio Maturities and Yields. The following table summarizes the scheduled repayments of our loan portfolio at September 30, 2013. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less.

	One-to-four family		Construction		Commercial		Commercial Real Estate	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
(Dollars in thousands)								
Due During the Years Ending September 30,								
2014	\$ 796	6.01%	\$		\$ 1,274	5.14%	\$ 22,942	5.11%
2015	652	5.39%			841	6.05%	13,325	4.98%
2016	2,057	5.48%			1,051	5.12%	9,696	5.48%
2017 to 2018	20,381	4.87%			1,614	5.11%	24,837	5.97%
2019 to 2023	100,667	3.91%			3,591	5.73%	27,428	4.66%
2024 to 2028	259,159	3.45%	392	2.76%	630	5.50%	21,894	4.94%
2028 and beyond	302,939	4.90%	1,896	3.68%	1,124	4.45%	39,347	4.86%
Total	\$ 686,651	4.21%	\$ 2,288	3.52%	\$ 10,125	5.36%	\$ 159,469	5.09%

	Political Subdivisions		Home Equity Loans and Lines of Credit		Other		Total	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
(Dollars in thousands)								
Due During the Years Ending September 30,								
2014	\$ 92	3.25%	\$ 498	5.78%	\$ 677	5.39%	\$ 26,279	5.15%
2015			424	5.21%	262	5.94%	15,504	5.08%
2016			1,873	4.13%	201	7.46%	14,878	5.31%
2017 to 2018			2,681	5.55%	1,014	5.72%	50,527	5.47%
2019 to 2023	4,087	3.36%	11,277	5.35%	147	8.42%	147,197	4.19%
2024 to 2028	2,217	1.66%	13,101	3.66%		0.00%	297,393	3.56%
2028 and beyond	27,049	3.96%	12,069	3.82%	92	4.74%	384,516	4.79%
Total	\$ 33,445	3.73%	\$ 41,923	4.34%	\$ 2,393	5.93%	\$ 936,294	4.36%

The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at September 30, 2013 that are contractually due after September 30, 2014.

Due After September 30, 2014
Fixed Adjustable Total
(In thousands)

Residential first mortgage loans:			
	Fixed	Adjustable	Total
One-to-four family	\$ 644,398	\$ 41,457	\$ 685,855
Construction	2,270	18	2,288
Commercial	3,894	4,957	8,851
Commercial real estate	25,385	111,142	136,527
Obligations of states and political subdivisions	15,308	18,045	33,353
Home equity loans and lines of credit	14,269	27,156	41,425
Other	1,556	160	1,716
Total	\$ 707,080	\$ 202,935	\$ 910,015

Table of Contents

Loan Originations and Repayments. We originate residential mortgage loans pursuant to underwriting standards that generally conform to Fannie Mae and Freddie Mac guidelines. Loan origination activities are primarily concentrated in Monroe, Northampton and Lehigh Counties, Pennsylvania and secondarily from other Pennsylvania counties contiguous to Monroe County. New loans are generated primarily from the efforts of employees and advertising, a network of select mortgage brokers, other parties with whom we do business, customer referrals, and from walk-in customers. Loan applications are centrally underwritten and processed at our corporate center.

One-to-four family Residential Loans. Historically, our principal lending activity has consisted of the origination of one-to-four family residential mortgage loans secured primarily by properties located in Monroe and Northampton Counties, Pennsylvania. At September 30, 2013, approximately \$686.7 million, or 73.3% of our loan portfolio, consisted of one-to-four family residential loans. Our origination of one-to-four family loans increased in fiscal year 2013 compared to fiscal years 2012 and 2011. Originations in fiscal year 2013 were positively influenced by a significant amount of refinancing activity due to record low mortgage rates. Generally, one-to-four family residential mortgage loans are originated in amounts up to 80% of the lesser of the appraised value or purchase price of the property, although loans may be made with higher loan-to-value ratios if private mortgage insurance is specified to compensate for the risk. Fixed-rate loans are originated for terms of 10, 15, 20 and 30 years. At September 30, 2013, our largest loan secured by one-to-four family real estate had a principal balance of approximately \$1.4 million and was secured by a single family house. This loan was performing in accordance with its repayment terms.

We also offer adjustable-rate mortgage loans which have initial fixed terms of one, three, five or seven-years before converting to an annual adjustment schedule based on changes in a designated United States Treasury index. We originated \$750,000 of adjustable rate one-to-four family residential loans during the year ended September 30, 2013 and \$1.3 million during the year ended September 30, 2012. Our adjustable rate mortgage loans provide for maximum rate adjustments of 200 basis points per adjustment, with a lifetime maximum adjustment of 500 basis points. Our adjustable rate mortgage loans amortize over terms of up to 30 years.

Adjustable rate mortgage loans decrease the risk associated with changes in market interest rates by periodically repricing, but involve other risks. As interest rates increase, the principal and interest payments on the loan increase, thus increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Adjustment of the contractual interest rate is limited by the periodic and lifetime interest rate adjustments specified by our loan documents; and therefore, is potentially limited in effectiveness during periods of rapidly rising interest rates. At September 30, 2013, \$41.5 million, or 6.0%, of our one-to-four family residential loans had adjustable rates of interest.

All one-to-four family residential mortgage loans that we originate include due-on-sale clauses, which give us the right to declare a loan immediately due and payable in the event that the borrower sells or otherwise conveys title to the real property subject to the mortgage and the loan is not repaid.

Regulations limit the amount that a savings association may lend relative to the value of the real estate securing the loan, as determined by an appraisal of the property at the time the loan is originated. For all purchase money loans, we utilize outside independent appraisers approved by the Board of Directors. All purchase money and most refinance loans require a lender's title insurance policy. Certain modest refinance requests may utilize an automated valuation model with an exterior inspection report and title search. We also require fire and casualty insurance and, where circumstances warrant, flood insurance.

Home Equity Loans and Lines of Credit. Home equity loans and lines of credit are generated almost exclusively by our branch staff. Eligible properties include primary and vacation homes in northeastern Pennsylvania, with the majority of loans being originated in Monroe County. As of September 30, 2013, home equity loans and lines totaled

about \$41.9 million, or 4.5% of our loan portfolio.

The maximum combined loan-to-value originated is currently 80%, depending on the collateral and the holder of the first mortgage. There is a small portion of the portfolio originated in years past that contains original combined loan-to-values of up to 90%. Our home equity lines of credit typically feature a 10 year draw period with interest-only payments permitted, followed by another 10 years of fully amortizing payments with no further ability to draw funds. Similar combined loan-to-value characteristics and standards exist for the lines as are outlined above for the loans.

Loan underwriting standards limit the maximum size of a junior lien loan to between \$100,000 and \$200,000, depending on the loan type and collateral. All loans exceeding 70-75% of value require an appraisal by bank-approved, licensed appraisers. Loans up to \$25,000 with lesser loan-to-value ratios may have utilized either automated valuation models or county tax assessments. Title/lien searches are secured on all home equity loans and lines greater than \$25,000.

Table of Contents

Commercial Real Estate Loans. At September 30, 2013, \$159.5 million, or 17.0% of our total loan portfolio consisted of commercial real estate loans. Commercial real estate loans are secured by office buildings, mixed-use properties and other commercial properties. We generally originate adjustable rate commercial real estate loans with an initial term of five years and a repricing option, and a maximum term of up to 25 years. The maximum loan-to-value ratio for most commercial real estate loans is 75% to 80% and 85% for select loans with faster amortizations. At September 30, 2013, we had 665 commercial real estate loans with an outstanding balance of \$159.5 million. At September 30, 2013, our largest commercial real estate loan balance was \$5.4 million, which was performing in accordance with its terms. At September 30, 2013, 61 of our loans secured by commercial real estate totaling \$10.8 million were not performing in accordance with their terms and were on nonaccrual status.

We consider a number of factors in originating commercial real estate loans. We evaluate the qualifications and financial condition of the borrower, including credit history, profitability and expertise, as well as the value and condition of the mortgaged property securing the loan. When evaluating the qualifications of the borrower, we consider the financial resources of the borrower, the borrower's experience in owning or managing similar property and the borrower's payment history with us and other financial institutions. In evaluating the property securing the loan, the factors we consider include the net operating income of the mortgaged property before debt service and depreciation, the ratio of the loan amount to the appraised value of the mortgaged property and the debt service coverage ratio (the ratio of net operating income to debt service) to ensure that it is at least 120% of the monthly debt service. All commercial real estate loans in excess of \$250,000 are appraised by outside independent appraisers approved by the Board of Directors. Personal guarantees are obtained from commercial real estate borrowers although we may occasionally waive this requirement given very strong loan to value and debt service coverage ratios. All purchase money and most asset refinance borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance.

Loans secured by commercial real estate generally are considered to present greater risk than one-to-four family residential loans. Commercial real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate.

First Mortgage Construction Loans. At September 30, 2013, \$2.3 million, or 0.2%, of our total loan portfolio consisted of first mortgage construction loans. Most of our first mortgage construction loans are for the construction of residential properties. We currently offer fixed and adjustable-rate residential first mortgage construction loans. First mortgage construction loans are generally structured for permanent mortgage financing once the construction is completed. At September 30, 2013, our largest first mortgage construction loan balance was \$350,000. The loan was performing in accordance with its terms. First mortgage construction loans will generally be made in amounts of up to 80% of the appraised value of the completed property, or the actual cost of the improvements. First mortgage construction loans require only the payment of interest during the construction period. Once converted to permanent financing, they generally repay over a thirty-year period. Funds are disbursed based on our inspections in accordance with a schedule reflecting the completion of portions of the project.

First mortgage construction loans generally involve a greater degree of credit risk than other one-to-four family residential mortgage loans. The risk of loss on a construction loan depends, in part, upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost of construction and the successful completion of construction within budget.

For all such loans, we utilize outside independent appraisers approved by the Board of Directors. All borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance on properties.

Other Loans. We offer a variety of loans that are either unsecured or secured by property other than real estate. These loans include loans secured by deposits, personal loans and automobile loans. At September 30, 2013, these other loans totaled \$2.4 million, or 0.3% of the total loan portfolio.

Loan Approval Procedures and Authority. The loan approval process is intended to assess the borrower's ability to repay the loan, the viability of the loan, and the adequacy of the value of the property that will secure the loan. To assess the borrower's ability to repay, we review each borrower's employment and credit history and information on the historical and projected income and expenses of mortgagors. For all loans the Board has granted lending authority to prescribed loan committees. Larger and more complex loan requests require the involvement of senior management or the Board.

Table of Contents

Non-Performing Loans and Problem Assets

After a real estate secured loan becomes 15 days late, we deliver a computer generated late charge notice to the borrower and will attempt to contact the borrower by telephone. When a loan becomes 30 days delinquent, we send a delinquency letter to the borrower. We attempt to make satisfactory arrangements to bring the account current, including interviewing the borrower, until the loan is brought current or a determination is made to recommend foreclosure, deed-in-lieu of foreclosure or other appropriate action. After 75 days, if no satisfactory arrangements have been made, we will commence foreclosure proceedings.

Mortgage loans are reviewed on a regular basis and such loans 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. Further income is recognized only if and when the loan is performing and demonstrates the likelihood of full repayment.

Non-performing Loans. At September 30, 2013, \$23.3 million (or 2.6% of our total loans) were non-performing loans. The majority of these loans were commercial real estate loans and residential mortgage loans. Commercial real estate loans totaled \$10.8 million. Residential first mortgage loans that were 90 days or more past due or troubled debt restructured loans that were considered non-performing at September 30, 2013 totaled \$11.5 million. In connection with the First Star Bank acquisition, the Company acquired loans with deteriorated credit quality totaling \$12.9 million. These loans are being carried at \$7.1 million at September 30, 2013 and contributed to the significant increase in non-performing loans at September 30, 2012 compared to non-performing loans at September 30, 2011. These loans were adjusted to fair market value at the time of acquisition.

Real Estate Owned. At September 30, 2013, the Company had \$2.1 million of real estate owned consisting of 28 properties. These properties are being carried on the Company's books at fair value less estimated costs to sell. All these properties are being actively marketed and additional losses may occur.

Table of Contents

Non-Performing Assets. The table below sets forth the amounts and categories of our non-performing assets at the dates indicated.

	2013	2012	2011	2010	2009
	At September 30,				
	(Dollars in thousands)				
Non-accrual loans:					
Residential first mortgage loans:					
One-to-four family	\$ 10,945	\$ 10,536	\$ 6,854	\$ 8,360	\$ 3,524
Construction					
Commercial	1,177	1,870	306	199	122
Commercial real estate	10,818	10,909	3,502	1,411	580
Home equity loans and lines of credit	339	373	248	200	180
Other		19	61	346	159
Total	23,279	23,707	10,971	10,516	4,565
Accruing loans 90 days or more past due:					
Residential first mortgage loans:					
One-to-four family					
Construction					
Commercial					
Commercial real estate					
Home equity loans and lines of credit					
Other					
Total loans 90 days or more past due					
Troubled debt restructurings	585	533	529	361	589
Total non-performing loans	23,864	24,240	11,500	10,877	5,154
Real estate owned	2,111	2,998	2,356	2,034	2,579
Total non-performing assets	\$ 25,975	\$ 27,238	\$ 13,856	\$ 12,911	\$ 7,733
Troubled debt restructurings: *					
Residential first mortgage loans:					
One-to-four family	\$ 6,024	\$ 7,342	\$ 5,430	\$ 5,054	\$ 2,981
Construction					
Commercial	18	227	120	3	
Commercial real estate	1,582	5,344	4,372	1,865	180

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

Home equity loans and lines of credit	197	167	250	21	7
Other			58	59	
Total	\$ 7,821	\$ 13,080	\$ 10,230	\$ 7,002	\$ 3,168

Ratios:

Total non-performing loans to total loans	2.55%	2.53%	1.54%	1.47%	0.70%
Total non-performing loans to total assets	1.74%	1.71%	1.05%	1.01%	0.49%
Total non-performing assets to total assets	1.89%	1.92%	1.26%	1.20%	0.74%

* Non-performing troubled debt restructurings are included in total troubled debt restructurings for September 30, 2013 as part of the non-performing assets table.

For the year ended September 30, 2013, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$883,000.

Table of Contents

At September 30, 2013, the principal balance of troubled debt restructures was \$7.8 million as compared to \$13.1 million at September 30, 2012. Of the \$7.8 million of troubled debt restructures at September 30, 2013, \$4.5 million are performing loans and \$3.4 million are non-accrual loans. An additional \$585,000 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 make up our troubled debt restructures at September 30, 2013, no loans were granted a rate concession at a below market interest rate. Seventeen loans with balances totaling \$2.7 million were granted market rate and terms concessions and 42 loans with balances totaling \$5.1 million were granted terms concessions.

Residential real estate loans make up the vast majority of our troubled debt restructures. As of September 30, 2013, troubled debt restructures were comprised of 40 residential loans totaling \$6.0 million, 13 commercial and commercial real estate loans totaling \$1.6 million, and six consumer (Home equity loans, home equity lines and credit, and other) totaling \$197,000.

For the year ended September 30, 2013, 28 loans totaling \$6.3 million were removed from TDR status. Two loans totaling \$454,000 were transferred to foreclosed real estate, 24 loans for \$5.5 million had completed timely payments, and two loans totaling \$331,000 were paid off.

We have modified terms of performing loans that do not meet the definition of a TDR. The vast majority of such loans were simply rate modifications of residential first mortgage loans in lieu of refinancing. The non-TDR rate modifications were all performing loans when the rates were reset to current market rates. For the year ended September 30, 2013, we modified 266 loans (\$38.8 million) in this fashion. With regard to commercial loans, including commercial real estate loans, various non-troubled loans were modified, either for the purpose of a rate reduction to reflect current market rates (in lieu of a refinance) or the extension of a loan's maturity date. In total, they numbered 30 in the year ended September 30, 2013 with an aggregate balance of approximately \$11.4 million.

Table of Contents

Delinquencies. The following table sets forth certain information with respect to our loan portfolio delinquencies at the dates indicated. Loans delinquent for 90 days or more are generally classified as nonaccrual loans.

Loans Delinquent For
90 Days and
60-89 Days **Over** **Total**
Number Amount **Number Amount** **Number Amount**
(Dollars in thousands)

At September 30, 2013

Residential first mortgage loans:						
One-to-four family	8	\$ 990	92	\$ 10,945	100	\$ 11,935
Construction						
Commercial			19	1,177	19	1,177
Commercial real estate			61	10,818	61	10,818
Obligations of states and political subdivisions						
Home equity loans and lines of credit	4	77	10	339	14	416
Other						
Total	12	\$ 1,067	182	\$ 23,279	194	\$ 24,346

At September 30, 2012

Residential first mortgage loans:						
One-to-four family	11	\$ 1,274	78	\$ 10,536	89	\$ 11,810
Construction						
Commercial			27	1,870	27	1,870
Commercial real estate	3	3,348	59	10,909	62	14,257
Obligations of states and political subdivisions						
Home equity loans and lines of credit	4	138	15	373	19	511
Other			1	19	1	19
Total	18	\$ 4,760	180	\$ 23,707	198	\$ 28,467

At September 30, 2011

Residential first mortgage loans:						
One-to-four family	7	\$ 928	40	\$ 6,854	47	\$ 7,782
Construction						
Commercial	1	1	7	306	8	307
Commercial real estate			17	3,502	17	3,502
Obligations of states and political subdivisions						
Home equity loans and lines of credit	5	187	8	248	13	435
Other	1	2	2	61	3	63
Total	14	\$ 1,118	74	\$ 10,971	88	\$ 12,089

At September 30, 2010

Residential first mortgage loans:

One-to-four family	6	\$ 558	50	\$ 8,360	56	\$ 8,918
Construction						
Commercial	1	151	2	199	3	350
Commercial real estate	1	107	8	1,411	9	1,518
Home equity loans and lines of credit	5	146	6	200	11	346
Other			3	346	3	346
Total	13	\$ 962	69	\$ 10,516	82	\$ 11,478

At September 30, 2009

Residential first mortgage loans:

One-to-four family	11	\$ 1,795	19	\$ 3,524	30	\$ 5,319
Construction						
Commercial			2	122	2	122
Commercial real estate	4	537	4	580	8	1,117
Obligations of states and political subdivisions						
Home equity loans and lines of credit			5	180	5	180
Other	1	6	3	159	4	165
Total	16	\$ 2,338	33	\$ 4,565	49	\$ 6,903

Table of Contents

Classified Assets. Banking regulations and our Asset Classification Policy provide that loans and other assets considered to be of lesser quality should be classified as Substandard, Doubtful or Loss assets. An asset is considered Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all of the weaknesses inherent in those classified Substandard, with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified as Loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. We classify an asset as Special Mention if the asset has a potential weakness that warrants management's close attention. While such assets are not impaired, management has concluded that if the potential weakness in the asset is not addressed, the value of the asset may deteriorate, thereby adversely affecting the repayment of the asset.

At September 30, 2013, the Company classified approximately \$18.1 million of our assets as special mention of which \$9.9 million were commercial and commercial real estate loans, \$38.6 million as substandard of which \$20.5 million were commercial and commercial real estate loans, none as doubtful and none as loss. On the basis of management's review of its assets, at September 30, 2012, we classified approximately \$13.8 million of our assets as special mention, \$40.4 million as substandard, none as doubtful, and none as loss.

The loan portfolio is reviewed on a regular basis to determine whether any loans require classification in accordance with applicable regulations. Not all classified assets constitute non-performing assets.

Allowance for Loan Losses

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 unallocated 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 (at least quarterly) 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. Loan impairment is measured based on the fair value of collateral method, taking into account the appraised value, any valuation assumptions used, estimated costs to sell and trends in the market since the appraisal date. 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 September 30, 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 Federal Reserve Board of Governors (the Federal Reserve Board), the FDIC and the Pennsylvania Department of Banking, as an integral part of their examination process, periodically review 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

The following table sets forth activity in our allowance for loan losses for the periods indicated.

	At or For the Years Ended September 30,				
	2013	2012	2011	2010	2009
	(Dollars in thousands)				
Balance at beginning of year	\$ 7,302	\$ 8,170	\$ 7,448	\$ 5,815	\$ 4,915
Charge-offs:					
Residential first mortgage loans:					
One-to-four family	(2,401)	(2,366)	(1,175)	(190)	(117)
Construction					
Commercial		(31)	(131)	(53)	(9)
Commercial real estate	(403)	(987)		(186)	(457)
Obligations of states and political subdivisions					
Home equity loans and lines of credit	(243)	(380)	(188)	(107)	(20)
Other	(6)	(13)	(4)	(36)	
Total charge-offs	(3,053)	(3,777)	(1,498)	(572)	(603)
Recoveries:					
Residential first mortgage loans:					
One-to-four family	50	291	146		
Construction					
Commercial		26	2		
Commercial real estate	2	7		4	
Obligations of states and political subdivisions					
Home equity loans and lines of credit	13	33	14		
Other		2	3	26	3
Total recoveries	65	359	165	30	3
Net charge-offs	(2,988)	(3,418)	(1,333)	(542)	(600)
Provision for loan losses	3,750	2,550	2,055	2,175	1,500
Balance at end of year	\$ 8,064	\$ 7,302	\$ 8,170	\$ 7,448	\$ 5,815
Ratios:					
Net charge-offs to average loans outstanding	0.32%	0.44%	0.18%	0.07%	0.08%
Allowance for loan losses to non-performing loans at end of year	33.79%	30.12%	71.04%	68.48%	112.82%
Allowance for loan losses to total loans at end of year	0.86%	0.76%	1.09%	1.01%	0.79%

As previously disclosed, the Bank's primary federal regulator was changed from the Office of Thrift Supervision (OTS) to the Federal Deposit Insurance Corporation (FDIC) in July of 2011. Because the FDIC places a different emphasis on the timing of charge offs than the OTS did, the Company determined that a change to its allowance for loan loss process was necessary. Previously, where a loan loss was considered likely and that loss was measured, a specific allocation of the Company's allowance for loan losses was made to cover this loss. Actual losses were charged off when the loan in question was foreclosed upon. Beginning in March of 2012, these likely losses are being charged-off against the allowance for loan losses when determined. The Company does not believe that these additional charge offs reflect any deterioration of the credit quality of the Company's loan portfolio. These charge offs did, however, reduce the balance of the Company's allowance for loan losses by a corresponding amount. Further, the Company believes that these charge offs have also reduced the risk perceived in the loan portfolio and that the loans loss allowance at September 30, 2013 is reasonable and adequate.

See Non-Performing Loans and Problem Assets. There can be no assurance that we will not experience a deterioration of our loan portfolio, including increases in non-performing loans, problem assets and charge-offs, in the future.

Table of Contents

Allocation of Allowance for Loan Losses. The following tables set forth the allowance for loan losses allocated by loan category, the percent of the allowance to the total allowance and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	2013			2012			2011		
	Percent of Allowance to Total Amount	Percent of Loans in Category to Total Loans	Percent of Loans in Category to Total Loans	Percent of Allowance to Total Amount	Percent of Loans in Category to Total Loans	Percent of Loans in Category to Total Loans	Percent of Allowance to Total Amount	Percent of Loans in Category to Total Loans	Percent of Loans in Category to Total Loans
(Dollars in thousands)									
Residential first mortgage loans:									
One-to-four family	\$ 5,787	71.76%	73.34%	\$ 5,401	73.97%	72.75%	\$ 5,220	63.89%	78.10%
Construction	20	0.25	0.24	29	0.40	0.40	8	0.10	0.10
Commercial	337	4.18	1.08	474	6.49	1.34	500	6.12	2.00
Commercial real estate	946	11.73	17.03	699	9.57	16.73	1,329	16.26	14.10
Obligations of states and political subdivisions	130	1.61	3.57	127	1.74	3.52			
Home equity loans and lines of credit	430	5.33	4.48	499	6.83	5.00	622	7.62	5.40
Other	21	0.26	0.26	22	0.30	0.26	80	0.98	0.30
Total allocated allowance	7,671	95.12	100.00	7,251	99.30	100.00	7,759	94.97	100.00
Unallocated allowance	393	4.88		51	0.70		411	5.03	
Total allowance for loan losses	\$ 8,064	100.00%	100.00%	\$ 7,302	100.00%	100.00%	\$ 8,170	100.00%	100.00%

	2010	2009
Amount	Percent of	Percent of
	Loans in	Loans in

	Allowance to Total Allowance	Category to Total Loans	Allowance to Total Allowance	Category to Total Loans		
	(Dollars in thousands)					
Residential first mortgage loans:						
One-to-four family	\$ 4,462	59.91%	80.80%	\$ 3,796	65.28%	81.70%
Construction	15	0.20	0.20	11	0.19	0.20
Commercial	204	2.74	2.20	248	4.27	2.20
Commercial real estate	1,556	20.89	10.60	1,116	19.19	9.20
Obligations of states and political subdivisions						
Home equity loans and lines of credit						
Home equity loans and lines of credit	569	7.64	5.90	510	8.77	6.30
Other	22	0.29	0.30	33	0.56	0.40
Total allocated allowance	6,828	91.67	100.00	5,714	98.26	100.00
Unallocated allowance	620	8.33		101	1.74	
Total allowance for loan losses	\$ 7,448	100.00%	100.00%	\$ 5,815	100.00%	100.00%

We use the accrual method of accounting for all performing loans. The accrual of interest income is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. When a loan is placed on nonaccrual status, unpaid interest previously credited to income is reversed. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, residential and consumer loans are restored to accrual status when the obligation is brought current in accordance with the contractual terms for a reasonable period of time and ultimate collectibility of total contractual principal and interest is no longer in doubt. Commercial loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and ultimate collectibility of total contractual principal and interest no longer is in doubt.

Table of Contents

In our collection efforts, we will first attempt to cure any delinquent loan. If a real estate secured loan is placed on nonaccrual status, it will be subject to transfer to the real estate owned (REO) portfolio (properties acquired by or in lieu of foreclosure), upon which our loan servicing department will pursue the sale of the real estate. Prior to this transfer, the loan balance will be reduced, if necessary, to reflect its current market value less estimated costs to sell. Write downs of REO that occur after the initial transfer from the loan portfolio and costs of holding the property are recorded as other operating expenses, except for significant improvements which are capitalized to the extent that the carrying value does not exceed estimated net realizable value.

Fair values for determining the value of collateral are estimated from various sources, such as real estate appraisals, financial statements and from any other reliable sources of available information. For those loans deemed to be impaired, collateral value is reduced for the estimated costs to sell. Reductions of collateral value are based on historical loss experience, current market data, and any other source of reliable information specific to the collateral.

This analysis process is inherently subjective, as it requires us to make estimates that are susceptible to revisions as more information becomes available. Although we believe that we have established the allowance at levels to absorb probable and estimable losses, future additions may be necessary if economic or other conditions in the future differ from the current environment.

Securities Activities

Our securities investment policy is established by our Board of Directors. This policy dictates that investment decisions be made based on the safety of the investment, liquidity requirements, potential returns, cash flow targets, and consistency with our interest rate risk management strategy. Our investment policy is reviewed annually by our ALCO/Investment management committee. All policy changes recommended by this management committee must be approved by the Board of Directors. The Committee is comprised of the Chief Executive Officer, Chief Financial Officer, Controller, Lending Services Division Manager, Retail Services Division Manager and the Delivery Systems Division Manager. Authority to make investments under the approved guidelines is delegated by the Committee to appropriate officers. While general investment strategies are developed and authorized by the ALCO/Investment management committee, the execution of specific actions rests with the Chief Financial Officer.

The approved investment officers are authorized to execute investment transactions up to \$5.0 million per transaction without the prior approval of the ALCO/Investment management committee and within the scope of the established investment policy. These officers are also authorized to execute investment transactions between \$5.0 million and \$10.0 million with the additional approval from the Chief Executive Officer. Each transaction in excess of \$10.0 million must receive prior approval of the ALCO/Investment Committee.

Our current investment policy generally permits investments in debt securities issued by the U.S. government and U.S. agencies, municipal bonds, and corporate debt obligations, as well as investments in the Federal Home Loan Bank of Pittsburgh (federal agency securities) and, to a much lesser extent, other equity securities. Securities in these categories are classified as investment securities for financial reporting purposes. The policy also permits investments in mortgage-backed securities, including pass-through securities issued and guaranteed by Fannie Mae, Freddie Mac and Government National Mortgage Association (GNMA) as well as commercial paper, corporate debt and municipal securities. Our current investment strategy uses a risk management approach of diversified investing in fixed-rate securities with short- to intermediate-term maturities, as well as adjustable-rate securities, which may have a longer term to maturity. The emphasis of this approach is to increase overall investment securities yields while managing interest rate risk.

Our policy is that, at the time of purchase, we designate a security as held to maturity, available-for-sale, or trading, depending on our ability and intent. Securities available-for-sale are reported at fair value, while securities held to maturity are reported at amortized cost. Currently, all securities are classified as available-for-sale.

Mortgage-Backed Securities. We purchase mortgage-backed securities in order to generate positive interest rate spreads with minimal administrative expense, lower credit risk as a result of the guarantees provided by Freddie Mac, Fannie Mae and GNMA and increased liquidity. We invest primarily in mortgage-backed securities issued or sponsored by Fannie Mae, Freddie Mac, and GNMA. At September 30, 2013, our mortgage-backed securities portfolio had a fair value of \$217.8 million, consisting primarily of Freddie Mac, Fannie Mae and GNMA mortgage-backed securities.

Mortgage-backed securities are created by pooling mortgages and issuing a security collateralized by the pool of mortgages with an interest rate that is less than the interest rate on the underlying mortgages. Mortgage-backed securities typically represent a participation interest in a pool of single-family or multi-family mortgages, although most of our mortgage-backed securities are collateralized by single-family mortgages. The issuers of such securities (generally U.S. government agencies and U.S. government sponsored enterprises, including Fannie Mae, Freddie Mac and GNMA) pool and resell the participation interests in the form of securities to investors, such as ESSA Bank & Trust, and guarantee the payment of principal and interest to these investors. Investments in mortgage-backed securities involve a risk that actual prepayments will be greater or less than the prepayment rate estimated at the time of purchase, which may require adjustments to the amortization of any premium or accretion of any discount

Table of Contents

relating to such instruments, thereby affecting the net yield on such securities. We review prepayment estimates for our mortgage-backed securities at the time of purchase to ensure that prepayment assumptions are reasonable considering the underlying collateral for the securities at issue and current interest rates, and to determine the yield and estimated maturity of the mortgage-backed securities portfolio. Periodic reviews of current prepayment speeds are performed in order to ascertain whether prepayment estimates require modification that would cause amortization or accretion adjustments.

Equity Securities. At September 30, 2013, our equity securities had a fair value of \$2.0 million.

In addition, we hold Federal Home Loan Bank of Pittsburgh (FHLB-Pittsburgh) common stock to qualify for membership in the Federal Home Loan Bank System and to be eligible to borrow funds under the FHLB advance program. There is no market for the common stock.

The aggregate fair value of our FHLB-Pittsburgh common stock as of September 30, 2013 was \$9.4 million based on its par value. No unrealized gains or losses have been recorded because we have determined that the par value of the common stock represents its fair value. We owned shares of FHLB-Pittsburgh common stock at September 30, 2013 with a par value that was \$514,000 more than we were required to own to maintain our membership in the Federal Home Loan Bank System and to be eligible to obtain advances. We are required to purchase additional stock as our outstanding advances increase. Any excess stock we own is redeemed monthly by the FHLB-Pittsburgh.

We review equity and debt securities with significant declines in fair value on a periodic basis to determine whether they should be considered temporarily or other than temporarily impaired. If a decline in the fair value of a security is determined to be other than temporary, we are required to reduce the carrying value of the security to its fair value and record a non-cash, credit related impairment charge in the amount of the decline, net of tax effect, against our current income.

Our 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 United States government, and debt obligations of a State or political subdivision.

Our policy is to recognize an other-than-temporary impairment of equity securities where the fair value has been significantly below cost for four consecutive quarters. For fixed maturity investments with unrealized losses due to interest rates where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before its anticipated recovery in market value, declines in value below cost are not assumed to be other than temporary. We review our position quarterly and concluded that at September 30, 2013, declines included in the table below represent temporary declines due to interest rate change, and we do not intend to sell those securities and it is more likely than not that we will not have to sell those securities before their anticipated recovery in market value.

Table of Contents

The following table sets forth the composition of our securities portfolio (excluding FHLB-Pittsburgh common stock) at the dates indicated.

	2013		At September 30, 2012		2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Investment securities available for sale:						
Mortgage-backed securities	\$ 218,115	\$ 217,837	\$ 208,265	\$ 215,804	\$ 196,641	\$ 204,209
Obligations of state and political subdivisions	23,754	23,909	18,611	19,517	13,760	14,499
U.S. Government agency obligations	52,775	52,520	74,106	74,484	21,797	22,083
Corporate obligations	12,756	12,773	8,602	8,657	4,598	4,584
Trust-preferred securities	4,943	5,414	5,852	6,233		
Other debt securities	1,147	1,154	1,476	1,512		
Total debt securities	313,490	313,607	316,912	326,207	236,796	245,375
Equity securities financial services	2,025	2,015	3,267	3,378	11	18
Total investment securities available-for-sale	\$ 315,515	\$ 315,622	\$ 320,179	\$ 329,585	\$ 236,807	\$ 245,393

Table of Contents

Portfolio Maturities and Yields. The composition and maturities of the investment securities portfolio at September 30, 2013 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur.

	One Year or Less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total Securities		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield
	(Dollars in thousands)										
Investment securities available for sale:											
U.S. Government agency obligations	\$		\$ 28,785	1.42%	\$ 20,274	0.58%	\$ 3,716	1.11%	\$ 52,775	\$ 52,520	1.08%
Obligations of state and political subdivisions	2,527	2.29%	5,488	2.44%	15,739	3.01%			23,754	23,909	2.80%
Mortgage-backed securities			988	4.34%	24,715	2.87%	192,412	2.29%	218,115	217,837	2.37%
Corporate obligations	499	1.41%	6,628	2.41%	5,052	3.12%	577	5.21%	12,756	12,773	2.78%
Trust preferred securities							4,943	2.95%	4,943	5,414	2.95%
Other debt securities							1,147	6.43%	1,147	1,154	6.43%
Total debt securities	3,026	2.14%	41,889	1.78%	65,780	2.22%	202,795	2.32%	313,490	313,607	2.22%
Equity securities							2,025	4.44%	2,025	2,015	4.44%
Total investment securities available for-sale	\$ 3,026	2.14%	\$ 41,889	1.78%	\$ 65,780	2.22%	\$ 204,820	2.34%	\$ 315,515	\$ 315,622	2.24%

Table of Contents**Sources of Funds**

General. Deposits, borrowings, repayments and prepayments of loans and securities, proceeds from maturing securities and cash flows from operations are the primary sources of our funds for use in lending, investing and for other general purposes.

Deposits. We offer a variety of deposit accounts with a range of interest rates and terms. Our deposit accounts consist of savings accounts, NOW accounts, checking accounts, money market accounts, club accounts, certificates of deposit and IRAs and other qualified plan accounts. We provide commercial checking accounts for businesses.

At September 30, 2013, our deposits totaled \$1.041 billion. Interest-bearing NOW, savings and club and money market deposits totaled \$348.1 million at September 30, 2013. At September 30, 2013, we had a total of \$634.2 million in certificates of deposit. Noninterest-bearing demand deposits totaled \$58.8 million. Although we have a significant portion of our deposits in shorter-term certificates of deposit, we monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a large portion of these accounts upon maturity.

Our deposits are obtained predominantly from the areas in which our branch offices are located. We rely on our favorable locations, customer service and competitive pricing to attract and retain these deposits. While we accept certificates of deposit in excess of \$100,000 for which we may provide preferential rates, we generally do not solicit such deposits as they are more difficult to retain than core deposits. At September 30, 2013, we had a total of \$233.3 million of brokered certificates of deposits, an increase of \$76.5 million from the prior fiscal year end. Our brokered certificates of deposits range from one- to six-year terms, and are purchased only through pre-approved brokers.

The following table sets forth the distribution of average deposit accounts, by account type, at the dates indicated.

	For the Years Ended September 30,								
	2013			2012			2011		
	Average Balance	Percent	Average Rate Paid	Average Balance	Percent	Average Rate Paid	Average Balance	Percent	Average Rate Paid
	(Dollars in thousands)								
Deposit type:									
Noninterest bearing demand accounts	\$ 56,467	5.68%		% \$ 37,064	5.21%		% \$ 30,236	4.93%	%
Interest bearing NOW	91,201	9.18%	0.06	65,747	9.25	0.04	58,795	9.58%	0.04
Money market	143,103	14.40%	0.23	117,118	16.47	0.28	117,946	19.23%	0.47
Savings and club	104,234	10.49%	0.05	78,943	11.10	0.10	69,732	11.37%	0.22
Certificates of deposit	598,759	60.25%	1.17	412,207	57.97	1.71	336,668	54.89%	2.01

Total deposits	\$ 993,764	100.00%	0.75%	\$ 711,079	100.00%	1.05%	\$ 613,377	100.00%	1.22%
----------------	------------	---------	-------	------------	---------	-------	------------	---------	-------

As of September 30, 2013, the aggregate amount of outstanding certificates of deposit in amounts greater than or equal to \$100,000 was approximately \$443.9 million. The following table sets forth the maturity of those certificates as of September 30, 2013.

	At September 30, 2013 (In thousands)
Three months or less	\$ 82,817
Over three months through six months	71,392
Over six months through one year	43,247
Over one year	246,407
Total	\$ 443,863

At September 30, 2013, \$312.2 million of our certificates of deposit had maturities of one year or less. We monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a significant portion of these accounts upon maturity.

Table of Contents

Borrowings. Our short-term borrowings consist of Federal Home Loan Bank and Federal Reserve Bank advances. The following table sets forth information concerning balances and interest rates on all of our short-term borrowings at the dates and for the years indicated.

	At or For the Years Ended September 30,		
	2013	2012	2011
	(Dollars in thousands)		
Balance at end of year	\$ 23,000	\$ 43,281	\$ 4,000
Maximum outstanding at any month end	\$ 84,500	\$ 43,281	\$ 28,086
Average balance during year	\$ 45,792	\$ 11,712	\$ 6,439
Weighted average interest rate at end of year	0.29%	0.30%	0.22%
Average interest rate during year	0.28%	0.27%	0.71%

At September 30, 2013, we had the ability to borrow approximately \$598.6 million under our credit facilities with the FHLB-Pittsburgh.

Competition

We face significant competition in both originating loans and attracting deposits. The counties in which we operate have a significant concentration of financial institutions, many of which are significantly larger institutions and have greater financial resources than we, and many of which are our competitors to varying degrees. Our competition for loans comes principally from commercial banks, savings banks, mortgage banking companies, credit unions, leasing companies, insurance companies and other financial service companies. Our most direct competition for deposits has historically come from commercial banks, savings banks and credit unions. We face additional competition for deposits from nondepository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies.

We seek to meet this competition by the convenience of our branch locations, emphasizing personalized banking and the advantage of local decision-making in our banking business. Specifically, we promote and maintain relationships and build customer loyalty within local communities by focusing our marketing and community involvement on the specific needs of individual neighborhoods. As of June 30, 2013, ESSA Bank & Trust had the largest deposit market share in Monroe County, Pennsylvania. We do not rely on any individual, group, or entity for a material portion of our deposits.

Employees

As of September 30, 2013, we had 224 full-time employees and 58 part-time employees. The employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be good.

Subsidiary Activities

ESSA Bank & Trust has four wholly owned subsidiaries, ESSACOR, Inc., Pocono Investment Company, ESSA Advisory Services, LLC, and Integrated Financial Corporation and its fully owned subsidiary Integrated Abstract Incorporated. 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 of ESSA Bank & Trust, including

certain intellectual property. ESSA Advisory Services, LLC is a Pennsylvania limited liability company owned 100% by ESSA Bank & Trust. ESSA Advisory Services, LLC is a full-service insurance benefits consulting company offering group services such as health insurance, life insurance, short term and long term disability, dental, vision and 401(K) retirement planning as well as individual health products. Integrated Financial Corporation is a Pennsylvania Corporation that provided investment advisory services to the general public as a former subsidiary of First Star Bank. Integrated Financial Corporation is currently inactive. Integrated Abstract Incorporated is a Pennsylvania Corporation that provides title insurance services.

Table of Contents

SUPERVISION AND REGULATION

General

ESSA Bancorp, Inc. is a Pennsylvania corporation. As a savings and loan holding company, we are required to file certain reports with, and otherwise comply with the rules and regulations of the Federal Reserve Board.

ESSA Bank & Trust is a Pennsylvania-chartered savings association and its deposit accounts are insured up to applicable limits by the Federal Deposit Insurance Corporation under the Deposit Insurance Fund (DIF). We are subject to extensive regulation by the Pennsylvania Department of Banking, our chartering agency, and by the Federal Deposit Insurance Corporation, our primary federal regulator. We must file reports with the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation concerning our activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions including, but not limited to, mergers with or acquisitions of other savings institutions. There are periodic examinations by the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation to test our compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the Federal Deposit Insurance Corporation insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and with their examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Pennsylvania Department of Banking or the Federal Deposit Insurance Corporation could have a material adverse impact on us and our operations.

Federal Legislation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act), enacted on July 21, 2010, has significantly changed the bank regulatory structure and is affecting the lending, investment, trading and operating activities of depository institutions and their holding companies. The Dodd-Frank Act eliminated, as of July 21, 2011, our former primary federal regulator, the Office of Thrift Supervision, and required ESSA Bank & Trust to be regulated by the Federal Deposit Insurance Corporation (the primary federal regulator for state-chartered banks that are not members of the Federal Reserve System). The Dodd-Frank Act also authorized the Federal Reserve Board to supervise and regulate all savings and loan holding companies such as ESSA Bancorp, Inc., in addition to the bank holding companies, that it currently regulates. The Dodd-Frank Act requires the Federal Reserve Board to set minimum capital levels for depository institution holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital will be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. Under the Dodd-Frank Act, the proceeds of trust preferred securities are excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank or savings and loan holding companies with less than \$15 billion of assets. The legislation also establishes a floor for capital of insured depository institutions that cannot be lower than the standards in effect today, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months from the enactment of the Dodd-Frank Act that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives. The required capital regulations have been issued and are effective January 1, 2015.

The Dodd-Frank Act also created a new Consumer Financial Protection Bureau with substantial power to implement and oversee consumer protection laws. The Consumer Financial Protection Bureau has broad rulemaking authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as ESSA Bank & Trust, including the authority to prohibit unfair, deceptive or abusive acts and practices. The Consumer Financial Protection

Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks and savings institutions with \$10 billion or less in assets will continue to be examined for compliance by their applicable bank regulators.

The legislation broadened the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a depository institution. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor, retroactive to January 1, 2008. The Dodd-Frank Act increased stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called golden parachute payments, and by authorizing the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate their own candidates using a company's proxy materials. The Dodd-Frank Act also provided for originators of certain securitized loans to retain a percentage of the risk for transferred loan, directed the Federal Reserve Board to regulate pricing of certain debit card interchange fees and contained a number of reforms related to mortgage origination.

Table of Contents

Many of the provisions of the Dodd-Frank Act have delayed effective dates and the legislation requires various federal agencies to promulgate numerous and extensive implementing regulations over the next several years. Although the substance and scope of these regulations cannot be completely determined at this time, it is expected that the legislation and implementing regulations will increase our operating and compliance costs.

Regulation by the Pennsylvania Department of Banking

The Pennsylvania Savings Association Code of 1967, as amended (the Savings Association Code) contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, employees, and depositors, as well as corporate powers, savings and investment operations and other aspects of ESSA Bank & Trust and its affairs. The Savings Association Code delegates extensive rulemaking power and administrative discretion to the Pennsylvania Department of Banking so that the supervision and regulation of state-chartered savings associations may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

One of the purposes of the Savings Association Code is to provide savings associations with the opportunity to be competitive with each other and with other financial institutions existing under other Pennsylvania laws as well as other state, federal and foreign laws. A Pennsylvania savings association may locate or change the location of its principal place of business and establish an office anywhere in Pennsylvania, with the prior approval of the Pennsylvania Department of Banking.

The Pennsylvania Department of Banking generally examines each savings association not less frequently than once every two years. Although the Department may accept the examinations and reports of the Federal Deposit Insurance Corporation in lieu of the Department's examination, the current practice is for the Department to conduct individual examinations. The Department may order any savings association to discontinue any violation of law or unsafe or unsound business practice and may direct any trustee, officer, attorney, or employee of a savings association engaged in an objectionable activity, after the Department has ordered the activity to be terminated, to show cause at a hearing before the Department why such person should not be removed.

Recent changes to Pennsylvania law have repealed the Savings Association Code. Consequently, ESSA Bank & Trust is in process of converting its charter to a Pennsylvania savings bank whose state law powers are primarily governed by Chapter 5 of the Pennsylvania Banking Code of 1965, as amended. The charter conversion is not expected to have material effect on the operations of ESSA Bank & Trust.

Regulation by the Federal Deposit Insurance Corporation

ESSA Bank & Trust is also subject to extensive regulation, examination and supervision, among other things, by the Federal Deposit Insurance Corporation, as its primary federal regulator. Such regulation and supervision:

establishes a comprehensive framework of activities in which ESSA Bank & Trust can engage;

limits the ability of ESSA Bank & Trust to extend credit to any given borrower;

significantly limits the transactions in which ESSA Bank & Trust may engage with its affiliates;

requires ESSA Bank & Trust to meet a qualified thrift lender test which requires ESSA Bank & Trust to invest in qualified thrift investments, which primarily include residential mortgage loans and related investments;

places limitations on capital distributions by savings associations, such as ESSA Bank & Trust, including cash dividends;

establishes a continuing and affirmative obligation, consistent with ESSA Bank & Trust's safe and sound operation, to help meet the credit needs of its community, including low and moderate income neighborhoods;

establishes various capital categories resulting in various levels of regulatory scrutiny applied to the institutions in a particular category; and

establishes standards for safety and soundness.

The Federal Deposit Insurance Corporation generally examines each savings association not less frequently than once every two years. The Federal Deposit Insurance Corporation has the authority to order any savings association or its directors, trustees, officers, attorneys or employees to discontinue any violation of law or unsafe or unsound banking practice.

The prospective conversion of ESSA Bank & Trust to a Pennsylvania savings bank will not change the status of the Federal Deposit Insurance Corporation as the primary federal regulator of ESSA Bank & Trust.

Table of Contents

Transactions with Affiliates

Sections 23A and 23B of the Federal Reserve Act and its implementing regulations govern transactions between depository institutions and their affiliates. These provisions are made applicable to savings associations, such as ESSA Bank & Trust, by the Home Owners Loan Act and federal regulations. In a holding company context, the parent holding company of a savings association and any companies that are controlled by the parent holding company are affiliates of the savings association.

Section 23A limits the extent to which a savings association or its subsidiaries may engage in certain transactions with its affiliates. These transactions include, among other things, the making of loans or other extensions of credit to an affiliate and the purchase of assets from an affiliate. Generally, these transactions between the savings association and any one affiliate cannot exceed 10% of the savings association's capital stock and surplus, and these transactions between the savings institution and all of its affiliates cannot, in the aggregate, exceed 20% of the savings institution's capital stock and surplus. Section 23A also establishes specific collateral requirements for loans or extensions of credit to an affiliate, and for guarantees or acceptances on letters of credit issued on behalf of an affiliate. Applicable regulations prohibit a savings association from lending to any affiliate engaged in activities not permissible for a bank holding company or for the purpose of acquiring the securities of most affiliates.

Section 23B requires that transactions covered by Section 23A and a broad list of other specified transactions be on terms and under circumstances substantially the same, or no less favorable to the savings association or its subsidiary, as similar transactions with non-affiliates. In addition to the restrictions on transactions with affiliates that Sections 23A and 23B of the Federal Reserve Act impose on depository institutions, federal law generally prohibits a savings association from purchasing or investing in securities issued by an affiliate (other than a subsidiary) or lending to an affiliate engaged in an activity not permitted for bank holding companies.

Insurance of Accounts and Regulation by the Federal Deposit Insurance Corporation

Deposit accounts in ESSA Bank & Trust are insured by the Federal Deposit Insurance Corporation generally up to a maximum of \$250,000 per separately insured depositor and up to a maximum of \$250,000 for self-directed retirement accounts. ESSA Bank & Trust, therefore, is subject to Federal Deposit Insurance Corporation deposit insurance assessments.

In the second quarter of 2009, the Federal Deposit Insurance Corporation increased its quarterly deposit insurance assessment rates and amended the method by which assessments are calculated. Institutions were placed in an initial base assessment rate ranging from 12 to 45 basis points of assessable deposits depending on risk category assignment by the Federal Deposit Insurance Corporation. The initial base assessment was then adjusted depending upon the institution's level of unsecured debt, secured liabilities and brokered deposits, to establish a total base assessment rate ranging from seven to 77.5 basis points, with riskier institutions paying higher assessments.

Effective April 1, 2011, the Federal Deposit Insurance Corporation implemented a requirement of the Dodd-Frank Act to revise its assessment system to base it on each institution's total assets less tangible capital instead of deposits. The FDIC also revised its assessment schedule so that it ranges from 2.5 basis points for the least risky institutions to 45 basis points for the riskiest.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation upon a finding that an institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the Federal Deposit Insurance Corporation. ESSA Bank & Trust does not believe that it is taking or is subject to any action, condition or violation

that could lead to termination of its deposit insurance.

All FDIC-insured institutions are required to pay a pro rata portion of the interest due on obligations issued by the Financing Corporation (FICO) for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the now defunct Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. For the quarter ended September 30, 2013, the annualized FICO assessment was 0.66 basis point of an institution's total assets less tier 1 capital.

Capital Requirements

Federal regulations require savings associations to meet three minimum capital standards: a 1.5% tangible capital ratio, a 4% leverage ratio (3% for savings associations receiving the highest rating on the CAMELS rating system) and an 8% risk-based capital ratio.

The risk-based capital standard for savings associations requires the maintenance of Tier 1 (core) and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100%, assigned by the regulatory, based on the risks believed inherent in the type of asset. Core capital is defined as common shareholders' equity (including retained earnings), certain non-cumulative perpetual preferred stock and related surplus and minority

Table of Contents

interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital. Additionally, a savings association that retains credit risk in connection with an asset sale may be required to maintain additional regulatory capital because of the recourse back to the savings association.

At September 30, 2013, the ESSA Bank & Trust's capital exceeded all applicable requirements.

Any state-chartered savings association that fails any of the capital requirements is subject to possible enforcement actions by the Federal Deposit Insurance Corporation. Such actions could include a capital directive, a cease and desist order, civil money penalties, the establishment of restrictions on an institution's operations, termination of federal deposit insurance, and the appointment of a conservator or receiver. Certain corrective actions are required by law.

We are also subject to more stringent capital guidelines of the Pennsylvania Department of Banking. Although not adopted in regulation form, the Pennsylvania Department of Banking utilizes capital standards of 6% leverage capital and 10% risk-based capital. The components of leverage and risk-based capital are substantially the same as those defined by the Federal Deposit Insurance Corporation.

In July 2013, the Federal Deposit Insurance Corporation and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain available-for-sale securities holdings to be included for purposes of calculating regulatory capital unless a one-time opt-out is exercised and requires more stringent treatment of mortgage servicing assets and certain deferred tax assets. The rule limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a capital conservation buffer consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule becomes effective for ESSA Bank & Trust on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

Dividends from ESSA Bank & Trust

Our ability to pay dividends depends, to a large extent, upon ESSA Bank & Trust's ability to pay dividends to ESSA Bancorp. The Savings Association Code states, in part, that dividends may be declared and paid by the Bank only out of net earnings for the then current year. A dividend may not be declared or paid if it would impair the general reserves of ESSA Bank & Trust that are required to be maintained under the Savings Association Code. The Federal Deposit Insurance Corporation also requires a prior notice or application of a capital distribution under certain circumstances. In addition, ESSA Bank & Trust is required to notify the Federal Reserve Board prior to declaring a dividend and receive the nonobjection of the Federal Reserve Board to any such dividend. No dividend may generally

be paid that would result in ESSA Bank & Trust failing to comply with its regulatory capital requirements.

Qualified Thrift Lender Test

As a savings association, ESSA Bank & Trust must satisfy the qualified thrift lender, or QTL, test. Under the QTL test, ESSA Bank & Trust must maintain at least 65% of its portfolio assets in qualified thrift investments in at least nine months of the most recent 12 months. Portfolio assets generally means total assets of a savings institution, less the sum of specified liquid assets up to 20% of total assets, goodwill and other intangible assets, and the value of property used in the conduct of the savings bank's business.

Qualified thrift investments include various types of loans made for residential and housing purposes, investments related to such purposes, including certain mortgage-backed and related securities, and loans for personal, family, household and certain other purposes up to a limit of 20% of portfolio assets. Qualified thrift investments also include 100% of an institution's credit card loans, education loans and small business loans. ESSA Bank & Trust also may satisfy the QTL test by qualifying as a domestic building and loan association as defined in the Internal Revenue Code.

Table of Contents

A savings association that fails the qualified thrift lender test is subject to certain operating restrictions. In addition, the Dodd-Frank Act made noncompliance with the QTL test potentially subject to agency enforcement action for violation of laws. At September 30, 2013, ESSA Bank & Trust held 85.3% of its portfolio assets in qualified thrift investments, and satisfied this test.

Loans-to-One-Borrower Limitation

Under federal regulations, with certain limited exceptions, a Pennsylvania chartered savings association may lend to a single or related group of borrowers on an unsecured basis an amount equal to 15% of its unimpaired capital and surplus. An additional amount, equal to 10% of unimpaired capital and surplus, may be lent if such loan is secured by readily marketable collateral, which is defined to include certain securities, but generally does not include real estate. Our internal policy, however, is to not make a commercial loan in excess of \$5.0 million, nor to allow more than \$7.5 million in total loan relationships with any one borrower, including the borrower's residential mortgage and consumer loans. However, in special circumstances this limit may be exceeded subject to the approval of the Management Loan Committee in addition to a majority of the members of the Board of Directors.

Prompt Corrective Action

Under the federal Prompt Corrective Act regulations, a savings association is deemed to be (i) well capitalized if it has total risk-based capital of 10.0% or more, has a Tier 1 risk-based capital ratio of 6.0% or more, has a Tier I leverage capital ratio of 5.0% or more and is not subject to any written capital order or directive; (ii) adequately capitalized if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 4.0% or more and a Tier I leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of well capitalized; (iii) undercapitalized if it has a total risk-based capital ratio that is less than 8.0%, a Tier I risk-based capital ratio that is less than 4.0% or a Tier I leverage capital ratio that is less than 4.0% (3.0% under certain circumstances); (iv) significantly undercapitalized if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 3.0% or a Tier I leverage capital ratio that is less than 3.0%; and (v) critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Federal regulations also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution to comply with supervisory actions as if it were in the next lower category (except that the Federal Deposit Insurance Corporation may not reclassify a significantly undercapitalized institution as critically undercapitalized).

Generally, the FDIC is required to appoint a receiver or conservator for a savings association that becomes critically undercapitalized within specific time frames. The regulations also provide that a capital restoration plan must be filed with the FDIC within 45 days of the date a savings association receives notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Any holding company for the savings bank required to submit a capital restoration plan must guarantee the lesser of: an amount equal to 5% of a savings bank's assets at the time it was notified or deemed to be undercapitalized by the FDIC, or the amount necessary to restore the savings association to adequately capitalized status. This guarantee remains in place until the FDIC notifies the savings association that it has maintained adequately capitalized status for each of four consecutive calendar quarters. The FDIC may also take any one of a number of discretionary supervisory actions against an undercapitalized savings association, including the issuance of a capital directive and the replacement of senior executive officers and directors.

The recently proposed rules that would increase regulatory capital requirements would, if adopted, adjust the prompt corrective actions categories accordingly.

As of September 30, 2013, the Bank was a well-capitalized institution under the Prompt Corrective Action regulations.

The USA PATRIOT Act

The USA PATRIOT Act of 2001 gave the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. The USA PATRIOT Act also required the federal banking agencies to take into consideration the effectiveness of controls designed to combat money laundering activities in determining whether to approve a merger or other acquisition application of a member institution. Accordingly, if we engage in a merger or other acquisition, our controls designed to combat money laundering would be considered as part of the application process. We have established policies, procedures and systems designed to comply with these regulations.

Holding Company Regulation

ESSA Bancorp, Inc. is a unitary savings and loan holding company, subject to regulation and supervision by the Federal Reserve Board. The Federal Reserve Board will have enforcement authority over ESSA Bancorp, Inc. and its non-savings institution subsidiaries. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a risk to ESSA Bank & Trust.

Table of Contents

In connection with the conversion of ESSA Bank & Trust to a savings bank charter, it expects to exercise an election in federal law to continue to have ESSA Bancorp, Inc. regulated as a savings and loan holding company rather than a bank holding company. A condition of the election is that ESSA Bank & Trust must continue to comply with the QTL test discussed previously.

Under prior law, a unitary savings and loan holding company generally had no regulatory restrictions on the types of business activities in which it could engage, provided that its subsidiary savings association was a qualified thrift lender. The Gramm-Leach-Bliley Act of 1999, however, restricts unitary savings and loan holding companies not existing on, or applied for before, May 4, 1999 to those activities permissible for financial holding companies or for multiple savings and loan holding companies. The Company is not a grandfathered unitary savings and loan holding company and, therefore, is limited to the activities permissible for financial holding companies or for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance as well as activities that are incidental to financial activities or complementary to a financial activity. The Dodd-Frank Act specifies that a savings and loan holding company may only engage in financial holding company activities if it meets the qualitative criteria for a bank holding company to engage in such activities. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, subject to the prior approval of the Federal Reserve Board, and certain additional activities authorized by federal regulations.

Federal law prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring control of another savings institution or holding company thereof, without prior written approval of the Federal Reserve Board. It also prohibits, with specified exceptions, the acquisition or retention of more than 5% of the equity securities of a company engaged in activities that are not closely related to banking or financial in nature or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board must consider such things as the financial and managerial resources and future prospects of the savings institution involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community, the effectiveness of each parties anti-money laundering program, and competitive factors.

Savings and loan holding companies are not currently subject to specific regulatory capital requirements. The Dodd-Frank Act, however, requires the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. Instruments such as cumulative preferred stock and trust preferred securities will no longer be includable as Tier 1 capital, as is currently permitted for bank holding companies. Instruments issued by May 19, 2010 may be grandfathered for companies with consolidated assets of \$15 billion or less. The previously discussed final rule regarding regulatory capital requirements implements the Dodd-Frank Act's directive as to savings and loan holding companies. The consolidated regulatory capital requirements will apply to savings and loan holding companies as of January 1, 2015. As is the case with institutions themselves, the capital conservation buffer will be phased in between 2016 and 2019.

The Federal Reserve Board has issued a policy statement regarding the payment of dividends by bank holding companies that it has also applied to savings and loan holding companies as well. In general, the Federal Reserve Board's policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. Federal Reserve Board guidance provides for prior regulatory review of capital distributions in certain circumstances such as where the company's net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund the dividend or the company's overall rate of earnings retention is inconsistent with the company's capital needs and overall financial condition. Stock repurchases

are also subject to prior regulatory review under certain circumstances. The ability of a holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of the Company to pay dividends or otherwise engage in capital distributions.

Source of Strength. The Dodd-Frank Act extended the source of strength doctrine to savings and loan holding companies. The Federal Reserve Board has issued regulations requiring that all savings and loan holding companies serve as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

Federal Securities Laws

Shares of ESSA Bancorp, Inc.'s common stock are registered with the SEC under Section 12(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act). ESSA Bancorp, Inc. is also subject to the proxy rules, tender offer rules, insider trading restrictions, annual and periodic reporting, and other requirements of the Exchange Act.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was enacted in response to public concerns regarding corporate accountability in connection with certain accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to

Table of Contents

provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The Sarbanes-Oxley Act generally applies to all companies that file or are required to file periodic reports with the Securities and Exchange Commission, under the Securities Exchange Act of 1934.

The Sarbanes-Oxley Act includes specific additional disclosure requirements, requires the Securities and Exchange Commission and national securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules, and mandates further studies of certain issues by the Securities and Exchange Commission. The Sarbanes-Oxley Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

Although we have and will continue to incur additional expense in complying with the provisions of the Sarbanes-Oxley Act and the resulting regulations, management does not expect that such compliance will have a material impact on our results of operations or financial condition.

Regulatory Enforcement Authority

Federal law provides federal banking regulators with substantial enforcement powers. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders, and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

FEDERAL AND STATE TAXATION

Federal Taxation

General. ESSA Bancorp, Inc. and ESSA Bank & Trust are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize material federal income tax matters and is not a comprehensive description of the tax rules applicable to ESSA Bancorp, Inc. and ESSA Bank & Trust.

Method of Accounting. For federal income tax purposes, ESSA Bancorp, Inc. currently reports its income and expenses on the accrual method of accounting and uses a tax year ending September 30th for filing its consolidated federal income tax returns. The Small Business Protection Act of 1996 eliminated the use of the reserve method of accounting for bad debt reserves by savings institutions, effective for taxable years beginning after 1995.

Bad Debt Reserves. Prior to the Small Business Protection Act of 1996, ESSA Bank & Trust was permitted to establish a reserve for bad debts for tax purposes and to make annual additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at ESSA Bank & Trust's taxable income. As a result of the Small Business Protection Act of 1996, ESSA Bank & Trust must use the specific charge off method in computing its bad debt deduction for tax purposes.

Taxable Distributions and Recapture. Prior to the Small Business Protection Act of 1996, bad debt reserves created prior to 1988 were subject to recapture into taxable income if ESSA Bank & Trust failed to meet certain thrift asset and definition tests. The Small Business Protection Act of 1996 eliminated these thrift-related recapture rules.

However, under current law, pre-1988 reserves remain subject to tax recapture should ESSA Bank & Trust make certain distributions from its tax bad debt reserve or cease to maintain a financial institution charter. At September 30, 2013, ESSA Bank & Trust's total federal pre-1988 reserve was approximately \$4.3 million. This reserve reflects the cumulative effects of federal tax deductions by ESSA Bank & Trust for which no federal income tax provision has been made.

Minimum Tax. The Internal Revenue Code of 1986, as amended, imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences, referred to as alternative minimum taxable income. The alternative minimum tax is payable to the extent alternative minimum tax income is in excess of the regular income tax. Net operating losses can, in general, offset no more than 90% of alternative minimum taxable income. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years. At September 30, 2013, ESSA Bank & Trust had no minimum tax credit carryforward.

Net Operating Loss Carryovers. A financial institution may carry back net operating losses to the preceding two taxable years (five years for losses incurred in 2001, 2002 and 2009) and forward to the succeeding 20 taxable years. At September 30, 2013, ESSA Bank & Trust had no net operating loss carryforward for federal income tax purposes.

Table of Contents

Corporate Dividends. We may exclude from our income 100% of dividends received from ESSA Bank & Trust as a member of the same affiliated group of corporations.

Audit of Tax Returns. ESSA Bank & Trust's federal income tax returns have not been audited in the most recent five-year period. The 2009, 2010 and 2011 tax years remains open.

State Taxation

Pennsylvania State Taxation. ESSA Bancorp, Inc. is subject to the Pennsylvania Corporate Net Income Tax, Capital Stock and Franchise Tax. The Corporation Net Income Tax rate for fiscal year 2013 is 9.9% and is imposed on unconsolidated taxable income for federal purposes with certain adjustments. In general, the Capital Stock and Franchise Tax is a property tax imposed on a corporation's capital stock value at a statutorily defined rate, such value being determined in accordance with a fixed formula based upon average net income and net worth. ESSA Bank & Trust is subject to tax under the Pennsylvania Mutual Thrift Institutions Tax Act, as amended to include thrift institutions having capital stock. Pursuant to the Mutual Thrift Institutions Tax, the tax rate is 11.5%. The Mutual Thrift Institutions Tax exempts ESSA Bank & Trust from other taxes imposed by the Commonwealth of Pennsylvania for state income tax purposes and from all local taxation imposed by political subdivisions, except taxes on real estate and real estate transfers. The Mutual Thrift Institutions Tax is a tax upon net earnings, determined in accordance with generally accepted accounting principles with certain adjustments. The Mutual Thrift Institutions Tax, in computing income according to generally accepted accounting principles, allows for the deduction of interest earned on state and federal obligations, while disallowing a percentage of thrift's interest expense deduction in the proportion of interest income on those securities to the overall interest income of ESSA Bank & Trust. Net operating losses, if any, thereafter can be carried forward three years for Mutual Thrift Institutions Tax purposes.

Item 1A. Risk Factors

Financial reform legislation recently enacted has, among other things, changed our holding company and bank regulators, created a new Consumer Financial Protection Bureau, and will result in new laws and regulations that are expected to increase our costs of operations, as well as tightened capital standards.

On July 21, 2010 the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). This new law has significantly changed the current bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

Certain provisions of the Dodd-Frank Act are expected to have a near term effect on us. For example, the Federal Reserve Board now supervises and regulates all savings and loan holding companies that were formerly regulated by the Office of Thrift Supervision, including ESSA Bancorp, Inc. The Federal Deposit Insurance Corporation, which is currently the primary federal regulator for state banks that are not members of the Federal Reserve System, has become the primary federal regulator for state savings associations such as ESSA Bank & Trust.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to

prohibit unfair, deceptive or abusive acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks with more than \$10 billion in assets. Banks with \$10 billion or less in assets such as ESSA Bank & Trust will continue to be examined for compliance with the consumer laws by their primary bank regulators. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

The Dodd-Frank Act requires the implementation of regulations for bank and savings and loan holding companies which establish capital standards that are no less than those applicable to depository institutions themselves. Such regulations which will exclude certain instruments that previously have been eligible for inclusion by bank holding companies as Tier 1 capital, such as trust preferred securities. The required regulations have been issued and will take effect January 1, 2015. Savings and loan holding companies such as ESSA Bancorp, Inc. have not previously been subject to regulatory capital requirements.

Capital distributions by ESSA Bank & Trust, including dividends paid to ESSA Bancorp, Inc., require notice to and nonobjection of the Federal Reserve Board as well as notice or application to the Federal Deposit Insurance Corporation in some circumstances. In addition, certain regulatory policies of the Federal Reserve Board may also limit ESSA Bancorp's ability to make capital distributions including paying dividends.

Table of Contents

The Dodd-Frank Act eliminated the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. Depending on competitive responses, this significant change to existing law could have an adverse impact on our interest expense.

The Dodd-Frank Act broadened the base for Federal Deposit Insurance Corporation deposit insurance assessments. Assessments are now being based on the average consolidated total assets less tangible equity capital of a financial institution, rather than deposits. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor, retroactive to January 1, 2008.

The Dodd-Frank Act will require publicly traded companies to give stockholders a non-binding vote on executive compensation and so-called golden parachute payments, and by authorizing the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate their own candidates using a company's proxy materials. The legislation also directs the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and certain yet-to-be written implementing rules and regulations will have on community banks. However, it is expected that at a minimum they will increase our operating and compliance costs and could increase our interest expense.

Increases to the Allowance for Credit Losses May Cause Our Earnings to Decrease.

Our customers may not repay their loans according to the original terms, and the collateral securing the payment of those loans may be insufficient to pay any remaining loan balance. In addition, the estimates used to determine the fair value of such loans as of the acquisition date may be inconsistent with the actual performance of the acquired loans. Hence, we may experience significant credit losses, which could have a material adverse effect on our operating results. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. In determining the amount of the allowance for credit losses, we rely on loan quality reviews, past loss experience, and an evaluation of economic conditions, among other factors. If our assumptions prove to be incorrect, our allowance for credit losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to the allowance. Material additions to the allowance would materially decrease our net income.

Our emphasis on the origination of commercial real estate and business loans is one of the more significant factors in evaluating our allowance for credit losses. As we continue to increase the amount of these loans, additional or increased provisions for credit losses may be necessary and as a result would decrease our earnings.

Bank regulators periodically review our allowance for credit losses and may require us to increase our provision for credit losses or loan charge-offs. Any increase in our allowance for credit losses or loan charge-offs as required by these regulatory authorities could have a material adverse effect on our results of operations and/or financial condition.

Future Changes in Interest Rates Could Reduce Our Profits.

Our ability to make a profit largely depends on our net interest income, which could be negatively affected by changes in interest rates. Net interest income is the difference between:

1. the interest income we earn on our interest-earning assets, such as loans and securities; and
2. the interest expense we pay on our interest-bearing liabilities, such as deposits and borrowings.

From September, 2007 through December, 2008, the Federal Reserve Board of Governors decreased its target for the federal funds rate from 5.25% to 0.25%. The federal funds rate has remained at 0.25% since December 2008 and is expected to remain at or around that level for an extended period of time. While these short term market interest rates (which we use as a guide to price our deposits) decreased, longer term market interest rates (which we use as a guide to price our longer term loans) also decreased but not to the same degree. With the decline in shorter term market interest rates the Company's cost of funds declined. This decline in our cost of funds was initially beneficial to our net interest spread. However, as short term market rates have remained low and longer term interest rates also declined, the Company's net interest margin decreased from 2.93% for the year ended September 30, 2009 to 2.65% for the year ended September 30, 2012. The Company's acquisition of First Star Bancorp was effective July 31, 2012. The acquisition, along with increases in longer term interest rates during the third and fourth quarter of our 2013 fiscal year helped to increase our net interest margin to 3.08% for the year ended September 30, 2013. If shorter term interest rates increase or if longer term interest rates decline, there could be further negative pressure exerted on our net interest margin.

In addition, changes in interest rates can affect the average life of loans and mortgage-backed and related securities. A reduction in interest rates results in increased prepayments of loans and mortgage-backed and related securities, as borrowers refinance their loans in order to reduce their borrowing costs. This creates reinvestment risk, which is the risk that we may not be able to reinvest prepayments at rates that are comparable to the rates we earned on the prepaid loans or securities. Alternatively, increases in interest rates may decrease loan demand and/or make it more difficult for borrowers to repay adjustable rate loans.

Table of Contents

Changes in interest rates also affect the current market value of our interest-earning securities portfolio. Generally, the value of securities moves inversely with changes in interest rates. At September 30, 2013, the fair value of our debt securities available for sale totaled \$313.6 million. Unrealized net gains on these available for sale securities totaled approximately \$117,000 at September 30, 2013 and are reported as a separate component of stockholders' equity. Decreases in the fair value of securities available for sale in future periods would have an adverse effect on stockholders' equity.

We evaluate interest rate sensitivity by estimating the change in ESSA Bank & Trust's Economic Value of Equity (EVE) over a range of interest rate scenarios. EVE is the net present value of the Company's asset cash flows minus the net present value of the Company's liability cash flows. At September 30, 2013, in the event of an immediate 200 basis point increase in interest rates, the Company's model projects that we would experience a \$30.0 million, or 15.4%, decrease in net portfolio value. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Management of Market Risk.

Concentration of Loans in Our Primary Market Area, Which Has Experienced an Economic Downturn, May Increase the Risk of Increased Nonperforming Assets.

Our success depends primarily on the general economic conditions in the Pennsylvania counties of Monroe, Northampton, and Lehigh as nearly all of our loans are to customers in these markets. Accordingly, the local economic conditions in these market areas has a significant impact on the ability of borrowers to repay loans as well as our ability to originate new loans. As such, a continuation of the decline in real estate values in these market areas would also lower the value of the collateral securing loans on properties in these market areas. In addition, continued weakening in general economic conditions such as inflation, recession, unemployment or other factors beyond our control could negatively affect our financial results.

Continued and Sustained Deterioration in the Housing Sector and Related Markets and Prolonged Elevated Unemployment Levels May Adversely Affect Our Business and Financial Results.

Over the last several years, general economic conditions continued to worsen nationally as well as in our market area. While we did not invest in sub-prime mortgages and related investments, our lending business is tied significantly to the housing market. Declines in home prices, and increases in foreclosures and unemployment levels, have adversely impacted the credit performance of real estate loans, resulting in the write-down of asset values. The continuing housing slump has resulted in reduced demand for the construction of new housing, further declines in home prices, and increased delinquencies on construction, residential and commercial mortgage loans. The ongoing concern about the economy in general has caused many lenders to reduce or cease providing funding to borrowers. These conditions may also cause a further reduction in loan demand, and increases in our non-performing assets, net charge-offs and provisions for loan losses. A worsening of these negative economic conditions could adversely affect our prospects for growth, asset and goodwill valuations and could result in a decrease in our interest income and a material increase in our provision for loan losses.

Negative Developments in the Financial Industry and the Domestic and International Credit Markets May Continue to Adversely Affect our Operations and Results.

Negative developments that began in the latter half of 2007 in the global credit and securitization markets resulted in uncertainty in the financial markets in general with the expectation of the general economic downturn would continue. Loan portfolio quality has deteriorated at many institutions. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. Bank and bank holding company stock prices have been negatively affected, as has the ability of banks and bank holding companies to raise

capital or borrow in the debt markets. As a result, the potential exists for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be active in responding to concerns and trends identified in examinations, including the expected issuance of many formal enforcement orders. Negative developments in the financial industry and the domestic and international credit markets, and the impact of new legislation in response to those developments, may negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance. In addition, these risks could affect the value of our loan portfolio as well as the value of our investment portfolio, which would also negatively affect our financial performance.

Our Continued Emphasis On Commercial Real Estate Lending Increases Our Exposure To Increased Lending Risks.

Our business strategy centers on continuing our emphasis on commercial real estate lending. We have grown our loan portfolio in recent years with respect to this type of loan and intend to continue to emphasize this type of lending. At September 30, 2013, \$159.5 million, or 17.0%, of our total loan portfolio consisted of commercial real estate loans. Loans secured by commercial real estate generally expose a lender to greater risk of non-payment and loss than one-to-four family residential mortgage loans because repayment of the commercial real estate loans often depends on the successful operation of the property and the income

Table of Contents

stream of the underlying property. Additionally, such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four family residential mortgage loans. Accordingly, an adverse development with respect to one loan or one credit relationship can expose us to greater risk of loss compared to an adverse development with respect to a one-to-four family residential mortgage loan. We seek to minimize these risks through our underwriting policies, which require such loans to be qualified on the basis of the property's collateral value, net income and debt service ratio; however, there is no assurance that our underwriting policies will protect us from credit-related losses.

At September 30, 2013, our largest commercial real estate lending relationship was \$6.8 million of loans located in Monroe County, Pennsylvania and secured by real estate. This loan was performing in accordance with its repayment terms. See Item 1. Business Lending Activities Commercial Real Estate Loans.

Strong Competition Within Our Market Areas May Limit Our Growth and Profitability.

Competition in the banking and financial services industry is intense. In our market areas, we compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally and elsewhere. Some of our competitors have greater name recognition and market presence that benefit them in attracting business, and offer certain services that we do not or cannot provide. In addition, larger competitors may be able to price loans and deposits more aggressively than we do, which could affect our ability to grow and remain profitable on a long-term basis. Our profitability depends upon our continued ability to successfully compete in our market areas. For additional information see Item 1. Business Competition.

Economic Conditions May Adversely Affect Our Liquidity and Financial Condition.

Recent significant declines in the values of mortgage-backed securities and derivative securities issued by financial institutions, government sponsored entities, and major commercial and investment banks have led to decreased confidence in financial markets among borrowers, lenders, and depositors, as well as disruption and extreme volatility in the capital and credit markets and the failure of some entities in the financial sector. As a result, many lenders and institutional investors have reduced or ceased to provide funding to borrowers. Continued turbulence in the capital and credit markets may adversely affect our liquidity and financial condition and the willingness of certain counterparties and customers to do business with us.

We Operate in a Highly Regulated Environment and May Be Adversely Affected by Changes in Laws and Regulations.

We are subject to extensive regulation, supervision, and examination by the Federal Reserve Board, as successor regulator to Office of Thrift Supervision, the FDIC and the Pennsylvania Department of Banking. Such regulators govern the activities in which we may engage, primarily for the protection of depositors. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of a bank, the classification of assets by a bank, the imposition of higher capital requirements, and the adequacy of a bank's allowance for credit losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, could have a material impact on us and our operations. Notably, the federal banking agencies have recently proposed regulations which, if finalized, would significantly increase regulatory capital requirements for insured depository institutions as well as applying such requirements to savings and loan holding companies. We believe that we are in substantial compliance with applicable federal, state and local laws, rules and regulations. Because our business is highly regulated, the laws, rules and applicable regulations are subject to regular modification and change. There can be no assurance that proposed laws,

rules and regulations, or any other laws, rules or regulations, will not be adopted in the future, which could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition or prospects.

The Soundness of Other Financial Services Institutions May Adversely Affect Our Credit Risk.

We rely on other financial services institutions through trading, clearing, counterparty, and other relationships. We maintain limits and monitor concentration levels of our counterparties as specified in our internal policies. Our reliance on other financial services institutions exposes us to credit risk in the event of default by these institutions or counterparties. These losses could adversely affect our results of operations and financial condition.

Any Future FDIC Insurance Premium Increases May Adversely Affect our Earnings.

We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures we may be required to pay even higher FDIC premiums than the recently increased levels. Such increases and any future increases or required prepayments of FDIC insurance premiums may adversely impact our earnings. See [Supervision and Regulation Deposit Insurance](#) for more information about FDIC insurance premiums.

Table of Contents

Our Information Systems May Experience an Interruption or Security Breach.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the possible failure, interruption or security breach of our information systems, there can be no assurance that any such failure, interruption or security breach will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failure, interruption or security breach of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny or expose us to civil litigation and possible financial liability.

A Substantial Decline in the Value of Our FHLB-Pittsburgh Common Stock May Adversely Affect Our Financial Condition.

We own common stock of the FHLB-Pittsburgh in order to qualify for membership in the Federal Home Loan Bank system, which enables us to borrow funds under the Federal Home Loan Bank advance program. The carrying value and fair value of our FHLB-Pittsburgh common stock was \$9.4 million as of September 30, 2013.

Recent published reports indicate that certain member banks of the Federal Home Loan Bank system may be subject to asset quality risks that could result in materially lower regulatory capital levels. In an extreme situation, it is possible that the capitalization of a Federal Home Loan Bank, including the FHLB-Pittsburgh, could be substantially diminished or reduced to zero. Consequently, given that there is no market for our FHLB-Pittsburgh common stock, we believe that there is a risk that our investment could be deemed other than temporarily impaired at some time in the future. If this occurs, it may adversely affect our results of operations and financial condition.

If the capitalization of the FHLB-Pittsburgh is substantially diminished and if it reduces or suspends its dividend, our liquidity may be adversely impaired if we are not able to obtain an alternative source of funding.

Recent health care legislation could increase our expenses or require us to pass further costs on to our employees, which could adversely affect our operations, financial condition and earnings.

Legislation enacted in 2010 requires companies to provide expanded health care coverage to their employees, such as affordable coverage to part-time employees and coverage to dependent adult children of employees. Companies will also be required to enroll new employees automatically into their health plans. Compliance with these and other new requirements of the health care legislation will increase our employee benefits expense, and may require us to pass these costs on to our employees, which could give us a competitive disadvantage in hiring and retaining qualified employees.

The Company may fail to realize the cost savings estimated for the Franklin Security merger.

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

Item 1B. Unresolved Staff Comments

Not applicable.

Table of Contents**Item 2. Properties**

The following table provides certain information as of September 30, 2013 with respect to our main office located in Stroudsburg, Pennsylvania, and our 26 full service branch offices.

Location	Leased or Owned	Year Acquired or Leased	Square Footage
Main Office:			
200 Palmer Street			
Stroudsburg, PA 18360	Owned	2003	36,000
Full Service Branches:			
249 Route 940			
Blakeslee, PA 18610	Owned	2002	2,688
1881 Route 209			
Brodheads ville, PA 18322	Owned	1983	4,100
5801 Milford Road			
East Stroudsburg, PA 18302	Leased	1997	1,700
695 North Courtland Street			
East Stroudsburg, PA 18301	Leased	1999	420
75 Washington Street			
East Stroudsburg, PA 18301	Owned	1966	3,300
143 Seven Bridge Road			
Marshalls Creek, PA 18335	Leased	1991	2,627
3236 Route 940, Suite 23			
Mt. Pocono, PA 18344	Leased	1999	536
1321A Blue Valley Drive			
Pen Argyl, PA 18072	Leased	2001	444
744 Main Street			
Stroudsburg, PA 18360	Owned	1985	12,000
Route 611	Leased	2000	488

1070 North Ninth Street			
Stroudsburg, PA 18360			
2836 Route 611, Ste 105			
Tannersville, PA 18372	Leased	1993	611
924 Weir Lake Road Suite 101			
Brodheads ville, PA 18322	Leased	1997	576
Tannersville Plaza			
2826 Route 611			
Tannersville, PA 18372	Owned	2007	2,500
975 Route 390			
Cresco, PA 18326	Owned	2010	2,912
1500 N. Cedar Crest Blvd, Unit 2			
Allentown, PA 18104	Leased	2010	530
5580 Crawford Drive			
Bethlehem, PA 18017	Leased	2010	468
5020 Route 873			
Schnecksville, PA 18078	Leased	2010	460

Table of Contents

Location	Leased or Owned	Year Acquired or Leased	Square Footage
418 West Broad Street			
Bethlehem, PA 18018	Owned	2012	4,500
358 South Walnut Street			
Bath, PA 18014	Leased	2012	2,000
2415 Park Avenue			
Easton, PA 18045	Owned	2012	3,460
14 South Main Street			
Nazareth, PA 18064	Leased	2012	450
471-497 Wabash Street			
Allentown, PA 18103	Owned	2012	4,411
11 North Main Street			
Alburtis, PA 18011	Owned	2012	2,091
1430 Jacobsburg Road			
Wind Gap, PA 18091	Leased	2012	1,400
Moravian Village Tower			
526 Wood Street			
Bethlehem, PA 18018	Leased	2012	160
6302 Route 309			
New Tripoli, PA 18066	Owned	2012	3,460
Other Properties			
746-752 Main Street			
Stroudsburg, PA 18360	Owned	2005	4,650
Five Highland Avenue, Suite D			
Bethlehem, PA 18017	Leased	2011	4,354
414 West Broad Street			
Bethlehem, PA 18018	Owned	2012	3,604

The net book value of our premises, land and equipment was \$15.7 million at September 30, 2013.

Item 3. 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 results of operations.

Item 4. Mine Safety Disclosures

Not applicable.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our shares of common stock are traded on the Nasdaq Global Market under the symbol ESSA. The approximate number of holders of record of ESSA Bancorp, Inc.'s common stock as of September 30, 2013 was 2,254. Certain shares of ESSA Bancorp, Inc. are held in nominee or street name and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number. The following tables present quarterly market information for ESSA Bancorp, Inc.'s common stock for the periods ended September 30, 2012 and September 30, 2013. The following information was provided by the Nasdaq Stock Market.

Fiscal 2013	High	Low	Dividends
Quarter ended September 30, 2013	\$ 11.50	\$ 10.26	\$ 0.05
Quarter ended June 30, 2013	10.99	10.13	0.05
Quarter ended March 31, 2013	11.50	10.80	0.05
Quarter ended December 31, 2012	10.89	9.50	0.05

Fiscal 2012	High	Low	Dividends
Quarter ended September 30, 2012	\$ 11.38	\$ 10.00	\$ 0.05
Quarter ended June 30, 2012	10.80	9.67	0.05
Quarter ended March 31, 2012	10.79	9.45	0.05
Quarter ended December 31, 2011	11.38	10.03	0.05

The Board of Directors has the authority to declare cash dividends on shares of common stock, subject to statutory and regulatory requirements. We began to pay quarterly cash dividends in the third quarter of fiscal 2008. In determining whether and in what amount to pay a cash dividend in the future, the Board will take into account a number of factors, including capital requirements, our consolidated financial condition and results of operations, tax considerations, statutory and regulatory limitations and general economic conditions. No assurances can be given that cash dividends will not be reduced or eliminated in the future.

The sources of funds for the payment of a cash dividend are the retained proceeds from the initial sale of shares of common stock and earnings on those proceeds, interest and principal payments with respect to ESSA Bancorp, Inc.'s loan to the Employee Stock Ownership Plan, and dividends from ESSA Bank & Trust. For a discussion of the limitations applicable to ESSA Bank & Trust's ability to pay dividends, see Item 1. Business Supervision and Regulation.

Stock Performance Graph

Set forth hereunder is a stock performance graph comparing (a) the cumulative total return on the common stock between September 30, 2009 and September 30, 2013, (b) the cumulative total return on stock included in the SNL Thrift Index over such period, and (c) the cumulative total return on stocks included in the Russell 2000 Index over such period. Cumulative return assumes the reinvestment of dividends, and is expressed in dollars based on an assumed investment of \$100.

There can be no assurance that the ESSA Bancorp, Inc. s stock performance will continue in the future with the same or similar trend depicted in the graph. ESSA Bancorp, Inc. will not make or endorse any predictions as to future stock performance.

Table of Contents**ESSA BANCORP, INC.**

<i>Index</i>	<i>Period Ending</i>					
	09/30/08	09/30/09	09/30/10	09/30/11	09/30/12	09/30/13
ESSA Bancorp, Inc.	100.00	96.29	87.72	79.16	79.82	81.58
SNL Thrift Index	100.00	76.59	76.49	64.86	84.28	101.47
Russell 2000	100.00	90.45	102.53	98.91	130.47	169.68

Source: SNL Financial LC, Charlottesville, NC

On May 27, 2008, the Board of Directors approved a stock repurchase program and authorized the repurchase of up to 15% of the Company's outstanding shares of common stock. In June 2009 the Company announced the completion of its 15% repurchase program, having purchased 2,547,135 shares at a weighted average cost of \$13.14. In June 2009 the Company announced a second repurchase program to purchase up to an additional 10% of its outstanding stock. In October 2010 the Company announced the completion of the second repurchase program, having purchased 1,499,100 shares at a weighted average cost of \$12.36. In October 2010, the Company announced a third repurchase program to purchase up to an additional 5% of its outstanding stock. In April 2011, the Company announced the completion of the third repurchase program, having purchased 679,900 shares at a weighted average cost of \$12.82. In May 2011, the Company announced a fourth repurchase program to purchase up to an additional 5% of its outstanding stock. In September 2011, the Company announced the completion of the fourth repurchase program, having purchased 637,200 shares at a weighted average cost of \$11.57. The Company did not repurchase any stock during the year ended September 30, 2012. In December 2012, the company announced a fifth repurchase program to repurchase up to an additional 10% of its outstanding stock. During the year ended September 30, 2013, the Company purchased 1,263,765 shares at a weighted average cost of \$11.07 per share. The following table presents a summary of the Company's share repurchases during the quarter ended September 30, 2013.

Table of Contents**Company Purchases of Common Stock**

Month Ending	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
July 31, 2013	110,000	\$ 11.20	110,000	
August 31, 2013	145,100	11.28	145,100	
September 30, 2013				
Total	255,100	\$ 11.25	255,100	59,226

Table of Contents**Item 6. Selected Financial Data**

The following information is derived from the audited consolidated financial statements of ESSA Bancorp, Inc. For additional information, reference is made to Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements of ESSA Bancorp, Inc. and related notes included elsewhere in this Annual Report.

	2013	2012	At September 30, 2011			2010	2009
			(In thousands)				
Selected Financial Condition Data:							
Total assets	\$ 1,372,315	\$ 1,418,786	\$ 1,097,480	\$ 1,071,997	\$ 1,042,119		
Cash and cash equivalents	26,648	15,550	41,694	10,890	18,593		
Investment securities:							
Available for sale	315,622	329,585	245,393	252,341	217,566		
Held to maturity				12,795	6,709		
Loans, net	928,230	950,355	738,619	730,842	733,580		
Regulatory stock	9,415	21,914	16,882	20,727	20,727		
Premises and equipment	15,747	16,170	11,494	12,189	10,620		
Bank owned life insurance	28,797	27,848	23,256	15,618	15,072		
Deposits	1,041,059	995,634	637,924	540,410	408,855		
Borrowed funds	152,260	234,741	288,410	350,076	438,598		
Equity	166,446	175,411	161,679	171,623	185,506		

	2013	2012	For the Years Ended September 30, 2011			2010	2009
			(In thousands)				
Selected Data:							
Interest income	\$ 51,102	\$ 45,200	\$ 47,176	\$ 49,257	\$ 52,733		
Interest expense	11,257	16,132	18,280	21,306	23,739		
Net interest income	39,845	29,068	28,896	27,951	28,994		
Provision for loan losses	3,750	2,550	2,055	2,175	1,500		
Net interest income after provision for loan losses	36,095	26,518	26,841	25,776	27,494		
Non-interest income	8,024	6,735	6,325	6,708	5,728		
Non-interest expense	32,462	33,005	26,045	26,128	24,113		
Income before income tax expense	11,657	248	7,121	6,356	9,109		
Income tax expense	2,834	33	1,863	1,844	2,553		
Net income	\$ 8,823	\$ 215	\$ 5,258	\$ 4,512	\$ 6,556		

Earnings per share

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

Basic	\$	0.76	\$	0.02	\$	0.46	\$	0.36	\$	0.47
Diluted	\$	0.76	\$	0.02	\$	0.46	\$	0.36	\$	0.47

Table of Contents

	At or For the Years Ended September 30,				
	2013	2012	2011	2010	2009
Selected Financial Ratios and Other Data:					
Performance Ratios:					
Return on average assets	0.64%	0.02%	0.48%	0.43%	0.64%
Return on average equity	5.12%	0.13%	3.15%	2.49%	3.42%
Interest rate spread (1)	2.97%	2.42%	2.47%	2.34%	2.40%
Net interest margin (2)	3.08%	2.65%	2.78%	2.78%	2.93%
Efficiency ratio (3)	67.81%	91.90%	75.62%	75.39%	69.45%
Noninterest expense to average total assets	2.34%	2.84%	2.39%	2.49%	2.34%
Average interest-earning assets to average interest-bearing liabilities	113.50%	116.55%	117.90%	121.11%	123.00%
Asset Quality Ratios:					
Non-performing assets as a percent of total assets	1.89%	1.92%	1.26%	1.20%	0.74%
Non-performing loans as a percent of total loans	2.55%	2.53%	1.54%	1.47%	0.70%
Allowance for loan losses as a percent of non-performing loans	33.79%	30.12%	71.04%	68.48%	112.82%
Allowance for loan losses as a percent of total loans	0.86%	0.76%	1.09%	1.01%	0.79%
Capital Ratios:					
Total risk-based capital (to risk weighted assets)	20.35%	19.71%	28.54%	32.60%	31.00%
Tier 1 risk-based capital (to risk weighted assets)	19.42%	18.81%	27.30%	31.35%	29.86%
Tangible capital (to tangible assets)	11.03%	11.08%	14.18%	15.07%	15.17%
Tier 1 leverage (core) capital (to adjusted tangible assets)	11.03%	11.08%	14.18%	15.07%	15.17%
Average equity to average total assets	12.42%	14.30%	15.27%	17.26%	18.59%
Other Data:					
Number of full service offices	26	26	17	17	13

- (1) The interest rate spread represents the difference between the weighted-average yield on a fully tax equivalent basis on interest-earning assets and the weighted-average cost of interest-bearing liabilities for the year.
- (2) The net interest margin represents net interest income on a fully tax equivalent basis as a percent of average interest-earning assets for the year.
- (3) The efficiency ratio represents non-interest expense divided by the sum of net interest income and non-interest income.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Business Strategy

Our business strategy is to grow and improve our profitability by:

Increasing customer relationships through the offering of excellent service and the distribution of

that service through effective delivery systems;

Continuing to transform into a full service community bank by meeting the financial services needs of our customers;

Continuing to develop into a high performing financial institution, in part by increasing interest revenue and fee income;

Remaining within our risk management parameters; and

Employing affordable technology to increase profitability and improve customer service.

We intend to continue to pursue our business strategy, subject to changes necessitated by future market conditions and other factors. We also intend to focus on the following:

Increasing customer relationships through a continued commitment to service and enhancing products and delivery systems. We will continue to increase customer relationships by focusing on customer satisfaction with regard to service, products, systems and operations. We have upgraded and expanded certain of our facilities, including our corporate center and added additional branches to provide additional capacity to manage future growth and expand our delivery systems.

Table of Contents

Continuing to develop into a high performing financial institution. We will continue to enhance profitability by focusing on increasing non-interest income as well as increasing commercial products, including commercial real estate lending, which often have a higher profit margin than more traditional products. We also will pursue lower-cost commercial deposits as part of this strategy.

Remaining within our risk management parameters. We place significant emphasis on risk management and compliance training for all of our directors, officers and employees. We focus on establishing regulatory compliance programs to determine the degree of such compliance and to maintain the trust of our customers and community.

Employing cost-effective technology to increase profitability and improve customer service. We will continue to upgrade our technology in an efficient manner. We have implemented new software for marketing purposes and have upgraded both our internal and external communication systems.

Continuing our emphasis on commercial real estate lending to improve our overall performance. We intend to continue to emphasize the origination of higher interest rate margin commercial real estate loans as market conditions, regulations and other factors permit. We have expanded our commercial banking capabilities by adding experienced commercial bankers, and enhancing our direct marketing efforts to local businesses.

Expanding our banking franchise through branching and acquisitions. We will attempt to use our stock holding company structure, to expand our market footprint through *de novo* branching as well as through additional acquisitions of banks, savings institutions and other financial service providers in our primary market area. We will also consider establishing *de novo* branches or acquiring additional financial institutions in contiguous counties. We will continue to review and assess locations for new branches both within Monroe County and the contiguous counties around Monroe. There can be no assurance that we will be able to consummate any new acquisitions or establish any additional new branches. We may continue to explore acquisition opportunities involving other banks and thrifts, and possibly financial service companies, when and as they arise, as a means of supplementing internal growth, filling gaps in our current geographic market area and expanding our customer base, product lines and internal capabilities, although we have no current plans, arrangements or understandings to make any acquisitions.

Maintaining the quality of our loan portfolio. Maintaining the quality of our loan portfolio is a key factor in managing our growth. We will continue to use customary risk management techniques, such as independent internal and external loan reviews, risk-focused portfolio credit analysis and field inspections of collateral in overseeing the performance of our loan portfolio.

Critical Accounting Policies

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

income, to be critical accounting policies. We consider the following to be our critical accounting policies:

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

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

Table of Contents

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

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

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

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

Comparison of Financial Condition at September 30, 2013 and September 30, 2012

Total Assets. Total assets decreased \$46.5 million, or 3.28%, to \$1.37 billion at September 30, 2013, compared to \$1.42 billion at September 30, 2012. Decreases in investment securities available for sale, loans receivable, regulatory stock and other assets were partially offset by an increase in cash and due from banks.

Interest-Bearing Deposits with Other Institutions. Interest-bearing deposits with other institutions decreased \$261,000, or 5.8%, to \$4.3 million at September 30, 2013 from \$4.5 million at September 30, 2012. The primary reason for the decrease was a decrease in the Company's interest bearing demand deposit account at the

FHLB-Pittsburgh of \$168,000.

Investment Securities Available for Sale. Investment securities available for sale decreased \$14.0 million, or 4.24% to \$315.6 million at September 30, 2013 from \$329.6 million at September 30, 2012. The decrease was due primarily to declines in U.S. government agency securities of \$22.0 million offset in part by increases in obligations of states and political subdivisions of \$4.4 million and corporate obligations of \$4.1 million.

Net Loans. Net loans decreased \$22.1 million, or 2.3%, to \$928.2 million at September 30, 2013 from \$950.4 million at September 30, 2012. The primary reasons for the decrease were decreases in residential, commercial real estate and home equity loans. Residential real estate loans decreased by \$10.0 million to \$686.7 million at September 30, 2013 from \$696.7 million at September 30, 2012. Commercial real estate loans decreased by \$723,000 to \$159.5 million at September 30, 2013 from \$160.2 million at September 30, 2012. Home equity loans decreased by \$6.0 million to \$41.9 million at September 30, 2013 from \$47.9 million at September 30, 2012.

Goodwill and Deferred Income Taxes. Goodwill increased to \$8.8 million at September 30, 2013 from \$8.5 million at September 30, 2012. For the same period, deferred income taxes decreased \$153,000 to \$11.2 million from \$11.3 million.

Table of Contents

Other Assets. Other assets decreased \$8.3 million, or 27.7% to \$21.5 million at September 30, 2013 from \$29.8 million at September 30, 2012. The primary reason for the decrease was a decrease in accounts receivable of \$6.8 million at September 30, 2013 compared to September 30, 2012. Accounts receivable decreased primarily due to \$6.0 million of brokered deposits that the Company contracted for prior to September 30, 2012 for which the funds were not received until October 1, 2012.

Deposits. Deposits increased by \$45.4 million, or 4.6%, to \$1.04 billion at September 30, 2013 from \$995.6 million at September 30, 2012. Overall, the increases in deposits at September 30, 2013 compared to September 30, 2012 included increases in non-interest bearing demand accounts of \$17.0 million or 40.8%, and certificates of deposit of \$48.0 million or 8.2% offset in part by declines in money market accounts of \$17.6 million or 11.3% and NOW accounts of \$10.1 million or 9.2%. Included in the certificates of deposit was an increase of \$76.5 million or 48.8% in brokered certificates of deposit. The increase in brokered certificates of deposit was the result of the Company's decision to purchase brokered certificates based on cost compared to other available funding sources. At September 30, 2013, the Company had \$233.3 million of brokered certificates of deposit outstanding.

Borrowed Funds. Borrowed funds, short term and other, declined \$82.5 million or 35.1% to \$152.3 million at September 30, 2013 from \$234.7 million at September 30, 2012. Included in borrowed funds at September 30, 2013 were \$10.0 million of repurchase agreements with various financial institution third parties. Except for these borrowings, all borrowed funds are from the FHLB. The decrease in borrowed funds was primarily due to the use of cheaper funding sources to replace maturing FHLB borrowings.

Stockholders' Equity. Stockholders' equity decreased by \$9.0 million, or 5.1% to \$166.4 million at September 30, 2013 from \$175.4 million at September 30, 2012. The decrease was due primarily to stock repurchases and a decrease in other comprehensive income. For the twelve months ended September 30, 2013, the Company repurchased 1,263,765 shares at an average cost of \$11.07 per share. Accumulated other comprehensive income declined due primarily to a decrease in unrealized gain on available for sale securities of \$6.1 million to \$70,000 at September 30, 2013 from \$6.2 million at September 30, 2012 due primarily to an increase in longer term rates during the year.

Comparison of Operating Results for the Years Ended September 30, 2013 and September 30, 2012

Net Income. Net income increased \$8.6 million to \$8.8 million for the fiscal year ended September 30, 2013 from \$215,000 for the fiscal year ended September 30, 2012. The increase was primarily due to increases in net interest income and noninterest income offset in part by increases in income tax expense.

Net Interest Income. Net interest income increased by \$10.8 million, or 37.1%, to \$39.8 million for fiscal year 2013 from \$29.1 million for fiscal year 2012.

Interest Income. Interest income increased \$5.9 million or 13.1% to \$51.1 million for fiscal year 2013 from \$45.2 million for fiscal year 2012. The increase resulted from a \$196.0 million increase in average interest earning assets which had the effect of increasing interest income by \$8.6 million offset in part by a 17 basis point decrease in the overall yield on interest earning assets to 3.96% for fiscal year 2013 from 4.13% for fiscal year 2012 which decreased interest income by \$2.7 million. The increase in average interest earning assets during 2013 compared to 2012 included increases in average loans of \$162.9 million, average investments of \$34.5 million and average mortgage backed securities of \$10.5 million. These increases were partially offset by decreases in average other interest earning assets of \$11.1 million and regulatory stock of \$886,000. The average yield on loans decreased to 4.73% for the fiscal year 2013, from 4.9% for the fiscal year 2012. The average yields on investment securities decreased to 1.96% from 2.13% and the average yields on mortgage backed securities decreased to 1.99% from 2.61% for the 2013 and 2012 periods, respectively.

Interest Expense. Interest expense decreased \$4.9 million, or 30.2% to \$11.3 million for fiscal year 2013 from \$16.1 million for fiscal year 2012. The decrease resulted from a 73 basis point decrease in the overall cost of interest-bearing liabilities to 0.99% for fiscal 2013 from 1.71% for fiscal 2012 which decreased interest expense by \$5.8 million. A \$198.1 million increase in average interest-bearing liabilities had the effect of increasing interest expense by \$908,000. Average savings and club accounts increased by \$25.3 million, average NOW accounts increased \$25.5 million, average money market accounts increased \$26.0 million and average certificates of deposit increased \$186.6 million. For fiscal 2013, average borrowed funds decreased \$65.2 million over 2012. The cost of money market accounts decreased to 0.23% for fiscal year 2013 from 0.28% for fiscal year 2012. The cost of savings and club accounts decreased to 0.05% for fiscal 2013 from 0.10% for fiscal 2012. The cost of certificates of deposit decreased to 1.17% from 1.71% and the cost of borrowed funds decreased to 1.91% from 3.24% for fiscal years 2013 and 2012, respectively. Borrowed fund declined primarily due to prepayments of \$10.0 million in repurchase agreements and \$27.0 million of FHLB borrowings in 2012.

Provision for Loan Losses. The Company establishes provisions for loan losses, which are charged to earnings, at a level necessary to absorb known and inherent losses that are both probable and reasonably estimable at the date of the financial statements. 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 the borrower's ability to repay, the estimated value of any

Table of Contents

underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events occur. After an evaluation of these factors, the Company made a provision of \$3.8 million for fiscal year 2013 compared to a \$2.6 million provision for the 2012 fiscal year. The allowance for loan losses was \$8.1 million or 0.86% of loans outstanding at September 30, 2013, compared to \$7.3 million, or 0.76% of loans outstanding at September 30, 2012.

Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. Management reviews the level of the allowance on a quarterly basis, and establishes the provision for loan losses based on the factors set forth in the preceding paragraph. Historically, the Bank's loan portfolio has consisted primarily of one-to-four-family residential mortgage loans. However, our current business plan calls for increases in commercial real estate loan originations. As management evaluates the allowance for loan losses, the increased risk associated with larger non-homogenous commercial real estate may result in large additions to the allowance for loan losses in future periods. Loans secured by commercial real estate generally expose a lender to greater risk of non-payment and loss than one-to-four family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the underlying property. Additionally, such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four family residential mortgage loans. Accordingly, an adverse development with respect to one loan or one credit relationship can expose us to greater risk of loss compared to an adverse development with respect to a one-to-four family residential mortgage loan.

Although we believe that we use the best information available to establish the allowance for loan losses, future additions to the allowance may be necessary, based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. In addition, the Federal Reserve Board, as an integral part of its examination process, will periodically review our allowance for loan losses. This agency may require us to recognize adjustments to the allowance, based on its judgments about information available to it at the time of its examination.

Non-Interest Income. Non-interest income increased \$1.3 million or 19.1%, to \$8.0 million for the year ended September 30, 2013, from \$6.7 million for the comparable 2012 period. The increase was primarily due to increases in earnings on gain on sale of investments of \$406,000, service charges and fees on loans, and service fees on deposit accounts of \$262,000 which were partially offset by a decrease in the trust and investment fees of \$52,000.

Non-Interest Expense. Non-interest expense decreased \$543,000, or 1.7%, to \$32.5 million for fiscal year 2013 from \$33.0 million for the comparable period in 2012. The primary reasons for the decrease were declines in merger related costs of \$1.4 million and prepayment penalties on borrowings of \$4.6 million which was partially offset by increases in compensation and employee benefits of \$2.7 million.

Income Taxes. Income tax expense of \$2.8 million was recognized for fiscal year 2013 compared to an income tax expense of \$33,000 recognized for fiscal year 2012. The primary reason for the increase was the increases in income before income taxes of \$11.4 million.

Comparison of Operating Results for the Years Ended September 30, 2012 and September 30, 2011

Net Income. Net income decreased \$5.0 million, or 95.9%, to \$215,000 for the fiscal year ended September 30, 2012 from \$5.3 million for the fiscal year ended September 30, 2011. The decrease was primarily due to \$1.4 million in merger related costs and \$4.6 million in prepayment penalties incurred on borrowings during the year ended September 30, 2012.

Net Interest Income. Net interest income increased by \$172,000, or 0.60%, to \$29.1 million for fiscal year 2012 from \$28.9 million for fiscal year 2011.

Interest Income. Interest income decreased \$2.0 million or 4.2% to \$45.2 million for fiscal year 2012 from \$47.2 million for fiscal year 2011. The decrease resulted from a 41 basis point decrease in the overall yield on interest earning assets to 4.13% for fiscal year 2012 from 4.54% for fiscal year 2011 which decreased interest income by \$4.1 million. This decrease was partially offset by a \$55.2 million increase in average interest earning assets which had the effect of increasing interest income by \$2.1 million. The increase in average interest earning assets during 2012 compared to 2011 included increases in average loans of \$34.7 million, average investments of \$18.2 million and average other interest earning assets of \$6.6 million. These increases were partially offset by decreases in average mortgage-backed securities of \$2.2 million and regulatory stock of \$2.1 million. The average yield on loans decreased to 4.90% for the fiscal year 2012, from 5.2% for the fiscal year 2011. The average yields on investment securities decreased to 2.13% from 2.56% and the average yields on mortgage backed securities decreased to 2.61% from 3.36% for the 2012 and 2011 periods, respectively.

Interest Expense. Interest expense decreased \$2.1 million, or 11.8% to \$16.1 million for fiscal year 2012 from \$18.3 million for fiscal year 2011. The decrease resulted from a 36 basis point decrease in the overall cost of interest-bearing liabilities to 1.71% for fiscal 2012 from 2.07% for fiscal 2011 which decreased interest expense by \$2.4 million. A \$57.5 million increase in

Table of Contents

average interest-bearing liabilities had the effect of increasing interest expense by \$287,000 as borrowed funds matured and were replaced by lower cost alternatives. Average savings and club accounts increased by \$9.2 million, average NOW accounts increased \$7.0 million, average money market accounts decreased \$828,000 and average certificates of deposit increased \$75.5 million. For fiscal 2012, average borrowed funds decreased \$33.3 million over 2011. The cost of money market accounts decreased to 0.28% for fiscal year 2012 from 0.47% for fiscal year 2011. The cost of savings and club accounts decreased to 0.10% for fiscal 2012 from 0.22% for fiscal 2011. The cost of certificates of deposit decreased to 1.71% from 2.01% and the cost of borrowed funds decreased to 3.24% from 3.60% for fiscal 2012 and 2011, respectively.

Provision for Loan Losses. The Company establishes provisions for loan losses, which are charged to earnings, at a level necessary to absorb known and inherent losses that are both probable and reasonably estimable at the date of the financial statements. 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 the 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 susceptible to significant revision as more information becomes available or as future events occur. After an evaluation of these factors, the Company made a provision of \$2.6 million for fiscal year 2012 compared to a \$2.1 million provision for the 2011 fiscal year. The allowance for loan losses was \$7.3 million or 0.76% of loans outstanding at September 30, 2012, compared to \$8.2 million, or 1.09% of loans outstanding at September 30, 2011.

Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. Management reviews the level of the allowance on a quarterly basis, and establishes the provision for loan losses based on the factors set forth in the preceding paragraph. Historically, the Bank's loan portfolio has consisted primarily of one-to-four-family residential mortgage loans. However, our current business plan calls for increases in commercial real estate loan originations. As management evaluates the allowance for loan losses, the increased risk associated with larger non-homogenous commercial real estate may result in large additions to the allowance for loan losses in future periods. Loans secured by commercial real estate generally expose a lender to greater risk of non-payment and loss than one-to-four family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the underlying property. Additionally, such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four family residential mortgage loans. Accordingly, an adverse development with respect to one loan or one credit relationship can expose us to greater risk of loss compared to an adverse development with respect to a one-to-four family residential mortgage loan.

Although we believe that we use the best information available to establish the allowance for loan losses, future additions to the allowance may be necessary, based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. In addition, the Federal Reserve Board, as an integral part of its examination process, will periodically review our allowance for loan losses. This agency may require us to recognize adjustments to the allowance, based on its judgments about information available to it at the time of its examination.

Non-Interest Income. Non-interest income increased \$410,000 or 6.5%, to \$6.7 million for the year ended September 30, 2012, from \$6.3 million for the comparable 2011 period. The increase was primarily due to increases in earnings on bank-owned life insurance of \$168,000 and insurance commissions of \$387,000 which were partially offset by a decrease in the gains on the sales of loans and investments of \$156,000. Earnings on bank-owned life insurance increased during fiscal 2012 as a result of the purchase of \$7.0 million of additional bank-owned life insurance during fiscal 2011. Insurance commissions increased in fiscal 2012 because the Company's insurance subsidiary was not purchased until the third quarter of fiscal 2011.

Non-Interest Expense. Non-interest expense increased \$7.0 million, or 26.7%, to \$33.0 million for fiscal year 2012 from \$26.0 million for the comparable period in 2011. The primary reasons for the increase were the increases in merger related costs of \$1.4 million and prepayment penalties on borrowings of \$4.6 million.

Income Taxes. Income tax expense of \$33,000 was recognized for fiscal year 2012 compared to an income tax expense of \$1.9 million recognized for fiscal year 2011. The primary reason for the decline was the decline in income before income taxes of \$6.9 million.

Table of Contents

Average Balances and Yields. The following table sets forth average balance sheets, average yields and costs, and certain other information for the periods indicated. All average balances are monthly 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 Years Ended September 30,								
	2013			2012			2011		
	Average Balance	Interest Income/Expense	Yield/Cost	Average Balance	Interest Income/Expense	Yield/Cost	Average Balance	Interest Income/Expense	Yield/Cost
	(Dollars in thousands)								
Interest-earning assets:									
Loans ^{(1) (2)}	\$ 946,358	\$ 44,744	4.73%	\$ 783,444	\$ 38,384	4.90%	\$ 748,765	\$ 38,949	5.20%
Investment securities									
Taxable ⁽³⁾	88,757	1,585	1.79%	58,643	1,116	1.90%	43,629	869	1.99%
Exempt from federal income tax ^{(3) (4)}	13,166	272	3.13%	8,731	209	3.63%	5,516	258	7.09%
Total investment securities	101,923	1,857	1.96%	67,374	1,325	2.13%	49,145	1,127	2.56%
Mortgage-backed securities	219,697	4,373	1.99%	209,161	5,467	2.61%	211,382	7,095	3.36%
Regulatory stock	15,635	115	0.74%	16,521		0.00%	18,626		0.00%
Other	8,849	13	0.15%	19,917	24	0.12%	13,315	5	0.04%
Total interest-earning assets	1,292,462	51,102	3.96%	1,096,417	45,200	4.13%	1,041,233	47,176	4.54%
Allowance for loan losses	(7,709)			(7,899)			(7,967)		
Noninterest-earning assets	102,057			69,458			58,031		
Total assets	\$ 1,386,810			\$ 1,157,976			\$ 1,091,297		
Interest-bearing liabilities:									
NOW accounts	\$ 91,201	51	0.06%	\$ 65,747	25	0.04%	\$ 58,795	25	0.04%
Money market accounts	143,103	327	0.23%	117,118	327	0.28%	117,946	552	0.47%
Savings and club accounts	104,234	50	0.05%	78,943	80	0.10%	69,732	156	0.22%

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

Certificates of deposit	598,759	6,980	1.17%	412,207	7,054	1.71%	336,668	6,754	2.01%
Borrowed funds	201,483	3,849	1.91%	266,691	8,646	3.24%	300,024	10,793	3.60%
Total interest-bearing liabilities	1,138,780	11,257	0.99%	940,706	16,132	1.71%	883,165	18,280	2.07%
Non-interest bearing demand accounts	56,467			37,064			30,236		
Noninterest-bearing liabilities	19,277			14,618			11,280		
Total liabilities	1,214,524			992,388			924,681		
Equity	172,286			165,588			166,616		
Total liabilities and equity	\$ 1,386,810			\$ 1,157,976			\$ 1,091,297		
Net interest income		\$ 39,845			\$ 29,068			\$ 28,896	
Interest rate spread			2.97%			2.42%			2.47%
Net interest-earning assets	\$ 153,682			\$ 155,711			\$ 158,068		
Net interest margin ⁽⁵⁾			3.08%			2.65%			2.78%
Average interest-earning assets to average interest-bearing liabilities			113.50%			116.55%			117.90%

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

(2) Interest income on loans includes net amortized revenues (costs) on loans totaling \$43,000 in 2013, \$1,000 for 2012, and \$35,000 for 2011.

(3) Held to maturity securities are reported as amortized cost. Available for sale securities are reported at fair value.

(4) Yields on tax exempt securities have been calculated on a fully tax equivalent basis assuming a tax rate of 34%.

(5) Represents the difference between interest earned and interest paid, divided by average total interest earning assets.

Table of Contents**Rate/Volume Analysis**

The following table presents the effects of changing rates and volumes on our net interest income for the years indicated. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately based on the changes due to rate and the changes due to volume.

	For the Years Ended September 30, 2013 vs. 2012			For the Years Ended September 30, 2012 vs. 2011		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Net	Volume	Rate	Net
	(In thousands)					
Interest-earning assets:						
Loans	\$ 7,733	\$(1,373)	\$ 6,360	\$ 1,754	\$(2,319)	\$ (565)
Investment securities	656	(124)	532	470	(272)	198
Mortgage-backed securities	262	(1,356)	(1,094)	(77)	(1,551)	(1,628)
Federal Home Loan Bank stock		115	115			
Other	(16)	5	(11)	1	18	19
Total interest-earning assets	8,635	(2,733)	5,902	2,148	(4,124)	(1,976)
Interest-bearing liabilities:						
NOW accounts	1	25	26			
Money market accounts	65	(65)		(4)	(221)	(225)
Savings and club accounts	54	(84)	(30)	24	(100)	(76)
Certificates of deposit	2,579	(2,653)	(74)	1,397	(1,097)	300
Borrowed funds	(1,791)	(3,006)	(4,797)	(1,130)	(1,017)	(2,147)
Total interest-bearing liabilities	908	(5,783)	(4,875)	287	(2,435)	(2,148)
Net change in interest income	\$ 7,727	\$ 3,050	\$ 10,777	\$ 1,861	\$(1,689)	\$ 172

Management of Market Risk

General. 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.

Net interest income, which is the primary source of the Company's earnings, is impacted by changes in interest rates and the relationship of different interest rates. To manage the impact of the rate changes, the balance sheet should be structured so that repricing opportunities exist for both assets and liabilities at approximately the same time intervals. The Company uses net interest simulation to assist in interest rate risk management. The process includes simulating various interest rate environments and their impact on net interest income. As of September 30, 2013, the level of net interest income at risk in a 200 basis points increase was within the Company's policy limit of a decline less than 10% of net interest income. Due to the inability to reduce many deposit rates by the full 200 basis points, the Company's net interest income at risk in a 100 basis point decline was within the Company's policy limit of a decline of less than 10% of net interest income.

Table of Contents

The following table sets forth the results of the twelve month projected net interest income model as of September 30, 2013.

Change in Interest Rates in Basis Points (Rate Ramp)	Net Interest Income		
	Amount \$	Change \$	Change (%)
	(Dollars in thousands)		
-100	\$ 33,310	\$ (1,076)	(3.2)
Static	34,386		
+100	33,576	(810)	(2.4)
+200	32,490	(1,896)	(5.5)
+300	30,701	(3,685)	(10.7)

The above table indicates that as of September 30, 2013, in the event of a 300 basis point instantaneous (shock) increase in interest rates, the Company would experience a 10.7% or \$3.7 million decrease in net interest income. In the event of a 100 basis point decrease in interest rates, (shock), the Company would experience a 3.2% or \$1.1 million decrease in net interest income.

Another measure of interest rate sensitivity is to model changes in economic value of equity through the use of immediate and sustained interest rate shocks. The following table illustrates the economic value of equity model results as of September 30, 2013.

Change in Interest Rates in Basis Points	Net Interest Income		
	Amount \$	Change \$	Change (%)
	(Dollars in thousands)		
-100	\$ 198,090	\$ 3,743	1.9
Flat	194,347		
+100	180,554	(13,793)	(7.1)
+200	164,346	(30,001)	(15.4)
+300	146,762	(47,585)	(24.5)

The preceding table indicates that as of September 30, 2013, in the event of an immediate and sustained 300 basis point increase in interest rates, the Company would experience a 24.5%, or \$47.6 million reduction in the present value of equity. If rates were to decrease 100 basis points, the Company would experience a 1.9% or \$3.7 million increase in the present value of equity.

Certain shortcomings are inherent in the methodologies used in the above interest rate risk measurements. Modeling changes in net interest income requires the making of certain assumptions regarding prepayment and deposit decay rates, which may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. While management believes such assumptions are reasonable, there can be no assurance that assumed prepayment rates and decay rates will approximate actual future loan prepayment and deposit withdrawal activity. Moreover, the net interest income table presented assumes that the composition of interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Accordingly, although the net interest income table provides an

indication of the Company's interest rate risk exposure at a particular point in time, such measurement is not intended to and does not provide a precise forecast of the effect of changes in market interest rates on net interest income and will differ from actual results.

Liquidity and Capital Resources

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

Our primary sources of liquidity are deposits, amortization and prepayment 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 FHLB advances and other borrowings. 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 September 30, 2013, \$26.6 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

Table of Contents

of mortgage-backed securities and increases in deposit accounts. Short-term investment securities (maturing in one year or less) totaled \$3.0 million at September 30, 2013. As of September 30, 2013, we had \$142.3 million in borrowings outstanding from the FHLB-Pittsburgh and \$10.0 million in repurchase agreements. We have access to FHLB advances of up to approximately \$598.6 million.

At September 30, 2013, we had \$69.1 million in loan commitments outstanding, which included \$3.4 million in undisbursed construction loans, \$31.9 million in unused home equity lines of credit and \$10.1 million in commercial lines of credit. Certificates of deposit due within one year of September 30, 2013 totaled \$312.2 million, or 49.2% of certificates of deposit. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before September 30, 2013. 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 \$23.2 million, \$5.3 million and \$10.2 million for the years ended September 30, 2013, 2012 and 2011, respectively. These amounts differ from our net income because of a variety of cash receipts and disbursements that did not affect net income for the respective periods. Net cash provided by/(used) in investing activities was \$34.2 million, \$75.4 million and \$4.1 million in fiscal years 2013, 2012 and 2011, respectively, principally reflecting our loan and investment security activities in the respective periods along with our acquisition of First Star Bank in 2012. Investment security cash flows had the most significant effect, as net cash utilized in purchases amounted to \$131.3 million, \$92.0 million and \$96.8 million in the years ended September 30, 2013, 2012 and 2011, respectively. Cash proceeds from principal repayments, maturities and sales of investment securities amounted to \$135.1 million, \$117.5 million and \$120.9 million in the years ended September 30, 2013, 2012 and 2011, respectively. Deposit and borrowing cash flows have traditionally comprised most of our financing activities which resulted in net cash (used)/provided of \$(46.3) million in fiscal year 2013, \$(106.9) million in fiscal year 2012 and \$16.5 million in fiscal year 2011. In addition, during fiscal 2013 we used \$14.5 million and in fiscal 2011 we used \$16.9 million to repurchase our stock as part of previously disclosed stock repurchase plans.

The following table summarizes our significant fixed and determinable contractual principal obligations and other funding needs by payment date at September 30, 2013. The payment amounts represent those amounts due to the recipient and do not include any unamortized premiums or discounts or other similar carrying amount adjustments.

Contractual Obligations	Payments Due by Period				Total
	Less than One Year	One to Three Years	Three to Five Years	More than Five Years	
	(In thousands)				
Long-term debt	\$ 33,710	\$ 38,600	\$ 43,250	\$ 13,700	\$ 129,260
Operating leases	524	842	358	1,151	2,875
Certificates of deposit	312,151	186,822	103,861	31,335	634,169
Total	\$ 346,385	\$ 226,264	\$ 147,469	\$ 46,186	\$ 766,304

Commitments to extend credit	\$ 27,102	\$	\$	\$ 42,016	\$ 69,118
------------------------------	-----------	----	----	-----------	-----------

We also have obligations under our post retirement plan as described in note 13 to the Consolidated Financial Statements. The post retirement benefit payments represent actuarially determined future payments to eligible plan participants. We expect to contribute \$600,000 to our post retirement plan in 2014.

Off-Balance Sheet Arrangements. In the normal course of operations, we engage in a variety of financial transactions that, in accordance with generally accepted accounting principles are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit. For information about our loan commitments, letters of credit and unused lines of credit, see Note 11 of the notes to the Consolidated Financial Statements.

For fiscal year 2013, we did not engage in any off-balance-sheet transactions other than loan origination commitments and standby letters of credit in the normal course of our lending activities.

Impact of Inflation and Changing Prices

The financial statements and related notes of ESSA Bancorp, Inc. have been prepared in accordance with United States generally accepted accounting principles (GAAP). GAAP generally requires the measurement of financial position and operating

Table of Contents

results in terms of historical dollars without consideration for changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than the effects of inflation.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

For information regarding market risk, see Item 7. Management's Discussion and Analysis of Financial Conditions and Results of Operation.

Item 8. Financial Statements and Supplementary Data

The Financial Statements are included in Part III, Item 15 of this Form 10-K.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

Not Applicable.

Item 9A. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including our Principle Executive Officer and Principle 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 Exchange Act) as of the end of the fiscal year (the Evaluation Date). Based upon that evaluation, the Principle Executive Officer and Principle Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective.

(b) Changes in internal controls.

There were no changes in our internal control over financial reporting that occurred during the fourth quarter of fiscal 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

(c) Management report on internal control over financial reporting.

The management of ESSA Bancorp, Inc. (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting. ESSA Bancorp's internal control system is a process designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of ESSA Bancorp; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of ESSA Bancorp's assets that could have a material effect on our financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

ESSA Bancorp, Inc.'s management assessed the effectiveness of the Company's internal control over financial reporting as of September 30, 2013. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control-Integrated Framework*. Based on our assessment we believe that, as of September 30, 2013, the Company's internal control over financial reporting is effective based on those criteria.

ESSA Bancorp, Inc.'s independent registered public accounting firm that audited the consolidated financial statements has issued an audit report on the effectiveness of the Company's internal control over financial reporting as of September 30, 2013. See the Consolidated Financial Statements of ESSA Bancorp, Inc. and related notes included elsewhere in this Annual Report.

The Sarbanes-Oxley Act Section 302 Certifications have been filed with the SEC as exhibit 31.1 and exhibit 31.2 to this Annual Report on Form 10-K.

Table of Contents**Item 9B. Other Information**

Not Applicable.

PART III**Item 10. Directors, Executive Officers and Corporate Governance**

Information regarding directors, executive officers and corporate governance of the Company is presented under the headings Proposal 1 Election of Directors-General, Nominees for Directors, Continuing Directors, Board Matters and Committees, Executive Officers of the Bank Who Are Not Also Directors, Corporate Governance, Code of Ethics and Business conduct and Section 16(a) Beneficial Ownership Reporting Compliance in the Company's definitive Proxy Statement for the 2013 Annual Meeting of Stockholders to be held on March 6, 2014 (the Proxy Statement) and is incorporated herein by reference.

Item 11. Executive Compensation

Information regarding executive compensation is presented under the headings Proposal I Election of Directors-Director Compensation, Benefit Plans and Arrangements, and Summary Compensation Table in the Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information regarding security ownership of certain beneficial owners and management is presented under the heading Security Ownership of Certain Beneficial Owners and Management in the Proxy Statement and is incorporated herein by reference.

Securities Authorized for Issuance Under Equity Compensation Plans

Set forth below is information, as of September 30, 2013 regarding equity compensation plans categorized by those plans that have been approved by stockholders and those plans that have not been approved by stockholders.

Plan	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights \$	Number of Securities Remaining Available For Future Issuance Under Equity Compensation Plans
	1,458,379	12.35	239,711

Equity compensation plans approved by stockholders			
Equity compensation plans not approved by stockholders			
Total	1,458,379	12.35	239,711

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information regarding certain relationships and related transactions, and director independence is presented under the heading Transactions with Certain Related Persons and Proposal II Election of Directors Director Independence in the Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

Information regarding principal accounting fees and services is presented under the heading Proposal 2 Ratification of Appointment of Independent Registered Public Accountants in the Proxy Statement and is incorporated herein by reference.

Table of Contents

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) **Financial Statements**

The following documents are filed as part of this Form 10-K.

- (A) Report of Independent Registered Public Accounting Firm
- (B) Consolidated Balance Sheet - at September 30, 2013 and 2012
- (C) Consolidated Statement of Income - Years ended September 30, 2013, 2012 and 2011
- (D) Consolidated Statement of Changes In Stockholders Equity - Years ended September 30, 2013, 2012 and 2011
- (E) Consolidated Statement of Cash Flows - Years ended September 30, 2013, 2012 and 2011
- (F) Notes to Consolidated Financial Statements.

(a)(2) **Financial Statement Schedules**

None.

(a)(3) **Exhibits**

- 2.1 Agreement and Plan of Merger, dated as of 11/15/13 by and between ESSA Bancorp, Inc., ESSA Acquisition Corp. and Franklin Security Bancorp, Inc.¹
- 3.1 Certificate of Incorporation of ESSA Bancorp, Inc.²
- 3.2 Bylaws of ESSA Bancorp, Inc.²
- 4 Form of Common Stock Certificate of ESSA Bancorp, Inc.²
- 10.2 Amended and Restated Employment Agreement for Gary S. Olson³

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

10.3	Amended and Restated Employment Agreement for Robert S. Howes ³
10.4	Amended and Restated Employment Agreement for Allan A. Muto ³
10.5	Amended and Restated Employment Agreement for Diane K. Reimer ³
10.6	Amended and Restated Employment Agreement for V. Gail Bryant (Warner) ³
10.7	Supplemental Executive Retirement Plan ⁴
10.8	Endorsement Split Dollar Life Insurance Agreement for Gary S. Olson ⁴
10.9	Endorsement Split Dollar Life Insurance Agreement for Robert S. Howes ⁴
10.10	Endorsement Split Dollar Life Insurance Agreement for Allan A. Muto ⁴
10.11	Endorsement Split Dollar Life Insurance Agreement for Diane K. Reimer ⁴
10.12	Endorsement Split Dollar Life Insurance Agreement for V. Gail Warner (Bryant) ⁴
10.13	ESSA Bancorp, Inc. 2007 Equity Incentive Plan ⁵
21	Subsidiaries of Registrant
23	Consent of S.R. Snodgrass, A.C.
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.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

- 1 Incorporated by reference to ESSA Bancorp's current report on Form 8-K filed with the Securities and Exchange Commission on November 19, 2013.
- 2 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.
- 3 Incorporated by reference to ESSA Bancorp, Inc.'s current report on Form 8-K filed with the Securities and Exchange Commission on May 1, 2013.
- 4 Incorporated by reference to ESSA Bancorp, Inc.'s current report on Form 8-K filed with the Securities and Exchange Commission