

ESSA Bancorp, Inc.
Form 10-Q
February 09, 2009
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended December 31, 2008

OR

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

Commission File No. 001-33384

ESSA Bancorp, Inc.

(Exact name of registrant as specified in its charter)

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

Pennsylvania
(State or other jurisdiction of
incorporation or organization)

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

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

18360
(Zip Code)

(570) 421-0531
(Registrant's telephone number)

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

As of February 5, 2009 there were 15,876,214 shares of the Registrant's common stock, par value \$0.01 per share, outstanding.

Table of Contents

ESSA Bancorp, Inc.

FORM 10-Q

Index

| | Page |
|--|-------------|
| <u>Part I. Financial Information</u> | |
| Item 1. <u>Financial Statements (unaudited)</u> | 3 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 15 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 23 |
| Item 4T. <u>Controls and Procedures</u> | 23 |
| <u>Part II. Other Information</u> | |
| Item 1. <u>Legal Proceedings</u> | 23 |
| Item 1A. <u>Risk Factors</u> | 23 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 24 |
| Item 3. <u>Defaults Upon Senior Securities</u> | 24 |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u> | 24 |
| Item 5. <u>Other Information</u> | 24 |
| Item 6. <u>Exhibits</u> | 24 |
| <u>Signature Page</u> | 25 |

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

ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEET

(UNAUDITED)

| | December 31, 2008 | September 30, 2008 |
|--|------------------------|-----------------------|
| | (dollars in thousands) | |
| ASSETS | | |
| Cash and due from banks | \$ 8,475 | \$ 8,382 |
| Interest-bearing deposits with other institutions | 10,996 | 4,232 |
| Total cash and cash equivalents | 19,471 | 12,614 |
| Certificates of deposit | 6,756 | 3,777 |
| Investment securities available for sale | 219,186 | 204,078 |
| Investment securities held to maturity (estimated fair value of \$11,619 and \$11,924) | 11,398 | 11,857 |
| Loans receivable (net of allowance for loan losses of \$4,833 and \$4,915) | 718,406 | 706,890 |
| Federal Home Loan Bank stock | 20,727 | 19,188 |
| Premises and equipment | 10,605 | 10,662 |
| Bank-owned life insurance | 14,655 | 14,516 |
| Foreclosed real estate | 2,150 | 31 |
| Other assets | 9,325 | 9,869 |
| TOTAL ASSETS | \$ 1,032,679 | \$ 993,482 |
| LIABILITIES | | |
| Deposits | \$ 373,808 | \$ 370,529 |
| Short-term borrowings | 73,162 | 39,510 |
| Other borrowings | 381,247 | 373,247 |
| Advances by borrowers for taxes and insurance | 3,504 | 2,047 |
| Other liabilities | 6,835 | 8,063 |
| TOTAL LIABILITIES | 838,556 | 793,396 |
| Commitment and contingencies | | |
| STOCKHOLDERS EQUITY | | |
| Preferred Stock (\$.01 par value; 10,000,000 shares authorized, none issued) | | |
| Common stock (\$.01 par value; 40,000,000 shares authorized, 16,980,900 issued; 16,107,814 and 16,777,667 outstanding at December 31, 2008 and September 30, 2008) | 170 | 170 |
| Additional paid in capital | 160,522 | 159,919 |
| Unallocated common stock held by the Employee Stock Ownership Plan (ESOP) | (12,679) | (12,792) |
| Retained earnings | 59,414 | 58,227 |
| Treasury stock, at cost; 873,086 and 203,233 shares outstanding at December 31, 2008 and September 30, 2008 | (11,497) | (2,753) |
| Accumulated other comprehensive loss | (1,807) | (2,685) |
| TOTAL STOCKHOLDERS EQUITY | 194,123 | 200,086 |

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

| | | |
|---|--------------|------------|
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 1,032,679 | \$ 993,482 |
|---|--------------|------------|

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

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

| | For the Three Months Ended December 31, 2008 2007 (dollars in thousands, except per share data) | |
|--|---|---------------|
| INTEREST INCOME | | |
| Loans receivable | \$ 10,601 | \$ 9,783 |
| Investment securities: | | |
| Taxable | 2,453 | 2,702 |
| Exempt from federal income tax | 83 | 83 |
| Other investment income | 119 | 321 |
| Total interest income | 13,256 | 12,889 |
| INTEREST EXPENSE | | |
| Deposits | 1,971 | 2,689 |
| Short-term borrowings | 155 | 438 |
| Other borrowings | 4,136 | 3,563 |
| Total interest expense | 6,262 | 6,690 |
| NET INTEREST INCOME | 6,994 | 6,199 |
| Provision for loan losses | 375 | 150 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 6,619 | 6,049 |
| NONINTEREST INCOME | | |
| Service fees on deposit accounts | 840 | 906 |
| Services charges and fees on loans | 121 | 152 |
| Trust and investment fees | 209 | 246 |
| Earnings on bank-owned life insurance | 139 | 146 |
| Other | 16 | 13 |
| Total noninterest income | 1,325 | 1,463 |
| NONINTEREST EXPENSE | | |
| Compensation and employee benefits | 3,584 | 2,995 |
| Occupancy and equipment | 710 | 684 |
| Professional fees | 335 | 289 |
| Data processing | 469 | 479 |
| Advertising | 203 | 145 |
| Other | 466 | 440 |
| Total noninterest expense | 5,767 | 5,032 |
| Income before income taxes | 2,177 | 2,480 |
| Income taxes | 347 | 783 |

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

| | | |
|------------|----------|----------|
| NET INCOME | \$ 1,830 | \$ 1,697 |
|------------|----------|----------|

EARNINGS PER SHARE:

| | | |
|---------|---------|---------|
| Basic | \$ 0.13 | \$ 0.11 |
| Diluted | 0.13 | 0.11 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(UNAUDITED)

| | Common Stock | | Unallocated Common Stock Held by the ESOP | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Loss | Total Stockholders Equity | Comprehensive Income |
|--|------------------------|------------------------------|---|----------------------|-------------------|---|---------------------------------|-------------------------|
| | Number of Shares | Amount Paid In Capital | | | | | | |
| | (Dollars in thousands) | | | | | | | |
| Balance, September 30, 2008 | 16,777,667 | \$ 170 | \$ 159,919 | \$ (12,792) | \$ 58,227 | \$ (2,753) | \$ (2,685) | \$ 200,086 |
| Cumulative effect adjustment of emerging issues task force issue 06-4 | | | | (49) | | | (49) | |
| Net income | | | | 1,830 | | | 1,830 | \$ 1,830 |
| Other comprehensive income: | | | | | | | | |
| Unrealized gain on securities available for sale, net of income taxes of \$435 | | | | | | 843 | 843 | 843 |
| Change in unrecognized pension cost, net of income taxes of \$10 | | | | | | 35 | 35 | 35 |
| Comprehensive income | | | | | | | | \$ 2,708 |
| Cash dividends declared (\$0.04 per share) | | | | (594) | | | (594) | |
| Stock based compensation | | | 538 | | | | 538 | |
| Allocation of ESOP stock | | | 53 | 113 | | | 166 | |
| Restricted Stock Forfeitures | (906) | | 12 | | (12) | | | |
| Treasury Shares purchased | (668,947) | | | | (8,732) | | (8,732) | |
| Balance, December 31, 2008 | 16,107,814 | \$ 170 | \$ 160,522 | \$ (12,679) | \$ 59,414 | \$ (11,497) | \$ (1,807) | \$ 194,123 |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

| | For the Three Months Ended December 31, 2008 2007 (dollars in thousands) | |
|---|--|------------------|
| OPERATING ACTIVITIES | | |
| Net income | \$ 1,830 | \$ 1,697 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 375 | 150 |
| Provision for depreciation and amortization | 315 | 306 |
| Accretion of discounts and premiums, net | (135) | (12) |
| Compensation expense on ESOP | 166 | 171 |
| Stock based compensation | 538 | |
| Decrease in accrued interest receivable | 267 | 404 |
| Decrease in accrued interest payable | (4) | (195) |
| Earnings on bank-owned life insurance | (139) | (143) |
| Deferred federal income taxes | 173 | 132 |
| Other, net | (842) | 175 |
| Net cash provided by operating activities | 2,544 | 2,685 |
| INVESTING ACTIVITIES | | |
| Purchase of certificates of deposit | (2,926) | |
| Investment securities available for sale: | | |
| Proceeds from principal repayments and maturities | 29,319 | 36,141 |
| Purchases | (43,102) | (36,826) |
| Investment securities held to maturity: | | |
| Proceeds from principal repayments and maturities | 457 | 2,266 |
| Increase in loans receivable, net | (13,972) | (19,182) |
| Redemption of FHLB stock | 509 | 1,443 |
| Purchase of FHLB stock | (2,048) | (1,478) |
| Purchase of premises, equipment, and software | (213) | (286) |
| Net cash used for investing activities | (31,976) | (17,922) |
| FINANCING ACTIVITIES | | |
| Increase (decrease) in deposits, net | 3,279 | (11,822) |
| Net increase (decrease) in short-term borrowings | 33,652 | (1,891) |
| Proceeds from other borrowings | 28,000 | 41,000 |
| Repayment of other borrowings | (20,000) | (11,000) |
| Increase in advances by borrowers for taxes and insurance | 1,457 | 1,632 |
| Purchase of treasury stock shares | (9,505) | |
| Dividends on common stock | (594) | |
| Net cash provided by financing activities | 36,289 | 17,919 |
| Increase in cash and cash equivalents | 6,857 | 2,682 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 12,614 | 16,779 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 19,471 | \$ 19,461 |

SUPPLEMENTAL CASH FLOW DISCLOSURES

Cash Paid:

| | | |
|-------------------------|----------|----------|
| Interest | \$ 6,266 | \$ 6,886 |
| Income taxes | 475 | 117 |
| Noncash items: | | |
| Other real estate owned | 2,150 | |
| Treasury shares payable | 259 | |

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

ESSA BANCORP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(unaudited)

1. Nature of Operations and Basis of Presentation

The unaudited, consolidated financial statements include the accounts of ESSA Bancorp, Inc. (the Company), and its wholly owned subsidiary, ESSA Bank & Trust (the Bank), and the Bank's wholly owned subsidiaries, ESSACOR Inc. and Pocono Investment Company. The primary purpose of the Company is to act as a holding company for the Bank. The Company is subject to regulation and supervision by the Office of Thrift Supervision (the OTS). The Bank is a Pennsylvania chartered savings association located in Stroudsburg, Pennsylvania. The Bank's primary business consists of the taking of deposits and granting of loans to customers generally in Monroe and Northampton counties, Pennsylvania. The Bank is subject to regulation and supervision by the Pennsylvania Department of Banking and the OTS. The investment in subsidiary on the parent company's financial statements is carried at the parent company's equity in the underlying net assets.

ESSACOR, Inc. is a Pennsylvania corporation that is currently inactive. Pocono Investment Company is a Delaware corporation formed as an investment company subsidiary to hold and manage certain investments of the Bank, including certain intellectual property. All intercompany transactions have been eliminated in consolidation.

The unaudited consolidated financial statements reflect all adjustments, which in the opinion of management are necessary for a fair presentation of the results of the interim periods and are of a normal and recurring nature. Operating results for the three-month period ended December 31, 2008 are not necessarily indicative of the results that may be expected for the year ending September 30, 2009.

2. Earnings per Share

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation for the three months ended December 31, 2008 and 2007.

| | Three Months Ended | |
|--|---------------------------|---------------------|
| | December 31, | December 31, |
| | 2008 | 2007 |
| Weighted average common shares outstanding | 16,980,900 | 16,980,900 |
| Average treasury stock shares | (599,273) | |
| Average unearned ESOP shares | (1,271,807) | (1,318,388) |
| Average unearned non-vested shares | (530,790) | |
| Weighted average common shares and common stock equivalents used to calculate basic earnings per share | 14,579,030 | 15,662,512 |
| Additional common stock equivalents (non-vested stock) used to calculate diluted earnings per share | 23,382 | |
| Additional common stock equivalents (stock options) used to calculate diluted earnings per share | | |
| Weighted average common shares and common stock equivalents used to calculate diluted earnings per share | 14,602,412 | 15,662,512 |

Table of Contents

3. Use of Estimates in the Preparation of Financial Statements

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

4. Comprehensive Income

The components of comprehensive income consist of unrealized gains and losses on available for sale securities and the change in minimum pension liability. For the three months ended December 31, 2008, this activity is shown under the heading Comprehensive Income as presented in the Consolidated Statement of Changes in Stockholders' Equity (Unaudited). For the three months ended December 31, 2007 comprehensive income totaled \$2.2 million.

5. Recent Accounting Pronouncements

In September 2006, the FASB reached consensus on the guidance provided by Emerging Issues Task Force Issue 06-4 (EITF 06-4), *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. The guidance is applicable to endorsement split-dollar life insurance arrangements, whereby the employer owns and controls the insurance policy, that are associated with a postretirement benefit. EITF 06-4 requires that for a split-dollar life insurance arrangement within the scope of the Issue, an employer should recognize a liability for future benefits in accordance with FAS No. 106 (if, in substance, a postretirement benefit plan exists) or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. The Company adopted EITF 06-4 as of October 1, 2008 and the cumulative effect of a change in accounting principle to recognize a liability for the death benefit promised under a split-dollar life insurance arrangement totaled \$49,000 and was recorded as a reduction in retained earnings.

In September 2006, the FASB issued FAS No. 157, *Fair Value Measurements*, which provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require or permit assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. FAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB issued Staff Position No. 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*, which removed leasing transactions accounted for under FAS No. 13 and related guidance from the scope of FAS No. 157. Also in February 2008, the FASB issued Staff Position No. 157-2, *Partial Deferral of the Effective Date of Statement 157*, which deferred the effective date of FAS No. 157 for all nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In September 2006, the FASB issued FAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Post Retirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)*. This statement requires that employers measure plan assets and obligations as of the balance sheet date. This requirement is effective for fiscal years ending after December 15, 2008. The other provisions of the statement were effective as of the end of the fiscal year ending after December 15, 2006, for public companies. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In February 2007, the FASB issued FSP No. FAS 158-1, *Conforming Amendments to the Illustrations in FASB Statements No. 87, No. 88, and No. 106 and to the Related Staff Implementation Guides*. This FSP provides conforming amendments to the illustrations in FAS Statements No. 87, 88, and 106 and to related staff implementation guides as a result of the issuance of FAS Statement No. 158. The conforming amendments made by this FSP are effective as of the effective dates of Statement No. 158. The unaffected guidance that this FSP

Table of Contents

codifies into Statements No. 87, 88, and 106 does not contain new requirements and, therefore, does not require a separate effective date or transition method. The adoption of this FSP is not expected to have a material effect on the Company's results of operations or financial position.

In December 2007, the FASB issued FAS No. 141 (revised 2007), *Business Combinations* (FAS 141(R)), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. FAS No. 141(R) is effective for fiscal years beginning on or after December 15, 2008. Earlier adoption is prohibited. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In December 2007, the FASB issued FAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51*. FAS No. 160 amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Among other requirements, this statement requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. FAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. Earlier adoption is prohibited. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In February 2008, the FASB issued FSP No. FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*. This FSP concludes that a transferor and transferee should not separately account for a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. The FSP is effective for financial statements issued for fiscal years beginning on or after November 15, 2008, and interim periods within those fiscal years. The adoption of this FSP is not expected to have a material effect on the Company's results of operations or financial position.

In March 2008, the FASB issued FAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, to require enhanced disclosures about derivative instruments and hedging activities. The new standard has revised financial reporting for derivative instruments and hedging activities by requiring more transparency about how and why an entity uses derivative instruments; how derivative instruments and related hedged items are accounted for under FAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*; and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. FAS No. 161 requires disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. It also requires entities to provide more information about their liquidity by requiring disclosure of derivative features that are credit risk-related. Further, it requires cross-referencing within footnotes to enable financial statement users to locate important information about derivative instruments. FAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In April 2008, the FASB issued FASB Staff Position No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing assumptions about renewal or extension used in estimating the useful life of a recognized intangible asset under FAS No. 142, *Goodwill and Other Intangible Assets*. This standard is intended to improve the consistency between the useful life of a recognized intangible asset under FAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under FAS No. 141R and other GAAP. FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The measurement provisions of this standard will apply only to intangible assets of the Company acquired after the effective date.

Table of Contents

In June 2008, the FASB issued FASB Staff Position (FSP) No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, to clarify that instruments granted in share-based payment transactions can be participating securities prior to the requisite service having been rendered. A basic principle of the FSP is that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are to be included in the computation of EPS pursuant to the two-class method. The provisions of this FSP are effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period EPS data presented (including interim financial statements, summaries of earnings, and selected financial data) are required to be adjusted retrospectively to conform with the provisions of the FSP. The adoption of this FSP is not expected to have a material effect on the Company's results of operations or financial position.

In December 2008, the FASB issued Staff Position No. FAS 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets* (FSP FAS 132(R)-1). FSP FAS 132(R)-1 requires more detailed disclosures about employers' plan assets in a defined benefit pension or other postretirement plan, including employers' investment strategies, major categories of plan assets, concentrations of risk within plan assets, and inputs and valuation techniques used to measure the fair value of plan assets. FSP FAS 132(R)-1 also requires, for fair value measurements using significant unobservable inputs (Level 3), disclosure of the effect of the measurements on changes in plan assets for the period. The disclosures about plan assets required by FSP FAS 132(R)-1 must be provided for fiscal years ending after December 15, 2009. As this pronouncement is only disclosure-related, it will not have an impact on the financial position and results of operations.

Table of Contents**6. Investment Securities**

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

| | December 31, 2008 | | | Estimated Fair Value |
|---|-------------------|------------------------------|-------------------------------|----------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
| Available for Sale | | | | |
| Fannie Mae | \$ 53,672 | \$ 449 | \$ (450) | \$ 53,672 |
| Freddie Mac | 78,876 | 854 | (329) | 79,401 |
| Governmental National Mortgage Association securities | 46,660 | 304 | (48) | 46,916 |
| Total mortgage-backed securities | 179,208 | 1,607 | (827) | 179,989 |
| Obligations of states and political subdivisions | 7,170 | 132 | (207) | 6,995 |
| U.S. government agency securities | 31,708 | 466 | | 32,173 |
| Total debt securities | 218,086 | 2,105 | (1,034) | 219,157 |
| Equity securities | 80 | | (51) | 29 |
| Total | \$ 218,166 | \$ 2,105 | \$ (1,085) | \$ 219,186 |

| | | | | |
|-----------------------------------|-----------|--------|---------|-----------|
| Held to Maturity | | | | |
| Fannie Mae | \$ 5,948 | \$ 122 | \$ (15) | \$ 6,055 |
| Freddie Mac | 3,450 | 74 | (2) | 3,522 |
| Total mortgage-backed securities | 9,398 | 196 | (17) | 9,577 |
| U.S. government agency securities | 2,000 | 42 | | 2,042 |
| Total | \$ 11,398 | \$ 238 | \$ (17) | \$ 11,619 |

| | September 30, 2008 | | | Estimated Fair Value |
|---|--------------------|------------------------------|-------------------------------|----------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
| Available for Sale | | | | |
| Fannie Mae | \$ 56,462 | \$ 189 | \$ (515) | \$ 56,136 |
| Freddie Mac | 77,700 | 269 | (282) | 77,687 |
| Governmental National Mortgage Association securities | 14,037 | 113 | (28) | 14,122 |
| Total mortgage-backed securities | 148,199 | 571 | (825) | 147,945 |
| Obligations of states and political subdivisions | 7,171 | 104 | (129) | 7,146 |
| U.S. government agency securities | 48,887 | 140 | (136) | 48,891 |
| Total debt securities | 204,257 | 815 | (1,090) | 203,982 |
| Equity securities | 79 | 17 | | 96 |
| Total | \$ 204,336 | \$ 832 | \$ (1,089) | \$ 204,078 |

| | | | | |
|-------------------------|----------|-------|---------|----------|
| Held to Maturity | | | | |
| Fannie Mae | \$ 6,179 | \$ 25 | \$ (23) | \$ 6,181 |
| Freddie Mac | 3,678 | 43 | (1) | 3,720 |

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

| | | | | |
|-----------------------------------|-----------|-------|---------|-----------|
| Total mortgage-backed securities | 9,857 | 68 | (24) | 9,901 |
| U.S. government agency securities | 2,000 | 23 | | 2,023 |
| Total | \$ 11,857 | \$ 91 | \$ (24) | \$ 11,924 |

Table of Contents

The amortized cost and estimated fair value of debt securities at December 31, 2008, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

| | Available For Sale | | Held To Maturity | |
|--|--------------------|----------------------|------------------|----------------------|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| Due in one year or less | \$ 10,259 | \$ 10,325 | \$ 2,924 | \$ 2,975 |
| Due after one year through five years | 25,965 | 26,388 | 3,527 | 3,574 |
| Due after five years through ten years | 1,022 | 998 | 2,972 | 3,074 |
| Due after ten years | 180,840 | 181,446 | 1,975 | 1,996 |
| Total | \$ 218,086 | \$ 219,157 | \$ 11,398 | \$ 11,619 |

The Bank had no sale of investment securities for the three months ended December 31, 2008 or 2007.

7. Fair Value Measurement

The Company adopted FAS No. 157, *Fair Value Measurements* on October 1, 2008, which provides consistency and comparability in determining fair value measurements and provides for expanded disclosures about fair value measurements. The definition of fair value maintains the exchange price notion in earlier definitions of fair value but focuses on the exit price of the asset or liability. The exit price is the price that would be received to sell the asset or paid to transfer the liability adjusted for certain inherent risks and restrictions. Expanded disclosures are also required about the use of fair value to measure assets and liabilities.

The following table presents information about the Company's securities and other real estate owned measured at fair value on a recurring basis as of December 31, 2008, and indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value:

| Fair Value Measurements Utilized for the Company's Securities (in thousands): | Quoted Prices in Active | Significant Other | Significant | Balances |
|--|---|--------------------------------|----------------------------------|-------------------------------|
| | Markets for Identical Assets (Level 1) | Observable Inputs (Level 2) | Unobservable Inputs (Level 3) | as of December 31, 2008 |
| Securities available-for-sale | \$ 29 | \$ 219,157 | \$ | \$ 219,186 |
| Other real estate owned | \$ 2,150 | \$ | \$ | \$ 2,150 |

As required by FASB No. 157, each financial asset and liability must be identified as having been valued according to specified level of input, 1, 2 or 3. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank has the ability to access at the measurement date. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset, either directly or indirectly. Level 2 inputs include quoted prices for similar assets in active markets, and inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy, within which the fair value measurement in its entirety falls, has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset.

The measurement of fair value should be consistent with one of the following valuation techniques: market approach, income approach, and/or cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering factors

Table of Contents

specific to the measurement (qualitative and quantitative). Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on a security's relationship to other benchmark quoted securities. As of December 31, 2008, all of the financial assets measured at fair value utilized the market approach. Other real estate owned (OREO) is measured at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Income and expenses from operations and changes in valuation allowance are included in the net expenses from OREO. For the three months ended December 31, 2008, no fair value adjustment was recorded that impacted OREO.

8. Loans Receivable, Net and Allowance for Loan Losses

Loans receivable consist of the following (in thousands):

| | December 31, 2008 | September 30, 2008 |
|---------------------------------------|----------------------|-----------------------|
| Real Estate Loans: | | |
| Residential | \$ 585,581 | \$ 572,038 |
| Construction | 9,837 | 8,254 |
| Commercial | 66,239 | 69,505 |
| Commercial | 11,259 | 11,987 |
| Home equity loans and lines of credit | 47,579 | 47,508 |
| Other | 3,087 | 3,059 |
| | 723,582 | 712,351 |
| Less deferred loan fees | 343 | 546 |
| | 723,239 | 711,805 |
| Less allowance for loan losses | 4,833 | 4,915 |
| Net loans | \$ 718,406 | \$ 706,890 |

The activity in the allowance for loan losses is summarized as follows (in thousands):

| | Three Months Ended December 31, | |
|---------------------------------|------------------------------------|----------|
| | 2008 | 2007 |
| Balance, beginning of period | \$ 4,915 | \$ 4,206 |
| Add | | |
| Provision charged to operations | 375 | 150 |
| Loan recoveries | | 1 |
| | 5,290 | 4,357 |
| Less loans charged off | (457) | |
| Balance, end of period | \$ 4,833 | \$ 4,357 |

9. Deposits

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

| | December 31, 2008 | September 30, 2008 |
|--------------------------------------|----------------------|-----------------------|
| Non-interest bearing demand accounts | \$ 23,923 | \$ 24,862 |
| NOW accounts | 53,938 | 55,694 |
| Money market accounts | 81,515 | 74,807 |
| Savings and club accounts | 61,031 | 61,444 |
| Certificates of deposit | 153,401 | 153,722 |
| Total | \$ 373,808 | \$ 370,529 |

10. Net Periodic Benefit Cost-Defined Benefit Plan

For a detailed disclosure on the Bank's pension and employee benefits plans, please refer to Note 15 of the Company's Consolidated Financial Statements for the year ended September 30, 2008 included in the Company's Form 10-K.

Table of Contents

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

| | Three Months Ended | |
|---------------------------------------|---------------------------|---------------|
| | December 31, | |
| | 2008 | 2007 |
| Service Cost | \$ 90 | \$ 129 |
| Interest Cost | 127 | 143 |
| Expected return on plan assets | (127) | (165) |
| Amortization of prior service cost | 2 | 2 |
| Amortization of unrecognized loss | 51 | 52 |
| Amortization of transition obligation | | |
| Net periodic benefit cost | \$ 143 | \$ 162 |

The Bank expects to contribute \$409,000 to its pension plan in 2009.

11. Equity Incentive Plan

In May 2008, the Company implemented the ESSA Bancorp, Inc. 2007 Equity Incentive Plan (the Plan). The Plan provides for a total of 2,377,326 shares of common stock for issuance upon the grant or exercise of awards. Of the shares available under the Plan, 1,698,090 may be issued in connection with the exercise of stock options and 679,236 may be issued as restricted stock. The Plan allows for the granting of non-qualified stock options (NSOs), incentive stock options (ISOs), and restricted stock. Options are granted at no less than the fair value of the Company's common stock on the date of the grant.

On May 23, 2008, certain officers, employees and outside directors were granted in aggregate 1,140,469 NSOs; 317,910 ISOs; and 590,320 shares of restricted stock. In accordance with Statement of Financial Accounting Standards (FAS) No. 123R *Share-Based Payment*, the Company began to expense the fair value of all share-based compensation grants over the requisite service periods.

In accordance with Securities Exchange Commission Staff Accounting Bulletin (SAB) No. 107, the Company classifies share-based compensation for employees and outside directors within Compensation and employee benefits in the consolidated statement of income to correspond with the same line item as compensation paid. Additionally, FAS No.123R requires the Company to report: (1) the expense associated with the grants as an adjustment to operating cash flows and (2) any benefits of realized tax deductions in excess of previously recognized tax benefits on compensation expense as a financing cash flow.

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

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

During the three months ended December 31, 2008, the Company recorded \$538,000 of share-based compensation expense, comprised of stock option expense of \$174,000 and restricted stock expense of \$364,000. Expected future expense relating to the 1,458,379 non-vested options outstanding as of December 31, 2008, is \$3.1 million over the remaining vesting period of 4.42 years. Expected future compensation expense relating to the 589,414 restricted shares at December 31, 2008, is \$6.4 million over the remaining vesting period of 4.42 years.

Table of Contents

The following is a summary of the Company's stock option activity and related information for its option plan for the three months ended December 31, 2008.

| | Number of Stock Options | Weighted- average Exercise Price | Weighted- average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (in thousands) |
|---------------------------------|----------------------------|---|--|---|
| Outstanding, September 30, 2008 | \$ 1,458,379 | \$ 12.35 | | \$ |
| Granted | | | | |
| Exercised | | | | |
| Forfeited | | | | |
| Outstanding, December 31, 2008 | 1,458,379 | \$ 12.35 | 9.42 | \$ 2,595 |
| Exercisable at year-end | | \$ | | \$ |

The following is a summary of the Company's non-vested options as of December 31, 2008, and changes therein during the year then ended:

| | Number of Stock Options | Weighted- average Grant Date Fair Value |
|---------------------------------|----------------------------|--|
| Nonvested at September 30, 2008 | 1,458,379 | \$ 2.38 |
| Granted | | |
| Exercised | | |
| Forfeited | | |
| Nonvested at December 31, 2008 | 1,458,379 | \$ 2.38 |

The following is a summary of the status of the Company's restricted stock as of December 31, 2008, and changes therein during the year then ended:

| | Number of Restricted Stock | Weighted- average Grant Date Fair Value |
|---------------------------------|-------------------------------|--|
| Nonvested at September 30, 2008 | 589,414 | \$ 12.35 |
| Granted | | |
| Vested | | |
| Forfeited | | |
| Nonvested at December 31, 2008 | 589,414 | \$ 12.35 |

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Forward Looking Statements**

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

This quarterly report contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These forward-looking statements include:

statements of our goals, intentions and expectations;

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

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

estimates of our risks and future costs and benefits.

Table of Contents

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

significantly increased competition among depository and other financial institutions;

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

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

adverse changes in the securities markets;

legislative or regulatory changes that adversely affect our business;

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

changes in consumer spending, borrowing and savings habits;

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

changes in our organization, compensation and benefit plans.

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

Overview

The Company consummated its initial stock offering on April 3, 2007 with the sale of 15,870,000 shares of common stock. The Company also contributed 1,110,900 shares of the Company's outstanding common stock, and contributed \$1.6 million in cash, to the ESSA Bank & Trust Foundation. Net proceeds of the offering were approximately \$155.8 million prior to the contribution to the Foundation.

Comparison of Financial Condition at December 31, 2008 and September 30, 2008

Total Assets. Total assets increased by \$39.2 million, or 4.0%, to \$1,032.7 million at December 31, 2008 from \$993.5 million at September 30, 2008. This increase was primarily due to increases in interest-bearing deposits with other institutions, certificates of deposit, investment securities available for sale and net loans receivable.

Interest-Bearing Deposits with Other Institutions. Interest-bearing deposits with other institutions increased \$6.8 million, or 159.8%, to \$11.0 million at December 31, 2008 from \$4.2 million at September 30, 2008. The primary reason for the increase was an increase in the Company's interest-bearing demand deposit account at FHLBank Pittsburgh of \$6.8 million. This increase was primarily the result of the Company's need to

provide liquidity to fund its stock buyback program.

Certificates of Deposit. The Company invested an additional \$2.9 million in certificates of deposit at other FDIC-insured financial institutions in November 2008, to replace maturities of other investment securities.

Investment Securities Available for Sale. Investment securities available for sale increased \$15.1 million, or 7.4%, to \$219.2 million at December 31, 2008 from \$204.1 million at September 30, 2008. The increase was due primarily to an increase of \$32.0 million in the Company's portfolio of mortgage-backed securities issued by United States government sponsored agencies or entities and was offset in part by a \$16.7 million decrease in the Company's portfolio of United States government agency securities. The growth in the mortgage-backed securities portfolio was due to the reinvestment of the proceeds from United States government agency security maturities, in addition to the investment of approximately \$20.0 million in mortgage-backed securities issued by United States government sponsored agencies or entities as part of a leverage strategy to take advantage of the steepening yield curve.

Table of Contents

Net Loans. Net loans increased \$11.5 million, or 1.6%, to \$718.4 million at December 31, 2008 from \$706.9 million at September 30, 2008. Loan growth was primarily attributed to growth in several product categories as a result of continued demand in our market area. During this period, residential loans outstanding increased by \$13.5 million to \$585.6 million, construction loans outstanding increased by \$1.6 million to \$9.8 million, home equity loans and lines of credit outstanding increased \$71,000 to \$47.6 million and other loans outstanding increased \$28,000 to \$3.1 million. These increases were partially offset by decreases in commercial real estate loans outstanding of \$3.3 million to \$66.2 million and commercial loans outstanding of \$728,000 to \$11.3 million.

Deposits. Deposits increased \$3.3 million, or 0.9%, to \$373.8 million at December 31, 2008 from \$370.5 million at September 30, 2008. At December 31, 2008 compared to September 30, 2008 money market accounts increased \$6.7 million to \$81.5 million. This increase was offset in part during the same period by decreases in NOW accounts of \$1.8 million to \$53.9 million, non-interest bearing demand accounts of \$939,000 to \$23.9 million, savings and club accounts of \$413,000 to \$61.0 million and certificates of deposit of \$321,000 to \$153.4 million. Included in the certificates of deposit at December 31, 2008 was a decrease of \$1.9 million in brokered certificates of deposit to \$9.0 million. The decline in brokered certificates was the result of the Company's decision not to renew maturing certificates based on the cost of renewing those certificates compared to other available funding sources. The increase in money market deposits is primarily the result of increased deposits by a few large depositors.

Borrowed Funds. Borrowed funds increased by \$41.7 million, or 11.3%, to \$454.4 million at December 31, 2008, from \$412.7 million at September 30, 2007. The increase in borrowed funds was primarily due to the need to fund additional loan growth and to purchase investment securities and certificates of deposit.

Stockholders' Equity. Stockholders' equity decreased by \$6.0 million, or 3.0%, to \$194.1 million at December 31, 2008 from \$200.1 million at September 30, 2008. This decrease was primarily the result of a stock repurchase program the company began in June 2008. As of December 31, 2008, the Company had purchased 1,462,500 shares at an average price of \$13.09 per share. Stock repurchases for the quarter ended December 31, 2008 totaled \$8.7 million. This decrease was partially offset by increases in net income of \$1.8 million, unrealized gains on available for sale securities, net of taxes of \$843,000 and allocation of shares held by the Bank's ESOP of \$324,000.

Table of Contents**Average Balance Sheets for the Three Months Ended December 31, 2008 and 2007**

The following tables set forth average balance sheets, average yields and costs, and certain other information for the periods indicated. All average balances are daily average balances, the yields set forth below include the effect of deferred fees and discounts and premiums that are amortized or accreted to interest income.

| | For the Three Months Ended December 31, | | | | | |
|---------------------------------------|---|--------------------|-------------|-----------------|--------------------|-------------|
| | 2008 | | | 2007 | | |
| | Average | Interest | Yield/ Cost | Average Balance | Interest | Yield/ Cost |
| | Balance | Income/ Expense | | | Income/ Expense | |
| | (dollars in thousands) | | | | | |
| Interest-earning assets: | | | | | | |
| Loans (1) | \$ 716,409 | \$ 10,601 | 5.87% | \$ 634,561 | \$ 9,783 | 6.12% |
| Investment securities | | | | | | |
| Taxable (2) | 45,260 | 422 | 3.70% | 86,455 | 1,071 | 4.91% |
| Exempt from federal income tax(2) (3) | 6,927 | 83 | 7.20% | 7,349 | 83 | 6.79% |
| Total investment securities | 52,187 | 505 | 4.16% | 93,804 | 1,154 | 5.06% |
| Mortgage-backed securities | 162,296 | 2,031 | 4.96% | 129,428 | 1,631 | 5.00% |
| Federal Home Loan Bank stock | 19,559 | 112 | 2.27% | 16,869 | 236 | 5.55% |
| Other | 9,166 | 7 | 0.30% | 6,822 | 85 | 4.94% |
| Total interest-earning assets | 959,617 | 13,256 | 5.50% | 881,484 | 12,889 | 5.82% |
| Allowance for loan losses | (4,719) | | | (4,258) | | |
| Noninterest-earning assets | 47,476 | | | 42,869 | | |
| Total assets | \$ 1,002,374 | | | \$ 920,095 | | |
| Interest-bearing liabilities: | | | | | | |
| NOW accounts | \$ 53,203 | 10 | 0.07% | \$ 54,355 | 12 | 0.09% |
| Money market accounts | 76,392 | 473 | 2.46% | 43,976 | 403 | 3.64% |
| Savings and club accounts | 60,710 | 63 | 0.41% | 62,406 | 72 | 0.46% |
| Certificates of deposit | 158,463 | 1,425 | 3.57% | 191,295 | 2,202 | 4.57% |
| Borrowed funds | 423,389 | 4,291 | 4.02% | 329,999 | 4,001 | 4.81% |
| Total interest-bearing liabilities | 772,157 | 6,262 | 3.22% | 682,031 | 6,690 | 3.89% |
| Non-interest bearing NOW accounts | 23,766 | | | 23,617 | | |
| Noninterest-bearing liabilities | 9,315 | | | 7,699 | | |
| Total liabilities | 805,238 | | | 713,347 | | |
| Equity | 197,136 | | | 206,748 | | |
| Total liabilities and equity | \$ 1,002,374 | | | \$ 920,095 | | |
| Net interest income | | \$ 6,994 | | | \$ 6,199 | |
| Interest rate spread | | | 2.28% | | | 1.93% |
| Net interest-earning assets | \$ 187,460 | | | \$ 199,453 | | |
| Net interest margin(4) | | | 2.89% | | | 2.79% |
| | | 124.28% | | | 129.24% | |

Average interest-earning assets to average interest-bearing liabilities

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

Table of Contents**Comparison of Operating Results for the Three Months Ended December 31, 2008 and December 31, 2007**

Net Income. Net income increased \$133,000, to \$1.8 million for the three months ended December 31, 2008 compared to net income of \$1.7 million for the comparable period in 2007. The net income of \$1.8 million for the three months ending December 31, 2008 included a one time tax benefit of \$317,000 related to the Company's other than temporary impairment (OTTI) charge taken in the previous fiscal year. The OTTI charge related to Fannie Mae perpetual preferred stock held in the Company's available for sale securities portfolio.

Net Interest Income. Net interest income increased \$795,000 or 12.8%, to \$7.0 million for the three months ended December 31, 2008 from \$6.2 million for the comparable period in 2007. The increase was primarily attributable to an increase of 35 basis points in the Company's interest rate spread to 2.28% for the three months ended December 31, 2008, from 1.93% for the comparable period in 2007, which was offset in part by a decrease in average net earning assets of \$12.0 million for the three months ended December 31, 2008 as compared to average net earning assets for the comparable period in 2007.

Interest Income. Interest income increased \$367,000 or 2.9%, to \$13.3 million for the three months ended December 31, 2008 from \$12.9 million for the comparable 2007 period. The increase resulted primarily from a \$78.1 million increase in average interest-earning assets, partially offset by a 32 basis point decrease in average yield on interest earning assets. The average yield on interest earning assets was 5.50% for the three months ended December 31, 2008, as compared to 5.82% for the comparable 2007 period. Loans increased on average \$81.8 million between the two periods along with increases in the average balance of mortgage backed securities of \$32.9 million. In addition, average Federal Home Loan Bank stock increased \$2.7 million and average other interest earning assets increased \$2.3 million. These increases were offset in part by a decrease in the average balances of investment securities of \$41.6 million. The primary reason for the increase in mortgage backed securities was the partial reinvestment of borrowing proceeds, maturing certificates of deposit and investment securities into these assets. Average Federal Home Loan Bank stock increased as a result of the Bank's increase in borrowings from the FHLBank Pittsburgh. As a member of the Federal Home Loan Bank System, the Bank maintains an investment in the capital stock of the FHLBank Pittsburgh in an amount not less than 70 basis points of the outstanding unused FHLB borrowing capacity or 1/20 of its outstanding FHLB borrowings, whichever is greater, as calculated throughout the year. On December 23, 2008, the FHLBank Pittsburgh notified its members, including the Company, that it was suspending the payment of dividends on its capital stock and the repurchase of excess capital stock until further notice. The increase in average other interest earning assets was the result of an increase in the average balance of interest earning deposits held by the Company in its FHLBank Pittsburgh demand account.

Interest Expense. Interest expense decreased \$428,000, to \$6.3 million for the three months ended December 31, 2008 from \$6.7 million for the comparable 2007 period. The decrease resulted from a 67 basis point decrease in the overall cost of interest bearing liabilities to 3.22% for the three months ended December 31, 2008 from 3.89% for the comparable 2007 period, partially offset by a \$90.1 million increase in average interest-bearing liabilities. Average interest bearing deposits decreased \$3.3 million which was offset by an increase in average borrowed funds of \$93.4 million.

Provision for Loan Losses. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are subject to interpretation and revision as more information becomes available or as future events occur. After an evaluation of these factors, and after considering the growth in the Company's loan portfolio, management made a provision for loan losses of \$375,000 for the three months ended December 31, 2008 as compared to \$150,000 for the three months ended December 31, 2007. The allowance for loan losses was \$4.8 million, or 0.67% of loans outstanding, at December 31, 2008, compared to \$4.4 million, or 0.68% of loans outstanding at December 31, 2007.

Table of Contents

Non-interest Income. Non-interest income decreased \$138,000 or 9.4%, to \$1.3 million from \$1.5 million for the comparable period in 2007. The primary reasons for the decrease were declines in service fees on deposit accounts of \$66,000, service charges and fees on loans of \$31,000 and trust and investment fees of \$37,000.

Non-interest Expense. Non-interest expense increased \$735,000, or 14.6%, to \$5.8 million for the three months ended December 31, 2008 from \$5.0 million for the comparable period in 2007. The primary reasons for the increases were increases in compensation and employee benefits of \$589,000, professional fees of \$46,000 and advertising fees of \$58,000. Compensation and employee benefits increased primarily as a result of an expense of \$538,000 for the three months ended December 31, 2008, related to the Company's equity incentive plan. As previously announced, the Company's stockholders approved the ESSA Bancorp, Inc. 2007 Equity Incentive Plan at the 2008 Annual Meeting of Stockholders on May 8, 2008. Awards granted under the Equity Incentive Plan were made on May 23, 2008. Professional fees increased primarily as a result of increased regulatory fees associated with being a public company. Advertising fees increased due to production costs associated with the Company's annual report.

Income Taxes. Income tax expense decreased \$437,000 to \$347,000 for the three months ended December 31, 2008 from \$783,000 for the comparable 2007 period. The decrease was primarily a result of a one-time tax benefit of \$317,000 related to the Company's other than temporary impairment (OTTI) charge taken in the previous year. The OTTI charge related to Fannie Mae perpetual preferred stock held in the Company's available for sale portfolio. The effective tax rate was 15.9% for the three months ended December 31, 2008, compared to 31.6% for the 2007 period.

Non-Performing Assets

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

| | December 31, 2008 | September 30, 2008 |
|--|----------------------|-----------------------|
| Non-performing assets: | | |
| Non-accruing loans | \$ 1,723 | \$ 3,938 |
| Accruing loans past due 90 days or more | | |
| Total non-performing loans | 1,723 | 3,938 |
| Real estate owned | 2,150 | 31 |
| Total non-performing assets | \$ 3,873 | \$ 3,969 |
| Ratio of non-performing loans to total loans | 0.24% | 0.55% |
| Ratio of non-performing loans to total assets | 0.17% | 0.40% |
| Ratio of non-performing assets to total assets | 0.38% | 0.40% |

Loans are reviewed on a regular basis and are placed on non-accrual status when they become more than 90 days delinquent. When loans are placed on non-accrual status, unpaid accrued interest is fully reserved, and further income is recognized only to the extent received.

At September 30, 2008, \$3.9 million (or less than 1.0% of our total loans) were non-performing loans. Three related commercial real estate development loans with a balance of \$2.5 million made up the majority of non-performing loans at September 30, 2008. These loans, together with a commercial business relationship with a combined loan relationship of \$201,000 were judged by management to be impaired. Specific loan loss allowances were allocated to these loans in the amounts of \$457,000 and \$77,000 for the commercial real estate and business loans, respectively. On October 30, 2008, the Company received a deed in lieu of foreclosure on the commercial real estate loans. The property is being actively marketed and additional losses may occur. At December 31, 2008 the commercial business relationship of \$201,000 is still an impaired loan. The specific loan loss allowance allocated to these loans was \$77,000 at December 31, 2008.

Table of Contents

Liquidity and Capital Resources

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

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

A portion of our liquidity consists of cash and cash equivalents and borrowings, which are a product of our operating, investing and financing activities. At December 31, 2008, \$19.5 million of our assets were invested in cash and cash equivalents. Our primary sources of cash are principal repayments on loans, proceeds from the maturities of investment securities, principal repayments of mortgage-backed securities and increases in deposit accounts. Short-term investment securities (maturing in one year or less) totaled \$13.3 million at December 31, 2008. As of December 31, 2008, we had \$409.4 million in borrowings outstanding from FHLBank Pittsburgh and \$45.0 million in borrowings through repurchase agreements with other financial institutions. We have access to additional FHLBank advances of up to approximately \$109.7 million.

At December 31, 2008, we had \$55.4 million in loan commitments outstanding, which included, in part, \$19.9 million in undisbursed construction loans, \$23.5 million in unused home equity lines of credit, \$6.5 million in commercial lines of credit and \$1.4 million to originate primarily multi-family and nonresidential mortgage loans. Certificates of deposit due within one year of December 31, 2008 totaled \$99.0 million, or 64.6 % of certificates of deposit. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before December 31, 2009. 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 \$2.5 million and \$2.7 million for the three months ended December 31, 2008 and 2007, respectively. These amounts differ from our net income because of a variety of cash receipts and disbursements that did not affect net income for the respective periods. Net cash used in investing activities was \$32.0 million and \$18.0 million for the three months ended December 31, 2008 and 2007, respectively, principally reflecting our loan and investment security activities. Deposit and borrowing cash flows have comprised most of our financing activities which resulted in net cash provided of \$36.3 million and \$18.0 million for the three months ended December 31, 2008 and 2007, respectively.

Critical Accounting Policies

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

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

Table of Contents

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

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

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

Deferred Income Taxes. We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. We consider the determination of this valuation allowance to be a critical accounting policy because of the need to exercise significant judgment in evaluating the amount and timing of recognition of deferred tax liabilities and assets, including projections of future taxable income. These judgments and estimates are reviewed on a continual basis as regulatory and business factors change. A valuation allowance for deferred tax assets may be required if the amount of taxes recoverable through loss carryback declines, or if we project lower levels of future taxable income. Such a valuation allowance would be established through a charge to income tax expense which would adversely affect our operating results. At December 31, 2008 the Company had a \$2.6 million reserve established against its deferred tax asset. The tax deduction generated by the contribution to the Foundation as part of the Company's stock offering exceeded the allowable federal income tax deduction limitations resulting in the establishment of this valuation allowance for the contribution carry forward.

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

Table of Contents

Off-Balance Sheet Arrangements

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

Contractual Obligations

During the first three months of fiscal 2009, the Company's contractual obligations have not changed materially from those discussed in the Company's Financial Statements for the year ended September 30, 2008.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. The net proceeds from the offering increased our capital and provided management with greater flexibility to manage our interest rate risk. In particular, management used the majority of the capital we received to increase our interest-earning assets. There have been no material changes in our interest rate risk since September 30, 2008.

Item 4T. Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

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

Part II Other Information

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

There have been no material changes in the Risk Factors disclosed in the Company's Annual Report for the fiscal year ended September 30, 2008 on Form 10-K filed on December 12, 2008.

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

The following table presents a summary of the Company's share repurchases during the quarter ended December 31, 2008.

Company Purchases of Common Stock

| Period | 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 |
|--------------------------|----------------------------------|------------------------------|--|--|
| October 1- ,October 31, | 324,700 | \$ 13.14 | 324,700 | 1,428,882 |
| November 1 - November 30 | 162,747 | 12.61 | 162,747 | 1,266,135 |
| December 1 - December 31 | 181,500 | 13.14 | 181,500 | 1,084,635 |
| Total | 668,947 | \$ 13.05 | 668,947 | 1,084,635 |

- (1) On May 27, 2008, the Board of Directors approved a stock repurchase program, which authorized the repurchase of up to 2,547,135 shares of the Company's outstanding shares of common stock. Stock repurchases will be made from time to time and may be effected through open market purchases, block trades and in privately negotiated transactions.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

During the period covered by this report, the company did not submit any matters to a vote of security holders.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

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

- 3.1 Charter of ESSA Bancorp, Inc.*
- 3.2 Bylaws of ESSA Bancorp, Inc.*
- 4 Form of Common Stock Certificate of ESSA Bancorp, Inc.*
- 10.1 Form of Employee Stock Ownership Plan*
- 10.2 Form of Employment Agreement for Chief Executive Officer*
- 10.3 Form of Employment Agreement for Executive Officers*

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

- 10.4 Form of Change in Control Agreement*
- 10.5 (Reserved)
- 10.6 Supplemental Retirement Plan for Gary S. Olson*
- 10.7 Supplemental Retirement Plan for Robert S. Howes, Jr.*
- 10.8 Supplemental Retirement Plan for Diane K. Reimer*
- 10.9 Supplemental Retirement Plan for Thomas J. Grayuski*
- 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

* Filed as exhibits to the Company's Registration Statement on Form S-1, and any amendments thereto, with the Securities and Exchange Commission (Registration No. 333-139157).

Table of Contents

SIGNATURES

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

ESSA BANCORP, INC.

Date: February 9, 2009

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

Date: February 9, 2009

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