

ESSA Bancorp, Inc.
Form 10-Q
February 09, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended December 31, 2010

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)

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Pennsylvania (State or other jurisdiction of incorporation or organization)	20-8023072 (I.R.S. Employer Identification Number)
200 Palmer Street, Stroudsburg, Pennsylvania (Address of Principal Executive Offices)	18360 (Zip Code)
(570) 421-0531 (Registrant's telephone number)	
N/A (Former name or former address, if changed since last report)	

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

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

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

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 7, 2011 there were 13,181,590 shares of the Registrant's common stock, par value \$0.01 per share, outstanding.

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ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEET

(UNAUDITED)

	December 31, 2010 (dollars in thousands)	September 30, 2010
ASSETS		
Cash and due from banks	\$ 5,365	\$ 7,454
Interest-bearing deposits with other institutions	1,981	3,436
Total cash and cash equivalents	7,346	10,890
Investment securities available for sale	249,457	252,341
Investment securities held to maturity (estimated fair value of \$11,653 and \$13,254)	11,429	12,795
Loans receivable (net of allowance for loan losses of \$7,738 and \$7,448)	747,822	730,842
Federal Home Loan Bank stock	19,690	20,727
Premises and equipment	12,059	12,189
Bank-owned life insurance	15,755	15,618
Foreclosed real estate	2,393	2,034
Other assets	15,090	14,561
TOTAL ASSETS	\$ 1,081,041	\$ 1,071,997
LIABILITIES		
Deposits	\$ 581,270	\$ 540,410
Short-term borrowings	11,856	14,719
Other borrowings	310,657	335,357
Advances by borrowers for taxes and insurance	3,291	1,465
Other liabilities	7,807	8,423
TOTAL LIABILITIES	914,881	900,374
Commitment and contingencies		
STOCKHOLDERS' EQUITY		
Preferred Stock (\$.01 par value; 1,000,000 shares authorized, none issued)		
Common stock (\$.01 par value; 40,000,000 shares authorized, 16,980,900 issued; 13,181,590 and 13,482,612 outstanding at December 31, 2010 and September 30, 2010)	170	170
Additional paid in capital	165,087	164,494
Unallocated common stock held by the Employee Stock Ownership Plan (ESOP)	(11,777)	(11,891)
Retained earnings	64,685	64,272
Treasury stock, at cost; 3,799,310 and 3,498,288 shares at December 31, 2010 and September 30, 2010, respectively	(48,714)	(44,870)
Accumulated other comprehensive loss	(3,291)	(552)
TOTAL STOCKHOLDERS' EQUITY	166,160	171,623

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TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,081,041	\$ 1,071,997
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See accompanying notes to the unaudited consolidated financial statements.

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

	For the Three Months Ended December 31, (dollars in thousands, except per share data)	
	2010	2009
INTEREST INCOME		
Loans receivable	\$ 9,844	\$ 10,341
Investment securities:		
Taxable	1,922	2,237
Exempt from federal income tax	78	83
Other investment income		1
Total interest income	11,844	12,662
INTEREST EXPENSE		
Deposits	1,696	1,406
Short-term borrowings	22	49
Other borrowings	2,996	3,924
Total interest expense	4,714	5,379
NET INTEREST INCOME	7,130	7,283
Provision for loan losses	480	500
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,650	6,783
NONINTEREST INCOME		
Service fees on deposit accounts	762	827
Services charges and fees on loans	210	101
Trust and investment fees	211	220
Gain on sale of loans, net	3	155
Earnings on Bank-owned life insurance	137	140
Other	12	13
Total noninterest income	1,335	1,456
NONINTEREST EXPENSE		
Compensation and employee benefits	3,880	3,736
Occupancy and equipment	777	559
Professional fees	429	377
Data processing	449	450
Advertising	186	98
Federal Deposit Insurance Corporation (FDIC) premiums	184	358
Loss on foreclosed real estate	106	1,200

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Other	627	453
Total noninterest expense	6,638	7,231
Income before income taxes	1,347	1,008
Income taxes	335	214
NET INCOME	\$ 1,012	\$ 794
Earnings per share		
Basic	\$ 0.09	\$ 0.06
Diluted	\$ 0.09	\$ 0.06
Dividends per share	\$ 0.05	\$ 0.05
See accompanying notes to the unaudited consolidated financial statements.		

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ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(UNAUDITED)

	Common Stock						Accumulated Other Comprehensive	Total
	Number of Shares	Amount	Additional Paid In Capital	Unallocated Common Stock Held by the ESOP	Retained Earnings	Treasury Stock	Income (loss)	Stockholders Equity
Balance, September 30, 2010	13,482,612	\$ 170	\$ 164,494	\$ (11,891)	\$ 64,272	\$ (44,870)	\$ (552)	\$ 171,623
Net income					1,012			1,012
Other comprehensive (loss):								
Unrealized loss on securities available for sale, net of income tax benefit of \$1,446							(2,807)	(2,807)
Change in unrecognized pension cost, net of income taxes of \$35							68	68
Cash dividends declared (\$.05 per share)					(599)			(599)
Stock based compensation			560					560
Allocation of ESOP stock			33	114				147
Treasury shares purchased	(301,022)					(3,844)		(3,844)
Balance, December 31, 2010	13,181,590	\$ 170	\$ 165,087	\$ (11,777)	\$ 64,685	\$ (48,714)	\$ (3,291)	\$ 166,160

See accompanying notes to the unaudited consolidated financial statements.

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

	For the Three Months Ended December 31, 20102009 (dollars in thousands)	
OPERATING ACTIVITIES		
Net income	\$ 1,012	\$ 794
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	480	500
Provision for depreciation and amortization.	292	288
Accretion of discounts and premiums, net	379	113
Gain on sale of loans, net	(3)	(155)
Origination of mortgage loans sold	(97)	(5,706)
Proceeds from sale of mortgage loans originated for sale	100	5,861
Compensation expense on ESOP	147	141
Stock based compensation	560	538
Decrease in accrued interest receivable	328	175
Increase in accrued interest payable	135	2
Earnings on bank-owned life insurance	(137)	(140)
Deferred federal income taxes	(126)	61
Prepaid FDIC premiums	166	(1,712)
Loss on foreclosed real estate	73	1,200
Other, net	21	(634)
Net cash provided by operating activities	3,330	1,326
INVESTING ACTIVITIES		
Proceeds from repayments of certificates of deposit		1,685
Investment securities available for sale:		
Proceeds from principal repayments and maturities	34,940	13,769
Purchases	(36,687)	(12,129)
Investment securities held to maturity:		
Proceeds from principal repayments and maturities	1,353	1,027
(Increase) decrease in loans receivable, net	(17,860)	2,920
Redemption of FHLB stock	1,037	
Capital improvements to foreclosed real estate	(20)	(22)
Purchase of premises, equipment, and software	(142)	(900)
Net cash provided by (used for) investing activities	(17,379)	6,350
FINANCING ACTIVITIES		
Increase (decrease) in deposits, net	40,860	(8,687)
Net (decrease) increase in short-term borrowings	(2,863)	12,922
Proceeds from other borrowings	8,300	13,200
Repayment of other borrowings	(33,000)	(23,000)
Increase in advances by borrowers for taxes and insurance	1,826	1,627
Purchase of treasury stock.	(4,019)	(3,592)
Dividends on common stock	(599)	(667)

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Net cash provided by (used for) financing activities	10,505	(8,197)
Decrease in cash and cash equivalents	(3,544)	(521)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	10,890	18,593
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 7,346	\$ 18,072

SUPPLEMENTAL CASH FLOW DISCLOSURES

Cash Paid:

Interest	\$ 4,579	\$ 5,377
Income taxes	375	23

Noncash items:

Transfers from loans to foreclosed real estate	412	344
Treasury stock payable	(175)	

See accompanying notes to the unaudited consolidated financial statements.

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ESSA BANCORP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

(unaudited)

1. Nature of Operations and Basis of Presentation

The 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, Northampton and Lehigh 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, 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, 2010 are not necessarily indicative of the results that may be expected for the year ending September 30, 2011.

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, 2010 and 2009.

	Three months ended	
	December 31, 2010	December 31, 2009
Weighted-average common shares outstanding	16,980,900	16,980,900
Average treasury stock shares	(3,658,950)	(2,274,573)
Average unearned ESOP shares	(1,171,255)	(1,216,531)
Average unearned non-vested shares	(293,358)	(412,902)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	11,857,337	13,076,894
Additional common stock equivalents (non-vested stock) used to calculate diluted earnings per share		
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	2,873	
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	11,860,210	13,076,894

At December 31, 2010 and 2009 there were options to purchase 317,910 and 1,458,379 shares, respectively, of common stock outstanding at a price of \$12.35 per share that were not included in the computation of diluted EPS because to do so would have been anti-dilutive. At December 31, 2010 and 2009 there were 283,264 and 402,758 shares, respectively, of nonvested stock outstanding at a price of \$12.35 per share that were not included in the computation of diluted EPS because to do so would have been anti-dilutive.

3. Use of Estimates in the Preparation of Financial Statements

The accounting principles followed by the Company and its subsidiaries and the methods of applying these principles conform to U.S. generally accepted accounting principles 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.

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

	December 31,	
	2010	2009
Net income	\$ 1,012	\$ 794
Unrealized loss on securities available for sale	(4,253)	(819)
Change in unrecognized pension cost	103	77
Other comprehensive loss before tax benefit	(4,150)	(742)
Income tax benefit related to comprehensive loss	(1,411)	(253)
Other comprehensive loss	(2,739)	(489)
Comprehensive income (loss)	\$ (1,727)	\$ 305

5. Recent Accounting Pronouncements

In January 2010, the FASB issued ASU 2010-05, *Compensation - Stock Compensation (Topic 718): Escrowed Share Arrangements and the Presumption of Compensation*. ASU 2010-05 updates existing guidance to address the SEC staff's views on overcoming the presumption that for certain shareholders escrowed share arrangements represent compensation. ASU 2010-05 is effective January 15, 2010. The adoption of this guidance did not have a material impact on the Company's financial position or results of operation.

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of this guidance is not expected to have a significant impact on the Company's financial statements.

In July 2010, FASB issued ASU No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU 2010-20 is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The amendments in ASU 2010-20 encourage, but do not require, comparative disclosures for earlier reporting periods that ended before initial adoption. However, an entity should provide comparative disclosures for those reporting periods ending after initial adoption. The Company has presented the necessary disclosures in Note 8, herein.

In September, 2010, the FASB issued ASU 2010-25, *Plan Accounting - Defined Contribution Pension Plans*. The amendments in this ASU require that participant loans be classified as notes receivable from participants, which are segregated from plan investments and measured at their unpaid principal balance plus any accrued but unpaid interest. The amendments in this update are effective for fiscal years ending after December 15, 2010 and are not expected to have a significant impact on the Company's financial statements.

In October, 2010, the FASB issued ASU 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. This ASU addresses the diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The amendments are effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2011 and are not expected to have a significant impact on the Company's financial statements.

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In December, 2010, the FASB issued ASU 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*. This ASU modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating an impairment may exist. The qualitative factors are consistent with the existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For public entities, the amendments in this Update are effective for fiscal year, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Nonpublic entities may early adopt the amendments using the effective date for public entities. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In December 2010, the FASB issued ASU 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations*. The amendments in this update specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures under Topic 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments in this Update are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

6. Investment Securities

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

	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale				
Fannie Mae	\$ 108,674	\$ 1,274	\$ (1,587)	\$ 108,361
Freddie Mac	53,116	1,499	(306)	54,309
Governmental National Mortgage Association securities	32,641	782	(65)	33,358
Total mortgage-backed securities	194,431	3,555	(1,958)	196,028
Obligations of states and political subdivisions	16,559	99	(119)	16,539
U.S. government agency securities	34,750	163	(224)	34,689
Corporate obligations	2,142	16		2,158
Total debt securities	247,882	3,833	(2,301)	249,414
Equity securities	12	31		43
Total	\$ 247,894	\$ 3,864	\$ (2,301)	\$ 249,457
Held to Maturity				
Fannie Mae	\$ 2,180	\$ 116	\$	\$ 2,296
Freddie Mac	9,249	108		9,357
Total	\$ 11,429	\$ 224	\$	\$ 11,653

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	September 30, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale				
Fannie Mae	\$ 99,142	\$ 2,412	\$ (9)	\$ 101,545
Freddie Mac	47,693	1,895		49,588
Governmental National Mortgage Association securities	35,211	1,040	(96)	36,155
Total mortgage-backed securities	182,046	5,347	(105)	187,288
Obligations of states and political subdivisions	10,637	279	(12)	10,904
U.S. government agency securities	52,177	279	(22)	52,434
Corporate obligations	1,654	23		1,677
Total debt securities	246,514	5,928	(139)	252,303
Equity securities	12	26		38
Total	\$ 246,526	\$ 5,954	\$ (139)	\$ 252,341
Held to Maturity				
Fannie Mae	\$ 2,600	\$ 140	\$	\$ 2,740
Freddie Mac	10,195	319		10,514
Total	\$ 12,795	\$ 459	\$	\$ 13,254

The amortized cost and fair value of debt securities at December 31, 2010, 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	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 3	\$ 3	\$ 6	\$ 6
Due after one year through five years	30,429	30,469	945	1,002
Due after five years through ten years	45,738	46,251	1,140	1,207
Due after ten years	171,712	172,691	9,338	9,438
Total	\$ 247,882	\$ 249,414	\$ 11,429	\$ 11,653

The Bank had no sales of investment securities for the three months ended December 31, 2010 or 2009.

7. Unrealized Losses on Securities

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

	December 31, 2010					
	Less than Twelve Months	Twelve Months or Greater			Total	
Number of Securities	Fair Value	Gross Unrealized	Fair Value	Gross Unrealized	Fair Value	Gross Unrealized

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			Losses		Losses		Losses
Fannie Mae	20	\$ 50,675	\$ (1,587)	\$	\$	\$ 50,675	\$ (1,587)
Freddie Mac	4	9,765	(306)			9,765	(306)
Governmental National Mortgage Association securities	5	10,842	(65)			10,842	(65)
Obligations of states and political subdivisions	4	3,965	(119)			3,965	(119)
U.S. government agency securities	11	21,297	(224)			21,297	(224)
Total	44	\$ 96,544	\$ (2,301)	\$	\$	\$ 96,544	\$ (2,301)

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		Less than Twelve Months		September 30, 2010		Total	
	Number of Securities	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fannie Mae	1	\$ 2,060	\$ (9)	\$	\$	\$ 2,060	\$ (9)
Governmental National Mortgage Association securities	2	5,605	(96)			5,605	(96)
Obligations of states and political subdivisions	1	610	(12)			610	(12)
U.S. government agency securities	4	6,484	(22)			6,484	(22)
Total	8	\$ 14,759	\$ (139)	\$	\$	\$ 14,759	\$ (139)

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

The Company reviews its position quarterly and has asserted that at December 31, 2010, the declines outlined in the above table represent temporary declines and the Company would not be required to sell the security before its anticipated recovery in market value.

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

8. Loans Receivable, Net and Allowance for Loan Losses

Loans receivable consist of the following (in thousands):

	December 31, 2010	September 30, 2010
Real Estate Loans:		
Residential	\$ 598,852	\$ 596,170
Construction	1,755	1,302
Commercial	94,387	78,056
Commercial	15,496	16,569
Home equity loans and lines of credit	42,610	43,538
Other	2,231	2,486
	755,331	738,121
Plus deferred loan costs	229	169
	755,560	738,290
Less allowance for loan losses	7,738	7,448
Net loans	\$ 747,822	\$ 730,842

Real Estate Loans				Home Equity and Lines of Credit	Other Loans	Total
Residential	Construction	Commercial	Commercial Loans			
(dollars in thousands)						
December 31, 2010						

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Total Loans	\$ 598,852	\$ 1,755	\$ 94,387	\$ 15,496	\$ 42,610	\$ 2,231	\$ 755,331
Individually evaluated for impairment	5,261		3,464	25	116		8,866
Collectively evaluated for impairment	593,591	1,755	90,923	15,471	42,494	2,231	746,465

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

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

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

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

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2010					
With no specific allowance recorded:					
Real Estate Loans					
Residential	\$ 3,328	\$ 3,321	\$	\$ 3,081	\$ 60
Construction					
Commercial	2,254	2,254		2,398	23
Commercial	22	22		42	
Home equity loans and lines of credit	14	14		14	
Other					
Total	5,618	5,611		5,535	83
With an allowance recorded:					
Real Estate Loans					
Residential	1,940	1,940	239	1,996	
Construction					
Commercial	1,211	1,210	200	657	
Commercial	3	3	3	3	
Home equity loans and lines of credit	102	102	58	74	
Other					
Total	3,256	3,255	500	2,730	
Total:					
Real Estate Loans					
Residential	5,268	5,261	239	5,077	60
Construction					
Commercial	3,465	3,464	200	3,055	23

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Commercial	25	25	3	45	
Home equity loans and lines of credit	116	116	58	88	
Other					
Total Impaired Loans	\$ 8,874	\$ 8,866	\$ 500	\$ 8,265	\$ 83

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Management uses an eight point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first four categories are considered not criticized, and are aggregated as Pass rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. The portion of any loan that represents a specific allocation of the allowance for loan losses is placed in the Doubtful category. Any portion of a loan that has been charged off is placed in the Loss category.

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

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system as of December 31, 2010 (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2010					
Real estate loans					
Residential	\$ 573,322	\$ 8,158	\$ 17,372	\$	\$ 598,852
Construction	1,755				1,755
Commercial	77,670	2,618	14,099		94,387
Commercial	15,107	271	118		15,496
Home equity loans and lines of credit	41,081	625	904		42,610
Other	2,136	5	90		2,231
Total	\$ 711,071	\$ 11,677	\$ 32,583	\$	\$ 755,331

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of December 31, 2010 (in thousands):

	Current	31-60 Days Past Due	61-90 Days Past Due	Greater than 90 Days Past Due and still accruing	Non-Accrual	Total Past Due and Non- Accrual	Total Loans
December 31, 2010							
Real estate loans							
Residential	\$ 584,270	\$ 4,453	\$ 749	\$	\$ 9,380	\$ 14,582	\$ 598,852
Construction	1,755						1,755
Commercial	92,276				2,111	2,111	94,387
Commercial	15,429	5			62	67	15,496
Home equity loans and lines of credit	42,149	204	77		180	461	42,610
Other	2,023	7	5		196	208	2,231

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Total	\$ 737,902	\$ 4,669	\$ 831	\$ 11,929	\$ 17,429	\$ 755,331
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Nonperforming assets were \$14.7 million at December 31, 2010. Nonperforming assets were \$12.9 million at September 30, 2010. The increase was due to increases of \$1.0 million in nonperforming residential loans, \$564,000 in commercial loans and \$359,000 in other real estate loans offset, in part, by a decrease of \$170,000 in consumer loans. Commercial nonperforming loans increased primarily as a result of the addition of two commercial real estate relationships. Non-performing residential loans increased due to increases in outstanding balances of new non-performing residential loans. The number of non-performing residential loans remained unchanged from September 30, 2010 at 50 loans. Foreclosed real estate was \$2.4 million at December 31, 2010 and \$2.0 million at September 30, 2010.

Our allowance for loan losses is maintained at a level necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. Our allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an allocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management's judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary based on changing economic conditions. Payments received on impaired loans generally are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. The allowance for loan losses as of December 31, 2010 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 Office of Thrift Supervision and the Pennsylvania Department of Banking, as an integral part of its 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.

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

The following table summarizes the primary segments of the ALL, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of December 31, 2010 (in thousands):

Real Estate Loans								
	Residential	Construction	Commercial	Commercial Loans	Home Equity Loans and Lines of Credit	Other Loans	Unallocated	Total
ALL balance at December 31, 2010	4,840	15	2,081	148	603	23	28	7,738
Individually evaluated for impairment	239		200	3	58			500
Collectively evaluated for impairment	4,601	15	1,881	145	545	23	28	7,238

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

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

	Three Months Ended December 31,	
	2010	2009
Balance, beginning of period	\$ 7,448	\$ 5,815
Add		
Provision charged to operations	480	500
Loan recoveries	48	25
	7,976	6,340
Less loans charged off	(238)	(136)
Balance, end of period	\$ 7,738	\$ 6,204

9. Deposits

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

	December 31, 2010	September 30, 2010
Non-interest bearing demand accounts	\$ 28,886	\$ 30,448
NOW accounts	58,834	61,878
Money market accounts	119,132	119,238
Savings and club accounts	68,376	67,763
Certificates of deposit	306,042	261,083
Total	\$ 581,270	\$ 540,410

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 14 of the Company's Consolidated Financial Statements for the year ended September 30, 2010 included in the Company's Form 10-K.

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

	Three Months Ended December 31,	
	2010	2009
Service Cost	\$ 133	\$ 105
Interest Cost	174	143
Expected return on plan assets	(192)	(145)
Amortization of prior service cost	2	2
Amortization of unrecognized loss	101	76

Net periodic benefit cost	\$ 218	\$ 181
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The Bank expects to contribute \$500,000 to its pension plan in 2011.

11. Equity Incentive Plan

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

Certain officers, employees and outside directors were granted in aggregate 1,140,469 NSOs; 317,910 ISOs; and 590,320 shares of restricted stock. In accordance with generally accepted accounting principles for *Share-*

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Based Payments, the Company expenses the fair value of all share-based compensation grants over the requisite service periods.

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

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

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

For the three months ended December 31, 2010 and 2009, the Company recorded \$560,000 of share-based compensation expense, comprised of stock option expense of \$190,000 and restricted stock expense of \$370,000. Expected future expense relating to the 863,027 non-vested options outstanding as of December 31, 2010, is \$1.7 million over the remaining vesting period of 2.42 years. Expected future compensation expense relating to the 351,638 restricted shares at December 31, 2010, is \$3.5 million over the remaining vesting period of 2.42 years.

The following is a summary of the Company's stock option activity and related information for its option grants for the three month period ended December 31, 2010.

	Number of Stock Options	Weighted- average Exercise Price	Weighted- average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding, September 30, 2010	1,458,379	\$ 12.35	7.67	\$
Granted				
Exercised				
Forfeited				