

ESSA Bancorp, Inc.  
Form 10-Q  
May 10, 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 March 31, 2011

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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<b>Pennsylvania</b> (State or other jurisdiction of incorporation or organization)	<b>20-8023072</b> (I.R.S. Employer Identification Number)
<b>200 Palmer Street, Stroudsburg, Pennsylvania</b> (Address of Principal Executive Offices)	<b>18360</b> (Zip Code)
<b>(570) 421-0531</b> (Registrant's telephone number)	
<b>N/A</b> (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 May 6, 2011 there were 12,778,790 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)

	March 31, 2011	September 30, 2010
	(dollars in thousands)	
<b>ASSETS</b>		
Cash and due from banks	\$ 8,054	\$ 7,454
Interest-bearing deposits with other institutions	12,155	3,436
Total cash and cash equivalents	20,209	10,890
Investment securities available for sale	251,862	252,341
Investment securities held to maturity (estimated fair value of \$10,179 and \$13,254)	9,971	12,795
Loans receivable (net of allowance for loan losses of \$8,129 and \$7,448)	744,108	730,842
Federal Home Loan Bank stock	18,706	20,727
Premises and equipment	11,858	12,189
Bank-owned life insurance	17,886	15,618
Foreclosed real estate	3,160	2,034
Other assets	16,112	14,561
<b>TOTAL ASSETS</b>	<b>\$ 1,093,872</b>	<b>\$ 1,071,997</b>
<b>LIABILITIES</b>		
Deposits	\$ 632,213	\$ 540,410
Short-term borrowings		14,719
Other borrowings	286,657	335,357
Advances by borrowers for taxes and insurance	4,416	1,465
Other liabilities	8,018	8,423
<b>TOTAL LIABILITIES</b>	<b>931,304</b>	<b>900,374</b>
<b>Commitment and contingencies</b>		
<b>STOCKHOLDERS EQUITY</b>		
Preferred Stock (\$.01 par value; 10,000,000 shares authorized, none issued)		
Common stock (\$.01 par value; 40,000,000 shares authorized, 16,980,900 issued; 12,819,971 and 13,482,612 outstanding at March 31, 2011 and September 30, 2010)	170	170
Additional paid in capital	165,652	164,494
Unallocated common stock held by the Employee Stock Ownership Plan (ESOP)	(11,664)	(11,891)
Retained earnings	65,309	64,272
Treasury stock, at cost; 4,160,929 and 3,498,288 shares at March 31, 2011 and September 30, 2010, respectively	(53,346)	(44,870)
Accumulated other comprehensive loss	(3,553)	(552)
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>162,568</b>	<b>171,623</b>

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TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,093,872	\$ 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 March 31,		For the Six Months Ended March 31,	
	2011	2010	2011	2010
	(dollars in thousands, except per share data)			
<b>INTEREST INCOME</b>				
Loans receivable	\$ 9,795	\$ 10,166	\$ 19,639	\$ 20,507
Investment securities:				
Taxable	2,016	2,164	3,938	4,401
Exempt from federal income tax	75	77	153	160
Other investment income	1	1	1	2
<b>Total interest income</b>	<b>11,887</b>	<b>12,408</b>	<b>23,731</b>	<b>25,070</b>
<b>INTEREST EXPENSE</b>				
Deposits	1,795	1,458	3,491	2,864
Short-term borrowings	23	35	45	84
Other borrowings	2,727	3,711	5,723	7,635
<b>Total interest expense</b>	<b>4,545</b>	<b>5,204</b>	<b>9,259</b>	<b>10,583</b>
<b>NET INTEREST INCOME</b>	<b>7,342</b>	<b>7,204</b>	<b>14,472</b>	<b>14,487</b>
Provision for loan losses	650	650	1,130	1,150
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>6,692</b>	<b>6,554</b>	<b>13,342</b>	<b>13,337</b>
<b>NONINTEREST INCOME</b>				
Service fees on deposit accounts	729	777	1,491	1,604
Services charges and fees on loans	145	124	355	225
Trust and investment fees	195	212	406	432
Gain on sale of investments, net	115	308	115	308
Gain on sale of loans, net		40	3	195
Earnings on bank-owned life insurance	131	135	268	275
Other	8	11	20	24
<b>Total noninterest income</b>	<b>1,323</b>	<b>1,607</b>	<b>2,658</b>	<b>3,063</b>
<b>NONINTEREST EXPENSE</b>				
Compensation and employee benefits	3,933	3,601	7,813	7,337
Occupancy and equipment	796	763	1,573	1,322
Professional fees	420	386	849	763
Data processing	481	467	930	917
Advertising	183	166	369	264
Federal Deposit Insurance Corporation (FDIC) premiums	222	123	406	481
(Gain)/Loss on foreclosed real estate	(94)		12	1,200
Other	514	539	1,141	992

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Total noninterest expense	6,455	6,045	13,093	13,276
Income before income taxes	1,560	2,116	2,907	3,124
Income taxes	345	513	680	727
<b>NET INCOME</b>	<b>\$ 1,215</b>	<b>\$ 1,603</b>	<b>\$ 2,227</b>	<b>\$ 2,397</b>
Earnings per share				
Basic	\$ 0.10	\$ 0.12	\$ 0.19	\$ 0.18
Diluted	\$ 0.10	\$ 0.12	\$ 0.19	\$ 0.18
Dividends per share	\$ 0.05	\$ 0.05	\$ 0.10	\$ 0.10

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		Additional Paid In Capital	Unallocated Common Stock Held by the ESOP	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (loss)	Total Stockholders Equity
	Number of Shares	Amount						
Balance, September 30, 2010	13,482,612	\$ 170	\$ 164,494	\$ (11,891)	\$ 64,272	\$ (44,870)	\$ (552)	\$ 171,623
Net income					2,227			2,227
Other comprehensive (loss):								
Unrealized loss on securities available for sale, net of income tax benefit of \$1,616							(3,137)	(3,137)
Change in unrecognized pension cost, net of income taxes of \$70							136	136
Cash dividends declared (\$.10 per share)					(1,190)			(1,190)
Stock based compensation			1,094					1,094
Allocation of ESOP stock			64	227				291
Treasury shares purchased	(662,641)					(8,476)		(8,476)
Balance, March 31, 2011	12,819,971	\$ 170	\$ 165,652	\$ (11,664)	\$ 65,309	\$ (53,346)	\$ (3,553)	\$ 162,568

See accompanying notes to the unaudited consolidated financial statements.



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## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

	<b>For the Six Months Ended March 31, 2011      2010 (dollars in thousands)</b>	
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 2,227	\$ 2,397
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,130	1,150
Provision for depreciation and amortization	572	579
Accretion of discounts and premiums, net	668	249
Gain on sale of investment securities, net	(115)	(308)
Gain on sale of loans, net	(3)	(195)
Origination of mortgage loans sold	(97)	(8,218)
Proceeds from sale of mortgage loans originated for sale	100	8,413
Compensation expense on ESOP	291	279
Stock based compensation	1,094	1,070
Decrease in accrued interest receivable	194	5
Decrease in accrued interest payable	(164)	(95)
Earnings on bank-owned life insurance	(268)	(275)
Deferred federal income taxes	(628)	179
Prepaid FDIC premiums	372	(1,600)
Loss on foreclosed real estate	224	1,200
Other, net	(434)	(1,339)
Net cash provided by operating activities	5,163	3,491
<b>INVESTING ACTIVITIES</b>		
Proceeds from repayments of certificates of deposit		3,385
Investment securities available for sale:		
Proceeds from sale of investment securities	6,209	13,940
Proceeds from principal repayments and maturities	53,701	31,199
Purchases	(64,739)	(52,018)
Investment securities held to maturity:		
Proceeds from sale of investment securities	643	
Proceeds from principal repayments and maturities	2,174	1,633
Purchases		(10,163)
(Increase) decrease in loans receivable, net	(15,895)	3,396
Redemption of FHLB stock	2,021	
Purchase of bank owned life insurance	(2,000)	
Proceeds from sale of other real estate	192	
Capital improvements to foreclosed real estate	(20)	(43)
Purchase of premises, equipment, and software	(271)	(2,158)
Net cash used for investing activities	(17,985)	(10,829)
<b>FINANCING ACTIVITIES</b>		
Increase in deposits, net	91,803	73,672

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Net decrease in short-term borrowings	(14,719)	(33,091)
Proceeds from other borrowings	8,300	15,750
Repayment of other borrowings	(57,000)	(35,500)
Increase in advances by borrowers for taxes and insurance	2,951	2,846
Purchase of treasury stock	(8,004)	(7,694)
Dividends on common stock	(1,190)	(1,323)
Net cash provided by financing activities	22,141	14,660
Increase in cash and cash equivalents	9,319	7,322
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	10,890	18,593
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 20,209	\$ 25,915

SUPPLEMENTAL CASH FLOW DISCLOSURES

Cash Paid:		
Interest	\$ 9,423	\$ 10,678
Income taxes	1,775	1,246
Noncash items:		
Transfers from loans to foreclosed real estate	1,508	379
Treasury stock payable	472	\$ (345)

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 and six month periods ended March 31, 2011 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 and six month periods ended March 31, 2011 and 2010.

	Three months ended		Six months ended	
	March 31, 2011	March 31, 2010	March 31, 2011	March 31, 2010
Weighted-average common shares outstanding	16,980,900	16,980,900	16,980,900	16,980,900
Average treasury stock shares	(3,870,623)	(2,501,794)	(3,763,624)	(2,386,935)
Average unearned ESOP shares	(1,159,939)	(1,205,215)	(1,165,659)	(1,210,935)
Average unearned non-vested shares	(274,148)	(393,162)	(278,867)	(398,124)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	11,676,190	12,880,729	11,772,750	12,984,906
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	9,690		6,273	
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	11,685,880	12,880,729	11,779,023	12,984,906

At March 31, 2011 and 2010 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 March 31, 2011

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and 2010 there were 253,960 and 372,026 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.

**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 other comprehensive income (loss) are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	March 31		March 31	
	2011	2010	2011	2010
Net income	\$ 1,215	\$ 1,603	\$ 2,227	\$ 2,397
Unrealized loss on securities available for sale	(385)	(281)	(4,638)	(1,100)
Realized gains included in net income	(115)	(308)	(115)	(308)
Change in unrecognized pension cost	103	79	206	156
Other comprehensive loss before tax benefit	(397)	(510)	(4,547)	(1,252)
Income tax benefit related to comprehensive loss	(135)	(173)	(1,546)	(426)
Other comprehensive loss	(262)	(337)	(3,001)	(826)
Comprehensive income (loss)	\$ 953	\$ 1,266	\$ (774)	\$ 1,571

**5. Recent Accounting Pronouncements**

In January 2010, the Financial Accounting Standards Board (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.

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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. This ASU is not expected to have a significant impact on the Company's financial statements.

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.

In January 2011, the FASB issued ASU 2011-01, *Receivables (Topic 310): Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20*. The amendments in this Update temporarily delay the effective date of the disclosures about troubled debt restructurings in Update 2010-20, enabling public-entity creditors to provide those disclosures after the FASB clarifies the guidance for determining what constitutes a troubled debt restructuring. The deferral in this Update will result in more consistent disclosures about troubled debt restructurings. This amendment does not defer the effective date of the other disclosure requirements in Update 2010-20. In the proposed Update for determining what constitutes a troubled debt restructuring, the FASB proposed that the clarifications would be effective for interim and annual periods ending after June 15, 2011. For the new disclosures about troubled debt restructurings in Update 2010-20, those clarifications would be applied retrospectively to the beginning of the fiscal year in which the proposal is adopted. The adoption of this guidance is not expected to have a significant impact on the Company's financial statements.

In April 2011, the FASB issued ASU 2011-02, *Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. The amendments in this Update provide additional guidance or clarification to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The amendments in this Update are effective for the first interim or annual reporting period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning annual period of adoption. As a result of applying these amendments, an entity may identify receivables that are newly considered impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

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

	March 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available for Sale</b>				
Fannie Mae	\$ 126,130	\$ 1,264	\$ (1,750)	\$ 125,644
Freddie Mac	45,999	1,415	(426)	46,988
Governmental National Mortgage Association	30,661	795	(329)	31,127
<b>Total mortgage-backed securities</b>	<b>202,790</b>	<b>3,474</b>	<b>(2,505)</b>	<b>203,759</b>
Obligations of states and political subdivisions	15,935	280	(279)	15,936
U.S. government agency securities	29,935	125	(113)	29,947
Corporate obligations	2,130	15	(5)	2,140
<b>Total debt securities</b>	<b>250,790</b>	<b>3,894</b>	<b>(2,902)</b>	<b>251,782</b>
Equity securities	11	69		80
<b>Total</b>	<b>\$ 250,801</b>	<b>\$ 3,963</b>	<b>\$ (2,902)</b>	<b>\$ 251,862</b>

<b>Held to Maturity</b>				
Fannie Mae	\$ 1,413	\$ 81	\$	\$ 1,494
Freddie Mac	8,558	127		8,685
<b>Total</b>	<b>\$ 9,971</b>	<b>\$ 208</b>	<b>\$</b>	<b>\$ 10,179</b>

	September 30, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available for Sale</b>				
Fannie Mae	\$ 99,142	\$ 2,412	\$ (9)	\$ 101,545
Freddie Mac	47,693	1,895		49,588
Governmental National Mortgage Association	35,211	1,040	(96)	36,155
<b>Total mortgage-backed securities</b>	<b>182,046</b>	<b>5,347</b>	<b>(105)</b>	<b>187,288</b>
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
<b>Total debt securities</b>	<b>246,514</b>	<b>5,928</b>	<b>(139)</b>	<b>252,303</b>
Equity securities	12	26		38
<b>Total</b>	<b>\$ 246,526</b>	<b>\$ 5,954</b>	<b>\$ (139)</b>	<b>\$ 252,341</b>

<b>Held to Maturity</b>				
Fannie Mae	\$ 2,600	\$ 140	\$	\$ 2,740
Freddie Mac	10,195	319		10,514
<b>Total</b>	<b>\$ 12,795</b>	<b>\$ 459</b>	<b>\$</b>	<b>\$ 13,254</b>



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The amortized cost and fair value of debt securities at March 31, 2011, 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	\$ 2,061	\$ 2,067	\$	\$
Due after one year through five years	21,608	21,679	786	834
Due after five years through ten years	48,000	48,595	1,033	1,095
Due after ten years	179,121	179,441	8,152	8,250
<b>Total</b>	<b>\$ 250,790</b>	<b>\$ 251,782</b>	<b>\$ 9,971</b>	<b>\$ 10,179</b>

For the three and six months ended March 31, 2011, the Company realized gross gains of \$148,000 and gross losses of \$33,000 and proceeds from the sale of investment securities of \$14.0 million. For the three and six months ended March 31, 2010, the Company realized gross gains of \$308,000 and proceeds from the sale of investment securities of \$13.9 million. Included in the gross gains realized for the three and six months ended March 31, 2011 was \$18,000 from the sale of investment securities classified as held to maturity. Proceeds from the sale of these securities were \$643,000. The investment remaining in these securities at the time of sale was less than 20% of the original investment.

**Table of Contents****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):

	Number of Securities	Less than Twelve Months		March 31, 2011 Twelve Months or Greater		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fannie Mae	28	\$ 67,531	\$ (1,750)	\$	\$	\$ 67,531	\$ (1,750)
Freddie Mac	6	14,310	(426)			14,310	(426)
Governmental National Mortgage Association	8	13,296	(329)			13,296	(329)
Obligations of states and political subdivisions	5	4,372	(279)			4,372	(279)
U.S. government agency securities	6	11,841	(113)			11,841	(113)
Corporate obligations	1	495	(5)			495	(5)
<b>Total</b>	<b>54</b>	<b>\$ 111,845</b>	<b>\$ (2,902)</b>	<b>\$</b>	<b>\$</b>	<b>\$ 111,845</b>	<b>\$ (2,902)</b>

	Number of Securities	Less than Twelve Months		September 30, 2010 Twelve Months or Greater		Total	
		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	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)
<b>Total</b>	<b>8</b>	<b>\$ 14,759</b>	<b>\$ (139)</b>	<b>\$</b>	<b>\$</b>	<b>\$ 14,759</b>	<b>\$ (139)</b>

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

The Company reviews its position quarterly and has asserted that at March 31, 2011, 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.

**Table of Contents****8. Loans Receivable, Net and Allowance for Loan Losses**

Loans receivable consist of the following (in thousands):

	March 31, 2011	September 30, 2010
Real Estate Loans:		
Residential	\$ 595,470	\$ 596,455
Construction	904	1,302
Commercial	96,857	77,943
Commercial	15,169	16,545
Home equity loans and lines of credit	41,770	43,559
Other	2,067	2,486
	752,237	738,290
Less allowance for loan losses	8,129	7,448
Net loans	\$ 744,108	\$ 730,842

	Real Estate Loans			Commercial Loans (dollars in thousands)	Home Equity and Lines of Credit	Other Loans	Total
	Residential	Construction	Commercial				
<b>March 31, 2011</b>							
Total Loans	\$ 595,470	\$ 904	\$ 96,857	\$ 15,169	\$ 41,770	\$ 2,067	\$ 752,237
Individually evaluated for impairment	6,212		5,089	153	298		11,752
Collectively evaluated for impairment	589,258	904	91,768	15,016	41,472	2,067	740,485

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.



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	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
<b>March 31, 2011</b>					
<b>With no specific allowance recorded:</b>					
Real Estate Loans					
Residential	\$ 2,922	\$ 2,915	\$	\$ 2,481	\$
Construction					
Commercial	3,850	3,855		2,524	
Commercial	116	116		47	
Home equity loans and lines of credit	91	91		25	
Other					
Total	6,979	6,977		5,077	
<b>With an allowance recorded:</b>					
Real Estate Loans					
Residential	3,290	3,286	435	2,806	
Construction					
Commercial	1,239	1,240	247	938	
Commercial	37	37	37	8	
Home equity loans and lines of credit	207	207	109	101	
Other					
Total	4,773	4,770	828	3,853	
<b>Total:</b>					
Real Estate Loans					
Residential	6,212	6,201	435	5,287	
Construction					
Commercial	5,089	5,095	247	3,462	
Commercial	153	153	37	55	
Home equity loans and lines of credit	298	298	109	126	
Other					
Total Impaired Loans	\$ 11,752	\$ 11,747	\$ 828	\$ 8,930	\$

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.



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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 March 31, 2011 (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
Commercial real estate loans	81,638	1,479	13,740		96,857
Commercial	14,607	284	243	35	15,169
<b>Total</b>	<b>\$ 96,245</b>	<b>\$ 1,763</b>	<b>\$ 13,983</b>	<b>\$ 35</b>	<b>\$ 112,026</b>

All other loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or non-performing.

	Performing	Non-performing	Total
<b>March 31, 2011</b>			
Real estate loans:			
Residential	\$ 586,283	\$ 9,187	\$ 595,470
Construction	904		904
Home Equity loans and lines of credit	41,594	176	41,770
Other	1,874	193	2,067
<b>Total</b>	<b>\$ 630,655</b>	<b>\$ 9,556</b>	<b>\$ 640,211</b>

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 March 31, 2011 (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
<b>March 31, 2011</b>							
Real estate loans							
Residential	\$ 581,285	\$ 3,481	\$ 1,517	\$	\$ 9,187	\$ 14,185	\$ 595,470
Construction	904						904
Commercial	94,086	410			2,361	2,771	96,857
Commercial	15,039	74			56	130	15,169
Home equity loans and lines of credit	41,094	360	141		175	676	41,770
Other	1,864	3	7		193	203	2,067
<b>Total</b>	<b>\$ 734,272</b>	<b>\$ 4,328</b>	<b>\$ 1,665</b>	<b>\$</b>	<b>\$ 11,972</b>	<b>\$ 17,965</b>	<b>\$ 752,237</b>

Non-performing assets, which are composed of non-performing loans of \$12.0 million, troubled debt restructures of \$322,000, and foreclosed real estate of \$3.2 million, were \$15.5 million at March 31, 2011. Nonperforming assets were \$12.9 million at September 30, 2010. The increase was due to increases of \$825,000 in nonperforming residential loans, \$807,000 in nonperforming commercial loans and \$1.1 million in foreclosed real estate offset, in part, by a decrease of \$178,000 in nonperforming consumer loans. Commercial nonperforming loans increased primarily as a result of the addition of two commercial real estate relationships. Nonperforming residential loans increased due to an increase in

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the average per loan balance of nonperforming residential loans to \$180,000 at March 31, 2011 compared to \$167,000 at September 30, 2010. The number of nonperforming residential loans at March 31, 2011 increased by one loan to 51 compared to 50 at September 30, 2010. Within the non-performing loans of \$12.0 million at March 31, 2011, \$4.3 million were impaired loans. As of March 31, 2011, the Company had total impaired loans of \$11.5 million which the Company has determined that a reserve of \$828,000 is required. Foreclosed real estate was \$3.2 million at March 31, 2011 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



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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 March 31, 2011 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 March 31, 2011 (in thousands):

	Real Estate Loans			Home Equity Loans and Lines of Credit			Unallocated	Total
	Residential	Construction	Commercial	Commercial Loans	Other Loans			
ALL balance at September 30, 2010	4,462	15	1,556	204	569	22	620	7,448
Charge-offs	(314)			(132)	(101)			(547)
Recoveries	83			1	14			98
Provision	811	(7)	(135)	274	152	2	33	1,130
ALL balance at March 31, 2011	5,042	8	1,421	347	634	24	653	8,129
Individually evaluated for impairment	435		247	37	109			828
Collectively evaluated for impairment	4,607	8	1,174	310	525	24	653	7,301

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date. The Company allocated increased provisions to the residential real estate, commercial and home equity loans and lines of credit segments for the six month period ending March 31, 2011 due to increased charge off activity in those segments. Despite the above allocations, the allowance for loan losses is general in nature and is available to absorb losses from any loan segment.

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

	Six Months Ended March 31,	
	2011	2010
Balance, beginning of period	\$ 7,448	\$ 5,815
Add		
Provision charged to operations	1,130	1,150
Loan recoveries	98	26
	8,676	6,991
Less loans charged off	(547)	(396)
Balance, end of period	\$ 8,129	\$ 6,595

**9. Deposits**

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

	March 31, 2011	September 30, 2010
Non-interest bearing demand accounts	\$ 28,712	\$ 30,448
NOW accounts	59,058	61,878
Money market accounts	118,692	119,238
Savings and club accounts	72,511	67,763
Certificates of deposit	353,240	261,083
Total	\$ 632,213	\$ 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 March 31,		Six Months Ended March 31,	
	2011	2010	2011	2010
Service Cost	\$ 134	\$ 106	\$ 267	\$ 211
Interest Cost	175	142	349	285
Expected return on plan assets	(193)	(145)	(385)	(290)
Amortization of prior service cost	2	3	4	5
Amortization of unrecognized loss	101	74	202	150

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Net periodic benefit cost	\$ 219	\$ 180	\$ 437	\$ 361
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The Bank expects to contribute \$500,000 to its pension plan in fiscal 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-Based Payments*, the Company expenses the fair value of all share-based compensation grants over the requisite service periods.

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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 six months ended March 31, 2011 and 2010, the Company recorded \$1.1 million of share-based compensation expense, comprised of stock option expense of \$362,000 and restricted stock expense of \$732,000 for the March 31, 2011 period and stock option expense of \$347,000 and restricted stock expense of \$724,000 for the March 31, 2010 period. Expected future expense relating to the 863,027 non-vested options outstanding as of March 31, 2011, is \$1.5 million over the remaining vesting period of 2.17 years. Expected future compensation expense relating to the 351,638 restricted shares at March 31, 2011, is \$3.1 million over the remaining vesting period of 2.17 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 March 31, 2011.

	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				
Outstanding, March 31, 2011	1,458,379	\$ 12.35	7.12	\$ 1,240
Exercisable at March 31, 2011	595,352	\$ 12.35	7.12	\$ 506

The weighted-average grant date fair value of the Company's non-vested options as of March 31, 2011 and 2010, was \$2.38.

The following is a summary of the status of the Company's restricted stock as of March 31, 2011, and changes therein during the six month period then ended:

	Number of Restricted Stock	Weighted- average Grant Date Fair Value
Nonvested at September 30, 2010	352,448	\$ 12.35
Granted		
Vested	810	12.35
Forfeited		
Nonvested at March 31, 2011	351,638	\$ 12.35

**12. Fair Value Measurement**

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

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The following table presents information about the Company's securities, other real estate owned and impaired loans measured at fair value as of March 31, 2011 and September 30, 2010 and indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value:

**Fair Value Measurement at March 31, 2011**

Fair Value Measurements Utilized for the Company's Financial Assets (in thousands):	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of March 31, 2011
<b>Securities available-for-sale measured on a recurring basis</b>				
Mortgage backed securities	\$	\$ 203,759	\$	\$ 203,759
Obligations of states and political subdivisions		15,936		15,936
U.S. government agencies		29,947		29,947
Corporate obligations		2,140		2,140
Equity securities	24	56		80
<b>Total debt and equity securities</b>	\$ 24	\$ 251,838	\$	\$ 251,862
Foreclosed real estate owned measured on a non-recurring basis	\$	\$	\$ 3,160	\$ 3,160
Impaired loans measured on a non-recurring basis	\$	\$	\$ 10,924	\$ 10,924
Mortgage servicing rights measured on a non-recurring basis	\$	\$	\$ 273	\$ 273

**Fair Value Measurement at September 30, 2010**

Fair Value Measurements Utilized for the Company's Financial Assets (in thousands):	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of March 31, 2011
<b>Securities available-for-sale measured on a recurring basis</b>				
Mortgage backed securities	\$	\$ 187,288	\$	\$ 187,288
Obligations of states and political subdivisions		10,904		10,904
U.S. government agencies		52,434		52,434
Corporate obligations		1,677		1,677
Equity securities	38			38
<b>Total debt and equity securities</b>	\$ 38	\$ 252,303	\$	\$ 252,341
Foreclosed real estate owned measured on a non-recurring basis	\$	\$ 2,034	\$	\$ 2,034
Impaired loans measured on a non-recurring basis	\$	\$ 7,646	\$	\$ 7,646
Mortgage servicing rights measured on a non-recurring basis	\$	\$	\$ 318	\$ 318

As required by generally accepted accounting principles, 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 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

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quoted prices for the specific securities, but rather by relying on a security's relationship to other benchmark quoted securities. Most of the securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Securities reported at fair value utilizing Level 1 inputs are limited to actively traded equity securities whose market price is readily available from the New York Stock Exchange or the NASDAQ exchange. Other real estate owned (OREO) is measured at fair value, less cost to sell at the date of foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value, less cost to sell. Income and expenses from operations and changes in valuation allowance are included in the net expenses from OREO. Impaired loans are reported at fair value utilizing level three inputs. For these loans, a review of the collateral is conducted and an appropriate allowance for loan losses is allocated to the loan. At March 31, 2011, 174 impaired loans with a carrying value of \$11.7 million were reduced by specific valuation allowance totaling \$828,000 resulting in a net fair value of \$10.9 million based on Level 3 inputs.

**Disclosures about Fair Value of Financial Instruments**

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

	March 31, 2011		September 30, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 20,209	\$ 20,209	\$ 10,890	\$ 10,890
<b>Investment and mortgage-backed securities:</b>				
Available for sale	251,862	251,862	252,341	252,341
Held to maturity	9,971	10,179	12,795	13,254
Loans receivable, net	744,108	765,066	730,842	755,871
Accrued interest receivable	4,198	4,198	4,392	4,392
FHLB stock	18,706	18,706	20,727	20,727
Mortgage servicing rights	273	273	318	318
Bank owned life insurance	17,886	17,886	15,618	15,618
<b>Financial liabilities:</b>				
Deposits	\$ 632,213	\$ 638,589	\$ 540,410	\$ 548,352
Short-term borrowings			14,719	14,719
Other borrowings	286,657	298,612	335,357	353,358
Advances by borrowers for taxes and insurance	4,416	4,416	1,465	1,465
Accrued interest payable	1,482	1,482	1,646	1,646

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

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

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

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

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





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

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

The fair value approximates the current book value.

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

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

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

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

### **Loans Receivable, Deposits, Other Borrowings, and Mortgage Servicing Rights**

The fair values for loans and mortgage servicing rights are estimated by discounting contractual cash flows and adjusting for prepayment estimates. Discount rates are based upon market rates generally charged for such loans with similar characteristics. Demand, savings, and money market deposit accounts are valued at the amount payable on demand as of year-end. Fair values for time deposits and other borrowings are estimated using a discounted cash flow calculation that applies contractual costs currently being offered in the existing portfolio to current market rates being offered for deposits and borrowings of similar remaining maturities.

### **Commitments to Extend Credit**

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

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

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

statements of our goals, intentions and expectations;

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

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

estimates of our risks and future costs and benefits.

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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;

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

changes in consumer spending, borrowing and savings habits;

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

changes in our organization, compensation and benefit plans.

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

**Comparison of Financial Condition at March 31, 2011 and September 30, 2010**

**Total Assets.** Total assets increased by \$21.9 million, or 2.0%, to \$1,093.9 million at March 31, 2011 from \$1,072.0 million at September 30, 2010. This increase was primarily due to increases in net loans receivable and interest bearing deposits with other institutions.

**Investment Securities Available for Sale.** Investment securities available for sale decreased \$479,000, or 0.2%, to \$251.9 million at March 31, 2011 from \$252.3 million at September 30, 2010. The decrease was due primarily to a decrease of \$22.5 million in the Company's portfolio of United States government sponsored agency securities, offset in part by a \$16.5 million increase in the Company's portfolio of mortgage-backed securities issued by United States government sponsored agencies and a \$5.0 million increase in obligations of state and political subdivisions.

**Investment securities held to maturity.** Investment securities held to maturity decreased \$2.8 million, or 22.1%, to \$10.0 million at March 31, 2011 from \$12.8 million at September 30, 2010. The decrease was due to normal repayments received on the mortgage-backed portfolio and the sale of \$643,000 of held to maturity investment securities. At the time of their sale, these securities had paid down to less than 20% of their original investment value.

**Net Loans.** Net loans increased \$13.3 million, or 1.8%, to \$744.1 million at March 31, 2011 from \$730.8 million at September 30, 2010. The increase in net loans receivable was primarily attributed to an increase in commercial real estate loans. During this period, commercial real estate loans outstanding increased by \$18.9 million to \$97.0 million. This increase was partially offset by decreases in commercial loans outstanding of \$1.4 million to \$15.2 million, residential real estate loans outstanding of \$1.1 million to \$595.1 million, home equity loans and lines of credit outstanding of \$1.8 million to \$41.8, construction loans outstanding of \$398,000 to \$904,000 and other loans outstanding of \$419,000 to \$2.1 million.

**Deposits.** Deposits increased \$91.8 million, or 17.0%, to \$632.2 million at March 31, 2011 from \$540.4 million at September 30, 2010. At March 31, 2011 compared to September 30, 2010, certificate of deposit accounts increased \$92.2 million to \$353.2 million, and savings and club accounts increased \$4.7 million to \$72.5 million. These increases were offset in part during the same period by decreases in non-interest bearing demand accounts of \$1.7 million to \$28.7 million, NOW accounts of \$2.8 million to \$59.1 million and money market accounts of \$546,000 to \$118.7 million. Included in the certificates of deposit at March 31, 2011 was an increase of \$54.0 million in brokered certificates of deposit to \$124.6 million. The increase in brokered certificates was the result of the Company's decision to replace maturing FHLBank Pittsburgh borrowings with lower priced brokered certificates of deposit.

**Borrowed Funds.** Borrowed funds decreased by \$63.4 million, or 18.1%, to \$286.7 million at March 31, 2011, from \$350.1 million at September 30, 2010. The decrease in borrowed funds was primarily due to maturities of FHLBank Pittsburgh borrowings.

**Stockholders' Equity.** Stockholders' equity decreased by \$9.1 million, or 5.3%, to \$162.6 million at March 31, 2011 from \$171.6 million at September 30, 2010. This decrease was primarily the result of a stock repurchase program the Company began in June 2008 and an increase in the Company's accumulated other comprehensive loss. The accumulated other comprehensive loss increased by \$3.0 million at March 31, 2011 compared to September 30, 2010 primarily due to a decrease in the unrealized gain, net of taxes, on the Company's investment securities available for sale. The unrealized gain decreased due to changes in interest rates. In June, 2009, the Company announced that it had completed its first stock repurchase program having purchased 2,547,135 shares at a weighted average cost of \$13.14. On October 6, 2010, the Company announced that it had completed its second stock repurchase program having purchased 1,499,100 shares at a weighted average cost of \$12.36. It

was also announced

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that the Company's Board of Directors authorized a third repurchase program to purchase up to an additional 5% of its outstanding shares. During the quarter ended March 31, 2011, the Company had purchased an additional 361,619 shares at a weighted average cost of \$12.81 per share under the third stock repurchase program. In April 2011, the Company announced that it had completed the third repurchase program having purchased 679,900 shares at a weighted average cost of \$12.82.

**Average Balance Sheets for the Three and Six Months Ended March 31, 2011 and 2010**

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 March 31					
	2011			2010		
	Average Balance	Interest Income/Expense	Yield/ Cost (dollars in thousands)	Average Balance	Interest Income/Expense	Yield/ Cost
<b>Interest-earning assets:</b>						
Loans (1)	\$ 756,105	\$ 9,795	5.25%	\$ 733,330	\$ 10,166	5.62%
Investment securities						
Taxable (2)	44,739	234	2.12%	37,483	207	2.24%
Exempt from federal income tax (2) (3)	6,649	75	6.93%	6,915	77	6.84%
Total investment securities	51,388	309	2.74%	44,398	284	2.96%
Mortgage-backed securities	210,447	1,782	3.43%	185,390	1,957	4.28%
Federal Home Loan Bank stock	19,292		0.00%	20,727		0.00%
Other	6,603	1	0.06%	10,330	1	0.04%
Total interest-earning assets	1,043,835	11,887	4.63%	994,175	12,408	5.08%
Allowance for loan losses	(7,857)			(6,358)		
Noninterest-earning assets	54,515			50,065		
Total assets	\$ 1,090,493			\$ 1,037,882		
<b>Interest-bearing liabilities:</b>						
NOW accounts	\$ 56,376	6	0.04%	\$ 53,460	10	0.08%
Money market accounts	119,474	155	0.53%	114,275	324	1.15%
Savings and club accounts	67,972	48	0.29%	67,047	51	0.31%
Certificates of deposit	326,236	1,586	1.97%	165,463	1,073	2.63%
Borrowed funds	312,757	2,750	3.57%	417,239	3,746	3.64%
Total interest-bearing liabilities	\$ 882,815	\$ 4,545	2.09%	\$ 817,484	\$ 5,204	2.58%
Non-interest bearing NOW accounts	28,766			26,472		
Noninterest-bearing liabilities	11,685			10,707		
Total liabilities	923,266			854,663		
Equity	167,227			183,219		
Total liabilities and equity	\$ 1,090,493			\$ 1,037,882		
Net interest income		\$ 7,342			\$ 7,204	

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Interest rate spread		2.54%	2.50%
Net interest-earning assets	\$ 161,020		\$ 176,691
Net interest margin (4)		2.85%	2.94%
Average interest-earning assets to average interest-bearing liabilities		118.24%	121.61%

- (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.

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	For the Six Months Ended March 31,					
	2011			2010		
	Average	Interest	Yield/ Cost	Average	Interest	Yield/ Cost
	Balance	Income/ Expense	(dollars in thousands)	Balance	Income/ Expense	
<b>Interest-earning assets:</b>						
Loans (1)	\$ 747,920	\$ 19,639	5.27%	\$ 735,338	\$ 20,507	5.59%
Investment securities						
Taxable (2)	47,566	442	1.86%	33,893	393	2.33%
Exempt from federal income tax (2) (3)	6,745	153	6.89%	7,169	160	6.78%
Total investment securities	54,311	595	2.49%	41,062	553	3.10%
Mortgage-backed securities	206,599	3,496	3.39%	187,547	4,008	4.29%
Federal Home Loan Bank stock	19,647		0.00%	20,727		0.00%
Other	4,106	1	0.05%	7,148	2	0.06%
Total interest-earning assets	1,032,583	23,731	4.62%	991,822	25,070	5.09%
Allowance for loan losses	(7,743)			(6,139)		
Noninterest-earning assets	54,534			48,791		
Total assets	\$ 1,079,374			\$ 1,034,474		
<b>Interest-bearing liabilities:</b>						
NOW accounts	\$ 57,280	13	0.05%	\$ 53,667	20	0.07%
Money market accounts	118,580	320	0.54%	111,893	642	1.15%
Savings and club accounts	67,238	90	0.27%	66,144	109	0.33%
Certificates of deposit	305,571	3,067	2.01%	155,312	2,093	2.70%
Borrowed funds	321,567	5,769	3.60%	426,329	7,719	3.63%
Total interest-bearing liabilities	870,236	9,259	2.13%	813,345	10,583	2.61%
Non-interest bearing NOW accounts	28,998			26,555		
Noninterest-bearing liabilities	10,923			10,060		
Total liabilities	910,157			849,960		
Equity	169,217			184,514		
Total liabilities and equity	\$ 1,079,374			\$ 1,034,474		
Net interest income		\$ 14,472			\$ 14,487	
Interest rate spread			2.49%			2.48%
Net interest-earning assets	\$ 162,347			\$ 178,477		
Net interest margin (4)			2.81%			2.93%
Average interest-earning assets to average interest-bearing liabilities		118.66%			121.94%	

(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 March 31, 2011 and March 31, 2010**

**Net Income.** Net income decreased \$388,000, or 24.2%, to \$1.2 million for the three months ended March 31, 2011 compared to net income of \$1.6 million for the comparable period in 2010. Net income for the three months ending March 31, 2011 includes an increase in non-interest expense related to the opening of one branch in the second quarter of 2010 and three branches in the third quarter of 2010.

**Net Interest Income.** Net interest income increased \$138,000 or 1.9%, to \$7.3 million for the three months ended March 31, 2011 from \$7.2 million for the comparable period in 2010. The increase was primarily attributable to an increase in the Company's interest rate spread to 2.54% for the three months ended March 31, 2011, from 2.50% for the comparable period in 2010, offset in part by a decrease of \$15.7 million in the Company's average net earnings assets.

**Interest Income.** Interest income decreased \$521,000 or 4.2%, to \$11.9 million for the three months ended March 31, 2011 from \$12.4 million for the comparable 2010 period. The decrease resulted primarily from a 45 basis point decrease in average yield on interest earning assets partially offset by a \$49.7 million increase in average interest-earning assets. The average yield on interest earning assets was 4.63% for the three months ended March 31, 2011, as compared to 5.08% for the comparable 2010 period as the Company's interest earning assets continued to re-price downward throughout the period. Loans increased on average \$22.8 million between the two periods along with increases in the average balance of mortgage backed securities of \$25.1 million. In addition, average taxable investment securities increased \$7.3 million. These increases were offset in part by decreases in the average balances of tax exempt investment securities of \$266,000 and average other interest earning assets of \$3.7 million. The primary reason for the increase in mortgage backed and taxable investment securities was the partial reinvestment of borrowing proceeds, deposit proceeds and maturing investment securities into these assets. Average FHLBank Pittsburgh stock declined \$1.4 million as a result of a repurchase by the FHLB of stock in the six month period ended December 31, 2010. As a member of the FHLB system, the Bank maintains an investment in the capital stock of the FHLB in an amount not less than 45 basis points of the outstanding FHLB member asset value plus 4.6% of its outstanding FHLB borrowings, 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 decrease in other interest earning assets was primarily due to a decrease in the average balance of cash held at FHLBank Pittsburgh.

**Interest Expense.** Interest expense decreased \$659,000 or 12.7%, to \$4.5 million for the three months ended March 31, 2011 from \$5.2 million for the comparable 2010 period. The decrease resulted from a 49 basis point decrease in the overall cost of interest bearing liabilities to 2.09% for the three months ended March 31, 2011 from 2.58% for the comparable 2010 period, partially offset by a \$65.3 million increase in average interest-bearing liabilities. Average interest bearing deposits increased \$169.8 million and average borrowed funds decreased \$104.5 million. Average interest bearing deposits increased primarily as a result of a \$160.8 million increase in average certificates of deposit. Borrowed funds decreased primarily due to maturities of FHLBank Pittsburgh borrowings. Average certificates of deposit included an increase of \$86.4 million in average brokered certificates of deposit. The Company primarily replaced maturing FHLBank Pittsburgh borrowings with brokered certificates because they were a cheaper funding source.

**Provision for Loan Losses.** In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are subject to interpretation and revision as more information becomes available or as future events occur. After an evaluation of these factors, management made a provision for loan losses of 650,000 for the three months ended March 31, 2011 as compared to \$650,000 for the three months ended March 31, 2010. The allowance for loan losses was \$8.1 million, or 1.08% of loans outstanding, at March 31, 2011, compared to \$7.4 million, or 1.01% of loans outstanding at September 30, 2010.

**Non-interest Income.** Non-interest income decreased \$284,000 or 17.7% to \$1.3 million from \$1.6 million for the comparable period in 2010. The primary reasons for the decrease were the declines in gains on the sale of investments of \$193,000, gains on sale of loans, net of \$40,000, and service fees and deposit accounts of \$48,000 during the 2010 period. The Company took advantage of favorable market conditions in the three months ended March 31, 2010 and recorded a gain on sale of investments of \$308,000 compared to \$115,000 for the three months ended March 31, 2011.

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**Non-interest Expense.** Non-interest expense increased \$410,000, or 6.8%, to \$6.5 million for the three months ended March 31, 2011 from \$6.0 million for the comparable period in 2010. The primary reason for the increase was an increase in compensation and employee benefits of \$332,000 and FDIC insurance premiums of \$99,000, offset in part, by decreases in foreclosed real estate of \$94,000, and other expense of \$25,000. Compensation and employee benefits increased primarily, as a result, of staff increases required for the opening of four branches in 2010. FDIC premiums increased as a result of increases in FDIC insurance costs.

**Income Taxes.** Income tax expense decreased \$168,000 to \$345,000 for the three months ended March 31, 2011 from \$513,000 for the comparable 2010 period. The decrease was primarily a result of the decrease in income before taxes of \$556,000 million for the three months ended March 31, 2011. The effective tax rate was 22.1% for the three months ended March 31, 2011, compared to 24.2% for the 2010 period.

**Comparison of Operating Results for the Six Months Ended March 31, 2011 and March 31, 2010**

**Net Income.** Net income decreased \$170,000 or 7.1%, to \$2.2 million for the six months ended March 31, 2011 compared to net income of \$2.4 million for the comparable period in 2010. The net income of \$2.2 million for the six months ending March 31, 2011 included expenses related to the opening of four new branch offices and a decline in gains on sales of loans and investments.

**Net Interest Income.** Net interest income decreased \$15,000 or 0.1%, to \$14.5 million for the six months ended March 31, 2011 from \$14.5 million for the comparable period in 2010. The decrease was primarily attributable to a decrease in the Company's average net earning assets of \$16.1 million, offset by a slight increase in the Company's interest rate spread to 2.49% for the six months ended March 31, 2011 from 2.48% for the comparable period in 2010.

**Interest Income.** Interest income decreased \$1.3 million or 5.3%, to \$23.7 million for the six months ended March 31, 2011 from \$25.1 million for the comparable 2010 period. The decrease resulted primarily from a 47 basis point decrease in average yield on interest earning assets partially offset by a \$40.8 million increase in average interest-earning assets. The average yield on interest earning assets was 4.62% for the six months ended March 31, 2011, as compared to 5.09% for the comparable 2010 period. Loans increased on average \$12.6 million between the two periods along with increases in the average balance of mortgage backed securities of \$19.1 million and total investment securities of \$13.2 million. These increases were offset in part by a decrease in the average balances of other earning assets of \$3.0 million and capital stock of FHLBank Pittsburgh of \$1.1 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. As a member of the FHLB system, the Bank maintains an investment in the capital stock of the FHLB in an amount not less than 45 basis points of the outstanding FHLB member asset value plus 4.6% of its outstanding FHLB borrowings, 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.

**Interest Expense.** Interest expense decreased \$1.3 million, to \$9.3 million for the six months ended March 31, 2011 from \$10.6 million for the comparable 2010 period. The decrease resulted from a 48 basis point decrease in the overall cost of interest bearing liabilities to 2.13% for the six months ended March 31, 2011 from 2.61% for the comparable 2010 period, partially offset by a \$56.9 million increase in average interest-bearing liabilities. Average interest bearing deposits increased \$161.7 million and average borrowed funds decreased \$104.8 million. Average interest bearing deposits increased primarily as a result of an increase of \$150.3 million in average certificates of deposit. Borrowed funds decreased primarily due to maturities of FHLBank Pittsburgh borrowings. Average certificates of deposit included an increase of \$85.2 million in average brokered certificates of deposit. The Company primarily replaced maturing FHLBank Pittsburgh borrowings with brokered certificates of deposit.

**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. Non-performing

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assets at March 31, 2011 were \$15.5 million compared to non-performing assets of \$11.9 million at March 31, 2010. After an evaluation of these factors, management made a provision for loan losses of \$1.1 million for the six months ended March 31, 2011 as compared to \$1.2 million for the six months ended March 31, 2010. The allowance for loan losses was \$8.1 million, or 1.08% of loans outstanding, at March 31, 2011, compared to \$6.6 million, or 0.90% of loans outstanding at March 31, 2010.

**Non-interest Income.** Non-interest income decreased \$405,000 or 13.2%, to \$2.7 million from \$3.1 million for the comparable period in 2010. The primary reasons for the decrease were decreases in gain on sale of investments of \$193,000, gain on sale of loans of \$192,000, and service fees on deposit accounts of \$113,000 which were partially offset by increases in service charges and fees on loans of \$130,000. The Company took advantage of favorable market conditions in the six months ended March 31, 2010 and recorded gains on sale of investments of \$308,000 and gains on sales of loans of \$195,000 versus \$115,000 and \$3,000 for the comparable period in 2011, respectively.

**Non-interest Expense.** Non-interest expense decreased \$183,000, or 1.4%, to \$13.1 million for the six months ended March 31, 2011 from \$13.3 million for the comparable period in 2010. The primary reason for the decrease was a decline in write-down in foreclosed real estate of \$1.2 million. This decrease was offset in part by increases in occupancy and equipment expense of \$251,000 and compensation and employee benefit expense of \$476,000. Write-downs of foreclosed real estate decreased because the Company took a \$1.2 million charge off in the first fiscal quarter of 2010 related to a single property in the Bank's foreclosed real estate portfolio. Compensation and employee benefits increased primarily as a result of the hiring of additional employees to staff the Company's branch expansion.

**Income Taxes.** Income tax expense decreased \$47,000 or 6.5%, to \$680,000 for the six months ended March 31, 2011 from \$727,000 for the comparable 2010 period. The decrease in income tax expense was primarily the result of a decrease of \$217,000 in income before taxes for the six months ended March 31, 2011 compared to the comparable period in 2010. The effective tax rate was 23.4% for the six months ended March 31, 2011, compared to 23.3% for the 2010 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)

	March 31, 2011	September 30, 2010
Non-performing assets:		
Non-accruing loans	\$ 11,972	\$ 10,516
Troubled debt restructures	322	360
Total non-performing loans	12,294	10,876
Foreclosed real estate	3,160	2,034
Total non-performing assets	\$ 15,454	\$ 12,910
Ratio of non-performing loans to total loans	1.63%	1.47%
Ratio of non-performing loans to total assets	1.12%	1.01%
Ratio of non-performing assets to total assets	1.41%	1.20%
Ratio of allowance for loan losses to total loans	1.08%	1.01%

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. Nonperforming assets increased \$2.5 million to \$15.5 million at March 31, 2011 from \$12.9 million at September 30, 2010. Nonperforming loans increased \$1.4 million to \$12.3 million at March 31, 2011 from \$10.9 million at September 30, 2010. The \$11.9 million of non-accruing loans included 51 residential loans with an aggregate outstanding balance of \$9.2 million that were past due 90 or more days at March 31, 2011, 15 commercial loans with aggregate outstanding balances of \$2.4 million and 10 consumer loans with aggregate balances of \$369,000. Foreclosed real estate increased \$1.1 million to \$3.2 million at March 31, 2011 from \$2.0 million at September 30, 2010. The \$1.1 million increase included the addition of 13 residential properties valued at \$1.4 million to the foreclosed real estate portfolio, which was partially offset by write-downs of



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\$123,000. The Company also sold two foreclosed properties totaling \$178,000 for the period. The Company's largest foreclosed property is a former townhouse project valued at \$1.0 million at March 31, 2011. This property is expected to be sold without the recognition of any additional losses, during the third quarter.

A loan is considered to be a troubled debt restructure ( 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 of 12 months.

At March 31, 2011 the principal balance of troubled debt restructures was \$9.4 million as compared to \$7.0 million at September 30, 2010. Within the \$9.4 million of troubled debt restructures at March 31, 2011, \$5.5 million are performing loans and \$3.6 million are non-accrual loans. An additional \$322,000 of performing troubled debt restructures are classified as non-performing assets because they were non-performing assets at the time they were restructured.

Of the 58 loans that make up our troubled debt restructures at March 31, 2011, one loan with a balance of \$2,000 was granted a rate concession at a below market interest rate. One loan with a balance of \$230,000 was granted a rate concession at market rates. Four loans with balances totaling \$1.1 million were granted market rate and terms concessions and 52 loans with balances totaling \$8.1 million were granted terms concessions.

Residential real estate loans make up the vast majority of our troubled debt restructures. As of March 31, 2011, troubled debt restructures were comprised of 34 residential loans totaling \$6.0 million, 18 commercial and commercial real estate loans totaling \$3.1 million, and six consumer (Home equity loans, home equity lines and credit, and other) totaling \$273,000.

For the six month period ended March 31, 2011, six loans totaling \$787,000 were removed from TDR status. One loan for \$148,000 was transferred to foreclosed real estate, one loan for \$409,000 had completed 12 timely payments, and four loans totaling \$230,000 were paid off.

We have modified terms of loans that do not meet the definition of a TDR. The vast majority of such loans were simply rate modifications of residential first mortgage loans in lieu of refinancing. The non-TDR rate modifications were all performing loans when the rates were reset to current market rates. For the six months ended March 31, 2011, we modified 217 loans (\$29.4 million) in this fashion. With regard to commercial loans, including commercial real estate loans, various non-troubled loans were modified, either for the purpose of a rate reduction to reflect current market rates (in lieu of a refinance) or the extension of a loan's maturity date. In total, they numbered 22 in the six months ended March 31, 2011 with an aggregate balance of approximately \$12.7 million.

## **Liquidity and Capital Resources**

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

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 March 31, 2011, \$20.2 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.

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Short-term investment securities (maturing in one year or less) totaled \$2.1 million at March 31, 2011. As of March 31, 2011, we had \$226.7 million in borrowings outstanding from FHLBank Pittsburgh and \$60.0 million in borrowings through repurchase agreements with other financial institutions. We have access to additional FHLBank advances of up to approximately \$276.4 million.

At March 31, 2011, we had \$53.8 million in loan commitments outstanding, which included, in part, \$3.0 million in undisbursed construction loans, \$22.9 million in unused home equity lines of credit, \$7.3 million in commercial lines of credit and \$16.9 million to originate primarily multi-family and nonresidential mortgage loans. Certificates of deposit due within one year of March 31, 2011 totaled \$120.0 million, or 34.0% 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, 2011. 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. The Company intends to purchase low income housing tax credits at a cost of approximately \$8.0 million to be disbursed during the next two years.

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 \$5.2 million and \$3.5 million for the three months ended March 31, 2011 and 2010, 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 \$(18.0) million and \$(10.8) million for the three months ended March 31, 2011 and 2010, 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 \$22.1 million and \$14.7 million for the three months ended March 31, 2011 and 2010, respectively.

### **Critical Accounting Policies**

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

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

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

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

The analysis of the allowance for loan losses has two components: specific and general allocations. Specific allocations are made for loans that are determined to be impaired. Impairment is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The general allocation is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. We also analyze historical loss





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experience, delinquency trends, general economic conditions and geographic and industry concentrations. This analysis establishes factors that are applied to the loan groups to determine the amount of the general allocations. Actual loan losses may be significantly more than the allowance for loan losses we have established which could have a material negative effect on our financial results.

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

***Deferred Income Taxes.*** We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. We consider the determination of this valuation allowance to be a critical accounting policy because of the need to exercise significant judgment in evaluating the amount and timing of recognition of deferred tax liabilities and assets, including projections of future taxable income. These judgments and estimates are reviewed on a continual basis as regulatory and business factors change. A valuation allowance for deferred tax assets may be required if the amount of taxes recoverable through loss carryback declines, or if we project lower levels of future taxable income. Such a valuation allowance would be established through a charge to income tax expense which would adversely affect our operating results. At March 31, 2011 the Company had a \$2.8 million valuation allowance 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.

### **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 six months of fiscal 2011, the Company's contractual obligations did not change materially from those discussed in the Company's Financial Statements for the year ended September 30, 2010.

### **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, 2010.

**Table of Contents****Item 4. Controls and Procedures**

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

There were no 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**

There have been no material changes in the Risk Factors disclosed in the Company's Annual Report for the fiscal year ended September 30, 2010 on Form 10-K filed on December 14, 2010.

**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 March 31, 2011.

**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
January 1 - January 31, 2011		\$		402,800
February 1 - February 28, 2011	21,468	12.61	21,468	381,332
March 1 - March 31, 2011	340,151	12.82	340,151	41,181
Total	361,619	\$ 12.81	361,619	

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4.** [Removed and Reserved]

**Item 5. Other Information**

Not applicable.

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**Item 6. Exhibits**

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

- 3.1 Certificate of Incorporation of ESSA Bancorp, Inc.\*
- 3.2 Bylaws of ESSA Bancorp, Inc.\*
- 4 Form of Common Stock Certificate of ESSA Bancorp, Inc.\*
- 10.2 Amended and Restated Employment Agreement for Gary S. Olson\*\*
- 10.3 Amended and Restated Employment Agreement for Robert S. Howes\*\*
- 10.4 Amended and Restated Employment Agreement for Allan A. Muto\*\*
- 10.5 Amended and Restated Employment Agreement for Diane K. Reimer\*\*
- 10.6 Amended and Restated Employment Agreement for V. Gail Warner\*\*
- 10.7 Supplemental Executive Retirement Plan\*\*
- 10.8 Endorsement Split Dollar Life Insurance Agreement for Gary S. Olson\*\*
- 10.9 Endorsement Split Dollar Life Insurance Agreement for Robert S. Howes\*\*
- 21 Subsidiaries of Registrant\*
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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

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

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**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: May 10, 2011

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

Date: May 10, 2011

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