

ESSA Bancorp, Inc.  
Form 10-K  
December 14, 2018

SECURITIES AND EXCHANGE COMMISSION

100 F Street NE

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Fiscal Year Ended September 30, 2018

or

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

Commission File No. 001-33384

ESSA Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania  
(State or other jurisdiction of

incorporation or organization)

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

20-8023072  
(I.R.S. Employer

Identification Number)

18360  
(Zip Code)

(570) 421-0531

(Registrant's telephone number)

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

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Title of each class	Name of each exchange on which registered
Common Stock, \$0.01 par value	The NASDAQ Stock Market, LLC

Securities Registered Pursuant to Section 12(g) of the Act: None

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES NO .

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of December 1, 2018, there were 18,133,095 shares issued and 11,611,681 shares outstanding of the Registrant's Common Stock.

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the last sale price on March 31, 2018, was \$154,016,589.

DOCUMENTS INCORPORATED BY REFERENCE

Proxy Statement for the 2019 Annual Meeting of Stockholders of the Registrant (Part III).

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## Forward Looking Statements

This Annual Report on Form 10-K contains certain “forward-looking statements” which may be identified by the use of words such as “believe,” “expect,” “anticipate,” “should,” “planned,” “estimated” and “potential.” Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operations and business that are subject to various factors which could cause actual results to differ materially from these estimates and most other statements that are not historical in nature. These factors include, but are not limited to, general and local economic conditions, changes in interest rates, deposit flows, demand for mortgage, and other loans, real estate values, competition, changes in accounting principles, policies, or guidelines, changes in legislation or regulation, and other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and the ability to successfully complete or close transactions or to integrate acquired entities. Because of these and a wide variety of other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. Please also see “Item 1A. Risk Factors.”

## PART I

### Item 1. Business

#### ESSA Bancorp, Inc.

ESSA Bancorp, Inc. (“ESSA Bancorp” or the “Company”) is a Pennsylvania-chartered holding company for ESSA Bank & Trust (the “Bank”). ESSA Bancorp owns 100% of the outstanding shares of common stock of the Bank. Since being formed in 2006, ESSA Bancorp has engaged primarily in the business of holding the common stock of the Bank. Our executive offices are located at 200 Palmer Street, Stroudsburg, Pennsylvania 18360. Our telephone number at this address is (570) 421-0531. ESSA Bancorp is subject to comprehensive regulation and examination by the Federal Reserve Board of Governors. On July 31, 2012, ESSA Bancorp completed its acquisition of First Star Bancorp, Inc. and its wholly-owned subsidiary, First Star Bank (“First Star”). On April 4, 2014, ESSA Bancorp completed its acquisition of Franklin Security Bancorp, Inc. and its wholly owned subsidiary, Franklin Security Bank (“Franklin Security”). On December 4, 2015, ESSA Bancorp completed its acquisition of Eagle National Bancorp, Inc. (“ENB”), whereby ESSA Bancorp acquired ENB and its wholly owned subsidiary, Eagle National Bank. Effective November 14, 2014, ESSA Bancorp converted its holding company status from a savings and loan holding company to a bank holding company, and it elected the financial holding company designation as a bank holding company. At September 30, 2018, ESSA Bancorp had consolidated assets of \$1.8 billion, consolidated deposits of \$1.3 billion and consolidated stockholders’ equity of \$179.2 million. Consolidated net income for the fiscal year ended September 30, 2018 was \$6.5 million. Results for the year ended September 30, 2018, reflected a one-time charge to income tax expense of \$3.7 million related to the reduction in the carrying value of the Company’s deferred tax assets, which resulted from the reduction in the Federal corporate income tax rate under the Tax Cuts and Jobs Act of 2017.

The Company is a public company, and files interim, quarterly and annual reports with the Securities and Exchange Commission (“SEC”). The SEC maintains an Internet site ([www.sec.gov](http://www.sec.gov)) that contains reports, proxy and information statements and other information regarding issuers such as the Company that file electronically with the SEC. All filed SEC reports and interim filings can also be obtained from the Bank’s website ([www.essabank.com](http://www.essabank.com)), on the “Investor Relations” page, without charge from the Company.

#### ESSA Bank & Trust

##### General

The Bank was organized in 1916. The Bank is a Pennsylvania chartered full-service, community-oriented savings bank. We provide financial services to individuals, families and businesses through our 22 full-service banking offices, located in Monroe, Northampton, Lehigh, Lackawanna, Luzerne, Chester, Delaware and Montgomery Counties, Pennsylvania. The Bank is subject to comprehensive regulation and examination by the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation. In March 2014, the Bank converted its charter from a Pennsylvania savings and loan association to a Pennsylvania savings bank. The charter change did not have a material effect on the operations of the Bank.

The Bank’s business consists primarily of accepting deposits from the general public and investing those deposits, together with funds generated from operations and borrowings, in residential first mortgage loans (including construction mortgage loans), commercial real estate loans, home equity loans and lines of credit, commercial and consumer loans. We offer a variety of deposit accounts, including checking, savings and certificates of deposits. We

also offer asset management and trust services. We offer investment services through our relationship with Cetera Investment Services LLC, a third party broker/dealer and investment advisor. We offer insurance benefit consulting services through our wholly owned subsidiary, ESSA Advisory Services, LLC.

The Bank's executive offices are located at 200 Palmer Street, Stroudsburg, Pennsylvania 18360. Our telephone number at this address is (570) 421-0531. Our website address is [www.essabank.com](http://www.essabank.com).

#### Market Area

At September 30, 2018, our 22 full-service banking offices consisted of 7 offices in Monroe County, 3 offices in Lehigh County, 6 offices in Northampton County, 1 office in Lackawanna County, 1 office in Luzerne County, 1 office in Chester County, 2 offices in Delaware County and 1 office in Montgomery County, Pennsylvania. Our primary market for deposits is currently concentrated around the areas where our full-service banking offices are located. Our primary lending area consists of the counties where our branch offices are located, and to a lesser extent, the contiguous counties in the Commonwealth of Pennsylvania.

Monroe County is located in eastern Pennsylvania, situated 90 miles north of Philadelphia, 75 miles west of New York and 116 miles northeast of Harrisburg. Monroe County is comprised of 611 square miles of mostly rural terrain. Major industries include tourism, healthcare and educational facilities. Northampton County is located south of Monroe County and directly borders New Jersey. Lehigh County is located southwest of Monroe County. Luzerne and Lackawanna Counties are located north of Monroe County. Chester and Montgomery Counties are located south and Delaware County southwest of Monroe County. As of June 30, 2018, the most recent FDIC market share data available, we had a deposit market share of approximately 29.3% in Monroe County, which represented the largest deposit market share in Monroe County, 2.9% in Northampton County, 1.9% in Lehigh County, 0.1% in Lackawanna County, 0.9% in Luzerne County, 0.1% in Chester County, 0.1% in Montgomery County and 0.6% in Delaware County.

### Lending Activities

Historically, our principal lending activity has been the origination of first mortgage loans for the purchase, construction or refinancing of one- to four-family residential real estate property. In recent years, we have increased our originations of commercial loans and commercial real estate loans in an effort to increase interest income, diversify our loan portfolio, and better serve the community. Commercial real estate loans have increased from \$288.4 million or 23.5% of our total loan portfolio at September 30, 2016 to \$416.6 million, or 31.6%, of our total loan portfolio at September 30, 2018. One- to four-family residential real estate mortgage loans represented \$580.6 million, or 44.1%, of our loan portfolio at September 30, 2018. Home equity loans and lines of credit totaled \$44.0 million, or 3.3%, of our loan portfolio at September 30, 2018. Commercial loans totaled \$49.5 million, or 3.8%, of our loan portfolio at September 30, 2018 and construction first mortgage loans totaled \$3.9 million, or 0.3%, of the total loan portfolio at September 30, 2018. Obligations of states and political subdivisions totaled \$73.4 million, or 5.6%, of our loan portfolio at September 30, 2018. Auto loans totaled \$146.2 million or 11.1% of the total loan portfolio at September 30, 2018. As previously disclosed, the Bank discontinued originating indirect auto loans in July, 2018. We originate other consumer loans on a limited basis.

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

	At September 30, 2018		2017		2016		
	Amount	Percent	Amount	Percent	Amount	Percent	
(Dollars in thousands)							
<b>Residential first mortgage loans:</b>							
One- to four-family	\$580,561	44.1 %	\$586,708	47.1 %	\$596,645	48.6 %	
Construction	3,920	0.3	3,097	0.2	1,733	0.1	
Commercial	49,479	3.8	44,129	3.5	39,978	3.3	
Commercial real estate	416,573	31.6	318,323	25.6	288,447	23.5	
Obligations of states and political subdivisions	73,362	5.6	58,079	4.7	56,923	4.6	
Home equity loans and lines of credit	43,962	3.3	46,219	3.7	48,163	3.9	
Auto loans	146,220	11.1	186,646	15.0	193,078	15.7	
Other	2,682	0.2	2,845	0.2	3,302	0.3	
Total loans receivable	\$1,316,759	100.0 %	\$1,246,046	100.0 %	\$1,228,269	100.0 %	
Allowance for loan losses	(11,688 )		(9,365 )		(9,056 )		
Total loans receivable, net	\$1,305,071		\$1,236,681		\$1,219,213		



Loan Portfolio Maturities. The following table summarizes the scheduled repayments of our loan portfolio at September 30, 2018. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less.

	One-to four-		Commercial	
	family	Construction	Commercial	Real Estate
	(Dollars in thousands)			
Due During the Years Ending September 30,				
2019	\$ 1,240	\$ -	\$ 13,698	\$ 42,966
2020	1,691	-	4,012	26,744
2021	2,363	-	994	19,256
2022 to 2023	17,388	-	10,131	41,868
2024 to 2028	132,704	-	14,850	123,878
2029 to 2033	108,870	-	2,001	49,765
2033 and beyond	316,305	3,920	3,793	112,096
Total	\$580,561	\$ 3,920	\$ 49,479	\$ 416,573

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	Obligations of States and Loans				
	Political subdivisions	Lines of Credit	Auto Loans	Other	Total
Due During the Years Ending September 30,					
2019	\$ 689	\$ 1,388	\$ 2,003	\$ 284	\$ 62,268
2020	211	1,002	10,645	465	44,770
2021	6,909	2,023	30,777	343	62,665
2022 to 2023	11,066	5,126	82,544	692	168,815
2024 to 2028	20,762	10,133	20,251	348	322,926
2029 to 2033	14,255	12,861	-	339	188,091
2033 and beyond	19,470	11,429	-	211	467,224
<b>Total</b>	<b>\$ 73,362</b>	<b>\$ 43,962</b>	<b>\$ 146,220</b>	<b>\$ 2,682</b>	<b>\$ 1,316,759</b>

The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at September 30, 2018 that are contractually due after September 30, 2019.

	Due After September 30, 2019		
	Fixed	Adjustable	Total
(In thousands)			
Residential first mortgage loans:			
One- to four-family	\$543,665	\$ 35,656	\$579,321
Construction	3,920	-	3,920
Commercial	24,150	11,631	35,781
Commercial real estate	92,583	281,024	373,607
Obligations of states and political subdivisions	33,771	38,902	72,673
Home equity loans and lines of credit	19,392	23,182	42,574
Auto loans	144,217	-	144,217
Other	2,398	-	2,398
<b>Total</b>	<b>\$864,096</b>	<b>\$ 390,395</b>	<b>\$ 1,254,491</b>

**Loan Originations and Repayments.** We originate residential mortgage loans pursuant to underwriting standards that generally conform to Fannie Mae and Freddie Mac guidelines. Loan origination activities are primarily concentrated in Monroe, Northampton, Lehigh, Lackawanna, Luzerne, Chester, Delaware, and Montgomery Counties, Pennsylvania and secondarily in other Pennsylvania counties contiguous to our primary market area. New loans are generated primarily from the efforts of employees and advertising, a network of select mortgage brokers, other parties with whom we do business, customer referrals, and from walk-in customers. Loan applications are centrally underwritten and processed at our corporate center. At September 30, 2018, \$580.6 million, or 44.1%, of our loan portfolio, consisted of one- to four-family residential loans. Generally, one- to four-family residential mortgage loans are originated in amounts up to 80% of the lesser of the appraised value or purchase price of the property, although loans may be made with higher loan-to-value ratios private mortgage insurance is required to compensate for the risk. Fixed-rate loans are originated for terms of 10, 15, 20 and 30 years. At September 30, 2018, our largest loan secured by one- to four-family real estate had a principal balance of approximately \$1.8 million and was secured by a single

family house. This loan was performing in accordance with its repayment terms.

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We also offer adjustable-rate mortgage loans which have initial fixed terms of one, three, five or seven-years before converting to an annual adjustment schedule based on changes in a designated United States Treasury index. We originated \$9.3 million of adjustable rate one- to four-family residential loans during the year ended September 30, 2018 and \$5.0 million during the year ended September 30, 2017. Our adjustable rate mortgage loans provide for maximum rate adjustments of 200 basis points per adjustment, with a lifetime maximum adjustment of 500 basis points. Our adjustable rate mortgage loans amortize over terms of up to 30 years.

Adjustable rate mortgage loans decrease the risk associated with changes in market interest rates by periodically repricing, but involve other risks. As interest rates increase, the principal and interest payments on the loan increase, thus increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Adjustment of the contractual interest rate is limited by the periodic and lifetime interest rate adjustments specified by our loan documents and therefore, is potentially limited in effectiveness during periods of rapidly rising interest rates. At September 30, 2018, \$35.7 million, or 6.1%, of our one- to four-family residential loans had adjustable rates of interest.

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

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

Home Equity Loans and Lines of Credit. Home equity loans and lines of credit are generated by our Mortgage Professionals. Eligible properties include primary and vacation homes located in Monroe, Northampton, Lackawanna, Luzerne, Lehigh, Chester, Delaware, and Montgomery Counties, Pennsylvania and secondarily in other Pennsylvania counties contiguous to our primary market area. As of September 30, 2018, home equity loans and lines totaled about \$44.0 million, or 3.3%, of our loan portfolio.

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

Loan underwriting standards limit the maximum size of a junior lien loan to between \$250,000 and \$500,000, depending on the loan type and collateral. All loans exceeding 75% of value require an appraisal by bank-approved, licensed appraisers. Loans up to \$25,000 with lesser loan-to-value ratios may utilize an automated valuation model. Title/lien searches are secured on all home equity loans and lines.

Commercial Real Estate Loans. At September 30, 2018, \$416.6 million, or 31.6%, of our total loan portfolio consisted of commercial real estate loans. Commercial real estate loans are secured by office buildings, multi-family, mixed-use properties and other commercial properties. We generally originate adjustable rate commercial real estate loans with an initial term of five years and a repricing option, and a maximum term of up to 25 years. The maximum loan-to-value ratio for most commercial real estate loans is 75% to 80% and 85% for select loans with faster amortizations. At September 30, 2018, our largest commercial real estate relationship balance was \$23.2 million,

which was performing in accordance with its terms.

We consider a number of factors in originating commercial real estate loans. We evaluate the qualifications and financial condition of the borrower, including credit history, profitability and expertise, as well as the value and condition of the mortgaged property securing the loan. When evaluating the qualifications of the borrower, we consider the financial resources of the borrower, the borrower's experience in owning or managing similar property and the borrower's payment history with us and other financial institutions. In evaluating the property securing the loan, the factors we consider include the net operating income of the mortgaged property before debt service and depreciation, the ratio of the loan amount to the appraised value of the mortgaged property and the debt service coverage ratio (the ratio of net operating income to debt service) to ensure that it is at least 120% of the monthly debt service. All commercial real estate loans in excess of \$500,000 are appraised by outside independent appraisers approved in accordance with the Bank's Appraisal Policy. Personal guarantees are obtained from commercial real estate borrowers although we may occasionally waive this requirement given very strong loan to value and debt service coverage ratios. All purchase money and most asset refinance borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance.

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

**First Mortgage Construction Loans.** At September 30, 2018, \$3.9 million, or 0.3%, of our total loan portfolio consisted of first mortgage construction loans. Our first mortgage construction loans are for the construction of residential properties. We currently offer fixed and adjustable-rate residential first mortgage construction loans. First mortgage construction loans are generally structured for permanent mortgage financing once the construction is completed. At September 30, 2018, our largest first mortgage construction loan balance was \$484,000. The loan was performing in accordance with its terms. First mortgage construction loans will generally be made in amounts of up to 80% of the appraised value of the completed property, or the actual cost of the improvements. First mortgage construction loans require only the payment of interest during the construction period. Once converted to permanent financing, they generally repay over a 30 year period. Funds are disbursed based on our inspections in accordance with a schedule reflecting the completion of portions of the project.

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

For all such loans, we utilize outside independent appraisers approved in accordance with the Bank's Appraisal Policy. All borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance on properties.

**Commercial Loans.** At September 30, 2018, \$49.5 million, or 3.8%, of our loan portfolio, consisted of commercial loans. We generally offer commercial loans to individuals and businesses located in our primary market area. The commercial loan portfolio includes lines of credit, equipment loans, vehicle loans, improvement loans and term loans. These loans are primarily secured by vehicles, machinery and equipment, inventory, accounts receivable, marketable securities, deposit accounts and real estate.

**Obligations of States and Political Subdivisions.** At September 30, 2018, \$73.4 million, or 5.6%, of our total loan portfolio consisted of loan transactions including tax and revenue anticipation notes, general obligation notes, and authority general revenue notes. The financial strength of the state or political subdivision, type of transaction, relationship efforts, and profitability of return are considered when pricing and structuring each transaction.

**Auto Loans.** At September 30, 2018, \$146.2 million, or 11.1% of our total loan portfolio consisted of auto loans. Although collateralized, these loans require stringent underwriting standards and procedures. Each loan decision is based primarily on the credit history of the individual(s) and their ability to repay the loan. Collision and comprehensive insurance is required and the Bank must be listed as the loss payee. As previously disclosed, the Bank discontinued originating indirect auto loans.

Indirect auto loans are inherently risky as they are often secured by assets that depreciate rapidly. In some cases, repossessed collateral for a defaulted automobile loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency may not warrant further substantial collection efforts against the borrower. Automobile loan collections depend on the borrower's continuing financial stability, and therefore, are more likely to be adversely affected by job loss, divorce, illness, or personal bankruptcy.

Other Loans. We offer a variety of loans that are either unsecured or secured by property other than real estate. These loans include loans secured by deposits and personal unsecured loans. At September 30, 2018, these other loans totaled \$2.7 million, or 0.2%, of the total loan portfolio.

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

## Non-Performing Loans and Problem Assets

Performance of the loan portfolio is reviewed on a regular basis by Bank Management. A number of factors regarding the borrower, such as overall financial strength, collateral values and repayment ability, are considered in deciding what actions should be taken when determining the collectability of interest for accrual purposes.

When a loan, including a loan that is impaired, is classified as nonaccrual, the accrual of interest on such a loan is discontinued. A loan is typically classified as nonaccrual when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about the further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid accrued interest is fully reversed. Interest payments received on nonaccrual loans are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal.

Loans are usually restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

**Non-performing Loans.** At September 30, 2018, \$10.5 million, or 0.80% of our total loans, were non-performing loans. The majority of these loans were commercial real estate loans and residential mortgage loans. Non-performing commercial real estate loans totaled \$3.5 million at September 30, 2018. Residential first mortgage loans that were 90 days or more past due totaled \$5.3 million at September 30, 2018.

**Real Estate Owned.** At September 30, 2018, the Company had \$1.1 million of real estate owned consisting of 17 properties. These properties are being carried on the Company's books at fair value less estimated costs to sell. All these properties are being actively marketed and additional losses may occur.



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

	At September 30,					
	2018		2017		2016	
	(Dollars in thousands)					
Non-accrual loans:						
Residential first mortgage loans:						
One- to four-family	\$5,317		\$6,592		\$8,972	
Construction	-		-		-	
Commercial	876		813		874	
Commercial real estate	3,497		5,441		8,144	
Home equity loans and lines of credit	216		643		950	
Auto loans	587		736		344	
Other	18		38		31	
Total	10,511		14,263		19,315	
Accruing loans 90 days or more past due:						
Residential first mortgage loans:						
One- to four-family	-		-		-	
Construction	-		-		-	
Commercial	-		-		-	
Commercial real estate	-		-		-	
Home equity loans and lines of credit	-		-		-	
Auto Loans	-		-		-	
Other	-		-		-	
Total loans 90 days or more past due	-		-		-	
Non-performing troubled debt restructurings	-		-		-	
Total non-performing loans	10,511		14,263		19,315	
Real estate owned	1,141		1,424		2,659	
Other repossessed assets	16		9		9	
Total non-performing assets	\$11,668		\$15,696		\$21,983	
Troubled Debt Restructurings <sup>(1)</sup> :						
Residential first mortgage loans:						
One- to four-family	\$3,260		\$3,642		\$4,981	
Construction	-		-		-	
Commercial	-		-		-	
Commercial real estate	976		1,106		2,625	
Home equity loans and lines of credit	66		120		234	
Auto loans	58		-		-	
Other	-		-		-	
Total	\$4,360		\$4,868		\$7,840	
Ratios:						
Total non-performing loans to total loans	0.80	%	1.14	%	1.57	%
Total non-performing loans to total assets	0.57	%	0.80	%	1.09	%
Total non-performing assets to total assets	0.64	%	0.88	%	1.24	%

1) Non-performing troubled debt restructurings are included in total troubled debt restructurings as part of the non-performing assets table.

For the years ended September 30, 2018, 2017 and 2016, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$171,000, \$449,000 and \$782,000 respectively.

At September 30, 2018, the principal balance of troubled debt restructurings (“TDRs”) was \$4.4 million as compared to \$4.9 million at September 30, 2017. Of the \$4.4 million of TDRs at September 30, 2018, \$106,000 were performing loans and \$4.3 million were non-accrual loans.

TDRs at September 30, 2018 were comprised of 28 residential loans totaling \$3.3 million, 6 commercial real estate loans totaling \$976,000 and 8 consumer loans (home equity loans, home equity lines of credit, auto and other) totaling \$124,000.

For the year ended September 30, 2018, 10 loans totaling \$1.1 million were removed from TDR status, 2 loans totaling \$269,000 were transferred to foreclosed real estate and 8 loans for \$827,000 had completed timely payments.

We have modified terms of performing loans that do not meet the definition of a TDR. The vast majority of such loans were simply rate modifications of residential first mortgage loans in lieu of refinancing. The non-TDR rate modifications were all performing loans when the rates were reset to current market rates. For the year ended September 30, 2018, we modified 14 loans totaling \$1.7 million. 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 we modified 5 commercial loans with an aggregate balance of approximately \$7.3 million for the year ended September 30, 2018.

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

	Loans Delinquent For					
	60-89 Days		90 Days and Over		Total	
	Number	Amount	Number	Amount	Number	Amount
	(Dollars in thousands)					
At September 30, 2018						
Residential first mortgage loans:						
One- to four-family	5	\$ 920	58	\$5,317	63	\$6,237
Construction	-	-	-	-	-	-
Commercial	1	11	9	876	10	887
Commercial real estate	-	-	16	3,497	16	3,497
Obligations of states and political subdivisions	-	-	-	-	-	-
Home equity loans and lines of credit	-	-	11	216	11	216
Auto loans	2	20	74	587	76	607
Other	-	-	4	18	4	18
Total	8	\$ 951	172	\$10,511	180	\$11,462
At September 30, 2017						
Residential first mortgage loans:						
One- to four-family	8	\$ 421	76	\$6,592	84	7,013
Construction	-	-	-	-	-	-
Commercial	-	-	37	5,441	37	5,441
Commercial real estate	-	-	10	813	10	813
Obligations of states and political subdivisions	-	-	-	-	-	-
Home equity loans and lines of credit	1	15	17	643	18	658
Auto loans	2	32	61	736	63	768
Other	1	4	5	38	6	42
Total	12	\$ 472	206	\$14,263	218	\$14,735
At September 30, 2016						
Residential first mortgage loans:						

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One- to four-family	6	\$ 660	92	\$8,972	98	\$9,632
Construction	-	-	-	-	-	-
Commercial	1	57	13	874	14	931
Commercial real estate	3	191	49	8,144	52	8,335
Obligations of states and political subdivisions	-	-	-	-	-	-
Home equity loans and lines of credit	2	147	17	950	19	1,097
Auto loans	12	232	22	344	34	576
Other	-	-	3	31	3	31
Total	24	\$ 1,287	196	\$19,315	220	\$20,602

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

At September 30, 2018, the Company classified approximately \$10.3 million of our assets as Special Mention, of which \$9.0 million were commercial and commercial real estate loans, and \$22.7 million as Substandard, of which \$16.4 million were commercial and commercial real estate loans. No loans were classified Doubtful or Loss. At September 30, 2017, we classified approximately \$4.1 million of our assets as Special Mention, of which \$3.4 million were commercial and commercial real estate loans, and \$27.0 million as Substandard, of which \$17.5 million were commercial and commercial real estate loans. No loans were classified as Doubtful or Loss.

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

#### Allowance for Loan Losses

Our allowance for loan losses is maintained at a level necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. Our allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an unallocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review (at least quarterly) of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Loan impairment is measured based on the fair value of collateral method, taking into account the appraised value, any valuation assumptions used, estimated costs to sell and trends in the market since the appraisal date. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management’s judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary based on changing economic conditions. Payments received on impaired loans generally are either applied against principal or reported as interest income, according to management’s judgment as to the collectability of principal. The allowance for loan losses as of September 30, 2018 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 Board of Governors of the Federal Reserve System (the “Federal Reserve Board”), the Federal Deposit Insurance Corporation (“FDIC”) and the Pennsylvania Department of Banking and Securities, as an integral part of their examination process, periodically review our allowance for loan losses. The banking regulators may require that we recognize additions to the allowance based on their analysis and review of information available to them at the time of their examination.

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

	At or For the Years Ended		
	September 30,		
	2018	2017	2016
	(Dollars in thousands)		
Balance at beginning of year	\$9,365	\$9,056	\$8,919
Charge-offs:			
Residential first mortgage loans:			
One- to four-family	(335 )	(504 )	(1,040)
Construction	-	-	-
Commercial	(151 )	(31 )	(18 )
Commercial real estate	(54 )	(1,352)	(266 )
Obligations of states and political subdivisions	-	-	-
Home equity loans and lines of credit	(68 )	(18 )	(209 )
Auto loans	(1,833 )	(2,009)	(1,262)
Other	(21 )	(9 )	-
Total charge-offs	(2,462 )	(3,923)	(2,795)
Recoveries:			
Residential first mortgage loans:			
One- to four-family	12	22	59
Construction	-	-	-
Commercial	10	1	7
Commercial real estate	49	27	52
Obligations of states and political subdivisions	-	-	-
Home equity loans and lines of credit	54	8	9
Auto loans	655	815	246
Other	5	9	9
Total recoveries	785	882	382
Net charge-offs	(1,677 )	(3,041)	(2,413)
Provision for loan losses	4,000	3,350	2,550
Balance at end of year	\$11,688	\$9,365	\$9,056
Ratios:			
Net charge-offs to average loans outstanding	0.13 %	0.25 %	0.20 %
Allowance for loan losses to non-performing loans at end			
of year	111.20%	65.66 %	46.89 %
Allowance for loan losses to total loans at end of year	0.89 %	0.75 %	0.74 %

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

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

	2018			2017			2016		
	Amount	Percent of Allowance to Total	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total	Percent of Loans in Category to Total Loans
(Dollars in thousands)									
Residential first mortgage loans:									
One- to four-family	\$3,605	30.84	% 44.09	\$3,878	41.41	% 47.08	\$4,426	48.88	% 48.58
Construction	35	0.30	0.30	23	0.25	0.25	13	0.14	0.14
Commercial	1,462	12.51	3.76	987	10.54	25.55	882	9.74	3.25
Commercial real estate	3,458	29.59	31.64	1,758	18.77	3.54	852	9.41	23.49
Obligations of states and political subdivisions	323	2.76	5.57	248	2.65	4.66	215	2.37	4.63
Home equity loans and lines of credit	296	2.53	3.34	470	5.02	3.71	455	5.02	3.92
Auto loans	1,859	15.91	11.10	1,836	19.60	14.98	1,880	20.76	15.72
Other	23	0.20	0.20	21	0.22	0.23	25	0.28	0.27
Total allocated allowance	11,061	94.64	100.00	9,221	98.46	100.00	8,748	96.60	100.00
Unallocated allowance	627	5.36	-	144	1.54	-	308	3.40	-
Total allowance for loan losses	\$11,688	100.00	% 100.00	\$9,365	100.00	% 100.00	\$9,056	100.00	% 100.00



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

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

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

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

## Securities Activities

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

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

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

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

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

The aggregate fair value of our FHLB-Pittsburgh common stock as of September 30, 2018 was \$12.8 million based on its par value. No unrealized gains or losses have been recorded because we have determined that the par value of the common stock represents its fair value. We owned shares of FHLB-Pittsburgh common stock at September 30, 2018 with a par value that was equal to what we were required to own to maintain our membership in the Federal Home Loan Bank System and to be eligible to obtain advances. We are required to purchase additional stock as our outstanding advances increase. Any excess stock we own is redeemed weekly by the FHLB-Pittsburgh.

Evaluation of Securities Portfolio. We review equity and debt securities with significant declines in fair value on a periodic basis to determine whether they should be considered temporarily or other than temporarily impaired. If a decline in the fair value of a security is determined to be other than temporary, we are required to reduce the carrying

value of the security to its fair value and record a non-cash, credit related impairment charge in the amount of the decline, net of tax effect, against our current income.

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

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Our policy is to recognize an other-than-temporary impairment of equity securities where the fair value has been significantly below cost for four consecutive quarters. For fixed maturity investments with unrealized losses due to interest rates where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before its anticipated recovery in market value, declines in value below cost are not assumed to be other than temporary. We review our position quarterly and concluded that at September 30, 2018, declines included in the table below represent temporary declines due to interest rate change, and we do not intend to sell those securities and it is more likely than not that we will not have to sell those securities before their anticipated recovery in market value.

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

	At September 30, 2018		2017		2016	
	Amortized Fair		Amortized Fair		Amortized Fair	
	Cost	Value	Cost	Value	Cost	Value
	(In thousands)					
Investment securities available for sale:						
Mortgage-backed securities	\$269,184	\$258,123	\$235,610	\$233,823	\$216,112	\$219,162
Obligations of state and political subdivisions	42,090	40,949	64,382	65,358	71,323	73,690
U.S. government agency securities	5,678	5,558	18,615	18,671	25,669	25,941
Corporate obligations	48,559	47,415	49,025	48,742	38,331	38,418
Trust-preferred securities	-	-	-	-	489	500
Other debt securities	20,295	19,373	24,200	23,833	32,473	32,674
Total debt securities	385,806	371,418	391,832	390,427	384,397	390,385
Equity securities – financial services	25	20	25	25	25	25
Total investment securities available-for-sale	\$385,831	\$371,438	\$391,857	\$390,452	\$384,422	\$390,410

Portfolio Maturities and Yields. The composition and maturities of the investment securities portfolio at September 30, 2018 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur.

	One Year or Less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total Securities		Weighted Average
	Weighted	Amortized Average	Weighted	Amortized Average	Weighted	Amortized Average	Weighted	Amortized Average	Weighted	Amortized Average	
	Cost	Yield	Cost	Yield	Cost	Yield	Cost	Yield	Cost	Value	Yield
(Dollars in thousands)											
Investment securities available for sale:											
U.S. government agency securities	\$-	% -	\$2,337	% 4.44	\$3,341	% 1.59	\$-	% -	\$5,678	\$5,558	% -
Obligations of state and political subdivisions											
subdivisions	-	-	14,930	2.60	22,353	2.45	4,807	2.51	42,090	40,949	2.51
Mortgage-backed securities	12	4.15	4,277	2.24	40,859	2.42	224,036	2.85	269,184	258,123	2.78
Corporate obligations	500	1.97	14,435	2.16	31,042	4.54	2,582	4.05	48,559	47,415	3.78
Other debt securities	-	-	610	2.35	1,778	4.35	17,907	2.70	20,295	19,373	2.83
Total debt securities	512	2.02	36,589	2.50	99,373	3.09	249,332	2.85	385,806	371,418	2.88
Equity securities	-	-	-	-	-	-	25	-	25	20	-
Total investment securities available											
for-sale	\$512	% -	\$36,589	% 2.50	\$99,373	% 3.09	\$249,357	% 2.85	\$385,831	\$371,438	% 2.88



## Sources of Funds

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

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

At September 30, 2018, our deposits totaled \$1.3 billion. Interest-bearing demand, savings and club, and money market deposits totaled \$653.3 million at September 30, 2018. At September 30, 2018, we had a total of \$525.2 million in certificates of deposit. Noninterest-bearing demand deposits totaled \$158.3 million. Although we have a significant portion of our deposits in shorter-term certificates of deposit, we monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a large portion of these accounts upon maturity.

Our deposits are obtained predominantly from the areas in which our branch offices are located. We rely on our favorable locations, customer service and competitive pricing to attract and retain these deposits. While we accept certificates of deposit in excess of \$100,000 for which we may provide preferential rates, we generally do not solicit such deposits as they are more difficult to retain than core deposits. At September 30, 2018, we had a total of \$168.7 million of brokered certificates of deposits, an increase of \$31.0 million from the prior fiscal year end. Our brokered certificates of deposits range from less than one- to three-year terms, and are purchased only through pre-approved brokers.

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

Deposit type:	For the Years Ended September 30,											
	2018			2017			2016			Average		
	Average	Rate	Average	Rate	Average	Rate	Average	Rate	Average	Rate	Average	Rate
	Balance	Percent	Paid	Balance	Percent	Paid	Balance	Percent	Paid	Balance	Percent	Paid
	(Dollars in thousands)											
Noninterest bearing demand accounts	\$154,662	12.29 %	- %	\$147,554	12.16 %	- %	\$138,070	11.72 %	- %			
Interest bearing demand accounts	184,041	14.63 %	0.25 %	158,294	13.04 %	0.15 %	110,437	9.37 %	0.11 %			
Money market	263,281	20.92 %	0.65 %	251,432	20.72 %	0.51 %	198,717	16.86 %	0.31 %			
	135,893	10.80 %	0.05 %	138,818	11.44 %	0.05 %	135,030	11.46 %	0.05 %			

Savings and club										
Certificates of deposit	520,465	41.36 %	1.55 %	517,569	42.64 %	1.33 %	596,143	50.59 %	1.14 %	
Total deposits	\$1,258,342	100.00%	0.82 %	\$1,213,667	100.00%	0.70 %	\$1,178,397	100.00%	0.73 %	

As of September 30, 2018, the aggregate amount of outstanding certificates of deposit in amounts greater than or equal to \$100,000 was approximately \$186.8 million. The following table sets forth the maturity of those certificates as of September 30, 2018.

	At
	September 30, 2018
	(In thousands)
Three months or less	\$ 37,224
Over three months through six months	27,064
Over six months through one year	62,579
Over one year	59,947
Total	\$ 186,814

At September 30, 2018, \$379.9 million of our certificates of deposit had maturities of one year or less. We monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a significant portion of these accounts upon maturity.



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

	At or For the Years Ended					
	September 30,					
	2018		2017		2016	
	(Dollars in thousands)					
Balance at end of year	\$179,773		\$137,466		\$129,460	
Maximum outstanding at any month end	\$260,797		\$185,201		\$182,636	
Average balance during year	\$210,050		\$147,765		\$120,590	
Weighted average interest rate at end of year	2.31	%	1.36	%	0.64	%
Average interest rate during year	1.86	%	0.98	%	0.55	%

At September 30, 2018, we had the ability to borrow approximately \$648.9 million under our credit facilities with the FHLB-Pittsburgh.

#### Competition

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

We seek to meet this competition by the convenience of our branch locations, emphasizing personalized banking and the advantage of local decision-making in our banking business. Specifically, we promote and maintain relationships and build customer loyalty within local communities by focusing our marketing and community involvement on the specific needs of individual neighborhoods. As of September 30, 2018, the Bank had the largest deposit market share in Monroe County, Pennsylvania. We do not rely on any individual, group, or entity for a material portion of our deposits.

#### Employees

As of September 30, 2018, we had 256 full-time employees, and 21 part-time employees. The employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be good.

#### Subsidiary Activities

The Bank has four wholly owned subsidiaries, ESSACOR, Inc., Pocono Investment Company, ESSA Advisory Services, LLC, and Integrated Financial Corporation and its fully owned subsidiary Integrated Abstract Incorporated. ESSACOR, Inc. is a Pennsylvania corporation that has been used to purchase properties at tax sales that represent collateral for delinquent loans of the Bank and is currently inactive. Pocono Investment Company is a Delaware

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

## SUPERVISION AND REGULATION

### General

The Company is a Pennsylvania corporation. The Company was formerly regulated as a savings and loan holding company, and in November 2014 took the steps necessary to be regulated as a bank holding company. As a bank holding company, we are required to file certain reports with, and otherwise comply with the rules and regulations of the Federal Reserve Board.

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

### Regulation by the Pennsylvania Department of Banking and Securities

The Pennsylvania Banking Code of 1965, as amended (the “Banking Code”) contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, employees, and depositors, as well as corporate powers, savings and investment operations and other aspects of the Bank and its affairs. The Banking Code delegates extensive rulemaking power and administrative discretion to the Department so that the supervision and regulation of state-chartered savings banks may be flexible and readily responsive to changes in economic conditions and in savings and lending practices. The Department may also take enforcement actions against savings banks and may appoint a receiver or conservator for a savings bank under certain circumstances.

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

The Bank was formerly a Pennsylvania savings association. Changes to Pennsylvania law repealed the Savings Association Code. Consequently, in March 2014, the Bank converted its charter to a Pennsylvania savings bank whose state law powers are primarily governed by Chapter 5 of the Pennsylvania Banking Code of 1965, as amended. The charter conversion did not have a material effect on the operations of the Bank.

### Regulation by the Federal Deposit Insurance Corporation

The Bank is also subject to extensive regulation, examination and supervision, among other things, by the FDIC, as its primary federal regulator. Such regulation and supervision:

- limits the investment authority of the Bank;
- establishes a continuing and affirmative obligation, consistent with the Bank's safe and sound operation, to help meet the credit needs of its community, including low and moderate income neighborhoods;
- establishes various capital categories resulting in various levels of regulatory scrutiny applied to the institutions in a particular category; and
- establishes standards for safety and soundness.

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

Federal law and FDIC regulations generally limit the activities as principal and investments of state-chartered FDIC insured banks and their subsidiaries to those permissible for national banks and their subsidiaries, unless such activities and investments are specifically exempted by law or consented to by the FDIC.

Before engaging in a new activity as principal that is not permissible for a national bank or otherwise permissible under federal law or FDIC regulations, an insured savings bank must seek approval from the FDIC to engage in such activity. The FDIC will not approve the activity unless the savings bank meets its minimum capital requirements and the FDIC determines that the activity does not present a significant risk to the FDIC insurance funds. Certain activities of subsidiaries that are engaged in activities permitted for national banks only through a “financial subsidiary” are subject to additional restrictions. Although the Bank meets all conditions necessary to establish and engage in permitted activities through financial subsidiaries, it has not chosen to engage in such activities.

#### Transactions with Affiliates

Transactions between an insured bank, such as the Bank, and any of its affiliates are governed by Sections 23A and 23B of the Federal Reserve Act and implementing regulations. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. Generally, a subsidiary of a bank that is not also a depository institution or financial subsidiary is not treated as an affiliate of the bank under Sections 23A and 23B but instead is considered part of the bank for purposes of the applicable limits and requirements.

#### Section 23A:

• limits the extent to which a bank and its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of such bank’s capital stock and retained earnings, and limits all such transactions with all affiliates to an amount equal to 20% of such capital stock and retained earnings; and  
• requires that all such transactions be on terms that are consistent with safe and sound banking practices.

The term “covered transaction” includes the making of loans, purchase of assets, issuance of guarantees and similar transactions. Most loans by a bank to any of its affiliates must be secured by collateral in amounts ranging from 100% to 130% of the loan amounts, depending on the type of collateral. In addition, any covered transaction by a bank with an affiliate and any purchase of assets or services by a bank from an affiliate must be on terms that are substantially the same, or at least as favorable to the bank, as those that would be provided to a non-affiliate

#### Insurance of Accounts and Regulation by the Federal Deposit Insurance Corporation

Deposit accounts in the Bank are insured by the FDIC’s Deposit Insurance Fund (“DIF”) generally up to a maximum of \$250,000 per separately insured depositor and up to a maximum of \$250,000 for self-directed retirement accounts.

Under the FDIC’s risk-based assessment system, insured institutions were previously assigned a risk category based on supervisory evaluations, regulatory capital levels and certain other factors. An institution’s rate depended upon the category to which it is assigned and certain adjustments specified by FDIC regulations. Institutions deemed less risky pay FDIC assessments. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) required the FDIC to revise its procedures to base its assessments upon each insured institution’s total assets less tangible equity instead of deposits. The FDIC finalized a rule, effective April 1, 2011, that set the assessment range at 2.5 to 45 basis points of total assets less tangible equity. Effective July 1, 2016, the FDIC adopted changes that eliminated the risk categories and base assessments for most banks on financial measures and supervisory ratings

derived from statistical modeling estimating the probability of failure over three years. In conjunction with the DIF reserve ratio achieving 1.5%, the assessment range (inclusive of possible adjustments) was also reduced for most banks to 1.5 basis points to 30 basis points.

The FDIC may adjust its risk-based assessment system in the future, except that no adjustment can be made without notice and comment rulemaking. No institution may pay a dividend if in default of the federal deposit insurance assessment.

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

All FDIC-insured institutions are required to pay a pro rata portion of the interest due on obligations issued by the Financing Corporation (“FICO”) for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the now defunct Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature by year-end 2019. For the quarter ended September 30, 2018, the annualized FICO assessment was 0.32 basis points of an institution’s total assets less tier 1 capital.

### Capital Requirements

Federal regulations require FDIC insured depository institutions to meet several minimum capital standards: a common equity Tier 1 capital to risk-based assets ratio, a Tier 1 capital to risk-based assets ratio, a total capital to risk-based assets, and a Tier 1 capital to total adjusted assets leverage ratio. The existing capital requirements were effective January 1, 2015 and are the result of a final rule implementing regulatory amendments based on recommendations of the Basel Committee on Banking Supervision and certain requirements of the Dodd-Frank Act.

The capital standards require the maintenance of common equity Tier 1 capital, Tier 1 capital and total capital to risk-weighted assets of at least 4.5%, 6% and 8%, respectively, and a leverage ratio of at least 4% Tier 1 capital. Common equity Tier 1 capital is generally defined as common stockholders’ equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and additional Tier 1 capital. Additional Tier 1 capital includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus, meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of Accumulated Other Comprehensive Income (“AOCI”), up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Institutions that have not exercised the AOCI opt-out have AOCI incorporated into common equity Tier 1 capital (including unrealized gains and losses on available-for-sale securities). The Bank elected to opt out of this requirement. Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations.

In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, all assets, including certain off-balance sheet assets (e.g., recourse obligations, direct credit substitutes, residual interests) are multiplied by a risk weight factor assigned by the regulations based on the risks believed inherent in the type of asset. Higher levels of capital are required for asset categories believed to present greater risk. For example, a risk weight of 0% is assigned to cash and U.S. government securities, a risk weight of 50% is generally assigned to prudently underwritten first lien one to four- family residential mortgages, a risk weight of 100% is assigned to commercial and consumer loans, a risk weight of 150% is assigned to certain past due loans and a risk weight of between 0% to 600% is assigned to permissible equity interests, depending on certain specified factors.

In addition to establishing the minimum regulatory capital requirements, the regulations limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted asset above the amount necessary to meet its

minimum risk-based capital requirements. A bank's failure to achieve the "capital conservation buffer" will result in restrictions on paying dividends, engaging in stock repurchases and paying discretionary bonuses. The capital conservation buffer requirement is being phased in. It began on January 1, 2016 at 0.625% of risk-weighted assets and has increased on January 1 of each succeeding year by 0.625%. It will be fully implemented at 2.5% on January 1, 2019.

Legislation enacted in May 2018 requires the federal banking agencies, including the FDIC, to establish for institutions with assets of less than \$10 billion of assets a "community bank leverage ratio" of between 8 to 10% tangible equity/consolidated assets. Institutions with capital meeting the specified requirement will be considered to comply with the applicable regulatory capital requirements, including the risk-based requirements. The establishment of the community bank leverage ratio is subject to notice and comment rulemaking by the federal regulators.

In assessing an institution's capital adequacy, the FDIC takes into consideration, not only these numeric factors, but qualitative factors as well, and has the authority to establish higher capital requirements for individual institutions where deemed necessary.



At September 30, 2018, the Bank's capital exceeded all applicable requirements.

Any state-chartered savings bank that fails any of the capital requirements is subject to possible enforcement actions by the FDIC. Such actions could include a capital directive, a cease and desist order, civil money penalties, the establishment of restrictions on an institution's operations, termination of federal deposit insurance and the appointment of a conservator or receiver. Certain corrective actions are required by law, as described further under "Prompt Corrective Action."

We are also subject to capital regulations of the Department which generally incorporate federal requirements.

#### Dividends from ESSA Bank & Trust

Our ability to pay dividends depends, to a large extent, upon the Bank's ability to pay dividends to the Company. The Banking Code states that no dividend may be paid out of surplus without approval of the Department. Dividends may be paid out of accumulated net earnings. No dividend may generally be paid that would result in the Bank failing to comply with its regulatory capital requirements.

#### Prompt Corrective Action

Under the federal Prompt Corrective Action regulations, a savings bank is deemed to be (i) "well capitalized" if it has total risk-based capital of 10.0% or more, a Tier 1 risk-based capital ratio of 8.0% or more, a Tier I leverage capital ratio of 5.0% or more, a common equity Tier 1 ratio of 6.5% or more and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 6.0% or more, a Tier I leverage capital ratio of 4.0% or more, a common equity Tier 1 capital ratio of 4.5% or more, and does not meet the definition of "well capitalized"; (iii) "undercapitalized" if it has a total risk-based capital ratio that is less than 8.0%, a Tier I risk-based capital ratio that is less than 6.0%, a Tier I leverage capital ratio that is less than 4.0% or a common equity Tier 1 leverage ratio of less than 4.5%, (iv) "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 4.0%, a Tier I leverage capital ratio that is less than 3.0% or a common equity Tier 1 ratio of less than 3%; and (v) "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Federal regulations also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution to comply with supervisory actions as if it were in the next lower category (except that the FDIC may not reclassify a significantly undercapitalized institution as critically undercapitalized).

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

The Prompt Corrective categories discussed above were effective January 1, 2015 and reflect the revised regulatory capital requirements effective the same date.

As of September 30, 2018, the Bank was a “well-capitalized institution” under the Prompt Corrective Action regulations.

#### The USA PATRIOT Act

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

## Holding Company Regulation

The Company is a bank holding company that has elected to be a financial holding company and is subject to examination, regulation and periodic reporting under the Bank Holding Company Act of 1956 (the “Bank Holding Company Act”), as administered by the Federal Reserve Board. The Federal Reserve Board has adopted capital adequacy regulations for bank holding companies on a consolidated basis. The Dodd-Frank Act required the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. Consolidated regulatory capital requirements identical to those applicable to the subsidiary institutions applied to bank holding companies of greater than \$1 billion in assets, including the Company, effective January 1, 2015. However, federal legislation enacted in May 2018 and implemented by the Federal Reserve Board effective August 30, 2018, raised the threshold of the Federal Reserve Board’s “Small Bank Holding Company” exception to the application of consolidated capital requirements from \$1 billion to \$3 billion of consolidated assets. Consequently, bank holding companies of under \$3 billion of consolidated assets are no longer subject to the consolidated requirements unless otherwise directed by the Federal Reserve Board.

Regulations of the Federal Reserve Board provide that a bank holding company must serve as a source of strength to any of its subsidiary banks and must not conduct its activities in an unsafe or unsound manner. The Dodd-Frank Act codified the source of strength policy and required the issuance of implementing regulations. Under the prompt corrective action provisions of the Federal Deposit Insurance Act, a bank holding company parent of an undercapitalized subsidiary bank must guarantee, within limitations, the capital restoration plan that is required of an undercapitalized bank. If an undercapitalized bank fails to file an acceptable capital restoration plan or to implement an accepted plan, the Federal Reserve Board may prohibit the bank holding company parent of the undercapitalized bank from paying any dividend or making any other form of capital distribution. In addition, Federal Reserve Board policy is that a bank holding company should pay cash dividends only to the extent that the company’s net income for the past year is consistent with the company’s capital needs, asset quality and overall financial condition.

A bank holding company is required to give the Federal Reserve Board prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, will equal 10% or more of the company’s consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe and unsound practice, or would violate any law, regulation, Federal Reserve Board order or directive, or any condition imposed by, or written agreement with, the Federal Reserve Board. Such notice and approval is not required for a bank holding company that is “well capitalized” under applicable regulations of the Federal Reserve Board, has received at least an overall “satisfactory” composite rating, as well as “satisfactory” rating for management, at its most recent bank holding company examination by the Federal Reserve Board, and that is not the subject of any unresolved supervisory issues. In addition, Federal Reserve Board guidance provides for agency prior review of bank holding company dividends and stock redemptions and repurchases in certain circumstances, which may affect our ability to pay dividends, or engage in redemptions or repurchases.

As a financial holding company, we are permitted (1) to engage in other activities that the Federal Reserve Board determines to be financial in nature, incidental to an activity that is financial in nature, or complementary to a financial activity and that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally, or (2) to acquire shares of companies engaged in such activities. We may not, however, directly or indirectly acquire the ownership or control of more than 5% of any class of voting shares, or substantially all of the assets, of a bank holding company or a bank without the prior approval of the Federal Reserve Board.

In order to maintain our status as a financial holding company, we must remain “well capitalized” and “well managed” under applicable regulations and maintain a “satisfactory” or better rating under the Community Reinvestment Act. Failure to meet one or more of the requirements would mean, depending on the requirements not met, that we could not undertake new activities, make acquisitions other than those permitted generally for bank holding companies, or continue certain activities.

#### Federal Securities Laws

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

## Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was enacted in response to public concerns regarding corporate accountability in connection with certain accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The Sarbanes-Oxley Act generally applies to all companies that file or are required to file periodic reports with the SEC, under the Securities Exchange Act of 1934.

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

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

## Regulatory Enforcement Authority

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

## FEDERAL AND STATE TAXATION

### Federal Taxation

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

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

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

**Taxable Distributions and Recapture.** Prior to the Small Business Protection Act of 1996, bad debt reserves created prior to 1988 were subject to recapture into taxable income if the Bank failed to meet certain thrift asset and definition tests. The Small Business Protection Act of 1996 eliminated these thrift-related recapture rules. However, under current law, pre-1988 reserves remain subject to tax recapture should the Bank make certain distributions from its tax bad debt reserve or cease to maintain a financial institution charter. At September 30, 2018, the Bank's total federal pre-1988 reserve was approximately \$4.6 million. This reserve reflects the cumulative effects of federal tax deductions by the Bank for which no federal income tax provision has been made.

**Minimum Tax.** The Internal Revenue Code of 1986, as amended, imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences, referred to as "alternative minimum taxable income." The alternative minimum tax is payable to the extent alternative minimum tax income is in excess of the regular income tax. Net operating losses can, in general, offset no more than 90% of alternative minimum taxable income. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years. At September 30, 2018, the Bank had a \$604,000 minimum tax credit carryforward.

**Net Operating Loss Carryovers.** A financial institution may carry back net operating losses to the preceding two taxable years (five years for losses incurred in 2001, 2002 and 2009) and forward to the succeeding 20 taxable years. At September 30, 2018, the Bank had no net operating loss carryforward for federal income tax purposes.

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

**Audit of Tax Returns.** ESSA Bancorp's federal income tax returns have not been audited in the most recent three-year period. The 2014, 2015, 2016 and 2017 tax years remain open.

#### State Taxation

ESSA Bancorp, Inc. is subject to the Pennsylvania Corporate Net Income Tax, Capital Stock and Franchise Tax. The Corporation Net Income Tax rate for fiscal year 2018 is 10.0% and is imposed on unconsolidated taxable income for federal purposes with certain adjustments. In general, the Capital Stock and Franchise Tax is a property tax imposed on a corporation's capital stock value at a statutorily defined rate, such value being determined in accordance with a fixed formula based upon average net income and net worth. The Bank is subject to tax under the Pennsylvania Mutual Thrift Institutions Tax Act, as amended to include thrift institutions having capital stock. Pursuant to the Mutual Thrift Institutions Tax, the tax rate is 11.5%. The Mutual Thrift Institutions Tax exempts the Bank from other taxes imposed by the Commonwealth of Pennsylvania for state income tax purposes and from all local taxation imposed by political subdivisions, except taxes on real estate and real estate transfers. The Mutual Thrift Institutions Tax is a tax upon net earnings, determined in accordance with generally accepted accounting principles with certain adjustments. The Mutual Thrift Institutions Tax, in computing income according to generally accepted accounting principles, allows for the deduction of interest earned on state and federal obligations, while disallowing a percentage of thrift's interest expense deduction in the proportion of interest income on those securities to the overall interest income of the Bank. Net operating losses, if any, thereafter can be carried forward three years for Mutual Thrift Institutions Tax purposes.

#### Item 1A. Risk Factors

In addition to factors discussed in the description of our business and elsewhere in this report, the following are factors that could adversely affect our future results of operations and financial condition.

##### Future Changes in Interest Rates Could Reduce Our Profits.

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

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

In response to improving economic conditions, the Federal Reserve Board's Open Market Committee has slowly increased its federal funds target rate from a range of 0.00%-0.25% that was in effect for several years to the current range of 2.00%-2.25% that was in effect at September 30, 2018. Longer term rates have not increased at the same pace as short term rates. If shorter term interest rates continue to increase or if longer term interest rates continue to decline, there could be negative pressure on our net interest margin.

In addition, changes in interest rates can affect the average life of loans and mortgage-backed and related securities. A reduction in interest rates results in increased prepayments of loans and mortgage-backed and related securities, as

borrowers refinance their loans in order to reduce their borrowing costs. This creates reinvestment risk, which is the risk that we may not be able to reinvest prepayments at rates that are comparable to the rates we earned on the prepaid loans or securities. Alternatively, increases in interest rates may decrease loan demand and/or make it more difficult for borrowers to repay adjustable rate loans.

Changes in interest rates also affect the current market value of our interest-earning securities portfolio. Generally, the value of securities moves inversely with changes in interest rates. At September 30, 2018, the fair value of our debt securities available for sale totaled \$371.4 million. Unrealized net losses on these available for sale securities totaled approximately \$14.4 million at September 30, 2018 and are reported as a separate component of stockholders' equity. Decreases in the fair value of securities available for sale in future periods would have an adverse effect on stockholders' equity.



We evaluate interest rate sensitivity by estimating the change in the Bank's Economic Value of Equity ("EVE") over a range of interest rate scenarios. EVE is the net present value of the Company's asset cash flows minus the net present value of the Company's liability cash flows. At September 30, 2018, in the event of an immediate 200 basis point increase in interest rates, the Company's model projects that we would experience a \$41.0 million, or 14.3%, decrease in net portfolio value. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Management of Market Risk."

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

Our business strategy centers on continuing our emphasis on commercial real estate lending. We have grown our loan portfolio in recent years with respect to this type of loan and intend to continue to emphasize this type of lending. At September 30, 2018, \$416.6 million, or 31.6%, of our total loan portfolio consisted of commercial real estate loans. Loans secured by commercial real estate generally expose a lender to greater risk of non-payment and loss than one- to four-family residential mortgage loans because repayment of the commercial real estate loans often depends on the successful operation of the property and the income stream of the underlying property. Additionally, such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one- to four-family residential mortgage loans. Accordingly, an adverse development with respect to one loan or one credit relationship can expose us to greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. We seek to minimize these risks through our underwriting policies, which require such loans to be qualified on the basis of the property's collateral value, net income and debt service ratio; however, there is no assurance that our underwriting policies will protect us from credit-related losses.

At September 30, 2018, our largest commercial real estate lending relationship was \$23.2 million of loans located in Lehigh County, Pennsylvania and secured by real estate. These loans were performing in accordance with its repayment terms. See "Item 1. Business—Lending Activities—Commercial Real Estate Loans."

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

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

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

The Financial Accounting Standards Board has adopted a new accounting standard that will be effective for our first fiscal year after December 15, 2019. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for credit losses. This will change the current method of providing allowances for credit losses that are probable, which may require us to increase our allowance for loan losses, and may greatly increase the types of data we would need to collect and review to determine the appropriate level of the allowance for

credit losses.

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

The Dodd-Frank Act, Among Other Things, Established the CFPB, Tightened Capital Standards and Will Continue to Result In New Laws and Regulations That Are Expected to Increase Our Costs of Operations.

The Dodd-Frank Act significantly changed the current bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act required various federal agencies to adopt a broad range of new rules and regulations, and to prepare numerous studies and reports for Congress. Much of the impact of the Dodd-Frank Act may not be known for many years. However, it is expected that the legislation and implementing regulations will continue to materially increase our operating and compliance costs.

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The Bank is Subject to More Stringent Capital Requirements, Which May Adversely Impact Our Return on Equity, Require Us to Raise Additional Capital, or Constrain Us from Paying Dividends or Repurchasing Shares.

In July 2013, the federal banking agencies approved a new rule that substantially amended regulatory risk-based capital rules. The final rule implemented the regulatory capital reforms from the Basel Committee on Banking Supervision (“Basel III”) and changes required by the Dodd-Frank Act, and was effective January 1, 2015.

The final rule included new minimum risk-based capital and leverage ratios, which became effective on January 1, 2015, and refined the definition of what constitutes “capital” for calculating these ratios. The revised minimum capital requirements are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from prior rules); and (iv) a Tier 1 leverage ratio of 4%. The final rule also required unrealized gains and losses on certain “available-for-sale” securities holdings to be included for calculating regulatory capital requirements unless a one-time opt-out was exercised. The Bank elected to opt out of the requirement under the final rule to include certain “available-for-sale” securities holdings for calculating its regulatory capital requirements. The final rule also established a “capital conservation buffer” of 2.5%, that, when fully phased in, will result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 to risk-based assets capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. Phase in of the new capital conservation buffer requirement began in January 2016 at 0.625% of risk-weighted assets and increases 0.625% at January 1 of each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that can be utilized for such actions.

The application of these more stringent capital requirements, among other things, may result in lower returns on equity, require the raising of additional capital and result in regulatory actions if the Bank were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy, and could limit our ability to make distributions, including paying dividends or repurchasing shares. Specifically, the Bank’s ability to pay dividends will be limited if it does not have the capital conservation buffer required by the new capital rules, which may further limit our ability to pay dividends to stockholders. See “Item 1. Business—Supervision and Regulation—Capital Requirements.”

Final CFPB Regulations Could Restrict Our Ability to Originate and Sell Mortgage Loans.

The CFPB has issued a rule designed to clarify for lenders how they can avoid monetary damages under the Dodd-Frank Act, which would hold lenders accountable for ensuring a borrower’s ability to repay certain mortgages. Loans that meet this “qualified mortgage” definition will be presumed to have complied with the new ability-to-repay standard. Under the CFPB’s rule, a “qualified mortgage” loan must not contain certain specified features, including:

- excessive upfront points and fees (those exceeding 3% of the total loan amount, less “bona fide discount points” for prime loans);
- interest-only payments;
- negative-amortization; and
- terms longer than 30 years.

Also, to qualify as a “qualified mortgage,” a borrower’s total debt-to-income ratio may not exceed 43%. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and

underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments. The CFPB's rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive/and or time consuming to make these loans, which could limit our growth or profitability.

#### Concentration of Loans in Our Primary Market Area May Increase the Risk of Increased Nonperforming Assets.

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

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

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

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

We are subject to extensive regulation, supervision, and examination by the Federal Reserve Board, the FDIC and the Department. Such regulators govern the activities in which we may engage, primarily for the protection of depositors. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of a bank, the classification of assets by a bank, the imposition of higher capital requirements, and the adequacy of a bank’s allowance for credit losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, could have a material impact on us and our operations. We believe that we are in substantial compliance with applicable federal, state and local laws, rules and regulations. Because our business is highly regulated, the laws, rules and applicable regulations are subject to regular modification and change. There can be no assurance that proposed laws, rules and regulations, or any other laws, rules or regulations, will not be adopted in the future, which could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition or prospects.

#### We May be Adversely Affected by Recent Changes in U.S. Tax Laws.

Changes in tax laws contained in the Tax Cuts and Jobs Act, which was enacted in December 2017, include a number of provisions that will have an impact on the banking industry, borrowers and the market for single-family residential real estate. Changes include (i) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (ii) the elimination of interest deductions for home equity loans, (iii) a limitation on the deductibility of business interest expense and (iv) a limitation on the deductibility of property taxes and state and local income taxes. The recent changes in the tax laws may have an adverse effect on the market for, and valuation of, residential properties, and on the demand for such loans in the future, and could make it harder for borrowers to make their loan payments, if home ownership becomes less attractive, demand for mortgage loans could decrease. The value of the properties securing loans in our loan portfolio may be adversely impacted as a result of the changing economics of home ownership, which could require an increase in our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations. The

mortgage banking originations may be adversely impacted as a result of changing economics of home ownership, which could also reduce profitability of our business, financial condition and results of operation.

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

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

**Risks Associated With System Failures, Interruptions, Or Breaches of Security Could Negatively Affect Our Earnings.**

Information technology systems are critical to our business. We use various technology systems to manage our customer relationships, general ledger, securities investments, deposits, and loans. We have established policies and procedures to prevent or limit the impact of system failures, interruptions, and security breaches (including privacy breaches), but such events may still occur or may not be adequately addressed if they do occur. In addition, any compromise of our systems could deter customers from using our products and services. Although we rely on security systems to provide security and authentication necessary to effect the secure transmission of data, these precautions may not protect our systems from compromises or breaches of security.

In addition, we outsource a majority of our data processing to certain third-party providers. If these third-party providers encounter difficulties, or if we have difficulty communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely affected. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any system failures, interruption, or breach of security could damage our reputation and result in a loss of customers and business thereby subjecting us to additional regulatory scrutiny, or could expose us to litigation and possible financial liability. Any of these events could have a material adverse effect on our financial condition and results of operations.

**Risks Associated with Cyber-Security Could Negatively Affect Our Earnings.**

The financial services industry has experienced an increase in both the number and severity of reported cyber attacks aimed at gaining unauthorized access to bank systems as a way to misappropriate assets and sensitive information, corrupt and destroy data, or cause operational disruptions.

We have established policies and procedures to prevent or limit the impact of security breaches, but such events may still occur or may not be adequately addressed if they do occur. Although we rely on security safeguards to secure our data, these safeguards may not fully protect our systems from compromises or breaches.

We also rely on the integrity and security of a variety of third party processors, payment, clearing and settlement systems, as well as the various participants involved in these systems, many of which have no direct relationship with us. Failure by these participants or their systems to protect our customers' transaction data may put us at risk for possible losses due to fraud or operational disruption.

Our customers are also the target of cyber attacks and identity theft. Large scale identity theft could result in customers' accounts being compromised and fraudulent activities being performed in their name. We have implemented certain safeguards against these types of activities but they may not fully protect us from fraudulent financial losses.

The occurrence of a breach of security involving our customers' information, regardless of its origin, could damage our reputation and result in a loss of customers and business and subject us to additional regulatory scrutiny, and could expose us to litigation and possible financial liability. Any of these events could have a material adverse effect on our financial condition and results of operations.

**Item 1B. Unresolved Staff Comments**

Not applicable.





## Item 2. Properties

The following table provides certain information as of September 30, 2018 with respect to our main office located in Stroudsburg, Pennsylvania, and our 25 full service branch offices.

Location	Year Acquired		Square Footage
	Leased or Owned	or Leased	
Main Office:			
200 Palmer Street			
Stroudsburg, PA 18360	Owned	2003	36,000
Full Service Branches:			
249 Route 940			
Blakeslee, PA 18610	Owned	2002	2,688
1881 Route 209			
Brodheads ville, PA 18322	Owned	1983	4,100
75 Washington Street			
East Stroudsburg, PA 18301	Owned	1966	3,300
5120 Milford Rd.			
East Stroudsburg, PA 18302	Owned	2014	3,610
744 Main Street			
Stroudsburg, PA 18360	Owned	1985	12,000
Tannersville Plaza			
2826 Route 611			
Tannersville, PA 18372	Owned	2007	2,500
975 Route 390			
Cresco, PA 18326	Owned	2010	2,912
418 West Broad Street	Owned	2012	4,500

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Bethlehem, PA 18018

358 South Walnut Street

Bath, PA 18014	Leased	2012	2,000
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2415 Park Avenue

Easton, PA 18045	Owned	2012	3,460
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14 South Main Street

Nazareth, PA 18064	Leased	2012	450
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600 Hamilton Street Suite 100

Allentown, PA 18101	Leased	2018	4,578
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11 North Main Street

Alburtis, PA 18011	Owned	2012	2,091
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1430 Jacobsburg Road

Wind Gap, PA 18091	Leased	2012	1,400
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526 Wood Street

Bethlehem, PA 18018	Leased	2012	200
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6302 Route 309

New Tripoli, PA 18066	Owned	2012	3,460
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1065 Highway 315		
Wilkes Barre, PA 18702	Leased	2014 7,536
300 Mulberry Street		
Scranton, PA 18503	Leased	2014 3,800
8045 West Chester Pike		
Upper Darby, PA 19082	Leased	2015 4,000
354 West Lancaster Avenue		
Haverford, PA 19041	Leased	2015 3,128
48 West Marshall Road		
Lansdowne, PA 19050	Owned	2015 2,555
227 West Lancaster Avenue		
Devon, PA 19333	Leased	2015 1,886
Other Properties		
746-752 Main Street		
Stroudsburg, PA 18360	Owned	2005 4,650
Plymouth Meeting Road, Suite 101		
Plymouth Meeting, PA 19462	Leased	2016 4,389
190 Brodhead Road, Suite 200		
Bethlehem, PA 18017	Leased	2017 6,909

The net book value of our premises, land and equipment was \$14.6 million at September 30, 2018.

### Item 3. Legal Proceedings

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

The Bank was named as the defendant in an action commenced on September 13, 2016 by one plaintiff. The plaintiff alleges that the Bank repossessed motor vehicles, sold the vehicles and sought to collect deficiency balances in a manner that did not comply with the notice requirements of the Pennsylvania Uniform Commercial Code ("UCC"). The

plaintiff seeks to pursue the action as a class action on behalf of the named plaintiff and other similarly situation plaintiffs who had their automobiles repossessed and see to recover damages under the UCC. The Bank denies the plaintiff's allegations. The parties attended a mediation in October 2017 where they reached an agreement to resolve the claims asserted against the Bank on a class wide basis. The terms of the settlement call for the Bank to make a payment of \$1,325,000 to the plaintiff's. The Bank's insurance carrier will cover the payment made by the Bank in excess of a \$125,000 retention. The court has approved the settlement.

The Bank was named as a defendant in an action commenced on December 8, 2016 by one plaintiff who will also seek to pursue this action as a class action on behalf of the entire class of people similarly situated. The plaintiff alleges that a bank previously acquired by ESSA Bancorp in the process of making loans, received unearned fees and kickbacks in violation of the Real Estate Settlement Procedures Act. In an order dated January 29, 2018, the court granted the Bank's motion to dismiss the case. The plaintiff appealed the court's ruling. The plaintiff submitted her brief in support of her appeal in May 2018, and the Bank submitted its opposition brief in July 2018. The appellate court has scheduled oral arguments for December 2018. To the extent that pending or threatened litigation could result in exposure to the Bank, the amount of such exposure is not currently estimable.

Item 4. Mine Safety Disclosures

Not applicable.

## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's shares of common stock are traded on the Nasdaq Global Market under the symbol "ESSA." The approximate number of holders of record of ESSA Bancorp's common stock as of September 30, 2018 was 1,822. Certain shares of ESSA Bancorp are held in "nominee" or "street" name and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number. The following tables present quarterly market information for ESSA Bancorp common stock for the periods ended September 30, 2017 and September 30, 2018. The following information was provided by the Nasdaq Stock Market.

Fiscal 2018	High	Low	Dividends
Quarter ended September 30, 2018	\$ 16.44	\$ 15.59	\$ 0.09
Quarter ended June 30, 2018	16.09	14.37	0.09
Quarter ended March 31, 2018	16.74	14.28	0.09
Quarter ended December 31, 2017	16.22	15.32	0.09

Fiscal 2016	High	Low	Dividends
Quarter ended September 30, 2017	\$ 16.01	\$ 14.50	\$ 0.09
Quarter ended June 30, 2017	15.70	14.48	0.09
Quarter ended March 31, 2017	16.72	14.09	0.09
Quarter ended December 31, 2016	16.68	13.35	0.09

The Board of Directors has the authority to declare cash dividends on shares of common stock, subject to statutory and regulatory requirements. We began to pay quarterly cash dividends in the third quarter of fiscal 2008. In November 2018, it was announced that the Company's dividend would be increased from \$0.09 per share to \$0.10 per share effective in the first quarter of Fiscal 2019. In determining whether and in what amount to pay a cash dividend in the future, the Board will take into account a number of factors, including capital requirements, our consolidated financial condition and results of operations, tax considerations, statutory and regulatory limitations and general economic conditions. No assurances can be given that cash dividends will not be reduced or eliminated in the future.

The sources of funds for the payment of a cash dividend are interest and principal payments with respect to ESSA Bancorp loan to the Employee Stock Ownership Plan, and dividends from the Bank. For a discussion of the limitations applicable to the Bank's ability to pay dividends, see "Item 1. Business—Supervision and Regulation."

Through the year ended September 30, 2017, the Company repurchased a total of 6,911,400 shares of its common stock pursuant to six repurchase programs. The Company did not repurchase any shares of its common stock during the year ended September 30, 2018. On August 1, 2018 the Company announced that its Board of Directors had approved a seventh stock repurchase program for up to 400,000 shares of its common stock. The Company may repurchase the shares from time to time through open market purchases, privately negotiated stock transactions or in any other manner that is compliant with applicable securities law.



## Item 6. Selected Financial Data

The following information is derived from the audited consolidated financial statements of ESSA Bancorp. For additional information, reference is made to “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the Consolidated Financial Statements of ESSA Bancorp and related notes included elsewhere in this Annual Report on Form 10-K.

	At September 30,				
	2018	2017	2016	2015	2014
	(In thousands)				
<b>Selected Financial Condition Data:</b>					
Total assets	\$1,833,790	\$1,785,218	\$1,772,479	\$1,606,544	\$1,574,815
Cash and cash equivalents	43,539	41,683	43,658	18,758	22,301
Investment securities:					
Available for sale	371,438	390,452	390,410	379,407	383,078
Loans, net	1,305,071	1,236,681	1,219,213	1,102,118	1,058,267
Regulatory stock	12,973	13,832	15,463	13,831	14,284
Premises and equipment	14,601	16,234	16,844	16,553	16,957
Bank owned life insurance	38,630	37,626	36,593	30,655	29,720
Deposits	1,336,855	1,274,861	1,214,820	1,096,754	1,133,889
Borrowed funds	298,496	311,614	360,061	320,440	259,320
Equity	179,186	182,727	176,344	171,280	167,309

	For the Years Ended September 30,				
	2018	2017	2016	2015	2014
	(In thousands, except per share data)				
<b>Selected Results of Operations Data:</b>					
Interest income	\$64,503	\$58,318	\$58,366	\$54,179	\$50,776
Interest expense	16,268	12,799	11,431	10,390	10,627
Net interest income	48,235	45,519	46,935	43,789	40,149
Provision for loan losses	4,000	3,350	2,550	2,075	2,350
Net interest income after provision for loan losses	44,235	42,169	44,385	41,714	37,799
Non-interest income	7,813	8,199	8,783	7,896	7,407
Non-interest expense	39,853	41,438	42,858	36,865	33,811
Income before income tax expense	12,195	8,930	10,310	12,745	11,395
Income tax expense	5,664	1,591	2,583	2,954	2,891
Net income	\$6,531	\$7,339	\$7,727	\$9,791	\$8,504
Earnings per share					
Basic	\$0.60	\$0.69	\$0.74	\$0.94	\$0.79
Diluted	\$0.60	\$0.69	\$0.73	\$0.93	\$0.79

	At or For the Years Ended September 30,									
	2018	2017	2016	2015	2014					
<b>Selected Financial Ratios and Other Data:</b>										
<b>Performance Ratios:</b>										
Return on average assets	0.36	%	0.42	%	0.45	%	0.62	%	0.59	%
Return on average equity	3.61	%	4.11	%	4.40	%	5.68	%	5.01	%
Interest rate spread <sup>(1)</sup>	2.71	%	2.69	%	2.81	%	2.89	%	2.89	%
Net interest margin <sup>(2)</sup>	2.85	%	2.77	%	2.89	%	2.96	%	2.97	%
Efficiency ratio <sup>(3)</sup>	71.11	%	77.14	%	76.92	%	71.33	%	71.10	%
Noninterest expense to average total assets	2.20	%	2.35	%	2.47	%	2.33	%	2.32	%
Average interest-earning assets to average interest-										
bearing liabilities	116.30	%	115.99	%	116.18	%	113.81	%	112.36	%
<b>Asset Quality Ratios:</b>										
Non-performing assets as a percent of total assets	0.64	%	0.88	%	1.24	%	1.41	%	1.58	%
Non-performing loans as a percent of total loans	0.80	%	1.14	%	1.57	%	1.81	%	2.08	%
Allowance for loan losses as a percent of non-performing										
loans	111.20	%	65.66	%	46.89	%	44.36	%	38.98	%
Allowance for loan losses as a percent of total loans	0.89	%	0.75	%	0.74	%	0.80	%	0.81	%
<b>Capital Ratios:</b>										
Total risk-based capital (to risk weighted assets) <sup>(4)</sup>	13.59	%	13.96	%	13.71	%	16.35	%	16.98	%
Common equity Tier 1 capital (to risk weighted										
assets) <sup>(4)</sup>	12.70	%	13.18	%	12.93	%	15.47	%	N/A	
Tier 1 risk-based capital (to risk weighted assets) <sup>(4)</sup>	12.70	%	13.18	%	12.93	%	15.47	%	16.08	%
Tangible capital (to tangible assets)	9.28	%	9.19	%	8.76	%	10.03	%	10.04	%
Tier 1 leverage (core) capital (to adjusted tangible										
assets) <sup>(4)</sup>	9.28	%	9.19	%	8.76	%	10.03	%	10.04	%
Average equity to average total assets	9.96	%	10.13	%	10.13	%	10.90	%	11.67	%
<b>Other Data:</b>										
Number of full service offices	22		25		26		25		27	

(1) The interest rate spread represents the difference between the weighted-average yield on a fully tax equivalent basis on interest-earning assets and the weighted-average cost of interest-bearing liabilities for the year.

(2) The net interest margin represents net interest income on a fully tax equivalent basis as a percent of average interest-earning assets for the year.

(3) The efficiency ratio represents non-interest expense divided by the sum of net interest income and non-interest income.

(4) Ratios are for the Bank and do not include capital retained at the holding company level.



## Business Strategy

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

- ◆ Increasing customer relationships through the offering of excellent service and the distribution of that service through effective delivery systems;
- ◆ Continuing to transform into a full service community bank by meeting the financial services needs of our customers;
- ◆ Continuing to develop into a high performing financial institution, in part by increasing interest revenue and fee income;
- ◆ Remaining within our risk management parameters; and
- ◆ Employing affordable technology to increase profitability and improve customer service.

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

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

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

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

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

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

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

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

#### Critical Accounting Policies

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

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



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

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

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

**Goodwill and Intangible Assets.** Goodwill is not amortized, but it is tested at least annually for impairment in the fourth quarter, or more frequently if indicators of impairment are present. If the estimated current fair value of a reporting unit exceeds its carrying value, no additional testing is required and an impairment loss is not recorded. The Company uses market capitalization and multiples of tangible book value methods to determine the estimated current fair value of its reporting unit. Based on this analysis, no impairment was recorded in 2018 or 2017.

The other intangibles assets are assigned useful lives, which are amortized on an accelerated basis over their weighted-average lives. The Company periodically reviews the intangible assets for impairment as events or changes in circumstances indicate that the carrying amount of such asset may not be recoverable. Based on these reviews, no impairment was recorded in 2018 or 2017.

**Derivative Instruments and Hedging Activities.** The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives may also be designated as hedges of the foreign currency exposure of a net investment in a foreign operation. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company

elects not to apply hedge accounting.

Employee Benefit Plans. The Bank maintains a noncontributory, defined benefit pension plan for all employees who have met age and length of service requirements. The Bank also maintains a defined contribution Section 401(k) plan covering eligible employees. The Company created an employee stock ownership plan (“ESOP”) for the benefit of employees who meet certain eligibility requirements. The Company makes cash contributions to the ESOP on an annual basis.

The Company maintains an equity incentive plan to provide for issuance or granting of shares of common stock for stock options or restricted stock. The Company has recorded stock-based employee compensation cost using the fair value method as allowed under generally accepted accounting principles. Management estimated the fair values of all option grants using the Black-Scholes option-pricing model. Management estimated the expected life of the options using the simplified method as allowed under generally accepted accounting principles. The risk-free rate was determined utilizing the treasury yield for the expected life of the option contract.

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Fair Value Measurements. We group our assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level I – Valuation is based upon quoted prices for identical instruments traded in active markets.

Level II – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level III – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset.

We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is our policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy in generally accepted accounting principles.

Fair value measurements for most of our assets are obtained from independent pricing services that we have engaged for this purpose. When available, we, or our independent pricing service, use quoted market prices to measure fair value. If market prices are not available, fair value measurement is based upon models that incorporate available trade, bid, and other market information. Subsequently, all of our financial instruments use either of the foregoing methodologies to determine fair value adjustments recorded to our financial statements. In certain cases, however, when market observable inputs for model-based valuation techniques may not be readily available, we are required to make judgments about assumptions market participants would use in estimating the fair value of financial instruments. The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted market prices or observable market parameters. For financial instruments that trade actively and have quoted market prices or observable market parameters, there is minimal subjectivity involved in measuring fair value. When observable market prices and parameters are not fully available, management judgment is necessary to estimate fair value. In addition, changes in the market conditions may reduce the availability of quoted prices or observable data. When market data is not available, we use valuation techniques requiring more management judgment to estimate the appropriate fair value measurement. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, that could significantly affect the results of current or future valuations.

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

Deferred Income Taxes. We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. We consider the determination of this valuation allowance to be a critical accounting policy because of the need to exercise significant judgment in

evaluating the amount and timing of recognition of deferred tax liabilities and assets, including projections of future taxable income. These judgments and estimates are reviewed on a continual basis as regulatory and business factors change. A valuation allowance for deferred tax assets may be required if the amount of taxes recoverable through loss carryback declines, or if we project lower levels of future taxable income. Such a valuation allowance would be established through a charge to income tax expense which would adversely affect our operating results.

Comparison of Financial Condition at September 30, 2018 and September 30, 2017

Total Assets. Total assets increased \$48.6 million, or 2.72%, to \$1.8 billion at September 30, 2018, compared to September 30, 2017.

**Cash and Due from Banks.** Cash and due from banks increased \$3.2 million, or 8.9%, to \$39.2 million at September 30, 2018 from \$36.0 million at September 30, 2017. The primary reason for the increase were increases in the Federal Reserve Bank's required reserves of \$8.1 million.

**Interest-Bearing Deposits with Other Institutions.** Interest-bearing deposits with other institutions decreased \$1.3 million, or 23.5%, to \$4.3 million at September 30, 2018 from \$5.7 million at September 30, 2017. The primary reason for the decrease was a decrease in the Company's interest bearing demand deposit account at the FHLB-Pittsburgh of \$776,000.

**Investment Securities Available for Sale.** Investment securities available for sale decreased \$19.0 million, or 4.9%, to \$371.4 million at September 30, 2018 from \$390.5 million at September 30, 2017. The decrease was due primarily to decreases in obligations of states and political subdivisions of \$24.4 million, US government agency securities of \$13.1 million and other debt securities of \$4.5 million, which were offset in part by increases in mortgage backed securities of \$24.3 million.

**Net Loans.** Net loans increased \$68.4 million, or 5.5%, to \$1.3 billion at September 30, 2018 from September 30, 2017. The primary reasons for the increase was an increase in commercial real estate loans and obligations of states and political subdivisions offset in part by decreases in one-to-four family loans, home equity loans and lines of credit and auto loans. Commercial real estate loans increased by \$98.3 million to \$416.6 million at September 30, 2018 from \$318.3 million at September 30, 2017. Obligations of states and political subdivisions increased by \$15.3 million to \$73.4 million at September 30, 2018 from \$58.1 million at September 30, 2017. One-to-four family loans decreased by \$6.1 million to \$580.6 million at September 30, 2018 from \$586.7 million at September 30, 2017. Home equity loans decreased by \$2.2 million to \$44.0 million at September 30, 2018 from \$46.2 million at September 30, 2017. Auto loans decreased \$40.4 million to \$146.2 million at September 30, 2018 from \$186.6 million at September 30, 2017. The Company discontinued indirect auto lending in July 2018.

**Deposits.** Deposits increased by \$62.0 million, or 4.9%, to \$1.3 billion at September 30, 2018, primarily as a result of increases in interest bearing demand accounts, money market accounts and certificates of deposit. Overall, the changes in deposits at September 30, 2018 compared to September 30, 2017 included a decrease in non-interest bearing demand accounts of \$1.8 million, or 1.1%, an increase in interest bearing demand accounts of \$13.0 million, or 6.2%, an increase in money market accounts of \$42.1 million, or 16.6%, a decrease in savings and club accounts of \$5.7 million, or 4.0%, and an increase in certificates of deposit of \$14.4 million, or 2.8%. Included in the certificates of deposit was an increase of \$31.0 million, or 22.5%, in brokered certificates of deposit. At September 30, 2018, the Company had \$168.7 million of brokered certificates of deposit outstanding.

**Borrowed Funds.** Borrowed funds, short term and other, decreased \$13.1 million, or 4.2%, to \$298.5 million at September 30, 2018 from \$311.6 million at September 30, 2017. All borrowed funds are from the FHLB, whose rates were more competitively priced than other wholesale funding sources.

**Stockholders' Equity.** Stockholders' equity decreased by \$3.5 million, or 1.9%, to \$179.2 million at September 30, 2018 from \$182.7 million at September 30, 2017. The decrease was primarily due to a decrease other comprehensive income of \$8.8 million and cash dividends paid of \$3.9 million partially offset by net income of \$6.5 million.

#### Comparison of Operating Results for the Years Ended September 30, 2018 and September 30, 2017

**Net Income.** Net income decreased by \$808,000, or 11.0%, to \$6.5 million for the fiscal year ended September 30, 2018 from \$7.3 million for the fiscal year ended September 30, 2017. The decrease was primarily due to an increase in income taxes and a decrease in non interest income partially offset by an increase in net interest income and a decrease in non interest expense. The Company recorded a one time charge to income tax expense of \$3.7 million related to the



reduction in the carrying value of the Company's deferred tax assets, which resulted from the reduction in the Federal corporate income tax rate under the Tax Cuts and Jobs Act of 2017.

Net Interest Income. Net interest income increased by \$2.7 million, or 6.0%, to \$48.2 million for fiscal year 2018 from \$45.5 million for fiscal year 2017, primarily due to the increases in interest income from loans.

**Interest Income.** Interest income increased \$6.2 million, or 10.6%, to \$64.5 million for fiscal year 2018 from \$58.3 million for fiscal year 2017. The increase resulted from an increase of 24 basis points in the overall yield on interest earning assets to 3.83% from 3.59%, which had the effect of increasing interest income by \$3.7 million. This increase was supplemented by a \$51.5 million increase in average interest earning assets, which had the effect of increasing interest income by \$2.5 million. The increase in average interest earning assets during 2018 compared to 2017 included increases in average loans of \$65.4 million, average mortgage backed securities of \$10.9 million and average regulatory stock of \$206,000. These increases were partially offset by a decrease in average investment securities of \$22.5 million and average other assets of \$2.6 million. The average yield on loans increased to 4.13% for the fiscal year 2018, from 3.92% for the fiscal year 2017. The average yields on investment securities increased to 3.33% from 3.20% and the average yields on mortgage backed securities increased to 2.34% for 2018 from 2.14% for the 2017 period.

**Interest Expense.** Interest expense increased \$3.5 million, or 27.1%, to \$16.3 million for fiscal year 2018 from \$12.8 million for fiscal year 2017, while average interest bearing liabilities increased by \$40.5 million year over year. The increase in interest expense resulted from a 22 basis point increase in the overall cost of interest bearing liabilities to 1.12% for fiscal 2018 from 0.90% for fiscal 2017 which had the effect of increasing interest expense by \$3.3 million along with an increase in average interest bearing liabilities which had the effect of increasing interest expense by \$180,000. Average savings and club accounts decreased by \$2.9 million, average interest bearing demand deposit accounts increased \$25.7 million, average money market accounts increased \$11.8 million and average certificates of deposit increased \$2.9 million. For fiscal 2018, average borrowed funds increased \$2.9 million compared to fiscal 2017. The cost of money market accounts increased to 0.65% for fiscal year 2018 from 0.51% for fiscal year 2017. The cost of interest bearing demand deposit accounts increased to 0.25% for fiscal year 2018 from 0.15% for fiscal year 2017. The cost of savings and club accounts remained unchanged at 0.05% for fiscal 2018. The cost of certificates of deposit increased to 1.55% from 1.33% and the cost of borrowed funds increased to 1.69% from 1.24% for fiscal years 2018 and 2017, respectively.

**Provision for Loan Losses.** The Company establishes provisions for loan losses, which are charged to earnings, at a level necessary to absorb known and inherent losses that are both probable and reasonably estimable at the date of the financial statements. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events occur. After an evaluation of these factors, the Company made a provision of \$4.0 million for fiscal year 2018 compared to a \$3.4 million provision for the 2017 fiscal year. The allowance for loan losses was \$11.7 million, or 0.89% of loans outstanding, at September 30, 2018, compared to \$9.4 million, or 0.75% of loans outstanding, at September 30, 2017.

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

mortgage loan.

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

**Non-Interest Income.** Non-interest income decreased \$386,000, or 4.7%, to \$7.8 million for the year ended September 30, 2018, from \$8.2 million for the comparable 2017 period. The decrease was primarily due to decreases in service fees on deposit accounts of \$67,000, service charges and fees on loans of \$18,000, gain on sale of investments, net of \$133,000, earnings on bank owned life insurance of \$29,000 and other expenses of \$424,000. These decreases were offset, in part, by increases in trust and investment fees of \$268,000 and insurance commissions of \$17,000. Other income for the year ended September 30, 2017 included a one time recovery of approximately \$400,000 from the redemption by the seller of purchased loans that had been previously written down by the company. The Company sold \$37.9 million in securities in Fiscal 2018 as compared to \$17.4 million in Fiscal 2017.

**Non-Interest Expense.** Non-interest expense decreased \$1.6 million, or 3.8%, to \$39.9 million for fiscal year 2018 from \$41.4 million for the comparable period in 2017. As a result of the Company's efforts to reduce costs and increase efficiencies, all categories of noninterest expenses declined for the year ended September 30, 2018 compared to the comparable 2017 period except for increases in gain on foreclosed real estate of \$346,000 and other expenses of \$214,000.

**Income Taxes.** Income tax expense of \$5.7 million was recognized for fiscal year 2018 compared to an income tax expense of \$1.6 million recognized for fiscal year 2017. The increase in income tax expense was primarily due to a one time charge to income tax expense of \$3.7 million related to the reduction in the carrying value of the Company's deferred tax assets, which resulted from the reduction in the Federal corporate income tax rate under the Tax Cuts and Jobs Act of 2017. The effective tax rate for the year ended September 30, 2018 was 46.4% compared to 17.8% for the 2017 period.

**Average Balance Sheets for the Years Ended September 30, 2018 and 2017**

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 Years Ended September 30,					
	2018			2017		
	Average	Interest	Yield/	Average	Interest	Yield/
	Balance	Expense	Cost	Balance	Expense	Cost
	(Dollars in thousands)					
<b>Interest-earning assets:</b>						
Loans <sup>(1) (2)</sup>	\$1,293,002	\$53,399	4.13 %	\$1,227,590	\$48,162	3.92 %
<b>Investment securities</b>						
Taxable <sup>(3)</sup>	75,401	2,658	3.53 %	87,055	2,616	3.00 %
<b>Exempt from federal income</b>						
tax <sup>(3) (4)</sup>	40,229	903	2.97 %	51,029	1,194	3.55 %
Total investment securities	115,630	3,561	3.33 %	138,084	3,810	3.20 %
Mortgage-backed securities	263,934	6,168	2.34 %	253,000	5,426	2.14 %
Regulatory stock	15,347	1,004	6.54 %	15,141	729	4.81 %
Other	5,532	371	6.71 %	8,100	191	2.36 %
Total interest-earning assets	1,693,445	64,503	3.83 %	1,641,915	58,318	3.59 %
Allowance for loan losses	(10,422 )			(9,322 )		
Noninterest-earning assets	131,655			130,816		
Total assets	\$1,814,678			\$1,763,409		
<b>Interest-bearing liabilities:</b>						
Interest bearing demand accounts	184,041	469	0.25 %	158,294	243	0.15 %
Money market accounts	263,281	1,713	0.65 %	251,432	1,282	0.51 %
Savings and club accounts	135,893	71	0.05 %	138,818	74	0.05 %
Certificates of deposit	520,465	8,055	1.55 %	517,569	6,872	1.33 %

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Borrowed funds	352,423	5,960	1.69 %	349,513	4,328	1.24 %
Total interest-bearing liabilities	1,456,103	16,268	1.12 %	1,415,626	12,799	0.90 %
Non-interest bearing demand accounts	154,662			147,554		
Noninterest-bearing liabilities	23,154			21,600		
Total liabilities	1,633,919			1,584,780		
Equity	180,759			178,629		
Total liabilities and equity	\$1,814,678			\$1,763,409		
Net interest income		\$48,235			\$45,519	
Interest rate spread			2.71 %			2.69 %
Net interest-earning assets	\$237,342			\$226,289		
Net interest margin <sup>(5)</sup>			2.85 %			2.77 %
Average interest-earning assets to						
average interest-bearing liabilities			116.30 %			115.99 %

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

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- (2) Interest income on loans includes net amortized costs on loans totaling \$2.5 million in 2018 and \$2.6 million in 2017.
- (3) Held to maturity securities are reported as amortized cost. Available for sale securities are reported at fair value.
- (4) Yields on tax exempt securities have been calculated on a fully tax equivalent basis assuming a tax rate of 34%.
- (5) Represents the difference between interest earned and interest paid, divided by average total interest earning assets.
- Rate/Volume Analysis

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

	For the			For the		
	Years Ended September			Years Ended September		
	30,			30,		
	2018 vs. 2017			2017 vs. 2016		
	Increase			Increase		
	(Decrease)			(Decrease)		
	Due to		Net	Due to		Net
	Volume	Rate		Volume	Rate	
	(In thousands)					
<b>Interest-earning assets:</b>						
Loans	\$2,611	\$2,626	\$5,237	\$453	\$(1,375)	\$(922 )
Investment securities	(297 )	47	(250 )	179	375	554
Mortgage-backed securities	235	508	743	(101)	307	206
Regulatory stock	10	265	275	(15 )	(9 )	(24 )
Other	(37 )	217	180	84	54	138
<b>Total interest-earning assets</b>	<b>2,522</b>	<b>3,663</b>	<b>6,185</b>	<b>600</b>	<b>(648 )</b>	<b>(48 )</b>
<b>Interest-bearing liabilities:</b>						
NOW accounts	44	182	226	67	56	123
Money market accounts	63	368	431	192	468	660
Savings and club accounts	(3 )	-	(3 )	5	-	5
Certificates of deposit	39	1,144	1,183	(333)	421	88
Borrowed funds	37	1,595	1,632	(78 )	570	492
<b>Total interest-bearing liabilities</b>	<b>180</b>	<b>3,289</b>	<b>3,469</b>	<b>(147)</b>	<b>1,515</b>	<b>1,368</b>
<b>Net change in interest income</b>	<b>\$2,342</b>	<b>\$374</b>	<b>\$2,716</b>	<b>\$747</b>	<b>\$(2,163)</b>	<b>\$(1,416)</b>

#### Management of Market Risk

General. The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of loans, having longer maturities than our liabilities,

consisting primarily of deposits and borrowings. As a result, a principal part of our business strategy is to manage interest rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly, our Board of Directors has approved guidelines for managing the interest rate risk inherent in our assets and liabilities, given our business strategy, operating environment, capital, liquidity and performance objectives. Senior management monitors the level of interest rate risk on a regular basis and the asset/liability committee meets quarterly to review our asset/liability policies and interest rate risk position. We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates.

Net interest income, which is the primary source of the Company's earnings, is impacted by changes in interest rates and the relationship of different interest rates. To manage the impact of the rate changes, the balance sheet should be structured so that repricing opportunities exist for both assets and liabilities at approximately the same time intervals. The Company uses net interest simulation to assist in interest rate risk management. The process includes simulating various interest rate environments and their impact on net interest income. As of September 30, 2018, the level of net interest income at risk in a 200 basis points increase or a 200 basis point decrease was within the Company's policy limit of a decline less than 10% of net interest income.

The following table sets forth the results of the twelve month projected net interest income model as of September 30, 2018.

Change in Interest Rates in Basis Points (Rate Shock)	Net Interest Income		
	Amount	Change	Change
	\$	\$	(%)
	(Dollars in thousands)		
-200	46,802	248	0.5
-100	47,730	1,176	2.5
Static	46,554	-	-
+100	44,055	(2,501 )	(5.4 )
+200	41,724	(4,830 )	(10.4 )
+300	39,096	(7,458 )	(16.0 )
+400	36,415	(10,139)	(21.8 )

The above table indicates that as of September 30, 2018, in the event of a 400 basis point instantaneous increase in interest rates, the Company would experience an 21.8%, or \$10.1 million, decrease in net interest income. In the event of a 200 basis point decrease in interest rates, the Company would experience a 0.5%, or \$248,000, increase in net interest income.

Another measure of interest rate sensitivity is to model changes in the economic value of equity through the use of immediate and sustained interest rate shocks. The following table illustrates the economic value of equity model results as of September 30, 2018.

Change in Interest Rates in Basis Points	Economic Value of Equity		
	Amount	Change	Change
	\$	\$	(%)
	(Dollars in thousands)		
-200	288,377	815	0.3
-100	297,953	10,391	3.6
Flat	287,562	-	-
+100	268,487	(19,075)	(6.6 )
+200	246,523	(41,039)	(14.3 )
+300	226,289	(61,273)	(21.3 )
+400	206,387	(81,175)	(28.2 )

The preceding table indicates that as of September 30, 2018, in the event of an immediate and sustained 400 basis point increase in interest rates, the Company would experience a 28.2%, or \$81.2 million, decrease in the present value of equity. If rates were to decrease 200 basis points, the Company would experience a 0.3%, or \$815,000, increase in the present value of equity.



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

#### Liquidity and Capital Resources

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

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

A portion of our liquidity consists of cash and cash equivalents and borrowings, which are a product of our operating, investing and financing activities. At September 30, 2018, \$43.5 million of our assets were invested in cash and cash equivalents. Our primary sources of cash are principal repayments on loans, proceeds from the maturities of investment securities, principal repayments of mortgage-backed securities and increases in deposit accounts. Short-term investment securities (maturing in one year or less) totaled \$512,000 at September 30, 2018. As of September 30, 2018, we had \$298.5 million in borrowings outstanding from the FHLB-Pittsburgh. We have access to FHLB advances of up to approximately \$648.9 million.

At September 30, 2018, we had \$214.0 million in loan commitments outstanding, which included \$61.1 million in undisbursed construction loans, \$35.6 million in unused home equity lines of credit and \$107.6 million in commercial lines of credit. Certificates of deposit due within one year of September 30, 2018 totaled \$379.9 million, or 72.3% of certificates of deposit. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before September 30, 2019. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

As reported in the Consolidated Statements of Cash Flows, our cash flows are classified for financial reporting purposes as operating, investing or financing cash flows. Net cash provided by operating activities was \$23.4 million and \$19.5 million for the years ended September 30, 2018 and 2017, 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 for investing activities was \$(69.7) million and \$(30.2) million in fiscal years 2018 and 2017, respectively, principally reflecting our loan and investment security activities in the respective periods. Investment security cash flows had the most significant effect, as net cash utilized in purchases amounted to \$86.9 million and \$87.2 million in the years ended September 30, 2018 and 2017, respectively. Cash proceeds from principal repayments, maturities and sales of investment securities amounted to \$91.3 million and \$78.2 million in the years ended September 30, 2018 and 2017, respectively. Deposit and borrowing cash flows have traditionally comprised most of our financing activities which resulted in net cash provided of \$48.2 million in fiscal year 2018, and \$8.8 million in fiscal year 2017.

We also have obligations under our post retirement plan as described in Note 12 to the Consolidated Financial Statements. The post retirement benefit payments represent actuarially determined future payments to eligible plan participants. We froze our pension plan in fiscal year 2017.

Off-Balance Sheet Arrangements. In the normal course of operations, we engage in a variety of financial transactions that, in accordance with generally accepted accounting principles are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit. For information about our loan commitments, letters of credit and unused lines of credit, see Note 10 of the notes to the Consolidated Financial Statements. The Company also uses derivative financial instruments to manage interest rate risk. For information about the Company's derivatives and hedging activities, see Note 18 of the notes to the

Consolidated Financial Statements.

For fiscal year 2018, we did not engage in any off-balance-sheet transactions other than loan origination commitments and standby letters of credit in the normal course of our lending activities. The Company used derivative financial instruments as part of its interest rate hedging activities in 2018.

Impact of Inflation and Changing Prices

The financial statements and related notes of ESSA Bancorp have been prepared in accordance with United States generally accepted accounting principles (“GAAP”). GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without consideration for changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than the effects of inflation.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

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

Item 8. Financial Statements and Supplementary Data

The Financial Statements are included in Part IV, Item 15 of this Annual Report on Form 10-K.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure  
Not Applicable.

Item 9A. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including our Principle Executive Officer and Principle Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the fiscal year (the “Evaluation Date”). Based upon that evaluation, the Principle Executive Officer and Principle Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective.

(b) Changes in internal controls.

There were no changes in our internal control over financial reporting that occurred during the fourth quarter of fiscal 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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

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

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

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

ESSA Bancorp, Inc.’s management assessed the effectiveness of the Company’s internal control over financial reporting as of September 30, 2018. In making this assessment, we used the criteria set forth in 2013, by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework. Based on our assessment we believe that, as of September 30, 2018, the Company’s internal control over financial reporting is effective based on those criteria.

ESSA Bancorp, Inc.'s independent registered public accounting firm that audited the consolidated financial statements has issued an audit report on the effectiveness of the Company's internal control over financial reporting as of September 30, 2018. See the Consolidated Financial Statements of ESSA Bancorp and related notes included elsewhere in this Annual Report on Form 10-K.

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

Item 9B. Other Information  
Not Applicable.

## PART III

## Item 10. Directors, Executive Officers and Corporate Governance

Information regarding directors, executive officers and corporate governance of the Company is presented under the headings “Section 16(a) Beneficial Ownership Reporting Compliance,” “Proposal 1 — Election of Directors,” “— Directors and Executive Officers,” “— Corporate Governance and Code of Ethics and Business Conduct” and “— Board Meetings and Committees” in the Company’s definitive Proxy Statement for the 2019 Annual Meeting of Stockholders to be held on February 28, 2019 (the “Proxy Statement”) and is incorporated herein by reference.

## Item 11. Executive Compensation

Information regarding executive compensation is presented under the headings “Proposal I — Election of Directors — “— Summary Compensation Table,” “— Other Benefit Plans and Agreements,” and “— Director Compensation” Proxy Statement and is incorporated herein by reference.

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

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

## Securities Authorized for Issuance Under Equity Compensation Plans

Set forth below is information, as of September 30, 2018 regarding equity compensation plans categorized by those plans that have been approved by stockholders and those plans that have not been approved by stockholders.

Plan	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available For Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by stockholders	—	\$	— 176,787
Equity compensation plans not approved by stockholders	—	—	—
Total	—	\$	— 176,787

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

Information regarding certain relationships and related transactions, and director independence is presented under the heading “Proposal I — Election of Directors — Director Independence” and “— Transactions with Certain Related Persons” in

the Proxy Statement and is incorporated herein by reference.

**Item 14. Principal Accounting Fees and Services**

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

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) Financial Statements

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

(A) Report on Management's Assessment of Internal Control over Financial Reporting

(B) Report of Independent Registered Public Accounting Firm

(C) Consolidated Balance Sheet - at September 30, 2018 and 2017

(D) Consolidated Statement of Income - Years ended September 30, 2018 and 2017

(E) Consolidated Statement of Comprehensive Income (Loss) – Years ended September 30, 2018 and 2017

(F) Consolidated Statement of Changes in Stockholders' Equity - Years ended September 30, 2018 and 2017

(G) Consolidated Statement of Cash Flows - Years ended September 30, 2018 and 2017

(H) Notes to the Consolidated Financial Statements

(a)(2) Financial Statement Schedules

None.



(a)(3) Exhibits

- 3.1 Articles of Incorporation of ESSA Bancorp, Inc.<sup>(1)</sup>
- 3.2 Bylaws of ESSA Bancorp, Inc.<sup>(1)</sup>
- 4 Form of Common Stock Certificate of ESSA Bancorp, Inc.<sup>(1)</sup>
- 10.1 Amended and Restated Employment Agreement for Gary S. Olson<sup>(2)</sup>
- 10.2 Amended and Restated Employment Agreement for Allan A. Muto<sup>(2)</sup>
- 10.3 Amended and Restated Employment Agreement for Chuck D. Hangen<sup>(3)</sup>
- 10.4 Amended and Restated Employment Agreement for Diane K. Reimer<sup>(2)</sup>
- 10.5 Amended and Restated Employment Agreement for Thomas J. Grayuski
- 10.6 Supplemental Executive Retirement Plan<sup>(4)</sup>
- 10.7 Endorsement Split Dollar Life Insurance Agreement for Gary S. Olson<sup>(4)</sup>
- 10.8 Endorsement Split Dollar Life Insurance Agreement for Allan A. Muto<sup>(4)</sup>
- 10.9 Endorsement Split Dollar Life Insurance Agreement for Diane K. Reimer<sup>(4)</sup>
- 10.10 Endorsement Split Dollar Life Insurance Agreement for Thomas J. Grayuski
- 10.11 ESSA Bancorp, Inc. 2016 Equity Incentive Plan<sup>(5)</sup>
- 21 Subsidiaries of Registrant
- 23 Consent of S.R. Snodgrass, P.C.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Definition Linkbase Document

101.LAB XBRL Taxonomy Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

1 Incorporated by reference to 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.

2 Incorporated by reference to ESSA Bancorp, Inc.'s Current Report on Form 8-K filed with the Securities and Exchange Commission on May 1, 2013.

3 Incorporated by reference to ESSA Bancorp, Inc.'s Current Report on Form 8-K filed with the Securities and Exchange Commission on October 14, 2016.

4 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.

5 Incorporated by reference to Appendix A to the Proxy Statement for the Annual Meeting of Stockholders of ESSA Bancorp, Inc. (file no. 001-33384), filed by ESSA Bancorp, Inc. under the Exchange Act on January 26, 2016.

Item 16. Form 10-K Summary

None.

ESSA BANCORP, INC. AND SUBSIDIARY

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2018

	Page Number
<u>Report on Management's Assessment of Internal Control Over Financial Reporting</u>	F-1
<u>Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting</u>	F-2
<u>Report of Independent Registered Public Accounting Firm on Financial Statements</u>	F-4
Financial Statements	
<u>Consolidated Balance Sheet</u>	F-6
<u>Consolidated Statement of Income</u>	F-7
<u>Consolidated Statement of Comprehensive (Loss) Income</u>	F-8
<u>Consolidated Statement of Changes in Stockholders' Equity</u>	F-9
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<u>Notes to the Consolidated Financial Statements</u>	F-12 – F-56

REPORT ON MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL  
OVER FINANCIAL REPORTING

ESSA Bancorp, Inc. (the "Company") is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with United States generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments.

We, as management of the Company, are responsible for establishing and maintaining effective internal control over financial reporting that is designed to produce reliable financial statements in conformity with United States generally accepted accounting principles. The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by management and tested for reliability. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

Management assessed the Company's system of internal control over financial reporting as of September 30, 2018, in relation to criteria for effective internal control over financial reporting as described in "Internal Control — Integrated Framework," issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. Based on this assessment, management concludes that, as of September 30, 2018, its system of internal control over financial reporting is effective and meets the criteria of the "Internal Control — Integrated Framework". S.R. Snodgrass P.C., independent registered public accounting firm, has issued an attestation report on management's assessment of the Company's internal control over financial reporting.

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

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

December 14, 2018

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of ESSA Bancorp, Inc.

Opinion on Internal Control over Financial Reporting

We have audited ESSA Bancorp, Inc. and subsidiary (the “Company”)’s internal control over financial reporting as of September 30, 2018, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2018, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Company as of September 30, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in stockholders’ equity, and cash flows for the years then ended, of the Company and our report dated December 14, 2018, expressed an unqualified opinion.

Basis for Opinion

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting in the accompanying Report on Management’s Assessment of Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ S.R. Snodgrass, P.C.

Cranberry Township, Pennsylvania

December 14, 2018

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of ESSA Bancorp, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of ESSA Bancorp, Inc. and subsidiary (the “Company”) as of September 30, 2018 and 2017; the related consolidated statements of income, comprehensive income, changes in stockholders’ equity, and cash flows for the years then ended; and the related notes to the consolidated financial statements (collectively, the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of September 30, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company’s internal control over financial reporting as of September 30, 2018, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated December 14, 2018, expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks.

Basis for Opinion (Continued)

Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 2005.

/s/ S.R. Snodgrass, P.C.

Cranberry Township, Pennsylvania

December 14, 2018

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## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEET

	September 30,	
	2018	2017
	(dollars in thousands)	
<b>ASSETS</b>		
Cash and due from banks	\$39,197	\$36,008
Interest-bearing deposits with other institutions	4,342	5,675
Total cash and cash equivalents	43,539	41,683
Certificates of deposit	500	500
Investment securities available for sale, at fair value	371,438	390,452
Loans receivable (net of allowance for loan losses of \$11,688 and \$9,365)	1,305,071	1,236,681
Regulatory stock, at cost	12,973	13,832
Premises and equipment, net	14,601	16,234
Bank-owned life insurance	38,630	37,626
Foreclosed real estate	1,141	1,424
Intangible assets, net	1,375	1,844
Goodwill	13,801	13,801
Deferred income taxes	8,441	10,422
Other assets	22,280	20,719
<b>TOTAL ASSETS</b>	<b>\$1,833,790</b>	<b>\$1,785,218</b>
<b>LIABILITIES</b>		
Deposits	\$1,336,855	\$1,274,861
Short-term borrowings	179,773	137,446
Other borrowings	118,723	174,168
Advances by borrowers for taxes and insurance	6,826	5,163
Other liabilities	12,427	10,853
<b>TOTAL LIABILITIES</b>	<b>1,654,604</b>	<b>1,602,491</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, 18,133,095 issued; 11,782,718 and 11,596,263 outstanding at September 30, 2018 and 2017, respectively)	-	-
Additional paid-in capital	180,765	180,764
Unallocated common stock held by the Employee Stock Ownership Plan ("ESOP")	(8,255 )	(8,720 )
Retained earnings	94,112	91,147
Treasury stock, at cost; 6,350,377 and 6,536,832 shares at September 30, 2018 and 2017, respectively	(77,707 )	(79,891 )
Accumulated other comprehensive loss	(9,910 )	(754 )
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>179,186</b>	<b>182,727</b>

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,833,790	\$1,785,218
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See accompanying notes to the consolidated financial statements.

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## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF INCOME

	Years Ended September 30, 2018      2017 (dollars in thousands except per share data)	
<b>INTEREST INCOME</b>		
Loans receivable, including fees	\$53,399	\$48,162
Investment securities:		
Taxable	8,826	8,042
Exempt from federal income tax	903	1,194
Other investment income	1,375	920
<b>Total interest income</b>	<b>64,503</b>	<b>58,318</b>
<b>INTEREST EXPENSE</b>		
Deposits	10,308	8,471
Short-term borrowings	3,516	1,449
Other borrowings	2,444	2,879
Total interest expense	16,268	12,799
<b>NET INTEREST INCOME</b>	<b>48,235</b>	<b>45,519</b>
Provision for loan losses	4,000	3,350
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>44,235</b>	<b>42,169</b>
<b>NONINTEREST INCOME</b>		
Service fees on deposit accounts	3,373	3,440
Services charges and fees on loans	1,319	1,337
Trust and investment fees	1,020	752
Gain on sale of investments, net	162	295
Earnings on bank-owned life insurance	1,004	1,033
Insurance commissions	764	747
Other	171	595
Total noninterest income	7,813	8,199
<b>NONINTEREST EXPENSE</b>		
Compensation and employee benefits	23,307	24,420
Occupancy and equipment	4,461	4,472
Professional fees	2,368	2,886
Data processing	3,561	3,657
Advertising	903	1,137
Federal Deposit Insurance Corporation ("FDIC") premiums	871	870
Gain on foreclosed real estate	(24 )	(370 )
Amortization of intangible assets	469	643
Other	3,937	3,723
Total noninterest expense	39,853	41,438
Income before income taxes	12,195	8,930
Income taxes	5,664	1,591

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NET INCOME	\$6,531	\$7,339
Earnings per share:		
Basic	\$0.60	\$0.69
Diluted	\$0.60	\$0.69
Dividends per share	\$0.36	\$0.36

See accompanying notes to the consolidated financial statements.

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## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF COMPREHENSIVE (LOSS) INCOME

	Years Ended September 30,	
	2018	2017
	(dollars in thousands)	
Net income	\$6,531	\$7,339
Other comprehensive (loss) income:		
Investment securities available for sale:		
Unrealized holding loss	(12,826)	(7,098)
Tax effect	2,943	2,414
Reclassification of gains recognized in net income	(162 )	(295 )
Tax effect	39	100
Net of tax amount	(10,006)	(4,879)
Pension plan adjustment:		
Change in unrealized gains	348	8,039
Tax effect	(73 )	(2,733)
Reclassification adjustment related to actuarial gains	-	226
Tax effect	-	(77 )
Net of tax amount	275	5,455
Derivative and hedging activities adjustments:		
Changes in unrealized holding gains on derivative included in net		
income	1,696	921
Tax effect	(427 )	(416 )
Reclassification adjustment for gains on derivatives included in net		
income	(459 )	(5 )
Tax effect	111	2
Net of tax amount	921	502
Total other comprehensive (loss) income	(8,810 )	1,078
Comprehensive (loss) income	\$(2,279 )	\$8,417

See accompanying notes to the consolidated financial statements.

ESSA BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock Number of Shares	Additional Paid-In Capital Amount (dollars in thousands except per share data)	Unallocated		Accumulated		Total Stockholders' Equity
			Common Stock Held by the ESO	Retained Earnings Stock	Other Comprehensive Loss		
Balance, September 30, 2016	11,393,558	\$181,900	\$ (9,174 )	\$87,638	\$(82,369)	\$ (1,832 )	\$ 176,344
Net income				7,339			7,339
Other comprehensive income							