

ESSA Bancorp, Inc.  
Form 10-Q  
August 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended June 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                    | 20-8023072             |
| (State or other jurisdiction of | (I.R.S. Employer       |
| incorporation or organization)  | Identification Number) |

|  |            |
|--|------------|
| 200 Palmer Street, Stroudsburg, Pennsylvania | 18360      |
| (Address of Principal Executive Offices)     | (Zip Code) |

(570) 421-0531

(Registrant's telephone number)

N/A

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if smaller reporting company)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 August 03, 2018 there were 11,790,596 shares of the Registrant’s common stock, par value \$0.01 per share, outstanding.

ESSA Bancorp, Inc.

FORM 10-Q

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## Part I. Financial Information

## Item 1. Financial Statements

## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEET

(UNAUDITED)

|   | June 30,<br>2018       | September 30,<br>2017 |
|---|------------------------|-----------------------|
|   | (dollars in thousands) |                       |
| Cash and due from banks   | \$32,750               | \$ 36,008             |
| Interest-bearing deposits with other institutions   | 5,157                  | 5,675                 |
| Total cash and cash equivalents   | 37,907                 | 41,683                |
| Certificates of deposit   | 500                    | 500                   |
| Investment securities available for sale, at fair value   | 371,109                | 390,452               |
| Loans receivable (net of allowance for loan losses of \$11,130 and \$9,365)   | 1,301,589              | 1,236,681             |
| Regulatory stock, at cost   | 16,597                 | 13,832                |
| Premises and equipment, net   | 15,080                 | 16,234                |
| Bank-owned life insurance   | 38,380                 | 37,626                |
| Foreclosed real estate  | 1,368                  | 1,424                 |
| Intangible assets, net  | 1,463                  | 1,844                 |
| Goodwill  | 13,801                 | 13,801                |
| Deferred income taxes   | 8,605                  | 10,422                |
| Other assets  | 20,875                 | 20,719                |
| <b>TOTAL ASSETS</b>   | <b>\$1,827,274</b>     | <b>\$ 1,785,218</b>   |
| <b>LIABILITIES</b>  |                        |                       |
| Deposits  | \$1,269,866            | \$ 1,274,861          |
| Short-term borrowings   | 220,006                | 137,446               |
| Other borrowings  | 131,119                | 174,168               |
| Advances by borrowers for taxes and insurance   | 14,802                 | 5,163                 |
| Other liabilities   | 12,671                 | 10,853                |
| <b>TOTAL LIABILITIES</b>  | <b>1,648,464</b>       | <b>1,602,491</b>      |
| <b>STOCKHOLDERS' EQUITY</b>   |                        |                       |
| Preferred Stock (\$0.01 par value; 10,000,000 shares authorized, none issued)   | —                      | —                     |
| Common stock (\$0.01 par value; 40,000,000 shares authorized, 18,133,095 issued;<br>11,790,596 and 11,596,263 outstanding at June 30, 2018 and September 30,<br>2017, respectively) | 181                    | 181                   |
| Additional paid in capital  | 180,537                | 180,764               |
| Unallocated common stock held by the Employee Stock Ownership Plan (ESOP)   | (8,372 )               | (8,720 )              |
| Retained earnings   | 92,011                 | 91,147                |
| Treasury stock, at cost; 6,342,499 and 6,536,832 shares outstanding at June 30, 2018<br>and September 30, 2017, respectively  | (77,512 )              | (79,891 )             |

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|   |                    |                     |
|---|--------------------|---------------------|
| Accumulated other comprehensive loss              | (8,035 )           | (754 )              |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>                 | <b>178,810</b>     | <b>182,727</b>      |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b> | <b>\$1,827,274</b> | <b>\$ 1,785,218</b> |

See accompanying notes to the unaudited consolidated financial statements.

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## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF OPERATIONS

(UNAUDITED)

|  | For the Three<br>Months Ended<br>June 30,<br>2018      |               | For the Nine<br>Months Ended<br>June 30,<br>2017       |               |
|--|--|---------------|--|---------------|
|  | (dollars in<br>thousands, except<br>per<br>share data) |               | (dollars in<br>thousands, except<br>per<br>share data) |               |
| <b>INTEREST INCOME</b>   |  |               |  |               |
| Loans receivable, including fees                               | \$13,968   | \$11,819      | \$39,704   | \$35,869      |
| Investment securities:   |  |               |  |               |
| Taxable  | 2,226  | 2,073         | 6,470  | 5,990         |
| Exempt from federal income tax                                 | 183  | 295           | 756  | 907           |
| Other investment income  | 341  | 221           | 1,011  | 671           |
| Total interest income  | 16,718   | 14,408        | 47,941   | 43,437        |
| <b>INTEREST EXPENSE</b>  |  |               |  |               |
| Deposits   | 2,561  | 2,186         | 7,297  | 6,267         |
| Short-term borrowings  | 992  | 376           | 2,527  | 923           |
| Other borrowings   | 603  | 686           | 1,852  | 2,151         |
| Total interest expense   | 4,156  | 3,248         | 11,676   | 9,341         |
| <b>NET INTEREST INCOME</b>                                     | <b>12,562</b>  | <b>11,160</b> | <b>36,265</b>  | <b>34,096</b> |
| Provision for loan losses                                      | 975  | 750           | 3,075  | 2,250         |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN<br/>LOSSES</b> | <b>11,587</b>  | <b>10,410</b> | <b>33,190</b>  | <b>31,846</b> |
| <b>NONINTEREST INCOME</b>                                      |  |               |  |               |
| Service fees on deposit accounts                               | 832  | 876           | 2,536  | 2,553         |
| Services charges and fees on loans                             | 342  | 285           | 1,010  | 912           |
| Trust and investment fees                                      | 255  | 183           | 732  | 547           |
| Gain on sale of investments, net                               | -  | 295           | 75   | 295           |
| Earnings on Bank-owned life insurance                          | 250  | 256           | 754  | 775           |
| Insurance commissions  | 200  | 181           | 575  | 577           |
| Other  | 18   | 44            | 129  | 102           |
| Total noninterest income                                       | 1,897  | 2,120         | 5,811  | 5,761         |
| <b>NONINTEREST EXPENSE</b>                                     |  |               |  |               |
| Compensation and employee benefits                             | 5,820  | 6,096         | 17,728   | 18,329        |
| Occupancy and equipment  | 1,049  | 1,106         | 3,420  | 3,387         |
| Professional fees  | 564  | 570           | 1,756  | 2,150         |
| Data processing  | 880  | 908           | 2,697  | 2,773         |
| Advertising  | 331  | 254           | 690  | 800           |

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|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Federal Deposit Insurance Corporation (FDIC) premiums | 234     | 245     | 679     | 645     |
| Loss(Gain) on foreclosed real estate                  | 4       | (19 )   | -       | (120 )  |
| Amortization of intangible assets                     | 102     | 158     | 381     | 485     |
| Other   | 1,179   | 1,002   | 3,082   | 2,777   |
| Total noninterest expense                             | 10,163  | 10,320  | 30,433  | 31,226  |
| Income before income taxes                            | 3,321   | 2,210   | 8,568   | 6,381   |
| Income taxes  | 500     | 448     | 5,122   | 1,051   |
| NET INCOME  | \$2,821 | \$1,762 | \$3,446 | \$5,330 |
| Earnings per share                                    |         |         |         |         |
| Basic   | \$0.26  | \$0.16  | \$0.32  | \$0.50  |
| Diluted   | \$0.26  | \$0.16  | \$0.32  | \$0.50  |
| Dividends per share                                   | \$0.09  | \$0.09  | \$0.27  | \$0.27  |

See accompanying notes to the unaudited consolidated financial statements.

## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

|   | For the Three<br>Months Ended<br>June 30,<br>2018 |         | For the Nine<br>Months Ended<br>June 30,<br>2017 |         |
|---|---|---------|--|---------|
|   | 2018  | 2017    | 2018   | 2017    |
|   | (dollars in thousands)                            |         |  |         |
| Net income  | \$2,821   | \$1,762 | \$3,446  | \$5,330 |
| Other comprehensive (loss) income   |   |         |  |         |
| Investment securities available for sale:   |   |         |  |         |
| Unrealized holding (loss) gain  | (1,741)   | 1,423   | (10,144)   | (7,625) |
| Tax effect  | 365   | (483 )  | 2,380  | 2,593   |
| Reclassification of gains recognized in net income                                | —   | (295 )  | (75 )  | (295 )  |
| Tax effect  | —   | 100     | 18   | 100     |
| Net of tax amount   | (1,376)   | 745     | (7,821 )   | (5,227) |
| Pension plan adjustment:  |   |         |  |         |
| Related to freezing pension   | —   | —       | —  | 7,143   |
| Tax effect  | —   | —       | —  | (2,429) |
| Reclassification of gains recognized in net income                                | —   | 23      | —  | 182     |
| Tax effect  | —   | (11 )   | —  | (67 )   |
| Net of tax amount   | —   | 12      | —  | 4,829   |
| Derivative and hedging activities adjustments:                                    |   |         |  |         |
| Changes in unrealized holding gains(losses) on derivatives included in net income | 249   | (231 )  | 1,445  | 867     |
| Tax effect  | (61 )   | 82      | (369 )   | (397 )  |
| Reclassification adjustment for gains on derivatives included in net income       | (153 )  | (3 )    | (252 )   | 3       |
| Tax effect  | 41  | 1       | 62   | (1 )    |
| Net of tax amount   | 76  | (151 )  | 886  | 472     |
| Total other comprehensive (loss) income   | (1,300)   | 606     | (6,935 )   | 74      |
| Comprehensive income (loss)   | \$1,521   | \$2,368 | \$(3,489 )                                       | \$5,404 |

See accompanying notes to the unaudited consolidated financial statements.



## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(UNAUDITED)

|   | Common Stock<br>Number of<br>Shares | Additional<br>Paid In<br>Capital<br>Amount | Unallocated<br>Common<br>Stock Held by<br>the ESOP | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders'<br>Equity |            |
|---|-------------------------------------|--|--|----------------------|-------------------|---|----------------------------------|------------|
| (dollars in thousands except share data)  |                                     |  |  |                      |                   |   |                                  |            |
| Balance,<br>September 30, 2017  | 11,596,263                          | \$ 181                                     | \$ 180,764   | \$ (8,720 )          | \$ 91,147         | \$ (79,891)                                   | \$ (754 )                        | \$ 182,727 |
| Net income  |                                     |  |  | 3,446                |                   |   |                                  | 3,446      |
| Other comprehensive<br>loss   |                                     |  |  |                      |                   | (6,935 )                                      | (6,935 )                         |            |
| Reclassification of<br>certain income<br><br>tax effects from<br>accumulated<br><br>other comprehensive<br>loss |                                     |  |  | 346                  |                   | (346 )  | —                                |            |
| Cash dividends<br>declared (\$0.27<br>per share)  |                                     |  |  | (2,928 )             |                   |   |                                  | (2,928 )   |
| Stock based<br>compensation   |                                     | 287  |  |                      |                   |   |                                  | 287        |
| Allocation of ESOP<br>stock   |                                     | 192  | 348  |                      |                   |   |                                  | 540        |
| Allocation of treasury<br>shares to<br><br>incentive plan   | 22,994                              | (281 )                                     |  |                      | 281               |   |                                  | —          |
| Stock options<br>exercised  | 171,339                             | (425 )                                     |  |                      | 2,098             |   |                                  | 1,673      |
| Balance, June 30,<br>2018   | 11,790,596                          | \$ 181                                     | \$ 180,537   | \$ (8,372 )          | \$ 92,011         | \$ (77,512)                                   | \$ (8,035 )                      | \$ 178,810 |



See accompanying notes to the unaudited consolidated financial statements.

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## ESSA BANCORP, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

|   | For the Nine<br>Months Ended<br>June 30,<br>2018      2017<br>(dollars in<br>thousands) |          |
|---|---|----------|
| <b>OPERATING ACTIVITIES</b>   |   |          |
| Net income  | \$3,446   | \$5,330  |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |          |
| Provision for loan losses   | 3,075   | 2,250    |
| Provision for depreciation and amortization                                       | 890   | 997      |
| Amortization and accretion of discounts and premiums, net                         | 3,250   | 3,387    |
| Net gain on sale of investment securities   | (75 )   | (295 )   |
| Compensation expense on ESOP  | 540   | 516      |
| Stock based compensation  | 287   | 245      |
| Increase in accrued interest receivable   | (116 )  | (70 )    |
| Increase in accrued interest payable  | 259   | 143      |
| Earnings on bank-owned life insurance   | (754 )  | (775 )   |
| Deferred federal income taxes   | 3,565   | (454 )   |
| (Decrease) increase in accrued pension liability                                  | (375 )  | 259      |
| Gain on foreclosed real estate, net   | —   | (120 )   |
| Amortization of identifiable assets   | 381   | 485      |
| Other, net  | 3,833   | 2,682    |
| Net cash provided by operating activities   | 18,206  | 14,580   |
| <b>INVESTING ACTIVITIES</b>   |   |          |
| Certificates of deposit maturities  | —   | 250      |
| Investment securities available for sale:   |   |          |
| Proceeds from sale of investment securities                                       | 22,074  | 17,378   |
| Proceeds from principal repayments and maturities                                 | 43,065  | 44,356   |
| Purchases   | (57,331)  | (67,932) |
| Increase in loans receivable, net   | (70,951)  | (11,555) |
| Redemption of regulatory stock  | 15,410  | 16,409   |
| Purchase of regulatory stock  | (18,175)  | (16,066) |
| Proceeds from sale of foreclosed real estate                                      | 1,165   | 2,221    |
| Purchase of premises, equipment and software                                      | (139 )  | (453 )   |
| Net cash used for investing activities  | (64,882)  | (15,392) |
| <b>FINANCING ACTIVITIES</b>   |   |          |
| (Decrease) increase in deposits, net  | (4,995 )  | 1,642    |
| Net increase in short-term borrowings   | 82,560  | 16,205   |
| Proceeds from other borrowings  | 38,630  | 43,057   |
| Repayment of other borrowings   | (81,679)  | (75,490) |

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|   |                 |                 |
|---|-----------------|-----------------|
| Increase in advances by borrowers for taxes and insurance | 9,639           | 7,257           |
| Exercising of stock options                               | 1,673           | 910             |
| Dividends on common stock                                 | (2,928 )        | (2,868 )        |
| Net cash provided by (used for) financing activities      | 42,900          | (9,287 )        |
| Decrease in cash and cash equivalents                     | (3,776 )        | (10,099)        |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>     | <b>41,683</b>   | <b>43,658</b>   |
| <b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>           | <b>\$37,907</b> | <b>\$33,559</b> |
| <b>SUPPLEMENTAL CASH FLOW DISCLOSURES</b>                 |                 |                 |
| Cash Paid:  |                 |                 |
| Interest  | \$11,417        | \$9,198         |
| Income taxes  | (2 )            | (389 )          |
| Noncash items:  |                 |                 |
| Transfers from loans to foreclosed real estate            | 1,109           | 2,301           |
| Unrealized holding loss                                   | (10,219)        | (7,920 )        |
| Pension Plan curtailment                                  | —               | 7,143           |

See accompanying notes to the unaudited consolidated financial statements.

## ESSA BANCORP, INC. AND SUBSIDIARY

## Notes to Consolidated Financial Statements

(unaudited)

## 1. Nature of Operations and Basis of Presentation

The consolidated financial statements include the accounts of ESSA Bancorp, Inc. (the “Company”), its wholly owned subsidiary, ESSA Bank & Trust (the “Bank”), and the Bank’s wholly owned subsidiaries, ESSACOR Inc.; Pocono Investments Company; ESSA Advisory Services, LLC; Integrated Financial Corporation; and Integrated Abstract Incorporated, a wholly owned subsidiary of Integrated Financial Corporation. The primary purpose of the Company is to act as a holding company for the Bank. On November 6, 2014, the Company converted its status from a savings and loan holding company to a bank holding company. In addition, the Bank converted from a Pennsylvania-chartered savings association to a Pennsylvania-chartered savings bank. The Bank’s primary business consists of the taking of deposits and granting of loans to customers generally in Monroe, Northampton, Lehigh, Delaware, Chester, Montgomery, Lackawanna, and Luzerne Counties, Pennsylvania. The Bank is subject to regulation and supervision by the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation (the “FDIC”). The investment in the Bank on the parent company’s financial statements is carried at the parent company’s equity in the underlying net assets.

ESSACOR, Inc. is a Pennsylvania corporation that 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, including certain intellectual property. ESSA Advisory Services, LLC is a Pennsylvania limited liability company owned 100 percent by ESSA Bank & Trust. ESSA Advisory Services, LLC is a full-service insurance benefits consulting company offering group services such as health insurance, life insurance, short-term and long-term disability, dental, vision, and 401(k) retirement planning as well as individual health products. Integrated Financial Corporation is a Pennsylvania corporation that provided investment advisory services to the general public and is currently inactive. Integrated Abstract Incorporated is a Pennsylvania corporation that provided title insurance services and is currently inactive. All significant intercompany accounts and transactions have been eliminated in consolidation.

The unaudited consolidated financial statements reflect all adjustments, which in the opinion of management, are necessary for a fair presentation of the results of the interim periods and are of a normal and recurring nature. Operating results for the three and nine month periods ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending September 30, 2018.

## 2. Earnings per Share

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation for the three and nine month periods ended June 30, 2018 and 2017.

|  | Three Months Ended |                  | Nine Months Ended |                  |
|--|--------------------|------------------|-------------------|------------------|
|  | June 30,<br>2018   | June 30,<br>2017 | June 30,<br>2018  | June 30,<br>2017 |
| Weighted-average common shares outstanding | 18,133,095         | 18,133,095       | 18,133,095        | 18,133,095       |
| Average treasury stock shares              | (6,360,627 )       | (6,547,695 )     | (6,447,516 )      | (6,629,264 )     |
| Average unearned ESOP shares               | (831,689 )         | (876,964 )       | (843,049 )        | (888,324 )       |
| Average unearned non-vested shares         | (29,310 )          | (29,580 )        | (43,302 )         | (43,801 )        |

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Weighted average common shares and common stock          |            |            |            |            |
| equivalents used to calculate basic earnings per share   | 10,911,469 | 10,678,856 | 10,799,228 | 10,571,706 |
| Additional common stock equivalents (non-vested stock)   |            |            |            |            |
| used to calculate diluted earnings per share             | —          | 332        | —          | —          |
| Additional common stock equivalents (stock options) used |            |            |            |            |
| to calculate diluted earnings per share                  | 11,391     | 63,820     | 9,395      | 68,519     |
| Weighted average common shares and common stock          |            |            |            |            |
| equivalents used to calculate diluted earnings per share | 10,922,860 | 10,743,008 | 10,808,623 | 10,640,225 |

At June 30, 2018 there were 45,642 shares of nonvested stock outstanding at an average weighted price of \$15.37 per share that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive. At June 30, 2017 there were 50,310 shares of nonvested stock outstanding at an average weighted price of \$14.38 per share that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive.

### 3. Use of Estimates in the Preparation of Financial Statements

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

### 4. Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (a new revenue recognition standard). The Update’s core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this Update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Since the guidance scopes out revenue associated with financial instruments, including loan receivables and investment securities, we do not expect the adoption of the new standard, or any of the amendments, to result in a material change from our current accounting for revenue because the majority of the Company’s revenue is not within the scope of Topic 606. However, we do expect that the standard will result in new disclosure requirements, which are currently being evaluated.

In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606). The amendments in this Update defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. All other entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. The Company is evaluating the effect of adopting this new accounting Update.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This Update applies to all entities that hold financial assets or owe financial liabilities and is intended to provide more useful information on the recognition, measurement, presentation, and disclosure of financial instruments. Among other things, this Update (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (g) clarifies that an entity should evaluate the need for a valuation allowance on a deferred



tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. All entities that are not public business entities may adopt the amendments in this Update earlier as of the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. A short-term lease is defined as one in which (a) the lease term is 12 months or less and (b) there is not an option to purchase the underlying asset that the lessee is reasonably certain to exercise. For short-term leases, lessees may elect to recognize lease payments over the lease term on a straight-line basis. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach

with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently assessing the practical expedients it may elect at adoption, but does not anticipate the amendments will have a significant impact on the financial statements. Based on the Company's preliminary analysis of its current portfolio, the impact to the Company's balance sheet is estimated to result in less than a one percent increase in assets and liabilities. The Company also anticipates additional disclosures to be provided at adoption.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606). The amendments in this Update affect entities with transactions included within the scope of Topic 606, which includes entities that enter into contracts with customers to transfer goods or services in exchange for consideration. The amendments in this Update do not change the core principle for revenue recognition in Topic 606. Instead, the amendments provide (1) more detailed guidance in a few areas and (2) additional implementation guidance and examples based on feedback the FASB received from its stakeholders. The amendments are expected to reduce the degree of judgment necessary to comply with Topic 606, which the FASB expects will reduce the potential for diversity arising in practice and reduce the cost and complexity of applying the guidance. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements in Topic 606 (and any other Topic amended by Update 2014-09). ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606), which among other things clarifies the objective of the collectability criterion in Topic 606, as well as certain narrow aspects of Topic 606. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements for Topic 606 (and any other Topic amended by Update 2014-09). ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. This Update is not expected to have a significant impact on the Company's financial statements

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We expect to recognize a one-time cumulative effect

adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which addresses eight specific cash flow issues with the objective of reducing diversity in practice. Among these include recognizing cash payments for debt prepayment or debt extinguishment as cash outflows for financing activities; cash proceeds received from the settlement of insurance claims should be classified on the basis of the related insurance coverage; and cash proceeds received from the settlement of bank-owned life insurance policies should be classified as cash inflows from investing activities while the cash payments for premiums on bank-owned policies may be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The amendments in this Update should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The Company is currently evaluating the impact the adoption of the standard will have on the Company's statement of cash flows.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business, which provides a more robust framework to use in determining when a set of assets and activities (collectively referred to as a “set”) is a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. Public business entities should apply the amendments in this Update to annual periods beginning after December 15, 2017, including interim periods within those periods. All other entities should apply the amendments to annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The amendments in this Update should be applied prospectively on or after the effective date. This Update is not expected to have a significant impact on the Company’s financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment. To simplify the subsequent measurement of goodwill, the FASB eliminated Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this Update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting units fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A public business entity that is a U.S. Securities and Exchange Commission (SEC) filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. A public business entity that is not an SEC filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2020. All other entities, including not-for-profit entities, that are adopting the amendments in this Update should do so for their annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2021. The Company is currently evaluating the impact the adoption of the standard will have on the Company’s financial position or results of operations.

In February 2017, the FASB issued ASU 2017-05, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20). The amendments in this Update clarify what constitutes a financial asset within the scope of Subtopic 610-20. The amendments also clarify that entities should identify each distinct nonfinancial asset or in substance nonfinancial asset that is promised to a counterparty and to derecognize each asset when the counterparty obtains control. There is also additional guidance provided for partial sales of a nonfinancial asset and when derecognition, and the related gain or loss, should be recognized. The amendments in this Update are effective at the same time as the amendments in Update 2014-09. Therefore, for public entities, the amendments are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. For all other entities, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. The Company is currently evaluating the impact the adoption of the standard will have on the Company’s financial position or results of operations.

In March 2017, the FASB issued ASU 2017-07, Compensation—Retirement Benefits (Topic 715). The amendments in this Update require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost as defined in paragraphs 715-30-35-4 and 715-60-35-9 are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments in this Update are effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those annual periods. For other entities, the amendments in this Update are effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The amendments in this Update should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In March 2017, the FASB issued ASU 2017-08, Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20). The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other

entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principle. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation – Stock Compensation (Topic 718), which affects any entity that changes the terms or conditions of a share-based payment award. This Update amends the definition of modification by qualifying that modification accounting does not apply to changes to outstanding share-based payment awards that do not affect the total fair value, vesting requirements, or equity/liability classification of the awards. The amendments in this Update are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for (1) public business entities for reporting periods for which financial statements have not yet been issued and (2) all other entities for reporting periods for which financial statements have not yet been made available for issuance. The amendments in this Update should be applied prospectively to an award modified on or after the adoption date. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In July 2017, the FASB issued ASU 2017-11, Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), and Derivative and Hedging (Topic 815). The amendments in Part I of this Update change the classification analysis of certain equity-linked financial instruments (or embedded features) with down-round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down-round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. The amendments also clarify existing disclosure requirements for equity-classified instruments. As a result, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down-round feature. For freestanding equity classified financial instruments, the amendments require entities that present earnings per share (EPS) in accordance with Topic 260 to recognize the effect of the down-round feature when it is triggered. That effect is treated as a dividend and as a reduction of income available to common shareholders in basic EPS. Convertible instruments with embedded conversion options that have down-round features are now subject to the specialized guidance for contingent beneficial conversion features (in Subtopic 470-20, Debt—Debt with Conversion and Other Options), including related EPS guidance (in Topic 260). The amendments in Part II of this Update recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Accounting Standards Codification, to a scope exception. Those amendments do not have an accounting effect. For public business entities, the amendments in Part I of this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments in Part I of this Update are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted for all entities, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments in Part I of this Update should be applied either retrospectively to outstanding financial instruments with a down-round feature by means of a cumulative-effect adjustment to the statement of financial position as of the beginning of the first fiscal year and interim period(s) in

which the pending content that links to this paragraph is effective or retrospectively to outstanding financial instruments with a down-round feature for each prior reporting period presented in accordance with the guidance on accounting changes in paragraphs 250-10-45-5 through 45-10. The amendments in Part II of this Update do not require any transition guidance because those amendments do not have an accounting effect. This Update is not expected to have a significant impact on the Company's financial statements.

August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 850), the objective of which is to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, the amendments in this Update make certain targeted improvements to simplify the application and disclosure of the hedge accounting guidance in current general accepted accounting principles. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods beginning after December 15, 2020. Early application is permitted in any period after issuance. For cash flow and net investment hedges existing at the date of adoption, an entity should apply a cumulative-effect adjustment related to eliminating the separate measurement of ineffectiveness to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the beginning of the fiscal year that an entity adopts the amendments in this Update. The amended presentation and disclosure guidance is required only prospectively. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In January 2018, the FASB issued ASU 2018-01, Leases (Topic 842), which provides an optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under the current lease guidance in Topic 840. An entity that elects this practical expedient should evaluate new or modified land easements under Topic 842 beginning at the date the entity adopts Topic 842; otherwise, an entity should evaluate all existing or expired land easements in connection with the adoption of the new lease requirements in Topic 842 to assess whether they meet the definition of a lease. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements in ASU 2016-02. This Update is not expected to have a significant impact on the Company's financial statements.

In February 2018, the FASB issued ASU 2018-03, Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10), to clarify certain aspects of the guidance issued in ASU 2016-01. (1) An entity measuring an equity security using the measurement alternative may change its measurement approach to a fair value method in accordance with Topic 820, Fair Value Measurement, through an irrevocable election that would apply to that security and all identical or similar investments of the same issuer. Once an entity makes this election, the entity should measure all future purchases of identical or similar investments of the same issuer using a fair value method in accordance with Topic 820. (2) Adjustments made under the measurement alternative are intended to reflect the fair value of the security as of the date that the observable transaction for a similar security took place. (3) Remeasuring the entire value of forward contracts and purchased options is required when observable transactions occur on the underlying equity securities. (4) When the fair value option is elected for a financial liability, the guidance in paragraph 825-10-45-5 should be applied, regardless of whether the fair value option was elected under either Subtopic 815-15, Derivatives and Hedging—Embedded Derivatives, or 825-10, Financial Instruments—Overall. (5) Financial liabilities for which the fair value option is elected, the amount of change in fair value that relates to the instrument specific credit risk should first be measured in the currency of denomination when presented separately from the total change in fair value of the financial liability. Then, both components of the change in the fair value of the liability should be remeasured into the functional currency of the reporting entity using end-of-period spot rates. (6) The prospective transition approach for equity securities without a readily determinable fair value in the amendments in Update 2016-01 is meant only for instances in which the measurement alternative is applied. An insurance entity subject to the guidance in Topic 944, Financial Services—Insurance, should apply a prospective transition method when applying the amendments related to equity securities without readily determinable fair values. An insurance entity should apply the selected prospective transition method consistently to the entity's entire population of equity securities for which the measurement alternative is elected. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. Public business entities with fiscal years beginning between December 15, 2017, and June 15, 2018, are not required to adopt these amendments until the interim period beginning after June 15, 2018, and public business entities with fiscal years beginning between June 15, 2018, and December 15, 2018, are not required to adopt these amendments before adopting the amendments in Update 2016-01. For all other entities, the effective date is the same as the effective date in Update 2016-01. All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted Update 2016-01. This Update is not expected to have a significant impact on the Company's financial statements.

ASU 2018-04, Investments – Debt Securities (Topic 320) and Regulated Operations (Topic 980) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273, ASU 2018-04 supersedes various SEC paragraphs and adds an SEC paragraph pursuant to the issuance of Staff Accounting Bulletin No. 117. This Update is not expected to have a significant impact on the Company's financial statements.



ASU 2018-05, Income Taxes (Topic 740) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin (SAB) No. 118, amends the Accounting Standards Codification to incorporate various SEC paragraphs pursuant to the issuance of SAB 118. SAB 118 addresses the application of generally accepted accounting principles in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts and Jobs Act. See Note 14 - Income Taxes.

ASU 2018-06, Codification Improvements to Topic 942, Financial Services-Depository and Lending, amends the guidance in Subtopic 942-740, Financial Services-Depository and Lending-Income Taxes, that is related to Circular 202 because that guidance has been rescinded by the Office of the Comptroller of the Currency (OCC) and no longer is relevant. This Update is not expected to have a significant impact on the Company's financial statements.

In June 2018, the FASB issued ASU 2018-07, Compensation – Stock Compensation (Topic 718), which simplified the accounting for nonemployee share-based payment transactions. The amendments in this update expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The amendments in this Update improve the following areas of nonemployee share-based payment accounting; (a) the overall measurement objective, (b) the measurement date, (c) awards with performance conditions, (d) classification reassessment of certain equity-classified awards, (e) calculated value (nonpublic entities only), and (f) intrinsic value (nonpublic entities only). The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. This Update is not expected to have a significant impact on the Company's financial statements.

ASU 2018-09, Codification Improvements, represents changes to clarify, correct errors in, or make minor improvements to the Codification. The amendments make the Codification easier to understand and easier to apply by eliminating inconsistencies and providing clarifications. The transition and effective date guidance is based on the facts and circumstances of each amendment. Some of the amendments do not require transition guidance and will be effective upon issuance of this ASU. However, many of the amendments in this ASU do have transition guidance with effective dates for annual periods beginning after December 15, 2018, for public business entities. This Update is not expected to have a significant impact on the Company's financial statements.

ASU 2018-10, Codification Improvements to Topic 842, Leases, represents changes to clarify, correct errors in, or make minor improvements to the Codification. The amendments in this ASU affect the amendments in ASU 2016-02, which are not yet effective, but for which early adoption upon issuance is permitted. For entities that early adopted Topic 842, the amendments are effective upon issuance of this ASU, and the transition requirements are the same as those in Topic 842. For entities that have not adopted Topic 842, the effective date and transition requirements will be the same as the effective date and transition requirements in Topic 842. This Update is not expected to have a significant impact on the Company's financial statements.

#### 5. Investment Securities

The amortized cost, gross unrealized gains and losses, and fair value of investment securities available for sale are summarized as follows (in thousands):

|   | June 30, 2018 |        |            |            |
|---|---------------|--------|------------|------------|
|   | Gross         |        | Gross      |            |
|   | Amortized     |        | Unrealized |            |
|   | Cost          | Gains  | Losses     | Fair Value |
| Available for Sale                                    |               |        |            |            |
| Fannie Mae  | \$136,467     | \$ 19  | \$(4,672)  | \$131,814  |
| Freddie Mac   | 97,624        | 13     | (3,700)    | 93,937     |
| Governmental National Mortgage Association Securities | 19,986        | —      | (685)      | 19,301     |
| Total mortgage-backed securities                      | 254,077       | 32     | (9,057)    | 245,052    |
| Obligations of states and political subdivisions      | 50,182        | 541    | (1,229)    | 49,494     |
| U.S. government agency securities                     | 12,853        | 7      | (157)      | 12,703     |
| Corporate obligations                                 | 44,582        | 187    | (1,150)    | 43,619     |
| Other debt securities                                 | 21,014        | 5      | (799)      | 20,220     |
| Total debt securities                                 | 382,708       | 772    | (12,392)   | 371,088    |
| Equity securities - financial services                | 25            | —      | (4)        | 21         |
| Total   | \$382,733     | \$ 772 | \$(12,396) | \$371,109  |

|                    | September 30, 2017 |       |            |            |
|--------------------|--------------------|-------|------------|------------|
|                    | Gross              |       | Gross      |            |
|                    | Amortized          |       | Unrealized |            |
|                    | Cost               | Gains | Losses     | Fair Value |
| Available for Sale |                    |       |            |            |

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|  |           |          |             |           |
|--|-----------|----------|-------------|-----------|
| Fannie Mae                                       | \$119,333 | \$ 207   | \$ (1,203 ) | \$118,337 |
| Freddie Mac                                      | 98,668    | 177      | (808 )      | 98,037    |
| Governmental National Mortgage Association       | 17,609    | 43       | (203 )      | 17,449    |
| Total mortgage-backed securities                 | 235,610   | 427      | (2,214 )    | 233,823   |
| Obligations of states and political subdivisions | 64,382    | 1,522    | (546 )      | 65,358    |
| U.S. government agency securities                | 18,615    | 61       | (5 )        | 18,671    |
| Corporate obligations                            | 49,025    | 335      | (618 )      | 48,742    |
| Other debt securities                            | 24,200    | 47       | (414 )      | 23,833    |
| Total debt securities                            | 391,832   | 2,392    | (3,797 )    | 390,427   |
| Equity securities - financial services           | 25        | —        | —           | 25        |
| Total  | \$391,857 | \$ 2,392 | \$ (3,797 ) | \$390,452 |

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The amortized cost and fair value of debt securities at June 30, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

|  | Available For Sale<br>Amortized |                  |
|--|---------------------------------|------------------|
|  | Cost                            | Fair<br>Value    |
| Due in one year or less                | \$728                           | \$729            |
| Due after one year through five years  | 36,878                          | 36,436           |
| Due after five years through ten years | 103,013                         | 100,186          |
| Due after ten years                    | 242,089                         | 233,737          |
| <b>Total</b>                           | <b>\$382,708</b>                | <b>\$371,088</b> |

For the three months ended June 30, 2018, the Company realized no gross gains or gross losses on proceeds from the sale of investment securities. For the nine months ended June 30, 2018, the Company realized gross gains of \$300,000 and gross losses of \$225,000 on proceeds from the sale on investment securities of \$22.1 million. For the three and nine months ended June 30, 2017, the Company realized gross gains of \$299,000 and gross losses of \$4,000 on proceeds from the sale of investment securities of \$17.4 million.

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

|   | June 30, 2018           |                            |                               |                             |                               |           |             |
|---|-------------------------|----------------------------|-------------------------------|-----------------------------|-------------------------------|-----------|-------------|
|   | Number<br>of Securities | Less than Twelve<br>Months |                               | Twelve Months or<br>Greater |                               | Total     |             |
|   |                         | Fair<br>Value              | Gross<br>Unrealized<br>Losses | Fair<br>Value               | Gross<br>Unrealized<br>Losses |           |             |
|   |                         |                            |                               |                             |                               |           |             |
| Fannie Mae  | 90                      | \$73,711                   | \$ (1,854 )                   | \$51,557                    | \$ (2,818 )                   | \$125,268 | \$ (4,672 ) |
| Freddie Mac   | 68                      | 51,483                     | (1,681 )                      | 37,623                      | (2,019 )                      | 89,106    | (3,700 )    |
| Governmental National Mortgage<br>Association       | 17                      | 12,872                     | (297 )                        | 6,429                       | (388 )                        | 19,301    | (685 )      |
| Obligations of states and political<br>subdivisions | 26                      | 11,231                     | (167 )                        | 17,983                      | (1,062 )                      | 29,214    | (1,229 )    |
| U.S. government agency securities                   | 6                       | 12,027                     | (157 )                        | —                           | —                             | 12,027    | (157 )      |
| Corporate obligations                               | 29                      | 19,368                     | (425 )                        | 9,806                       | (725 )                        | 29,174    | (1,150 )    |
| Other debt securities                               | 19                      | 1,279                      | (19 )                         | 17,697                      | (780 )                        | 18,976    | (799 )      |
| Equity securities                                   | 1                       | 21                         | (4 )                          | —                           | —                             | 21        | (4 )        |

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Total 256 \$181,992 \$ (4,604 ) \$141,095 \$ (7,792 ) \$323,087 \$ (12,396 )

September 30, 2017

Number

of Less than Twelve Twelve Months or

Months

Greater

Fair

Value

Gross

Unrealized

Losses

Greater

Fair

Value

Gross

Unrealized

Losses

Total

Fair

Value

Gross

Unrealized

Losses

|  |     |           |             |          |             |           |             |
|--|-----|-----------|-------------|----------|-------------|-----------|-------------|
| Fannie Mae                                       | 55  | \$61,852  | \$ (558 )   | \$20,679 | \$ (645 )   | \$82,531  | \$ (1,203 ) |
| Freddie Mac                                      | 39  | 38,913    | (354 )      | 16,427   | (454 )      | 55,340    | (808 )      |
| Governmental National Mortgage Association       | 11  | 6,669     | (41 )       | 6,903    | (162 )      | 13,572    | (203 )      |
| Obligations of states and political subdivisions | 25  | 10,944    | (59 )       | 17,425   | (487 )      | 28,369    | (546 )      |
| U.S. government agency securities                | 3   | 8,995     | (5 )        | —        | —           | 8,995     | (5 )        |
| Corporate obligations                            | 22  | 15,119    | (104 )      | 8,032    | (514 )      | 23,151    | (618 )      |
| Other debt securities                            | 19  | 7,141     | (104 )      | 13,806   | (310 )      | 20,947    | (414 )      |
| Total  | 174 | \$149,633 | \$ (1,225 ) | \$83,272 | \$ (2,572 ) | \$232,905 | \$ (3,797 ) |

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

The Company reviews its position quarterly and has asserted that at June 30, 2018, the declines outlined in the above table represent temporary declines and the Company would not be required to sell the above securities before their anticipated recovery in market value.

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

#### 6. Loans Receivable, Net and Allowance for Loan Losses

Loans receivable consist of the following (in thousands):

|  | June 30,<br>2018 | September 30,<br>2017 |
|--|------------------|-----------------------|
| Real estate loans:                               |                  |                       |
| Residential                                      | \$581,620        | \$ 586,708            |
| Construction                                     | 5,042            | 3,097                 |
| Commercial                                       | 396,762          | 318,323               |
| Commercial                                       | 49,615           | 44,129                |
| Obligations of states and political subdivisions | 67,468           | 58,079                |
| Home equity loans and lines of credit            | 45,043           | 46,219                |
| Auto Loans                                       | 164,437          | 186,646               |
| Other  | 2,732            | 2,845                 |
|  | 1,312,719        | 1,246,046             |
| Less allowance for loan losses                   | 11,130           | 9,365                 |
| Net loans  | \$1,301,589      | \$ 1,236,681          |

Purchased loans acquired in a business combination are recorded at fair value on their purchase date without a carryover of the related allowance for loan losses.

Changes in the accretable yield for purchased credit-impaired loans were as follows, since acquisition, for the three and nine months ended June 30, 2018 and 2017 (in thousands):

|   | For the Three<br>Months<br>Ended June<br>30, |       |
|---|--|-------|
|   | 2018   | 2017  |
| Balance at beginning of period            | \$574  | \$460 |
| Reclassification, new additions and other | —  | 33    |
| Accretion                                 | (282)  | (32)  |
| Balance at end of period                  | \$292  | \$461 |

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|   | For the Nine<br>Months<br>Ended June<br>30, |       |
|---|---|-------|
|   | 2018  | 2017  |
| Balance at beginning of period            | \$471                                       | \$478 |
| Reclassification, new additions and other | 681   | 151   |
| Accretion                                 | (860)                                       | (168) |
| Balance at end of period                  | \$292                                       | \$461 |

The following table presents additional information regarding loans acquired and accounted for in accordance with ASC 310-30 (in thousands):

|                     | June 30, 2018    | September 30, 2017 |
|---------------------|------------------|--------------------|
|                     | Acquired Loans   | Acquired Loans     |
|                     | with Specific    | with Specific      |
|                     | Evidence or      | Evidence or        |
|                     | Deterioration in | Deterioration in   |
|                     | Credit Quality   | Credit Quality     |
|                     | (ASC 310-30)     | (ASC 310-30)       |
| Outstanding balance | \$ 3,183         | \$ 5,490           |
| Carrying amount     | \$ 2,526         | \$ 4,388           |

The following tables show the amount of loans in each category that were individually and collectively evaluated for impairment at the dates indicated (in thousands):

|  | Total Loans  | Individually<br>Evaluated for<br>Impairment | Loans Acquired<br>with Deteriorated<br>Credit Quality | Collectively<br>Evaluated for<br>Impairment |
|--|--------------|---|---|---|
| June 30, 2018                                    |              |   |   |   |
| Real estate loans:                               |              |   |   |   |
| Residential                                      | \$ 581,620   | \$ 5,217                                    | \$ —  | \$ 576,403                                  |
| Construction                                     | 5,042        | —   | —   | 5,042                                       |
| Commercial                                       | 396,762      | 6,227                                       | 2,099   | 388,436                                     |
| Commercial                                       | 49,615       | 93  | 99  | 49,423                                      |
| Obligations of states and political subdivisions | 67,468       | —   | —   | 67,468                                      |
| Home equity loans and lines of credit            | 45,043       | 125   | 328   | 44,590                                      |
| Auto loans                                       | 164,437      | 433   | —   | 164,004                                     |
| Other  | 2,732        | 26  | —   | 2,706                                       |
| Total  | \$ 1,312,719 | \$ 12,121                                   | \$ 2,526  | \$ 1,298,072                                |

| Total Loans | Individually<br>Evaluated for<br>Impairment | Loans Acquired<br>with Deteriorated<br>Credit Quality | Collectively<br>Evaluated for<br>Impairment |
|-------------|---|---|---|
|-------------|---|---|---|



|   |              | Impairment | Credit Quality | Impairment   |
|---|--------------|------------|----------------|--------------|
| September 30, 2017                                |              |            |                |              |
| Real estate loans:                                |              |            |                |              |
| Residential                                       | \$ 586,708   | \$ 6,202   | \$ —           | \$ 580,506   |
| Construction                                      | 3,097        | —          | —              | 3,097        |
| Commercial  | 318,323      | 7,211      | 3,775          | 307,337      |
| Commercial  | 44,129       | 1,385      | 283            | 42,461       |
| Obligations of states and political sub divisions | 58,079       | —          | —              | 58,079       |
| Home equity loans and lines of credit             | 46,219       | 176        | 330            | 45,713       |
| Auto loans  | 186,646      | 572        | —              | 186,074      |
| Other   | 2,845        | 30         | —              | 2,815        |
| Total   | \$ 1,246,046 | \$ 15,576  | \$ 4,388       | \$ 1,226,082 |

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

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

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

The following tables include the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount at the dates indicated, if applicable (in thousands):

|  | Recorded   | Unpaid    |            |
|--|------------|-----------|------------|
|  | Investment | Principal | Associated |
|  |            | Balance   | Allowance  |
| <b>June 30, 2018</b>                             |            |           |            |
| With no specific allowance recorded:             |            |           |            |
| Real estate loans                                |            |           |            |
| Residential                                      | \$ 4,089   | \$ 5,703  | \$ —       |
| Construction                                     | —          | —         | —          |
| Commercial                                       | 6,227      | 7,972     | —          |
| Commercial                                       | 93         | 353       | —          |
| Obligations of states and political subdivisions | —          | —         | —          |
| Home equity loans and lines of credit            | 99         | 114       | —          |
| Auto loans                                       | 221        | 413       | —          |
| Other  | 26         | 33        | —          |
| Total  | 10,755     | 14,588    | —          |
| With an allowance recorded:                      |            |           |            |
| Real estate loans                                |            |           |            |
| Residential                                      | 1,128      | 1,305     | 118        |
| Construction                                     | —          | —         | —          |
| Commercial                                       | —          | —         | —          |
| Commercial                                       | —          | —         | —          |
| Obligations of states and political subdivisions | —          | —         | —          |
| Home equity loans and lines of credit            | 26         | 26        | 3          |
| Auto loans                                       | 212        | 228       | 98         |
| Other  | —          | —         | —          |
| Total  | 1,366      | 1,559     | 219        |
| Total:   |            |           |            |
| Real estate loans                                |            |           |            |
| Residential                                      | 5,217      | 7,008     | 118        |
| Construction                                     | —          | —         | —          |
| Commercial                                       | 6,227      | 7,972     | —          |

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|  |           |           |        |
|--|-----------|-----------|--------|
| Commercial                                       | 93        | 353       | —      |
| Obligations of states and political subdivisions | —         | —         | —      |
| Home equity loans and lines of credit            | 125       | 140       | 3      |
| Auto loans                                       | 433       | 641       | 98     |
| Other  | 26        | 33        | —      |
| Total Impaired Loans                             | \$ 12,121 | \$ 16,147 | \$ 219 |

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|  | Unpaid     |           |            |
|--|------------|-----------|------------|
|  | Recorded   | Principal | Associated |
|  | Investment | Balance   | Allowance  |
| September 30, 2017                               |            |           |            |
| With no specific allowance recorded:             |            |           |            |
| Real Estate Loans                                |            |           |            |
| Residential                                      | \$ 4,392   | \$5,730   | \$ —       |
| Construction                                     | —          | —         | —          |
| Commercial                                       | 7,191      | 9,396     | —          |
| Commercial                                       | 1,385      | 1,575     | —          |
| Obligations of states and political subdivisions | —          | —         | —          |
| Home equity loans and lines of credit            | 176        | 258       | —          |
| Auto Loans                                       | 123        | 237       | —          |
| Other  | 30         | 36        | —          |
| Total  | 13,297     | 17,232    | —          |
| With an allowance recorded:                      |            |           |            |
| Real Estate Loans                                |            |           |            |
| Residential                                      | 1,810      | 2,264     | 154        |
| Construction                                     | —          | —         | —          |
| Commercial                                       | 20         | 1,193     | 19         |
| Commercial                                       | —          | —         | —          |
| Obligations of states and political subdivisions | —          | —         | —          |
| Home equity loans and lines of credit            | —          | —         | —          |
| Auto Loans                                       | 449        | 468       | 172        |
| Other  | —          | —         | —          |
| Total  | 2,279      | 3,925     | 345        |
| Total:   |            |           |            |
| Real Estate Loans                                |            |           |            |
| Residential                                      | 6,202      | 7,994     | 154        |
| Construction                                     | —          | —         | —          |
| Commercial                                       | 7,211      | 10,589    | 19         |
| Commercial                                       | 1,385      | 1,575     | —          |
| Obligations of states and political subdivisions | —          | —         | —          |
| Home equity loans and lines of credit            | 176        | 258       | —          |
| Auto Loans                                       | 572        | 705       | 172        |
| Other  | 30         | 36        | —          |
| Total Impaired Loans                             | \$ 15,576  | \$21,157  | \$ 345     |

The following tables represent the average recorded investments in the impaired loans and the related amount of interest recognized during the time within the period that the impaired loans were impaired (in thousands):

|  | For the Three Months Ended June 30, |                  |                  |                  |
|--|-------------------------------------|------------------|------------------|------------------|
|  | 2018<br>Average                     | 2017<br>Average  | 2018<br>Interest | 2017<br>Interest |
|  | Recorded                            | Recorded         | Income           | Income           |
|  | Investment                          | Investment       | Recognized       | Recognized       |
| <b>With no specific allowance recorded:</b>      |                                     |                  |                  |                  |
| Real estate loans                                |                                     |                  |                  |                  |
| Residential                                      | \$3,968                             | \$ 4,800         | \$ 6             | \$ 9             |
| Construction                                     | —                                   | —                | —                | —                |
| Commercial                                       | 6,564                               | 8,502            | 70               | 61               |
| Commercial                                       | 445                                 | 1,584            | 8                | 30               |
| Obligations of states and political subdivisions | —                                   | —                | —                | —                |
| Home equity loans and lines of credit            | 133                                 | 208              | —                | —                |
| Auto loans                                       | 205                                 | 144              | —                | —                |
| Other  | 27                                  | 8                | —                | —                |
| <b>Total</b>                                     | <b>11,342</b>                       | <b>15,246</b>    | <b>84</b>        | <b>100</b>       |
| <b>With an allowance recorded:</b>               |                                     |                  |                  |                  |
| Real estate loans                                |                                     |                  |                  |                  |
| Residential                                      | 1,212                               | 1,384            | —                | —                |
| Construction                                     | —                                   | —                | —                | —                |
| Commercial                                       | 12                                  | 302              | —                | —                |
| Commercial                                       | —                                   | —                | —                | —                |
| Obligations of states and political subdivisions | —                                   | —                | —                | —                |
| Home equity loans and lines of credit            | 26                                  | 4                | —                | —                |
| Auto loans                                       | 190                                 | 298              | —                | 1                |
| Other  | —                                   | —                | —                | —                |
| <b>Total</b>                                     | <b>1,440</b>                        | <b>1,988</b>     | <b>—</b>         | <b>1</b>         |
| <b>Total:</b>                                    |                                     |                  |                  |                  |
| Real estate loans                                |                                     |                  |                  |                  |
| Residential                                      | 5,180                               | 6,184            | 6                | 9                |
| Construction                                     | —                                   | —                | —                | —                |
| Commercial                                       | 6,576                               | 8,804            | 70               | 61               |
| Commercial                                       | 445                                 | 1,584            | 8                | 30               |
| Obligations of states and political subdivisions | —                                   | —                | —                | —                |
| Home equity loans and lines of credit            | 159                                 | 212              | —                | —                |
| Auto loans                                       | 395                                 | 442              | —                | 1                |
| Other  | 27                                  | 8                | —                | —                |
| <b>Total Impaired Loans</b>                      | <b>\$12,782</b>                     | <b>\$ 17,234</b> | <b>\$ 84</b>     | <b>\$ 101</b>    |

|  | For the Nine Months Ended June 30, |            |            |            |
|--|------------------------------------|------------|------------|------------|
|  | 2018                               | 2017       | 2018       | 2017       |
|  | Average                            | Average    | Interest   | Interest   |
|  | Recorded                           | Recorded   | Income     | Income     |
|  | Investment                         | Investment | Recognized | Recognized |
| <b>With no specific allowance recorded:</b>      |                                    |            |            |            |
| Real estate loans                                |                                    |            |            |            |
| Residential                                      | \$4,192                            | \$ 5,633   | \$ 21      | \$ 30      |
| Construction                                     | —                                  | —          | —          | —          |
| Commercial                                       | 6,787                              | 9,428      | 211        | 233        |
| Commercial                                       | 970                                | 1,638      | 59         | 92         |
| Obligations of states and political subdivisions | —                                  | —          | —          | —          |
| Home equity loans and lines of credit            | 181                                | 243        | 1          | —          |
| Auto loans                                       | 183                                | 127        | 1          | —          |
| Other  | 28                                 | 8          | —          | —          |
| Total  | 12,341                             | 17,077     | 293        | 355        |
| <b>With an allowance recorded:</b>               |                                    |            |            |            |
| Real estate loans                                |                                    |            |            |            |
| Residential                                      | 1,332                              | 1,811      | —          | —          |
| Construction                                     | —                                  | —          | —          | —          |
| Commercial                                       | 17                                 | 330        | —          | —          |
| Commercial                                       | —                                  | 40         | —          | —          |
| Obligations of states and political subdivisions | —                                  | —          | —          | —          |
| Home equity loans and lines of credit            | 13                                 | 4          | —          | —          |
| Auto loans                                       | 228                                | 268        | —          | 7          |
| Other  | —                                  | —          | —          | —          |
| Total  | 1,590                              | 2,453      | —          | 7          |
| <b>Total:</b>                                    |                                    |            |            |            |
| Real estate loans                                |                                    |            |            |            |
| Residential                                      | 5,524                              | 7,444      | 21         | 30         |
| Construction                                     | —                                  | —          | —          | —          |
| Commercial                                       | 6,804                              | 9,758      | 211        | 233        |
| Commercial                                       | 970                                | 1,678      | 59         | 92         |
| Obligations of states and political subdivisions | —                                  | —          | —          | —          |
| Home equity loans and lines of credit            | 194                                | 247        | 1          | —          |
| Auto loans                                       | 411                                | 395        | 1          | 7          |
| Other  | 28                                 | 8          | —          | —          |
| Total Impaired Loans                             | \$13,931                           | \$ 19,530  | \$ 293     | \$ 362     |

The Company uses a ten-point internal risk-rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized and are aggregated as Pass-rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are fundamentally sound yet exhibit potentially unacceptable credit risk or deteriorating trends or characteristics which, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Company's credit position at some future date. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt and have a distinct possibility that some loss will be sustained if the weaknesses are not

corrected. All loans that are more than 90 days past due are considered Substandard. Loans in the Doubtful category have all the weaknesses inherent in loans classified as Substandard with the added characteristic that their weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Loans in the Loss category are considered uncollectible and of little value that their continuance as bankable assets is not warranted. Certain residential real estate loans, construction loans, home equity loans and lines of credit, auto loans and other consumer loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or non-performing.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death

occurs to raise awareness of a possible credit event. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating recommendation for the loans in their portfolios at origination and on an ongoing basis. The Bank's Commercial Loan Officers perform an annual review of all commercial relationships \$750,000 or greater. Confirmation of the appropriate risk grade is included in the review on an ongoing basis. The Bank engages an external consultant to conduct loan reviews on at least a semi-annual basis. Generally, the external consultant reviews commercial relationships greater than \$1,000,000 and/or all criticized relationships. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following tables present the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard, and Doubtful or Loss within the internal risk rating system at June 30, 2018 and September 30, 2017 (in thousands):

|  | Pass              | Special<br>Mention | Substandard      | Doubtful<br>or Loss | Total             |
|--|-------------------|--------------------|------------------|---------------------|-------------------|
| <b>June 30, 2018</b>                             |                   |                    |                  |                     |                   |
| Commercial real estate loans                     | \$ 373,124        | \$ 8,601           | \$ 15,037        | \$ —                | \$ 396,762        |
| Commercial                                       | 47,842            | 9                  | 1,764            | —                   | 49,615            |
| Obligations of states and political subdivisions | 67,468            | —                  | —                | —                   | 67,468            |
| <b>Total</b>                                     | <b>\$ 488,434</b> | <b>\$ 8,610</b>    | <b>\$ 16,801</b> | <b>\$ —</b>         | <b>\$ 513,845</b> |

|  | Pass              | Special<br>Mention | Substandard      | Doubtful<br>or Loss | Total             |
|--|-------------------|--------------------|------------------|---------------------|-------------------|
| <b>September 30, 2017</b>                        |                   |                    |                  |                     |                   |
| Commercial real estate loans                     | \$ 300,554        | \$ 3,376           | \$ 14,393        | \$ —                | \$ 318,323        |
| Commercial                                       | 40,996            | 32                 | 3,101            | —                   | 44,129            |
| Obligations of states and political subdivisions | 58,079            | —                  | —                | —                   | 58,079            |
| <b>Total</b>                                     | <b>\$ 399,629</b> | <b>\$ 3,408</b>    | <b>\$ 17,494</b> | <b>\$ —</b>         | <b>\$ 420,531</b> |

All other loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or non-performing. The following tables present the risk ratings in the consumer categories of performing and non-performing loans at June 30, 2018 and September 30, 2017 (in thousands):

|  | Performing | Non-performing | Purchased<br>Credit<br>Impaired | Total |
|--|------------|----------------|---------------------------------|-------|
|--|------------|----------------|---------------------------------|-------|



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| June 30, 2018                         |            |          |        |           |
|---------------------------------------|------------|----------|--------|-----------|
| Real estate loans:                    |            |          |        |           |
| Residential                           | \$ 576,193 | \$ 5,427 | \$ —   | \$581,620 |
| Construction                          | 5,042      | —        | —      | 5,042     |
| Home equity loans and lines of credit | 44,423     | 292      | 328    | 45,043    |
| Auto loans                            | 163,910    | 527      | —      | 164,437   |
| Other                                 | 2,705      | 27       | —      | 2,732     |
| Total                                 | \$ 792,273 | \$ 6,273 | \$ 328 | \$798,874 |

|                                       | Performing | Non-performing | Purchased |           |
|---------------------------------------|------------|----------------|-----------|-----------|
|                                       |            |                | Impaired  | Total     |
| September 30, 2017                    |            |                |           |           |
| Real estate loans:                    |            |                |           |           |
| Residential                           | \$ 580,116 | \$ 6,592       | \$ —      | \$586,708 |
| Construction                          | 3,097      | —              | —         | 3,097     |
| Home equity loans and lines of credit | 45,576     | 313            | 330       | 46,219    |
| Auto loans                            | 185,910    | 736            | —         | 186,646   |
| Other                                 | 2,807      | 38             | —         | 2,845     |
| Total                                 | \$ 817,506 | \$ 7,679       | \$ 330    | \$825,515 |

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The Company further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of June 30, 2018 and September 30, 2017 (in thousands):

|  |                    |                           |                           | 90 +<br>Days<br>Past          |                 |                   | Purchased                             |                 |                    |
|--|--------------------|---------------------------|---------------------------|-------------------------------|-----------------|-------------------|---------------------------------------|-----------------|--------------------|
|  | Current            | 31-60<br>Days<br>Past Due | 61-89<br>Days<br>Past Due | Due<br>and<br>Non-<br>accrual | Non-<br>accrual | Total<br>Past Due | Credit<br>Impaired<br>Non-<br>accrual | Total<br>Loans  |                    |
| <b>June 30, 2018</b>                             |                    |                           |                           |                               |                 |                   |                                       |                 |                    |
| Real estate loans:                               |                    |                           |                           |                               |                 |                   |                                       |                 |                    |
| Residential                                      | \$574,121          | \$ 1,101                  | \$ 971                    | \$ —                          | \$ 5,427        | \$7,499           | \$—                                   | \$—             | \$581,620          |
| Construction                                     | 5,042              | —                         | —                         | —                             | —               | —                 | —                                     | —               | 5,042              |
| Commercial                                       | 392,210            | 320                       | —                         | —                             | 2,133           | 2,453             | 258                                   | 1,841           | 396,762            |
| Commercial                                       | 49,439             | 40                        | —                         | —                             | 37              | 77                | —                                     | 99              | 49,615             |
| Obligations of states and political subdivisions |                    |                           |                           |                               |                 |                   |                                       |                 |                    |
| subdivisions                                     | 67,468             | —                         | —                         | —                             | —               | —                 | —                                     | —               | 67,468             |
| Home equity loans and lines of credit            |                    |                           |                           |                               |                 |                   |                                       |                 |                    |
| Auto loans                                       | 44,394             | 29                        | —                         | —                             | 292             | 321               | —                                     | 328             | 45,043             |
| Other  | 162,931            | 953                       | 26                        | —                             | 527             | 1,506             | —                                     | —               | 164,437            |
| Other  | 2,687              | 18                        | —                         | —                             | 27              | 45                | —                                     | —               | 2,732              |
| <b>Total</b>                                     | <b>\$1,298,292</b> | <b>\$ 2,461</b>           | <b>\$ 997</b>             | <b>\$ —</b>                   | <b>\$ 8,443</b> | <b>\$11,901</b>   | <b>\$258</b>                          | <b>\$ 2,268</b> | <b>\$1,312,719</b> |

|                           |           |                           |                           | 90 +<br>Days<br>Past          |                 |                   | Purchased                             |                |           |
|---------------------------|-----------|---------------------------|---------------------------|-------------------------------|-----------------|-------------------|---------------------------------------|----------------|-----------|
|                           | Current   | 31-60<br>Days<br>Past Due | 61-89<br>Days<br>Past Due | Due<br>and<br>Non-<br>accrual | Non-<br>accrual | Total<br>Past Due | Credit<br>Impaired<br>Non-<br>accrual | Total<br>Loans |           |
| <b>September 30, 2017</b> |           |                           |                           |                               |                 |                   |                                       |                |           |
| Real estate loans:        |           |                           |                           |                               |                 |                   |                                       |                |           |
| Residential               | \$577,034 | \$ 2,661                  | \$ 421                    | \$ —                          | \$ 6,592        | \$9,674           | \$—                                   | \$—            | \$586,708 |
| Construction              | 3,097     | —                         | —                         | —                             | —               | —                 | —                                     | —              | 3,097     |
| Commercial                | 312,098   | 172                       | —                         | —                             | 2,278           | 2,450             | 612                                   | 3,163          | 318,323   |
| Commercial                | 43,298    | 18                        | —                         | —                             | 530             | 548               | —                                     | 283            | 44,129    |
|                           | 58,079    | —                         | —                         | —                             | —               | —                 | —                                     | —              | 58,079    |

|  |             |         |       |     |          |          |       |         |             |
|--|-------------|---------|-------|-----|----------|----------|-------|---------|-------------|
| Obligations of states and political subdivisions |             |         |       |     |          |          |       |         |             |
| Home equity loans and lines of credit            | 45,460      | 101     | 15    | —   | 313      | 429      | —     | 330     | 46,219      |
| Auto loans                                       | 185,247     | 631     | 32    | —   | 736      | 1,399    | —     | —       | 186,646     |
| Other  | 2,789       | 14      | 4     | —   | 38       | 56       | —     | —       | 2,845       |
| Total  | \$1,227,102 | \$3,597 | \$472 | \$— | \$10,487 | \$14,556 | \$612 | \$3,776 | \$1,246,046 |

The 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. The allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an allocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management's judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary, based on changing economic conditions. Payments received on impaired loans generally are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. The allowance for loan losses as of June 30, 2018 was 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 FDIC and the Pennsylvania Department of Banking and Securities, as an integral part of their examination process, have periodically reviewed our allowance for loan losses. The banking regulators may require that we recognize additions to the allowance based on its analysis and review of information available to it at the time of its examination.

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

The following table summarizes changes in the primary segments of the ALL for the three and nine month periods ended June 30, 2018 and 2017 (in thousands):

|                              | Real Estate Loans |              | Commercial Loans |            | Political Subdivisions |              | Home<br>Obligation<br>States<br>and<br>Loans and<br>Lines<br>of<br>Credit | Other<br>Loans<br>Unallocated |        | Total       |       |
|------------------------------|-------------------|--------------|------------------|------------|------------------------|--------------|---|-------------------------------|--------|-------------|-------|
|                              | Residential       | Construction | Commercial       | Commercial | Political              | Subdivisions | Auto  | Loans                         | Loans  | Unallocated | Total |
| ALL balance at               |                   |              |                  |            |                        |              |   |                               |        |             |       |
| March 31, 2018               | \$3,755           | \$ 33        | \$ 2,821         | \$ 1,219   | \$ 269                 | \$ 401       | \$ 1,904  | \$ 21                         | \$ 87  | \$ 10,510   |       |
| Charge-offs                  | (120 )            | —            | (12 )            | —          | —                      | (41 )        | (328 )  | —                             | —      | (501 )      |       |
| Recoveries                   | 3                 | —            | —                | —          | —                      | 33           | 109   | 1                             | —      | 146         |       |
| Provision                    | (102 )            | 10           | 199              | 165        | 23                     | 15           | 185   | 1                             | 479    | 975         |       |
| ALL balance at June 30, 2018 | \$3,536           | \$ 43        | \$ 3,008         | \$ 1,384   | \$ 292                 | \$ 408       | \$ 1,870  | \$ 23                         | \$ 566 | \$ 11,130   |       |
| ALL balance at               |                   |              |                  |            |                        |              |   |                               |        |             |       |
| March 31, 2017               | \$4,130           | \$ 30        | \$ 1,038         | \$ 951     | \$ 244                 | \$ 445       | \$ 1,908  | \$ 24                         | \$ 596 | \$ 9,366    |       |
| Charge-offs                  | (23 )             | —            | (649 )           | —          | —                      | -            | (460 )  | —                             | —      | (1,132 )    |       |
| Recoveries                   | 11                | —            | 9                | 1          | —                      | 2            | 213   | 1                             | —      | 237         |       |
| Provision                    | 88                | 3            | 968              | 34         | 2                      | 47           | 205   | (2 )                          | (595 ) | 750         |       |
| ALL balance at June 30, 2017 | \$4,206           | \$ 33        | \$ 1,366         | \$ 986     | \$ 246                 | \$ 494       | \$ 1,866  | \$ 23                         | \$ 1   | \$ 9,221    |       |
| ALL balance at               |                   |              |                  |            |                        |              |   |                               |        |             |       |
| September 30, 2017           | \$3,878           | \$ 23        | \$ 1,758         | \$ 987     | \$ 248                 | \$ 470       | \$ 1,836  | \$ 21                         | \$ 144 | \$ 9,365    |       |
| Charge-offs                  | (215 )            | —            | (27 )            | (137 )     | —                      | (47 )        | (1,415 )  | (21 )                         | —      | (1,862 )    |       |
| Recoveries                   | 9                 | —            | 2                | 10         | —                      | 38           | 490   | 3                             | —      | 552         |       |
| Provision                    | (136 )            | 20           | 1,275            | 524        | 44                     | (53 )        | 959   | 20                            | 422    | 3,075       |       |
| ALL balance at June 30, 2018 | \$3,536           | \$ 43        | \$ 3,008         | \$ 1,384   | \$ 292                 | \$ 408       | \$ 1,870  | \$ 23                         | \$ 566 | \$ 11,130   |       |
| ALL balance at               |                   |              |                  |            |                        |              |   |                               |        |             |       |
| September 30, 2016           | \$4,426           | \$ 13        | \$ 852           | \$ 882     | \$ 215                 | \$ 455       | \$ 1,880  | \$ 25                         | \$ 308 | \$ 9,056    |       |
| Charge-offs                  | (390 )            | —            | (867 )           | (20 )      | —                      | (6 )         | (1,521 )  | (4 )                          | —      | (2,808 )    |       |
| Recoveries                   | 18                | —            | 19               | 1          | —                      | 5            | 673   | 7                             | —      | 723         |       |
| Provision                    | 152               | 20           | 1,362            | 123        | 31                     | 40           | 834   | (5 )                          | (307 ) | 2,250       |       |
| ALL balance at June 30, 2017 | \$4,206           | \$ 33        | \$ 1,366         | \$ 986     | \$ 246                 | \$ 494       | \$ 1,866  | \$ 23                         | \$ 1   | \$ 9,221    |       |

ALL balance at June  
30, 2017

Acquired loans are recorded at fair value on their purchase date without a carryover of the related allowance for loan losses.

The Company allocated increased provisions to commercial real estate loans due primarily to increased loan balances for the three and nine month periods ended June 30, 2018. The Company allocated increased provisions to commercial loans due primarily to increased loan balances for the three and nine month periods ended June 30, 2018. The Company allocated increased provisions to commercial real estate loans for the three month period ended June 30, 2017 due to charge off activity. The Company allocated increased provisions to auto loans for the three and nine month periods ended June 30, 2018 and 2017 due to increased charge offs, net of recoveries.

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The following table summarizes the primary segments of the ALL, segregated into two categories, the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of June 30, 2018 and September 30, 2017 (in thousands):

|                                   | Real Estate Residential | Loans Construction | Commercial | Loans Commercial | Political Subdivisions | Home Obligation States and of | Equity Loans and Lines | Auto Loans | Other Loans | Unallocated | Total |
|-----------------------------------|-------------------------|--------------------|------------|------------------|------------------------|-------------------------------|------------------------|------------|-------------|-------------|-------|
| Individually                      |                         |                    |            |                  |                        |                               |                        |            |             |             |       |
| evaluated for                     |                         |                    |            |                  |                        |                               |                        |            |             |             |       |
| impairment                        | \$ 118                  | \$ —               | \$ —       | \$ —             | \$ —                   | \$ 3                          | \$ 98                  | \$ —       | \$ —        | \$ 219      |       |
| Collectively                      |                         |                    |            |                  |                        |                               |                        |            |             |             |       |
| evaluated for                     |                         |                    |            |                  |                        |                               |                        |            |             |             |       |
| impairment                        | 3,418                   | 43                 | 3,008      | 1,384            | 292                    | 405                           | 1,772                  | 23         | 566         | 10,911      |       |
| ALL balance at June 30, 2018      | \$3,536                 | \$ 43              | \$ 3,008   | \$ 1,384         | \$ 292                 | \$ 408                        | \$ 1,870               | \$ 23      | \$ 566      | \$ 11,130   |       |
| Individually                      |                         |                    |            |                  |                        |                               |                        |            |             |             |       |
| evaluated for                     |                         |                    |            |                  |                        |                               |                        |            |             |             |       |
| impairment                        | \$ 154                  | \$ —               | \$ 19      | \$ —             | \$ —                   | \$ —                          | \$ 172                 | \$ —       | \$ —        | \$ 345      |       |
| Collectively                      |                         |                    |            |                  |                        |                               |                        |            |             |             |       |
| evaluated for                     |                         |                    |            |                  |                        |                               |                        |            |             |             |       |
| impairment                        | 3,724                   | 23                 | 1,739      | 987              | 248                    | 470                           | 1,664                  | 21         | 144         | 9,020       |       |
| ALL balance at September 30, 2017 | \$3,878                 | \$ 23              | \$ 1,758   | \$ 987           | \$ 248                 | \$ 470                        | \$ 1,836               | \$ 21      | \$ 144      | \$ 9,365    |       |

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

The following is a summary of troubled debt restructuring granted during the three and nine months ended June 30, 2018 and 2017 (dollars in thousands):

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For the Three Months Ended June 30,  
2018

|  | Pre-Modification                     |       | Post-Modification       |   |
|--|--------------------------------------|-------|-------------------------|---|
|  | Outstanding<br>Number<br>of Recorded |       | Outstanding<br>Recorded |   |
|  | Contract                             |       | Investment              |   |
| Troubled Debt Restructurings                     |                                      |       |                         |   |
| Real estate loans:                               |                                      |       |                         |   |
| Residential                                      | —                                    | —     | —                       | — |
| Construction                                     | —                                    | —     | —                       | — |
| Commercial                                       | —                                    | —     | —                       | — |
| Commercial                                       | —                                    | —     | —                       | — |
| Obligations of states and political subdivisions | —                                    | —     | —                       | — |
| Home equity loans and lines of credit            | —                                    | —     | —                       | — |
| Auto loans                                       | 3                                    | 20    | 20                      | — |
| Other  | —                                    | —     | —                       | — |
| Total  | 3                                    | \$ 20 | \$ 20                   | — |

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For the Three Months Ended June 30,  
2017

|  | Pre-Modification                     |               | Post-Modification       |               |
|--|--------------------------------------|---------------|-------------------------|---------------|
|  | Outstanding<br>Number<br>of Recorded |               | Outstanding<br>Recorded |               |
|  | Contract                             |               | Investment              |               |
| <b>Troubled Debt Restructurings</b>              |                                      |               |                         |               |
| Real estate loans:                               |                                      |               |                         |               |
| Residential                                      | 2                                    | \$ 529        |                         | \$ 529        |
| Construction                                     | —                                    | —             |                         | —             |
| Commercial                                       | —                                    | —             |                         | —             |
| Commercial                                       | —                                    | —             |                         | —             |
| Obligations of states and political subdivisions | —                                    | —             |                         | —             |
| Home equity loans and lines of credit            | —                                    | —             |                         | —             |
| Auto loans                                       | 1                                    | 13            |                         | 13            |
| Other  | —                                    | —             |                         | —             |
| <b>Total</b>                                     | <b>3</b>                             | <b>\$ 542</b> |                         | <b>\$ 542</b> |

For the Nine Months Ended June 30,  
2018

|  | Pre-Modification                     |               | Post-Modification       |               |
|--|--------------------------------------|---------------|-------------------------|---------------|
|  | Outstanding<br>Number<br>of Recorded |               | Outstanding<br>Recorded |               |
|  | Contract                             |               | Investment              |               |
| <b>Troubled Debt Restructurings</b>              |                                      |               |                         |               |
| Real estate loans:                               |                                      |               |                         |               |
| Residential                                      | 2                                    | \$ 243        |                         | \$ 235        |
| Construction                                     | —                                    | —             |                         | —             |
| Commercial                                       | 1                                    | 107           |                         | 107           |
| Commercial                                       | —                                    | —             |                         | —             |
| Obligations of states and political subdivisions | —                                    | —             |                         | —             |
| Home equity loans and lines of credit            | —                                    | —             |                         | —             |
| Auto loans                                       | 4                                    | 35            |                         | 35            |
| Other  | —                                    | —             |                         | —             |
| <b>Total</b>                                     | <b>7</b>                             | <b>\$ 385</b> |                         | <b>\$ 377</b> |

For the Nine Months Ended June 30,  
2017

Pre-Modification Post-Modification



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|  | Number<br>of<br>Contracts | Outstanding<br>Recorded<br>Investment | Outstanding<br>Recorded<br>Investment |
|--|---------------------------|---------------------------------------|---------------------------------------|
| <b>Troubled Debt Restructurings</b>              |                           |                                       |                                       |
| Real estate loans:                               |                           |                                       |                                       |
| Residential                                      | 5                         | \$ 902                                | \$ 902                                |
| Construction                                     | —                         | —                                     | —                                     |
| Commercial                                       | 1                         | 93                                    | 93                                    |
| Commercial                                       | —                         | —                                     | —                                     |
| Obligations of states and political subdivisions | —                         | —                                     | —                                     |
| Home equity loans and lines of credit            | —                         | —                                     | —                                     |
| Auto loans                                       | 1                         | 13                                    | 13                                    |
| Other  | 1                         | 21                                    | 21                                    |
| <b>Total</b>                                     | <b>8</b>                  | <b>\$ 1,029</b>                       | <b>\$ 1,029</b>                       |

The three new troubled debt restructurings granted for the three months ended June 30, 2018 totaling \$20,000 were granted term and rate concessions.

Of the three new troubled debt restructurings granted for the three months ended June 30, 2017, two loans totaling \$206,000 were granted term and rate concessions, one loan for \$336,000 was granted interest rate concessions.

For the nine months ended June 30, 2018, six loans totaling \$270,000 were granted term and rate concessions and one loan for \$107,000 was granted terms concessions.

Of the eight new troubled debt restructurings granted for the nine months ended June 30, 2017, one loan totaling \$133,000 was granted terms concessions, two loans totaling \$357,000 were granted interest rate concessions, and five loans totaling \$539,000 were granted terms and rate concessions.

For the three months ended June 30, 2018, no loans defaulted on a restructuring defaulted on a restructuring agreement within one year of modification.

For the nine months ended June 30, 2018, one loan totaling \$72,000 defaulted on a restructuring agreement within one year of modification.

For the three and nine months ended June 30, 2017 no loans defaulted on a restructuring agreement within one year of modification.

Foreclosed assets acquired in settlement of loans are carried at fair value, less estimated costs to sell, and are included in the Consolidated Balance Sheet. As of June 30, 2018, included within the foreclosed assets is \$1.2 million of consumer residential mortgages that were foreclosed on or received via a deed in lieu of foreclosure transaction prior to the period end. As of June 30, 2018, the Company has initiated formal foreclosure proceedings on \$3.0 million of consumer residential mortgages which have not yet been transferred into foreclosed assets.

#### 7. Deposits

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

|                                      | June 30,     | September 30, |
|--------------------------------------|--------------|---------------|
|                                      | 2018         | 2017          |
| Non-interest bearing demand accounts | \$ 164,777   | \$ 160,125    |
| Interest bearing demand accounts     | 169,521      | 208,369       |
| Money market accounts                | 267,990      | 253,949       |
| Savings and club accounts            | 141,176      | 141,521       |
| Certificates of deposit              | 526,402      | 510,897       |
| Total                                | \$ 1,269,866 | \$ 1,274,861  |

#### 8. Net Periodic Benefit Cost-Defined Benefit Plan

For a detailed disclosure on the Bank's pension and employee benefits plans, please refer to Note 12 of the Company's Consolidated Financial Statements for the year ended September 30, 2017 included in the Company's Annual Report on Form 10-K.

The following table comprises the components of net periodic benefit cost for the three and nine month periods ended June 30, 2018 and 2017 (in thousands):

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|                                   | For the Three<br>Months<br>Ended June<br>30, |         | For the Nine<br>Months Ended<br>June 30, |         |
|-----------------------------------|--|---------|--|---------|
|                                   | 2018   | 2017    | 2018                                     | 2017    |
| Service Cost                      | \$—  | \$69    | \$—                                      | \$447   |
| Interest Cost                     | 174  | 208     | 523                                      | 651     |
| Expected return on plan assets    | (298)  | (348)   | (895)                                    | (1,037) |
| Amortization of unrecognized loss | —  | 23      | —  | 182     |
| Net periodic benefit cost         | \$(124)                                      | \$(48 ) | \$(372)                                  | \$243   |

The Company's board of directors adopted resolutions to freeze the status of the Defined Benefit Plan ("the plan") effective February 28, 2017 ("the freeze date"). Accordingly, no additional participants will enter the plan after February 28, 2017; no additional years of service for benefit accrual purposes will be credited after the freeze date under the plan; and compensation earned by participants after the freeze date will not be taken into account under the plan.

As a result of the freeze, the Company's projected benefit obligation decreased by \$7.1 million and there was a tax effected \$4.7 million increase to accumulated other comprehensive income in the quarter ended March 31, 2017.

#### 9. Equity Incentive Plan

The Company previously maintained the ESSA Bancorp, Inc. 2007 Equity Incentive Plan (the "Plan"). The Plan provided for a total of 2,377,326 shares of common stock for issuance upon the grant or exercise of awards. Of the shares that were available under the Plan, 1,698,090 were available to be issued in connection with the exercise of stock options and 679,236 were available to be issued as restricted stock. The Plan allowed for the granting of non-qualified stock options ("NSOs"), incentive stock options ("ISOs"), and restricted stock. Options granted under the plan were granted at no less than the fair value of the Company's common stock on the date of the grant. As of the effective date of the 2016 Equity Incentive Plan (detailed below), no further grants will be made under the Plan and forfeitures of outstanding awards under the Plan will be added to the shares available under the 2016 Equity Incentive Plan.

The Company replaced the 2007 Equity Incentive Plan with the ESSA Bancorp, Inc. 2016 Equity Incentive Plan (the "2016 Plan") which was approved by shareholders on March 3, 2016. The 2016 Plan provides for a total of 250,000 shares of common stock for issuance upon the grant or exercise of awards. The 2016 Plan allows for the granting of restricted stock, restricted stock units, ISOs and NSOs.

Certain officers, employees and outside directors were granted in aggregate 1,140,469 NSOs; 317,910 ISOs; and 590,320 shares of restricted stock on May 23, 2008. Certain officers were granted in aggregate 30,000 shares of restricted stock on April 1, 2013, 19,880 shares of restricted stock on July 22, 2014, 21,843 shares of restricted stock on May 20, 2015, 23,491 shares of restricted stock on March 4, 2016, 20,675 shares of restricted stock on December 13, 2016, 3,296 shares of restricted stock on March 29, 2017, 1,250 shares of restricted stock on October 23, 2017 and 24,278 of restricted stock on December 6, 2017. In accordance with generally accepted accounting principles, the Company expenses the fair value of all share-based compensation grants over the requisite service periods.

The Company classifies share-based compensation for employees and outside directors within "Compensation and employee benefits" in the Consolidated Statement of Income to correspond with the same line item as compensation paid.

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

The 2013 restricted stock shares vested over an 18 month service period. The 2014 restricted shares vest over a 39 month service period. The 2015 restricted shares vest over a 40 month service period. The March 4, 2016 restricted shares vest over a 43 month service period. The December 13, 2016 restricted shares vest over a 46 month service period. The March 29, 2017 restricted shares vest over 42 months for 1,296 shares and over 18 months for 2,000 shares. The October 23, 2017 restricted shares vested over a 23 month service period. The December 6, 2017 restricted shares vest over a 46 month service period. The product of the number of shares granted and the grant date market price of the Company's common stock determines the fair value of restricted shares under the Company's restricted stock plan.

For the nine months ended June 30, 2018 and 2017, the Company recorded \$276,000 and \$231,000 of share-based compensation expense, respectively, comprised of restricted stock expense. Expected future compensation expense relating to the restricted shares issued in 2015, at June 30, 2018 is \$20,000 over the remaining vesting period of 0.25

years. Expected future compensation expense relating to the restricted shares issued in March 2016, at June 30, 2018 is \$106,000 over the remaining vesting period of 1.25 years. Expected future compensation expense relating to the restricted shares issued in December 2016, at June 30, 2018 is \$201,000 over the remaining vesting period of 2.25 years. Expected future compensation expense relating to the restricted shares (1,296) issued in March 2017, at June 30, 2018 is \$12,000 over the remaining vesting period of 2.25 years. Expected future compensation expense relating to the restricted shares (2,000) issued in March 2017, at June 30, 2018 is \$5,000 over the remaining vesting period of 0.25 years. Expected future compensation expense relating to the restricted shares issued in October 2017, at June 30, 2018 is \$12,000 over the remaining vesting period of 1.25 years. Expected future compensation expense relating to the restricted shares issued in December 2017, at June 30, 2018 is \$326,000 over the remaining vesting period of 3.25 years.

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The following is a summary of the Company's stock option activity and related information for its option grants for the nine month period ended June 30, 2018.

|                                   | Number of     | Exercise | Weighted-<br>average<br>Remaining<br>Contractual | Weighted-<br>average<br>Term (in years) | Aggregate<br>Intrinsic<br>Value<br>(in<br>thousands) |
|-----------------------------------|---------------|----------|--|---|--|
|                                   | Stock Options | Price    |  |   |  |
| Outstanding at September 30, 2017 | 294,646       | \$ 12.35 |  | 0.67                                    | \$ 987   |
| Granted                           | —             | —        |  | —                                       | —  |
| Exercised                         | 294,646       | 12.35    |  | —                                       | —  |
| Forfeited                         | —             | —        |  | —                                       | —  |
| Outstanding at June 30, 2018      | —             | \$ —     |  | —                                       | \$ —   |
| Exercisable at June 30, 2018      | —             | \$ —     |  | —                                       | \$ —   |

The following is a summary of the status of the Company's restricted stock as of June 30, 2018, and changes therein during the nine month period then ended:

|                                 | Number of        | Grant<br>Date | Weighted-<br>average<br>Fair Value |
|---------------------------------|------------------|---------------|------------------------------------|
|                                 | Restricted Stock |               |                                    |
| Nonvested at September 30, 2017 | 34,692           |               | \$ 14.89                           |
| Granted                         | 25,528           |               | 15.86                              |
| Vested                          | (1,000 )         |               | —                                  |
| Forfeited                       | (2,535 )         |               | 14.79                              |
| Nonvested at June 30, 2018      | 56,685           |               | \$ 15.31                           |

#### 10. Fair Value Measurement

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



The following tables present information about the Company's securities, derivatives, other real estate owned, impaired loans and mortgage servicing rights measured at fair value as of June 30, 2018 and September 30, 2017 and indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value:

| Fair Value Measurement at June 30, 2018                |                   |                     |                 |                   |
|--|-------------------|---------------------|-----------------|-------------------|
| Quoted<br>Prices                                       |                   |                     |                 |                   |
| in<br>Active   |                   |                     |                 |                   |
| Markets<br>for   |                   |                     |                 |                   |
| Significant Other Significant                          |                   |                     |                 |                   |
| Identical Assets                                       |                   |                     |                 |                   |
| Fair Value Measurements Utilized for the Company's     | Observable Inputs | Unobservable Inputs | Balances as of  |                   |
| (Level   | (Level 2)         | (Level 3)           | June 30, 2018   |                   |
| 1)   |                   |                     |                 |                   |
| Financial Assets (in thousands):                       |                   |                     |                 |                   |
| Assets measured at fair value on a recurring basis:    |                   |                     |                 |                   |
| Investment securities available for sale:              |                   |                     |                 |                   |
| Mortgage backed securities                             | \$—               | \$ 245,052          | \$ —            | \$ 245,052        |
| Obligations of states and political subdivisions       | —                 | 49,494              | —               | 49,494            |
| U.S. government agencies                               | —                 | 12,703              | —               | 12,703            |
| Corporate obligations                                  | —                 | 35,850              | 7,769           | 43,619            |
| Other debt securities                                  | —                 | 20,220              | —               | 20,220            |
| Equity securities-financial services                   | 21                | —                   | —               | 21                |
| <b>Total Securities</b>                                | <b>\$21</b>       | <b>\$ 363,319</b>   | <b>\$ 7,769</b> | <b>\$ 371,109</b> |
| Derivatives and hedging activities:                    | \$—               | \$ 2,408            | \$ —            | \$ 2,408          |
| Assets measured at fair value on a nonrecurring basis: |                   |                     |                 |                   |
| Foreclosed real estate                                 | \$—               | \$ —                | \$ 1,368        | \$ 1,368          |
| Impaired loans   | \$—               | \$ —                | \$ 11,902       | \$ 11,902         |
| Mortgage servicing rights                              | \$—               | \$ —                | \$ 210          | \$ 210            |

| Fair Value Measurement at September 30, 2017       |                   |                     |                |  |
|--|-------------------|---------------------|----------------|--|
| Quoted<br>Prices                                   |                   |                     |                |  |
| in<br>Active                                       |                   |                     |                |  |
| Markets<br>for                                     |                   |                     |                |  |
| Significant Other Significant                      |                   |                     |                |  |
| Identical Assets                                   |                   |                     |                |  |
| Fair Value Measurements Utilized for the Company's | Observable Inputs | Unobservable Inputs | Balances as of |  |
| (Level 2)  | (Level 2)         | (Level 3)           | September 30,  |  |
|  |                   |                     | 2017           |  |
| Financial Assets (in thousands):                   |                   |                     |                |  |



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(Level  
1)

Assets measured at fair value on a recurring basis:

Investment securities available for sale:

|  |             |                   |                 |                   |
|--|-------------|-------------------|-----------------|-------------------|
| Mortgage backed securities                       | \$—         | \$ 233,823        | \$ —            | \$ 233,823        |
| Obligations of states and political subdivisions | —           | 65,358            | —               | 65,358            |
| U.S. government agencies                         | —           | 18,671            | —               | 18,671            |
| Corporate obligations                            | —           | 41,518            | 7,224           | 48,742            |
| Other debt securities                            | —           | 23,833            | —               | 23,833            |
| Equity securities-financial services             | 25          | —                 | —               | 25                |
| <b>Total Securities</b>                          | <b>\$25</b> | <b>\$ 383,203</b> | <b>\$ 7,224</b> | <b>\$ 390,452</b> |
| Derivatives and hedging activities               | \$—         | \$ 1,215          | \$ —            | \$ 1,215          |

Assets measured at fair value on a nonrecurring basis:

|                           |     |      |           |           |
|---------------------------|-----|------|-----------|-----------|
| Foreclosed real estate    | \$— | \$ — | \$ 1,424  | \$ 1,424  |
| Impaired loans            | \$— | \$ — | \$ 15,231 | \$ 15,231 |
| Mortgage Servicing rights | \$— | \$ — | \$ 232    | \$ 232    |

The following tables present a summary of changes in the fair value of the Company's Level III investments for the three and nine month periods ended June 30, 2018 and 2017 (in thousands).

|   | Fair Value<br>Measurement<br>Using<br><br>Significant<br>Unobservable<br>Inputs<br><br>(Level III)<br>Three Months<br>Ended<br>June    June<br>30,    30,<br>2018   2017 |         |
|---|--|---------|
| Beginning balance                             | \$7,767  | \$8,735 |
| Purchases, sales, issuances, settlements, net | —  | —       |
| Total unrealized gain (loss):                 |  |         |
| Included in earnings                          | —  | —       |
| Included in other comprehensive income (loss) | 2  | (21 )   |
| Transfers in and/or out of Level III          | —  | —       |
|   | \$7,769  | \$8,714 |

|   | Fair Value<br>Measurement<br>Using<br><br>Significant<br>Unobservable<br>Inputs<br><br>(Level III)<br>Nine Months<br>Ended<br>June    June<br>30,    30,<br>2018   2017 |         |
|---|---|---------|
| Beginning balance                             | \$7,224   | \$7,485 |
| Purchases, sales, issuances, settlements, net | 500   | 756     |
| Total unrealized gain (loss):                 |   |         |
| Included in earnings                          | —   | —       |
| Included in other comprehensive income        | 45  | 473     |
| Transfers in and/or out of Level III          | —   | —       |
|   | \$7,769   | \$8,714 |

Each financial asset and liability is identified as having been valued according to a specified level of input, 1, 2 or 3. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset, either directly or indirectly. Level 2 inputs include quoted prices for similar assets in active markets, and inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy, within which the fair value measurement in its entirety falls, has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset.

The measurement of fair value should be consistent with one of the following valuation techniques: market approach, income approach, and/or cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering factors specific to the measurement (qualitative and quantitative). Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on a security's relationship to other benchmark quoted securities. Most of the securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quoted market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Securities reported at fair value utilizing Level 1 inputs are limited to actively traded equity securities whose market price is readily available from the New York Stock Exchange or the NASDAQ exchange. A few securities are valued using Level 3 inputs, all of these are classified as available for sale and are reported at fair value using Level 3 inputs. Mortgage servicing rights are also valued by an independent pricing service. Foreclosed real estate is measured at fair value, less cost to sell at the date of foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value, less cost to sell. Income and expenses from operations and changes in valuation allowance are included in the net expenses from foreclosed real estate. Impaired loans are reported at fair value utilizing level three inputs. For these loans, a review of the collateral is conducted and an appropriate allowance

for loan losses is allocated to the loan. At June 30, 2018, 130 impaired loans with a carrying value of \$12.1 million were reduced by specific valuation allowance totaling \$219,000 resulting in a net fair value of \$11.9 million based on Level 3 inputs. At September 30, 2017, 164 impaired loans with a carrying value of \$15.6 million were reduced by a specific valuation totaling \$345,000 resulting in a net fair value of \$15.2 million based on Level 3 inputs.

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

| (in thousands)               | Quantitative Information about Level 3 Fair Value Measurements |                                  |                           |                                 |
|------------------------------|--|----------------------------------|---------------------------|---------------------------------|
|                              | Fair Value   | Valuation Techniques             | Unobservable Input        | Range                           |
| June 30, 2018                |  |                                  |                           |                                 |
| Impaired loans               | \$ 11,902  | Appraisal of collateral (1)      | Appraisal adjustments (2) | 0% to 35%                       |
| Foreclosed real estate owned | 1,368  | Appraisal of collateral (1), (3) | Appraisal adjustments (2) | 20% to 46%                      |
| Mortgage servicing rights    | 210  | Discounted cash flow             | Discount rate             | 11.0%                           |
|                              |  |                                  | Prepayment speeds         | (11.0%)<br>8% to 31%<br>(12.1%) |

| (in thousands)               | Quantitative Information about Level 3 Fair Value Measurements |                                  |                           |            |
|------------------------------|--|----------------------------------|---------------------------|------------|
|                              | Fair Value   | Valuation Techniques             | Unobservable Input        | Range      |
| September 30, 2017           |  |                                  |                           |            |
| Impaired loans               | \$ 15,231  | Appraisal of collateral (1)      | Appraisal adjustments (2) | 0% to 57%  |
| Foreclosed real estate owned | 1,424  | Appraisal of collateral (1), (3) | Appraisal adjustments (2) | 20% to 46% |
|                              |  |                                  |                           | (22.0%)    |

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|                           |     |            |            |         |
|---------------------------|-----|------------|------------|---------|
| Mortgage servicing rights | 232 | Discounted | Discount   | 11.0%   |
|                           |     | cash flow  | rate       | (11.0%) |
|                           |     |            | Prepayment | 11% to  |
|                           |     |            | speeds     | 30%     |
|                           |     |            |            | (15.9%) |

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

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

## Disclosures about Fair Value of Financial Instruments

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

|   | June 30, 2018  |           |          |           | Total Fair       |
|---|----------------|-----------|----------|-----------|------------------|
|   | Carrying Value | Level I   | Level II | Level III | Value            |
| <b>Financial assets:</b>                      |                |           |          |           |                  |
| Cash and cash equivalents                     | \$37,907       | \$37,907  | \$—      | \$—       | \$37,907         |
| Certificates of deposit                       | 500            | —         | —        | 500       | 500              |
| Investment and mortgage backed securities     |                |           |          |           |                  |
| available for sale                            | 371,109        | 21        | 363,319  | 7,769     | 371,109          |
| Loans receivable, net                         | 1,301,589      | —         | —        | 1,271,806 | 1,271,806        |
| Accrued interest receivable                   | 6,265          | 6,265     | —        | —         | 6,265            |
| Regulatory stock                              | 16,597         | 16,597    | —        | —         | 16,597           |
| Mortgage servicing rights                     | 210            | —         | —        | 210       | 210              |
| Derivatives                                   | 2,408          | —         | 2,408    | —         | 2,408            |
| Bank owned life insurance                     | 38,380         | 38,380    | —        | —         | 38,380           |
| <b>Financial liabilities:</b>                 |                |           |          |           |                  |
| Deposits                                      | \$1,269,866    | \$743,464 | \$—      | \$522,313 | \$1,265,777      |
| Short-term borrowings                         | 220,006        | 220,006   | —        | —         | 220,006          |
| Other borrowings                              | 131,119        | —         | —        | 129,971   | 129,971          |
| Advances by borrowers for taxes and insurance | 14,802         | 14,802    | —        | —         | 14,802           |
| Accrued interest payable                      | 1,302          | 1,302     | —        | —         | 1,302            |
| <b>September 30, 2017</b>                     |                |           |          |           |                  |
|   | Carrying Value | Level I   | Level II | Level III | Total Fair Value |
| <b>Financial assets:</b>                      |                |           |          |           |                  |
| Cash and cash equivalents                     | \$41,683       | \$41,683  | \$—      | \$—       | \$41,683         |
| Certificates of deposit                       | 500            | —         | —        | 505       | 505              |
| Investment and mortgage backed securities     |                |           |          |           |                  |
| available for sale                            | 390,452        | 25        | 383,203  | 7,224     | 390,452          |
| Loans receivable, net                         | 1,236,681      | —         | —        | 1,235,368 | 1,235,368        |
| Accrued interest receivable                   | 6,149          | 6,149     | —        | —         | 6,149            |
| Regulatory stock                              | 13,832         | 13,832    | —        | —         | 13,832           |
| Mortgage servicing rights                     | 232            | —         | —        | 232       | 232              |
| Derivatives                                   | 1,215          | —         | 1,215    | —         | 1,215            |
| Bank owned life insurance                     | 37,626         | 37,626    | —        | —         | 37,626           |
| <b>Financial liabilities:</b>                 |                |           |          |           |                  |
| Deposits                                      | \$1,274,861    | \$763,964 | \$—      | \$511,392 | \$1,275,356      |

|   |         |         |   |         |         |
|---|---------|---------|---|---------|---------|
| Short-term borrowings                         | 137,446 | 137,446 | — | —       | 137,446 |
| Other borrowings                              | 174,168 | —       | — | 174,107 | 174,107 |
| Advances by borrowers for taxes and insurance | 5,163   | 5,163   | — | —       | 5,163   |
| Accrued interest payable                      | 1,043   | 1,043   | — | —       | 1,043   |

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

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

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

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

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

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

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

The fair value approximates the current book value.

Bank-Owned Life Insurance

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

Investment and Mortgage-Backed Securities Available for Sale and Regulatory Stock

The fair value of investment and mortgage-backed securities available for sale is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Since the Regulatory stock is not actively traded on a secondary market and held exclusively by member financial institutions, the fair market value approximates the carrying amount. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) are used to support fair values of certain Level 3 investments, if applicable.

Loans Receivable, Net

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Mortgage Servicing Rights

The Company utilizes a third party provider to estimate the fair value of certain loan servicing rights. Fair value for the purpose of this measurement is defined as the amount at which the asset could be exchanged in a current transaction between willing parties, other than in a forced liquidation.

Derivatives



Fair values of interest rate cap and interest rate swap contracts are based on dealer quotes.

Deposits (including Certificates of Deposit)

The fair values disclosed for demand, savings, and money market deposit accounts are valued at the amount payable on demand as of quarter-end. Fair values for time deposits are estimated using a discounted cash flow calculation that applies contractual costs currently being offered in the existing portfolio to current market rates being offered for deposits of similar remaining maturities.

## Other Borrowings

Fair values for other borrowings are estimated using a discounted cash flow calculation that applies contractual costs currently being offered in the existing portfolio to current market rates being offered for other borrowings of similar remaining maturities.

## Commitments to Extend Credit

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

## 11. Accumulated Other Comprehensive Loss

The activity in accumulated other comprehensive loss for the three and nine months period ended June 30, 2018 and 2017 is as follows (in thousands):

|  | Accumulated Other<br>Comprehensive Loss |   |             |           |
|--|---|---|-------------|-----------|
|  | Defined<br>Benefit<br>Pension<br>Plan   | Unrealized Gains<br>(Losses) on<br>Securities<br>Available for Sale | Derivatives | Total     |
| Balance at March 31, 2018  | \$(752 )                                | \$ (7,808 )   | \$ 1,825    | \$(6,735) |
| Other comprehensive income (loss) before<br>reclassifications  | —                                       | (1,376 )  | 188         | (1,188)   |
| Amounts reclassified from accumulated<br>other comprehensive loss                                    | —                                       | —   | (112 )      | (112 )    |
| Reclassification of certain income tax effects from<br>accumulated other comprehensive income (loss) | —                                       | —   | —           | —         |
| Period change  | —                                       | (1,376 )  | 76          | (1,300)   |
| Balance at June 30, 2018   | \$(752 )                                | \$ (9,184 )   | \$ 1,901    | \$(8,035) |
| Balance at March 31, 2017  | \$(1,266)                               | \$ (2,020 )   | \$ 922      | \$(2,364) |
| Other comprehensive income (loss) before<br>reclassifications  | —                                       | 940   | (149 )      | 791       |
| Amounts reclassified from accumulated<br>other comprehensive loss, net of tax                        | 12                                      | (195 )  | (2 )        | (185 )    |
| Period change  | 12                                      | 745   | (151 )      | 606       |

|                          |            |           |          |            |
|--------------------------|------------|-----------|----------|------------|
| Balance at June 30, 2017 | \$ (1,254) | \$ (1,275 | ) \$ 771 | \$ (1,758) |
|--------------------------|------------|-----------|----------|------------|

|   | Accumulated Other           |                    |             |            |
|---|-----------------------------|--------------------|-------------|------------|
|   | Comprehensive Income/(Loss) |                    |             |            |
|   | Unrealized Gains            |                    |             |            |
|   | Defined                     |                    |             |            |
|   | (Losses) on                 |                    |             |            |
|   | Benefit                     |                    |             |            |
|   | Securities                  |                    |             |            |
|   | Pension                     |                    |             |            |
|   | Plan                        | Available for Sale | Derivatives | Total      |
| Balance at September 30, 2017                       | \$(628 )                    | \$ (927 )          | \$ 801      | \$(754 )   |
| Other comprehensive income (loss) before            |                             |                    |             |            |
| reclassifications                                   | —                           | (7,764 )           | 1,076       | (6,688 )   |
| Amounts reclassified from accumulated other         |                             |                    |             |            |
| comprehensive loss, net of tax                      | —                           | (57 )              | (190 )      | (247 )     |
| Reclassification of certain income tax effects from |                             |                    |             |            |
| accumulated other comprehensive income              | (124 )                      | (436 )             | 214         | (346 )     |
| Period change                                       | (124 )                      | (8,257 )           | 1,100       | (7,281 )   |
| Balance at June 30, 2018                            | \$(752 )                    | \$ (9,184 )        | \$ 1,901    | \$(8,035 ) |
| Balance at September 30, 2016                       | \$(6,083 )                  | \$ 3,952           | \$ 299      | \$(1,832 ) |
| Other comprehensive income before reclassifications | 4,714                       | (5,032 )           | 470         | 152        |
| Amounts reclassified from accumulated other         |                             |                    |             |            |
| comprehensive loss, net of tax                      | 115                         | (195 )             | 2           | (78 )      |
| Period change                                       | 4,829                       | (5,227 )           | 472         | 74         |
| Balance at June 30, 2017                            | \$(1,254 )                  | \$ (1,275 )        | \$ 771      | \$(1,758 ) |

The following table presents significant amounts reclassified out of each component of accumulated other comprehensive loss for the three and nine month periods ended June 30, 2018 and 2017 (in thousands):

| Amount Reclassified from             |                                  |
|--------------------------------------|----------------------------------|
| Accumulated Other Comprehensive Loss |                                  |
| Accumulated                          |                                  |
| Other                                |                                  |
| Comprehensive                        |                                  |
| Loss for the                         |                                  |
| Three Months Ended June              | Affected Line Item in the        |
| 30,                                  | Consolidated Statement of Income |
| 2018                                 | 2017                             |

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|  |       |       |                                    |
|--|-------|-------|------------------------------------|
| Securities available for sale                              |       |       |                                    |
| Net securities gains reclassified into earnings            | \$—   | \$295 | Gains on sale of investments, net  |
| Related income tax expense                                 | —     | (100) | Income taxes                       |
| Net effect on accumulated other comprehensive loss for the |       |       |                                    |
| period   | —     | 195   | Net of tax                         |
| Defined benefit pension plan:                              |       |       |                                    |
| Amortization of net (loss) gain and prior service costs    | —     | (23 ) | Compensation and employee benefits |
| Related income tax expense                                 | —     | 11    | Income taxes                       |
| Net effect on accumulated other comprehensive loss for the |       |       |                                    |
| period   | —     | (12 ) | Net of tax                         |
| Derivatives and hedging activities:                        |       |       |                                    |
| Interest expense, effective portion                        | 153   | 3     | Interest expense                   |
| Related income tax expense                                 | (41 ) | (1 )  | Income taxes                       |
| Net effect on accumulated other comprehensive loss for the |       |       |                                    |
| period   | 112   | 2     | Net of tax                         |
| Total reclassification for the period                      | \$112 | \$185 |                                    |

|  | Amount Reclassified from             |                                  |                                    |
|--|--------------------------------------|----------------------------------|------------------------------------|
|  | Accumulated Other Comprehensive Loss |                                  |                                    |
|  | Accumulated                          |                                  |                                    |
|  | Other                                |                                  |                                    |
|  | Comprehensive                        |                                  |                                    |
|  | Loss For the                         |                                  |                                    |
|  | Nine Months                          | Affected Line Item in the        |                                    |
|  | Ended                                | Consolidated Statement of Income |                                    |
|  | June 30,                             | 2018                             | 2017                               |
| <b>Securities available for sale:</b>                      |                                      |                                  |                                    |
| Net securities gains reclassified into earnings            | \$75                                 | \$295                            | Gain on sale of investments, net   |
| Related income tax expense                                 | (18)                                 | (100)                            | Income taxes                       |
| Net effect on accumulated other comprehensive loss for the |                                      |                                  |                                    |
| period   | 57                                   | 195                              | Net of tax                         |
| <b>Defined benefit pension plan:</b>                       |                                      |                                  |                                    |
| Amortization of net (loss) gain and prior services costs   | —                                    | (182)                            | Compensation and employee benefits |
| Related income tax expense                                 | —                                    | 67                               | Income taxes                       |
| Net effect on accumulated other comprehensive loss for the |                                      |                                  |                                    |
| period   | —                                    | (115)                            | Net of tax                         |
| <b>Derivative and Hedging Activities:</b>                  |                                      |                                  |                                    |
| Interest expense, effective portion                        | 252                                  | (3)                              | Interest expense                   |
| Related income tax expense                                 | (62)                                 | 1                                | Income taxes                       |
| Net effect on accumulated other comprehensive loss for the |                                      |                                  |                                    |
| period   | 190                                  | (2)                              | Net of tax                         |
| <b>Total reclassification for the period</b>               | <b>\$247</b>                         | <b>\$78</b>                      |                                    |

## 12. Derivatives and Hedging Activities

### Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities and through the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to certain variable rate borrowings.

### Fair Values of Derivative Instruments on the Consolidated Balance Sheet

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Consolidated Balance Sheet as of June 30, 2018 and September 30, 2017 (in thousands).

| Fair Values of Derivative Instruments                |              |                          |              |          |
|--|--------------|--------------------------|--------------|----------|
| Asset Derivatives                                    |              |                          |              |          |
| As of June 30, 2018                                  |              | As of September 30, 2017 |              |          |
| Balance Sheet  | Fair         | Balance Sheet            | Fair         |          |
| Location   | Value        | Location                 | Value        |          |
| <b>Derivatives designated as hedging instruments</b> |              |                          |              |          |
| Interest Rate Products                               | Other Assets | \$ 2,408                 | Other Assets | \$ 1,215 |

#### Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest income and expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company has entered into interest rate swaps as part of its interest rate risk management strategy. These interest rate swaps are designated as cash flow hedges and involve the receipt of variable rate amounts from a counterparty in exchange for the Company making fixed payments. As of June 30, 2018, the Company had four interest rate swaps with a notional principal amount of \$100.0 million associated with the Company's cash outflows associated with various FHLB advances.

For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings), net of tax, and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. The Company assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged transactions. The Company did not recognize any hedge ineffectiveness in earnings during the period ended June 30, 2018.

Amounts reported in accumulated other comprehensive loss related to derivatives that will be reclassified to interest income/expense as interest payments are made/received on the Company's variable-rate assets/liabilities. During the three months ended June 30, 2018, the Company had \$133,000 of gains reclassified to interest expense. During the nine months ended June 30, 2018, the Company had \$232,000 of gains reclassified to interest expense. During the next twelve months, the Company estimates that \$0 will be reclassified as a decrease in interest expense.

The tables below present the pre-tax net gains (losses) of the Company's cash flow hedges for the three and nine month periods ended June 30, 2018 and 2017, respectively, and where they were recorded in the Consolidated Statement of Income, (in thousands).

| Derivatives in Cash Flow Hedging Relationships | Loss Recognized in OCI on Derivative (Effective Portion) |                | Location of Gain or (Loss) Reclassified from Accumulated OCI into Income | Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) |             | Location of Gain or (Loss) Recognized in Income on Derivative | Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) |             |
|--|--|----------------|--|--|-------------|---|---|-------------|
|  | Three Months Ended June 30, 2018                         | 2017           |  | Three Months Ended June 30, 2018   | 2017        |   | Three Months Ended June 30, 2018  | 2017        |
| Interest Rate Products                         | \$249  | \$(231)        | Interest expense   | \$ 153   | \$ 3        | Other non-interest income                                     | \$ —  | \$ —        |
| Ending balance of OCI                          |  |                |  |  |             |   |   |             |
| <b>Total</b>                                   | <b>\$249</b>   | <b>\$(231)</b> |  | <b>\$ 153</b>  | <b>\$ 3</b> |   | <b>\$ —</b>   | <b>\$ —</b> |

  

| Derivatives in Cash Flow Hedging Relationships | Gain Recognized in OCI on Derivative | Location of Gain or (Loss) Reclassified from Accumulated OCI | (Loss) Reclassified from Accumulated OCI into Income | Location of Gain or (Loss) Recognized in Income on Derivative | Gain or (Loss) Recognized in Income on Derivative |
|--|--------------------------------------|--|--|---|---|
|  |                                      |  |  |   |   |



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|                        | (Effective Portion)        |       | into Income         | (Effective Portion)        |         | Derivative                | Income on Derivative                 |
|------------------------|----------------------------|-------|---------------------|----------------------------|---------|---------------------------|--------------------------------------|
|                        | Nine Months Ended June 30, |       | (Effective Portion) | Nine Months Ended June 30, |         | (Ineffective Portion)     | (Ineffective Portion)                |
|                        | 2018                       | 2017  |                     | 2018                       | 2017    |                           | Nine Months Ended June 30, 2018 2017 |
| Interest Rate Products | \$1,445                    | \$873 | Interest expense    | \$ 252                     | \$ (3 ) | Other non-interest income | \$ — \$ —                            |
| Ending balance of OCI  |                            |       |                     |                            |         |                           |                                      |
| Total                  | \$1,445                    | \$873 |                     | \$ 252                     | \$ (3 ) |                           | \$ — \$ —                            |

Credit-risk-related Contingent Features

The Company has agreements with its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

The Company also has agreements with certain of its derivative counterparties that contain a provision where if the Company fails to maintain its status as a well / adequately capitalized institution, then the counterparty could terminate the derivative positions and the Company would be required to settle its obligations under the agreements.

As of June 30, 2018 the Company had no derivatives in a net liability position and was not required to post collateral against its obligations under these agreements. If the Company had breached any of these provisions at June 30, 2018, it could have been required to settle its obligations under the agreements at the termination value.

13. Contingent Liabilities  
 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 situated plaintiffs who had their automobiles repossessed and seek 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 calls for the Bank to make a payment of \$1,325,000 to the plaintiffs. 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, Inc., 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 has 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 tentatively scheduled oral arguments for October or November 2018. To the extent that this litigation could result in exposure to the bank, the amount is not currently estimable.

14. Income Taxes

The reconciliation of the federal statutory rate and the Company's effective income tax rate is as follows (in thousands):

| For the Three Months Ended June 30, |            |
|-------------------------------------|------------|
| 2018                                | 2017       |
| Amount% of                          | Amount% of |
| Pretax                              | Pretax     |

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|                                       | Income |         |  | Income |          |  |
|---------------------------------------|--------|---------|--|--------|----------|--|
| Provision at statutory rate           | \$806  | 24.2 %  |  | \$751  | 34.0 %   |  |
| Income from bank-owned life insurance | (61 )  | (2.2 %) |  | (88 )  | (4.8 %)  |  |
| Tax-exempt income                     | (112)  | (4.0 %) |  | (210)  | (11.4 %) |  |
| Low-income housing credits            | (53 )  | (1.9 %) |  | (25 )  | (1.4 %)  |  |
| Tax rate change                       | (98 )  | (3.5 %) |  |        | 0.0 %    |  |
| Other, net                            | 18     | 0.6 %   |  | 20     | 1.0 %    |  |
| Actual tax expense and effective rate | \$500  | 13.3 %  |  | \$448  | 17.5 %   |  |

|                                       | For the Nine Months Ended June 30, |         |         |          |  |  |
|---------------------------------------|------------------------------------|---------|---------|----------|--|--|
|                                       | 2018                               |         | 2017    |          |  |  |
|                                       |                                    | % of    |         | % of     |  |  |
|                                       |                                    | Pretax  |         | Pretax   |  |  |
|                                       | Amount                             | Income  | Amount  | Income   |  |  |
| Provision at statutory rate           | \$2,077                            | 24.2 %  | \$2,168 | 34.0 %   |  |  |
| Income from bank-owned life insurance | (183 )                             | (3.5 %) | (264 )  | (6.3 %)  |  |  |
| Tax-exempt income                     | (381 )                             | (7.3 %) | (642 )  | (15.4 %) |  |  |
| Low-income housing credits            | (96 )                              | (1.8 %) | (148 )  | (3.6 %)  |  |  |
| Tax rate change                       | 3,682                              | 70.2 %  | —       | 0.0 %    |  |  |
| Other, net                            | 23                                 | 0.4 %   | (63 )   | (1.5 %)  |  |  |
| Actual tax expense and effective rate | \$5,122                            | 82.3 %  | \$1,051 | 7.2 %    |  |  |

On December 22, 2017, the U.S. Government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act amends the Internal Revenue Code to reduce tax rates and modify policies, credits, and deductions for individuals and businesses. For businesses, the Tax Act reduces the corporate federal tax rate from a maximum of 35% to a flat 21% rate. The corporate tax rate reduction was effective January 1, 2018. Because the Company has a fiscal year end of September 30, the reduced corporate tax rate will result in the application of a blended federal statutory tax rate for its fiscal year 2018

and then a flat 21% thereafter. As a result, the carrying value of net deferred tax assets was reduced in December 2017, which increased income tax expense by \$3.7 million.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. 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. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. These calculations are based on many complex factors including estimates of the timing of reversals of temporary differences, the interpretation of federal income tax laws, and a determination of the differences between the tax and the financial reporting basis of assets and liabilities. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income tax assets and liabilities.

Under GAAP, a valuation allowance is required to be recognized if it is “more likely than not” that a portion of the deferred tax asset will not be realized. Our policy is to evaluate our deferred tax assets on a quarterly basis and record a valuation allowance for our deferred tax asset if we do not have sufficient positive evidence indicating that it is more likely than not that some or all of the deferred tax asset will be realized. Each quarter, we consider positive evidence, which may include taxes paid in carryback years, reversing timing differences, available tax planning strategies, and projected taxable income and weigh it against negative evidence, which may include cumulative losses in the most recent three year period and uncertainty regarding short-term future earnings, among other items. At June 30, 2018, management determined that no valuation allowance on the deferred tax asset was required. This determination was based on sufficient positive evidence associated with our profitability, demonstrated through consecutive earnings over the recent three year period, and our projections for future taxable income.

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

This Quarterly Report on Form 10-Q contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These forward-looking statements include:

- statements of our goals, intentions and expectations;
- statements regarding our business plans and prospects and growth and operating strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

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

- significantly increased competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- general economic conditions, either nationally or in our market areas, that are worse than expected;
- adverse changes in the securities markets;
- legislative or regulatory changes that adversely affect our business;
- our ability to enter new markets successfully and take advantage of growth opportunities, and the possible short-term dilutive effect of potential acquisitions or de novo branches, if any;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies and the FASB; and
- changes in our organization, compensation and benefit plans.

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

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

**Total Assets.** Total assets increased by \$42.1 million, or 2.4%, to \$1.83 billion at June 30, 2018 from \$1.79 billion at September 30, 2017 due primarily to growth in loans receivable, partially offset by a decrease in securities available for sale.

**Total Cash and Cash Equivalents.** Total cash and cash equivalents decreased \$3.8 million, or 9.1%, to \$37.9 million at June 30, 2018 from \$41.7 million at September 30, 2017. Decreases in interest bearing deposits with other institutions of \$518,000, and cash and due from banks of \$3.3 million, were the reasons for the net decrease.

**Net Loans.** Net loans increased \$64.9 million, or 5.3%, to \$1.30 billion at June 30, 2018 from September 30, 2017. During this period, residential loans decreased \$5.2 million to \$581.6 million, construction loans increased \$1.9 million to \$5.1 million, commercial real estate loans increased \$78.4 million to \$396.8 million, commercial loans increased \$5.5 million to \$49.6 million, obligations of states and political subdivisions increased \$9.4 million to \$67.5 million, home equity loans and lines of credit decreased \$1.2 million to \$45.0 million, auto loans decreased \$22.2 million to \$164.4 million, and other loans decreased \$113,000 to \$2.7 million.

Investment Securities Available for Sale. Investment securities available for sale decreased \$19.3 million, or 5.0%, to \$371.1 million at June 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 \$15.9 million, U.S. government securities of \$6.0 million, corporate obligations of \$5.1 million and other debt securities of \$3.6 million which were partially offset by an increase in mortgage backed securities of \$11.2 million. The Company realized a net gain of \$75,000 on the sale of investment securities totaling \$22.1 million for the nine months ended June 30, 2018. Proceeds from the sale were reinvested in U.S. agency pass-through securities, 50% of which were adjustable rate.

Deposits. Deposits decreased \$5.0 million, or 0.4%, to \$1.27 billion at June 30, 2018 from \$1.27 billion at September 30, 2017 due primarily to declines in municipal deposits. A decrease in interest bearing demand accounts of \$38.8 million was offset in part by increases in non interest bearing demand accounts of \$4.7 million, money market accounts of \$14.0 million and certificates of deposits of \$15.5 million. The increase in certificates of deposit, which increased to \$526.4 million at June 30, 2018, included an increase in brokered certificates of deposit of \$44.8 million to \$184.6 million.

Borrowed Funds. Borrowed funds increased by \$39.5 million, or 12.7%, to \$351.1 million at June 30, 2018, from \$311.6 million at September 30, 2017. The increase in borrowed funds was due to an increase in short term borrowings of \$82.6 million offset in part by a decrease in other borrowings of \$43.0 million. Short term borrowings increased due to asset growth and the decline in deposits. All borrowings at June 30, 2018 represent advances from the Federal Home Loan Bank of Pittsburgh (the "FHLB").

Stockholders' Equity. Stockholders' equity decreased by \$3.9 million, or 2.1%, to \$178.8 million at June 30, 2018 from \$182.7 million at September 30, 2017. The decrease in stockholders' equity was primarily due to an increase in accumulated other comprehensive loss of \$7.3 million and dividends of \$2.9 million partially offset by net income of \$3.4 million and stock option exercises of \$1.7 million.

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Average Balance Sheets for the Three and Nine Months Ended June 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 Three Months Ended June 30,<br>2018           |                             |            | 2017                        |                             |            |
|--|---|-----------------------------|------------|-----------------------------|-----------------------------|------------|
|  | Average Balance/<br>Expense<br>(dollars in thousands) | Interest Income/<br>Expense | Yield/Cost | Average Balance/<br>Expense | Interest Income/<br>Expense | Yield/Cost |
| <b>Interest-earning assets:</b>                        |   |                             |            |                             |                             |            |
| Loans <sup>(1)</sup>                                   | \$1,298,258   | \$ 13,968                   | 4.32 %     | \$1,219,591                 | \$ 11,819                   | 3.89 %     |
| <b>Investment Securities</b>                           |   |                             |            |                             |                             |            |
| Taxable <sup>(2)</sup>                                 | 72,139  | 660                         | 3.67 %     | 88,069                      | 669                         | 3.05 %     |
| <b>Exempt from federal income tax<sup>(2)(3)</sup></b> |   |                             |            |                             |                             |            |
|  | 34,868  | 182                         | 3.17 %     | 50,299                      | 294                         | 3.55 %     |
| Total investment securities                            | 107,007   | 842                         | 3.51 %     | 138,368                     | 963                         | 3.23 %     |
| Mortgage-backed securities                             | 264,327   | 1,566                       | 2.38 %     | 254,563                     | 1,405                       | 2.21 %     |
| Federal Home Loan Bank stock                           | 15,750  | 249                         | 6.34 %     | 14,341                      | 174                         | 4.87 %     |
| Other  | 5,833   | 93                          | 6.40 %     | 7,999                       | 47                          | 2.36 %     |
| Total interest-earning assets                          | 1,691,175   | 16,718                      | 3.99 %     | 1,634,862                   | 14,408                      | 3.57 %     |
| Allowance for loan losses                              | (10,755 )   |                             |            | (9,487 )                    |                             |            |
| Noninterest-earning assets                             | 130,556   |                             |            | 128,215                     |                             |            |
| Total assets   | \$1,810,976   |                             |            | \$1,753,590                 |                             |            |
| <b>Interest-bearing liabilities:</b>                   |   |                             |            |                             |                             |            |
| NOW accounts   | \$176,143   | \$ 102                      | 0.23 %     | \$149,386                   | \$ 51                       | 0.14 %     |
| Money market accounts                                  | 269,156   | 460                         | 0.69 %     | 249,047                     | 314                         | 0.51 %     |
| Savings and club accounts                              | 137,809   | 18                          | 0.05 %     | 140,723                     | 21                          | 0.06 %     |
| Certificates of deposit                                | 505,564   | 1,981                       | 1.57 %     | 532,499                     | 1,800                       | 1.36 %     |
| Borrowed funds   | 361,786   | 1,595                       | 1.77 %     | 329,872                     | 1,062                       | 1.29 %     |
| Total interest-bearing liabilities                     | 1,450,458   | 4,156                       | 1.15 %     | 1,401,527                   | 3,248                       | 0.93 %     |
| <b>Non-interest-bearing NOW accounts</b>               |   |                             |            |                             |                             |            |
|  | 156,668   |                             |            | 149,366                     |                             |            |
| Non-interest-bearing liabilities                       | 25,185  |                             |            | 21,256                      |                             |            |
| Total liabilities                                      | 1,632,311   |                             |            | 1,572,149                   |                             |            |
| Equity   | 178,665   |                             |            | 181,441                     |                             |            |
| Total liabilities and equity                           | \$1,810,976   |                             |            | \$1,753,590                 |                             |            |
| Net interest income                                    |   | \$ 12,562                   |            |                             | \$ 11,160                   |            |
| Interest rate spread                                   |   |                             | 2.84 %     |                             |                             | 2.64 %     |
| Net interest-earning assets                            | \$240,717   |                             |            | \$233,335                   |                             |            |
| Net interest margin <sup>(4)</sup>                     |   |                             | 2.98 %     |                             |                             | 2.74 %     |
| Average interest-earning assets to                     |   | 116.60 %                    |            |                             | 115.30 %                    |            |



average interest-bearing  
liabilities

- (1) Non-accruing loans are included in the outstanding loan balances.
- (2) Available for sale securities are reported at fair value.
- (3) Yields on tax exempt securities have been calculated on a fully tax equivalent basis assuming a tax rate of 24.25% for the three months ended June 30, 2018 and 34% for the three months ended June 30, 2017.
- (4) Represents the difference between interest earned and interest paid, divided by average total interest earning assets.

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For the Nine Months Ended June 30,  
2018

2017

|                                      | Interest Income/<br>Expense |           |      | Yield/Cost | Interest Income/<br>Expense |           |      | Yield/Cost |
|--------------------------------------|-----------------------------|-----------|------|------------|-----------------------------|-----------|------|------------|
|                                      | Average Balance             | Expense   |      |            | Average Balance             | Expense   |      |            |
|                                      | (dollars in thousands)      |           |      |            |                             |           |      |            |
| <b>Interest-earning assets:</b>      |                             |           |      |            |                             |           |      |            |
| Loans <sup>(1)</sup>                 | \$1,287,037                 | \$ 39,704 | 4.12 | %          | \$1,224,255                 | \$ 35,869 | 3.92 | %          |
| <b>Investment Securities</b>         |                             |           |      |            |                             |           |      |            |
| Taxable <sup>(2)</sup>               | 77,293                      | 2,001     | 3.46 | %          | 87,959                      | 1,956     | 2.97 | %          |
| <b>Exempt from federal income</b>    |                             |           |      |            |                             |           |      |            |
| tax <sup>(2)(3)</sup>                | 44,379                      | 756       | 3.45 | %          | 51,286                      | 907       | 3.58 | %          |
| Total investment securities          | 121,672                     | 2,757     | 3.46 | %          | 139,245                     | 2,863     | 3.20 | %          |
| Mortgage-backed securities           | 260,333                     | 4,469     | 2.29 | %          | 252,265                     | 4,034     | 2.14 | %          |
| Federal Home Loan Bank stock         | 15,617                      | 755       | 6.46 | %          | 15,158                      | 547       | 4.82 | %          |
| Other                                | 5,636                       | 256       | 6.07 | %          | 8,536                       | 124       | 1.94 | %          |
| Total interest-earning assets        | 1,690,295                   | 47,941    | 3.82 | %          | 1,639,459                   | 43,437    | 3.58 | %          |
| Allowance for loan losses            | (10,103 )                   |           |      |            | (9,335 )                    |           |      |            |
| Noninterest-earning assets           | 131,711                     |           |      |            | 131,024                     |           |      |            |
| Total assets                         | \$1,811,903                 |           |      |            | \$1,761,148                 |           |      |            |
| <b>Interest-bearing liabilities:</b> |                             |           |      |            |                             |           |      |            |
| NOW accounts                         | \$185,887                   | \$ 346    | 0.25 | %          | \$155,717                   | \$ 164    | 0.14 | %          |
| Money market accounts                | 255,830                     | 1,144     | 0.60 | %          | 251,173                     | 957       | 0.51 | %          |
| Savings and club accounts            | 136,265                     | 53        | 0.05 | %          | 138,720                     | 56        | 0.05 | %          |
| Certificates of deposit              | 517,361                     | 5,754     | 1.49 | %          | 521,328                     | 5,090     | 1.31 | %          |
| Borrowed funds                       | 359,614                     | 4,379     | 1.63 | %          | 349,553                     | 3,074     | 1.18 | %          |
| Total interest-bearing liabilities   | 1,454,957                   | 11,676    | 1.07 | %          | 1,416,491                   | 9,341     | 0.88 | %          |
| <b>Non-interest-bearing NOW</b>      |                             |           |      |            |                             |           |      |            |
| accounts                             | 153,086                     |           |      |            | 144,956                     |           |      |            |
| Non-interest-bearing liabilities     | 23,159                      |           |      |            | 22,626                      |           |      |            |
| Total liabilities                    | 1,631,202                   |           |      |            | 1,584,073                   |           |      |            |
| Equity                               | 180,701                     |           |      |            | 177,075                     |           |      |            |
| Total liabilities and equity         | \$1,811,903                 |           |      |            | \$1,761,148                 |           |      |            |
| Net interest income                  |                             | \$ 36,265 |      |            |                             | \$ 34,096 |      |            |
| Interest rate spread                 |                             |           | 2.75 | %          |                             |           | 2.70 | %          |
| Net interest-earning assets          | \$235,338                   |           |      |            | \$222,968                   |           |      |            |
| Net interest margin <sup>(4)</sup>   |                             |           | 2.87 | %          |                             |           | 2.78 | %          |
| Average interest-earning assets to   |                             |           |      |            |                             |           |      |            |
| average interest-bearing liabilities |                             | 116.17    | %    |            |                             | 115.74    | %    |            |

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

(2) Available for sale securities are reported at fair value.

(3) Yields on tax exempt securities have been calculated on a fully tax equivalent basis assuming a tax rate of 24.25% for the nine months ended June 30, 2018 and 34% for the nine months ended June 30, 2017.

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

Comparison of Operating Results for the Three Months Ended June 30, 2018 and June 30, 2017

Net Income. Net income increased \$1.1 million, or 60.1%, to \$2.8 million for the three months ended June 30, 2018 compared to net income of \$1.8 million for the comparable period in 2017. The increase was due to an increase in net interest income combined with a decrease in noninterest expenses, offset in part, by an increase in the provision for loan losses and a decrease in non interest income.

Net Interest Income. Net interest income increased \$1.4 million, or 12.6%, to \$12.6 million for the three months ended June 30, 2018 from \$11.2 million for the comparable period in 2017. The increase was primarily attributable to a \$7.4 million increase in the Company's net interest earning assets for the three months ended June 30, 2018 together with an increase of twenty basis points in the Company's interest rate spread to 2.84% for the three months ended June 30, 2018 from 2.64% for the comparable period in 2017.

**Interest Income.** Interest income increased \$2.3 million, or 16.0%, to \$16.7 million for the three months ended June 30, 2018 from \$14.4 million for the comparable 2017 period. The increase resulted primarily from an increase in the average yield on interest earning assets of 42 basis points to 3.99% for the three months ended June 30, 2018 from 3.57% in the comparable 2017 period and an increase in the average balance of interest earning assets of \$56.3 million. The average balance of loans increased \$78.7 million between the two periods. In addition between the two periods, the average balance of investment securities decreased \$31.4 million, mortgage-backed securities increased \$9.8 million, FHLB stock increased \$1.4 million and other interest earning assets decreased \$2.2 million. Interest income for the three months ended June 30, 2018 included approximately \$600,000 of non accrual interest from two commercial loans that was collected during the three months ended June 30, 2018 compared to a minimal amount collected during the comparable period in 2017.

**Interest Expense.** Interest expense increased \$908,000, or 28.0%, to \$4.2 million for the three months ended June 30, 2018 from \$3.2 million for the comparable 2017 period. The increase resulted from an increase in the cost of interest bearing liabilities of 22 basis points and an increase in the average balance of interest bearing liabilities of \$48.9 million between the two periods. The Federal Reserve increased the Fed Funds interest rate by a total of 100 basis points between June 30, 2017 and June 30, 2018. This increase was the primary reason for increases in the Company's cost of borrowed funds to 1.77% for the three months ended June 30, 2018 from 1.29% for the comparable period in 2017 and cost of certificates of deposit to 1.57% from 1.36% for the same comparative periods. For the three months ended June 30, 2018 and 2017 the average cost of interest bearing liabilities was 1.15% and 0.92%, respectively.

**Provision for Loan Losses.** In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are subject to interpretation and revision as more information becomes available or as future events occur. After an evaluation of these factors, management made a provision for loan losses of \$975,000 million for the three month period ended June 30, 2018 compared to \$750,000 for the three month period ended June 30, 2017. The allowance for loan losses was \$11.1 million, or 0.85% of loans outstanding, at June 30, 2018, compared to \$9.4 million, or 0.75% of loans outstanding, at September 30, 2017.

**Non-interest Income.** Non-interest income decreased \$223,000, or 10.5%, to \$1.9 million for the three months ended June 30, 2018 from \$2.1 million for the comparable period in 2017. Increases in trust and investment fees of \$72,000 and service charges and fees on loans of \$57,000, were offset by decreases in service fees on deposit accounts of \$44,000 and gain on sale of investments, net of \$295,000. Trust and investment fees increased primarily due to an increase in assets under management. Service related fees increased primarily due to increased volume.

**Non-interest Expense.** Non-interest expense decreased \$157,000, or 1.5%, to \$10.2 million for the three months ended June 30, 2018 from \$10.4 million for the comparable period in 2017. The primary reasons for the decrease were decreases in compensation and employee benefits of \$276,000, occupancy and equipment expenses of \$57,000, data processing expenses of \$28,000 and amortization of intangible assets of \$56,000 which were offset in part by an increase of \$177,000 in other expenses. Compensation expense decreased primarily due to a decrease in pension expense. Occupancy costs decreased primarily due to the closing of three supermarket branches during the first fiscal quarter of 2018. Other expenses include the write down to current value of the Company's Allentown branch location of \$300,000.

**Income Taxes.** Income tax expense increased \$52,000 to \$500,000 for the three months ended June 30, 2018 from \$448,000 for the comparable 2017 period. The increase was primarily a result of higher income before taxes in the three months ended June 30, 2018 compared to the comparable period in 2017. The effective tax rate for the three months ended June 30, 2018 was 15.1% compared to 20.3% for the 2017 period.

Comparison of Operating Results for the Nine Months Ended June 30, 2018 and June 30, 2017

Net Income. Net income decreased \$1.9 million, or 35.4%, to \$3.4 million for the nine months ended June 30, 2018 compared to net income of \$5.3 million for the comparable period in 2017. The decrease was due primarily to an increase in income tax expense of \$4.1 million due to a one-time charge to income tax expense of \$3.7 million, taken during the first fiscal quarter, 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. Income before income taxes was \$8.6 million for the nine months ended June 30, 2018 compared to \$6.4 million for the comparable period in 2017. The increase in income before income taxes was due to increases in net interest income and noninterest income combined with a decrease in noninterest expenses, offset in part, by an increase in the provision for loan losses.

**Net Interest Income.** Net interest income increased \$2.2 million, or 6.4%, to \$36.3 million for the nine months ended June 30, 2018 from \$34.1 million for the comparable period in 2017. The increase was primarily attributable to a \$12.4 million increase in the Company's net interest earning assets for the nine months ended June 30, 2018 and an increase of five basis point in the Company's interest rate spread to 2.75% for the nine months ended June 30, 2018 from 2.70% for the comparable period in 2017.

**Interest Income.** Interest income increased \$4.5 million, or 10.4%, to \$47.9 million for the nine months ended June 30, 2018 from \$43.4 million for the comparable 2017 period. The increase resulted primarily from an increase in the average yield on interest earning assets of 24 basis points to 3.82% for the nine months ended June 30, 2018 from 3.58% in the comparable 2017 period and an increase in the average balance of interest earning assets of \$50.8 million. The average balance of loans increased \$62.8 million between the two periods. In addition, the average balance of investment securities decreased \$17.6 million, mortgage-backed securities increased \$8.1 million, regulatory stock increased \$459,000 and other interest earning assets decreased \$2.9 million.

**Interest Expense.** Interest expense increased \$2.3 million, or 25.0%, to \$11.7 million for the nine months ended June 30, 2018 from \$9.3 million for the comparable 2017 period. The increase resulted from an increase in the cost of interest bearing liabilities of 19 basis points and an increase in the average balance of interest bearing liabilities of \$38.5 million between the two periods. The Federal Reserve increased the Fed Funds interest rate by a total of 100 basis points between June 30, 2017 and June 30, 2018. This increase was the primary reason for increases in the Company's cost of borrowed funds to 1.63% for the nine months ended June 30, 2018 from 1.18% for the comparable period in 2017 and cost of certificates of deposit to 1.49% from 1.31% for the same comparative periods. For the nine months ended June 30, 2018 and 2017 the average cost of interest bearing liabilities was 1.07% and 0.88%, respectively.

**Provision for Loan Losses.** In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are subject to interpretation and revision as more information becomes available or as future events occur. After an evaluation of these factors, management made a provision for loan losses of \$3.1 million for the nine month period ended June 30, 2018 compared to \$2.3 million for the nine month period ended June 30, 2017. The allowance for loan losses was \$11.1 million, or 0.85% of loans outstanding, at June 30, 2018, compared to \$9.4 million, or 0.75% of loans outstanding, at September 30, 2017.

**Non-interest Income.** Non-interest income increased \$50,000, or 0.9%, to \$5.8 million for the nine months ended June 30, 2018. Increases in service charges and fees on loans of \$98,000 and trust and investment fees of \$185,000 were partially offset by a decrease in gain on sale of investments, net of \$220,000. Trust and investment fees increased primarily due to an increase in assets under management. Service related fees increased primarily due to increased volume.

**Non-interest Expense.** Non-interest expense decreased \$793,000, or 2.5%, to \$30.4 million for the nine months ended June 30, 2018 from \$31.2 million for the comparable period in 2017. The primary reasons for the decrease were decreases in compensation and employee benefits of \$601,000, data processing of \$76,000, professional fees of \$394,000, advertising expenses of \$110,000, and amortization of intangible assets of \$104,000 which were offset in part by an increase in occupancy and equipment of \$33,000, a decrease in the gain on foreclosed real estate of \$120,000 and an increase of other expenses of \$305,000. Included in other expenses is \$219,000 in one-time expenses related to the closing of three supermarket branches during December 2017 and approximately \$300,000 related to the write-down of the Company's Allentown branch. Compensation expense decreased primarily due to a decrease in pension expense. Professional fees decreased primarily due to a decrease in consulting fees and advertising expenses

decreased primarily due to a decrease in the advertising frequency.

**Income Taxes.** Income tax expense increased \$4.0 million to \$5.1 million for the nine months ended June 30, 2018 from \$1.1 million for the comparable 2017 period. The increase was primarily a result of 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.

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

|   | June 30,<br>2018 | September 30,<br>2017 |   |   |
|---|------------------|-----------------------|---|---|
| Non-performing assets:                            |                  |                       |   |   |
| Non-accruing loans                                | \$8,443          | \$ 10,487             |   |   |
| Non-accruing purchased credit impaired loans      | 2,268            | 3,776                 |   |   |
| Total non-performing loans                        | 10,711           | 14,263                |   |   |
| Foreclosed real estate                            | 1,368            | 1,424                 |   |   |
| Other repossessed assets                          | 9                | 9                     |   |   |
| Total non-performing assets                       | \$12,088         | \$ 15,696             |   |   |
| Ratio of non-performing loans to total loans      | 0.82             | 1.14                  | % | % |
| Ratio of non-performing loans to total assets     | 0.59             | 0.80                  | % | % |
| Ratio of non-performing assets to total assets    | 0.66             | 0.88                  | % | % |
| Ratio of allowance for loan losses to total loans | 0.85             | 0.75                  | % | % |

Loans are reviewed on a regular basis and are placed on non-accrual status when they become more than 90 days delinquent. When loans are placed on non-accrual status, unpaid accrued interest is fully reserved, and further income is recognized only to the extent received. Non-performing assets decreased \$3.6 million from September 30, 2017 to June 30, 2018. The number of nonperforming residential loans was 63 at June 30, 2018 compared to 76 at September 30, 2017. The \$10.7 million of non-accruing loans at June 30, 2018 included 63 residential loans with an aggregate outstanding balance of \$5.4 million, 25 commercial and commercial real estate loans with aggregate outstanding balances of \$4.1 million and 65 consumer loans with aggregate balances of \$1.2 million. Within the residential loan balance are \$3.4 million of loans less than 90 days past due. In the quarter ended June 30, 2018, the Company identified 29 residential loans which, although paying as agreed, have a high probability of default. Foreclosed real estate decreased \$55,000 to \$1.4 million at June 30, 2018. Foreclosed real estate consists of 15 residential properties, one building lot and four commercial properties.

At June 30, 2018, the principal balance of troubled debt restructures ("TDRs") was \$4.3 million compared to \$4.9 million at September 30, 2017. Of the \$4.3 million of troubled debt restructures at June 30, 2018, \$107,000 are performing loans and \$4.2 million are non-accrual loans.

As of June 30, 2018, TDRs were comprised of 27 residential loans totaling \$3.1 million, five commercial and commercial real estate loans totaling \$1.1 million, and seven consumer (home equity loans, home equity lines and credit, indirect auto and other) loan totaling \$138,000.

For the three month period ended June 30, 2018, two loans were removed from non-performing TDR status. For the nine month period ended June 30, 2018 four loans were removed from non-performing TDR status due to completion of one year of consecutive timely payments.

We have modified the terms of certain loans that do not meet the definition of a TDR. The vast majority of such loans were rate modifications of residential first mortgage loans in lieu of refinancing. The non-TDR rate modifications were all on performing loans where the rates were reset to current market rates. For the three months ended June 30, 2018, we modified three loans totaling \$465,000 in this fashion. With regard to commercial loans, including commercial real estate loans, four loans totaling \$1.1 million were modified for the three months ended June 30, 2018.



## Liquidity and Capital Resources

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

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

A portion of our liquidity consists of cash and cash equivalents and borrowings, which are a product of our operating, investing and financing activities. At June 30, 2018, \$37.9 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 \$729,000 million at June 30, 2018. As of June 30, 2018, we had \$351.1 million in borrowings outstanding from the Pittsburgh FHLB. We have access to total FHLB advances of up to approximately \$633.3 million.

At June 30, 2018, we had \$209.4 million in loan commitments outstanding, which included, in part, \$64.7 million in undisbursed construction loans and land development loans, \$36.2 million in unused home equity lines of credit, \$96.1 million in commercial lines of credit and commitments to originate commercial loans, \$4.4 million in performance standby letters of credit and \$8.2 million in other unused commitments which are primarily to originate residential mortgage loans and multifamily loans. Certificates of deposit due within one year of June 30, 2018 totaled \$368.2 million, or 70.0% of certificates of deposit. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before June 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 Flow, our cash flows are classified for financial reporting purposes as operating, investing or financing cash flows. Net cash provided by operating activities was \$18.2 million and \$14.6 million for the nine months ended June 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 \$64.9 million and \$15.4 million for the nine months ended June 30, 2018 and 2017, respectively, principally reflecting our loan and investment security activities. Deposit and borrowing cash flows have comprised most of our financing activities, which resulted in net cash provided by (used for) \$42.9 million and (\$9.3) million for the nine months ended June 30, 2018 and 2017, respectively.

#### Critical Accounting Policies

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

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

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

determine that the resulting values reasonably reflect amounts realizable on the related loans.

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

The analysis of the allowance for loan losses has two components: specific and general allocations. Specific allocations are made for loans that are determined to be impaired. Impairment is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The general allocation is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. We also analyze historical loss 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 2017 or 2016.

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 2017 and 2016.

**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 a 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 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.

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.

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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 that would adversely affect our operating results.

#### Off-Balance Sheet Arrangements

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

results of operations, liquidity, capital expenditures or capital resources.

#### Contractual Obligations

During the first nine months of fiscal 2018, the Company's contractual obligations did not change materially from those discussed in the Company's Financial Statements for the year ended September 30, 2017.

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### Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. The net proceeds from the Company's stock offering increased our capital and provided management with greater flexibility to manage our interest rate risk. In particular, management used the majority of the capital we received to increase our interest-earning assets. There have been no material changes in our interest rate risk since September 30, 2017.

### Item 4. Controls and Procedures

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

There were no changes made in the Company's internal controls over financial reporting (as defined by rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) or in other factors that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting during the period covered by this Report.



## Part II – Other Information

### Item 1. Legal Proceedings

From time to time, the Company or its subsidiaries are engaged in legal proceedings in the ordinary course of business, none of which are currently considered to have a material impact on the Company's financial position or results of operations, except as previously disclosed in Part I, Item 3 of the Company's Annual Report on Form 10-K for the year ended September 30, 2017, and as described below.

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 situated plaintiffs who had their automobiles repossessed and seek 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 calls for the Bank to make a payment of \$1,325,000 to the plaintiffs. 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, Inc., 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 has 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 tentatively scheduled oral arguments for October or November 2018. To the extent this litigation could result in exposure to the Bank, the amount of such exposure is not currently estimable.

### Item 1A. Risk Factors

There have been no material changes in the "Risk Factors" as disclosed in the Company's response to Item 1A in Part 1 of its Annual Report on Form 10-K for the year ended September 30, 2017, filed on December 14, 2017.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

### Item 3. Defaults Upon Senior Securities

Not applicable.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

Not applicable.

Item 6. Exhibits

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

- 3.1 Articles of Incorporation of ESSA Bancorp, Inc.\*
- 3.2 Bylaws of ESSA Bancorp, Inc.\*
- 4 Form of Common Stock Certificate of ESSA Bancorp, Inc.\*
- 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 Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statements of Condition; (ii) the Consolidated Statement of Income; (iii) the Consolidated Statement of Changes in Stockholder Equity; the Consolidated Statement of Cash Flows; and (iv) the Notes to Consolidated Financial Statements.

\*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.

SIGNATURES

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

ESSA BANCORP, INC.

Date: August 9, 2018 /s/ Gary S. Olson  
Gary S. Olson  
President and Chief Executive Officer

Date: August 9, 2018 /s/ Allan A. Muto  
Allan A. Muto  
Executive Vice President and Chief Financial Officer