

Section 1: 10-Q (10-Q)

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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, 2019

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. 001-38131

Esquire Financial Holdings, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Maryland
(State or Other Jurisdiction of
Incorporation or Organization)

27-5107901
(I.R.S. Employer
Identification No.)

100 Jericho Quadrangle, Suite 100, Jericho, New York
(Address of Principal Executive Offices)

11753
(Zip Code)

(516) 535-2002

(Registrant's Telephone Number, Including Area Code)

N/A

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$0.01 par value	ESQ	The Nasdaq Stock Market LLC

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 every Interactive Data File required to be submitted 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 such files).

YES NO

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

Large accelerated filer
Non-accelerated filer


Accelerated filer
Smaller reporting company
Emerging growth company

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of August 1, 2019, there were 7,541,670 outstanding shares of the issuer's common stock.



**Esquire Financial Holdings, Inc.
Form 10-Q**

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

ESQUIRE FINANCIAL HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Dollars in thousands, except per share data)
(Unaudited)

	June 30, 2019	December 31, 2018
ASSETS		
Cash and due from banks	\$ 614	\$ 659
Interest earning deposits	39,538	29,903
Total cash and cash equivalents	40,152	30,562
Securities available-for-sale, at fair value	147,693	145,698
Securities, restricted, at cost	2,665	2,583
Loans	514,558	468,101
Less: allowance for loan losses	(6,433)	(5,629)
Loans, net	508,125	462,472
Premises and equipment, net	2,902	2,694
Accrued interest receivable	3,356	3,855
Other assets	27,557	16,035
Total assets	\$ 732,450	\$ 663,899
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Demand	\$ 234,507	\$ 212,721
Savings, NOW and money market	368,793	335,283
Time	19,870	20,417
Total deposits	623,170	568,421
Secured borrowings	88	89
Accrued expenses and other liabilities	6,841	2,615
Total liabilities	\$ 630,099	\$ 571,125
Commitments and Contingencies		
	—	—
Stockholders' equity:		
Preferred stock, par value \$0.01; authorized 2,000,000 shares; no shares issued and outstanding at June 30, 2019 and December 31, 2018	—	—
Common stock, par value \$0.01; authorized 15,000,000 shares; issued and outstanding 7,536,723 shares at June 30, 2019 and 7,532,723 shares at December 31, 2018	75	75
Additional paid-in capital	89,129	88,539
Retained earnings	13,227	6,774
Accumulated other comprehensive loss	(80)	(2,614)
Total stockholders' equity	102,351	92,774
Total liabilities and stockholders' equity	\$ 732,450	\$ 663,899

See accompanying condensed notes to interim condensed consolidated financial statements.

ESQUIRE FINANCIAL HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share data)
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2019	2018	2019	2018
Interest income:				
Loans	\$ 8,020	\$ 5,657	\$15,212	\$10,946
Securities	1,058	1,006	2,123	1,870
Interest earning deposits and other	244	201	471	317
Total interest income	<u>9,322</u>	<u>6,864</u>	<u>17,806</u>	<u>13,133</u>
Interest expense:				
Savings, NOW and money market deposits	611	167	1,040	289
Time deposits	126	51	251	98
Borrowings	1	5	3	10
Total interest expense	<u>738</u>	<u>223</u>	<u>1,294</u>	<u>397</u>
Net interest income	8,584	6,641	16,512	12,736
Provision for loan losses	400	300	825	525
Net interest income after provision for loan losses	<u>8,184</u>	<u>6,341</u>	<u>15,687</u>	<u>12,211</u>
Noninterest income:				
Merchant processing income	2,895	1,211	4,709	2,232
Customer related fees and service charges	195	769	462	1,823
Total noninterest income	<u>3,090</u>	<u>1,980</u>	<u>5,171</u>	<u>4,055</u>
Noninterest expense:				
Employee compensation and benefits	3,587	3,008	7,023	6,069
Occupancy and equipment, net	443	432	882	858
Professional and consulting services	837	684	1,330	1,312
FDIC and regulatory assessments	86	83	172	155
Advertising and marketing	294	171	362	296
Travel and business relations	124	111	237	268
Data processing	713	446	1,219	930
Other operating expenses	423	354	763	673
Total noninterest expense	<u>6,507</u>	<u>5,289</u>	<u>11,988</u>	<u>10,561</u>
Net income before income taxes	4,767	3,032	8,870	5,705
Income tax expense	<u>1,299</u>	<u>811</u>	<u>2,417</u>	<u>1,526</u>
Net income	<u>\$ 3,468</u>	<u>\$ 2,221</u>	<u>\$ 6,453</u>	<u>\$ 4,179</u>
Earnings per share				
Basic	\$ 0.47	\$ 0.30	\$ 0.87	\$ 0.57
Diluted	\$ 0.45	\$ 0.29	\$ 0.83	\$ 0.54

See accompanying condensed notes to interim condensed consolidated financial statements

ESQUIRE FINANCIAL HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in thousands)
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2019	2018	2019	2018
Net income	\$3,468	\$ 2,221	\$ 6,453	\$ 4,179
Other comprehensive income (loss):				
Unrealized gains (losses) arising during the period on securities available- for-sale	1,524	(844)	3,487	(2,572)
Reclassification adjustment for net gains included in net income	—	—	—	—
Tax effect	(434)	232	(953)	705
Total other comprehensive income (loss)	<u>1,090</u>	<u>(612)</u>	<u>2,534</u>	<u>(1,867)</u>
Total comprehensive income	<u>\$4,558</u>	<u>\$ 1,609</u>	<u>\$ 8,987</u>	<u>\$ 2,312</u>

See accompanying condensed notes to interim condensed consolidated financial statements.

	Preferred shares	Common shares	Preferred stock	Common stock	paid-in capital	Retained earnings	comprehensive loss	stockholders' equity
Six months ended								
June 30, 2018								
Balance at								
January 1, 2018	—	7,326,536	\$ —	\$ 73	\$ 86,660	\$ (1,960)	\$ (1,390)	\$ 83,383
Net income	—	—	—	—	—	4,179	—	4,179
Other comprehensive loss	—	—	—	—	—	—	(1,867)	(1,867)
Exercise of stock options, net of repurchases	—	42,687	—	1	377	—	—	378
Restricted stock grants	—	76,500	—	—	—	—	—	—
Stock compensation expense	—	—	—	—	423	—	—	423
Balance at								
June 30, 2018	<u>—</u>	<u>7,445,723</u>	<u>\$ —</u>	<u>\$ 74</u>	<u>\$ 87,460</u>	<u>\$ 2,219</u>	<u>\$ (3,257)</u>	<u>\$ 86,496</u>

See accompanying condensed notes to interim condensed consolidated financial statements.

ESQUIRE FINANCIAL HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	For the Six Months Ended June 30,	
	2019	2018
Cash flows from operating activities:		
Net income	\$ 6,453	\$ 4,179
Adjustments to reconcile net income to net cash used in operating activities:		
Net cash used in operating activities:		
Provision for loan losses	825	525
Depreciation	234	205
Stock compensation expense	540	423
Net amortization:		
Securities	207	216
Loans	214	198
Right of use asset	181	—
Changes in other assets and liabilities:		
Accrued interest receivable	499	(1,189)
Other assets	(9,599)	(3,612)
Operating lease liability	(110)	—
Accrued expenses and other liabilities	1,279	1,900
Net cash provided by operating activities	<u>723</u>	<u>2,845</u>
Cash flows from investing activities:		
Net change in loans	(46,692)	(42,893)
Purchases of securities available-for-sale	(9,918)	(33,822)
Principal repayments on securities available-for-sale	11,203	12,024
Purchase of securities, restricted	(82)	(160)
Purchase of equity investment without readily determinable fair value	—	(2,410)
Purchases of premises and equipment	(442)	(152)
Net cash used in investing activities	<u>(45,931)</u>	<u>(67,413)</u>
Cash flows from financing activities:		
Net increase in deposits	54,749	48,621
Decrease in secured borrowings	(1)	(4)
Exercise of stock options	50	378
Net cash provided by financing activities	<u>54,798</u>	<u>48,995</u>
Increase (decrease) in cash and cash equivalents	9,590	(15,573)
Cash and cash equivalents at beginning of the period	<u>30,562</u>	<u>43,077</u>
Cash and cash equivalents at end of the period	<u>\$ 40,152</u>	<u>\$ 27,504</u>
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 1,295	\$ 396
Taxes	1,966	1,005
Noncash transactions:		
Right of use asset obtained in exchange for lease liability	3,640	—

See accompanying condensed notes to interim condensed consolidated financial statements.

ESQUIRE FINANCIAL HOLDINGS, INC.
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 — Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The Interim Consolidated Financial Statements include the accounts of Esquire Financial Holdings, Inc. and its wholly owned subsidiary, Esquire Bank, N.A, are collectively referred to as “the Company.” All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited Interim Condensed Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial information. In the opinion of management, the interim statements reflect all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows of the Company on a consolidated basis and all such adjustments are recurring in nature. These financial statements and the accompanying notes should be read in conjunction with the Company’s audited financial statements for the years ended December 31, 2018 and 2017. Operating results for the three and six months ended June 30, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019 or any other period.

Subsequent Events

The Company has evaluated subsequent events for recognition and disclosure through the date of issuance.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the Consolidated Financial Statements.

New Accounting Pronouncements

On February 25, 2016, the FASB established Topic 842, Leases, by issuing Accounting Standards Update (ASU) No. 2016-02, which requires lessees to recognize leases on-balance sheet and disclose key information about leasing arrangements. Topic 842 was subsequently amended by ASU No. 2018-01, Land Easement Practical Expedient for Transition to Topic 842; ASU No. 2018-10, Codification Improvements to Topic 842, Leases; and ASU No. 2018-11, Targeted Improvements. The new standard establishes a right-of-use model (ROU) that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months.

The new standard was adopted by the Company on January 1, 2019 utilizing the modified retrospective transition approach where it was applied to all leases existing at the date of initial application. Upon adoption, we recognized a ROU asset, presented within other assets on the Consolidated Statement of Financial Condition, and a lease liability, presented within accrued expenses and other liabilities on the Consolidated Statement of Financial Condition, of approximately \$3.1 million and \$3.6 million, respectively.

In transition, we elected the ‘package of practical expedients’, which permitted the Company not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. Management did not elect the use-of-hindsight or the practical expedient pertaining to land easements; the latter not being applicable to us.

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The new standard also provided practical expedients for an entity's ongoing accounting. Management elected the short-term lease recognition exemption for all leases that qualify. This means, for those leases with an initial term of 12 months or less, the Company did not recognize ROU assets or lease liabilities, and this included not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition.

In recognizing ROU lease assets and related lease liabilities, we exclude variable and non-lease components (such as taxes, insurance, and common area maintenance costs) and expense these costs as incurred. At lease commencement date, the lease payments over the expected term are discounted using our incremental borrowing rate referenced to the Federal Home Loan Bank advance rates of a similar term to determine the present value of our lease obligation and ROU asset to be recorded on the Statement of Financial Condition. Lease expense is then recognized on a straight-line basis.

The Company has committed to rent premises used in business operations under non-cancelable operating leases that have renewal options for additional 3-5 year terms which were not considered in determining our ROU asset or lease liability as renewal is not reasonably certain.

On June 16, 2016, the FASB issued Accounting Standards Update No. 2016-13, "Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" (the ASU). This ASU replaces the incurred loss model with an expected loss model, referred to as "current expected credit loss" (CECL) model. It will significantly change estimates for credit losses related to financial assets measured at amortized cost, including loans receivable and certain other contracts. This ASU will be effective for the Company in fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. At its July 17, 2019 public meeting, FASB issued a proposal to delay the effective date of ASU 2016-13 for certain entities, including SEC filers classified as smaller reporting companies. If the proposal is ratified, the revised effective date for adoption for the Company, which is classified as a smaller reporting company, would be January 1, 2023. Until there is a change in effective date, the Company plans to adopt ASU 2016-13 on January 1, 2020, using the required modified retrospective method with a cumulative effect adjustment as of the beginning of the reporting period. The Company has gathered the necessary data and is working on the implementation of this standard.

NOTE 2 — Debt Securities

Available-for-Sale Securities

The amortized cost, gross unrealized gains and losses and estimated fair value of securities available for sale were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	<u>(In thousands)</u>			
<u>June 30, 2019</u>				
Mortgage-backed securities – agency	\$ 26,291	\$ 415	\$ (149)	\$ 26,557
Collateralized mortgage obligations (CMO's) – agency	121,514	272	(650)	121,136
Total available-for-sale	<u>\$ 147,805</u>	<u>\$ 687</u>	<u>\$ (799)</u>	<u>\$147,693</u>
<u>December 31, 2018</u>				
Mortgage-backed securities – agency	\$ 27,384	\$ 15	\$ (724)	\$ 26,675
Collateralized mortgage obligations (CMO's) – agency	121,913	32	(2,922)	119,023
Total available-for-sale	<u>\$ 149,297</u>	<u>\$ 47</u>	<u>\$ (3,646)</u>	<u>\$145,698</u>

Mortgage-backed securities included all residential pass-through certificates guaranteed by FHLMC, FNMA, or GNMA and the CMO's are backed by government agency pass-through certificates. The 2019 and 2018 pass-through certificates are fixed rate instruments. CMO's, by virtue of the underlying residential collateral or structure, are fixed rate current pay sequentials or planned amortization classes (PAC's). As actual maturities may differ from contractual

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maturities because certain borrowers have the right to call or prepay certain obligations, these securities are not considered to have a single maturity date.

When purchasing investment securities, the Company's overall interest-rate risk profile is considered as well as the adequacy of expected returns relative to risks assumed, including prepayments. In managing the investment securities portfolio, management occasionally sells investment securities in response to, or in anticipation of, changes in interest rates and spreads, actual or anticipated prepayments, liquidity needs and credit risk associated with a particular security.

There were no sales or calls of securities for the three and six months ended June 30, 2019 and 2018.

At June 30, 2019, securities having a fair value of \$122.8 million were pledged to the Federal Home Loan Bank of New York (FHLB) for borrowing capacity totaling \$117.6 million. At December 31, 2018, securities having a fair value of \$120.7 million were pledged to the FHLB for borrowing capacity totaling \$115.0 million. At June 30, 2019 and December 31, 2018, the Company had no outstanding FHLB advances.

At June 30, 2019, securities having a fair value of \$24.9 million were pledged to the Federal Reserve Bank of New York (FRB) for borrowing capacity totaling \$24.2 million. At December 31, 2018, securities having a fair value of \$25.0 million were pledged to the FRB for borrowing capacity totaling \$24.2 million. At June 30, 2019 and December 31, 2018, the Company had no outstanding FRB borrowings.

The following table provides the gross unrealized losses and fair value, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position as of:

	<u>Less Than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
(In thousands)						
<u>June 30, 2019</u>						
Mortgage-backed securities – agency	\$ —	\$ —	\$ 15,041	\$ (149)	\$ 15,041	\$ (149)
CMO's – agency	13,091	(55)	55,776	(595)	68,867	(650)
Total temporarily impaired securities	<u>\$13,091</u>	<u>\$ (55)</u>	<u>\$ 70,817</u>	<u>\$ (744)</u>	<u>\$ 83,908</u>	<u>\$ (799)</u>
<u>December 31, 2018</u>						
Mortgage-backed securities - agency	\$ 9,528	\$ (99)	\$ 15,497	\$ (625)	\$ 25,025	\$ (724)
CMO's - Agency	19,184	(73)	85,775	(2,849)	104,959	(2,922)
Total temporarily impaired securities	<u>\$28,712</u>	<u>\$ (172)</u>	<u>\$101,272</u>	<u>\$ (3,474)</u>	<u>\$129,984</u>	<u>\$ (3,646)</u>

Management reviews the investment portfolio on a quarterly basis to determine the cause, magnitude and duration of declines in the fair value of each security. In estimating other-than-temporary impairment (OTTI), management considers many factors including: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the security or more likely than not will be required to sell the security before its anticipated recovery. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: (1) OTTI related to credit loss, which must be recognized in the income statement and (2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. The assessment of whether any other than temporary decline exists may involve a high degree of subjectivity and judgment and is based on the information available to management at a point in time. Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation.

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At June 30, 2019, securities in unrealized loss positions were issuances from government sponsored entities. Due to the decline in fair value being attributable to changes in interest rates, not credit quality and because the Company does not have the intent to sell the securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider the securities to be other-than-temporarily impaired at June 30, 2019.

No impairment charges were recorded for the three and six months ended June 30, 2019 and 2018.

NOTE 3 — Loans

The composition of loans by class is summarized as follows:

	June 30, 2019	December 31, 2018
	(In thousands)	
1 – 4 family residential	\$ 51,604	\$ 56,043
Commercial	234,434	191,828
Multifamily	134,044	136,537
Commercial real estate	37,611	33,145
Construction	6,403	5,921
Consumer	49,844	43,675
Total Loans	513,940	467,149
Deferred costs and unearned premiums, net	618	952
Allowance for loan losses	(6,433)	(5,629)
Loans, net	\$ 508,125	\$ 462,472

The following tables present the activity in the allowance for loan losses by class for the three months ending June 30, 2019 and 2018:

	1-4 Family Residential	Commercial	Multifamily	Commercial Real Estate	Construction	Consumer	Total
	(In thousands)						
June 30, 2019							
Allowance for loan losses:							
Beginning balance	\$ 380	\$ 3,486	\$ 949	\$ 408	\$ 159	\$ 667	\$6,049
Provision (credit) for loan losses	(8)	371	(29)	(2)	2	66	400
Recoveries	—	—	—	—	—	—	—
Loans charged-off	—	(14)	—	—	—	(2)	(16)
Total ending allowance balance	\$ 372	\$ 3,843	\$ 920	\$ 406	\$ 161	\$ 731	\$6,433
June 30, 2018							
Allowance for loan losses:							
Beginning balance	\$ 378	\$ 2,485	\$ 696	\$ 262	\$ 151	\$ 517	\$4,489
Provision (credit) for loan losses	47	33	130	83	17	(10)	300
Recoveries	—	—	—	—	—	—	—
Loans charged-off	—	—	—	—	—	—	—
Total ending allowance balance	\$ 425	\$ 2,518	\$ 826	\$ 345	\$ 168	\$ 507	\$4,789



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The following tables present the activity in the allowance for loan losses by class for the six months ending June 30, 2019 and 2018:

	<u>1-4 Family Residential</u>	<u>Commercial</u>	<u>Multifamily</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Consumer</u>	<u>Total</u>
	(In thousands)						
June 30, 2019							
Allowance for loan losses:							
Beginning balance	\$ 407	\$ 3,110	\$ 952	\$ 357	\$ 149	\$ 654	\$5,629
Provision for loan losses	(35)	752	(32)	49	12	79	825
Recoveries	—	—	—	—	—	—	—
Loans charged-off	—	(19)	—	—	—	(2)	(21)
Total ending allowance balance	<u>\$ 372</u>	<u>\$ 3,843</u>	<u>\$ 920</u>	<u>\$ 406</u>	<u>\$ 161</u>	<u>\$ 731</u>	<u>\$6,433</u>
June 30, 2018							
Allowance for loan losses:							
Beginning balance	\$ 382	\$ 2,272	\$ 713	\$ 266	\$ 127	\$ 504	\$4,264
Provision (credit) for loan losses	43	246	113	79	41	3	525
Recoveries	—	—	—	—	—	—	—
Loans charged-off	—	—	—	—	—	—	—
Total ending allowance balance	<u>\$ 425</u>	<u>\$ 2,518</u>	<u>\$ 826</u>	<u>\$ 345</u>	<u>\$ 168</u>	<u>\$ 507</u>	<u>\$4,789</u>

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by class and based on impairment method as of June 30, 2019 and December 31, 2018:

	<u>1-4 Family Residential</u>	<u>Commercial</u>	<u>Multifamily</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Consumer</u>	<u>Total</u>
	(In thousands)						
June 30, 2019							
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Collectively evaluated for impairment	<u>372</u>	<u>3,843</u>	<u>920</u>	<u>406</u>	<u>161</u>	<u>731</u>	<u>6,433</u>
Total ending allowance balance	<u>\$ 372</u>	<u>\$ 3,843</u>	<u>\$ 920</u>	<u>\$ 406</u>	<u>\$ 161</u>	<u>\$ 731</u>	<u>\$ 6,433</u>
Loans:							
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Loans collectively evaluated for impairment	<u>51,604</u>	<u>234,434</u>	<u>134,044</u>	<u>37,611</u>	<u>6,403</u>	<u>49,844</u>	<u>513,940</u>
Total ending loans balance	<u>\$ 51,604</u>	<u>\$ 234,434</u>	<u>\$ 134,044</u>	<u>\$ 37,611</u>	<u>\$ 6,403</u>	<u>\$ 49,844</u>	<u>\$513,940</u>



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Recorded investment is not adjusted for accrued interest, deferred costs, and unearned premiums due to immateriality.

	1-4 Family Residential	Commercial	Multifamily	Commercial Real Estate	Construction	Consumer	Total
	(In thousands)						
December 31, 2018							
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Collectively evaluated for impairment	407	3,110	952	357	149	654	5,629
Total ending allowance balance	\$ 407	\$ 3,110	\$ 952	\$ 357	\$ 149	\$ 654	\$ 5,629
Loans:							
Loans individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Loans collectively evaluated for impairment	56,043	191,828	136,537	33,145	5,921	43,675	467,149
Total ending loans balance	\$ 56,043	\$ 191,828	\$ 136,537	\$ 33,145	\$ 5,921	\$ 43,675	\$ 467,149

Nonperforming Loans

Nonperforming loans include loans 90 days past due and still accruing and nonaccrual loans. At June 30, 2019 and December 31, 2018, the Company did not have any nonperforming loans.

The following tables present the aging of the recorded investment in past due loans by class of loans as of June 30, 2019 and December 31, 2018:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
	(In thousands)					
June 30, 2019						
1 – 4 family residential	\$ —	\$ —	\$ —	\$ —	\$ 51,604	\$ 51,604
Commercial	—	—	—	—	234,434	234,434
Multifamily	—	—	—	—	134,044	134,044
Commercial real estate	—	—	—	—	37,611	37,611
Construction	—	—	—	—	6,403	6,403
Consumer	—	2	—	2	49,842	49,844
Total	\$ —	\$ 2	\$ —	\$ 2	\$ 513,938	\$ 513,940

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	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>Greater than 90 Days Past Due</u>	<u>Total Past Due</u>	<u>Loans Not Past Due</u>	<u>Total</u>
	(In thousands)					
<u>December 31, 2018</u>						
1 – 4 family residential	\$ —	\$ —	\$ —	\$ —	\$ 56,043	\$ 56,043
Commercial	—	—	—	—	191,828	191,828
Multifamily	—	—	—	—	136,537	136,537
Commercial real estate	—	—	—	—	33,145	33,145
Construction	—	—	—	—	5,921	5,921
Consumer	—	40	—	40	43,635	43,675
Total	<u>\$ —</u>	<u>\$ 40</u>	<u>\$ —</u>	<u>\$ 40</u>	<u>\$ 467,109</u>	<u>\$467,149</u>

Credit Quality Indicators

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed whenever a credit is extended, renewed or modified, or when an observable event occurs indicating a potential decline in credit quality, and no less than annually for large balance loans.

The Company uses the following definitions for risk ratings:

Special Mention - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful - Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

Based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

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	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>
	(In thousands)			
June 30, 2019				
1 – 4 family residential	\$ 51,604	\$ —	\$ —	\$ —
Commercial	229,725	4,559	150	—
Multifamily	134,044	—	—	—
Commercial real estate	37,611	—	—	—
Construction	6,403	—	—	—
Consumer	49,844	—	—	—
Total	<u>\$509,231</u>	<u>\$ 4,559</u>	<u>\$ 150</u>	<u>\$ —</u>

	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>
	(In thousands)			
December 31, 2018				
1 – 4 family residential	\$ 56,043	\$ —	\$ —	\$ —
Commercial	182,482	9,166	180	—
Multifamily	136,537	—	—	—
Commercial real estate	33,145	—	—	—
Construction	5,921	—	—	—
Consumer	43,675	—	—	—
Total	<u>\$457,803</u>	<u>\$ 9,166</u>	<u>\$ 180</u>	<u>\$ —</u>

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Company evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity.

The Company has no loans identified as troubled debt restructurings at June 30, 2019 and December 31, 2018. Furthermore, there were no loans modified during the three and six months ended June 30, 2019 and 2018 as troubled debt restructurings. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification.

NOTE 4 — Noninterest Income

Descriptions of revenue-generating activities that are within the scope of Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers, and are presented in the Consolidated Statements of Income as components of noninterest income, are as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
	(In thousands)			
Noninterest income				
Customer related fees and service charges				
Administrative service income	\$ 115	\$ 688	\$ 288	\$1,652
Merchant processing income				
Merchant services income	2,743	1,129	4,461	2,070
ACH income	152	82	248	162
Other	80	81	174	171
Total noninterest income	<u>\$ 3,090</u>	<u>\$ 1,980</u>	<u>\$ 5,171</u>	<u>\$4,055</u>

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The Company has made no significant judgments in applying the revenue guidance prescribed in ASC 606 that affect the determination of the amount and timing of revenue from the above-described contracts with customers.

- **Administrative service income** – Administrative service income is derived from the management of qualified settlement funds (QSFs), which are funds from settled mass torts and class action lawsuits. Our performance obligations with the QSFs are outlined in court approved orders which includes ensuring funds are invested into safe investment vehicles such as U.S. treasuries and FDIC insured products. Our fees for placing these funds in appropriate vehicles are earned over the course of a month, representing the period over which the Company satisfies the performance obligation.
- **Merchant services income** – We provide merchant services as an acquiring bank through the third-party or ISO business model in which we process credit and debit card transactions on behalf of merchants. We enter into a tri-party merchant agreement, between the company, ISO and each merchant. The Company's performance obligation is clearing and settling credit and debit transactions on behalf of the merchants. The Company recognizes revenue monthly once it summarizes and computes all revenue and expenses applicable to each ISO, which is our performance obligation.
- **ACH income** – We provide ACH services for merchants and other commercial customers. Contracts are entered into with third parties that require ACH transactions processed on behalf of their customers. Fees are variable and based on the volume of transactions within a given month. Our performance obligations are processing and settling ACH's on behalf of the customers. Our obligation is satisfied within each business day when the transactions (ACH files) are sent to the Federal Reserve Bank for clearing. Revenue is recognized based on the total volume of transactions processed that month for a given customer.
- **Other** – The other category includes revenue from service charges on deposit accounts, debit card interchange fees, and certain loan related fees where revenue is recognized as performance obligations are satisfied.

NOTE 5 — Share-Based Payment Plans

The Company issues incentive and nonqualified stock options and restricted stock awards to certain employees and directors pursuant to its equity incentive plans, which have been approved by the stockholders. Share-based awards are granted by the Compensation Committee of the Board of Directors.

Under the plans, options are granted with an exercise price equal to the fair value of the Company's stock at the date of the grant. Options granted vest over three or five years and have ten-year contractual terms. All options provide for accelerated vesting upon a change in control (as defined in the plans). Restricted shares are granted at the fair value on the date of grant and typically vest over 6 years with a third vesting after years four, five, and six. Restricted shares have the same voting rights as common stock and nonvested restricted shareholders do not have rights to the accrued dividends until vested.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on peer volatility. The Company uses peer data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on peer data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

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There were no stock options granted during the three and six months ended June 30, 2019 and the three months ended June 30, 2018. The fair value of options granted during the six months ended June 30, 2018 was determined using the following weighted average assumptions as of the grant date:

	Six months ended June 30, 2018
Risk-Free Interest Rate	2.54 %
Expected Term	84 months
Expected Stock Price Volatility	21.0 %
Dividend Yield	0.00 %
Weighted Average Fair Value	\$ 5.63

The following table presents a summary of the activity related to options as of June 30, 2019:

<u>June 30, 2019</u>	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
Outstanding at beginning of year	919,175	\$ 13.39	
Granted	—	—	
Exercised	(4,000)	12.50	
Forfeited	—	—	
Outstanding at period end	<u>915,175</u>	<u>\$ 13.40</u>	<u>6.30</u>
Vested or expected to vest	<u>915,175</u>	<u>\$ 13.40</u>	<u>6.30</u>
Exercisable at period end	<u>602,480</u>	<u>\$ 12.74</u>	<u>5.83</u>

The Company recognized compensation expense related to options of \$131 thousand and \$163 thousand for the three months ended June 30, 2019 and 2018, respectively. The Company recognized compensation expense related to options of \$264 thousand and \$317 thousand for the six months ended June 30, 2019 and 2018, respectively. At June 30, 2019, unrecognized compensation cost related to nonvested options was approximately \$915 thousand and is expected to be recognized over a weighted average period of 1.95 years. The intrinsic value for outstanding options and for options vested or expected to vest was \$10.8 million and \$7.5 million for exercisable options at June 30, 2019.

The following table presents a summary of the activity related to restricted stock as of June 30, 2019:

<u>June 30, 2019</u>	Shares	Weighted Average Grant Date Fair Value
Outstanding at beginning of year	148,500	\$ 22.56
Granted	—	—
Vested	—	—
Outstanding at period end	<u>148,500</u>	<u>\$ 22.56</u>

The Company recognized compensation expense related to restricted stock of \$139 thousand and \$61 thousand for the three months ended June 30, 2019 and 2018, respectively. The Company recognized compensation expense related to restricted stock of \$276 thousand and \$106 thousand for the six months ended June 30, 2019 and 2018, respectively. As of June 30, 2019, there was \$2.9 million of total unrecognized compensation cost related to nonvested shares granted under the plan. The cost is expected to be recognized over a weighted-average period of 5.17 years.



NOTE 6 — Earnings per Share

The factors used in the earnings per share computation follow:

	Three months ended		Six months ended	
	At June 30,		At June 30,	
	2019	2018	2019	2018
	(Dollars in thousands, except per share data)			
Basic				
Net income	\$ 3,468	\$ 2,221	\$ 6,453	\$ 4,179
Weighted average common shares outstanding	7,385,674	7,369,223	7,384,952	7,366,950
Basic earnings per share	\$ 0.47	\$ 0.30	\$ 0.87	\$ 0.57
Diluted				
Net income	\$ 3,468	\$ 2,221	\$ 6,453	\$ 4,179
Weighted average shares outstanding for basic earnings per share	7,385,674	7,369,223	7,384,952	7,366,950
Add: Dilutive effects of share based awards	392,647	346,792	374,575	323,853
Average shares and dilutive potential common shares	7,778,321	7,716,015	7,759,527	7,690,803
Diluted earnings per share	\$ 0.45	\$ 0.29	\$ 0.83	\$ 0.54

Share-based awards (stock options and restricted shares) totaling 42,500 shares of common stock were not considered in computing diluted earnings per common share for the three months ended June 30, 2019 because they were anti-dilutive. There were no anti-dilutive share-based awards for the three months ended June 30, 2018. Share-based awards totaling 129,500 and 43,500 shares of common stock were not considered in computing diluted earnings per common share for the six months ended June 30, 2019 and June 30, 2018, respectively, because they were anti-dilutive.

NOTE 7 — Leases

The Company adopted ASU 2016-02 on January 1, 2019. As a result of adoption, the Company recognized operating lease assets and corresponding lease liabilities related to its office facilities and retail branch. The operating lease assets represent the Company's right to use an underlying asset for the lease term, and the lease liability represents the Company's obligation to make lease payments over the lease term.

The operating lease asset and lease liability are determined at the commencement date of the lease based on the present value of the lease payments. As most of our leases do not provide an implicit rate, the Company used its incremental borrowing rate, the rate of interest to borrow on a collateralized basis for a similar term, at the lease commencement date.

The Company made a policy election to exclude the recognition requirements of ASU 2016-02 to short-term leases, those leases with original terms of 12 months or less. Short-term lease payments are recognized in the income statement on a straight-line basis over the lease term. Certain leases may include one or more options to renew. The exercise of lease renewal options is typically at the Company's discretion, and are included in the operating lease liability if it is reasonably certain that the renewal option will be exercised. Certain real estate leases may contain lease and non-lease components, such as common area maintenance charges, real estate taxes, and insurance, which are generally accounted for separately and are not included in the measurement of the lease liability since they are generally able to be segregated. The Company does not sublease any of its leased properties. The Company does not lease properties from any related parties.

As of June 30, 2019, ROU lease assets and related lease liabilities were \$2.9 million and \$3.5 million, respectively, and the Company does not have any leases that have not yet commenced.

Maturities of the Company's operating lease liabilities at June 30, 2019 are as follows:

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	Year ending December 31, (In thousands)
2019 ^(a)	\$ 263
2020	519
2021	510
2022	523
2023	536
Thereafter	1,641
Total operating lease payments	\$ 3,992
Less: interest	462
Present value of operating lease liabilities	\$ 3,530

(a) Excluding six months ended June 30, 2019

	As of and for the six months ended June 30, 2019 (Dollars in thousands)
Operating lease cost	\$ 240
Cash paid for operating lease liability	169
Weighted-average remaining lease term	7.35 years
Weighted-average discount rate	3.28 %

NOTE 8 — Fair Value Measurements

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values.

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a company’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

For available-for-sale securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2).

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Assets and liabilities measured at fair value on a recurring basis are summarized below:

	Fair Value Measurements Using		
	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)		
June 30, 2019			
Assets			
Available-for-sale securities			
Mortgage-backed securities – agency	\$ —	\$ 26,557	\$ —
CMO's – agency	—	121,136	—
Total	\$ —	\$ 147,693	\$ —
December 31, 2018			
Assets			
Available-for-sale securities			
Mortgage-backed securities – agency	\$ —	\$ 26,675	\$ —
CMO's – agency	—	119,023	—
Total	\$ —	\$ 145,698	\$ —

There were no transfers between Level 1 and Level 2 during the three and six months ended June 30, 2019 and 2018. There were no assets measured on a nonrecurring basis as of June 30, 2019 and December 31, 2018.

The following tables present the carrying amounts and fair values (represents exit price) of financial instruments at June 30, 2019 and December 31, 2018:

	Fair Value Measurement at June 30, 2019, Using:				
	Carrying Value	(Level 1)	(Level 2)	(Level 3)	Total
	(In thousands)				
Financial Assets:					
Cash and cash equivalents	\$ 40,152	\$ 614	\$ 39,538	\$ —	\$ 40,152
Securities available-for-sale	147,693	—	147,693	—	147,693
Securities, restricted, at cost	2,665	N/A	N/A	N/A	N/A
Loans, net	508,125	—	—	510,174	510,174
Accrued interest receivable	3,356	—	394	2,962	3,356
Financial Liabilities:					
Time deposits	19,870	—	19,838	—	19,838
Demand and other deposits	603,300	603,300	—	—	603,300
Secured borrowings	88	—	88	—	88
Accrued interest payable	14	—	14	—	14

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	Fair Value Measurement at December 31, 2018, Using:				
	Carrying Value	(Level 1)	(Level 2)	(Level 3)	Total
	(In thousands)				
Financial Assets:					
Cash and cash equivalents	\$ 30,562	\$ 659	\$ 29,903	\$ —	\$ 30,562
Securities available-for-sale	145,698	—	145,698	—	145,698
Securities, restricted, at cost	2,583	N/A	N/A	N/A	N/A
Loans, net	462,472	—	—	464,144	464,144
Accrued interest receivable	3,855	—	368	3,487	3,855
Financial Liabilities:					
Time deposits	20,417	—	20,377	—	20,377
Demand and other deposits	548,004	548,004	—	—	548,004
Secured borrowings	89	—	89	—	89
Accrued interest payable	15	—	15	—	15

NOTE 9 — Accumulated Other Comprehensive Loss

The following presents changes in accumulated other comprehensive loss by component, net of tax for the three and six months ending June 30, 2019 and 2018:

	Three months ended		Six months ended	
	At June 30,		At June 30,	
	2019	2018	2019	2018
	(In thousands)			
Unrealized Losses on Available-for-Sale Securities				
Beginning balance	\$ (1,170)	\$ (2,645)	\$ (2,614)	\$ (1,390)
Other comprehensive income (loss) before reclassifications, net of tax	1,090	(612)	2,534	(1,867)
Amounts reclassified from accumulated other comprehensive income	—	—	—	—
Net current period other comprehensive income (loss)	1,090	(612)	2,534	(1,867)
Ending balance	\$ (80)	\$ (3,257)	\$ (80)	\$ (3,257)

There were no reclassifications out of accumulated other comprehensive loss for the three and six months ended June 30, 2019 and 2018.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

General

Management’s discussion and analysis of financial condition at June 30, 2019 and December 31, 2018 and results of operations for the three and six months ended June 30, 2019 and 2018 is intended to assist in understanding the financial condition and results of operations of Esquire Financial Holdings, Inc. The information contained in this section should be read in conjunction with the unaudited Consolidated Financial Statements and the audited Consolidated Financial Statements as of December 31, 2018 and the notes thereto appearing in Part I, Item 1, of this quarterly report on Form 10-Q.

Cautionary Note Regarding Forward-Looking Statements

This quarterly report contains forward-looking statements, which can be identified by the use of words such as “may,” “might,” “should,” “could,” “predict,” “potential,” “believe,” “expect,” “attribute,” “continue,” “will,” “anticipate,” “seek,” “estimate,” “intend,” “plan,” “projection,” “goal,” “target,” “outlook,” “aim,” “would,” “annualized” and “outlook,” or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements include, but are not limited to:

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

These forward-looking statements are based on our current beliefs and expectations and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this quarterly report.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- our ability to manage our operations under the current economic conditions nationally and in our market area;
- adverse changes in the financial industry, securities, credit and national local real estate markets (including real estate values);
- risks related to a high concentration of loans secured by real estate located in our market area;
- risks related to a high concentration of loans and deposits dependent upon the legal and “litigation” market;
- the impact of any potential strategic transactions;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- significant increases in our loan losses, including as a result of our inability to resolve classified and nonperforming assets or reduce risks associated with our loans, and management’s assumptions in determining the adequacy of the allowance for loan losses;



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- interest rate fluctuations, which could have an adverse effect on our profitability;
- external economic and/or market factors, such as changes in monetary and fiscal policies and laws, including the interest rate policies of the Board of Governors of the Federal Reserve System, inflation or deflation, changes in the demand for loans, and fluctuations in consumer spending, borrowing and savings habits, which may have an adverse impact on our financial condition;
- continued or increasing competition from other financial institutions, credit unions, and non-bank financial services companies, many of which are subject to different regulations than we are;
- credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and in our allowance for loan losses and provision for loan losses;
- our success in increasing our legal and “litigation” market lending;
- our ability to attract and maintain deposits and our success in introducing new financial products;
- losses suffered by merchants or Independent Sales Organizations with whom we do business;
- our ability to effectively manage risks related to our merchant services business;
- our ability to leverage the professional and personal relationships of our board members and advisory board members;
- changes in interest rates generally, including changes in the relative differences between short-term and long-term interest rates and in deposit interest rates, that may affect our net interest margin and funding sources;
- fluctuations in the demand for loans;
- technological changes that may be more difficult or expensive than expected;
- changes in consumer spending, borrowing and savings habits;
- declines in the yield on our assets resulting from the current low interest rate environment;
- declines in our merchant processing income as a result of reduced demand, competition and changes in laws or government regulations or policies affecting financial institutions, including the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Jumpstart Our Business Startups Act (the “JOBS Act”), which could result in, among other things, increased deposit insurance premiums and assessments, capital requirements, regulatory fees and compliance costs, particularly the new capital regulations, and the resources we have available to address such changes;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission or the Public Company Accounting Oversight Board;
- loan delinquencies and changes in the underlying cash flows of our borrowers;
- the impairment of our investment securities;

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- our ability to control costs and expenses, particularly those associated with operating as a publicly traded company;
- the failure or security breaches of computer systems on which we depend;
- political instability;
- acts of war or terrorism;
- competition and innovation with respect to financial products and services by banks, financial institutions and non-traditional providers, including retail businesses and technology companies;
- changes in our organization and management and our ability to retain or expand our management team and our board of directors, as necessary;
- the costs and effects of legal, compliance and regulatory actions, changes and developments, including the initiation and resolution of legal proceedings, regulatory or other governmental inquiries or investigations, and/or the results of regulatory examinations and reviews;
- the ability of key third-party service providers to perform their obligations to us; and
- other economic, competitive, governmental, regulatory and operational factors affecting our operations, pricing, products and services described elsewhere in this Quarterly Report on Form 10-Q.

The foregoing factors should not be construed as exhaustive and should be read in conjunction with other cautionary statements that are included in this Quarterly Report on Form 10-Q. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate. Accordingly, you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. New risks and uncertainties arise from time to time, and it is not possible for us to predict those events or how they may affect us. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Summary of Significant Accounting Policies

A summary of our accounting policies is described in Note 1 to the Consolidated Financial Statements included in our annual report. Critical accounting estimates are necessary in the application of certain accounting policies and procedures and are particularly susceptible to significant change. Critical accounting policies are defined as those involving significant judgments and assumptions by management that could have a material impact on the carrying value of certain assets or on income under different assumptions or conditions. Management believes that the most critical accounting policies, which involve the most complex or subjective decisions or assessments, are as follows:

Allowance for Loan Losses. The allowance for loan losses is a valuation allowance for probable incurred credit losses. The allowance for loan losses is increased by provisions for loan losses charged to income. Losses are charged to the allowance when all or a portion of a loan is deemed to be uncollectible. Subsequent recoveries of loans previously charged off are credited to the allowance for loan losses when realized. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

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The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

All loans, except for consumer loans, are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated as a specific allowance. The measurement of an impaired loan is based on (i) the present value of expected future cash flows discounted at the loan's effective interest rate, (ii) the loan's observable market price or (iii) the fair value of the collateral if the loan is collateral dependent.

Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The determination of the economic factors is a qualitative assessment that involves significant management judgment.

Management has identified the following loan segments: Commercial Real Estate, Multifamily, Construction, Commercial, 1 – 4 Family Residential and Consumer. The risks associated with a concentration in real estate loans include potential losses from fluctuating values of land and improved properties. Commercial Real Estate and Multifamily loans are expected to be repaid from the cash flow of the underlying property so the collective amount of rents must be sufficient to cover all operating expenses, property management and maintenance, taxes and debt service. Increases in vacancy rates, interest rates or other changes in general economic conditions can all have an impact on the borrower and their ability to repay the loan. Construction loans are considered riskier than commercial financing on improved and established commercial real estate. The risk of potential loss increases if the original cost estimates or time to complete are significantly off. The remainder of the loan portfolio is comprised of commercial and consumer loans. The primary risks associated with the commercial loans is the cash flow of the business, the experience and quality of the borrowers' management, the business climate, and the impact of economic factors. The primary risks associated with 1 – 4 Family Residential and Consumer loans relate to the borrower, such as the risk of a borrower's unemployment as a result of deteriorating economic conditions or the amount and nature of a borrower's other existing indebtedness, and the value of the collateral securing the loan if the Bank must take possession of the collateral.

Income Taxes. Income taxes are provided for under the asset and liability 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 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 taxes of a change in tax rates is recognized in income in the



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period the change occurs. Deferred tax assets are reduced, through a valuation allowance, if necessary, by the amount of such benefits that are not expected to be realized based on current available evidence.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Emerging Growth Company. Pursuant to the JOBS Act, an emerging growth company is provided the option to adopt new or revised accounting standards that may be issued by the Financial Accounting Standards Board (“FASB”) or the SEC either (i) within the same periods as those otherwise applicable to non-emerging growth companies or (ii) within the same time periods as private companies. We have irrevocably elected to adopt new accounting standards within the public company adoption period.

We have taken advantage of some of the reduced regulatory and reporting requirements that are available to it so long as we qualify as an emerging growth company, including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation, and exemptions from the requirements of holding non-binding advisory votes on executive compensation and golden parachute payments.

Overview

We are a bank holding company headquartered in Jericho, New York and registered under the Bank Holding Company Act of 1956, as amended. Through our wholly owned bank subsidiary, Esquire Bank, National Association (“Esquire Bank” or the “Bank”), we are a full service commercial bank dedicated to serving the financial needs of the legal and small business communities on a national basis, as well as commercial and retail customers in the New York metropolitan market. We offer tailored products and solutions to the legal community and their clients as well as dynamic and flexible merchant services solutions to small business owners, both on a national basis. We also offer traditional banking products for businesses and consumers in our local market area.

Our results of operations depend primarily on our net interest income which is the difference between the interest income we earn on our interest-earning assets and the interest we pay on our interest-bearing liabilities. Our results of operations also are affected by our provisions for loan losses, noninterest income and noninterest expense. Noninterest income currently consists primarily of merchant processing income and customer related fees and charges. Noninterest expense currently consists primarily of employee compensation and benefits and professional and consulting services. Our results of operations also may be affected significantly by general and local economic and competitive conditions, changes in market interest rates, governmental policies, the litigation market and actions of regulatory authorities.

Comparison of Financial Condition at June 30, 2019 and December 31, 2018

Assets. Our total assets were \$732.5 million at June 30, 2019, an increase of \$68.6 million, or 10.3%, from \$663.9 million at December 31, 2018, primarily due to increases in loans of \$46.5 million, or 9.9%, cash and cash equivalents of \$9.6 million, or 31.4% and securities of \$2.0 million, or 1.4%.

Loans. At June 30, 2019, loans were \$514.6 million, or 82.6% of total deposits, compared to \$468.1 million, or 82.4% of total deposits, at December 31, 2018. The growth in loans was primarily driven by increases in commercial loans. Commercial loans increased \$42.6 million, or 22.2%, to \$234.4 million at June 30, 2019 from \$191.8 million at December 31, 2018.

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The following table sets forth the composition of our Attorney-Related loan portfolio by type of loan at the dates indicated:

	<u>June 30, 2019</u>		<u>December 31, 2018</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
(Dollars in thousands)				
Attorney-Related Loans				
Commercial Attorney-Related:				
Working capital lines of credit	\$110,815	47.9 %	\$112,742	53.3 %
Case cost lines of credit	48,384	20.9	37,054	17.6
Term loans	34,478	14.9	26,851	12.7
Total Commercial Attorney-Related	193,677	83.7	176,647	83.6
Consumer Attorney-Related:				
Post-settlement consumer loans	36,737	15.9	33,576	15.9
Structured settlement loans	922	0.4	1,137	0.5
Total Consumer Attorney-Related	37,659	16.3	34,713	16.4
Total Attorney-Related Loans	<u>\$231,336</u>	<u>100.0 %</u>	<u>\$211,360</u>	<u>100.0 %</u>

At June 30, 2019, our Attorney-Related loans, which include commercial loans to law firms and consumer lending to plaintiffs/claimants and attorneys, totaled \$231.3 million, or 45.0% of our total loan portfolio, compared to \$211.4 million at December 31, 2018. The balance of Attorney-Related loans can fluctuate based on paydowns and draws of lines of credit. We remain focused on prudently growing our Attorney-Related loan portfolio.

Securities. Securities available for sale increased \$2.0 million, or 1.4%, to \$147.7 million at June 30, 2019 from \$145.7 million at December 31, 2018, driven by purchases of \$9.9 million and unrealized gains of \$3.5 million, offset by paydowns of \$11.2 million and net amortization of \$0.2 million.

Funding. Total deposits increased \$54.7 million, or 9.6%, to \$623.2 million at June 30, 2019 from \$568.4 million at December 31, 2018. We continue to focus on the acquisition and expansion of core deposit relationships, which we define as all deposits except for certificates of deposit. Core deposits totaled \$603.3 million at June 30, 2019, or 96.8% of total deposits at that date, compared to \$548.0 million or 96.4% of total deposits at December 31, 2018.

At June 30, 2019, we had the ability to borrow a total of \$117.6 million from the Federal Home Loan Bank of New York. We also had an available line of credit with the Federal Reserve Bank of New York discount window of \$24.2 million. At June 30, 2019, we also had \$17.5 million in aggregate unsecured lines of credit with unaffiliated correspondent banks. No amounts were outstanding on any of the aforementioned lines of credit at June 30, 2019.

Equity. Total stockholders' equity increased \$9.6 million, or 10.3%, to \$102.4 million at June 30, 2019, from \$92.8 million at December 31, 2018.

Average Balance Sheets

The following tables present average balance sheet information, interest income, interest expense and the corresponding average yields earned and rates paid for periods indicated. The average balances are daily averages and, for loans, include both performing and nonperforming balances. Interest income on loans includes the effects of discount

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accretion and net deferred loan origination costs accounted for as yield adjustments. No tax-equivalent yield adjustments were made, as the effect thereof was not material.

	For the Three Months Ended June 30,					
	2019			2018		
	(Dollars in thousands)					
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
INTEREST EARNING ASSETS						
Loans	\$505,688	\$ 8,020	6.36 %	\$370,981	\$ 5,657	6.12 %
Securities, includes restricted stock	154,284	1,058	2.75 %	154,224	1,006	2.62 %
Interest earning cash	43,471	244	2.25 %	49,686	201	1.62 %
Total interest earning assets	<u>703,443</u>	<u>9,322</u>	<u>5.32 %</u>	<u>574,891</u>	<u>6,864</u>	<u>4.79 %</u>
NONINTEREST EARNING ASSETS	<u>32,867</u>			<u>13,534</u>		
TOTAL AVERAGE ASSETS	<u><u>\$736,310</u></u>			<u><u>\$588,425</u></u>		
INTEREST BEARING LIABILITIES						
Savings, NOW, Money Markets	\$364,699	\$ 611	0.67 %	\$272,929	\$ 167	0.25 %
Time deposits	19,932	126	2.54 %	33,780	51	0.61 %
Total deposits	384,631	737	0.77 %	306,709	218	0.29 %
Short-term borrowings	1	—	— %	1	—	— %
Secured borrowings	88	1	4.56 %	275	5	7.29 %
Total interest bearing liabilities	<u>384,720</u>	<u>738</u>	<u>0.77 %</u>	<u>306,985</u>	<u>223</u>	<u>0.29 %</u>
NONINTEREST BEARING LIABILITIES						
Demand deposits	244,072			193,555		
Other liabilities	8,442			2,848		
Total noninterest bearing liabilities	<u>252,514</u>			<u>196,403</u>		
Stockholders' equity	99,076			85,037		
TOTAL AVG. LIABILITIES AND EQUITY	<u><u>\$736,310</u></u>			<u><u>\$588,425</u></u>		
Net interest income		<u>\$ 8,584</u>			<u>\$ 6,641</u>	
Net interest spread			<u>4.55 %</u>			<u>4.50 %</u>
Net interest margin			<u>4.89 %</u>			<u>4.63 %</u>

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	For the Six Months Ended June 30,					
	2019			2018		
	(Dollars in thousands)					
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
INTEREST EARNING ASSETS						
Loans	\$484,076	\$ 15,212	6.34 %	\$363,085	\$ 10,946	6.08 %
Securities, includes restricted stock	154,174	2,123	2.78 %	145,450	1,870	2.59 %
Interest earning cash	39,109	471	2.43 %	43,539	317	1.47 %
Total interest earning assets	<u>677,359</u>	<u>17,806</u>	<u>5.30 %</u>	<u>552,074</u>	<u>13,133</u>	<u>4.80 %</u>
NONINTEREST EARNING ASSETS	<u>28,259</u>			<u>9,906</u>		
TOTAL AVERAGE ASSETS	<u>\$705,618</u>			<u>\$561,980</u>		
INTEREST BEARING LIABILITIES						
Savings, NOW, Money Markets	\$344,247	\$ 1,040	0.61 %	\$258,499	\$ 289	0.23 %
Time deposits	20,101	251	2.52 %	31,991	98	0.62 %
Total deposits	<u>364,348</u>	<u>1,291</u>	<u>0.71 %</u>	<u>290,490</u>	<u>387</u>	<u>0.27 %</u>
Short-term borrowings	1	—	— %	2	—	— %
Secured borrowings	89	3	6.80 %	276	10	7.31 %
Total interest bearing liabilities	<u>364,438</u>	<u>1,294</u>	<u>0.72 %</u>	<u>290,768</u>	<u>397</u>	<u>0.28 %</u>
NONINTEREST BEARING LIABILITIES						
Demand deposits	237,460			184,645		
Other liabilities	7,114			2,308		
Total noninterest bearing liabilities	<u>244,574</u>			<u>186,953</u>		
Stockholders' equity	96,606			84,259		
TOTAL AVG. LIABILITIES AND EQUITY	<u>\$705,618</u>			<u>\$561,980</u>		
Net interest income		<u>\$ 16,512</u>			<u>\$ 12,736</u>	
Net interest spread			<u>4.58 %</u>			<u>4.52 %</u>
Net interest margin			<u>4.92 %</u>			<u>4.65 %</u>

Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for major components of interest earning assets and interest bearing liabilities for the periods indicated. The table distinguishes between: (1) changes attributable to volume (changes in volume multiplied by the prior period's rate); (2) changes attributable to rate (change in rate multiplied by the prior year's volume); and (3) total increase (decrease) (the sum of

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the previous columns). Changes attributable to both volume and rate are allocated ratably between the volume and rate categories.

	For the Three Months Ended June 30, 2019 vs. 2018			For the Six Months Ended June 30, 2019 vs. 2018		
	Increase		Total	Increase		Total
	(Decrease) due to		(Decrease)	(Decrease) due to		(Decrease)
	Volume	Rate	(Decrease)	Volume	Rate	(Decrease)
Interest earned on:						
Loans	\$ 2,128	\$ 235	\$ 2,363	\$ 3,785	\$ 481	\$ 4,266
Securities, includes restricted stock	—	52	52	116	137	253
Interest earning cash	(28)	71	43	(35)	189	154
Total interest income	<u>2,100</u>	<u>358</u>	<u>2,458</u>	<u>3,866</u>	<u>807</u>	<u>4,673</u>
Interest paid on:						
Savings, NOW, Money Markets	72	372	444	122	629	751
Time deposits	(29)	104	75	(49)	202	153
Total deposits	43	476	519	73	831	904
Short-term borrowings	—	—	—	—	—	—
Secured borrowings	(3)	(1)	(4)	(6)	(1)	(7)
Total interest expense	<u>40</u>	<u>475</u>	<u>515</u>	<u>67</u>	<u>830</u>	<u>897</u>
Change in net interest income	<u>\$ 2,060</u>	<u>\$ (117)</u>	<u>\$ 1,943</u>	<u>\$ 3,799</u>	<u>\$ (23)</u>	<u>\$ 3,776</u>

Comparison of Operating Results for the Three Months Ended June 30, 2019 and 2018

General. Net income increased \$1.2 million, or 56.1%, to \$3.5 million for the three months ended June 30, 2019 from \$2.2 million for the three months ended June 30, 2018. The increase resulted from a \$1.9 million increase in net interest income and a \$1.1 million increase in noninterest income, which was partially offset by a \$1.2 million increase in noninterest expense.

Interest Income. Interest income increased \$2.5 million, or 35.8%, to \$9.3 million for the three months ended June 30, 2019 from \$6.9 million for the three months ended June 30, 2018. This was primarily attributable to an increase in loan interest income, which increased \$2.4 million, or 41.8%, to \$8.0 million for the three months ended June 30, 2019 from \$5.7 million for the three months ended June 30, 2018.

The increase in interest income on loans was due to an increase in average loans during the quarter ended June 30, 2019 of \$134.7 million or 36.3% as well as a 24 basis point increase in the average rate of loans. The increase in the average rate of loans is due to volume increases in higher yielding loan categories and the positive effects of increases in short-term rates.

Interest Expense. Interest expense increased \$515 thousand, or 230.9%, to \$738 thousand for the three months ended June 30, 2019 from \$223 thousand for the three months ended June 30, 2018, primarily due to increases in rates of deposits. The average rate we paid on interest bearing deposits increased 48 basis points to 0.77% for the three months ended June 30, 2019 compared to 0.29% for the three months ended June 30, 2018, driven by increases in short-term rates.

Net Interest Income. Net interest income increased \$1.9 million, or 29.3%, to \$8.6 million for the three months ended June 30, 2019 from \$6.6 million for the three months ended June 30, 2018, primarily due to an increase in average interest earning assets and rising rates. Our net interest rate spread increased 5 basis points to 4.55% for the three months ended June 30, 2019 from 4.50% for the three months ended June 30, 2018, while our net interest margin increased 26 basis points to 4.89% for the three months ended June 30, 2019 from 4.63% for the three months ended June 30, 2018. The increase in net interest margin was due to a 53 basis point increase in the average yield earned on interest earning assets, primarily driven by an increase in loan yields, partially offset by an increase in our cost of funds.



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Provision for Loan Losses. Our provision for loan losses was \$400 thousand for the three months ended June 30, 2019 compared to \$300 thousand for the three months ended June 30, 2018. The provisions recorded resulted in an allowance for loan losses of \$6.4 million, or 1.25% of total loans at June 30, 2019, compared to \$5.6 million, or 1.20% of total loans at December 31, 2018. The higher provision is reflective of growth in the loan portfolio. As of June 30, 2019 the Company had no nonperforming assets.

Noninterest Income. Noninterest income information is as follows:

	For the Three Months Ended June 30,		Change	
	2019	2018	Amount	Percent
	(Dollars in thousands)			
Noninterest income				
Merchant processing income	\$ 2,895	\$ 1,211	\$ 1,684	139.1 %
Customer related fees and service charges	195	769	(574)	(74.6)
Total noninterest income	\$ 3,090	\$ 1,980	\$ 1,110	56.1 %

Merchant processing income increased due to growth in our sales channels through ISOs and merchants with average monthly volumes increasing 63.4% to \$1.0 billion for the three months ended June 30, 2019 compared to \$622.7 million for the three months ended June 30, 2018. Customer related fees and service charges, consisting primarily of administrative service payments (“ASP”) on off-balance sheet funds, declined by \$574 thousand or 74.6% compared to the three months ended June 30, 2018. ASP fee income is impacted the volume of off-balance sheet funds, the duration of these funds, and short-term interest rates.

Noninterest Expense. Noninterest expense information is as follows:

	For the Three Months Ended June 30,		Change	
	2019	2018	Amount	Percent
	(Dollars in thousands)			
Noninterest expense				
Employee compensation and benefits	\$ 3,587	\$ 3,008	\$ 579	19.2 %
Occupancy and equipment	443	432	11	2.5
Professional and consulting services	837	684	153	22.4
FDIC and regulatory assessments	86	83	3	3.6
Advertising and marketing	294	171	123	71.9
Travel and business relations	124	111	13	11.7
Data processing	713	446	267	59.9
Other operating expenses	423	354	69	19.5
Total noninterest expense	\$ 6,507	\$ 5,289	\$ 1,218	23.0 %

Employee compensation and benefits costs increased due to an increase in the number of employees as well as the impact of year end salary increases. Data processing costs were higher due to increased processing volume primarily driven by our merchant services platform as well as additional costs related to certain system implementations. Professional and consulting costs increased due to our IT enterprise-wide architecture assessments and other pre-development IT costs. Advertising costs increased due to certain targeted events focused on our commercial attorney platform.

Income Tax Expense. We recorded an income tax expense of \$1.3 million for the three months ended June 30, 2019, reflecting an effective tax rate of 27.3%, compared to \$811 thousand, or 26.8%, for the three months ended June 30, 2018.

Comparison of Operating Results for the Six Months Ended June 30, 2019 and 2018

General. Net income increased \$2.3 million, or 54.4%, to \$6.5 million for the six months ended June 30, 2019 from \$4.2 million for the six months ended June 30, 2018. The increase resulted from a \$3.8 million increase in net interest income and a \$1.1 million increase in noninterest income, which was partially offset by a \$1.4 million increase in noninterest expense.

Interest Income. Interest income increased \$4.7 million, or 35.6%, to \$17.8 million for the six months ended June 30, 2019 from \$13.1 million for the six months ended June 30, 2018. This was primarily attributable to an increase in loan interest income, which increased \$4.3 million, or 39.0%, to \$15.2 million for the six months ended June 30, 2019 from \$10.9 million for the six months ended June 30, 2018.

The increase in interest income on loans was due to an increase in average loans during the six months ended June 30, 2019 of \$121.0 million or 33.3% as well as a 26 basis point increase in the average rate of loans. The increase in the average rate of loans is due to volume increases in higher yielding loan categories and the positive effects of increases in short-term rates. Securities interest income also increased due to an increase in the average balance of securities during the six months ended June 30, 2019 of \$8.7 million, or 6.0% and a 19 basis point increase in the average rate of securities when compared to the first six months of 2018.

Interest Expense. Interest expense increased \$897 thousand, or 225.9%, to \$1.3 million for the six months ended June 30, 2019 from \$397 thousand for the six months ended June 30, 2018, primarily due to increases in rates of deposits. The average rate we paid on interest bearing deposits increased 44 basis points to 0.71% for the six months ended June 30, 2019 compared to 0.27% for the six months ended June 30, 2018, driven by increases in short-term rates.

Net Interest Income. Net interest income increased \$3.8 million, or 29.6%, to \$16.5 million for the six months ended June 30, 2019 from \$12.7 million for the six months ended June 30, 2018, primarily due to an increase in average interest earning assets and rising rates. Our net interest rate spread increased 6 basis points to 4.58% for the six months ended June 30, 2019 from 4.52% for the six months ended June 30, 2018, while our net interest margin increased 27 basis points to 4.92% for the six months ended June 30, 2019 from 4.65% for the six months ended June 30, 2018. The increase in net interest margin was due to a 50 basis point increase in the average yield earned on interest earning assets, primarily driven by an increase in loan yields, partially offset by an increase in our cost of funds.

Provision for Loan Losses. Our provision for loan losses was \$825 thousand for the six months ended June 30, 2019 compared to \$525 thousand for the six months ended June 30, 2018. The higher provision is reflective of growth as well as the composition of the loan portfolio. As of June 30, 2019, the Company had no nonperforming assets.

Noninterest Income. Noninterest income information is as follows:

	For the Six Months Ended		Change	
	June 30, 2019	2018	Amount	Percent
	(Dollars in thousands)			
Noninterest income				
Merchant processing income	\$ 4,709	\$ 2,232	\$ 2,477	111.0 %
Customer related fees and service charges	462	1,823	(1,361)	(74.7)
Total noninterest income	\$ 5,171	\$ 4,055	\$ 1,116	27.5 %

Merchant processing income increased due to growth in our sales channels through ISOs and merchants with average monthly volumes increasing 76.6% to \$906.9 million for the six months ended June 30, 2019 compared to \$513.7 million for the six months ended June 30, 2018. Customer related fees and service charges, consisting primarily of administrative service payments (“ASP”) on off-balance sheet funds, declined by \$1.4 million or 74.7% compared to the six months ended June 30, 2018. ASP fee income is impacted the volume of off-balance sheet funds, the duration of these funds, and short-term interest rates.



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Noninterest Expense. Noninterest expense information is as follows:

	For the Six Months Ended		Change	
	June 30, 2019	2018	Amount	Percent
(Dollars in thousands)				
Noninterest expense				
Employee compensation and benefits	\$ 7,023	\$ 6,069	\$ 954	15.7 %
Occupancy and equipment	882	858	24	2.8
Professional and consulting services	1,330	1,312	18	1.4
FDIC and regulatory assessments	172	155	17	11.0
Advertising and marketing	362	296	66	22.3
Travel and business relations	237	268	(31)	(11.6)
Data processing	1,219	930	289	31.1
Other operating expenses	763	673	90	13.4
Total noninterest expense	\$11,988	\$10,561	\$ 1,427	13.5 %

Employee compensation and benefits costs increased due to an increase in the number of employees as well as the impact of year end salary increases. Data processing costs were higher due to increased processing volume primarily driven by our merchant services platform as well as additional costs related to certain system implementations.

Income Tax Expense. We recorded an income tax expense of \$2.4 million for the six months ended June 30, 2019, reflecting an effective tax rate of 27.3%, compared to \$1.5 million, or 26.8%, for the six months ended June 30, 2018.

Management of Market Risk

General. The principal objective of our asset and liability management function is to evaluate the interest rate risk within the balance sheet and pursue a controlled assumption of interest rate risk while maximizing net income and preserving adequate levels of liquidity and capital. The board of directors of our Bank has oversight of our asset and liability management function, which is managed by our Asset/Liability Management Committee. Our Asset/Liability Management Committee meets regularly to review, among other things, the sensitivity of our assets and liabilities to market interest rate changes, local and national market conditions and market interest rates. That group also reviews our liquidity, capital, deposit mix, loan mix and investment positions.

As a financial institution, our primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of our assets and liabilities, and the fair value of all interest earning assets and interest bearing liabilities, other than those which have a short term to maturity. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income.

We manage our exposure to interest rates primarily by structuring our balance sheet in the ordinary course of business. We do not typically enter into derivative contracts for the purpose of managing interest rate risk, but we may do so in the future. Based upon the nature of our operations, we are not subject to foreign exchange or commodity price risk. We do not own any trading assets.

Net Interest Income Simulation. We use an interest rate risk simulation model to test the interest rate sensitivity of net interest income and the balance sheet. Instantaneous parallel rate shift scenarios are modeled and utilized to evaluate risk and establish exposure limits for acceptable changes in net interest margin. These scenarios, known as rate shocks, simulate an instantaneous change in interest rates and use various assumptions, including, but not limited to, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment and replacement of asset and liability cash flows.



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The following table presents the estimated changes in net interest income of Esquire Bank, National Association, calculated on a bank-only basis, which would result from changes in market interest rates over a twelve-month period.

Changes in Interest Rates (Basis Points)	At June 30, 2019	
	Estimated 12-Months Net Interest Income	Change
	(Dollars in thousands)	
400	\$ 44,612	8,274
300	42,242	5,904
200	40,154	3,816
100	38,247	1,909
0	36,338	—
(100)	33,539	(2,799)
(200)	30,904	(5,434)

Economic Value of Equity Simulation. We also analyze our sensitivity to changes in interest rates through an economic value of equity (“EVE”) model. EVE represents the present value of the expected cash flows from our assets less the present value of the expected cash flows arising from our liabilities adjusted for the value of off-balance sheet contracts. EVE attempts to quantify our economic value using a discounted cash flow methodology. We estimate what our EVE would be as of a specific date. We then calculate what EVE would be as of the same date throughout a series of interest rate scenarios representing immediate and permanent, parallel shifts in the yield curve. We currently calculate EVE under the assumptions that interest rates increase 100, 200, 300 and 400 basis points from current market rates, and under the assumption that interest rates decrease 100 and 200 basis points from current market rates.

The following table presents the estimated changes in EVE of Esquire Bank, National Association, calculated on a bank-only basis that would result from changes in market interest rates at June 30, 2019.

Changes in Interest Rates (Basis Points)	At June 30, 2019	
	Economic Value of Equity	Change
	(Dollars in thousands)	
400	\$ 143,040	16,118
300	139,470	12,548
200	136,411	9,489
100	133,111	6,189
0	126,922	—
(100)	113,605	(13,317)
(200)	96,509	(30,413)

Many assumptions are used to calculate the impact of interest rate fluctuations. Actual results may be significantly different than our projections due to several factors, including the timing and frequency of rate changes, market conditions and the shape of the yield curve. The computations of interest rate risk shown above do not include actions that our management may undertake to manage the risks in response to anticipated changes in interest rates, and actual results may also differ due to any actions taken in response to the changing rates.

Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments and maturities and sales of securities. While maturities and



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scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

We regularly review the need to adjust our investments in liquid assets based upon our assessment of: (1) expected loan demand, (2) expected deposit flows, (3) yields available on interest earning deposits and securities, and (4) the objectives of our asset/liability management program. Excess liquid assets are invested generally in interest earning deposits and short- and intermediate-term securities.

Our most liquid assets are cash and cash equivalents. The levels of these assets are dependent on our operating, financing, lending and investing activities during any given period. At June 30, 2019, cash and cash equivalents totaled \$40.2 million.

At June 30, 2019, through pledging of our securities, we had the ability to borrow a total of \$117.6 million from the Federal Home Loan Bank of New York and had an available line of credit with the Federal Reserve Bank of New York discount window of \$24.2 million. At June 30, 2019, we also had \$17.5 million in aggregate unsecured lines of credit with unaffiliated correspondent banks. No amounts were outstanding on any of the aforementioned lines of credit at June 30, 2019.

We have no material commitments or demands that are likely to affect our liquidity other than set forth below. In the event loan demand were to increase faster than expected, or any unforeseen demand or commitment were to occur, we could access our borrowing capacity with the Federal Home Loan Bank of New York or obtain additional funds through brokered certificates of deposit.

Esquire Bank, National Association is subject to various regulatory capital requirements administered by Office of the Comptroller of the Currency (the “OCC”), and the Federal Deposit Insurance Corporation. At June 30, 2019, Esquire Bank exceeded all applicable regulatory capital requirements, and was considered “well capitalized” under regulatory guidelines.

We manage our capital to comply with our internal planning targets and regulatory capital standards administered by the OCC. We review capital levels on a monthly basis.

The following table presents our capital ratios as of the indicated dates for Esquire Bank.

	“Well Capitalized”	For Capital Adequacy Purposes Minimum Capital with Conservation Buffer	Actual At June 30, 2019
<u>Total Risk-based Capital Ratio</u>			
Bank	10.00 %	10.50 %	17.78 %
<u>Tier 1 Risk-based Capital Ratio</u>			
Bank	8.00 %	8.50 %	16.62 %
<u>Common Equity Tier 1 Capital Ratio</u>			
Bank	6.50 %	7.00 %	16.62 %
<u>Tier 1 Leverage Ratio</u>			
Bank	5.00 %	4.00 %	12.85 %

Basel III revised the capital adequacy requirements and the Prompt Corrective Action Framework effective January 1, 2015 for Esquire Bank. As of January 1, 2019, the fully phased in Basel Rules require Esquire Bank to maintain a 2.5% “capital conservation buffer” on top of the minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a (i) CET1 to risk-weighted assets, (ii) Tier 1 capital to risk-weighted assets or (iii) total capital to risk-weighted assets above the



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respective minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and discretionary bonus payments to executive officers based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and increased by 0.625% on each subsequent January 1, until it reached 2.5% on January 1, 2019.

As a result of the recently enacted Economic Growth, Regulatory Relief, and Consumer Protection Act, the Federal Reserve Board is required to amend its small bank holding company and savings and loan holding company policy statement to provide that holding companies with consolidated assets of less than \$3 billion that are (i) not engaged in significant nonbanking activities, (ii) do not conduct significant off-balance sheet activities, and (iii) do not have a material amount of SEC-registered debt or equity securities, other than trust preferred securities, that contribute to an organization's complexity, will no longer be subject to regulatory capital requirements, effective no later than November 2018.

In addition, as a result of the legislation, the federal banking agencies are required to develop a "Community Bank Leverage Ratio" (the ratio of a bank's tangible equity capital to average total consolidated assets) for financial institutions with assets of less than \$10 billion. A "qualifying community bank" that exceeds this ratio will be deemed to be in compliance with all other capital and leverage requirements, including the capital requirements to be considered "well capitalized" under Prompt Corrective Action statutes. The federal banking agencies may consider a financial institution's risk profile when evaluating whether it qualifies as a community bank for purposes of the capital ratio requirement. The federal banking agencies must set the minimum capital for the new Community Bank Leverage Ratio at not less than 8% and not more than 10%. A financial institution can elect to be subject to this new definition. The OCC, Federal Reserve Board and the FDIC have issued a proposed rule that would provide the simplified capital and leverage requirements consistent with the Economic Growth, Regulation Relief and Consumer Protection Act but such rule is not yet final.

Contractual Obligations and Off-Balance Sheet Arrangements

Contractual Obligations. In the ordinary course of our operations, we enter into certain contractual obligations. The following table presents our contractual obligations as of June 30, 2019.

	Contractual Maturities as of June 30, 2019				
	Due in One Year or Less	Due After One Year Through Three Years	Due After Three Years Through Five Years	Due After Five Years	Total
	(In thousands)				
Operating lease obligations	\$ 528	\$ 1,023	\$ 1,072	\$ 1,369	\$ 3,992
Time deposits	17,312	2,558	—	—	19,870
Total	\$ 17,840	\$ 3,581	\$ 1,072	\$ 1,369	\$ 23,862

Off-Balance Sheet Arrangements. We are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit, which involve elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Statements of Financial Condition. Our exposure to credit loss is represented by the contractual amount of the instruments. We use the same credit policies in making commitments as we do for on-balance sheet instruments.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The information required by this item is included in Item 2 of this quarterly report under "Management of Market Risk."

Item 4. Controls and Procedures

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of June 30, 2019. Based on that evaluation, the Company's management, including the Chief Executive Officer and the Chief Financial Officer, concluded that the Registrant's disclosure controls and procedures were effective.

During the quarter ended June 30, 2019, there have been no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

Periodically, we are involved in claims and lawsuits, such as claims to enforce liens, condemnation proceedings on properties in which we hold security interests, claims involving the making and servicing of real property loans and other issues incident to our business. At June 30, 2019, we are not a party to any pending legal proceedings that we believe would have a material adverse effect on our financial condition, results of operations or cash flows.

Item 1A. Risk Factors

There have been no material changes to our risk factors as disclosed in the Company's Annual Report on Form 10-K.

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

a) Not applicable.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Number	Description
3.1	Articles of Incorporation of Esquire Financial Holdings, Inc. (1)
3.3	Amended and Restated Bylaws of Esquire Financial Holdings, Inc. (2)
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Written Statement of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.0	The following materials for the quarter ended June 30, 2019, formatted in XBRL (Extensible Business Reporting Language): (i) Balance Sheets, (ii) Statements of Income, (iii) Statements of Comprehensive Income, (iv) Statements of Cash Flows, and (v) Notes to Financial Statements.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document
(1)	Incorporated by reference to Exhibit 3.1 in the Registration Statement on Form S-1 (File No. 333-218372) originally filed by the Company under the Securities Act of 1933 with the Commission on May 31, 2017, and all amendments or reports filed thereto.
(2)	Incorporated by reference to Exhibit 3.3 in the Registration Statement on Form S-1/A (File No. 333-218372) originally filed by the Company under the Securities Act of 1933 with the Commission on June 22, 2017, and all amendments or reports filed thereto.

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.

ESQUIRE FINANCIAL HOLDINGS, INC.

Date: August 8, 2019

/s/ Andrew C. Sagliocca

Andrew C. Sagliocca

President and Chief Executive Officer

Date: August 8, 2019

/s/ Michael Lacapria

Michael Lacapria

Senior Vice President and Chief Financial Officer

Section 2: EX-31.1 (EX-31.1)

Exhibit 31.1

Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Andrew C. Sagliocca, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Esquire Financial Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13-a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within the entity, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2019

/s/ Andrew C. Sagliocca
Andrew C. Sagliocca
President and Chief Executive Officer

Section 3: EX-31.2 (EX-31.2)

Exhibit 31.2

Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Michael Lacapria, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Esquire Financial Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13-a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within the entity, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2019

/s/ Michael Lacapria

Michael Lacapria
Senior Vice President and Chief Financial Officer

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Section 4: EX-32 (EX-32)

Exhibit 32

Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Andrew C. Sagliocca, President and Chief Executive Officer of Esquire Financial Holdings, Inc., (the “Company”) and Michael Lacapria, Senior Vice President and Chief Financial Officer of the Company, each certify in his capacity as an officer of the Company that they have reviewed the quarterly report on Form 10-Q for the quarter ended June 30, 2019 (the “Report”) and that to the best of their knowledge:

1. the Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 8, 2019

/s/ Andrew C. Sagliocca

Andrew C. Sagliocca

President and Chief Executive Officer

Date: August 8, 2019

/s/ Michael Lacapria

Michael Lacapria

Senior Vice President and Chief Financial Officer

The purpose of this statement is solely to comply with Title 18, Chapter 63, Section 1350 of the United States Code, as amended by Section 906 of the Sarbanes-Oxley Act of 2002.

A signed original of this written statement required by Section 906 has been provided to Esquire Financial Holdings, Inc. and will be retained by Esquire Financial Holdings, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.



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