

ENTERPRISE BANCORP INC /MA/

Form 10-Q

August 09, 2010

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the quarterly period ended June 30, 2010**

**or**

**o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934**

**For the transition period from                      to**

**Commission File Number: 001-33912**

**Enterprise Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

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**Massachusetts**

(State or other jurisdiction of  
incorporation or organization)

**04-3308902**

(I.R.S. Employer Identification No.)

**222 Merrimack Street, Lowell, Massachusetts**

(Address of principal executive offices)

**01852**

(Zip code)

**(978) 459-9000**

(Registrant's telephone number, including area code)

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 filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) ☐ Yes ☐ No

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

Large accelerate filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

(Do not check if smaller reporting company)

Smaller reporting company ☐

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:

**August 2, 2010** Common Stock - Par Value **\$0.01:** **9,237,765** shares outstanding

Table of Contents

**ENTERPRISE BANCORP, INC.**

**INDEX**

	<b>Page Number</b>
<u>Cover Page</u>	1
<u>Index</u>	2
<b>PART I - FINANCIAL INFORMATION</b>	
Item 1	
Financial Statements	
<u>Consolidated Balance Sheets June 30, 2010 and December 31, 2009</u>	3
<u>Consolidated Statements of Income - Three and six months ended June 30, 2010 and 2009</u>	4
<u>Consolidated Statement of Changes in Stockholders Equity - Six months ended June 30, 2010</u>	5
<u>Consolidated Statements of Cash Flows - Six months ended June 30, 2010 and 2009</u>	6
<u>Notes to Unaudited Consolidated Financial Statements</u>	7
Item 2	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
Item 3	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	43
Item 4	
<u>Controls and Procedures</u>	44
<b>PART II - OTHER INFORMATION</b>	
Item 1	
<u>Legal Proceedings</u>	44
Item 1A	
<u>Risk Factors</u>	44
Item 2	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	44
Item 3	
<u>Defaults Upon Senior Securities</u>	44
Item 4	
<u>[Removed and Reserved]</u>	44
Item 5	
<u>Other Information</u>	44
Item 6	
<u>Exhibits</u>	45
<u>Signature page</u>	45



Table of Contents**ENTERPRISE BANCORP, INC.**

## Consolidated Balance Sheets

<b>(Dollars in thousands)</b>	<b>June 30, 2010 (Unaudited)</b>	<b>December 31, 2009</b>
<i>Assets</i>		
Cash and cash equivalents:		
Cash and due from banks	\$ 30,504	\$ 25,851
Short-term investments	40,050	6,759
Total cash and cash equivalents	70,554	32,610
Investment securities	137,748	139,109
Loans, less allowance for loan losses of \$19,282 at June 30, 2010 and \$18,218 at December 31, 2009, respectively	1,096,978	1,064,612
Premises and equipment	24,360	22,924
Accrued interest receivable	5,432	5,368
Deferred income taxes, net	10,211	10,345
Bank-owned life insurance	14,114	13,835
Prepaid income taxes	1,041	
Prepaid expenses and other assets	7,922	9,466
Core deposit intangible, net of amortization	10	76
Goodwill	5,656	5,656
Total assets	\$ 1,374,026	\$ 1,304,001
<i>Liabilities and Stockholders' Equity</i>		
<i>Liabilities</i>		
Deposits	\$ 1,215,161	\$ 1,144,948
Borrowed funds	25,372	24,876
Junior subordinated debentures	10,825	10,825
Accrued expenses and other liabilities	9,003	14,270
Income taxes payable		98
Accrued interest payable	1,011	1,320
Total liabilities	1,261,372	1,196,337
<i>Commitments and Contingencies</i>		
<i>Stockholders' Equity</i>		
Preferred stock, \$0.01 par value per share; 1,000,000 shares authorized; no shares issued		
Common stock \$0.01 par value per share; 20,000,000 shares authorized; 9,237,765 and 9,090,518 issued and outstanding at June 30, 2010 and December 31, 2009, respectively	92	91
Additional paid-in capital	41,608	40,453
Retained earnings	68,699	65,042
Accumulated other comprehensive income	2,255	2,078
Total stockholders' equity	112,654	107,664
Total liabilities and stockholders' equity	\$ 1,374,026	\$ 1,304,001

See the accompanying notes to the unaudited consolidated financial statements.

Table of Contents**ENTERPRISE BANCORP, INC.**

## Consolidated Statements of Income

(Unaudited)

(Dollars in thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Interest and dividend income:</b>				
Loans	\$ 15,354	\$ 14,095	\$ 30,123	\$ 27,715
Investment securities	1,057	1,121	2,147	2,704
Short-term investments	14	56	20	73
Total interest and dividend income	16,425	15,272	32,290	30,492
<b>Interest expense:</b>				
Deposits	2,224	3,294	4,555	6,933
Borrowed funds	50	67	107	162
Junior subordinated debentures	295	295	589	589
Total interest expense	2,569	3,656	5,251	7,684
Net interest income	13,856	11,616	27,039	22,808
Provision for loan losses	1,033	864	1,912	1,966
Net interest income after provision for loan losses	12,823	10,752	25,127	20,842
<b>Non-interest income:</b>				
Investment advisory fees	879	697	1,733	1,346
Deposit service fees	1,034	905	2,006	1,778
Income on bank-owned life insurance	166	156	322	311
Other than temporary impairment on investment securities	(7)	(16)	(8)	(774)
Net gains on sales of investment securities	276		777	971
Gains on sales of loans	103	256	184	378
Other income	406	357	934	718
Total non-interest income	2,857	2,355	5,948	4,728
<b>Non-interest expense:</b>				
Salaries and employee benefits	6,676	6,179	13,122	12,081
Occupancy and equipment expenses	1,332	1,325	2,639	2,660
Technology and telecommunications expenses	1,010	751	1,922	1,507
Advertising and public relations expenses	755	446	1,281	992
Deposit insurance premiums	449	954	909	1,327
Audit, legal and other professional fees	328	351	595	625
Supplies and postage expenses	201	198	397	400
Investment advisory and custodial expenses	110	116	246	219
Other operating expenses	911	910	1,794	1,744
Total non-interest expense	11,772	11,230	22,905	21,555
Income before income taxes	3,908	1,877	8,170	4,015
Provision for income taxes	1,305	503	2,681	1,123

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Net income	\$	2,603	\$	1,374	\$	5,489	\$	2,892
Basic earnings per share	\$	0.28	\$	0.17	\$	0.60	\$	0.36
Diluted earnings per share	\$	0.28	\$	0.17	\$	0.60	\$	0.36
Basic weighted average common shares outstanding		9,219,171		8,181,721		9,172,194		8,120,867
Diluted weighted average common shares outstanding		9,223,965		8,195,116		9,176,734		8,133,032

See the accompanying notes to the unaudited consolidated financial statements.



Table of Contents

**ENTERPRISE BANCORP, INC.**

Consolidated Statement of Changes in Stockholders' Equity

(Unaudited)

Six months ended June 30, 2010

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive Income	Total Stockholders Equity
<b>Balance at December 31, 2009</b>	\$ 91	\$ 40,453	\$ 65,042		\$ 2,078	\$ 107,664
Comprehensive income						
Net income			5,489	\$ 5,489		5,489
Other comprehensive income, net				177	177	177
Total comprehensive income				\$ 5,666		
Common stock dividend paid (\$0.20 per share)			(1,832)			(1,832)
Common stock issued		793				793
Stock-based compensation	1	362				363
<b>Balance at June 30, 2010</b>	\$ 92	\$ 41,608	\$ 68,699		\$ 2,255	\$ 112,654

See the accompanying notes to the unaudited consolidated financial statements.

Table of Contents**ENTERPRISE BANCORP, INC.**

## Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)	Six months ended June 30,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 5,489	\$ 2,892
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,912	1,966
Depreciation and amortization	1,883	1,560
Amortization of intangible assets	66	66
Stock-based compensation expense	441	369
Mortgage loans originated for sale	(16,226)	(38,678)
Proceeds from mortgage loans sold	15,082	37,899
Gains on sales of loans	(184)	(378)
Gains on sales of OREO	(120)	
Net gains on sales of investment securities	(777)	(971)
Other-than-temporary-impairment on investment securities	8	774
Income on bank-owned life insurance, net of costs	(279)	(271)
Decrease (increase) in:		
Accrued interest receivable	(64)	203
Prepaid expenses and other assets	(583)	1,213
Deferred income taxes		(763)
Increase (decrease) in:		
Accrued expenses and other liabilities	435	786
Accrued interest payable	(309)	(136)
Net cash provided by operating activities	6,774	6,531
Cash flows from investing activities:		
Proceeds from sales of investment securities available for sale	5,330	39,505
Proceeds from maturities, calls and pay-downs of investment securities	16,952	22,659
Purchase of investment securities	(25,724)	(26,069)
Net increase in loans	(33,300)	(70,750)
Additions to premises and equipment, net	(3,124)	(2,792)
Proceeds from OREO sales and payments	1,556	632
Purchase of OREO		(340)
Net cash used in investing activities	(38,310)	(37,155)
Cash flows from financing activities:		
Net increase in deposits	70,213	137,287
Net decrease (increase) in borrowed funds	496	(76,504)
Cash dividends paid	(1,832)	(1,540)
Proceeds from issuance of common stock	603	537
Proceeds from the exercise of common stock options		220
Tax benefit from the exercise of common stock options		13
Net cash provided by financing activities	69,480	60,013
Net increase in cash and cash equivalents	37,944	29,389
Cash and cash equivalents at beginning of period	32,610	25,276
Cash and cash equivalents at end of period	\$ 70,554	\$ 54,665
Supplemental financial data:		
Cash Paid For: Interest	\$ 5,560	\$ 7,820

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Income taxes	3,834	2,408
Supplemental schedule of non-cash investing activity:		
Purchase of investment securities not yet settled		3,714
Transfer from loans to other real estate owned	350	600

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

**ENTERPRISE BANCORP, INC.**

Notes to Unaudited Consolidated Financial Statements

**(1) Organization of Holding Company**

The consolidated financial statements of Enterprise Bancorp, Inc. (the Company or Enterprise ) include the accounts of the Company and its wholly owned subsidiary Enterprise Bank and Trust Company (the Bank ). The Bank is a Massachusetts trust company organized in 1989. Substantially all of the Company's operations are conducted through the Bank.

The Bank has five wholly owned subsidiaries. The Bank's subsidiaries include Enterprise Insurance Services, LLC and Enterprise Investment Services, LLC, organized for the purposes of engaging in insurance sales activities and offering non-deposit investment products and services, respectively. In addition, the Bank has three subsidiary security corporations (Enterprise Security Corporation, Enterprise Security Corporation II, and Enterprise Security Corporation III), which hold various types of qualifying securities. The security corporations are limited to conducting securities investment activities that the Bank itself would be allowed to conduct under applicable laws.

Through the Bank and its subsidiaries, the Company offers a range of commercial and consumer loan products, deposit and cash management products, investment advisory and management, trust and insurance services. The services offered through the Bank and subsidiaries are managed as one strategic unit and represent the Company's only reportable operating segment.

The Federal Deposit Insurance Corporation (the FDIC ) and the Massachusetts Commissioner of Banks (the Commissioner ) have regulatory authority over the Bank. The Bank is also subject to certain regulatory requirements of the Board of Governors of the Federal Reserve System (the Federal Reserve Board ) and, with respect to its New Hampshire branch operations, the New Hampshire Banking Department. The business and operations of the Company are subject to the regulatory oversight of the Federal Reserve Board. The Commissioner also retains supervisory jurisdiction over the Company.

**(2) Basis of Presentation**

The accompanying unaudited consolidated financial statements and these notes should be read in conjunction with the Company's December 31, 2009 audited consolidated financial statements and notes thereto contained in the Company's 2009 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 12, 2010. Interim results are not necessarily indicative of results to be expected for the entire year.

The Company has not changed its significant accounting and reporting policies from those disclosed in its 2009 Annual Report on Form 10-K.

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In the opinion of management, the accompanying consolidated financial statements reflect all necessary adjustments consisting of normal recurring accruals for a fair presentation. All significant intercompany balances and transactions have been eliminated in the accompanying consolidated financial statements.

Certain amounts in the previous year's financial statements have been reclassified to conform to the current year's presentation, particularly under the subtitle "Non-interest expense" on the Consolidated Statements of Income, where changes were made, primarily to identify technology and telecommunications expense separately, in order to provide a more useful presentation.

### **(3) Critical Accounting Estimates**

In preparing the consolidated financial statements in conformity with U.S. generally accepted accounting principles, management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. These estimates and assumptions affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period then ended. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates should the assumptions and estimates used change over time due to changes in circumstances. Changes in those estimates resulting from continuing changes in the economic environment and other factors will be reflected in the financial statements and results of operations in future periods.

As discussed in the Company's 2009 Annual Report on Form 10-K, the three most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, impairment review of investment securities and the impairment review of goodwill and other intangible assets. Refer to

Table of Contents**ENTERPRISE BANCORP, INC.**

## Notes to Unaudited Consolidated Financial Statements

note 1 to the Company's consolidated financial statements included in the Company's 2009 Annual Report on Form 10-K for significant accounting policies.

**(4) Reporting Comprehensive Income**

Comprehensive income is defined as all changes to equity except investments by and distributions to stockholders. Net income is one component of comprehensive income, with other components referred to in the aggregate as other comprehensive income. The Company's only other comprehensive income component is the net unrealized holding gains or losses on investments available for sale, net of deferred income taxes.

The following table summarized the components of other comprehensive income for the six month periods ended June 30, 2010 and 2009.

<b>(Dollars in thousands)</b>	<b>2010</b>	<b>2009</b>
Gross unrealized holding gains on investments arising during the period	\$ 1,094	\$ 485
Income tax expense	(416)	(209)
Net unrealized holding gains, net of tax	678	276
Less: Reclassification adjustment for impairment included in net income:		
Other than temporary impairment loss arising during the period	(8)	(774)
Income tax benefit	3	263
Reclassification adjustment for impairment realized, net of tax	(5)	(511)
Less: Reclassification adjustment for net gains (losses) included in net income		
Net realized gains on sales of securities during the period	777	971
Income tax expense	(271)	(339)
Reclassification adjustment for gains realized, net of tax	506	632
Other comprehensive income, net of reclassifications	\$ 177	\$ 155

**(5) Accounting for Income Taxes**

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax attributable to differences between the financial statement carrying amounts and the tax basis of assets and liabilities. The deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred

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tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities will be adjusted accordingly through the provision for income taxes.

The Company's policy is to classify interest resulting from underpayment of income taxes as income tax expense in the first period the interest would begin accruing according to the provisions of the relevant tax law. The Company classifies penalties resulting from underpayment of income taxes as income tax expense in the period for which the Company claims or expects to claim an uncertain tax position or in the period in which the Company's judgment changes regarding an uncertain tax position.

The Company did not have any unrecognized tax benefits accrued as income tax liabilities or receivables or as deferred tax items at June 30, 2010. The Company's tax years beginning after December 31, 2005 are open to federal and state income tax examinations.

Table of Contents

**ENTERPRISE BANCORP, INC.**

Notes to Unaudited Consolidated Financial Statements

**(6) Stock-Based Compensation**

The Company currently has three individual stock incentive plans. The Company has not changed the general terms and conditions of these plans from those disclosed in the Company's 2009 Annual Report on Form 10-K.

The Company's stock-based compensation expense includes restricted stock awards and stock option awards to officers, other employees and directors, and stock compensation in lieu of cash fees to directors. Total stock-based compensation expense was \$245 thousand and \$441 thousand for the three and six months ended June 30, 2010, respectively, compared to \$215 thousand and \$369 thousand for the three and six months ended June 30, 2009, respectively.

*Restricted Stock Awards*

Stock-based compensation expense recognized in association with restricted stock awards amounted to \$146 thousand and \$238 thousand for the three and six months ended June 30, 2010, respectively, compared to \$80 thousand and \$104 thousand for the three and six months ended June 30, 2009, respectively.

There were no restricted stock awards granted during the three month periods ended June 30, 2010 or 2009.

During the first quarter of 2010, the Company granted 77,963 shares of common stock in the form of restricted stock awards comprised of 70,475 shares awarded to employees, vesting over four years, and 7,488 shares awarded to directors vesting over two years. The grant date fair value of the restricted stock awarded was \$12.51 per share, which reflects the market value of the common stock on the grant date. The 2010 awards vest, in each case, in equal portions starting on the first anniversary date of the award.

During the first quarter of 2009, the Company granted 83,200 shares of common stock to employees as restricted stock awards. The grant date fair value of the restricted stock awarded was \$8.75 per share, which reflects the market value of the common stock on the grant date. Of the 2009 award, 43,200 shares vest twenty-five percent per year and 40,000 shares vest fifty percent per year, in each case starting on the first anniversary date of the award. There have been 150 awards forfeited to date.

The restricted stock awards allow for the receipt of dividends, and the voting of all shares, whether or not vested, throughout the vesting periods.



If a grantee's employment or other service relationship, such as service as a director, is terminated for any reason, then any shares of restricted stock that have not vested as of the time of such termination must be forfeited, unless the compensation Committee or the Board of Directors, as the case may be, waives such forfeiture requirement.

*Stock Option Awards*

The Company recognized stock-based compensation expense related to stock option awards of \$60 thousand and \$125 thousand for the three and six months ended June 30, 2010, respectively, compared to \$80 thousand and \$159 thousand for the three and six months ended June 30, 2009, respectively. There were no stock option awards granted to employees during the three month periods ended June 30, 2010 or 2009.

There were 63,775 and 51,050 stock option awards granted to employees during the first quarters of 2010 and 2009, respectively. All of the options granted in 2010 and 2009 generally become exercisable at the rate of twenty-five percent per year on the anniversary date of the original grant, and provide for accelerated vesting of the entire grant for those who are age 62 on the grant date or upon attaining age 62 during the normal vesting period. Vested options are only exercisable while the employee remains employed with the Bank and for a limited period thereafter, and the options expire seven years from the date of grant.

Table of Contents**ENTERPRISE BANCORP, INC.**

## Notes to Unaudited Consolidated Financial Statements

The Company utilizes the Black-Scholes option valuation model in order to determine the per share grant date fair value of option grants. The table below provides a summary of the options granted, fair value, the fair value as a percentage of the market value of the stock at the date of grant and the average assumptions used in the model for the options granted in 2010 and 2009.

	2010	2009
Options granted	63,775	51,050
Average assumptions used in the model:		
Expected volatility	43%	40%
Expected dividend yield	2.98%	4.54%
Expected life in years	5.5	5.5
Risk-free interest rate	2.66%	2.32%
Market price on date of grant	\$ 12.51	\$ 8.75
Per share weighted average fair value	\$ 4.35	\$ 2.51
Percentage of market value at grant date	35%	29%

Refer to note 9 Stock Based Compensation Plans in the Company's 2009 Annual Report on Form 10-K for a further description of the assumptions used in the valuation model.

*Stock in Lieu of Directors Fees*

Stock-based compensation expense related to Directors' election to receive shares of common stock in lieu of cash fees for attendance at Board and Board Committee meetings amounted to \$39 thousand and \$78 thousand for the three and six months ended June 30, 2010, respectively compared to \$55 thousand and \$106 thousand for the three and six months ended June 30, 2009, respectively. In January 2010, 16,897 shares of common stock were issued to directors in lieu of cash fees related to 2009 annual directors' stock-based compensation expense of \$190 thousand.

**(7) Supplemental Retirement Plan and Other Postretirement Benefit Obligations***Supplemental Retirement Plan*

The Company has salary continuation agreements with three of its senior officers. These salary continuation agreements (SERPs) provide for a predetermined fixed-cash supplemental retirement benefit, the amount subject to vesting requirements, to be provided for a period of 20 years after the individual reaches a defined retirement age. Each officer has attained their individually defined retirement age and all participants are fully vested under the plan.

The following table illustrates the net periodic benefit cost for the SERPs for the periods indicated:

(Dollars in thousands)	Three months ended June 30,				Six months ended June 30,			
	2010		2009		2010		2009	
Service Cost	\$	14	\$	41	\$	55	\$	82
Interest Cost		46		45		92		89
Net periodic benefit cost	\$	60	\$	86	\$	147	\$	171

Benefits paid amounted to \$69 thousand for the three months and \$114 thousand for the six months ended June 30, 2010, compared to \$30 thousand and \$75 thousand for the three and six months ended June 30, 2009, respectively. The Company anticipates accruing an additional \$93 thousand to the plan during the remainder of 2010.

#### *Bank Owned Life Insurance*

The Company has purchased bank owned life insurance ( BOLI ) on certain senior and executive officers. The cash surrender value carried on the balance sheet at June 30, 2010 and December 31, 2009 amounted to \$14.1 million and \$13.8 million, respectively. There are no associated surrender charges under the outstanding policies.

Table of Contents**ENTERPRISE BANCORP, INC.**

## Notes to Unaudited Consolidated Financial Statements

*Supplemental Life Insurance*

For certain senior and executive officers on whom the Bank owns BOLI, the Bank has provided supplemental life insurance which provides a death benefit to the officer's designated beneficiaries.

The following table illustrates the net periodic post retirement benefit cost for the supplemental life insurance plans for the periods indicated:

(Dollars in thousands)	Three months ended June 30,			Six months ended June 30,				
	2010	2009		2010	2009			
Service Cost	\$	\$	5	\$	1	10		
Interest Cost		7	21		12	41		
Net periodic post retirement benefit cost	\$	7	\$	26	\$	13	\$	51

**(8) Earnings per share**

Basic earnings per share are calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the effect on weighted average shares outstanding of the number of additional shares outstanding if dilutive stock options were converted into common stock using the treasury stock method.

The table below presents the increase in average shares outstanding, using the treasury stock method, for the diluted earnings per share calculation and the effect of those shares on earnings, for the periods indicated:

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Basic weighted average common shares outstanding	9,219,171	8,181,721	9,172,194	8,120,867
Dilutive shares	4,794	13,395	4,540	12,165
Diluted weighted average common shares outstanding	9,223,965	8,195,116	9,176,734	8,133,032
Basic earnings per share	\$ 0.28	\$ 0.17	\$ 0.60	\$ 0.36
Effect of dilutive shares				
Diluted earnings per share	\$ 0.28	\$ 0.17	\$ 0.60	\$ 0.36

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For the six months ended June 30, 2010, there was an additional 674,106 average stock options outstanding, which were excluded from the year-to-date calculation of diluted earnings per share due to the exercise price of these options exceeding the average market price of the Company's common stock for the period. These options, which were not dilutive at that date, may potentially dilute earnings per share in the future.

Table of Contents**ENTERPRISE BANCORP, INC.**

## Notes to Unaudited Consolidated Financial Statements

**(9) Investment Securities**

The amortized cost and carrying values of investment securities at the dates specified are summarized as follows:

(Dollars in thousands)	June 30, 2010			
	Amortized cost	Unrealized gains	Unrealized losses	Carrying Amount
Federal agency obligations (1)	\$ 35,606	\$ 148	\$	\$ 35,754
Federal agency mortgage backed securities (MBS) (1)	36,393	1,280	2	37,671
Non-agency MBS	3,003		10	2,993
Municipal securities	51,783	1,584	40	53,327
Total fixed income securities	126,785	3,012	52	129,745
Equity investments	2,697	657	91	3,263
Total available for sale securities, at fair value	129,482	3,669	143	133,008
FHLB Boston stock, at cost (2)	4,740			4,740
Total investment securities	\$ 134,222	\$ 3,669	\$ 143	\$ 137,748

(Dollars in thousands)	December 31, 2009			
	Amortized cost	Unrealized gains	Unrealized losses	Carrying Amount
Federal agency Obligations(1)	\$ 25,653	\$ 45	\$ 67	\$ 25,631
MBS(1)	39,299	606	168	39,737
Non-agency MBS	3,479		34	3,445
Municipal securities	59,278	1,466	152	60,592
Total fixed income securities	127,709	2,117	421	129,405
Equity investments	3,459	1,505		4,964
Total available for sale securities, at fair value	131,168	3,622	421	134,369
FHLB stock, at cost(2)	4,740			4,740
Total investment securities	\$ 135,908	\$ 3,622	\$ 421	\$ 139,109

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- (1) Investments issued or guaranteed by government sponsored enterprises such as Fannie Mae (FNMA), Freddie Mac (FHLMC), Ginnie Mae (GNMA) or one of several Federal Home Loan Banks (FHLB). All agency MBS investments owned by the Company are backed by residential mortgages.
- (2) The Bank is required to purchase FHLB stock in association with advances from the FHLB; this stock is classified as a restricted investment and carried at cost, which management believes approximates fair value.

See Note 10, Fair Value Measurements below for further information regarding the Company's fair value measurements for available-for-sale securities.

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The net unrealized gain or loss in the Company's fixed income portfolio fluctuates as market interest rates rise and fall. Due to the fixed rate nature of this portfolio, as market rates fall the value of the portfolio rises, and as market rates rise, the value of the portfolio declines. The unrealized gains or losses on fixed income investments will also decline as the securities approach maturity. Unrealized gains or losses will be recognized in the statements of income if the securities are sold. However, if an unrealized loss on the fixed income portfolio is deemed to be other than temporary, the credit loss portion is charged to earnings and the noncredit portion is recognized in accumulated other comprehensive income.

As of June 30, 2010, the \$2 thousand of unrealized loss on the federal agency obligations and federal agency MBS investments was limited to one individual security, and was attributed to market volatility. The contractual cash flows of this investment is guaranteed by an agency of the U.S. Government, and the agencies that issued these securities are sponsored by the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the par value of the Company's investment. The Company does not consider this investment to be other-than-temporarily impaired at June 30, 2010, because the decline in market value is attributable to changes in interest rate volatility and not credit quality, additionally, the Company does not intend to, and it is more likely than not that it will not be required to, sell this investment prior to a market price recovery or maturity.

Table of Contents

**ENTERPRISE BANCORP, INC.**

Notes to Unaudited Consolidated Financial Statements

As of June 30, 2010, the Company's non-agency MBS portfolio consisted of one residential mortgage backed security. The \$10 thousand of unrealized loss was due to market conditions which resulted generally in lower prices for most non-agency MBSs in relation to government issued and agency securities. The Company does not consider this investment to be other-than-temporarily impaired at June 30, 2010 due to the AAA rating of the security and the high credit quality of the underlying loans. In addition, the Company does not intend to, and it is more likely than not that it will not be required to, sell this investment prior to a market price recovery or maturity.

As of June 30, 2010, the \$40 thousand of unrealized losses on the Company's municipal securities were related to six obligations and were attributed to market volatility and not a fundamental deterioration in the issuers. The Company does not consider these investments to be other-than-temporarily impaired at June 30, 2010. In addition, the Company does not intend to, and it is more likely than not that it will not be required to, sell those investments prior to a market price recovery or maturity.

The net unrealized gain or loss on equity securities will fluctuate based on changes in the market value of the funds and individual securities held in the portfolio. Unrealized gains or losses will be recognized in the statements of income if the securities are sold. However, if an unrealized loss on an equity security is deemed to be other than temporary prior to a sale, the loss is charged to earnings.

At June 30, 2010, the equity portfolio consisted primarily of investments in a diversified group of mutual funds, with a small portion of the portfolio (approximately 15%) invested in funds or individual common stock of entities in the financial services industry. At June 30, 2010, after the minor impairment charge discussed below, the Company had six individual equity mutual funds having combined unrealized losses of \$91 thousand which were short term in nature. Management regularly reviews the portfolio for securities with unrealized losses that are other than temporarily impaired. Management's assessment includes evaluating if any equity security or fund exhibits fundamental deterioration and whether it is unlikely that the security or fund will completely recover its unrealized loss within a reasonable time period. In determining the amount of the other than temporary impairment charge, management considers the severity of the declines and the uncertainty of recovery in the short-term for these equities. Based upon this review, the Company did not consider those equity funds to be other-than-temporarily impaired at June 30, 2010.

During the six months ended June 30, 2010, the Company recorded fair value impairment charges of \$8 thousand, on a certain previously impaired equity investment contained in its equity portfolio. During the six months ended June 30, 2009, the Company recorded fair value impairment charges of \$774 thousand, on certain investments contained in its equity portfolio, to reflect the impact of declines in the equities markets at that time. Management's decision to record these charges was based primarily on the severity of the declines and the uncertainty of recovery in the short-term for these equities. During the six months ended June 30, 2010, the Company sold \$1.6 million of previously impaired equity funds and recognized book gains of \$752 thousand.

As a member of the Federal Home Loan Bank of Boston (FHLB), the Company is required to purchase FHLB capital stock at par value in association with the Bank's advances from the FHLB; this stock is classified as a restricted investment and carried at cost. The FHLB is currently operating with retained earnings below its target level. The FHLB has instituted a plan to increase retained earnings which includes suspending its quarterly dividend and a moratorium on the repurchase of excess capital stock from member banks, among other programs. If further deterioration in the FHLB financial condition or capital levels occurs, the FHLB capital stock may become other than temporarily impaired to some degree and its carrying value correspondingly reduced. Management reviews its investment in FHLB stock for other than



temporary impairment based on an assessment of the ultimate recoverability of the par value. Management's most recent evaluation considered the long term nature of the investments, the liquidity position of the FHLB, actions taken by FHLB to address the issue, and the Company's intent and ability to hold the investment for sufficient time to recover the par value. Based on this review, management concluded that no other-than-temporary impairment charge on FHLB stock was necessary as of June 30, 2010.

**(10) Fair Value Measurements**

The Financial Accounting Standard Board ( FASB ) defines the fair value to be the price which a seller would receive in an orderly transaction between market participants (an exit price) and also establishes a fair value hierarchy segregating fair value measurements using three levels of inputs: (Level 1) quoted market prices in active markets for identical assets or liabilities; (Level 2) significant other observable inputs, including quoted prices for similar items in active markets, quoted prices for identical or similar items in markets that are not active, inputs such as interest rates and yield curves, volatilities, prepayment speeds, credit risks and default rates which provide a reasonable basis for fair value determination or inputs derived principally from observed market data; (Level 3) significant unobservable inputs for situations in which there is little, if any, market activity

Table of Contents**ENTERPRISE BANCORP, INC.**

## Notes to Unaudited Consolidated Financial Statements

for the asset or liability. Unobservable inputs must reflect reasonable assumptions that market participants would use in pricing the asset or liability, which are developed on the basis of the best information available under the circumstances.

The following tables summarize significant assets and liabilities carried at fair value at the dates specified:

(Dollars in thousands)	June 30, 2010	Fair Value Measurements using:		
	Fair Value	(level 1)	(level 2)	(level 3)
Assets measured on a recurring basis:				
Fixed income securities	\$ 129,745	\$	\$ 129,745	\$
Equity securities	3,263	3,263		
FHLB Stock	4,740			4,740
Assets measured on a non-recurring basis:				
Impaired loans	10,219			10,219

(Dollars in thousands)	December 31, 2009	Fair Value Measurements using:		
	Fair Value	(level 1)	(level 2)	(level 3)
Assets measured on a recurring basis:				
Fixed income securities	\$ 129,405	\$	\$ 129,405	\$
Equity securities	4,964	4,964		
FHLB Stock	4,740			4,740
Assets measured on a non-recurring basis:				
Impaired loans	7,912			7,912
Other real estate owned	1,086			1,086

During the six months ended June 30, 2010 the Company did not have cause to transfer any assets between the fair value measurement levels.

Investment securities that are considered available for sale are carried at fair value. The fixed income category above includes, federal agency obligations, federal agency MBS, non-agency MBS, and municipal securities, as held at those periods. The Company utilizes third-party pricing vendors to provide valuations on its fixed income securities. Fair values provided by the vendors were generally determined based upon pricing matrices utilizing observable market data inputs for similar or benchmark securities in active markets and/or based on a matrix pricing methodology which employs The Bond Market Association's standard calculations for cash flow and price/yield analysis, live benchmark bond pricing and terms/condition data available from major pricing sources. Therefore, management regards the inputs and methods used by third party pricing vendors to be Level 2 inputs and methods as defined in the fair value hierarchy provided in ASC Topic 820.

The Company's equity portfolio fair value is measured based on quoted market prices for the shares, therefore these securities are categorized as Level 1 within the fair value hierarchy.

Net unrealized appreciation and depreciation on investments available for sale, net of applicable income taxes, are reflected as a component of accumulated other comprehensive income.

The Bank is required to purchase FHLB stock at par value in association with advances from the FHLB; this stock is classified as a restricted investment and carried at cost which management believes approximates fair value, therefore these securities are categorized as Level 3 measures. See the discussion regarding FHLB stock in Note 9, Investment Securities above, for further information regarding the Company's fair value assessment of FHLB capital stock.

Impaired loan balances in the table above represent those collateral dependent impaired commercial loans where management has estimated the credit loss by comparing the loan's carrying value against the expected realizable fair value of the collateral (appraised value less estimated cost to sell, adjusted as necessary for changes in relevant valuation factors subsequent to the measurement date). Certain inputs used in appraisals, and possible subsequent adjustments, are not always observable, and therefore, collateral dependent impaired loans are categorized as Level 3 within the fair value hierarchy. A specific allowance is assigned to the collateral dependent impaired loan for the amount of management's estimated credit loss. The specific allowances assigned to the collateral dependent impaired loans at June 30, 2010 amounted to \$2.7 million compared to \$2.0 million at December 31, 2009, a net increase of \$754 thousand.

Table of Contents

**ENTERPRISE BANCORP, INC.**

Notes to Unaudited Consolidated Financial Statements

Real estate acquired by the Company through foreclosure proceedings or the acceptance of a deed in lieu of foreclosure is classified as Other Real Estate Owned ( OREO ). When property is acquired, it is generally recorded at the lesser of the loan's remaining principal balance, net of unamortized deferred fees, or the estimated fair value of the property acquired, less estimated costs to sell. The estimated fair value is based on market appraisals. Certain inputs used in appraisals are not always observable, and therefore, OREO may be categorized as Level 3 within the fair value hierarchy. The Company did not have any OREO property at June 30, 2010. The carrying value of OREO at December 31, 2009 consisted of five properties that sold during the six months ended June 30, 2010. Also during the six months ended June 30, 2010, one property was added to OREO through foreclosure, which was subsequently sold during that period. Net gains realized on these sales amounted to \$120 thousand for the six months ended June 30, 2010. There were no gains or losses on OREO sales during the six months ended June 30, 2009.

*Other Guarantees and Commitments*

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a customer to a third party. The fair value of these commitments was estimated to be the fees charged to enter into similar agreements, and accordingly these fair value measures are deemed to be FASB Level 2 measurements. In accordance with the FASB, the estimated fair values of these commitments are carried on the balance sheet as a liability and amortized to income over the life of the letters of credit, which are typically one year. The estimated fair value of these commitments carried on the balance sheet was \$5 thousand and \$53 thousand at June 30, 2010 and December 31, 2009, respectively, and were deemed immaterial.

Interest rate lock commitments related to the origination of mortgage loans that will be sold are considered derivative instruments. The Company estimates the fair value of these derivatives using the difference between the guaranteed interest rate in the commitment and the current market interest rate. To reduce the net interest rate exposure arising from its loan sale activity, the Company enters into the commitment to sell these loans at essentially the same time that the interest rate lock commitment is quoted on the origination of the loan. The commitments to sell loans are also considered derivative instruments, with estimated fair values based on changes in current market rates. These commitments represent the Company's only derivative instruments and are accounted for in accordance with FASB guidance. The fair values of the Company's derivative instruments are deemed to be FASB Level 2 measurements. At June 30, 2010 and December 31, 2009, the estimated fair value of the Company's derivative instruments was considered to be immaterial.

*Estimated Fair Values of Assets and Liabilities*

In addition to disclosures regarding the measurement of assets and liabilities carried at fair value on the balance sheet, the Company is also required to disclose fair value information about financial instruments for which it is practicable to estimate that value, whether or not recognized on the balance sheet. In cases where quoted fair values are not available, fair values are based upon estimates using various valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following methods and assumptions were used by the Company in estimating fair values of its financial instruments:

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The respective carrying values of certain financial instruments approximated their fair value, as they were short-term in nature or payable on demand. These include cash and due from banks, total short-term investments, accrued interest receivable, repurchase agreements, accrued interest payable and non-certificate deposit accounts.

Investments: Fair values for investments were based on quoted market prices, where available, as provided by third-party accounting and pricing vendors. If quoted market prices were not available, fair values provided by the vendors were based on quoted market prices of comparable instruments in active markets and/or based on a matrix pricing methodology. See the discussion regarding fair value of investment securities above for further information regarding the Company's fair value measurements of investments.

The carrying amount of FHLB stock reported approximates fair value. See the discussion regarding FHLB stock in Note 9, Investment Securities above, for further information regarding the Company's fair value assessment of FHLB capital stock.

Loans: The fair value of loans was determined using discounted cash flow analysis, using interest rates currently being offered by the Company. The incremental credit risk for non-accrual loans was considered in the determination of the fair value of the loans.

Commitments: The fair values of the unused portion of lines of credit and letters of credit were estimated to be the fees currently charged to enter into similar agreements. Commitments to originate non-mortgage loans were short-term and were at current market rates and estimated to have no significant change in fair value.

Table of Contents

**ENTERPRISE BANCORP, INC.**

Notes to Unaudited Consolidated Financial Statements

**Financial liabilities:** The fair values of certificates of deposit and FHLB borrowings were estimated using discounted cash flow analysis using rates offered by the Bank, or advance rates offered by the FHLB on June 30, 2010 and December 31, 2009 for similar instruments. The fair value of junior subordinated debentures was estimated using discounted cash flow analysis using a market rate of interest at June 30, 2010 and December 31, 2009.

**Limitations:** The estimates of fair value of financial instruments were based on information available at June 30, 2010 and December 31, 2009 and are not indicative of the fair market value of those instruments as of the date of this report. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument.

Because no active market exists for a portion of the Company's financial instruments, fair value estimates were based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates were based on existing on- and off-balance sheet financial instruments without an attempt to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments, including premises and equipment and foreclosed real estate.

In addition, the tax ramifications related to the realization of the unrealized appreciation and depreciation can have a significant effect on fair value estimates and have not been considered in any of the estimates. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The carrying values and estimated fair values of the Company's financial instruments at the dates indicated are summarized as follows:

(Dollars in thousands)	June 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 70,554	\$ 70,554	\$ 32,610	\$ 32,610
Investment securities	137,748	137,748	139,109	139,109
Loans, net	1,096,978	1,106,696	1,064,612	1,058,786
Accrued interest receivable	5,432	5,432	5,368	5,368
<b>Financial liabilities:</b>				

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Non-interest demand deposits	220,478	220,478	192,515	192,515
Interest bearing checking, savings, money market accounts (1)	727,644	727,644	655,401	655,401
Certificates of deposit (1)	267,039	267,530	297,032	297,431
Borrowed funds	25,372	25,455	24,876	24,927
Junior subordinated debentures	10,825	10,825	10,825	10,825
Accrued interest payable	1,011	1,011	1,320	1,320

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(1)-Includes brokered deposit balances

**(11) Recent Accounting Pronouncements**

In June 2009, the FASB amended the consolidation guidance applicable to variable interest entities (VIEs) by eliminating exceptions to consolidating qualifying special-purpose entities, changing the approach to determining a VIE's primary beneficiary, and requiring a company to more frequently reassess whether VIEs must be consolidated. This amended guidance is effective for the Company beginning in fiscal year 2010. The adoption of this guidance did not have a material impact on the Company's consolidated financial position or results of operations.

In June 2009, the FASB amended its guidance related to transfers and servicing of financial assets and extinguishments of liabilities to address certain practices that have developed that the FASB determined are not consistent with the original intent and

Table of Contents

**ENTERPRISE BANCORP, INC.**

Notes to Unaudited Consolidated Financial Statements

key requirements of the prior guidance, and to address concerns that financial assets that have been derecognized should continue to be reported in the financial statements of the transferors. The new guidance is intended to improve the information that a reporting entity provides in its financial reports about the transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows. The appropriateness of derecognition is evaluated based on whether or not the transferor has surrendered control of the transferred assets. The evaluation must consider any continuing involvement by the transferor in the financial assets. New disclosure requirements must be applied to transfers that occurred both before and after the effective date of this new guidance, which is effective for the first interim and annual periods that begin after November 15, 2009 and for interim and annual periods thereafter. Earlier application is prohibited. The implementation of this guidance did not have a material impact on the Company's financial position or results of operations.

In July 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. This ASU is intended to provide financial statement users with additional information about the nature of credit risks and how that risk is analyzed and assessed when determining the allowance for credit losses, as well as the reasons for changes in the allowance for credit losses. This Statement will require public companies to make numerous additional disclosures about the allowance for credit losses on a more detailed portfolio segment basis instead of on an aggregate basis. The additional disclosure requirements are required for public entities for all interim and annual reporting periods ending on or after December 15, 2010. As this ASU only amends the disclosures and not the underlying accounting treatment, adoption will have no impact on the Company's financial statements.



Table of Contents

**ENTERPRISE BANCORP, INC.**

**Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations**

Management's discussion and analysis should be read in conjunction with the Company's consolidated financial statements and notes thereto contained in this report and the Company's 2009 Annual Report on Form 10-K.

**Special Note Regarding Forward-Looking Statements**

This report contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements concerning plans, objectives, future events or performance and assumptions and other statements that are other than statements of historical fact. Forward-looking statements may be identified by reference to a future period or periods or by use of forward-looking terminology such as anticipates, believes, expects, intends, may, plans, pursue, views and similar terms or expressions. Various statements contained in Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 3 Quantitative and Qualitative Disclosures About Market Risk, including, but not limited to, statements related to management's views on the banking environment and the economy, competition and market expansion opportunities, the interest rate environment, credit risk and the level of future non-performing assets and charge-offs, potential asset and deposit growth, future non-interest expenditures and non-interest income growth, and borrowing capacity are forward-looking statements. The Company wishes to caution readers that such forward-looking statements reflect numerous assumptions and involve a number of risks and uncertainties that may adversely affect the Company's future results. The following important factors, among others, could cause the Company's results for subsequent periods to differ materially from those expressed in any forward-looking statement made herein: (i) changes in interest rates could negatively impact net interest income; (ii) changes in the business cycle and downturns in the local, regional or national economies, including deterioration in the local real estate market, could negatively impact credit and/or asset quality and result in credit losses and increases in the Company's allowance for loan losses; (iii) changes in consumer spending could negatively impact the Company's credit quality and financial results; (iv) increasing competition from larger regional and out-of-state banking organizations as well as non-bank providers of various financial services could adversely affect the Company's competitive position within its market area and reduce demand for the Company's products and services; (v) deterioration of securities markets could adversely affect the value or credit quality of the Company's assets and the availability of funding sources necessary to meet the Company's liquidity needs; (vi) changes in technology could adversely impact the Company's operations and increase technology-related expenditures; (vii) increases in employee compensation and benefit expenses could adversely affect the Company's financial results; (viii) changes in laws and regulations that apply to the Company's business and operations, including without limitation the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) and the additional regulations that will be forthcoming as a result thereof, could increase the Company's regulatory compliance costs and adversely affect the Company's business environment, operations and financial results; (ix) changes in accounting standards, policies and practices, as may be adopted or established by the regulatory agencies, the Financial Accounting Standards Board (the FASB) or the Public Company Accounting Oversight Board could negatively impact the Company's financial results; and (x) some or all of the risks and uncertainties described in Item 1A of the Company's 2009 Annual Report on Form 10-K could be realized, which could have a material adverse effect on the Company's business, financial condition and results of operation. Therefore, the Company cautions readers not to place undue reliance on any such forward-looking information and statements.

**Overview**

Management believes that the current banking environment continues to provide many opportunities for community banks like Enterprise Bank, as customers continue to migrate from larger, national banks to local community banks, choosing to do their banking business with local

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professional bankers. Enterprise reported strong financial results and continued to successfully grow deposits and loans, while at the same time expanding the branch network and investing in infrastructure, communities and employees, in order to seize current market opportunities and position Enterprise for continued long-term growth.

Net income amounted to \$2.6 million for the quarter ended June 30, 2010, compared to \$1.4 million for the quarter ended June 30, 2009, an increase of 89%. Net income for the six months ended June 30, 2010 amounted to \$5.5 million compared to \$2.9 million for the comparable 2009 period, an increase of 90%. Diluted earnings per share were \$0.28 and \$0.60 for the three and six months ended June 30, 2010 compared to \$0.17 and \$0.36 for each of the same periods in 2009, increases of 65% and 67% respectively.

Table of Contents

Total deposits, excluding brokered deposits, increased 9%, since December 31, 2009, representing an annualized growth rate of 17%. Compared to June 30, 2009, total deposits excluding brokered deposits, have increased 18%. Loans have increased by 3% since December 31, 2009 and 9% since June 30, 2009. In early June, the company opened a newly constructed full-service branch in Derry, New Hampshire, and recently announced plans for a new office in Hudson, NH, which is anticipated to open by the end of the year. Hudson will be the Company's third Southern New Hampshire location.

*Composition of Earnings*

The increases in net income for the quarter and year-to-date periods ended June 30, 2010, when compared to the same periods in 2009, were primarily attributed to growth in loans, deposits and investment assets under management during the past twelve months, increased net interest income spreads, and increased gains on securities in the current quarter. Results for the 2009 periods were also negatively impacted by the FDIC special assessment and impairment charges on investment securities.

The Company's earnings are largely dependent on its net interest income, which is the difference between interest earned on loans and investments and the cost of funding (primarily deposits and borrowings). Net interest income expressed as a percentage of average interest earning assets is referred to as net interest margin. The re-pricing frequency of the Company's assets and liabilities are not identical, and therefore subject the Company to the risk of adverse changes in interest rates. This is often referred to as interest rate risk and is reviewed in more detail in Item 3, Quantitative and Qualitative Disclosures About Market Risk, of this Form 10-Q.

Net interest income for the quarter ended June 30, 2010 amounted to \$13.9 million, an increase of \$2.2 million, or 19%, compared to the June 2009 quarter. Net interest income increased \$4.2 million, or 19%, for the six month period ended June 30, 2010, and amounted to \$27.0 million, compared to \$22.8 million for the six months ended June 30, 2009. The increase in net interest income over the comparable 2009 quarter and year-to-date periods was due primarily to loan growth. For the three months ended June 30, 2010, average loan balances increased \$112.5 million compared to the three months ended June 30, 2009. Average loan balances increased \$119.4 million for the year-to-date period ended June 30, 2010 compared to the same period in 2009. Additionally, net interest margin increased to 4.48% for the three months ended June 30, 2010, compared to 4.19% for the comparable 2009 period. Net interest margin was 4.42% for the quarter ended December 31, 2009. Year-to-date net interest margin was 4.46% and 4.18% for the six months ended June 30, 2010 and 2009, respectively, and 4.28% for the year ended December 31, 2009.

The provision for loan losses amounted to \$1.0 million for the three months ended June 30, 2010, compared to \$864 thousand for the same period in 2009. The provision for loan losses amounted to \$1.9 million and \$2.0 million for the six months ended June 30, 2010 and 2009, respectively. The provision was impacted primarily by the level of general non-performing loans and reserves for specific adversely classified loans, net charge-offs, and the level of loan growth. Loan growth during the first six months of 2010 amounted to \$33.4 million compared to \$70.8 million for the same period in 2009. For the year-to-date period ended June 30, 2010, the Company recorded net charge-offs of \$848 thousand, compared to net charge-offs of \$525 thousand for the period ended June 30, 2009. Annualized net charge-offs for the six months ended June 30, 2010 amounted to 0.16% of average total loans, and non-performing assets to total assets were 1.40% at June 30, 2010. The levels of charge-offs and non-performing assets, which reflect more normalized levels compared to the historic lows of recent years, are a function of the current economic environment and remain favorable compared to peer levels. The allowance for loan losses to total loans ratio was 1.73% at June 30, 2010, compared to 1.68% at December 31, 2009 and 1.64% at June 30, 2009.

Non-interest income for the three months ended June 30, 2010 amounted to \$2.9 million, an increase of \$502 thousand, or 21%, compared to the same quarter last year, primarily resulting from increases in net gains on sales of investment securities, investment advisory fees and deposit

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service fees, partially offset by declines in gains on loan sales. Non-interest income for the six months ended June 30, 2010 amounted to \$5.9 million an increase of \$1.2 million, or 26%, compared to the 2009 year-to-date period. The increase in the current year-to-date period primarily resulted from a reduction in the impairment charges on investment securities, increases in investment advisory fees, deposit service fees and gains on sales of REO, partially offset by decreases in net gains on sales of investment securities and in gains on loan sales.

Non-interest expense for the three months ended June 30, 2010, amounted to \$11.8 million, an increase of \$542 thousand, or 5%, compared to the same quarter last year. Non-interest expense for the six months ended June 30, 2010, amounted to \$22.9 million, an increase of \$1.4 million, or 6%, compared to the same period in the prior year. The increase in non-interest expense was related primarily to the Company's strategic growth initiatives resulting in increases in compensation-related costs, technology expenses and advertising expenses, partially offset by a reduction in deposit insurance expense due to a special assessment in June 2009.

Table of Contents

*Effective tax rates*

The effective tax rate for the six months ended June 30, 2010 was 32.8% compared to 28.0% in the 2009 period. The increase in the effective tax rate was primarily due to the higher level of taxable income as compared to 2009 levels, and the diminished impact of non-taxable income from certain tax-exempt assets on higher earnings.

*Sources and Uses of Funds*

The Company's primary sources of funds are deposits, brokered deposits, FHLB borrowings, current earnings and proceeds from the sales, maturities and pay-downs on loans and investment securities. These funds are used to originate loans, purchase investment securities, conduct operations, expand the branch network, and pay dividends to shareholders.

Total assets amounted to \$1.37 billion at June 30, 2010, an increase of 5% since December 31, 2009. The Company's core asset strategy is to grow loans, primarily high quality commercial loans. Total loans increased \$33.4 million, or 3%, since December 31, 2009 and amounted to \$1.12 billion, or 81% of total assets at June 30, 2010. Total commercial loans amounted to \$954.9 million, or 86% of gross loans, which was consistent with the composition at December 31, 2009. Management closely monitors the credit quality of individual delinquent and non-performing credit relationships, portfolio mix and industry concentrations, the local and regional real estate markets and current economic conditions. Although June 30, 2010 non-performing statistics have declined slightly since December 31, 2009, they have increased from the comparable 2009 period, as would be expected during the current economic environment and management does not consider this increase to be indicative of significant deterioration in the overall credit quality of the general loan portfolio at June 30, 2010.

The investment portfolio is the other key component of earning assets and is primarily used to invest excess funds, provide liquidity and to manage the Company's asset-liability position. The carrying value of total investments amounted to \$137.7 million at June 30, 2010, or 10% of total assets, and was comparable to the ratio of 11% at December 31, 2009.

Management's preferred strategy for funding asset growth is to grow low cost deposits (comprised of demand deposit accounts, interest and business checking accounts and traditional savings accounts). Asset growth in excess of low cost deposits is typically funded through higher cost deposits (comprised of money market accounts, commercial tiered rate savings accounts and certificates of deposit), customer repurchase agreements, wholesale funding (brokered deposits and FHLB borrowings), and investment portfolio cash flow.

At June 30, 2010, deposits, excluding brokered deposits, amounted to \$1.21 billion, representing \$95.1 million, or 9%, in growth over December 31, 2009 balances. At June 30, 2010, higher cost money market account balances increased \$74.4 million, or 23%, while checking account balances increased \$24.6 million, or 7%, compared to balances at December 31, 2009. The deposit growth is attributed to expansion and sales efforts to attract relationship customers seeking a competitive, but secure, alternative to the larger regional and national banks and mutual funds.

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Wholesale funding amounted to \$27.3 million at June 30, 2010, compared to \$51.4 million at December 31, 2009. At June 30, 2010, there were \$3.0 million in brokered deposits and \$24.3 million in FHLB borrowings. At December 31, 2009, wholesale funding included \$27.9 million in brokered deposits and FHLB borrowings amounting to \$23.5 million. The declines in wholesale funding were achieved due to the strong deposit growth during the period.

### *Opportunities and Risks*

The Company faces strong competition from multiple sources within its market area. National and larger regional banks have a local presence in the Company's market area. These established larger banks, as well as recent larger entrants into the local market area, have certain competitive advantages, including the ability to make larger loans to a single borrower than is possible for the Company, and greater financial resources. Numerous local savings banks, commercial banks, cooperative banks and credit unions also compete in the Company's market area. The expanded commercial lending capabilities of credit unions and the shift to commercial lending by traditional savings banks allow them to compete for the Company's targeted commercial customers. In addition, the non-taxable status of credit unions allows them certain advantages as compared to taxable institutions such as Enterprise. Competition for loans, investment advisory assets and deposits also comes from other businesses that provide financial services, including consumer finance companies, mortgage brokers, private lenders, insurance companies, securities brokerage firms, institutional mutual funds, registered investment advisors and internet based banks.

While the current economic environment continues to present significant challenges for all companies, management also believes that it has created opportunities for growth and customer acquisition. Notwithstanding the competition discussed above, management believes that customers continue to migrate from larger, national banks to local, stable community banks, choosing

Table of Contents

to do business with local professional bankers who can offer them the flexibility, responsiveness and personalized service that a community bank such as Enterprise provides. Management views the Company's product offerings, its customer service culture, and its investments in the communities we serve, as key elements in positioning Enterprise to take advantage of these market opportunities to grow deposits, loans and investment assets under management, with a focus on the needs of growing and established local businesses, professionals, non-profits and high net worth individuals.

The Company seeks to increase deposit share, in both existing and new markets, with continual review of deposit product offerings targeted to customer needs, focused and dynamic marketing strategies, and with carefully planned expansion into neighboring markets and new branch development. In the past two years, the Company has increased its branch network by three locations, and recently announced a new branch location in Hudson, NH, which is expected to open by the end of 2010, expanding its existing presence in Middlesex and Essex Counties of Massachusetts and in Southern New Hampshire. During this time, the Company has also made significant investments in renovations to its established branches and operations centers, and relocated both the Salem and Derry NH branches to larger newly built facilities in response to strong growth in those markets.

Management believes that Enterprise is also well equipped to capitalize on market potential to grow both the commercial and residential loan portfolios, by utilizing a disciplined and consistent lending approach and conservative credit review practices, which have served to provide quality asset growth over varying economic cycles during the Company's twenty-one year history. The Company has in place a skilled lending sales force with a broad breadth of business knowledge and depth of lending experience to draw upon.

The Company's ability to achieve its long-term growth and market share objectives will depend upon the Company's continued success in differentiating itself in the market place. The Company has built a reputation within its market area based on customer service and supporting the local communities, differentiating itself through its people, who act as trusted advisors to clients, possess strong technical skills, deliver a superior level of customer service, and uphold the Company's core values, including deep community involvement, which has led to a strong network with local business and community leaders. Management believes the Enterprise business model, of providing a full range of diversified financial products, services and technology, delivered through consistent, responsive and superior personalized customer service by experienced local banking professionals, with in-depth knowledge of our markets and a trusted reputation within the community, creates opportunities for the Company to be the leading provider of banking and investment management services in its growing market area. Management believes that Enterprise is uniquely positioned, both financially and strategically, to take full advantage of the opportunities created by the current challenging banking landscape and recent industry consolidation within the local market.

Management continues to undertake significant strategic initiatives, including investments in employee training and development, marketing and public relations, technology, operating facilities improvement, branch expansion and ongoing updates and renovations of existing branches. While management recognizes that such investments increase expenses in the short-term, it believes that such initiatives are an investment in the long-term growth and earnings of the Company and are reflective of the opportunities in the current marketplace for community banks such as Enterprise.

Notwithstanding the market opportunities that management believes the current economic environment has created, any long-term consequences of the nationwide or regional recession, or possible lagging effects, could further weaken the local New England economy, and have adverse repercussions on local industries leading to increased unemployment and foreclosures, further deterioration of local commercial real estate values, or other unforeseen consequences, which could have a severe negative impact on the Company's financial condition, capital position, liquidity, and performance. In addition, the loan portfolio consists primarily of commercial real estate, commercial and industrial and construction loans. These types of loans are typically larger and are generally viewed as having more risk of default than owner occupied residential real estate loans or consumer loans. The underlying commercial real estate values, customer cash flow and payment expectations and, in the case of commercial construction loans, the actual costs necessary to complete a construction project, can be more easily influenced by

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adverse conditions in the local or national economy, the real estate market, or the related industries. Any significant deterioration in the commercial loan portfolio or underlying collateral values due to a continuation or worsening of the current economic environment could have a material adverse effect on the Company's financial condition and results of operations.

The value of the investment portfolio as a whole, or individual securities held, including bonds issued by government agencies or municipalities and restricted FHLB capital stock could be negatively impacted by any continued volatility in the financial markets, tightening of credit markets, and any possible subsequent effects of the current economic recession, which could possibly result in the recognition of additional other-than-temporary-impairment charges in the future.

Any further changes in government regulation or oversight, including the recently enacted Dodd-Frank Act, could affect the Company in substantial and unpredictable ways, including, but not limited to, subjecting the Company to additional operating and compliance costs or potential loss of revenue due to new regulations. This sweeping federal legislation covers a wide variety of



Table of Contents

topics, some of which relate directly to activities of community banks, such as Enterprise, while others of which are directed at larger, systemically significant institutions. The full extent of the regulatory impact resulting from the Dodd-Frank Act will not be known for some time, as the various federal regulatory agencies will be required to draft and implement over 240 new regulations and the Government Accounting Office and other federal agencies are required to complete nearly 70 additional studies regarding various financial services industry issues that were raised during the legislative process.

Changes, prior to the enactment of the Dodd-Frank Act, in the FDIC's deposit insurance rates applicable to all insured banks and the Company's participation in the FDIC's Transaction Account Guaranty Program have already increased the Company's ongoing FDIC-related costs. The new legislation will also require several additional changes to the deposit insurance system, at least some of which could further increase these costs.

Additional significant challenges facing the Company continue to be the effective management of interest rate and credit risk, liquidity management, capital adequacy and operational risk.

The re-pricing frequency of interest earning assets and liabilities are not identical, and therefore subject the Company to the risk of adverse changes in interest rates. This is often referred to as interest rate risk and is reviewed in more detail under Item 3, Quantitative and Qualitative Disclosures About Market Risk below.

The risk of loss due to customers' non-payment of loans or lines of credit is called credit risk. Credit risk management is reviewed below in this Item 2 under the heading Credit Risk/Asset Quality and the Allowance for Loan Losses.

Liquidity management is the coordination of activities so that cash needs are anticipated and met, readily and efficiently. Liquidity management is reviewed further below in this Item 2 under the heading Liquidity.

Federal banking agencies require the Company and the Bank to meet minimum capital requirements. At June 30, 2010, the Company was categorized as well capitalized; however future unanticipated charges against capital could impact that regulatory capital designation. For information regarding the capital requirements applicable to the Company and the Bank and their respective capital levels at June 30, 2010, see the section entitled Capital Resources contained in this Item 2 below.

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events. Operational risk management is also a key component of the Company's risk management process, particularly as it relates to technology administration, information security, third-party vendor management and business continuity.

Management utilizes a combination of third party information security assessments, key technologies and ongoing internal evaluations in order to protect non-public personal information and continually monitor and safeguard information on its operating systems and those of third party service providers. The Company contracts with outside parties to perform a broad scope of both internal and external information security assessments on the Company's systems on a regular basis. These third parties conduct penetration testing and vulnerability scans to test the network configuration and security controls, and assess internal practices aimed at protecting the Company's operating systems. In addition, an

outside service provider monitors usage patterns and identifies unusual activity on bank issued debit/ATM cards. The Company also utilizes firewall technology and a combination of software and third-party monitoring to detect intrusion, protect against unauthorized access and continuously scan for computer viruses on the Company's information systems.

The Company may enter into third-party relationships by outsourcing certain operational functions or by using third parties to provide certain products and services to the Bank's customers. The Company is responsible for ensuring that activities conducted through third-party relationships are conducted in a safe and sound manner and in accordance with applicable laws and regulation, just as if the activity was performed by the Company itself. Management has instituted a third-party vendor management program in order to identify and control the risks arising from conducting activities through third party relationships. These risks may include operational risk and the failure to deliver a particular product or service; non-compliance with applicable laws and regulations; loss of non-public personal information; vendor business decisions that are inconsistent with the Company's strategic goals; or damage to the Company's reputation; among others. The Company's risk-based third-party vendor management program is designed to provide a mechanism to enable management to determine what risk, if any, a particular vendor exposes the Company to, and to mitigate that risk by properly performing initial and ongoing due diligence when selecting or maintaining a relationship with significant third-party providers.

The Business Continuity Plan consists of the information and procedures required to enable rapid recovery from an occurrence that would disable the Company for an extended period. The plan addresses issues and concerns regarding the loss of personnel, loss of information and/or loss of access to information under various scenarios including: the inability of staff or customers to travel to or to access bank offices, the serious threat of widespread public health or safety concerns, and the physical destruction

Table of Contents

or damage of facilities, infrastructure or systems. The plan, which is reviewed annually, establishes responsibility for assessing a disruption of business, contains alternative strategies for the continuance of critical business functions during an emergency situation, assigns responsibility for restoring services, and sets priorities by which critical services will be restored. Any contingency plan, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the plan are met as the assumptions used change over time or due to changes in circumstances and events.

In addition to the risks discussed above, numerous other factors that could adversely affect the Company's future results of operations and financial condition are addressed in Item 1A, Risk Factors, included in the Company's 2009 Annual Report on Form 10-K. This Opportunities and Risks discussion should be read in conjunction with Item 1A.

**Financial Condition**

Total assets increased \$70.0 million, or 5%, since December 31, 2009, to \$1.37 billion at June 30, 2010. The balance sheet composition and changes since December are discussed below:

*Short-term investments*

As of June 30, 2010, short-term investments amounted to \$40.1 million, or 3% of total assets, an increase of \$33.3 million compared to December 31, 2009. Short-term investments carried as cash equivalents consist of overnight and term federal funds sold and money market mutual funds. The balance of these investments will fluctuate depending on deposit inflows, investment sales proceeds and the immediate liquidity needs of the Company.

*Investments*

At June 30, 2010, the carrying value of the investment portfolio amounted to \$137.7 million and was relatively flat compared to December 31, 2009. The following table summarizes investments at the dates indicated:

(Dollars in thousands)	June 30, 2010	December 31, 2009	June 30, 2009
Federal agency obligations (1)	\$ 35,754	\$ 25,631	\$ 12,984
Federal agency mortgage backed securities (MBS) (1)	37,671	39,737	42,921
Non-agency MBS	2,993	3,445	4,008
Municipal securities	53,327	60,592	57,484
Total fixed income securities	\$ 129,745	\$ 129,405	\$ 117,397
Equity investments	3,263	4,964	5,353

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Total available for sale securities at fair value	\$	133,008	\$	134,369	\$	122,750
Federal Home Loan Bank stock (2)		4,740		4,740		4,740
Total investment securities	\$	137,748	\$	139,109	\$	127,490

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- (1) Investments issued or guaranteed by government sponsored enterprises such as Fannie Mae (FNMA), Freddie Mac (FHLMC), Ginnie Mae (GNMA) or one of several Federal Home Loan Banks. All agency MBS investments owned by the Company are backed by residential mortgages.
  - (2) The Bank is required to purchase stock of the Federal Home Loan Bank of Boston (the FHLB ) in association with advances from the FHLB; this stock is classified as a restricted investment and carried at cost, which management believes approximates fair value.

During the six months ended June, 2010, the Company sold \$4.6 million in securities, and recognized net gains of \$777 thousand. During that same period, the total principal pay downs, calls and maturities on fixed income securities amounted to \$17 million. These portfolio cash inflows were offset by the purchase of \$20.0 million in securities, primarily federal agency securities.

Net unrealized gains amounted to \$3.5 million at June 30, 2010 compared to \$3.2 million at December 31, 2009 and \$2.0 million at June 30, 2009. See Note 9, Investment Securities and Note 10, Fair Value Measurements to the Company's unaudited consolidated financial statements contained in Item 1 above for further information regarding the Company's unrealized gain and losses on debt and equity securities, including information about investments in an unrealized loss position for which an other-

Table of Contents

than-temporary impairment has or has not been recognized and the Company's fair value measurements for available-for-sale securities.

From time to time the Company may pledge securities from its investment portfolio as collateral for various municipal deposit accounts and repurchase agreements. The fair value of securities pledged as collateral for these purposes was \$36.5 million at June 30, 2010. In addition, securities designated as qualified collateral for FHLB borrowing capacity amounted to \$39.9 million at June 30, 2010. Securities designated as qualified collateral for borrowing from the Federal Reserve Bank of Boston (the "FRB") through its discount window amounted to \$52.6 million at June 30, 2010.

*Loans*

The Company specializes in lending to business entities, non-profit organizations, professionals and individuals. The Company's primary lending focus is on the development of high quality commercial relationships. Loans made by the Company to businesses include commercial mortgage loans, construction and land development loans, secured and unsecured commercial loans and lines of credit, and standby letters of credit. The Company also originates equipment lease financing for businesses. Loans made to individuals include conventional residential mortgage loans, home equity loans, residential construction loans on primary residences, secured and unsecured personal loans and lines of credit. The Company does not have a sub-prime mortgage program. The Company seeks to manage its loan portfolio to avoid concentration by industry or loan size to minimize its credit risk exposure.

Total loans increased \$33.4 million, or 3%, compared to December 31, 2009, and \$96.8 million, or 9%, since June 30, 2009. Total loans represented 81% of total assets at June 30, 2010 and 83% at December 31, 2009. The majority of the growth since December has been focused in the commercial portfolio, as total commercial loans have increased \$30.6 million, over the period.

The following table sets forth the loan balances by certain loan categories at the dates indicated and the percentage of each category to gross loans.

(Dollars in thousands)	June 30, 2010		December 31, 2009		June 30, 2009	
	Amount	Percent	Amount	Percent	Amount	Percent
Commercial real estate	\$ 571,789	51.2%	\$ 553,768	51.1%	\$ 522,197	51.2%
Commercial and industrial	282,652	25.3%	263,151	24.3%	243,991	23.9%
Commercial construction	100,499	9.0%	107,467	9.9%	98,049	9.6%
Total commercial loans	954,940	85.5%	924,386	85.3%	864,237	84.7%
Residential mortgages	89,920	8.0%	90,468	8.3%	90,530	8.9%
Residential construction	5,137	0.5%	6,260	0.6%	5,023	0.5%
Home equity	62,140	5.6%	58,732	5.4%	54,379	5.3%
Consumer	3,681	0.3%	3,824	0.4%	3,638	0.3%
Loans held for sale	1,706	0.1%	378	0.0%	2,753	0.3%
Gross loans	1,117,524	100.0%	1,084,048	100.0%	1,020,560	100.0%
Deferred fees, net	(1,264)		(1,218)		(1,137)	
Total loans	1,116,260		1,082,830		1,019,423	

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Allowance for loan losses	(19,282)	(18,218)	(16,710)
Net loans	\$ 1,096,978	\$ 1,064,612	\$ 1,002,713

Commercial real estate loans increased \$18.0 million, or 3%, as of June 30, 2010, compared to December 31, 2009, and 9% compared to June 30, 2009. Commercial real estate loans include loans secured by both owner-use and non-owner occupied real estate. These loans are typically secured by a variety of commercial and industrial property types including apartment buildings, office or mixed-use facilities, strip shopping malls or other commercial property.

Commercial and industrial loans increased by \$19.5 million, or 7%, since December 31, 2009, and 16% as compared to June 30, 2009. These loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), and term loans. Also included in commercial and industrial loans are loans under various U.S. Small Business Administration programs. These commercial and industrial loans include unsecured loans or lines to financially strong borrowers, loans secured in whole or in part by real estate unrelated to the principal purpose of the loan, or secured by inventories, equipment and/or receivables. Commercial and industrial loans are generally guaranteed by the principals of the borrower.

Table of Contents

Commercial construction loans decreased \$7.0 million, or 6%, since December 31, 2009, and were relatively flat compared to June 30, 2009. The decrease since December 31, 2009 reflects the limited new construction projects by qualified builders due to the current economic conditions in the construction industry. Commercial construction loans include the development of residential housing and condominium projects, the development of commercial and industrial use property and loans for the purchase and improvement of raw land. The Company limits the amount of financing provided to any single developer for the construction of properties built on a speculative basis. Funds for construction projects are disbursed as pre-specified stages of construction are completed. Regular site inspections are performed, either by experienced construction lenders on staff or by independent outside inspection companies, at each construction phase, prior to advancing additional funds.

Residential mortgages, residential construction, home equity mortgages and consumer loans combined represented approximately 14% of the total loan portfolio at June 30, 2010 and 15% at December 31, 2009. These loans remained relatively flat since December 31, 2009 and increased by \$7.3 million, or 5%, since June 30, 2009. The increase was primarily within the home equity portfolio.

Depending on the current interest rate environment, management projections of future interest rates and the overall asset-liability management program of the Company, management may elect to sell those fixed and adjustable rate residential mortgage loans which are eligible for sale in the secondary market, or hold some or all of this residential loan production for the Company's portfolio. The Company generally does not pool mortgage loans for sale, but instead sells the loans on an individual basis. The Company may retain or sell the servicing when selling the loans. All loans sold are currently sold without recourse, subject to an early payment default period covering the first four payments for certain loan sales. During the six months ended June 30, 2010, the Company originated \$16.2 million in residential loans designated for sale, compared to \$38.7 million for the comparable period in the prior year. The decrease in volume of residential loan production was due to the slightly more favorable market rates in 2009. Loans sold generated gains on sales of \$184 thousand and \$378 thousand for the six month periods ended June 30, 2010 and 2009, respectively.

At June 30, 2010, the Company had commercial loan balances participated out to various banks amounting to \$38.9 million, compared to \$34.7 million at December 31, 2009, and \$28.8 million at June 30, 2009. Balances participated out to other institutions are not carried as assets on the Company's financial statements. Loans originated by other banks in which the Company is the participating institution are carried in the loan portfolio at the Company's pro rata share of ownership and amounted to \$31.6 million, \$31.5 million and \$33.7 million at June 30, 2010, December 31, 2009 and June 30, 2009, respectively. The Company performs an independent credit analysis of each commitment prior to participation in any loan.

Loans designated as qualified collateral for FHLB borrowing capacity amounted to \$287.6 million and \$301.9 million at June 30, 2010 and December 31, 2009, respectively.

*Credit Risk/Asset Quality and the Allowance for Loan Losses*

There have been no material changes to the Company's underwriting practices or to the allowance for loan loss methodology used to estimate loan loss exposure as reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The provision for loan losses is a significant factor in the Company's operating results.

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The Company manages its loan portfolio to avoid concentration by industry or loan size to minimize its credit risk exposure. In addition, the Company does not have a sub-prime mortgage program. However, inherent in the lending process is the risk of loss due to customer non-payment, or credit risk. The Company's commercial lending focus may entail significant additional risks compared to long term financing on existing owner occupied residential real estate. These types of loans are typically larger and are generally viewed as having more risk of default than owner occupied residential real estate loans or consumer loans and the underlying commercial real estate values and construction projects can be more easily influenced by adverse conditions in the local or national economy, the real estate market, or the related industries. As such, an extended downturn in the national or local economy or real estate markets, among other factors, could have a material impact on the borrowers' ability to repay outstanding loans and on the value of the collateral securing these loans. While the Company endeavors to minimize this risk through the risk management function, management recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio and economic conditions.

The Company's credit risk management function focuses on a wide variety of factors, including, among others, current and expected economic conditions, the real estate market, the financial condition of borrowers, the ability of borrowers to adapt to changing conditions or circumstances affecting their business and the continuity of borrowers' management teams. Early detection of credit issues is critical to minimize credit losses. Accordingly, management regularly monitors these factors, among others, through ongoing credit reviews by the Credit Department, an external loan review service, reviews by members of senior management and the Loan Committee of the Board of Directors.



## Table of Contents

The Company's loan risk rating system classifies loans depending on risk of loss characteristics. The classifications range from substantially risk free for the highest quality loans and loans that are secured by cash collateral, to the most severe adverse classifications of substandard, doubtful and loss based on criteria established under banking regulations. Loans classified as substandard include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have all the weaknesses inherent in a substandard rated loan 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 classified as loss are generally considered uncollectible at present, although long term recovery of part or all of loan proceeds may be possible. These loss loans would require a specific loss reserve or charge-off. Adversely classified loans may be accruing or in non-accrual status and may be additionally designated as impaired or restructured, or some combination thereof. Loans which are evaluated to be of weaker credit quality are reviewed on a more regular basis by management.

Impaired loans are individually significant loans for which management considers it probable that not all amounts due in accordance with original contractual terms will be collected. The majority of impaired loans are included within the non-accrual balances; however, not every loan in non-accrual status has been designated as impaired. Management does not set any minimum delay of payments as a factor in reviewing for impaired classification. Management considers the payment status, net worth and earnings potential of the borrower, and the value and cash flow of the collateral as factors to determine if a loan will be paid in accordance with its contractual terms.

When a loan is deemed to be impaired, management estimates the credit loss by comparing the loan's carrying value against either 1) the present value of the expected future cash flows discounted at the loan's effective interest rate; 2) the loan's observable market price; or 3) the expected realizable fair value of the collateral, in the case of collateral dependent loans. A specific allowance is assigned to the impaired loan for the amount of estimated credit loss. Impaired loans are charged off, in whole or in part, when management believes that the recorded investment in the loan is uncollectible.

Impaired loans exclude large groups of smaller-balance homogeneous loans, such as residential mortgage loans and consumer loans, which are collectively evaluated for impairment, and loans that are measured at fair value, unless such loan is amended in a troubled debt restructure.

Loans are designated as a troubled debt restructured (or TDR) when a concession is made on a credit as a result of financial difficulties of the borrower. Typically, such concessions consist of a reduction in interest rate to a below market rate, taking into account the credit quality of the note, or a deferment of payments, principal or interest, which materially alters the Bank's position or significantly extends the note's maturity date, such that the present value of cash flows to be received is materially less than those contractually established at the loan's origination. TDR loans are included in the impaired loan category.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is generally discontinued when a loan becomes contractually past due, with respect to interest or principal, by ninety days, or when reasonable doubt exists as to the full and timely collection of interest or principal. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest accruals are resumed on such loans only when payments are brought current and have remained current for a period of ninety days or when, in the judgment of management, the collectability of both principal and interest is reasonably assured. Interest payments received on loans in a non-accrual status are generally applied to principal.

Real estate acquired by the Company through foreclosure proceedings or the acceptance of a deed in lieu of foreclosure is classified as Other Real Estate Owned (OREO). When property is acquired, it is generally recorded at the lesser of the loan's remaining principal balance or the estimated fair value of the property acquired, less estimated costs to sell. Any loan balance in excess of the estimated realizable fair value on the

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date of transfer is charged to the allowance for loan losses on that date. All costs incurred thereafter in maintaining the property, as well as subsequent declines in fair value are charged to non-interest expense.

Non-performing assets are comprised of non-accrual loans, deposit account overdrafts that are more than 90 days past due and OREO. The designation of a loan or other asset as non-performing does not necessarily indicate that loan principal and interest will ultimately be uncollectible. However, management recognizes the greater risk characteristics of these assets and therefore considers the potential risk of loss on assets included in this category in evaluating the adequacy of the allowance for loan losses.

On a quarterly basis, management prepares an estimate of the allowance necessary to cover estimated credit losses. The allowance for loan losses is an estimate of probable credit risk inherent in the loan portfolio as of the specified balance sheet date.

Table of Contents

The Company maintains the allowance at a level that it deems adequate to absorb all reasonably anticipated losses from specifically known and other credit risks associated with the portfolio.

In making its assessment on the adequacy of the allowance, management considers several quantitative and qualitative factors that could have an effect on the credit quality of the portfolio including individual assessment of larger and high risk credits, delinquency trends and the level of non-performing loans, net charge-offs, the growth and composition of the loan portfolio, expansion in geographic market area, the strength of the local and national economy, and comparison to industry peers, among other factors. Except for loans specifically identified as impaired, as discussed above, the estimate is a two-tiered approach that allocates loan loss reserves to adversely classified loans by credit rating and to non-classified loans by credit type. The general loss allocations take into account the historic loss experience as well as the quantitative and qualitative factors identified above. The allowance for loan losses is established through a provision for loan losses, a direct charge to earnings. Loan losses are charged against the allowance when management believes that the collectability of the loan principal is unlikely. Recoveries on loans previously charged-off are credited to the allowance.

There were no significant changes in the Company's underwriting, credit risk management system, or the allowance assessment methodology used to estimate loan loss exposure as reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

The allowance for loan losses to total loans ratio was 1.73% and 1.68% at June 30, 2010 and December 31, 2009 respectively, compared to the June 30, 2009 ratio of 1.64%. Based on the foregoing, as well as management's judgment as to the risks inherent in the loan portfolio, the Company's allowance for loan losses was deemed adequate to absorb probable losses from specifically known and other credit risks associated with the portfolio as of June 30, 2010.

Management closely monitors the credit quality of individual delinquent and non-performing relationships, industry concentrations, the local and regional real estate market and current economic conditions. The level of delinquent and non-performing assets is largely a function of economic conditions and the overall banking environment. Despite prudent loan underwriting, adverse changes within the Company's market area or further deterioration in the local, regional or national economic conditions could negatively impact the Company's level of non-performing assets requiring addition provisions to the allowance for loan losses in the future.

Table of Contents

The following table sets forth information regarding non-performing assets and past due loans at the dates indicated:

(Dollars in thousands)	June 30, 2010	December 31, 2009	June 30, 2009
Commercial real estate	\$ _____		