

ENTERPRISE BANCORP INC /MA/  
Form 10-K  
March 14, 2008

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

Washington, D.C. 20549

**Form 10-K**

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

**For the fiscal year ended December 31, 2007**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 0-21021**

**Enterprise Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

**Massachusetts**

(State or other jurisdiction of incorporation or organization)

**04-3308902**

(IRS Employer Identification No.)

**222 Merrimack Street, Lowell, Massachusetts**

**01852**

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(Address of principal executive offices)

(Zip code)

Registrant's telephone number, including area code

**(978) 459-9000**

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

**Common Stock, \$0.01 par value per share**  
(Title of each class)

**NASDAQ Global Market**  
(Name of exchange on which registered)

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

**NONE**

(Title of Class)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.  Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a 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

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State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid price and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter. **\$89,906,497** as of June 30, 2007

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: March 10, 2008, Common Stock - Par Value \$0.01: 7,955,011 shares outstanding

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the issuer's proxy statement for its annual meeting of stockholders to be held on May 6, 2008 are incorporated by reference in Part III of this Form 10-K. Such information incorporated by reference shall not be deemed to specifically incorporate by reference the information referred to in Item 402(a) (8) of Regulation S-K.

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ENTERPRISE BANCORP, INC.

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## **PART I**

### **Item 1. Business**

#### **General**

Enterprise Bancorp, Inc. (the company) is a Massachusetts corporation, which operates as the parent holding company of Enterprise Bank and Trust Company (the bank). The company's headquarters are located at 222 Merrimack Street in Lowell, Massachusetts.

Substantially all of the company's operations are conducted through the bank. The bank, a Massachusetts trust company, has five wholly owned subsidiaries which were included in the company's consolidated financial statements:

- Enterprise Insurance Services, LLC, organized for the purposes of engaging in insurance sales activities;
- Enterprise Investment Services, LLC, organized for the purpose of offering non-deposit investment products and services, and;
- Three Massachusetts 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 services, 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. All material intercompany balances and transactions have been eliminated in consolidation.

#### **Market Area and Competition**

The company's primary market area is the Merrimack Valley and North Central regions of Massachusetts and South Central New Hampshire. The company has fourteen full service branch banking offices located in the Massachusetts cities and towns of Andover, Billerica, Chelmsford, Dracut, Fitchburg, Leominster, Lowell, Tewksbury, and Westford; and in Salem, New Hampshire which serve those cities and towns as well as the surrounding communities. The company expects to open an additional branch facility, in the city of Methuen, Massachusetts, in spring 2008.

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In addition, the company is in the process of obtaining regulatory approvals to establish a new branch in the town of Derry, New Hampshire, and expects to open the facility for business in early 2009.

The company faces strong competition to attract deposits and investment advisory assets and to generate loans. National and larger regional banks have a local presence in the company's market area. Numerous local savings banks, commercial banks, cooperative banks and credit unions have one or more offices in the company's market area. Larger banks have certain competitive advantages over the company, including the ability to make larger loans to a single borrower than is possible for the company. The greater financial resources of larger banks also allow them to offer a broad range of automated banking services, to maintain numerous branch offices and to mount extensive advertising and promotional campaigns. 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. Advances in, and the increased use of, technology, such as internet banking and electronic transaction processing, are expected to have a significant impact on the future competitive landscape confronting financial institutions.

Notwithstanding the substantial competition with which the company is faced, management believes that the company has established a solid reputation within its market area. Management also believes that the company has differentiated itself from competitors by providing a broad range of commercial banking, investment and insurance products through highly personal and responsive service, based on management's familiarity and understanding of the banking and other financial service needs of its customers. The company's directors and officers have substantial business and personal ties in the cities and towns in which the company operates. Management seeks to hire, develop and retain highly motivated top professionals who understand the communities in which the bank operates as well as the local banking environment. In addition, the company continually examines new products and technologies in order to maintain a highly competitive mix of offerings and to target product lines to customer needs.

Management actively seeks to strengthen its position, by capitalizing on the market opportunities, and the continued pursuit of strategic growth within existing and into neighboring markets.

See also *Supervision and Regulation* below, and *Risk Factors* contained in Item 1A, for further discussion on how new laws and regulations and other factors may effect the company's competitive position, growth and/or profitability.

## **Lending**

### ***General***

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 achieved through active business development efforts, strong community involvement and focused marketing strategies. 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 has not and does not intend to originate mortgage loans that are considered sub-prime.

The company employs a seasoned commercial lending staff, with commercial lenders supporting each branch location. The company has an internal loan review function that assesses the compliance of loan originations with the company's internal policies and underwriting guidelines and monitors the ongoing quality of the loan portfolio. The company also contracts with an external loan review company to review loans in the loan portfolio on a pre-determined schedule, based on the type, size, rating, and overall risk of the loan.

A management loan review committee, consisting of senior lending officers and loan review personnel, is responsible for setting loan policy and procedures, as well as reviewing loans on the company's internal watched asset list and classified loan report. The company has an internal credit review committee, consisting of senior lending officers and loan review personnel. The committee generally meets three times per month, or on an as needed basis, to review loan requests related to borrowing relationships of certain levels, as well as other borrower relationships recommended for discussion by committee members.





The company's executive committee of the board of directors also approves loan relationships exceeding certain prescribed limits. A loan committee, consisting of five outside members of the board of directors, and two executive officers who are also members of the board of directors, reviews current portfolio statistics, new credits, construction loan reviews, watched assets, loan delinquencies, and allowance for loan losses, as well as current market conditions and issues relating to the construction and real estate development industry. The board's loan committee is also responsible for approval of charge-offs recommended by management. Approved charge-offs are forwarded to the full board for ratification.

At December 31, 2007, the bank's statutory lending limit, based on 20% of capital, to any individual borrower was approximately \$19.4 million, subject to certain exceptions provided under applicable law.

### *Commercial Real Estate, Commercial and Construction Loans*

Commercial real estate loans include loans secured by commercial and industrial properties, apartment buildings, office or mixed-use facilities, strip shopping malls, or other commercial property and are generally guaranteed by the principals of the borrower. Commercial real estate loans generally have repayment periods of approximately fifteen to twenty years. Variable interest rate loans have a variety of adjustment terms and indices, and are generally fixed for the first one to five years before periodic rate adjustment begins.

Commercial and industrial loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), loans partially guaranteed by the Small Business Administration (SBA), loans under various programs issued in conjunction with the Massachusetts Development and Finance Agency and other agencies. These commercial and industrial credits may be unsecured loans and lines to financially strong borrowers, secured in whole or in part by real estate unrelated to the principal purpose of the loan or secured by inventories, equipment, or receivables, and are generally guaranteed by the principals of the borrower. Variable rate loans in this portfolio have interest rates that are periodically adjusted, generally with fixed initial periods of one to three years. Commercial and industrial loans have average repayment periods of one to seven years.

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 and are secured in whole or in part by the underlying real estate collateral and are generally guaranteed by the principals of the borrower. The company's construction lenders work to cultivate long-term relationships with established developers. 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. Commercial construction loans generally have terms of one to three years.

From time to time the company participates in the financing of certain large commercial projects with other banks. In some cases the company may act as the lead lender, originating and servicing the loans, but participating out a portion of the funding to other banks. In other cases the company may participate in loans originated by other institutions. In each case the participating bank funds a percentage of the loan commitment and takes on the related risk. The 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. The company performs an independent credit analysis of each commitment prior to participation in the loan.



Standby letters of credit are conditional commitments issued by the company to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. If the letter of credit is drawn upon the company creates a loan for the customer, generally a commercial loan, with the same criteria associated with similar commercial loans.

### ***Residential Loans***

The company originates conventional mortgage loans on one-to-four family residential properties. These properties may serve as the borrower's primary residence, vacation homes or investment properties. Loan to value limits vary from 80% for adjustable rate and multi-family owner occupied properties, up to 100% for fixed rate loans on single family owner occupied properties, with mortgage insurance coverage required for loan-to-value ratios greater than 80% based on program parameters. In addition the company provides financing for the construction of owner occupied primary residences. Residential mortgage loans made by the company have terms of up to 30 years at either fixed or adjustable rates of interest. Fixed and adjustable rate residential mortgage loans are generally originated using secondary market underwriting and documentation standards.

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 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.

### ***Home Equity Loans and Lines of Credit***

Home equity loans are originated for the company's portfolio for one-to-four family residential properties with maximum original loan to value ratios generally up to 80% of the assessed or appraised value of the property securing the loan. Home equity loan payments consist of monthly principal and interest based on amortization ranging from three to fifteen years. The rates may initially be fixed for a one year period and reviewed annually thereafter, or fixed for a three year period and reviewed every three years thereafter, or the rate may be fixed for three to fifteen years.

Home equity lines are originated for the company's portfolio for one-to-four family residential properties with maximum original loan to value ratios generally up to 80% of the assessed or appraised value of the property securing the loan. Home equity lines generally have interest rates that adjust monthly based on changes in the Prime rate as published in the Wall Street Journal. Some home equity lines may be fixed for a period of time and then adjusted monthly thereafter. The payment schedule for home equity lines for the first ten years of the loans are interest only payments. Generally at the end of ten years the line is frozen to future advances and principal plus interest payments are collected over a fifteen-year amortization schedule.

*Consumer Loans*

Consumer loans primarily consist of secured or unsecured personal loans and overdraft protection lines on checking accounts extended to individual customers.

The company's residential, home equity and consumer lending activities are supported by the branch relationship managers, a centralized walk-in mortgage center, and an internet based eMortgage center.

*Credit Risk and Allowance for Loan Losses*

Information regarding the company's credit risk and allowance for loan losses is contained in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, under the headings Credit Risk/Asset Quality and Allowance for Loan Losses, contained in the section Financial Condition, and under the heading Allowance for Loan Losses, which is contained in the Critical Accounting Estimates section of Item 7.

**Investment Activities**

The company's investment activity is an integral part of the overall asset-liability management program of the company. The investment function provides readily available funds to support loan growth as well as to meet withdrawals and maturities of deposits and attempts to provide maximum return consistent with liquidity constraints and general prudence, including diversification and safety of investments.

The securities in which the company may invest are limited by regulation. In addition, the company has an internal investment policy which restricts fixed income investments to the following categories: U.S. treasury securities, federal agency obligations (obligations issued by government sponsored enterprises that are not backed by the full faith and credit of the United States government), mortgage-backed securities (MBSs), including collateralized mortgage obligations (CMOs), and state, county and municipal securities (Municipals), all of which must be considered investment grade by a recognized rating service. The company is also required to purchase Federal Home Loan Bank of Boston (FHLB) stock in association with the bank's outstanding advances from the FHLB; this stock is classified as a restricted investment and carried at cost. The company may also invest in certificates of deposit and, within prescribed regulatory limits, in publicly traded equity securities and registered mutual funds. The investment policy also limits the categories within the investment portfolio to particular percentages of the total portfolio and to certain percentages of total assets and/or capital. The effect of changes in interest rates, principal payments and market values are considered when purchasing securities. The company has not purchased sub-prime mortgage-backed securities.

The short-term investments classified as cash equivalents may be comprised of short-term U.S. Agency Discount Notes, money market mutual funds and overnight or short-term federal funds sold. Short-term investments not carried as cash equivalents would be classified as other short-term investments.

Investment transaction summaries, portfolio allocations and projected cash flows are prepared monthly and presented to the company's Asset-Liability Committee of the board of directors (ALCO) on a periodic basis. ALCO is comprised of five outside directors and three executive officers of the company who are also directors, with various management liaisons. In addition, several directors who are not on the committee rotate in on a regular basis. ALCO regularly reviews the composition and key risk characteristics of the company's investment portfolio, including effective duration, cash flow, market value at risk and asset class concentration. Credit risk inherent in the portfolio is closely monitored by management and presented at least annually to ALCO. ALCO also approves the company's ongoing investment strategy and management updates the committee at each meeting.

**Source of Funds**

*Deposits*

Deposits have traditionally been the principal source of the company's funds. The company offers commercial checking, business and municipal savings accounts, money market and business sweep accounts, and escrow management accounts, as well as checking and Simplified Employee Pension ( SEP ) accounts to employees of our business customers. The company also offers a broad selection of deposit products to the general public, including personal interest checking accounts ( PIC ), savings accounts, money market accounts, individual retirement accounts ( IRA ) and certificates of deposit ( CDs ).

The company utilizes third party money market mutual funds for sweep accounts. Management believes that commercial customers benefit from enhanced interest rate options on sweep accounts, while retaining a conservative investment option of the highest quality and safety. The balances transferred into mutual funds do not represent obligations of the company.

Terms on certificates of deposit range from one week to thirty months. In addition, the company may use brokered certificates of deposit ( brokered CD s ) as an alternative to borrowing funds to support asset growth in excess of internally generated deposits. Brokered CD terms generally range from three to twelve months.

Management determines the interest rates offered on deposit accounts based on current and expected economic conditions, competition, liquidity needs, the volatility of existing deposits, the asset-liability position of the company and the overall objectives of the company regarding the growth and retention of relationships.

#### ***Borrowed Funds***

The bank s membership in the FHLB enables the bank to borrow funds based on the pledge of qualifying collateral balances to the FHLB, including certain residential loans, commercial loans and U.S. Government and Agency securities. The company utilizes borrowings from the FHLB to fund short-term liquidity needs. This facility is an integral component of the company s asset-liability management program.

The company also borrows funds from customers (generally commercial and municipal customers) by entering into agreements to sell and repurchase investment securities from the company s portfolio, with terms that may range from one week to six months. These repurchase agreements represent a cost competitive funding source for the company. Interest rates paid by the company on these repurchase agreements are based on market conditions and the company s need for additional funds at the time of the transaction.

#### ***Junior Subordinated Debentures***

In March 2000 the company organized Enterprise (MA) Capital Trust I (the Trust ), a statutory business trust created under the laws of Delaware, in order to issue \$10.5 million of 10.875% trust preferred securities that mature in 2030 and are callable beginning in 2010. The proceeds from the sale of the trust preferred securities were used by the Trust, along with the company s \$325 thousand capital contribution, to acquire \$10.8 million in aggregate principal amount of the company s 10.875% Junior Subordinated Debentures that mature in 2030 and are callable beginning in 2010.

Pursuant to Financial Interpretation No. 46R, issued by the Financial Accounting Standards Board in December 2003, the company carries the \$10.8 million of Junior Subordinated Debentures on the company s financial statements as a liability, with related interest expense, and the \$10.5 million of trust preferred securities issued by the Trust, and the related non-interest expense, are excluded from the company s financial statements.



**Investment Advisory Group**

The company provides a range of investment advisory and management services to individuals, family groups, businesses, trusts, foundations, non-profit organizations, endowments and retirement plans. These services include a combination of securities brokerage services through a third party service arrangement with Commonwealth Financial Network, a licensed securities brokerage firm, and fee only investment advisory and trust services for management of equity and fixed income portfolios. Portfolios are managed based on the individual investment objectives of each client.

The company's Investment Advisory Group utilizes an open-architecture, manager of managers approach to client investment management. The philosophy is to identify and hire highly competitive outside mutual fund companies and investment management firms on behalf of our clients. The company performs a detailed search and due diligence review based on an objective analysis of each fund's historic returns, management, longevity, investment style, risk profile, and other criteria. The company identifies and hires the best service providers and maintains ongoing oversight and monitoring of their performance. This rigorous due diligence is intended to enable the company to customize sound investment portfolios that meet each customer's financial objectives and deliver superior long-term performance.

### **Enterprise Insurance Services**

Enterprise Insurance Services LLC engages in insurance sales activities through a third party arrangement with HUB International New England, LLC ( HUB ), which is a full service insurance agency, with offices in Massachusetts and New Hampshire, and is part of HUB International Limited, which operates throughout the United States and Canada. Enterprise Insurance Services provides, through HUB, a full array of insurance products including property and casualty, employee benefits and risk-management solutions tailored to serve the specific insurance needs of businesses in a range of industries operating in the company's market area.

### **On-line Banking**

The company uses an in-house turn-key solution from its core banking system vendor for internet banking services for retail and commercial customers. Major on-line banking capabilities include the following: balance inquiry; internal transfers; loan payments; bill payments; federal tax payments; placement of stop payments; access to images of checks paid; and access to prior period account statements. In addition, commercial customers may take advantage of remote deposit capture service and have the ability to initiate on-line electronic funds transfers, including ACH originations and wire transfers.

### **Company Website**

The company currently uses an outside vendor to design, support and host its internet website. The underlying structure of the site provides for dynamic maintenance of the information by company personnel. The site provides information on the company and its services, the ability to submit mortgage loan applications online, as well as providing the access point to various specified banking services and to various financial management tools. In addition, the site includes the following major capabilities: career opportunities; calculators; an ATM/Branch Locator/Map; and investor and corporate information, which includes a corporate governance page. The corporate governance page includes the company's corporate governance guidelines, code of business conduct and ethics, and whistleblower protection policy, as well as the charters of the board of Directors' audit, compensation and personnel, and corporate governance/nominating committees.

The company makes available free of charge, through a link on its web site to its SEC filings, copies of the company's annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as all registration statements that the company has been required to file in connection with the issuance of its shares. The company similarly makes available all insider stock ownership and transaction reports filed with the SEC by the company's executive officers, directors and any 10% stockholders under Section 16 of the Securities Exchange Act of 1934 (Forms 3, 4 and 5). Access to all of these reports is essentially simultaneous with the SEC's posting of these reports on its EDGAR system through the SEC website ([www.SEC.gov](http://www.SEC.gov)). The company's internet web address is: [EnterpriseBanking.com](http://EnterpriseBanking.com).



## Supervision and Regulation

### *General*

Bank holding companies and banks are subject to extensive government regulation through federal and state statutes and related regulations, which are subject to changes that can significantly affect the way in which financial service organizations conduct business.

As a general matter, regulation of the banking and financial services industries has undergone significant changes, some of which have been intended to ease legal and regulatory restrictions while others have increased regulatory requirements. For example, the Gramm-Leach-Bliley Act of 1999 (the GLB Act) eased regulatory restrictions on consolidated companies offering diversified financial services by removing the legal barriers that formerly served to separate the banking, insurance and securities industries. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which reduced geographic restrictions on banking organizations by enhancing their ability to operate on a nationwide basis, is another example of federal legislation that has reduced the legal and regulatory burdens on the business activity of banks and their holding companies.

Many of the more recent changes in law and regulation that have increased banks' and financial organizations' regulatory requirements have applied to operations relevant to the war on terrorism or areas affecting the interests of investors and consumers. For example the United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (a/k/a the Patriot Act) added new provisions to the Bank Secrecy Act that increased anti-money laundering and customer identification requirements, which are intended to facilitate the prevention, detection and prosecution of international money laundering and the financing of terrorism.

The passage of the Sarbanes-Oxley Act of 2002 added additional financial reporting and certification, accounting, corporate governance and internal controls requirements to the company's ongoing federal securities law compliance obligations, which are intended to enhance corporate accountability and improve the quality of investor information.

The Fair and Accurate Credit Transaction Act (FACT Act), which amended the Fair Credit Reporting Act in 2003, requires banks and other financial firms to take measures intended to help deter identity theft by developing appropriate fraud response programs and giving consumers greater control over their credit data.

The Check Clearing for the 21st Century Act (Check 21), which became effective in 2004, is designed to facilitate the automation of the nation's check-processing system away from physical transportation of paper checks. The law allows banks to process check information electronically, and to deliver digital images of the check to banks that choose to continue to receive paper checks. Check 21 requires all banks to accept legally equivalent substitute checks in place of originals and comply with federal regulations governing the treatment of remotely created checks and electronic check conversion transactions.

**Recently enacted legislative initiatives at the state level in Massachusetts have also further addressed data breaches affecting consumer financial information and residential mortgage lending and foreclosure matters.**

Any future increase in the extent of regulation imposed upon the banking or financial services industries generally could result in the company incurring additional operating and compliance costs, which in turn could impede profitability.

To the extent that the information in this report under the heading "Supervision and Regulation" describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory or regulatory provision so described. Any changes in applicable laws or regulations may have a material effect on the business and prospects of the company.

### ***Regulation of the Holding Company***

The company is a registered bank holding company under the federal Bank Holding Company Act of 1956, as amended (the Bank Holding Company Act). The business and operations of the company are subject to the supervision and examination of the Board of Governors of the Federal Reserve System (the Federal Reserve Board). Under applicable state laws, the company is also subject to the supervisory jurisdiction of the Massachusetts Commissioner of Banks (the Commissioner) and, with respect to its New Hampshire branch operations, the New Hampshire Banking Department.

The Bank Holding Company Act requires prior approval by the Federal Reserve Board of the acquisition by the company of substantially all the assets or more than five percent of the voting stock of any bank. The Bank Holding Company Act also authorizes the Federal Reserve Board to determine (by order or by regulation) what activities are so closely related to banking as to be a proper incident of banking, and thus, whether the company, either directly or indirectly through non-bank subsidiaries, can engage in such activities. The Bank Holding Company Act prohibits the company and the bank from engaging in certain tie-in arrangements in connection with any extension of credit, sale of property or furnishing of services. There are also restrictions on extensions of credit and other transactions between the bank, on the one hand, and the company, or other affiliates of the bank, on the other hand.

The GLB Act enhanced the authority of banks and their holding companies to engage in non-banking activities. By electing to become a financial holding company, a qualified parent company of a banking institution may engage, directly or through its non-bank subsidiaries, in any activity that is financial in nature or incidental to such financial activity or in any other activity that is complimentary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

A bank holding company will be able to successfully elect to be regulated as a financial holding company if all of its depository institution subsidiaries meet certain prescribed standards pertaining to management, capital adequacy and compliance with the federal Community Reinvestment Act. Financial holding companies remain subject to regulation and oversight by the Federal Reserve Board. The company believes that the bank, which is the company's sole depository institution subsidiary, presently satisfies all of the requirements that must be met to enable the company to successfully elect to become a financial holding company. However, the company has no current intention of seeking to become a financial holding company. Such a course of action may become necessary or appropriate at some time in the future depending upon the company's strategic plan.

### ***Regulation of the Bank***

As a trust company organized under Chapter 172 of the Massachusetts General Laws, the deposits of the bank are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (the FDIC), up to the maximum amount provided by law. The bank is subject to regulation, supervision and examination by the Commissioner and the FDIC. The bank is also subject to certain regulatory requirements of the Federal Reserve Board and, with respect to its New Hampshire branch operations, the New Hampshire Banking Department.

The regulations of these agencies govern many aspects of the bank's business, including permitted investments, the opening and closing of branches, the amount of loans which can be made to a single borrower, mergers, appointment and conduct of officers and directors, capital levels and terms of deposits. The Federal Reserve Board also requires the bank to maintain minimum reserves on its deposits. Federal and state

regulators can impose sanctions on the bank and its management if the bank engages in unsafe or unsound practices or otherwise fails to comply with regulatory standards. Various other federal and state laws and regulations, such as truth-in-lending and truth-in-savings statutes, the Equal Credit Opportunity Act, the Bank Secrecy Act, the Real Estate Settlement Procedures Act, the Community Reinvestment Act, Check 21 and the FACT Act, also govern the bank's activities and operations.

Pursuant to the GLB Act, the bank may also form, subject to the approvals of the Commissioner and the FDIC, financial subsidiaries to engage in any activity that is financial in nature or incidental to a financial activity. In order to qualify for the authority to form a financial subsidiary, the bank would be required to satisfy certain conditions, some of which are substantially similar to those that the company would be required to satisfy in order to elect to become a financial holding company. The company believes that the bank would be able to satisfy all of the conditions that would be required to form a financial subsidiary, although the company has no current intention of doing so. Such a course of action may become necessary or appropriate at some time in the future depending upon the company's strategic plan.

### *Deposit Insurance Assessment*

Effective January 1, 2007, the bank became subject to a revised deposit insurance assessment system as implemented by the FDIC in accordance with the requirements of the Federal Deposit Insurance Reform Act of 2005 (the Deposit Insurance Reform Act). Under the revised system, the deposit insurance assessment rates are determined based upon a combination of an institution's financial ratios and supervisory factors. There are four established risk categories under the assessment rules. Under this deposit insurance assessment system, even the highest risk-rated (i.e., least risk) banks and thrifts are subject to some level of assessment payable to the FDIC's Deposit Insurance Fund. In 2007, the bank qualified as a Risk Category I (least risk) and was assessed deposit insurance premiums, under the revised system, at an annualized rate of 5.2% of the bank's deposit assessment base, as defined by the FDIC. Prior to 2007, under the former FDIC system for assessing deposit insurance premiums, the bank was not assessed any deposit insurance premium based on its designation as well capitalized.

Under the Deposit Insurance Reform Act, eligible insured depository institutions, such as the bank, shared in a one-time assessment credit pool of approximately \$4.7 billion. This one-time credit was applied against the institutions' 2007 deposit insurance assessment, effectively reducing the amount these institutions were required to submit as an overall assessment in 2007. In the case of the company, the one-time credit of approximately \$333 thousand offset approximately 94% of the bank's deposit insurance assessment for 2007.

In 2008, the company will begin paying the full deposit insurance assessment and anticipates the bank will again qualify as Risk Category I.

### *Dividends*

Under Massachusetts law, the company's board of directors is generally empowered to pay dividends on the company's capital stock out of its net profits to the extent that the board of directors considers such payment advisable. Massachusetts banking law also imposes substantially similar standards upon the payment of dividends by the bank to the company. The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) also prohibits a bank from paying any dividends on its capital stock in the event that the bank is in default on the payment of any assessment to the FDIC or if the payment of any such dividend would otherwise cause the bank to become undercapitalized.

### **Capital Resources**

Capital planning by the company and the bank considers current needs and anticipated future growth. The primary sources of capital have been the sale of common stock in 1988 and 1989, the issuance of \$10.5 million of trust preferred securities in 2000 by the Trust, retention of earnings



less dividends paid since the bank commenced operations, proceeds from the exercise of employee stock options and proceeds from purchases of share pursuant to the company's dividend reinvestment plan and employee stock purchase plan.

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*The Company*



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The Federal Reserve Board has adopted capital adequacy guidelines that generally require bank holding companies to maintain total capital equal to 8% of total risk-weighted assets, with at least one-half of that amount (or 4% of total risk-weighted assets) consisting of core or Tier 1 capital. Total capital for the company consists of Tier 1 capital and supplementary or Tier 2 capital. Tier 1 capital for the company begins with common stockholders' equity and is reduced by certain intangible assets. In addition, trust preferred securities may compose up to 25% of the company's Tier 1 capital (subject to certain limitations and with any excess allocable to Tier 2 capital). Supplementary capital for the company is comprised solely of a portion of the allowance for loan losses. Assets are adjusted under the risk-based capital guidelines to take into account different levels of credit risk, for example, cash and government securities are placed in a 0% risk category (requiring no additional capital), most home mortgage loans are placed in a 50% risk category, and the bulk of assets that, by their nature in the ordinary course of business, pose a direct credit risk to a bank holding company, including commercial real estate loans, commercial business loans and consumer loans, are placed in a 100% risk category.

In addition to the risk-based capital requirements, the Federal Reserve Board requires bank holding companies to maintain a minimum leverage ratio of Tier 1 capital to quarterly average total assets of 4% (3% percent if given the highest regulatory rating and not experiencing significant growth).

### ***The Bank***



The bank is subject to separate capital adequacy requirements of the FDIC, which are substantially similar to the requirements of the Federal Reserve Board applicable to the company. However, trust preferred proceeds contributed to the bank from the company are included in Tier 1 capital of the bank without limitation. The company contributed \$10.3 million of proceeds from the sale of these securities to the bank in 2000. Under the FDIC requirements, the minimum total capital requirement is 8% of total assets and certain off-balance sheet items, weighted by risk. At least 4% of the total 8% ratio must consist of Tier 1 capital (primarily common equity including retained earnings) and the remainder may consist of subordinated debt, cumulative preferred stock and a limited amount of loan loss reserves. At the bank level, as at the company level on a consolidated basis, certain intangible assets are deducted from Tier 1 capital in calculating regulatory capital ratios.

Under the applicable FDIC capital requirements, the bank is also required to maintain a minimum leverage ratio. The ratio is determined by dividing Tier 1 capital by quarterly average total assets, less intangible assets and other adjustments. FDIC rules require a minimum of 3% for the highest rated banks. Banks experiencing high growth rates are expected to maintain capital positions well above minimum levels.

Depository institutions, such as the bank, are also subject to the prompt corrective action framework for capital adequacy established by FDICIA. Under FDICIA, the federal banking regulators are required to take prompt supervisory and regulatory actions against undercapitalized depository institutions. FDICIA establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. A well capitalized institution has a total capital to total risk-weighted assets ratio of at least 10%, a Tier 1 capital to total risk-weighted assets ratio of at least 6%, a leverage ratio of at least 5% and is not subject to any written order, agreement or directive; an adequately capitalized institution has a total capital to total risk-weighted assets ratio of at least 8%, a Tier 1 capital to total risk-weighted assets ratio of at least 4%, and a leverage ratio of at least 4% (3% percent if given the highest regulatory rating and not experiencing significant growth), but does not qualify as well capitalized. An undercapitalized institution fails to meet one of the three minimum capital requirements. A significantly undercapitalized institution has a total capital to total risk-weighted assets ratio of less than 6%, a Tier 1 capital to total risk-weighted assets ratio of less than 3%, and a leverage ratio of less than 3%. A critically undercapitalized institution has a ratio of tangible equity to assets of 2%, or less.

Under certain circumstances, a well capitalized , adequately capitalized or undercapitalized institution may be required to comply with supervisory actions as if the institution were in the next lowest category.

Failure to meet applicable minimum capital requirements, including a depository institution being classified as less than adequately capitalized within FDICIA's prompt corrective action framework, may subject a bank holding company or its subsidiary depository institution(s) to various enforcement actions, including substantial restrictions on operations and activities, dividend limitations, issuance of a directive to increase capital and, for a depository institution, termination of deposit insurance and the appointment of a conservator or receiver.

#### **Patents, Trademarks, etc.**

The company holds a number of registered service marks related to product names and corporate branding. The company holds no patents, registered trademarks, licenses (other than licenses required to be obtained from appropriate banking regulatory agencies), franchises or concessions which are material to its business.

#### **Employees**

At December 31, 2007, the company employed 286 full-time equivalent employees, including 104 officers. None of the company's employees are presently represented by a union or covered by a collective bargaining agreement. Management believes its employee relations to be excellent.

#### **Item 1A. Risk Factors**

An investment in the company's common stock is subject to a variety of risks and uncertainties. The material risks and uncertainties that management believes affect the company are described below. These risks and uncertainties are not listed in any particular order of priority and are not necessarily the only ones facing the company. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair the company's business and results of operations.

This report is qualified in its entirety by these risk factors.

If any of the following risks actually occur, the company's financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of the company's common stock could decline significantly, and shareholders could lose some or all of their investment.

*The Company Relies on Dividends From the Bank for Substantially All of its Revenue*





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The company is a separate and distinct legal entity from the bank. It receives substantially all of its revenue from dividends paid by the bank. These dividends are the principal source of funds used to pay dividends on the company's common stock and interest and principal on the company's subordinated debt. Various federal and state laws and regulations limit the amount of dividends that the bank may pay to the company. If the bank is unable to pay dividends to the company, then the company will be unable to service debt, pay obligations or pay dividends on the company's common stock. The inability to receive dividends from the bank could have a material adverse effect on the company's business, financial condition and results of operations.

*The Company May Be Impacted By Issues Associated With Sub-prime Mortgages*

As previously stated, the company has not and does not intend to originate mortgage loans that are considered sub-prime and the company has not purchased sub-prime mortgage-backed securities for the company's investment portfolio. However, what has been called the sub-prime mortgage crisis, referring to the recent dramatic increase in the level of foreclosures both locally and nationally and the failure of several large national mortgage brokers, may have far-reaching and as yet unknown long-term consequences in the financial services industry and the economy in general. The current crisis has been marked by the collapse of the market for sub-prime mortgage-backed securities, increased volatility in financial markets, the tightening of credit for both consumers and businesses, and further weakening of the real estate market. Any long-term continuation of these current trends or possible subsequent effects could weaken the local economy and negatively impact the company's financial condition and performance in a variety of ways even though the company itself has no direct exposure to sub-prime mortgages in either a lending or investment capacity. Among other potential adverse effects on the company that could result from the sub-prime mortgage crisis, the company could experience continued pressure on its net interest margin, deterioration in its asset quality and an increased level of delinquencies, an increase in the level of allowance for loan losses, decline in the value of the investment portfolio, and a decline in the market price of the company's common stock.

*The Company is Subject to Extensive Government Regulation and Supervision*



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The company is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not the interests of shareholders. These regulations affect the company's lending practices, capital structure, investment practices, dividend policy and growth, among other things. Federal and state statutes and related regulations, including tax policy and corporate governance rules, can significantly affect the way in which bank holding companies, and public companies in general, conduct business. Changes to federal or state statutes, regulations or regulatory and tax policies, including changes in interpretation or implementation of existing statutes, regulations or policies, could affect the company in substantial and unpredictable ways, including subjecting the company to additional operating and compliance costs, limiting the types of financial services and products the company may offer and/or increasing competition from other non-bank providers of financial services.

See the section entitled "Supervision and Regulation" contained in Item 1, "Business", for additional information regarding the supervisory and regulatory issues facing the company.

### *The Company Operates in a Highly Competitive Industry and Market Area*



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The company faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and have more financial resources than the company. These competitors include not only national, regional, and other community banks, but also various types of other non-bank financial institutions, such as credit unions, mortgage brokers, finance companies, brokerage firms, mutual fund companies, insurance companies, factoring companies and other financial intermediaries.

See the section entitled "Competition" contained in Item 1, "Business", for additional information regarding the competitive issues facing the company.





*The Company's Profitability Depends Significantly on Economic Conditions in the Company's Primary Market Areas*



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The company's success depends principally on the general economic conditions of the primary market areas in which the company operates. The local economic conditions in these areas have a significant impact on the demand for the company's products and services as well as the ability of the company's customers to repay loans, the value of the collateral securing loans and the stability of the company's deposit funding sources. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on the company's financial condition and results of operations.

*The Company is Subject to Interest Rate Risk*



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The company's earnings and cash flows are largely dependent upon its net interest income, meaning the difference between interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities. Interest rates are highly sensitive to many factors that are beyond the company's control. If the interest rates paid on interest-bearing liabilities increase at a faster rate than the interest rates received on loans and other investments, the company's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on interest-bearing liabilities.

See Item 7A, *Quantitative and Qualitative Disclosures About Market Risk*, for further discussions related to the company's management of interest rate risk.

*The Company is Subject to Lending Risk*



There are inherent risks associated with the company's lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the market areas in which the company operates. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans.

The company's loan portfolio consists primarily of commercial real estate, commercial and industrial and construction loans. These types of loans are generally viewed as having more risk of default than owner occupied residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. The underlying commercial real estate values, the actual costs necessary to complete a construction project, or customer cash flow and payment expectations on such loans can be more easily influenced by adverse conditions in the related industries, the real estate market or in the economy in general. Any significant deterioration in the company's commercial loan portfolio or underlying collateral values could have a material adverse effect on the company's financial condition and results of operations.

See the discussions contained in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, under the headings Loans and Credit Risk/Asset Quality included in the section entitled Financial Condition, for further information regarding the company's commercial loan portfolio and credit risk.





*The Company's Allowance for Loan Losses May Be Insufficient*



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The company maintains an allowance for loan losses, which is established through a provision for loan losses charged to earnings that represents management's estimate of probable losses that have been incurred within the existing portfolio of loans. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires the company to make significant estimates of current credit risks and future trends, all of which may undergo material changes. In addition, bank regulatory agencies periodically review the company's allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of the company's management. Any increases in the allowance for loan losses will result in a decrease in net income and, depending upon the magnitude of the changes, could have a material adverse effect on the company's financial condition and results of operations.

See the discussions contained in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, under the headings *Credit Risk/Asset Quality* and *Allowance for Loan Losses*, included in the section entitled *Financial Condition*, and under the heading *Allowance for Loan Losses*, which is contained in the *Critical Accounting Estimates* section of Item 7, for further information regarding the process by which the company determines the appropriate level of its allowance for loan losses.

### *The Company's Investment Portfolio May Incur Losses*

There are inherent risks associated with the company's investment activities. These risks include the impact of changes in interest rates, weakness in the real estate or other industries, adverse changes in regional or national economic conditions, and general turbulence in domestic and foreign financial markets, among other things. These conditions could adversely impact the fair market value and the ultimate collectability of the company's investments. Should an investment be deemed other than temporarily impaired, the company would be required to write-down the carrying value of the investment through earnings. Such write-down(s) may have a material adverse effect on the company's financial condition and results of operations.

### *Increased Reliance on Borrowings and Brokered CDs as Sources of Funds Could Adversely Affect the Company's Profitability*



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The company has traditionally obtained funds principally through deposits and borrowings. As a general matter, deposits are a lower cost source of funds than external funding (brokered CD s or borrowings), because interest rates paid for deposits are typically less than interest rates charged for external funding. If, as result of competitive pressures, market interest rates, general economic conditions or other events, the balance of the company s deposits decreases relative to the company s overall banking operations, the company may have to rely more heavily on external funding in the future. Any such increased reliance on external funding could have a negative impact on the company s net interest income and, consequently, on its results of operations and financial condition.

### *The Company Continually Encounters Technological Change*



The banking industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Many of the company's competitors have substantially greater resources to invest in technological improvements. Failure to successfully keep pace with technological change affecting the banking industry could have a material adverse effect on the company's business and, in turn, the company's financial condition and results of operations.





*The Company's Information Systems May Experience an Interruption or Breach in Security*



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The company relies heavily on communications and information systems to conduct its business. The occurrence of any failures, interruptions or security breaches of the company's information systems could interrupt the company's ability to conduct business, process transactions, damage the company's reputation, result in a loss of customer business, expose customer's personal information to unauthorized parties, subject the company to additional regulatory scrutiny, and expose the company to civil litigation and possible financial liability, any of which could have a material adverse effect on the company's financial condition and results of operations.

See the discussion under the heading "Opportunities and Risks" included in the section entitled "Overview", which is contained in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations", for further information regarding the company's information security and technology practices.

### *The Company Relies on Independent Service Providers*



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The company relies on independent firms to provide key services necessary to conducting its business. These services include, but are not limited to: electronic funds delivery networks; electronic banking services; investment advisory, management and custodial services; correspondent banking services; information security assessments; and loan underwriting and review services. The occurrence of any failures, interruptions or security breaches of the independent firms' systems or in their delivery of services, could result in a loss of customer business, expose customer's personal information to unauthorized parties, damage the company's reputation and expose the company to civil litigation and possible financial liability, any of which could have a material adverse effect on the company's financial condition and results of operations.

### *The Company's Controls and Procedures May Fail or Be Circumvented*



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Management regularly reviews and updates the company's internal controls over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, 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 system are met. Any failure or circumvention of the company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the company's business, results of operations and financial condition.

*Slower than Expected Growth in New Branches and New Products and Services Could Adversely Affect the Company's Profitability*





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The company has placed a strategic emphasis on expanding the bank's branch network and products and service offerings. Executing this strategy carries risks of slower than anticipated growth both in new branches and new products and services. New branches and new products and services require a significant investment of both financial and personnel resources. Lower than expected loan and deposit growth in new branches and/or lower than expected fee or other income from new products and services could decrease anticipated revenues and net income generated by such investments. Opening new branches and introducing new products and services could also divert resources from current core operations and thereby further adversely affect the company's growth and profitability.

### *Growth Strategies Involving Acquisitions Could Adversely Affect the Company's Profitability*

The company may in the future explore growth opportunities through acquisition of other banks, financial services companies or lines of their business. Any future acquisition could adversely affect the company's profitability based on management's ability to successfully complete the acquisition and integrate the acquired business.



*The Company May Not be Able to Attract and Retain Key Personnel*



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The company's success depends, in large part, on its ability to attract and retain key personnel. Competition for the best people in most activities engaged in by the company can be intense and the company may not be able to hire or retain the key personnel that it depends upon for success. The unexpected loss of services of one or more of the company's key personnel could have a material adverse impact on the company's business because of their skills, knowledge of the company's market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

### *Directors and Executive Officers Own a Significant Portion of Common Stock*



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The company's directors and executive officers as a group beneficially own approximately 28% of the company's outstanding common stock as of December 31, 2007. As a result of this combined ownership interest, the directors and executive officers have the ability, if they vote their shares in a like manner, to significantly influence the outcome of all matters submitted to shareholders for approval, including the election of directors.

*Shareholder Dilution May Occur if Additional Stock is Issued in the Future*





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If the company's board of directors should determine in the future that there is a need to obtain additional capital through the issuance of additional shares of the company's common stock or securities convertible into shares of common stock, such issuances could result in dilution to existing shareholders' ownership interest. Similarly, if the board of directors decides to grant additional restricted stock shares or options for the purchase of shares of common stock, the issuance of such additional restricted stock shares and/or the issuance of additional shares upon the exercise of such options may expose shareholders to dilution.

### *The Trading Volume in the Company's Common Stock is Less Than That of Larger Companies*

Although the company's common stock is listed for trading on the NASDAQ Global Market, the trading volume in the company's common stock is substantially less than that of larger companies. Given the lower trading volume of the company's common stock, significant purchases or sales of the company's common stock, or the expectation of such purchases or sales, could cause significant swings up or down in the company's stock price.

### *The Market Price of the Company's Common Stock May be Affected by General Industry Issues*

The banking industry may be more affected than other industries by certain economic, credit or information security issues. Although the company itself may or may not be directly impacted by such issues, the company's stock price may swing up or down due to the influence, both real and perceived, of these issues on the banking industry in general.

### *The Company's Articles Of Organization, By-Laws and Shareholders Rights Plan as Well as Certain Banking Laws May Have an Anti-Takeover Effect*



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Provisions of the company's articles of organization and by-laws, its shareholders rights plan and certain federal and state banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire the company, even if doing so would be perceived to be beneficial to the company's shareholders. The combination of these provisions effectively inhibits a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of the company's common stock.

### *Additional Factors Described Elsewhere in This Report*



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In addition to the factors listed above in this section, additional important factors that could adversely affect the results of the company's future operations are described below under the heading "Special Note Regarding Forward-Looking Statements" contained in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

**Item 1B.** Unresolved Staff Comments

None.

**Item 2. Properties**

The company conducts its business from its main office and operational support and lending offices in Lowell, Massachusetts. The company currently has fourteen full service branch banking offices serving the Merrimack Valley and North Central regions of Massachusetts and South Central New Hampshire, with two additional locations in the planning or construction phase. The company is obligated under various non-cancelable operating leases, most of which provide for periodic adjustments. The company believes that all its facilities are well maintained and suitable for the purpose for which they are used.

The following table sets forth general information related to facilities owned or used by the company as of December 31, 2007. All locations are in Massachusetts unless otherwise noted.

<b>BRANCH LOCATION</b>	<b>OWNED OR LEASED</b>
Andover 6-8 High Street	Leased
Billerica 674 Boston Road	Owned
Chelmsford 20 Drum Hill Road 185 Littleton Road	Owned Owned
Dracut 1168 Lakeview Avenue	Leased
Fitchburg 420 John Fitch Highway	Leased
Leominster 4 Central Street(1)	Leased
Lowell 430-434 Gorham Street 222 Merrimack Street (Main Office)	Leased Leased
North Billerica 223 Boston Road	Owned
Salem, NH 130 Main Street	Leased
Tewksbury 910 Andover Street 1120 Main Street	Leased Leased
Westford 237 Littleton Road	Owned
<b>OPERATION/LENDING OFFICES</b>	
Lowell 170 Merrimack Street(2) 21-27 Palmer Street(2)	Owned Owned
<b>PLANNED BRANCH LOCATION</b>	

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Methuen	
255 Broadway Street	Owned
Derry, NH(3)	
47 Crystal Avenue	Leased

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(1) The company has the option to purchase this facility on the last day of the basic term or at any time during any extended term at the price of \$550 thousand as adjusted for increases in the producer's price index.

(2) The company purchased these facilities, which had formerly been leased, in September 2007.

(3) The company entered into this lease on January 1, 2008.

Note: In addition to the above properties, through August 2007 the company leased a facility at 63 Park St in Andover. This temporary location housed the Andover branch prior to the opening of the permanent 6-8 High St. location in December, 2006. The lease expired in August 2007 and was not renewed.

See note 4, Premises and Equipment and note 12, Related Party Transactions to the consolidated financial statements in Item 8 below, for further information regarding the company's lease obligations and the 2007 purchase of the operation/lending offices listed above, respectively.

**Item 3.** Legal Proceedings

The company is involved in various legal proceedings incidental to its business. Management does not believe resolution of any present litigation will have a material adverse effect on the financial condition of the company.

**Item 4.** Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders during the quarter ended December 31, 2007.

**PART II****Item 5.** Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*Market for Common Stock*

In February 2005, the company's shares began trading on the NASDAQ National Market (now the NASDAQ Global Market) under the trading symbol EBTC. Prior to that date, there was no active trading market for the company's common stock, although shares were traded periodically on a privately negotiated basis. The company cannot state with certainty the sales price at which such privately negotiated transactions occurred. The following table sets forth sales volume and price information, to the best of management's knowledge, for the common stock of the company for the periods indicated.

Fiscal Year	Trading Volume	Share Price High	Share Price Low
2007:			
4th Quarter	72,061	\$ 14.89	\$ 12.00
3rd Quarter	82,731	16.00	12.42
2nd Quarter	142,138	16.39	15.06
1st Quarter	115,074	16.84	15.17
2006:			
4th Quarter	114,460	\$ 16.99	\$ 15.25
3rd Quarter	68,485	21.00	15.10
2nd Quarter	97,886	17.82	15.10
1st Quarter	119,230	17.31	15.26



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As of March 10, 2008, there were 721 registered shareholders of the company's common stock and 7,955,011 shares of the company's common stock outstanding.

On June 30, 2006, the company issued 3,842,015 shares in a two-for-one stock split paid in the form of a stock dividend. All share and per share amounts have been retroactively adjusted to reflect the stock dividend for all periods presented.

### *Dividends*

In 2007, quarterly dividends of \$0.08 per share were paid in March, June, September and December. Total 2007 dividends of \$0.32 per share represented an increase of 14% compared to total dividends of \$0.28 also paid on a quarterly basis in 2006.

The company maintains a dividend reinvestment plan (the "DRP"). The DRP enables stockholders, at their discretion, to elect to reinvest dividends paid on their shares of the company's common stock by purchasing additional shares of common stock from the company at a purchase price equal to fair market value. Shareholders utilized the DRP to reinvest \$1.1 million, of the \$2.5 million dividends paid by the company in 2007, into 70,675 shares of the company's common stock.

On January 15, 2008, the company announced a quarterly dividend of \$0.09, paid on March 3, 2008 to shareholders of record as of February 11, 2008. On an annualized basis, this quarterly dividend represents a 12.5% increase over the 2007 dividend rate.

As the principal asset of the company, the bank currently provides the only source of cash for the payment of dividends by the company. Under Massachusetts law, trust companies such as the bank may pay dividends only out of net profits and only to the extent that such payments will not impair the bank's capital stock. Any dividend payment that would exceed the total of the bank's net profits for the current year plus its retained net profits of the preceding two years would require the Commissioner's approval. FDICIA also prohibits a bank from paying any dividends on its capital stock if the bank is in default on the payment of any assessment to the FDIC or if the payment of dividends would otherwise cause the bank to become undercapitalized. These restrictions on the ability of the bank to pay dividends to the company may restrict the ability of the company to pay dividends to the holders of its common stock.

The statutory term net profits essentially equates with the accounting term net income and is defined under the Massachusetts banking statutes to mean the remainder of all earnings from current operations plus actual recoveries on loans and investments and other assets after deducting from such total all current operating expenses, actual losses, accrued dividends on any preferred stock and all federal and state taxes.

*Securities Authorized for Issuance under Equity Compensation Plans*



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The following table provides information as of December 31, 2007 with respect to the company's Amended and Restated 1998 Stock Incentive Plan and 2003 Stock Incentive Plan, as amended, which together constitute all of the company's existing equity compensation plans that have been previously approved by the company's stockholders. The company does not have any existing equity compensation plans, including any existing individual equity compensation arrangements, which have not been previously approved by the company's stockholders.

Plan Category	Number of Securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of Securities remaining available for future issuance under equity compensation plans (excluding securities reflected in second column from left)
Equity compensation plans approved by security holders	671,418 \$	13.89	329,168
Equity compensation plans not approved by security holders	0	0	0
<b>TOTAL</b>	<b>671,418 \$</b>	<b>13.89</b>	<b>329,168</b>

**Performance Graph**

The following graph compares the cumulative total return (which assumes the reinvestment of all dividends) on the company's common stock with the cumulative total return reflected by a broad based equity market index and an appropriate published industry index. This graph shows the changes over the five-year period ended on December 31, 2007 in the value of \$100 invested in (i) the company's common stock, (ii) the Standard & Poors 500 Index and (iii) the NASDAQ Bank Index. As of February 14, 2005, the company's shares began trading on the NASDAQ National Market (now the NASDAQ Global Market) under the trading symbol EBTC. Prior to February 14, 2005, there was no active trading market for the company's common stock, although shares were traded periodically on a privately negotiated basis. For each year prior to 2005 shown on the graph, the increase in the value of the company's common stock is based on the actual prices known to the company at which shares of the common stock were traded as of the most recent date prior to December 31 of each of these earlier periods. For purposes of the graph, the reinvestment of dividends paid prior to 2005 is based upon the annual valuation analysis of the company's common stock that was formerly undertaken in the years prior to the company's listing on the NASDAQ National Market pursuant to the company's administration of its dividend reinvestment plan.

	2002	2003	2004	2005	2006	2007
Enterprise Bancorp	\$ 100.00	\$ 120.00	\$ 147.38	\$ 147.91	\$ 155.80	\$ 125.01
S&P 500	\$ 100.00	\$ 128.68	\$ 142.68	\$ 149.69	\$ 173.33	\$ 182.85
NASDAQ Bank	\$ 100.00	\$ 133.04	\$ 151.23	\$ 148.30	\$ 168.80	\$ 135.19

*Sales of Unregistered Securities and Repurchases of Shares*

The company has not sold any equity securities that were not registered under the Securities Exchange Act of 1934 during the year ended December 31, 2007. Neither the company nor any affiliated purchaser (as defined in the SEC's Rule 10b-18(a)(3)) has repurchased any of the company's outstanding shares, nor caused any such shares to be repurchased on its behalf, during the fiscal quarter ended December 31, 2007.

## Item 6. Selected Financial Data

(Dollars in thousands, except per share data)	Year Ended December 31,				
	2007	2006	2005	2004	2003
<b>EARNINGS DATA</b>					
Net interest income	\$ 40,679	\$ 41,560	\$ 38,102	\$ 32,120	\$ 28,352
Provision for loan losses	1,000	1,259	1,135	1,650	1,075
Net interest income after provision for loan losses	39,679	40,301	36,967	30,470	27,277
Non-interest income	8,453	7,020	6,244	6,071	6,580
Net gains (losses) on sales of investment securities	1,655	(204)	191	906	2,150
Non-interest expense	34,844	32,540	30,235	25,687	23,342
Income before income taxes	14,943	14,577	13,167	11,760	12,665
Income tax expense	5,045	5,343	4,753	4,253	5,720
Net income	\$ 9,898	\$ 9,234	\$ 8,414	\$ 7,507	\$ 6,945

**COMMON SHARE DATA**

Basic earnings per share	\$ 1.27	\$ 1.21	\$ 1.13	\$ 1.03	\$ 0.97
Diluted earnings per share	1.25	1.18	1.09	0.99	0.94
Book value per share at year end	11.00	9.98	8.93	8.36	7.60
Dividends paid per share	\$ 0.320	\$ 0.280	\$ 0.240	\$ 0.215	\$ 0.190
Basic weighted average shares outstanding	7,819,160	7,661,178	7,468,498	7,294,760	7,131,504
Diluted weighted average shares outstanding	7,913,006	7,821,297	7,690,526	7,613,196	7,424,770

**YEAR END BALANCE SHEET AND OTHER DATA**

Total assets	\$ 1,057,666	\$ 979,259	\$ 918,477	\$ 848,171	\$ 751,545
Loans serviced for others	20,826	21,659	22,938	35,067	27,474
Investment assets under management	573,608	502,059	424,953	363,250	375,297
Total assets under management	\$ 1,652,100	\$ 1,502,977	\$ 1,366,368	\$ 1,246,488	\$ 1,154,316
Total loans	\$ 833,819	\$ 761,113	\$ 699,726	\$ 570,459	\$ 488,839
Allowance for loan losses	13,545	12,940	12,050	10,923	9,986
Investment securities at fair value	145,517	131,540	156,521	187,601	196,308
Total short-term investments	7,788	15,304	5,431	40,290	14,000
Deposits	868,786	867,522	775,387	768,644	660,824
Borrowed funds	81,429	15,105	58,639	3,651	21,424
Junior subordinated debentures	10,825	10,825	10,825	10,825	10,825
Total stockholders' equity	87,012	77,043	67,830	61,684	54,750

**RATIOS**

Return on average total assets	0.99%	0.98%	0.97%	0.95%	0.96%
Return on average stockholders' equity	12.11%	12.89%	13.10%	12.99%	13.52%
Allowance for loan losses to total loans	1.62%	1.70%	1.72%	1.91%	2.04%
Stockholders' equity to total assets	8.23%	7.87%	7.39%	7.27%	7.28%
Dividend payout ratio	25.20%	23.14%	21.24%	20.87%	19.59%





**Item 7.** 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 Item 8, the information contained in the description of the company's business in Item 1 and other financial and statistical information contained in this annual report.

**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 1 Business, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 7A

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 reserve 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 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 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 above in Item 1A 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.

## **Critical Accounting Estimates**

The company's significant accounting policies are described in note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements contained in Item 8. In applying these accounting policies, management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. Certain of the critical accounting estimates are more dependent on such judgment and in some cases may contribute to volatility in the company's reported financial performance should the assumptions and estimates used change over time due to changes in circumstances. The two most significant areas in which management applies critical assumptions and estimates include the areas described further below.

### *Allowance for Loan Losses*

The allowance for loan losses is an estimate of credit losses inherent in the loan portfolio. The company's allowance is accounted for in accordance with SFAS No. 114, as amended by SFAS No. 118, *Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures*, and SFAS No. 5, *Accounting for Contingencies*. 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. 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.

The company uses a systematic process to measure the amount of estimated loan loss exposure inherent in the portfolio for purposes of establishing a sufficient allowance for loan losses. The methodology makes use of specific reserves for loans individually evaluated and deemed impaired and general reserves for larger groups of homogeneous loans which rely on a combination of qualitative and quantitative factors that could have an impact on the credit quality of the portfolio.

Arriving at an appropriate level of allowance for loan losses involves a high degree of management judgment. The adequacy of the allowance for loan losses is reviewed and evaluated on a regular basis by an internal management committee, a sub-committee of the board of directors and the full board itself.

Management believes that the allowance for loan losses is adequate to absorb reasonably anticipated losses from specifically known and other credit risks associated with the loan portfolio as of the balance sheet dates. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the company's allowance for loan losses. Such agencies may require the company to recognize additions to the allowance based on judgments different from those of management.

Management's assessment of the adequacy of the allowance for loan losses is contained under the headings *Credit Risk/Asset Quality* and *Allowance for Loan Losses*, which are contained in the *Financial Condition* section of this Item 7.

*Impairment Review of Goodwill and Other Intangible Assets*

In accordance with generally accepted accounting principles, the company does not amortize goodwill and instead, at least annually, evaluates whether the carrying value of goodwill has become impaired. Impairment of the goodwill occurs when the estimated fair value of the company is less than its recorded value. A determination that goodwill has become impaired results in immediate write-down of goodwill to its determined value with a resulting charge to operations.

The annual impairment test is a two-step process used to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized, if any. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of the reporting unit (in this case, the company) with its carrying amount, or the book value of the reporting unit, including goodwill. If the fair value of the reporting unit equals or exceeds its book value, goodwill is considered not impaired, and the second step of the impairment test is unnecessary. The second step, if necessary, measures the amount of goodwill impairment loss to be recognized. The reporting unit must determine fair values for all assets and liabilities, excluding goodwill. The net of the assigned fair value of assets and liabilities is then compared to the book value of the reporting unit, and any excess book value becomes the implied fair value of goodwill. If the carrying amount of the goodwill exceeds the newly calculated implied fair value of that goodwill, an impairment loss is recognized in the amount required to write down the goodwill to the implied fair value.

The company's consolidated financial statements also include intangible assets (core deposit intangibles), which are amortized to expense over their estimated useful life of ten years and reviewed for impairment on an ongoing basis or whenever events or changes in business circumstances warrant a review of the carrying value. If impairment is determined to exist, the related write-down of the intangible asset's carrying value is charged to operations.

Based on these impairment reviews the company determined that goodwill and core deposit intangible assets were not impaired at December 31, 2007.

## **Overview**

### *Summary*

Over the past two years, the flat interest rate environment and the competitive marketplace has negatively impacted margins and challenged growth and earnings throughout the banking industry. At Enterprise Bancorp, Inc., this environment has contributed to a slight decline in low cost deposit balances and continued pressure on the company's net interest margin from rising funding costs. Despite these economic and industry issues, the company reported net income growth through December 31, 2007, of 7% for both the year-to-date and quarter-to-date results.

### *Composition of Earnings*

The company had net income of \$9.898 million for the year ended December 31, 2007 compared to \$9.234 million during the year ended December 31, 2006, an increase of 7%. Diluted earnings per share were \$1.25 for the year compared to \$1.18 for 2006, an increase of 6%.

Net income for the fourth quarter ended December 31, 2007 amounted to \$2.735 million compared to \$2.545 million for the same period in 2006, an increase of 7%. Diluted earnings per share were \$0.34 for the quarter ended December 31, 2007 compared to \$0.32 for the same period in 2006, an increase of 6%.

The company's year-to-date net income growth resulted primarily from increases in non-interest income and a decrease in the provision for loan losses, partially offset by increases in non-interest expense and a decrease in net interest income. 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). Tax equivalent net interest income expressed as a percentage of average interest earning assets is referred to as net interest margin ( margin ).

Net interest income for the year ended December 31, 2007 amounted to \$40.7 million compared to \$41.6 million for the year ended December 31, 2006, a decrease of 2%. The decrease was primarily due to a decline in net interest margin as discussed below, partially offset by an increase in interest income, due to an increase in average loan balances.

Net interest margin was 4.45% for the year ended December 31, 2007 compared to 4.78% for 2006. From a quarterly trend perspective, net interest margin was 4.33% for the three months ended December 31, 2007 compared to 4.40% and 4.74% for the three-month periods ended September 30, 2007 and December 31, 2006. The overall decrease in margin through 2007 resulted primarily from both the flat yield curve environment and rising funding costs, caused by the shift in funding from low-cost deposits to higher cost deposits, and the continued loan growth funded by higher cost brokered CD's and borrowings. In late 2007 and early 2008 the interest rate environment has shifted and the company has begun to experience aspects of a declining yield curve environment. Rates on earning assets have repriced downward, while rates on borrowing and deposits have declined at a slower pace due to market conditions. As such, net interest margin compression may continue into 2008.

Non-interest income for the year ended December 31, 2007 was \$10.1 million, an increase of \$3.3 million, or 48%, over the prior year. Included in non-interest income were net gains on sales of investment securities of \$1.7 million in the current year, compared to net losses of \$204 thousand in 2006. In the fourth quarter of 2007, the company realized net gains on sales of investment securities of \$786 thousand. Non-interest income, excluding net gains/losses on investment securities increased \$1.4 million, or 20%, over the prior year. This growth resulted primarily from increases in deposit-service fees and investment-advisory fees compared to the prior year.

Non-interest expense for the year ended December 31, 2007 amounted to \$34.8 million, an increase of 7%, compared to \$32.5 million for the year ended December 31, 2006. The increases over the prior year were predominantly in salaries and employee benefits and occupancy expenses which reflected the strategic and operational costs necessary to support the company's continued growth.

The provision for loan losses, which is impacted by asset quality and loan growth, amounted to \$1.0 million for the year compared to \$1.3 million in 2006. The provision for loan losses increased to \$650 thousand in the fourth quarter of 2007 as compared to \$367 thousand in the fourth quarter of 2006 due to loan growth. Asset quality remained favorable during the year with net charge-offs of only 0.05% of average total loans, or \$395 thousand compared to \$369 thousand in the prior year. The allowance for loan losses to total loans ratio was 1.62% at December 31, 2007 compared to 1.70% at December 31, 2006.

### ***Sources and Uses of Funds***

The company's primary sources of funds are deposits, brokered CD's, FHLB borrowings, repurchase agreements, current earnings and proceeds from the sales, maturities and paydowns on loans and investment securities. The company uses funds to originate loans, purchase investment securities, conduct operations, expand the branch network, and pay dividends to shareholders.

Total assets amounted to \$1.058 billion at December 31, 2007, an increase of 8% since December 31, 2006. The company's core asset strategy is to grow loans, primarily commercial loans. Total loans increased 10% since December 31, 2006 and amounted to \$833.8 million, or 79% of

total assets. Commercial loans increased 9% over the prior year and amounted to \$707.9 million, or 85% of the total loan portfolio at December 31, 2007.

The investment portfolio is the other key component of the company's earning assets and is primarily used to invest excess funds, provide liquidity and to manage the company's asset-liability position. The fair value of total investments amounted to \$145.5 million at December 31, 2007, or 14% of total assets. The carrying value of the portfolio has increased 11% since December 31, 2006 due primarily to purchases of municipal and agency CMO/MBS securities, offset by sales, principal paydowns and maturities during the period.

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 (certificates of deposit, money market accounts and investment savings products), brokered CD's, repurchase agreements, FHLB borrowings, and investment portfolio cash flow.

The current environment has continued to impact the company's ability to generate growth in lower costing deposits and therefore the company has continued to utilize brokered CD's and FHLB borrowings as alternative funding sources to support asset growth.

At December 31, 2007, total deposits, which included brokered CDs, amounted to \$868.8 million, representing \$1.3 million, or 0.1%, growth over December 31, 2006 balances. Total deposits, excluding brokered CDs, amounted to \$798.1 million at December 31, 2007, representing a decline of \$4.5 million, or 0.6% since December 31, 2006, compared to an increase of \$37.2 million, or 5%, for 2006 over 2005.

At December 31, 2007, the company had \$70.7 million in brokered CDs and \$73.2 million in FHLB borrowings outstanding compared to \$64.9 million and \$10.3 million, respectively, at December 31, 2006.

### *Opportunities and Risks*

Management remains committed to a long-term strategy of geographic market expansion and commercial banking growth. The company's primary market is the Merrimack Valley and North Central regions of Massachusetts and the South Central region of New Hampshire. Management recognizes that substantial competition exists in the marketplace and views this as a key business risk. Market competition includes the expanded commercial lending capabilities of credit unions, the shift to commercial lending by traditional savings banks, the presence of large regional and national commercial banks, and the products offered by non-bank financial services competitors.

Management continually strives to differentiate the company and provide a unique customer experience through highly competitive commercial banking, investment, and insurance products delivered through consistent, responsive and personal service based on an understanding of the financial service needs of its customers. Management believes the company's business model, strong service culture, skilled management team and brand name create opportunities for the company to be the leading provider of banking and investment management services in its growing market area.

Despite these competitive challenges, the company has been successful in growing its commercial banking base and its investment advisory and management services. Management believes this growth is the result of ongoing business development efforts and continued market expansion within existing and into new markets. The company has fourteen branch locations; its fifteenth branch facility is currently under construction in



the city of Methuen, Massachusetts and is expected to open in the spring of 2008. The company is also currently in the process of obtaining regulatory approvals to establish a branch to be located in the southern New Hampshire town of Derry, which will be the company's second New Hampshire branch office and is anticipated to open in early 2009. The company continues to look for market and branch opportunities that will increase long-term franchise value and shareholder returns. Such expansion typically increases the company's operating expenses, primarily in salary and benefits, marketing, and occupancy, before the growth benefits are fully realized in those markets.

In addition to competition and growth, the company's significant challenges continue to be the effective management of *interest rate*, *credit* 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 7A, Quantitative and Qualitative Disclosures About Market Risk.

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 7 under the headings Credit Risk/Asset Quality and Allowance for Loan Losses.

*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, and business continuity.

Management utilizes a combination of third party security assessments, key technologies and ongoing internal evaluations in order to protect non-public customer 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 security assessments on the company's systems on a regular basis. These third parties test the company's network configuration and security controls, and assess internal practices aimed at protecting the company's operating systems. In addition, the company contracts with an outside service provider to monitor usage patterns and identify unusual activity on bank issued debit/ATM cards. The company also utilizes firewall technology and an intrusion detection system to protect against unauthorized access and commercial software that continuously scans for computer viruses on the company's information systems.

The company has a Business Continuity Plan that 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 establishes responsibility for assessing a disruption of business, contains alternative strategies for the continuance of critical business functions, assigns responsibility for restoring services, and sets priorities by which critical services will be restored.

See Item 1A. Risk Factors for additional factors that could adversely affect the company's future results of operations and financial condition.

### **Financial Condition**

Total assets increased \$78.4 million, or 8%, over the prior year, amounting to \$1.058 billion at December 31, 2007. The increase was primarily attributable to an increase in total loans.

*Loans*

Total loans increased \$72.7 million, or 10%, and amounted to 79% of total assets at December 31, 2007, compared with 78% of total assets, at December 31, 2006. The company attributes the increase to its seasoned lending team, the company's sales and service culture and geographic expansion. The mix of loans within the company's portfolio remained relatively unchanged with commercial loans amounting to approximately 85% of total loans, reflecting the company's continued focus on commercial loan development.

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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)	2007		2006		December 31, 2005		2004		2003	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Comm l real estate	\$ 406,410	48.7%	\$ 368,621	48.3%	\$ 326,963	46.6%	\$ 257,657	45.1%	\$ 224,450	45.8%
Comm l & industrial	188,866	22.6%	164,865	21.6%	165,982	23.7%	142,909	25.0%	132,313	27.0%
Comm l construction	112,671	13.5%	114,078	15.0%	108,048	15.4%	80,597	14.1%	50,699	10.3%
Total Commercial	707,947	84.8%	647,564	84.9%	600,993	85.7%	481,163	84.2%	407,462	83.1%
Residential mortgages	73,933	8.9%	61,854	8.1%	47,207	6.7%	40,654	7.1%	39,465	8.0%
Resid construction	4,120	0.5%	3,981	0.5%	4,154	0.6%	2,848	0.5%	3,488	0.8%
Home equity	44,292	5.3%	44,038	5.8%	44,444	6.4%	42,823	7.5%	35,139	7.2%
Consumer	4,493	0.5%	4,307	0.6%	3,986	0.6%	4,139	0.7%	4,558	0.9%
Loans held for sale	268	0.0%	549	0.1%	267	0.0%	101	0.0%	262	0.0%
Gross loans	835,053	100.0%	762,293	100.0%	701,051	100.0%	571,728	100.0%	490,374	100.0%
Deferred fees, net	(1,234)		(1,180)		(1,325)		(1,269)		(1,535)	
Total loans	833,819		761,113		699,726		570,459		488,839	
Allowance for loan losses	(13,545)		(12,940)		(12,050)		(10,923)		(9,986)	
Net loans	\$ 820,274		\$ 748,173		\$ 687,676		\$ 559,536		\$ 478,853	

The following table sets forth the scheduled maturities of commercial real estate, commercial & industrial and commercial construction loans in the company's portfolio at December 31, 2007. The table also sets forth the dollar amount of loans which are scheduled to mature after one year which have fixed or adjustable rates.

(Dollars in thousands)	Commercial real estate	Commercial & industrial	Commercial construction
Amounts due:			
One year or less	\$ 25,165	\$ 86,508	\$ 70,041
After one year through five years	14,515	51,664	27,199
Beyond five years	366,730	50,694	15,431
	\$ 406,410	\$ 188,866	\$ 112,671
Interest rate terms on amounts due after one year:			
Fixed	\$ 24,307	\$ 43,292	\$ 5,955
Adjustable	356,938	59,066	36,675

Scheduled contractual maturities may not reflect the actual maturities of loans. The average maturity of loans may be shorter than their contractual terms principally due to prepayments.

During 2007, commercial real estate loans increased \$37.8 million, or 10%. Commercial real estate loans are typically secured by apartment buildings, office or mixed-use facilities, strip shopping malls or other commercial property.

Commercial and industrial loans increased by \$24.0 million, or 15%, since December 31, 2006. These loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), term loans, and revolving lines of credit. Also included in commercial and industrial loans are loans under various U.S. Small Business Administration programs.

Commercial construction loans decreased slightly year over year, by \$1.4 million, or 1%. 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.

Residential real estate loans, residential construction and home equity mortgages combined, increased by \$12.5 million, or 11%, and consumer loans increased \$186 thousand or 4% since December 31, 2006.

At December 31, 2007 the company had commercial loan balances participated out to various banks amounting to \$6.8 million, compared to \$8.2 million at December 31, 2006. These 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 at the company's prorata share of ownership and amounted to \$13.9 million and \$18.3 million at December 31, 2007 and 2006, respectively.

### ***Credit Risk/Asset Quality***

Inherent in the lending process is the risk of loss. The company's primary lending focus is on the development of high quality commercial real estate, commercial construction and commercial and industrial lending relationships with business entities, non-profit organizations, professionals and individuals. However, commercial lending may entail significant additional risks compared to long term financing on existing owner occupied residential real estate. Commercial loan size is typically larger and the underlying collateral values, the actual cost necessary to complete a project or customer cash flow and payment expectations on such loans can be more easily influenced by adverse conditions in the related industries, the real estate market or in the economy in general. 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.

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.

On a quarterly basis, the company prepares an estimate of the necessary reserves. Except for loans specifically identified as impaired, 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 quantitative and qualitative factors identified above.

The 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 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 bank 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 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 for real estate loans and generally sixty days for all other loans, 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 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.

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 groups may include residential mortgage loans and consumer loans, that are collectively evaluated for impairment, loans that are measured at fair value and leases as defined in SFAS No. 114.

Loans are designated as restructured 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. Restructured loans are generally included in the impaired loan category.

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 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 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, accruing loans that are more than 90 days past due but still accruing interest 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. Despite prudent loan underwriting, adverse changes within the bank's market area, or deterioration in local, regional or national economic conditions, could negatively impact the company's level of non-performing assets in the future.





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The following table sets forth information regarding non-performing assets, restructured loans and delinquent loans 60-89 days past due as to interest or principal, held by the company at the dates indicated:

(Dollars in thousands)	2007	2006	December 31, 2005	2004	2003
Non-accrual loans	\$ 3,956	\$ 1,785	\$ 1,475	\$ 2,140	\$ 2,983
Accruing loans > 90 days past due		7	1		
Total non-performing loans	3,956	1,792	1,476	2,140	2,983
Other real estate owned	200				
Total non-performing assets	\$ 4,156	\$ 1,792	\$ 1,476	\$ 2,140	\$ 2,983
<b>Total Loans</b>	<b>\$ 833,819</b>	<b>\$ 761,113</b>	<b>\$ 699,726</b>	<b>\$ 570,459</b>	<b>\$ 488,839</b>
Accruing restructured loans not included above	76	128	82	26	2,370
Delinquent loans 60-89 days past due	275	964	59	404	83
Non-performing loans to total loans	0.47%	0.24%	0.21%	0.38%	0.61%
Non-performing assets to total assets	0.39%	0.18%	0.16%	0.25%	0.40%
Loans 60-89 days past due to total loans	0.03%	0.13%	0.01%	0.07%	0.02%
Adversely Classified loans to total loans	0.76%	0.88%	0.77%	1.55%	1.25%

At December 31, 2007, the company had adversely classified loans (loans carrying substandard or doubtful classifications) amounting to \$6.3 million, compared to \$6.7 million at December 31, 2006. Included in these classified balances were \$3.6 million and \$1.4 million of non-performing loans at December 31, 2007 and 2006, respectively. The remaining balances of adversely classified loans were performing but possessed potential weaknesses and, as a result, could ultimately become non-performing loans.

The \$2.2 million net increase in total non-performing loans, and the resulting increase in the ratio of non-performing loans as a percentage of total loans outstanding, was due primarily to loans added to non-accrual status within the commercial real estate portfolio. The majority of this increase was due to four commercial relationships amounting to approximately \$1.9 million as of December 31, 2007. These non-accrual relationships were adequately supported by the value of the underlying property and management expects that all principal advanced will ultimately be collected. One of these relationships, with a carrying amount of approximately \$475 thousand, was subsequently fully paid in February 2008.

Impaired loans included in non-accrual balances were \$3.9 million and \$1.7 million as of December 31, 2007 and 2006, respectively. The increase since December 2006 was mainly due to the addition of the four relationships referred to above. Accruing impaired loans amounted to \$75 thousand and \$80 thousand at December 31, 2007 and 2006, respectively. In the opinion of management, impaired loans totaling \$195 thousand required specific reserve allocations of \$195 thousand and impaired loans totaling \$3.8 million required no specific reserves at December 31, 2007. In the opinion of management, there were no impaired loans requiring specific reserve allocations at December 31, 2006.

Total restructured loans outstanding as of December 31, 2007 and 2006 were \$1.3 million and \$653 thousand, respectively. The increase was primarily due to one of the commercial relationships referred to above being restructured in 2007. Restructured loans included in non-performing assets amounted to \$1.2 million and \$525 thousand at December 31, 2007 and 2006, respectively.

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One loan was transferred into OREO in 2007 as the result of foreclosure proceedings. The OREO property was subsequently sold in February 2008 and the company recovered the December 31st carrying value. There was no OREO during the year ended December 31, 2006.

As noted above, general non-performing statistics have trended slightly upward recently; however non-performing assets in 2006 and 2005 represented historically low levels. As such, management does not consider the increase since 2006 to be indicative of deterioration in the credit quality of the general loan portfolio. Overall asset quality remained favorable during the year and non-performing assets at December 31, 2007 are considered to be at low levels by historical standards.

*Allowance for Loan Losses*

The allowance for loan losses is an estimate of credit risk inherent in the loan portfolio as of the balance sheet dates. 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. There were no significant changes to the allowance assessment methodology, the company's underwriting, or in credit quality during the current period.

The allowance for loan loss to total loans ratio was 1.62% at December 31, 2007 compared to 1.70% at December 31, 2006. The reduced allowance reflects the continued favorable asset quality, level of loan growth and the low level of charge-offs during the 2007 period. The allowance for loan loss to total loans ratio was 2.04% at December 31, 2003 and reflected increased provisions for loan losses made after the 9/11 terrorist attacks, which brought the ratio from 1.99% at December 31, 2000, to a high of 2.27% at December 31, 2001. The increased provisions in that period resulted from expected economic weakness and anticipated credit quality deterioration. However, in the ensuing periods credit quality remained stable, and in 2003 it began to improve measurably. Consequently, the loan loss reserve ratio began declining in 2003.

Based on the foregoing, as well as management's judgment as to the existing credit risks inherent in the loan portfolio, the company's allowance for loan losses is deemed adequate to absorb reasonably anticipated losses from specifically known and other credit risks associated with the portfolio as of December 31, 2007.

The following table summarizes the activity in the allowance for loan losses for the periods indicated:

(Dollars in thousands)	Years Ended December 31,				
	2007	2006	2005	2004	2003
Balance at beginning of year	\$ 12,940	\$ 12,050	\$ 10,923	\$ 9,986	\$ 9,371
<b>Charged-off loans:</b>					
Commercial real estate	27	200			
Commercial and industrial	422	241	70	901	628
Construction	100				
<b>Residential mortgage</b>					
Home equity	77	68			
Consumer	25	70	57	84	55
Total charged-off	651	579	127	985	683
<b>Recoveries on charged-off loans:</b>					
Commercial real estate	82				2
Commercial and industrial	152	182	102	259	193
Construction					