

ENTERPRISE BANCORP INC /MA/

Form 10-K

March 12, 2010

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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, 2009

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 001-33912

Enterprise Bancorp, Inc.

(Exact name of registrant as specified in its charter)

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Massachusetts
(State or other jurisdiction of
incorporation or organization)

04-3308902
(IRS Employer Identification No.)

222 Merrimack Street, Lowell, Massachusetts
(Address of principal executive offices)

01852
(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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes No

Indicate by check mark 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.

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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 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

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. **\$68,113,636** as of June 30, 2009

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: March 8, 2010, Common Stock - Par Value \$01: 9,132,063 shares outstanding

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the issuer's proxy statement for its annual meeting of stockholders to be held on May 5, 2010 are incorporated by reference in Part III of this Form 10-K.

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PART I

Item 1. Business

Organization

Enterprise Bancorp, Inc. (the Company or Enterprise) is a Massachusetts corporation organized in 1996, which operates as the parent holding company of Enterprise Bank and Trust Company referred to as Enterprise Bank (the Bank). Substantially all of the Company s operations are conducted through the Bank. The Bank, a Massachusetts trust company which commenced banking operations in 1989, has five wholly owned subsidiaries which are included in the Company s consolidated financial statements:

- Enterprise Insurance Services, LLC, organized in 2000 for the purposes of engaging in insurance sales activities;
- Enterprise Investment Services, LLC, organized in 2000 for the purpose of offering non-deposit investment products and services, and;
- Three Massachusetts security corporations, Enterprise Security Corporation (2005), Enterprise Security Corporation II (2007) and Enterprise Security Corporation III (2007), 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.

Enterprise s headquarters are located at 222 Merrimack Street in Lowell, Massachusetts.

The services offered through the Bank and its 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

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The Company's primary market area is the Merrimack Valley and North Central region of Massachusetts and South Central New Hampshire. Enterprise has seventeen full service branch banking offices located in the Massachusetts cities and towns of Acton, Andover, Billerica, Chelmsford, Dracut, Fitchburg, Leominster, Lowell, Methuen, Tewksbury, and Westford; and in the New Hampshire towns of Derry and Salem, which serve those cities and towns as well as the surrounding communities.

Management believes that the Company has established a strong reputation within its market area and has differentiated itself based upon service level, a targeted focus on growing and established local businesses, professionals, non-profits and high net worth individuals, and active community involvement, which has led to a strong network with business and community leaders. Management actively seeks to strengthen its position, by capitalizing on market opportunities, and the continued pursuit of strategic growth within existing and into neighboring geographic markets.

Products and Services

Management continually examines new products and technologies in order to maintain a highly competitive mix of offerings and to target product lines to customer needs. The Bank and its subsidiaries offer a range of commercial and consumer loan products, deposit products, cash management and electronic banking services, investment advisory and management, trust and insurance services. These products and services are outlined below.

Lending Products

- **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 to

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businesses include commercial mortgage loans, construction and land development loans, secured and unsecured commercial loans and lines of credit, and standby letters of credit. The Company also originates equipment lease financing for businesses. Loans made to individuals include conventional residential mortgage loans, home equity loans, residential construction loans on primary residences, secured and unsecured personal loans and lines of credit. The Company does not have a sub-prime mortgage program. The Company seeks to manage its loan portfolio to avoid concentration by industry or loan size to minimize its credit risk exposure.

Enterprise employs a seasoned commercial lending staff, with commercial lenders supporting each branch location. An internal loan review function 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 internal watched asset list and classified loan report. An internal credit review committee, consisting of senior lending officers and loan review personnel, generally meets three times per month, or on an as needed basis, to review loan requests related to borrowing relationships of certain dollar levels, as well as other borrower relationships recommended for discussion by committee members.

The Executive Committee of the Company's Board of Directors, consists of five outside members of the Board and three executive officers who are also members of the Board, with several directors who are not on the committee rotating in on a regular basis. The Executive Committee approves loan relationships exceeding certain prescribed dollar limits. A Loan Committee, consisting of five outside members of the Board, and two executive officers who are also members of the Board, reviews current portfolio statistics, problem credits, construction loan reviews, watched assets, loan delinquencies, and the allowance for loan losses, as well as current market conditions and issues relating to the construction and real estate development industry and the report from the outside loan review company. 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, 2009, the Bank's statutory lending limit, based on 20% of capital (capital stock plus surplus and undivided profits, but excluding other comprehensive income), to any individual borrower and related entities was approximately \$23.2 million, subject to certain exceptions provided under applicable law.

See also Risk Factors contained in Item 1A, for further discussion on a variety of risks and uncertainties that may affect the Company's loan portfolio.

- **Commercial Real Estate, Commercial and Industrial, and Construction Loans**

Commercial real estate loans include loans secured by both owner-use and non-owner occupied real estate. These loans are typically secured by a variety of commercial and industrial property types including apartment buildings, office or mixed-use facilities, strip shopping malls, or other commercial property and are generally guaranteed by the principals of the borrower. Commercial real estate loans generally have repayment periods of approximately fifteen to twenty-five 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 adjustments begin.

Commercial and industrial loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), and term loans. Also included in commercial and industrial loans are loans partially guaranteed by the Small Business Administration (SBA), loans under various programs issued in conjunction with the Massachusetts Development Finance Agency and other agencies. 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 and lines in this portfolio have interest rates that

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are periodically adjusted, with loans generally having 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. These loans are secured in whole or in part by the underlying real estate collateral and are generally guaranteed by the principals of the borrowers. 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, Enterprise participates with other banks in the financing of certain commercial projects. 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 and a review of the participation institution 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 a loan is created for the customer, generally a commercial loan, with the same criteria associated with similar commercial loans.

- **Residential Loans**

Enterprise 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 generally from 80% for adjustable rate and multi-family owner occupied properties, up to 97% 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, financing is provided for the construction of owner occupied primary residences. Residential mortgage loans may 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 some or all of this residential loan production for the Company's portfolio. Mortgage loans are generally not pooled for sale, but instead sold on an individual basis. Enterprise may retain or sell the servicing when selling the loans. All loans sold are currently sold without recourse, subject to an early payment default period covering the first four payments for certain loan sales.

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

Home equity loans are originated for one-to-four family residential properties with maximum original loan to values ratios generally up to 80% of the assessed or appraised value of the property securing the loan. Home equity loan payments consist of monthly

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principal and interest based on amortization ranging from three to fifteen years. The rates may also be fixed for three to fifteen years.

The Company originates home equity lines 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, although minimum rates may be applicable. Some home equity line rates 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.

- **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.

Deposit Products

Deposits have traditionally been the principal source of the Company's funds. Enterprise 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. A broad selection of deposit products are also offered to the general public, including personal interest checking accounts (PIC), savings accounts, money market accounts, individual retirement accounts (IRA) and certificates of deposit (CDs).

In addition to on-balance sheet sweep products, third party money market mutual funds are also offered for commercial sweep accounts. Management believes that commercial customers benefit from this product flexibility, 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 and are not insured by the Federal Deposit Insurance Corporation (the FDIC).

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Terms on CDs typically range from one week to thirty months. In addition to traditional in-house CDs, CDs are also originated through the Certificate of Deposit Account Registry Service (CDARS) nationwide network. This allows the Company to offer full FDIC insurance coverage on larger CD balances by placing the excess funds in FDIC insured CD s issued by other banks in the network. In exchange, the other CDARS institutions place dollar-for-dollar matching funds with the Company. Essentially, the equivalent of the original deposit comes back to the Company in increments that are covered by FDIC insurance and is available to fund local loan growth. The Company s first CDAR s CD was placed with the network in January 2009.

Enterprise also utilizes brokered certificates of deposit (brokered CD s), from a number of available sources, as an alternative to borrowed funds to support asset growth in excess of internally generated deposits. Brokered CD terms generally range from one 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.

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Investment Services

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 under the label Enterprise Investment Advisors. Investment services are delivered via two channels, brokerage services and investment management. Brokerage services are offered through a third party arrangement with Commonwealth Financial Network, a licensed securities brokerage firm, with products designed primarily for the individual investor. Investment management includes customized management and trust services offered to high net worth individuals, institutions and businesses.

The Company utilizes an open-architecture, manager of managers approach to client investment management. The philosophy is to identify and hire high performing independent investment management firms on behalf of our clients. Since 2008, the Company has partnered with Fortigent, LLC, an investment research and diligence firm, with over \$20 billion in advisory assets under management, to strengthen strategic development, improve manager access and selection and provide performance monitoring capabilities. Fortigent performs detailed research and due diligence reviews and provides an objective analysis of each independent management firm based on historic returns, management, longevity, investment style, risk profile, and other criteria, and maintains ongoing oversight and monitoring of their performance. This due diligence is intended to enable the Company to customize investment portfolios to meet each customer's financial objectives and deliver superior long-term performance.

Complementing our open-architecture manager of managers approach, Enterprise Investment Advisors also offer the flexibility of an individually managed portfolio, for clients who prefer customized asset management, which includes our Large Cap Core Equity Strategy, a proprietary blend of value and growth stocks.

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 and Treasury Management Services

Major on-line banking capabilities include the following: internal transfers; loan payments; bill payments; placement of stop payments; balance inquiry; access to images of checks paid; and access to prior period account statements. In addition, business banking customers may take advantage of online cash management services, such as remote deposit capture service and the ability to initiate on-line electronic funds transfers, including ACH originations, electronic federal and state tax payments and wire transfers. Retail customers have the additional ability to open personal deposit and CD accounts.

Investment Activities

The investment portfolio 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, an internal investment policy restricts fixed income investments to high quality securities within the following categories: U.S. treasury securities, federal agency obligations

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(obligations issued by government sponsored enterprises that are not backed by the full faith and credit of the United States government), mortgage-backed securities (MBS s), including collateralized mortgage obligations (CMO s), and municipal securities (Municipals). The Company has not purchased sub-prime mortgage-backed securities or capital stock of FNMA or FHLMC. The Company is 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 both publicly traded and unlisted equity securities, registered mutual funds and unregistered funds, including private hedge funds, venture capital and private equity funds and funds of funds that may in turn invest in any of the foregoing. The investment policy also limits the categories within the investment portfolio and sets target sector ranges as a percentage of the total portfolio. The effect of changes in interest rates, principal payments and market values are considered when purchasing 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 are classified as other short-term investments.

As of the balance sheet dates reflected in this annual report all of the investment securities within the portfolio (with the exception of restricted FHLB stock) were classified as available for sale and carried at fair value. Management regularly reviews the portfolio for securities with unrealized losses that are other than temporarily impaired (OTTI). This assessment includes: evaluating the level and duration of the loss on individual securities; evaluating the credit quality of fixed income issuers; determining if any individual securities or mutual or other funds exhibit fundamental deterioration; and estimating whether it is unlikely that the individual security or fund will completely recover its unrealized loss within a reasonable period of time, or in the case of fixed income securities prior to maturity. If a decline in the market value of an equity security is considered other than temporary, the cost basis of the individual security is written down to market value with a charge to earnings. In the case of fixed income securities which the Company does not intend to sell and it is more likely than not that the Company will not be required to sell prior to a market price recovery or maturity, the noncredit portion of the impairment may be recognized in accumulated other comprehensive income with only the credit portion of the impairment charged to earnings.

Investment transaction summaries, portfolio allocations and projected cash flows are prepared quarterly and presented to the Asset-Liability Committee of the Company s Board of Directors (ALCO) on a periodic basis. ALCO is comprised of six outside directors and three executive officers who are also directors of the Company, with various management liaisons. In addition, several directors who are not on the committee rotate in to the committee 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.

See also Risk Factors contained in Item 1A, for further discussion on a variety of risks and uncertainties that may affect the Company s investment portfolio.

Other Sources of Funds

As discussed above deposit gathering has been the principal source of funds. Asset growth in excess of deposits may be funded through the investment portfolio cash flow, or the following sources.

Borrowed Funds

Total borrowing capacity includes borrowing arrangements at the FHLB and the Federal Reserve Bank of Boston (FRB) discount window, through federal funds purchase arrangements with correspondent banks and repurchase agreements with customers.

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Membership in the FHLB provides borrowing capacity based on qualifying collateral balances pre-pledged to the FHLB, including certain residential loans, home equity lines, commercial loans and U.S. Government and Agency securities. Borrowings from the FHLB have to date been utilized to fund short-term liquidity needs. This facility is an integral component of the Company's asset-liability management program.

In order to provide additional contingent liquidity and a competitive funding source, short-term borrowing capacity has also been established with the FRB Discount Window based on the pledge of qualifying collateral balances to the FRB. At December 31, 2009, the collateral pledged for this FRB facility was comprised primarily of certain municipal securities from the investment portfolio. Additional types of collateral are available to increase borrowing capacity with the FRB if necessary.

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. Interest rates paid on these repurchase agreements are based on market conditions and the Company's need for additional funds at the time of the transaction.

Pre-established federal funds purchase arrangements with large regional correspondent banks provide additional overnight and short-term borrowing capacity for the Company.

See also Risk Factors contained in Item 1A, for further discussion on a variety of risks and uncertainties that may affect the Company's ability to obtain funding and sustain liquidity.

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, at a premium if called between 2010 and 2020. 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. The Company contributed \$10.3 million of proceeds from the sale of these securities to the Bank in 2000.

Pursuant to the Accounting Standards Codification (ASC) Topic 810 Consolidation of Variable Interest Entities, issued by the Financial Accounting Standards Board (originally issued as Financial Interpretation No. 46R) 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.

Capital Resources

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Capital planning by the Company and the Bank considers current needs and anticipated future growth. The primary sources of capital have been the original capitalization of the Bank of \$15.5 million from the sale of common stock in 1988 and 1989, the issuance of \$10.5 million of trust preferred securities in 2000 by the Trust, net proceeds of \$8.8 million from the 2009 offering discussed below, retention of earnings less dividends paid since the Bank commenced operations, proceeds from the exercise of employee stock options and proceeds from purchases of shares pursuant to the Company's dividend reinvestment plan.

On September 10, 2009, the Company filed a shelf registration of rights and common stock with the Securities and Exchange Commission for the flexibility to raise, over a three year period, up to \$25 million in capital, in order to increase capital to ensure the Company is positioned to take advantage of growth and market share opportunities. In the fourth quarter of 2009, the Company successfully completed a combined Shareholder