

ENTERPRISE BANCORP INC /MA/

Form 10-Q

November 09, 2010

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

Washington, D.C. 20549

**Form 10-Q**

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

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

or

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

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

**Commission File Number: 001-33912**

**Enterprise Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

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**Massachusetts**  
(State or other jurisdiction of  
incorporation or organization)

**04-3308902**  
(I.R.S. Employer Identification No.)

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

**01852**  
(Zip code)

**(978) 459-9000**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

**November 5, 2010** Common Stock - Par Value **\$0.01: 9,264,732** shares outstanding.

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## Consolidated Balance Sheets

<b>(Dollars in thousands)</b>	<b>September 30, 2010 (unaudited)</b>	<b>December 31, 2009</b>
<i>Assets</i>		
Cash and cash equivalents:		
Cash and due from banks	\$ 23,856	\$ 25,851
Short-term investments	96,768	6,759
Total cash and cash equivalents	120,624	32,610
Investment securities	134,069	139,109
Loans, less allowance for loan losses of \$18,985 at September 30, 2010 and \$18,218 at December 31, 2009	1,095,593	1,064,612
Premises and equipment	24,474	22,924
Accrued interest receivable	5,527	5,368
Deferred income taxes, net	9,393	10,345
Bank-owned life insurance	14,257	13,835
Prepaid income taxes	966	
Prepaid expenses and other assets	9,983	9,466
Core deposit intangible, net of amortization		76
Goodwill	5,656	5,656
Total assets	\$ 1,420,542	\$ 1,304,001
<i>Liabilities and Stockholders' Equity</i>		
<i>Liabilities</i>		
Deposits	\$ 1,265,504	\$ 1,144,948
Borrowed funds	15,022	24,876
Junior subordinated debentures	10,825	10,825
Accrued expenses and other liabilities	12,059	14,270
Income taxes payable		98
Accrued interest payable	665	1,320
Total liabilities	1,304,075	1,196,337
<i>Commitments and Contingencies</i>		
<i>Stockholders' Equity</i>		
Preferred stock, \$0.01 par value per share; 1,000,000 shares authorized; no shares issued		
Common stock \$0.01 par value per share; 20,000,000 shares authorized; 9,264,732 and 9,090,518 shares issued and outstanding at September 30, 2010 and December 31, 2009 respectively	93	91
Additional paid-in capital	42,106	40,453
Retained earnings	70,505	65,042
Accumulated other comprehensive income	3,763	2,078
Total stockholders' equity	116,467	107,664
Total liabilities and stockholders' equity	\$ 1,420,542	\$ 1,304,001

See the accompanying notes to the unaudited consolidated financial statements.

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## Consolidated Statements of Income

Three and nine months ended September 30, 2010 and 2009

(unaudited)

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
<b>Interest and dividend income:</b>				
Loans	\$ 15,334	\$ 14,721	\$ 45,457	\$ 42,436
Investment securities	996	1,055	3,143	3,759
Short-term investments	23	15	43	88
Total interest and dividend income	16,353	15,791	48,643	46,283
<b>Interest expense:</b>				
Deposits	2,125	2,941	6,680	9,874
Borrowed funds	37	49	144	211
Junior subordinated debentures	294	294	883	883
Total interest expense	2,456	3,284	7,707	10,968
Net interest income	13,897	12,507	40,936	35,315
Provision for loan losses	1,275	1,140	3,187	3,106
Net interest income after provision for loan losses	12,622	11,367	37,749	32,209
<b>Non-interest income:</b>				
Investment advisory fees	880	688	2,613	2,034
Deposit service fees	1,040	1,037	3,046	2,815
Income on bank-owned life insurance	170	155	492	466
Other than temporary impairment on investment securities		(8)	(8)	(782)
Net gains on sales of investment securities			777	971
Gains on sales of loans	208	148	392	526
Other income	362	337	1,296	1,055
Total non-interest income	2,660	2,357	8,608	7,085
<b>Non-interest expense:</b>				
Salaries and employee benefits	6,703	6,158	19,825	18,239
Occupancy and equipment expenses	1,302	1,292	3,941	3,952
Technology and telecommunications expenses	839	797	2,761	2,304
Advertising and public relations expenses	477	514	1,758	1,506
Deposit insurance premiums	469	393	1,378	1,720
Audit, legal and other professional fees	280	302	875	927
Supplies and postage expenses	194	201	591	601
Investment advisory and custodial expenses	107	85	353	304
Other operating expenses	837	778	2,631	2,522
Total non-interest expense	11,208	10,520	34,113	32,075
Income before income taxes	4,074	3,204	12,244	7,219
Provision for income taxes	1,345	935	4,026	2,058

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Net income	\$	2,729	\$	2,269	\$	8,218	\$	5,161
Basic earnings per share	\$	0.30	\$	0.28	\$	0.89	\$	0.63
Diluted earnings per share	\$	0.30	\$	0.28	\$	0.89	\$	0.63
Basic weighted average common shares outstanding		9,246,601		8,228,897		9,197,269		8,157,273
Diluted weighted average common shares outstanding		9,250,665		8,239,729		9,201,468		8,171,171

See the accompanying notes to the unaudited consolidated financial statements.



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## Consolidated Statement of Changes in Stockholders' Equity

(Unaudited)

Nine months ended September 30, 2010

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive Income	Total Stockholders Equity
<b>Balance at December 31, 2009</b>	\$ 91	\$ 40,453	\$ 65,042		\$ 2,078	\$ 107,664
<b>Comprehensive income</b>						
Net income			8,218	\$ 8,218		8,218
Other comprehensive income, net				1,685	1,685	1,685
Total comprehensive income				\$ 9,903		
Common stock dividend paid (\$0.30 per share)			(2,755)			(2,755)
Common stock issued	1	901				902
Stock-based compensation	1	752				753
<b>Balance at September 30, 2010</b>	\$ 93	\$ 42,106	\$ 70,505		\$ 3,763	\$ 116,467

See the accompanying notes to the unaudited consolidated financial statements.

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## Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)	Nine months ended September 30,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 8,218	\$ 5,161
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	3,187	3,106
Depreciation and amortization	2,826	2,375
Amortization of intangible assets	76	99
Stock-based compensation expense	664	542
Mortgage loans originated for sale	(31,673)	(49,600)
Proceeds from mortgage loans sold	28,878	50,776
Gains on sales of loans	(392)	(526)
Gains on sales of OREO	(120)	
Net gains on sales of investment securities	(777)	(971)
Other-than-temporary-impairment on investment securities	8	782
Income on bank-owned life insurance, net of costs	(422)	(407)
Changes in:		
Accrued interest receivable	(159)	(147)
Prepaid expenses and other assets	(1,569)	2,967
Deferred income taxes		(1,349)
Accrued expenses and other liabilities	3,468	838
Accrued interest payable	(655)	(579)
Net cash provided by operating activities	11,558	13,067
Cash flows from investing activities:		
Proceeds from sales of investment securities available for sale	5,330	39,505
Proceeds from maturities, calls and pay-downs of investment securities	38,435	40,471
Purchase of investment securities	(41,286)	(49,725)
Net increase in loans	(32,331)	(112,489)
Additions to premises and equipment, net	(4,097)	(2,999)
Proceeds from OREO sales and payments	1,556	632
Purchase of OREO		(340)
Net cash used in investing activities	(32,393)	(84,945)
Cash flows from financing activities:		
Net increase in deposits	120,556	179,798
Net decrease in borrowed funds	(9,854)	(90,080)
Cash dividends paid	(2,755)	(2,321)
Proceeds from issuance of common stock	902	809
Proceeds from the exercise of common stock options		222
Tax benefit from the exercise of common stock options		13
Net cash provided by financing activities	108,849	88,441
Net increase in cash and cash equivalents	88,014	16,563
Cash and cash equivalents at beginning of period	32,610	25,276
Cash and cash equivalents at end of period	\$ 120,624	\$ 41,839
Supplemental financial data:		
Cash Paid For: Interest	\$ 8,362	\$ 11,547
Income taxes	5,105	3,123

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Supplemental schedule of non-cash investing activity:

Purchase of investment securities not yet settled		10,639
Transfer from loans to other real estate owned	1,350	695

See accompanying notes to the unaudited consolidated financial statements.

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**ENTERPRISE BANCORP, INC.**

**Notes to the Unaudited Consolidated Financial Statements**

**(1) Organization of Holding Company**

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

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

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

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

**(2) Basis of Presentation**

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

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

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

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

**(3) Critical Accounting Estimates**

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

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

Table of Contents**ENTERPRISE BANCORP, INC.****Notes to the Unaudited Consolidated Financial Statements**

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

**(4) Reporting Comprehensive Income**

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

The following table summarizes the components of other comprehensive income for the nine month periods ended September 30, 2010 and 2009.

(Dollars in thousands)	2010	2009
Gross unrealized holding gains on investments arising during the period	\$ 3,421	\$ 3,161
Income tax expense	(1,235)	(1,137)
Net unrealized holding gains, net of tax	2,186	2,024
Less: Reclassification adjustment for impairment included in net income:		
Other than temporary impairment loss arising during the period	(8)	(782)
Income tax benefit	3	266
Reclassification adjustment for impairment realized, net of tax	(5)	(516)
Less: Reclassification adjustment for net gains (losses) included in net income		
Net realized gains on sales of securities during the period	777	971
Income tax expense	(271)	(339)
Reclassification adjustment for gains realized, net of tax	506	632
Other comprehensive income, net of reclassifications	\$ 1,685	\$ 1,908

**(5) Accounting for Income Taxes**

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax attributable to differences between the financial statement carrying amounts and the tax basis of assets and

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

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

The Company did not have any unrecognized tax benefits accrued as income tax liabilities or receivables or as deferred tax items at September 30, 2010. The Company's tax years beginning after December 31, 2006 are open to federal and state income tax examinations.

**(6) Stock-Based Compensation**

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

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**ENTERPRISE BANCORP, INC.**

**Notes to the Unaudited Consolidated Financial Statements**

The Company's stock-based compensation expense includes restricted stock awards and stock option awards to officers, other employees and directors, and stock compensation in lieu of cash fees to directors. Total stock-based compensation expense was \$223 thousand and \$664 thousand for the three and nine months ended September 30, 2010, respectively, compared to \$173 thousand and \$542 thousand for the three and nine months ended September 30, 2009, respectively.

*Restricted Stock Awards*

Stock-based compensation expense recognized in association with restricted stock awards amounted to \$143 thousand and \$381 thousand for the three and nine months ended September 30, 2010, respectively, compared to \$79 thousand and \$183 thousand for the three and nine months ended September 30, 2009, respectively.

All of the restricted stock awards granted in 2010 and 2009 were granted in March of those years.

During the first quarter of 2010, the Company granted 77,963 shares of common stock in the form of restricted stock awards comprised of 70,475 shares awarded to employees, vesting over four years, and 7,488 shares awarded to directors vesting over two years. The grant date fair value of the restricted stock awarded was \$12.51 per share, which reflects the market value of the common stock on the grant date. The 2010 awards vest, in each case, in equal portions starting on the first anniversary date of the award. There have been 275 awards forfeited to date.

During the first quarter of 2009, the Company granted 83,200 shares of common stock to employees as restricted stock awards. The grant date fair value of the restricted stock awarded was \$8.75 per share, which reflects the market value of the common stock on the grant date. Of the 2009 award, 43,200 shares vest twenty-five percent per year and 40,000 shares vest fifty percent per year, in each case starting on the first anniversary date of the award. There have been 357 awards forfeited to date.

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

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

*Stock Option Awards*



The Company recognized stock-based compensation expense related to stock option awards of \$57 thousand and \$182 thousand for the three and nine months ended September 30, 2010, respectively, compared to \$53 thousand and \$212 thousand for the three and nine months ended September 30, 2009, respectively.

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

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

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

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

*Stock in Lieu of Directors Fees*

Stock-based compensation expense related to Directors' election to receive shares of common stock in lieu of cash fees for attendance at Board and Board committee meetings amounted to \$23 thousand and \$101 thousand for the three and nine months ended September 30, 2010, respectively, compared to \$41 thousand and \$147 thousand for the three and nine months ended September 30, 2009, respectively. In January 2010, 16,897 shares of common stock were issued to directors in lieu of cash fees related to 2009 annual directors' stock-based compensation expense of \$190 thousand.

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

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

fully vested under the plan.

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

(Dollars in thousands)	Three months ended September 30,		Nine months ended September 30,					
	2010	2009	2010	2009				
Service Cost	\$	\$	41	\$	55	\$	123	
Interest Cost		46	44		138		133	
Net periodic benefit cost	\$	46	\$	85	\$	193	\$	256

Benefits paid amounted to \$69 thousand for the three months and \$183 thousand for the nine months ended September 30, 2010, compared to \$60 thousand and \$135 thousand for the three and nine months ended September 30, 2009, respectively. The Company anticipates accruing an additional \$46 thousand to the plan during the remainder of 2010.

#### *Bank Owned Life Insurance*

The Company has purchased bank owned life insurance ( BOLI ) on certain senior and executive officers. The cash surrender value carried on the balance sheet at September 30, 2010 and December 31, 2009 amounted to \$14.3 million and \$13.8 million, respectively. There are no associated surrender charges under the outstanding policies.

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

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

(Dollars in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Service Cost	\$ 7	\$ 5	\$ 1	\$ 15
Interest Cost	7	20	19	61
Net periodic post retirement benefit cost	\$ 7	\$ 25	\$ 20	\$ 76

**(8) Earnings per share**

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Basic weighted average common shares outstanding	9,246,601	8,228,897	9,197,269	8,157,273
Dilutive shares	4,064	10,832	4,199	13,898
Diluted weighted average common shares outstanding	9,250,665	8,239,729	9,201,468	8,171,171
Basic earnings per share	\$ 0.30	\$ 0.28	\$ 0.89	\$ 0.63
Effect of dilutive shares				
Diluted earnings per share	\$ 0.30	\$ 0.28	\$ 0.89	\$ 0.63

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For the nine months ended September 30, 2010, there was an additional 682,606 average stock options outstanding, which were excluded from the year-to-date calculation of diluted earnings per share due to the exercise price of these options exceeding the average market price of the Company's common stock for the period. These options, which were not dilutive at that date, may potentially dilute earnings per share in the future.

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

(Dollars in thousands)	September 30, 2010			
	Amortized cost	Unrealized gains	Unrealized losses	Carrying Amount
Federal agency obligations (1)	\$ 31,165	\$ 135	\$	\$ 31,300
Federal agency mortgage backed securities (MBS)				
(1)	34,634	1,631		36,265
Non-agency MBS	2,733	66		2,799
Municipal securities	51,848	3,062		54,910
Total fixed income securities	120,380	4,894		125,274
Equity investments	3,096	969	10	4,055
Total available for sale securities, at fair value	123,476	5,863	10	129,329
FHLB Boston stock, at cost (2)	4,740			4,740
Total investment securities	\$ 128,216	\$ 5,863	\$ 10	\$ 134,069

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

(1) Investments issued or guaranteed by government sponsored enterprises such as Fannie Mae (FNMA), Freddie Mac (FHLMC), Ginnie Mae (GNMA) or one of several Federal Home Loan Banks (FHLB). All agency MBS investments owned by the Company are backed by residential mortgages.

(2) The Bank is required to purchase FHLB stock in association with advances from the FHLB; this stock is classified as a restricted investment and carried at cost, which management believes approximates fair value.

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

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

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

At September 30, 2010, the equity portfolio consisted primarily of investments in a diversified group of mutual funds, with a small portion of the portfolio (approximately 18%) invested in funds or individual common stock of entities in the financial services industry. At September 30, 2010, after the minor impairment charge discussed below, the Company had seven investments in equity mutual funds or individual stocks having combined unrealized losses of \$10 thousand which were short

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**ENTERPRISE BANCORP, INC.**

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term in nature. Management regularly reviews the portfolio for securities with unrealized losses that are other than temporarily impaired. Management's assessment includes evaluating if any equity security or fund exhibits fundamental deterioration and whether it is unlikely that the security or fund will completely recover its unrealized loss within a reasonable time period. In determining the amount of the other than temporary impairment charge, management considers the severity of the declines and the uncertainty of recovery in the short-term for these equities. Based upon this review, the Company did not consider those equity funds to be other-than-temporarily impaired at September 30, 2010.

During the nine months ended September 30, 2010, the Company recorded fair value impairment charges of \$8 thousand, on a certain previously impaired equity investment contained in its equity portfolio. During the nine months ended September 30, 2009, the Company recorded fair value impairment charges of \$782 thousand, on certain investments contained in its equity portfolio, to reflect the impact of declines in the equities markets at that time. Management's decision to record these charges was based primarily on the severity of the declines and the uncertainty of recovery in the short-term for these equities. During the nine months ended September 30, 2010, the Company sold \$1.6 million of previously impaired equity funds and recognized book gains of \$752 thousand.

As a member of the Federal Home Loan Bank of Boston (FHLB), the Company is required to purchase FHLB capital stock at par value in association with the Bank's advances from the FHLB; this stock is classified as a restricted investment and carried at cost. The FHLB is currently operating with retained earnings below its target level. The FHLB has instituted a plan to increase retained earnings which includes suspending its quarterly dividend and a moratorium on the repurchase of excess capital stock from member banks, among other programs. If further deterioration in the FHLB financial condition or capital levels occurs, the FHLB capital stock may become other than temporarily impaired to some degree and its carrying value correspondingly reduced. Management reviews its investment in FHLB stock for other than temporary impairment based on an assessment of the ultimate recoverability of the par value. Management's most recent evaluation considered the long term nature of the investments, the liquidity position of the FHLB, actions taken by FHLB to address the issue, and the Company's intent and ability to hold the investment for sufficient time to recover the par value. Based on this review, management concluded that no other-than-temporary impairment charge on FHLB stock was necessary as of September 30, 2010.

**(10) Fair Value Measurements**

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

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



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(Dollars in thousands)	September 30, 2010		Fair Value Measurements using:		
	Fair Value	(level 1)	(level 2)	(level 3)	
Assets measured on a recurring basis:					
Fixed income securities	\$ 125,274	\$	\$ 125,274	\$	
Equity securities	4,055	4,055			
FHLB Stock	4,740				4,740
Assets measured on a non-recurring basis:					
Impaired loans	8,538				8,538
Other real estate owned	1,000				1,000

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Fair Value measures (continued)

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

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

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

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

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

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

Impaired loan balances in the table above represent those collateral dependent impaired commercial loans where management has estimated the credit loss by comparing the loan's carrying value against the expected realizable fair value of the collateral (appraised value less estimated cost to sell, adjusted as necessary for changes in relevant valuation factors subsequent to the measurement date). Certain inputs used in appraisals, and possible subsequent adjustments, are not always observable, and therefore, collateral dependent impaired loans are categorized as Level 3 within the fair value hierarchy. A specific allowance is assigned to the collateral dependent impaired loan for the amount of management's estimated credit loss. The specific allowances assigned to the collateral dependent impaired loans at September 30, 2010 amounted to \$2.7 million compared to \$2.0 million at December 31, 2009, a net increase of \$706 thousand.

Real estate acquired by the Company through foreclosure proceedings or the acceptance of a deed in lieu of foreclosure is classified as Other Real Estate Owned ( OREO ). When property is acquired, it is generally recorded at the lesser of the loan's remaining principal balance, net of unamortized deferred fees, or the estimated fair value of the property acquired, less estimated costs to sell. The estimated fair value is based on market appraisals and the Company's internal analysis. Certain inputs used in appraisals are not always observable, and therefore, OREO may be categorized as Level 3 within the fair value hierarchy. The carrying value of OREO property at September 30, 2010 was \$1.0 million consisting of one property. The carrying value of OREO at December 31, 2009 was \$1.1 million and consisted of five properties. During 2010 two properties were added to OREO through foreclosure, one of which was sold in May 2010, and the five properties that had been held at December 31, 2009 were also sold during the period. Net gains realized on these sales amounted to \$120 thousand for the nine months ended September 30, 2010. There were no gains or losses on OREO sales during the nine months ended September 30, 2009.

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*Other Guarantees and Commitments*

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a customer to a third party. The fair value of these commitments was estimated to be the fees charged to enter into similar agreements, and accordingly these fair value measures are deemed to be FASB Level 2 measurements. In accordance with the FASB, the estimated fair values of these commitments are carried on the balance sheet as a liability and amortized to income over the life of the letters of credit, which are typically one year. The estimated fair value of these commitments carried on the balance sheet was \$44 thousand and \$53 thousand at September 30, 2010 and December 31, 2009, respectively, and were deemed immaterial.

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

*Estimated Fair Values of Assets and Liabilities*

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

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

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

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

Loans: The fair value of loans was determined using discounted cash flow analysis, using interest rates currently being offered by the Company. The incremental credit risk for non-accrual loans was considered in the determination of the fair value of the loans. This method of estimating fair value does not incorporate the exit price concept of fair value.

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

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

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

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

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

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

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

(Dollars in thousands)	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 120,624	\$ 120,624	\$ 32,610	\$ 32,610
Investment securities	134,069	134,069	139,109	139,109
Loans, net	1,095,593	1,098,984	1,064,612	1,058,786
Accrued interest receivable	5,527	5,527	5,368	5,368
<b>Financial liabilities:</b>				
Non-interest demand deposits	222,608	222,608	192,515	192,515
Interest bearing checking, savings, money market accounts (1)	771,012	771,012	655,401	655,401
Certificates of deposit (1)	271,884	272,385	297,032	297,431
Borrowed funds	15,022	15,116	24,876	24,927
Junior subordinated debentures	10,825	10,825	10,825	10,825
Accrued interest payable	665	665	1,320	1,320

(1)-Includes brokered deposit balances

**(11) Recent Accounting Pronouncements**

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

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

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**ENTERPRISE BANCORP, INC.**

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



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**ENTERPRISE BANCORP, INC.**

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

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

**Special Note Regarding Forward-Looking Statements**

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

**Overview**

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

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professional bankers. Enterprise reported strong financial results and continued growth for the quarter and nine months ended September 30, 2010. We continue to expand the branch network and invest in our infrastructure, communities and employees, in order to seize current market opportunities and position Enterprise for continued long-term growth.

Net income amounted to \$2.7 million for the quarter ended September 30, 2010, compared to \$2.3 million for the quarter ended September 30, 2009, an increase of 20%. Net income for the nine months ended September 30, 2010 amounted to \$8.2 million compared to \$5.2 million for the comparable 2009 period, an increase of 59%. Diluted earnings per share were \$0.30 and \$0.89 for the three and nine months ended September 30, 2010 compared to \$0.28 and \$0.63 for each of the same periods in 2009, increases of 7% and 41% respectively.

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Total deposits, excluding brokered deposits, have grown 17% on an annualized basis since December 31, 2009. During a period when many banks have experienced declining loan portfolios, loan balances have grown 4% on an annualized basis since December 31, 2009. The Company anticipates opening its third Southern New Hampshire location in Hudson within the next three to four months.

*Composition of Earnings*

The increase in net income is primarily attributed to growth in loans, deposits and investment assets under management from the 2009 levels, and an increase in net interest margin. Results for the 2009 year-to-date period were also negatively impacted by the FDIC special assessment and impairment charges on investment securities.

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

Net interest income for the quarter ended September 30, 2010 amounted to \$13.9 million, an increase of \$1.4 million, or 11%, compared to the September 2009 quarter. Net interest income increased \$5.6 million, or 16%, for the nine month period ended September 30, 2010 and amounted to \$40.9 million, compared to \$35.3 million for the nine months ended September 30, 2009. The increase in net interest income over the comparable 2009 quarter and year-to-date periods was due primarily to loan growth. For the three months ended September 30, 2010, average loan balances increased \$70.2 million compared to the three months ended September 30, 2009. Average loan balances increased \$102.8 million for the year-to-date period ended September 30, 2010 compared to the same period in 2009. Additionally, net interest margin increased to 4.40% for the three months ended September 30, 2010 compared to 4.32% for the quarter ended September 30, 2009. Net interest margin was 4.48% for the second quarter of 2010. Year-to-date net interest margin was 4.44% and 4.23% for the nine months ended September 30, 2010 and 2009, respectively, and 4.28% for the year ended December 31, 2009.

The provision for loan losses amounted to \$1.3 million for the three months ended September 30, 2010, compared to \$1.1 million for the same period in 2009. For the nine months ended September 30, 2010 and 2009, the provision for loan losses amounted to \$3.2 million and \$3.1 million, respectively. The provision for loan losses during any period is a function of the level of loan growth and level of general non-performing loans and reserves for specific adversely classified loans and net charge-offs during that period. Loan balances declined \$1.7 million during the quarter ended September 30, 2010 compared to growth of \$39.5 million for the same period in 2009. Loan growth during the first nine months of 2010 amounted to \$31.7 million compared to \$110.3 million for the same period in 2009. For the quarter ended September 30, 2010, the Company recorded net charge-offs of \$1.6 million, compared to net charge-offs of \$362 thousand for the comparable period ended September 30, 2009. For the year-to-date period ended September 30, 2010, the Company recorded net charge-offs of \$2.4 million, compared to net charge-offs of \$887 thousand for the comparable period ended September 30, 2009. Total non-performing assets to total assets were 1.36% at September 30, 2010, compared to 1.30% at September 30, 2009. Management continues to closely monitor the non-performing assets, charge-offs and necessary allowance levels, and believes that current loan quality statistics are a function of the current economic environment and reflect more normalized levels compared to the historic lows of recent years. The allowance for loan losses to total loans ratio was 1.70% at September 30, 2010, compared to 1.68% at December 31, 2009 and 1.65% at September 30, 2009.

Non-interest income for the three months ended September 30, 2010 amounted to \$2.7 million, an increase of \$303 thousand, or 13%, compared to the same quarter last year, primarily resulting from an increase in investment advisory fees. Non-interest income for the nine months ended

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September 30, 2010 amounted to \$8.6 million, an increase of \$1.5 million, or 21%, compared to the 2009 year-to-date period. The increase in the current year-to-date period primarily resulted from increases in investment advisory fees, deposit service fees and gains on sales of other real estate owned and a reduction in the impairment charges on investment securities, partially offset by decreases in net gains on sales of investment securities and in gains on loan sales.

Non-interest expense for the three months ended September 30, 2010, amounted to \$11.2 million, an increase of \$688 thousand, or 7%, compared to the same quarter last year, which was due primarily to increases in compensation-related costs. Non-interest expense for the nine months ended September 30, 2010, amounted to \$34.1 million, an increase of \$2 million, or 6%, compared to the same period in the prior year. This increase in non-interest expense was related primarily to the Company's strategic growth initiatives resulting in increases in compensation-related costs, technology and advertising expenses, partially offset by a reduction in deposit insurance expense due to a special assessment in June 2009.

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*Effective tax rates*

The effective tax rate for the nine months ended September 30, 2010 was 32.9% compared to 28.5% in the 2009 period. The increase in the effective tax rate was primarily due to the higher level of taxable income as compared to 2009 levels, and the diminished impact of non-taxable income from certain tax-exempt assets on higher earnings.

*Sources and Uses of Funds*

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

Total assets amounted to \$1.42 billion at September 30, 2010, an increase of 9% since December 31, 2009. The Company's core asset strategy is to grow loans, primarily high quality commercial loans. Total loans increased \$31.7 million, or 3%, since December 31, 2009 and amounted to \$1.11 billion, or 78% of total assets, at September 30, 2010, and have remained relatively flat as compared to the ending balance at June 30, 2010. Total commercial loans amounted to \$952.3 million, or 85% of gross loans, which was consistent with the composition at December 31, 2009. Management closely monitors the credit quality of individual delinquent and non-performing credit relationships, portfolio mix and industry concentrations, the local and regional real estate markets and current economic conditions. Although September 30, 2010 non-performing statistics have declined slightly since December 31, 2009, they have increased from the comparable 2009 period, as would be expected during the current economic environment and management does not consider this increase to be indicative of significant deterioration in the overall credit quality of the general loan portfolio at September 30, 2010.

The investment portfolio is the other key component of earning assets and is primarily used to invest excess funds, provide liquidity and to manage the Company's asset-liability position. The carrying value of total investments amounted to \$134.1 million at September 30, 2010, or 9% of total assets, and was comparable to the ratio of 11% at December 31, 2009.

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

At September 30, 2010, deposits, excluding brokered deposits, amounted to \$1.26 billion, representing \$144.7 million, or 13%, in growth over December 31, 2009 balances. At September 30, 2010, higher cost savings and money market account balances increased \$103.2 million, or 22%, primarily in the money market accounts, while checking account balances increased \$38.7 million, or 10%, compared to balances at December 31, 2009. The deposit growth is attributed to expansion and sales efforts to attract relationship customers seeking a competitive, but secure, alternative to the larger regional and national banks, mutual funds and lower yielding investment alternatives.

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Wholesale funding amounted to \$18.1 million at September 30, 2010, compared to \$51.4 million at December 31, 2009. At September 30, 2010, there were \$3.8 million in brokered deposits and \$14.3 million in FHLB borrowings. At December 31, 2009, wholesale funding included \$27.9 million in brokered deposits and FHLB borrowings amounting to \$23.5 million. The declines in wholesale funding were achieved due to the strong deposit growth during the period.

### *Opportunities and Risks*

The Company faces strong competition from multiple sources within its market area. National and larger regional banks have a local presence in the Company's market area. These established larger banks, as well as recent larger entrants into the local market area, have certain competitive advantages, including the ability to make larger loans to a single borrower than is possible for the Company, and greater financial resources. Numerous local savings banks, commercial banks, cooperative banks and credit unions also compete in the Company's market area. The expanded commercial lending capabilities of credit unions and the shift to commercial lending by traditional savings banks allow them to compete for the Company's targeted commercial customers. In addition, the non-taxable status of credit unions allows them certain advantages as compared to taxable institutions such as Enterprise. Competition for loans, investment advisory assets, deposits and insurance services 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, non-bank electronic delivery channels and internet based banks.

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While the current economic environment continues to present significant challenges for all companies, management also believes that it has created opportunities for growth and customer acquisition. Notwithstanding the competition discussed above, management believes that customers continue to migrate from larger, national banks to local, stable community banks, choosing to do business with local professional bankers who can offer them the flexibility, responsiveness and personalized service that a community bank such as Enterprise provides. Management views the Company's product offerings, its customer service culture, and its investments in the communities we serve, as key elements in positioning Enterprise to take advantage of these market opportunities to grow deposits, loans, investment assets under management, and insurance services with a focus on the needs of growing and established local businesses, professionals, non-profits and high net worth individuals.

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

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

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

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

Notwithstanding the market opportunities that management believes the current economic environment has created, any long-term consequences of the recent nationwide or regional recession, or possible lagging effects, could further weaken the local New England economy, and have adverse repercussions on local industries leading to increased unemployment and foreclosures, further deterioration of local commercial real estate values, or other unforeseen consequences, which could have a severe negative impact on the Company's financial condition, capital

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position, liquidity, and performance. In addition, the loan portfolio consists primarily of commercial real estate, commercial and industrial, and construction loans. These types of loans are typically larger and are generally viewed as having more risk of default than owner occupied residential real estate loans or consumer loans. The underlying commercial real estate values, customer cash flow and payment expectations and, in the case of commercial construction loans, the actual costs necessary to complete a construction project, can be more easily influenced by adverse conditions in the local or national economy, the real estate market, or the related industries. Any significant deterioration in the commercial loan portfolio or underlying collateral values due to a continuation or worsening of the current economic environment could have a material adverse effect on the Company's financial condition and results of operations.

The value of the investment portfolio as a whole, or individual securities held, including bonds issued by government agencies or municipalities and restricted FHLB capital stock, could be negatively impacted by any continued volatility in the financial



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markets, tightening of credit markets, and any possible subsequent effects of the current economic recession, which could possibly result in the recognition of additional other-than-temporary-impairment ( OTTI ) charges in the future.

In addition, any further changes in government regulation or oversight, including the recently enacted Dodd-Frank Act, could affect the Company in substantial and unpredictable ways, including, but not limited to, subjecting the Company to additional operating, governance and compliance costs or potential loss of revenue due to new regulations and their impact on the banking industry. This sweeping federal legislation covers a wide variety of topics, some of which relate directly to activities of community banks, such as Enterprise, while others of which are directed at larger, systemically significant institutions. The full extent of the regulatory impact resulting from the Dodd-Frank Act will not be known for some time, as the various federal regulatory agencies will be required to draft and implement over 240 new regulations and the Government Accounting Office and other federal agencies are required to complete nearly 70 additional studies regarding various financial services industry issues that were raised during the legislative process.

Changes, prior to the enactment of the Dodd-Frank Act, in the FDIC's deposit insurance rates applicable to all insured banks and the Company's participation in the FDIC's Transaction Account Guaranty Program have already increased the Company's ongoing deposit insurance related costs. What effects the new legislation and the FDIC's future efforts to restore its Deposit Insurance Fund will have on these costs remains unclear at this time.

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

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

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

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

Federal banking agencies require the Company and the Bank to meet minimum capital requirements. At September 30, 2010, the Company was categorized as well capitalized; however future unanticipated charges against capital could impact that regulatory capital designation. Moreover, recently announced revisions to international capital standards could eventually result in enhanced capital requirements for all U.S. banking organizations, including community banks, such as Enterprise Bank. For information regarding the capital requirements applicable to the Company and the Bank and their respective capital levels at September 30, 2010, see the section entitled Capital Resources contained in this Item 2 below.

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

Management utilizes a combination of third party information security assessments, key technologies and ongoing internal evaluations in order to protect non-public personal information and continually monitor and safeguard information on its operating systems and those of third party service providers. The Company contracts with outside parties to perform a broad scope of both internal and external information security assessments on the Company's systems on a regular basis. These third parties conduct penetration testing and vulnerability scans to test the network configuration and security controls, and assess internal practices aimed at protecting the Company's operating systems. In addition, an outside service provider monitors usage patterns and identifies unusual activity on bank issued debit/ATM cards. The Company also utilizes firewall technology and a combination of software and third-party monitoring to detect intrusion, protect against unauthorized access and continuously scan for computer viruses on the Company's information systems.

The Company may enter into third-party relationships by outsourcing certain operational functions or by using third parties to provide certain products and services to the Bank's customers. The Company is responsible for ensuring that activities conducted through third-party relationships are conducted in a safe and sound manner and in accordance with applicable laws and regulation, just as if the activity was performed by the Company itself. Management has instituted a third-party vendor management program in order to identify and control the risks arising from conducting activities through third party relationships. These risks may include operational risk and the failure to deliver a particular product or service; non-compliance with applicable laws and regulations; loss of non-public personal information; vendor business decisions that are inconsistent with the Company's

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strategic goals; or damage to the Company's reputation; among others. The Company's risk-based, third-party vendor management program is designed to provide a mechanism to enable management to determine what risk, if any, a particular vendor exposes the Company to, and to mitigate that risk by properly performing initial and ongoing due diligence when selecting or maintaining a relationship with significant third-party providers.

The Business Continuity Plan consists of the information and procedures required to enable rapid recovery from an occurrence that would disable the Company for an extended period. The plan addresses issues and concerns regarding the loss of personnel, loss of information and/or loss of access to information under various scenarios including: the inability of staff or customers to travel to or to access bank offices, the serious threat of widespread public health or safety concerns, and the physical destruction or damage of facilities, infrastructure or systems. The plan, which is reviewed annually, establishes responsibility for assessing a disruption of business, contains alternative strategies for the continuance of critical business functions during an emergency situation, assigns responsibility for restoring services, and sets priorities by which critical services will be restored. Any contingency plan, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the plan will be met as the assumptions used change over time or due to changes in circumstances and events.

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

### **Financial Condition**

Total assets increased \$116.5 million, or 9%, since December 31, 2009, to \$1.42 billion at September 30, 2010. The balance sheet composition and changes since December are discussed below.

#### *Short-term investments*

As of September 30, 2010, short-term investments amounted to \$96.8 million, or 7% of total assets, an increase of \$90.0 million compared to December 31, 2009. Short-term investments are carried as cash equivalents and consist of overnight and term federal funds sold and money market mutual funds. The balance of these investments will fluctuate depending on the timing of deposit inflows, investment sales proceeds and the immediate liquidity needs of the Company.

#### *Investments*

At September 30, 2010, the carrying value of the investment portfolio amounted to \$134.1 million and declined by \$5.0 million, or 4%, compared to December 31, 2009. The following table summarizes investments at the dates indicated:

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(Dollars in thousands)	September 30, 2010	December 31, 2009	September 30, 2009
Federal agency obligations (1)	\$ 31,300	\$ 25,631	\$ 27,254
Federal agency mortgage backed securities (MBS) (1)	36,265	39,737	42,433
Non-agency MBS	2,799	3,445	3,613
Municipal securities	54,910	60,592	58,625
Total fixed income securities	\$ 125,274	\$ 129,405	\$ 131,925
Equity investments	4,055	4,964	6,239
Total available for sale securities at fair value	\$ 129,329	\$ 134,369	\$ 138,164
Federal Home Loan Bank stock (2)	4,740	4,740	4,740
Total investment securities	\$ 134,069	\$ 139,109	\$ 142,904

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(1) Investments issued or guaranteed by government sponsored enterprises such as Fannie Mae (FNMA), Freddie Mac (FHLMC), Ginnie Mae (GNMA) or one of several Federal Home Loan Banks. All agency MBS investments owned by the Company are backed by residential mortgages.

(2) The Bank is required to purchase stock of the Federal Home Loan Bank of Boston (the FHLB ) in association with advances from the FHLB; this stock is classified as a restricted investment and carried at cost, which management believes approximates fair value.

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During the nine months ended September 2010, the Company sold \$4.6 million in securities, and recognized net gains of \$777 thousand. During that same period, the total principal pay downs, calls and maturities on fixed income securities amounted to \$38.4 million. These portfolio cash inflows were offset by the purchase of \$35.6 million in securities, primarily federal agency securities.

Net unrealized gains amounted to \$5.9 million at September 30, 2010 compared to \$3.2 million at December 31, 2009 and \$4.7 million at September 30, 2009. See Note 9, Investment Securities, and Note 10, Fair Value Measurements, to the Company's unaudited consolidated financial statements contained in Item 1 above for further information regarding the Company's unrealized gain and losses on debt and equity securities, including information about investments in an unrealized loss position for which an other-than-temporary impairment has or has not been recognized and the Company's fair value measurements for available-for-sale securities.

From time to time the Company may pledge securities from its investment portfolio as collateral for various municipal deposit accounts and repurchase agreements. The fair value of securities pledged as collateral for these purposes was \$36.2 million at September 30, 2010. In addition, securities designated as qualified collateral for FHLB borrowing capacity amounted to \$34.2 million at September 30, 2010. Securities designated as qualified collateral for borrowing from the Federal Reserve Bank of Boston (the FRB) through its discount window amounted to \$51.6 million at September 30, 2010.

*Loans*

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

Total loans increased \$31.7 million, or 3%, compared to December 31, 2009, and \$55.7 million, or 5%, since September 30, 2009. Total loans represented 78% of total assets at September 30, 2010 and 83% at December 31, 2009. The majority of the growth since December 31, 2009 has been focused in the commercial portfolio, as total commercial loans have increased \$27.9 million, over the period.

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

(Dollars in thousands)	September 30, 2010		December 31, 2009		September 30, 2009	
	Amount	Percent	Amount	Percent	Amount	Percent
Commercial real estate	\$ 574,493	51.5%	\$ 553,768	51.1%	\$ 538,723	50.8%
Commercial and industrial	270,074	24.2%	263,151	24.3%	255,693	24.1%

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Commercial construction	107,689	9.6%	107,467	9.9%	106,793	10.1%
Total commercial loans	952,256	85.3%	924,386	85.3%	901,209	85.0%
Residential mortgages	89,259	8.0%	90,468	8.3%	91,296	8.6%
Residential construction	3,379	0.3%	6,260	0.6%	5,857	0.5%
Home equity	63,684	5.7%	58,732	5.4%	55,879	5.3%
Consumer	3,736	0.4%	3,824	0.4%	4,936	0.5%
Loans held for sale	3,565	0.3%	378	0.0%	946	0.1%
Gross loans	1,115,879	100.0%	1,084,048	100.0%	1,060,123	100.0%
Deferred fees, net	(1,301)		(1,218)		(1,225)	
Total loans	1,114,578		1,082,830		1,058,898	
Allowance for loan losses	(18,985)		(18,218)		(17,488)	
Net loans	\$ 1,095,593		\$ 1,064,612		\$ 1,041,410	

Commercial real estate loans increased \$20.7 million, or 4%, as of September 30, 2010, compared to December 31, 2009, and 7% compared to September 30, 2009. Commercial real estate loans include loans secured by both owner-occupied and non-owner

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occupied real estate. These loans are typically secured by a variety of commercial and industrial property types including apartment buildings, office or mixed-use facilities, strip shopping malls or other commercial property.

Commercial and industrial loans increased by \$6.9 million, or 3%, since December 31, 2009, and 6% as compared to September 30, 2009. These loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), and term loans. Also included in commercial and industrial loans are loans under various U.S. Small Business Administration programs. These commercial and industrial loans include unsecured loans or lines to financially strong borrowers, loans secured in whole or in part by real estate unrelated to the principal purpose of the loan, or secured by inventories, equipment and/or receivables. Commercial and industrial loans are generally guaranteed by the principals of the borrower.

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

Residential mortgages, residential construction, home equity mortgages and consumer loans combined represented approximately 14% of the total loan portfolio at September 30, 2010 and 15% at December 31, 2009. These loans remained relatively flat since December 31, 2009 and increased by \$2.1 million, or 1%, since September 30, 2009. The increase was primarily within the home equity portfolio.

Depending on the current interest rate environment, management projections of future interest rates and the overall asset-liability management program of the Company, management may elect to sell those fixed and adjustable rate residential mortgage loans which are eligible for sale in the secondary market, or hold some or all of this residential loan production for the Company's portfolio. The Company generally does not pool mortgage loans for sale, but instead sells the loans on an individual basis. The Company may retain or sell the servicing when selling the loans. All loans sold are currently sold without recourse, subject to an early payment default period covering the first four payments for certain loan sales. During the three months ended September 30, 2010, the Company originated \$15.4 million in residential loans designated for sale, compared to \$10.9 million for the comparable quarter in the prior year. During the nine months ended September 30, 2010, the Company originated \$31.7 million in residential loans designated for sale, compared to \$49.6 million for the comparable period in the prior year. The decrease in the year to date volume of residential loan production was primarily due to declining residential loan rates in the early part of 2009. In the latter half of 2009 through June 2010, residential loan rates remained fairly consistent, but subsequently declined in the third quarter of 2010, triggering additional refinance activity. Loans sold generated gains on sales of \$392 thousand and \$526 thousand for the nine month periods ended September 30, 2010 and 2009, respectively.

At September 30, 2010, the Company had commercial loan balances participated out to various banks amounting to \$36.8 million, compared to \$34.7 million at December 31, 2009, and \$30.9 million at September 30, 2009. Balances participated out to other institutions are not carried as assets on the Company's financial statements. Loans originated by other banks in which the Company is the participating institution are carried in the loan portfolio at the Company's pro rata share of ownership and amounted to \$32.0 million, \$31.5 million and \$32.9 million at September 30, 2010, December 31, 2009 and September 30, 2009, respectively. The Company performs an independent credit analysis of each commitment prior to participation in any loan.

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Loans designated as qualified collateral for FHLB borrowing capacity amounted to \$281.1 million and \$301.9 million at September 30, 2010 and December 31, 2009, respectively.

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

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



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management function, management recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio and economic conditions.

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

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

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

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

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

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

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

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Real estate acquired by the Company through foreclosure proceedings or the acceptance of a deed in lieu of foreclosure is classified as Other Real Estate Owned ( OREO ). When property is acquired, it is generally recorded at the lesser of the loan's remaining principal balance or the estimated fair value of the property acquired, less estimated costs to sell. Any loan balance in excess of the estimated realizable fair value on the date of transfer is charged to the allowance for loan losses on that date. All costs incurred thereafter in maintaining the property, as well as subsequent declines in fair value are charged to non-interest expense.

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

On a quarterly basis, management prepares an estimate of the allowance necessary to cover estimated credit losses. The allowance for loan losses is an estimate of probable credit risk inherent in the loan portfolio as of the specified balance sheet date. The Company maintains the allowance at a level that it deems adequate to absorb all reasonably anticipated losses from specifically known and other credit risks associated with the portfolio.

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

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

The allowance for loan losses to total loans ratio was 1.70% and 1.68% at September 30, 2010 and December 31, 2009 respectively, compared to the September 30, 2009 ratio of 1.65%. Based on the foregoing, as well as management's judgment as to the risks inherent in the loan portfolio, the Company's allowance for loan losses was deemed adequate to absorb probable losses from specifically known and other credit risks associated with the portfolio as of September 30, 2010.

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



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

(Dollars in thousands)	September 30, 2010	December 31, 2009	September 30, 2009
Commercial real estate	\$ 8,845	\$ 11,789	\$ 10,324
Commercial and industrial	6,742	2,748	2,923
Commercial construction	1,043	4,662	1,193
Residential	1,474	1,379	1,278
Home Equity	135	18	305
Consumer	4	8	15
Total non-accrual loans	18,243	20,604	16,038
Overdrafts > 90 days past due	34	5	7
Total non-performing loans	18,277	20,609	16,045
Other real estate owned ( OREO )	1,000	1,086	721
Total non-performing assets	\$ 19,277	\$ 21,695	\$ 16,766
Total Loans	\$ 1,114,578	\$ 1,082,830	\$ 1,058,898
Accruing restructured loans not included above	24,746	20,125	19,800
Delinquent loans 60 - 89 day past due	1,870	2,104	1,285
Non-performing loans to total loans	1.64%	1.90%	1.52%
Non-performing assets to total assets	1.36%	1.66%	1.30%
Loans 60-89 days past due to total loans	0.17%	0.19%	0.12%
Adversely classified loans to total loans	2.01%	2.38%	2.17%
Allowance for loan losses	\$ 18,985	\$ 18,218	\$ 17,488
Allowance for loan losses: Non-performing loans	103.87%	88.40%	109.00%
Allowance for loan losses: Total loans	1.70%	1.68%	1.65%

In general, non-performing statistics trended upward since early 2009, which is consistent with the regional economic environment and its impact on the local commercial markets. Management does not consider the September 2010 levels to be significantly different than the levels at December 31, 2009. Management believes that the recent levels of non-performing statistics are reflective of more normalized commercial credit statistics compared to the historically low statistics seen in 2004 through 2007.

The \$2.3 million net decrease in total non-performing loans, since December 31, 2009, and the resulting decrease in the ratio of non-performing loans as a percentage of total loans outstanding, was due primarily to net reductions within the commercial real estate and construction portfolios, partially offset by increases primarily within the commercial and industrial portfolio. The non-performing loan reductions were primarily due to larger payoffs and settlement of \$3.1 million (within the commercial real estate and commercial construction loan portfolio), charge-offs of \$2.5 million, \$1.4 million transfers to OREO, an upgrade of \$2.3 million to performing status (in the commercial real estate portfolio), and payments applied to principal. These reductions were partially offset by \$6.9 million of non-performing loans added primarily within the commercial real estate and commercial and industrial portfolios. The majority of non-accrual loans at September 30, 2010, were also carried as impaired loans during the period, and are discussed further below.

Total impaired loans amounted to \$42.8 million and \$39.7 million at September 30, 2010 and December 31, 2009, respectively. Total accruing impaired loans amounted to \$25.3 million and \$20.2 million at September 30, 2010 and December 31, 2009, respectively, while non-accrual impaired commercial loans amounted to \$17.5 million and \$19.5 million at September 30, 2010 and December 31, 2009, respectively. Total loans added to impaired status during 2010 amounted to \$12.8 million, that included eleven larger commercial relationships amounting to \$10.9

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million, which were partially offset by net paydowns and reductions of impaired balances related primarily to the non-performing loan reductions discussed above.

In management's opinion the majority of impaired loan balances at September 30, 2010 were adequately supported by expected future cash flows or the net realizable value of the underlying collateral and management expects that the majority of these principal advances will ultimately be collected. Based on management's assessment at September 30, 2010, impaired loans

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amounting to \$31.6 million required no specific reserves and impaired loans totaling \$11.2 million required specific reserves of \$2.7 million. At December 31, 2009, impaired loans totaling \$29.6 million required no specific reserves and impaired loans totaling \$10.1 million required specific reserve allocations of \$2.1 million. Management closely monitors these relationships for collateral or credit deterioration.

Total TDR loans, included in the impaired loan figures above, as of September 30, 2010 and December 31, 2009 were \$35.2 million and \$28.3 million, respectively. The increase was due primarily to the addition of the impaired accruing relationships referred to above. TDR loans on accrual status amounted to \$24.7 million and \$20.1 million at September 30, 2010 and December 31, 2009, respectively. Restructured loans included in non-performing loans amounted to \$10.4 million and \$8.2 million at September 30, 2010 and December 31, 2009, respectively. The Company continues to work closely with classified relationships and enters into loan modifications to the extent deemed to be necessary or appropriate to ensure the best mutual outcome given the current economic environment.

At September 30, 2010, the Company had adversely classified loans (loans carrying substandard, doubtful or loss classifications) amounting to \$22.4 million, compared to \$25.8 million at December 31, 2009. There was \$9 thousand and \$13 thousand classified as Loss at September 30, 2010, and December 31, 2009, respectively, which were subsequently charged off. Adversely classified loans which were performing but possessed potential weaknesses and, as a result, could ultimately become non-performing loans amounted to \$5.9 million and \$7.0 million, at September 30, 2010 and December 31, 2009, respectively. The remaining balances of adversely classified loans were non-accrual loans, amounting to \$16.4 million and \$18.8 million at September 30, 2010 and December 31, 2009, respectively. Non-accrual loans that were not adversely classified amounted to \$1.8 million at both September 30, 2010 and December 31, 2009 and primarily represented the guaranteed portions of non-performing Small Business Administration loans.

The carrying value of OREO property at September 30, 2010 was \$1.0 million consisting of one property. The carrying value of OREO at December 31, 2009 was \$1.1 million and consisted of five properties. During 2010 two properties were added to OREO through foreclosure, one of which was sold in May 2010, and the five properties that had been held at December 31, 2009 were also sold during the period. Net gains realized on these sales amounted to \$120 thousand for the nine months ended September 30, 2010. There were no gains or losses on OREO sales during the nine months ended September 30, 2009.

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

(Dollars in thousands)	Nine months ended September 30,	
	2010	2009
Balance at beginning of year	\$ 18,218	\$ 15,269
<b>Charged-off loans:</b>		
Commercial real estate	(619)	(272)
Commercial and industrial	(536)	(820)
Commercial construction	(1,245)	
Residential	(25)	(76)
Home equity		(34)
Consumer	(44)	(83)
Total Charged off	(2,469)	(1,285)
<b>Recoveries on charged-off loans:</b>		
Commercial real estate	1	210
Commercial and industrial	34	71
Commercial construction		3
Residential		
Home equity		7
Consumer	14	107
Total recoveries	49	398
Net loans charged-off	(2,420)	(887)
Provision charged to operations	3,187	3,106
Balance at September 30,	\$ 18,985	\$ 17,488
Annualized net loans charged-off: Average loans outstanding	0.29%	0.12%

The allowance reflects management's estimate of loan loss reserves necessary to support the level of credit risk inherent in the portfolio during the period. Refer to Credit Risk/Asset Quality and Allowance for Loan Losses contained in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in the Company's 2009 Annual Report on Form 10-K for additional information regarding the Company's credit risk management process and allowance for loan losses.

*FDIC Deposit Insurance Assessment*

The Company's deposit accounts are insured by the FDIC's Deposit Insurance Fund (the "DIF") up to the maximum amount provided by law. As a result of nationwide bank failures in 2008 and 2009, the FDIC took several actions in order to restore the DIF reserves, which included increases in insurance premium assessments and special surcharges for all insured institutions in June 2009. The FDIC also required all insured institutions to make a one-time prepayment, on December 30, 2009, of estimated insurance assessments for 2010, 2011 and 2012. At September 30, 2010, the Company carried the remaining balance of its prepaid assessment totaling approximately \$4.6 million as a prepaid asset on its balance sheet.



The FDIC retains the ability to impose additional special assessments or implement future changes to the assessment rate or payment schedules.

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Total deposits increased \$120.6 million, or 11%, compared to December 31, 2009, and increased \$137.8 million, or 12%, since September 30, 2009.

The following table sets forth the deposit balances by certain categories at the dates indicated and the percentage of each category to total deposits.

(Dollars in thousands)	September 30, 2010		December 31, 2009		September 30, 2009	
	Amount	Percent	Amount	Percent	Amount	Percent
Non-interest bearing demand deposits	\$ 222,608	17.6%	\$ 192,515	16.8%	\$ 180,029	16.0%
Interest bearing checking	194,292	15.3%	185,693	16.2%	168,126	14.9%
Total checking	416,900	32.9%	378,208	33.0%	348,155	30.9%
Retail savings/money markets	240,421	19.0%	198,928	17.4%	171,212	15.2%
Commercial savings/money markets	332,485	26.3%	270,780	23.7%	260,657	23.1%
Total savings/money markets	572,906	45.3%	469,708	41.1%	431,869	38.3%
Certificates of deposit	271,884	21.5%	269,120	23.5%	259,481	23.0%
Total non-brokered deposits	1,261,690	99.7%	1,117,036	97.6%	1,039,505	92.2%
Brokered Deposits(1)	3,814	0.3%	27,912	2.4%	88,196	7.8%
Total deposits	\$ 1,265,504	100.0%	\$ 1,144,948	100.0%	\$ 1,127,701	100.0%

(1) Brokered deposits include time deposits originated through the Certificate of Deposit Account Registry ( CDAR ) nationwide network, and money market deposits originated through the Demand Deposit Marketplace .

Excluding brokered deposits, deposit balances increased \$144.7 million, or 13%, since December 31, 2009. At September 30, 2010, higher cost savings and money market account balances increased \$103.2 million, or 22%, primarily in the money market accounts, while checking account balances increased \$38.7 million, or 10%, over this period. The deposit growth is attributed to expansion and sales efforts to attract relationship customers seeking a competitive, but secure, alternative to the larger regional and national banks, mutual funds and lower yielding investment alternatives. This deposit growth has provided the Company with the ability to continue to grow loans and reduce wholesale funding balances.

From time to time, management utilizes both brokered deposits and FHLB borrowings (as discussed below) as cost effective alternative wholesale funding sources for continued loan growth. As of September 30, 2010, brokered deposits decreased by \$24.1 million compared to December 31, 2009, due primarily to the strong deposit growth during the period.

*Borrowed Funds*

Borrowed funds, consisting of securities sold under agreements to repurchase ( repurchase agreements ) and FHLB borrowings, decreased \$9.9 million, or 40%, since December 31, 2009, and decreased \$16.1 million, or 52%, since September 30, 2009, due primarily to the strong deposit growth during the period.

The following table sets forth the borrowed funds by categories at the dates indicated and the percentage of each category to total borrowed funds.

(Dollars in thousands)	September 30, 2010		December 31, 2009		September 30, 2009	
	Amount	Percent	Amount	Percent	Amount	Percent
Repurchase agreements	\$ 762	5.1%	\$ 1,416	5.7%	\$ 1,415	4.5%
FHLB borrowings	14,260	94.9%	23,460	94.3%	29,755	95.5%
Total borrowed funds	\$ 15,022	100.0%	\$ 24,876	100.0%	\$ 31,170	100.0%

At September 30, 2010, the Bank had the capacity to borrow additional funds from the FHLB of up to \$173 million and capacity to borrow from the FRB of \$48 million.

Table of Contents*Investment assets under management*

The Company provides a wide range of investment advisory and management services, including brokerage, trust, and investment management (together, investment advisory services ). The market values of these components are affected by fluctuations in the financial markets.

Also included in the investment assets under management total are commercial sweep accounts that are invested in third party money market mutual funds.

The following table sets forth the fair market value of investment assets under management by certain categories at the dates indicated.

(Dollars in thousands)	September, 30 2010	December 31, 2009	September, 30 2009
Investment advisory assets	\$ 460,716	\$ 421,466	\$ 406,519
Commercial sweep accounts	13,489	11,577	15,034
Investment assets under management	\$ 474,205	\$ 433,043	\$ 421,553

Investment advisory assets increased \$39.3 million, or 9%, since December 31, 2009 and \$54.2 million, or 13%, since September 30, 2009. The increase is attributable primarily to asset growth, both from new business and market value appreciation.

Total assets under management, which includes total assets, investment assets under management, and loans serviced for others amounted to \$1.96 billion at September 30, 2010, \$1.79 billion at December 31, 2009, and \$1.75 billion at September 30, 2009.

### Accounting Policies/Critical Accounting Estimates

In preparing the consolidated financial statements in conformity with U.S. generally accepted accounting principles; management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. These estimates and assumptions affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ should the assumptions and estimates used change over time due to changes in circumstances. The Company has not changed its significant accounting and reporting policies from those disclosed in its 2009 Annual Report on Form 10-K.

As discussed in the Company's 2009 Annual Report on Form 10-K, the three most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, impairment review of investment securities and the impairment review of goodwill and other intangible assets. Refer to note 1 to the Company's consolidated financial statements included in the Company's 2009 Annual Report on Form 10-K for significant accounting policies.

**Liquidity**

Liquidity is the ability to meet cash needs arising from, among other things, fluctuations in loans, investments, deposits and borrowings. Liquidity management is the coordination of activities so that cash needs are anticipated and met readily and efficiently. The Company's liquidity policies are set and monitored by the Company's Asset-Liability Committee of the Board of Directors. The Company's asset-liability objectives are to engage in sound balance sheet management strategies, maintain liquidity, provide and enhance access to a diverse and stable source of funds, provide competitively priced and attractive products to customers and conduct funding at a low cost relative to current market conditions. Funds gathered are used to support current commitments, to fund earning asset growth, and to take advantage of selected leverage opportunities.

The Company's liquidity is maintained by projecting cash needs, balancing maturing assets with maturing liabilities, monitoring various liquidity ratios, monitoring deposit flows, maintaining cash flow within the investment portfolio, and maintaining wholesale funding resources. The Company's wholesale funding sources include borrowing capacity in the brokered deposit markets, at the FHLB, through the FRB Discount Window, and through fed fund purchase arrangements with correspondent banks.

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Management believes that the Company has adequate liquidity to meet its obligations. The Company currently funds earning assets primarily with deposits, brokered deposits, repurchase agreements, FHLB borrowings, junior subordinated debentures, proceeds from stock offerings and earnings.

**Capital Resources**

As of September 30, 2010, both the Company and the Bank qualify as well capitalized under applicable regulations of the Federal Reserve Board and the Federal Deposit Insurance Corporation. To be categorized as well capitalized, the Company and the Bank must maintain minimum total, Tier 1 and, in the case of the Bank, leverage capital ratios as set forth in the table below.

The Company's actual capital amounts and ratios are presented as of September 30, 2010 in the table below. The Bank's capital amounts and ratios do not differ materially from the amounts and ratios presented for the Company.

(Dollars in thousands)	Actual		Minimum Capital for Capital Adequacy Purposes		Minimum Capital To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to risk weighted assets)	\$ 132,384	11.39%	\$ 93,012	8.00%	\$ 116,265	10.00%
Tier 1 Capital (to risk weighted assets)	\$ 117,365	10.09%	\$ 46,506	4.00%	\$ 69,759	6.00%
Tier 1 Capital (to average assets)	\$ 117,365	8.68%	\$ 54,100	4.00%	\$ 67,625	5.00%*

\* This requirement does not apply to the Company and is reflected in the table merely for informational purposes with respect to the Bank. For the Bank to qualify as well capitalized, it must also maintain a leverage capital ratio (Tier 1 capital to average assets) of at least 5%.

Although the Company believes its current capital is adequate to support ongoing operations, 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 subscription rights offering and supplemental community offering under the shelf registration, raising \$8.9 million in new capital (\$8.8 million net of offering expenses). The Company contributed the net proceeds from the combined offerings to the Bank.

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 invest \$902 thousand of the \$2.8 million cash dividend paid through September 30, 2010, into 79,836 shares of the Company's common stock.

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As previously announced on October 19, 2010, the Company declared a quarterly dividend of \$0.10 per share to be paid on December 1, 2010, to shareholders of record as of November 10, 2010. The quarterly dividend represents a 5.3% increase over the 2009 dividend rate.

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**Results of Operations**

**Three Months Ended September 30, 2010 vs. Three Months Ended September 30, 2009**

*Unless otherwise indicated, the reported results are for the three months ended September 30, 2010 with the comparable period, and prior period being the three months ended September 30, 2009. Average yields are presented on a tax equivalent basis.*

The Company reported third quarter 2010 net income of \$2.7 million compared to \$2.3 million for the same period in 2009, an increase of 20%. Diluted earnings per common share were \$0.30 for the three months ended September 30, 2010 and \$0.28 for the comparable period, an increase of 7%.

The increase in net income for the quarter ended September 30, 2010, when compared to the same period in 2009, was primarily due to increases in net interest income and non-interest income, partially offset by increases in non-interest expenses.

*Net Interest Income*

The Company's net interest income for the quarter ended September 30, 2010 amounted to \$13.9 million, compared to \$12.5 million in the September 2009 quarter, an increase of \$1.4 million, or 11%. The increase in net interest income over the comparable period was due primarily to loan growth and to a lesser extent the net interest margin increase noted below.

*Net Interest Margin*

The Company's tax equivalent net interest margin (margin) was 4.40% for the three months ended September 30, 2010, compared to 4.32% in the comparable 2009 period. This increase resulted primarily from the cost of funds declining at a faster rate than asset yields during the past year. The cost of funding declined by 34 basis points compared to the three months ended September 30, 2009, while interest earning asset yields declined 26 basis points over the same period.

*Rate / Volume Analysis*

The following table sets forth the extent to which changes in interest rates and changes in the average balances of interest-earning assets and interest-bearing liabilities have affected interest income and expense during the three months ended September 30, 2010 compared to the three months ended September 30, 2009. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to: (1) volume (change in average portfolio balance multiplied by prior period average rate); (2) interest rate (change in average interest rate multiplied by prior period average balance); and (3) rate and volume (the remaining difference).



(Dollars in thousands)	Net Change	Increase (decrease) due to		
		Volume	Rate	Rate/ Volume
<b>Interest Income</b>				
Loans	\$ 613	\$ 971	\$ (327)	\$ (31)
Investments (1)	(51)	279	(310)	(20)
Total interest earnings assets	562	1,250	(637)	(51)
<b>Interest Expense</b>				
Int chkg, savings and money market	14	274	(220)	(40)
Certificates of deposit	(633)	(5)	(632)	4
Brokered certificates of deposit	(197)	(197)		
Total Certificates of Deposit	(830)	(202)	(632)	4
Borrowed funds	(12)	(33)	72	(51)
Junior subordinated debentures				
Total interest-bearing deposits, borrowed funds and debentures	(828)	39	(780)	(87)
<b>Change in net interest income</b>	<b>\$ 1,390</b>	<b>\$ 1,211</b>	<b>\$ 143</b>	<b>\$ 36</b>

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(1) Investments include investment securities and short-term investments.

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The following table presents the Company's average balance sheet, net interest income and average rates for the three months ended September 30, 2010 and 2009.

**AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS**

(Dollars in thousands)	Three Months Ended September 30, 2010			Three Months Ended September 30, 2009		
	Average Balance	Interest	Average Yield(1)	Average Balance	Interest	Average Yield(1)
<b>Assets:</b>						
Loans (2)	\$ 1,115,812	\$ 15,334	5.50%	\$ 1,045,580	\$ 14,721	5.63%
Investments (3)	170,043	1,019	2.95%	140,852	1,070	3.83%
Total interest earnings assets	1,285,855	16,353	5.16%	1,186,432	15,791	5.42%
Other assets	77,515			74,772		
Total assets	\$ 1,363,370			\$ 1,261,204		
<b>Liabilities and stockholders' equity:</b>						
Int chkg, savings and money market	\$ 724,020	1,123	0.61%	\$ 581,294	1,109	0.76%
Certificates of deposit	268,730	1,002	1.48%	269,585	1,635	2.41%
Brokered certificates of deposit				60,979	197	1.28%
Borrowed funds	17,684	37	0.83%	57,288	49	0.34%
Junior subordinated debentures	10,825	294	10.88%	10,825	294	10.88%
Total interest-bearing funding	1,021,259	2,456	0.95%	979,971	3,284	1.33%
Net interest rate spread			4.21%			4.09%
Demand deposits	215,876			174,283		
Total deposits, borrowed funds and debentures	1,237,135	2,456	0.79%	1,154,254	3,284	1.13%
Other liabilities	11,504			11,376		
Total liabilities	1,248,639			1,165,630		
Stockholders' equity	114,731			95,574		
Total liabilities and stockholders' equity	\$ 1,363,370			\$ 1,261,204		
Net interest income		\$ 13,897			\$ 12,507	
Net interest margin (tax equivalent)			4.40%			4.32%

(1) Average yields are presented on a tax equivalent basis. The tax equivalent effect associated with loans and investments, which was not included in the interest amount above, was \$359 thousand and \$382 thousand for the periods ended September 30, 2010 and September 30, 2009 respectively.

(2) Average loans include non-accrual loans and are net of average deferred loan fees.

(3) Average investment balances are presented at average amortized cost and include investment securities and short-term investments.

*Interest Income*

For the third quarter of 2010, total interest income amounted to \$16.4 million, an increase of \$562 thousand, or 4%, compared to the prior period. The increase resulted primarily from an increase of \$99.4 million, or 8%, in the average balance of interest earning assets, primarily loans, partially offset by a 26 basis point decline in the yield on interest earning assets due to the lower interest rate environment during the period.

Interest income on loans, which accounts for the majority of interest income, amounted to \$15.3 million for the quarter ended September 30, 2010, an increase of \$613 thousand, or 4%, over the comparable period, due primarily to loan growth. The average loan balances increased \$70.2 million, or 7%, compared to the prior period, while the average yield on loans declined 13 basis points compared to the prior period and amounted to 5.50% for the three months ended September 30, 2010.

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Total investment income, which represents the remainder of interest income, amounted to \$1.0 million for the three months ended September 30, 2010, a decrease of \$51 thousand, or 5%, compared to the prior period. The decrease resulted from the impact of an 88 basis point decrease in the average yield on investment securities and an increase in the amount of short term investments held by the Company, partially offset by an increase of \$29.2 million, or 21%, in the average balances of investments over the comparable period.

*Interest Expense*

For the three months ended September 30, 2010, total interest expense amounted to \$2.5 million, a decrease of \$828 thousand, or 25%, compared to the prior period. The decrease resulted primarily from a 34 basis point decrease in the average cost of funding due primarily to the reduction in deposit market interest rates over the period and increases in the average balances of non-interest bearing deposits. This decrease was partially offset by the expense associated with the \$41.3 million, or 4%, increase in the average balance of interest bearing funding sources primarily attributed to expansion and sales efforts to attract deposit relationship customers seeking a competitive, but secure, alternative to the larger regional and national banks, mutual funds and lower yielding investment alternatives. This deposit growth has provided the Company with the ability to reduce wholesale funding balances.

Interest expense on interest checking, savings and money market accounts amounted to \$1.1 million for the quarter ended September 30, 2010, a decrease of \$14 thousand, or 1%, compared to the same quarter in the prior period. The average cost of these accounts decreased 15 basis points to 0.61%, while the average balances increased \$142.7 million, or 25%, compared to the prior period. Average balance increases were noted primarily in money market accounts. Included in average money market balances is \$2.6 million in brokered deposits associated with a recently introduced brokered money market product.

Interest expense on total CDs (brokered and non-brokered) decreased \$830 thousand, or 45%, compared to the prior period and amounted to \$1.0 million for the three months ended September 30, 2010.

- *Non-Brokered CDs:*

For the third quarter of 2010, interest expense on non-brokered CDs amounted to \$1.0 million, a decrease of \$633 thousand, or 39%, over the comparable period. The average cost of non-brokered CDs decreased 93 basis points, to 1.48%, for the three months ended September 30, 2010, while average balances remained relatively flat compared to the prior period.

- *Brokered CDs:*

There were no brokered CD balances in the third quarter of 2010, due to the increase in total deposits, therefore the interest expense on brokered CDs decreased \$197 thousand, or 100%, over the comparable period. The average balance decreased \$61.0 million, or 100% compared to the prior period.

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Interest expense on borrowed funds, consisting of FHLB borrowings and repurchase agreements, amounted to \$37 thousand for the third quarter of 2010, a decrease of \$12 thousand, or 24%, over the same period last year. The decrease was primarily attributed to the reduction in average balances of approximately \$39.6 million, or 69%, partially offset by a 49 basis point increase in the average cost compared to the prior period.

The interest expense and average rate on junior subordinated debentures remained the same at \$294 thousand and 10.88% for both the three months ended September 30, 2010 and September 30, 2009.

The average balance of non-interest bearing demand deposits, for the three months ended September 30, 2010, increased \$41.6 million, or 24%, as compared to the same period in 2009. Non-interest bearing demand deposits are an important component of the Company's core funding strategy. This non-interest bearing funding source represented 18% and 16% of total average deposit balances for the three months ended September 30, 2010 and 2009, respectively.

### *Provision for Loan Loss*

The provision for loan losses increased \$135 thousand compared to the same period last year and amounted to \$1.3 million for three months ended September 30, 2010. The provision for loan losses was impacted primarily by the level of general non-performing loans and reserves for specific adversely classified loans, net charge-offs, and the level of loan growth.

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

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For further discussion regarding the provision for loan losses and management's assessment of the adequacy of the allowance for loan losses see Financial Condition - Credit Risk/Asset Quality and the Allowance for Loan Losses in this Item 2 above and Risk Elements/Asset Quality and Allowance for Loan Losses in the Financial Condition section of Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's 2009 Annual Report on Form 10-K.

*Non-Interest Income*

Non-interest income for the three months ended September 30, 2010 amounted to \$2.7 million, an increase of \$303 thousand, or 13%, as compared to the three months ended September 30, 2009. The significant changes are discussed below.

There were no security sales or material OTTI charges on investment securities in the third quarters of 2010 or 2009.

Investment advisory income increased \$192 thousand, or 28%, in the three months ended September 30, 2010 compared to the same period in the prior year. The increase in investment advisory income primarily relates to net asset growth, both from market appreciation and new business, achieved since the end of the comparable period in 2009.

Net gain on loan sales increased \$60 thousand, or 41%, for the three months ended September 30, 2010 when compared to the same period in 2009 and resulted from the increase in volume of residential loan production in the current period due to the current low interest rates on residential mortgages. In the latter half of 2009 through June 2010, residential loan rates remained fairly consistent, but have declined in the third quarter of 2010.

*Non-Interest Expense*

Non-interest expense for the three months ended September 30, 2010 amounted to \$11.2 million, an increase of \$688 thousand, or 7%, compared to the same period in 2009. The significant changes are discussed below.

Salaries and employee benefits increased \$545 thousand, or 9%. The increase was primarily due to the personnel costs necessary to support the Company's strategic growth initiatives, as well as salary adjustments since the prior period, and increased expenses for performance-based incentive compensation and the companywide profit sharing plan.

For the three months ended September 30, 2010, deposit insurance premiums increased \$76 thousand, or 19%, primarily due to deposit growth.

*Income Tax Expense*

Income tax expense for the three months ended September 30, 2010 and 2009 was \$1.3 million and \$935 thousand, respectively. The effective tax rate for the three months ended September 30, 2010 and 2009 was 33.0% and 29.2%, respectively. The increase in the effective tax rate was primarily due to the higher level of taxable earnings in the current period, and the diminished impact of non-taxable income from certain tax-exempt assets on higher earnings.

**Results of Operations**

**Nine Months Ended September 30, 2010 vs. Nine Months Ended September 30, 2009**

*Unless otherwise indicated, the reported results are for the nine months ended September 30, 2010 with the comparable period , prior year and prior period being the nine months ended September 30, 2009. Average yields are presented on a tax equivalent basis.*

The Company reported year-to-date 2010 net income of \$8.2 million compared to \$5.2 million for the same period in 2009, an increase of 59%. Diluted earnings per common share were \$0.89 for the nine months ended September 30, 2010 compared to \$0.63 for the comparable 2009 period, an increase of 41%.

The increase in net income for the nine months ended September 30, 2010, when compared to the same period in 2009, was primarily due to increases in net interest income and non-interest income from growth, partially offset by increases in non-interest expenses. Results for the 2009 year-to-date period were also negatively impacted by the FDIC special assessment and impairment charges on investment securities.

Table of Contents*Net Interest Income*

The Company's net interest income for the nine months ended September 30, 2010 was \$40.9 million compared to \$35.3 million for the nine months ended September 30, 2009, an increase of \$5.6 million, or 16%. The increase in net interest income over the comparable period was due primarily to loan growth and the net interest margin increase noted below.

*Net Interest Margin*

The Company's tax equivalent net interest margin (margin) was 4.44% for the nine months ended September 30, 2010, compared to 4.23% in the comparable 2009 period. This increase resulted primarily from the cost of funds declining at a faster rate than asset yields during the past year. The cost of funding declined by 46 basis points compared to the nine months ended September 30, 2009, while interest earning asset yields declined 25 basis points over the same period.

*Rate / Volume Analysis*

The following table sets forth the extent to which changes in interest rates and changes in the average balances of interest-earning assets and interest-bearing liabilities have affected interest income and expense during the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to: (1) volume (change in average portfolio balance multiplied by prior period average rate); (2) interest rate (change in average interest rate multiplied by prior period average balance); and (3) rate and volume (the remaining difference).

(Dollars in thousands)	Net Change	Volume	Increase (decrease) due to	
			Rate	Rate/ Volume
<b>Interest Income</b>				
Loans	\$ 3,021	\$ 4,341	\$ (1,154)	\$ (166)
Investments (1)	(661)	322	(1,017)	34
Total interest earnings assets	2,360	4,663	(2,171)	(132)
<b>Interest Expense</b>				
Int chkg, savings and money market	(229)	1,209	(1,098)	(340)
Certificates of deposit	(2,124)	185	(2,235)	(74)
Brokered certificates of deposit	(841)	(825)	(433)	417
Total Certificates of Deposit	(2,965)	(640)	(2,668)	343
Borrowed funds	(67)	(126)	162	(103)
Junior subordinated debentures				
Total interest-bearing deposits, borrowed funds and debentures	(3,261)	443	(3,604)	(100)
Change in net interest income	\$ 5,621	\$ 4,220	\$ 1,433	\$ (32)



(1) Investments include investment securities and short-term investments.

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The following table presents the Company's average balance sheet, net interest income and average rates for the nine months ended September 30, 2010 and 2009.

**AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS**

(Dollars in thousands)	Nine Months Ended September 30, 2010			Nine Months Ended September 30, 2009		
	Average Balance	Interest	Average Yield(1)	Average Balance	Interest	Average Yield(1)
<b>Assets:</b>						
Loans (2)	\$ 1,102,604	\$ 45,457	5.55%	\$ 999,792	\$ 42,436	5.71%
Investments (3)	162,652	3,186	3.25%	152,279	3,847	4.14%
Total interest earnings assets	1,265,256	48,643	5.25%	1,152,071	46,283	5.50%
Other assets	76,376			72,358		
Total assets	\$ 1,341,632			\$ 1,224,429		
<b>Liabilities and stockholders' equity:</b>						
Int chkg, savings and money market	\$ 697,943	3,401	0.65%	\$ 524,154	3,630	0.93%
Certificates of deposit	273,555	3,262	1.59%	264,453	5,386	2.72%
Brokered Certificates of deposit	2,831	17	0.80%	71,373	858	1.61%
Borrowed funds	31,925	144	0.60%	82,679	211	0.34%
Junior subordinated debentures	10,825	883	10.88%	10,825	883	10.88%
Total interest-bearing funding	1,017,079	7,707	1.01%	953,484	10,968	1.54%
Net interest rate spread			4.24%			3.96%
Demand deposits	201,825			166,718		
Total deposits, borrowed funds and debentures	1,218,904	7,707	0.85%	1,120,202	10,968	1.31%
Other liabilities	10,940			10,453		
Total liabilities	1,229,844			1,130,655		
Stockholders' equity	111,788			93,774		
Total liabilities and stockholders' equity	\$ 1,341,632			\$ 1,224,429		
Net interest income		\$ 40,936			\$ 35,315	
Net interest margin (tax equivalent)			4.44%			4.23%

(1) Average yields are presented on a tax equivalent basis. The tax equivalent effect associated with loans and investments, which was not included in the interest amount above, was \$1.1 million and \$1.2 million for the periods ended September 30, 2010 and September 30, 2009 respectively.

(2) Average loans include non-accrual loans and are net of average deferred loan fees.

(3) Average investment balances are presented at average amortized cost and include investment securities and short-term investments.

*Interest Income*

Total interest income amounted to \$48.6 million for the nine months ended September 30, 2010, an increase of \$2.4 million, or 5%, compared to the prior period. The increase resulted primarily from an increase of \$113.2 million, or 10%, in the average balance of interest earning assets, partially offset by a 25 basis point decline in the yield on interest earning assets due to the lower interest rate environment during the period.

Interest income on loans, which accounts for the majority of interest income, amounted to \$45.5 million, an increase of \$3.0 million, or 7%, over the comparable period, due primarily to loan growth. The average loan balances increased \$102.8 million, or 10%, compared to the prior period, while the average yield on loans declined 16 basis points over the same period and amounted to 5.55% for the nine months ended September 30, 2010.

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Total investment income, which represents the remainder of interest income, amounted to \$3.2 million for the nine months ended September 30, 2010, a decrease of \$661 thousand, or 17%, compared to the prior period. The decrease resulted from the impact of an 89 basis point decrease in the average yield on investment securities. The decrease in yield resulted from the lower interest rate market and an increase in the amount of short term investments held by the Company. The average balances of investments increased \$10.4 million or 7%, compared to the prior comparable period.

*Interest Expense*

For the nine months ended September 30, 2010, total interest expense amounted to \$7.7 million, a decrease of \$3.3 million, or 30%, compared to the prior period. The decrease resulted primarily from a 46 basis point decline in the average cost of funding due to the reduction in market interest rates over the period and increases in the average balances of non-interest bearing deposits. This decrease was partially offset by the expense associated with the \$63.6 million, or 7%, increase in the average balance of interest bearing funding sources primarily attributed to expansion and sales efforts to attract deposit relationship customers seeking a competitive, but secure, alternative to the larger regional and national banks, mutual funds and lower yielding investment alternatives. This deposit growth has provided the Company with the ability to continue to grow loans and reduce wholesale funding balances.

Interest expense on interest checking, savings and money market accounts amounted to \$3.4 million for the nine months ended September 30, 2010, a decrease of \$229 thousand, or 6%, over the same period in the prior year. The average cost of these accounts decreased 28 basis points to 0.65%, while the average balances increased \$173.8 million, or 33%, compared to the prior period. Average balance increases were noted primarily in our money market accounts. Included in average money market balances is \$1.1 million in brokered deposits associated with a money market product introduced in the second quarter of 2010.

Interest expense on total CDs (brokered and non-brokered) decreased \$3.0 million, or 47%, compared to the prior period and amounted to \$3.3 million for the nine months ended September 30, 2010.

- *Non-Brokered CDs:*

Interest expense on non-brokered CDs amounted to \$3.3 million, a decrease of \$2.1 million, or 39%, over the comparable period. The average cost of non-brokered CDs decreased 113 basis points, to 1.59% for the nine months ended September 30, 2010, while average balances increased \$9.1 million, or 3%, compared to the prior period.

- *Brokered CDs:*

Interest expense on brokered CDs amounted to \$17 thousand, a decrease of \$841 thousand, or 98%, over the comparable period. The decrease resulted from both lower balances and declines in rates. The average cost of brokered CDs decreased 81 basis points, to 0.80%, for the nine months ended September 30, 2010 and the average balances decreased by \$68.5 million, or 96%, compared to the 2009 period, as deposit balances have increased as noted above. There were no brokered CD balances in the second or third quarter of 2010.

Interest expense on borrowed funds, consisting of FHLB borrowings and repurchase agreements, amounted to \$144 thousand, a decrease of \$67 thousand, or 32%, compared to the same period last year. The decrease was primarily attributed to the reduction in average balances of approximately \$50.8 million compared to the prior period, due primarily to the deposit growth achieved over the period, partially offset by an increase of 26 basis points in the cost of these borrowings.

The interest expense and average rate on junior subordinated debentures remained the same at \$883 thousand and 10.88% for both the nine months ended September 30, 2010 and September 30, 2009.

The average balance of non-interest bearing demand deposits, for the nine months ended September 30, 2010, increased \$35.1 million, or 21%, as compared to the same period in 2009. Non-interest bearing demand deposits are an important component of the Company's core funding strategy. This non-interest bearing funding represented 17% and 16% of total average deposit balances for the nine months ended September 30, 2010 and 2009, respectively.

*Provision for Loan Loss*

The provision for loan losses increased \$81 thousand compared to the same period last year and amounted to \$3.2 million for the nine months ended September 30, 2010. The provision for loan losses was impacted primarily by the level of general non-performing loans and reserves for specific adversely classified loans, net charge-offs, and the level of loan growth.

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

For further discussion regarding the provision for loan losses and management's assessment of the adequacy of the allowance for loan losses see Financial Condition - Credit Risk/Asset Quality and the Allowance for Loan Losses in this Item 2 above and Risk Elements/Asset Quality and Allowance for Loan Losses in the Financial Condition section of Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's 2009 Annual Report on Form 10-K.

*Non-Interest Income*

Non-interest income for the nine months ended September 30, 2010 amounted to \$8.6 million, an increase of \$1.5 million or 21%, as compared to the nine months ended September 30, 2009. The significant changes are discussed below.

Net gains on security sales and OTTI charges on certain equity securities, combined, increased \$580 thousand compared to the period ended September 30, 2009. Net gains on security sales were \$777 thousand in the nine months ended 2010 resulting from the sales of \$4.6 million of investment securities, compared to net gains of \$971 thousand from the sale of \$38.5 million in investment securities in comparable 2009 period, primarily in the first quarter of 2009. The OTTI charge on a certain previously impaired equity investment was \$8 thousand in the first nine months of 2010, compared to OTTI charges of \$782 thousand in the comparable period in 2009, based primarily on the severity of the declines in market values at that time and the uncertainty of recovery in the short-term for those equities.

Investment advisory fees increased \$579 thousand, or 28%, in the first nine months of 2010 over the same period in the prior year. The increase in investment advisory fees primarily relates to net asset growth, both from market appreciation and new business.

Deposit service fees increased \$231 thousand, or 8%, in the nine months ended September 30, 2010 as compared to the same period last year primarily in overdraft and electronic transaction fees.

Net gain on loan sales decreased \$134 thousand, or 25%, for the nine months ended September 30, 2010 when compared to the same period in 2009 and resulted from the decrease in volume of residential loan production in the current period, primarily in the first half of 2010.

The increase in year to date 2010 other income over the same period in 2009 was primarily due to the sales of six properties in the first half of 2010 resulting in net gains on sales of OREO of \$120 thousand. There were no gains on sales of OREO during the same period in 2009.

*Non-Interest Expense*

Non-interest expense for the nine months ended September 30, 2010 amounted to \$34.1 million, an increase of \$2 million, or 6%, compared to the same period in 2009. The significant changes are discussed below.

Salaries and employee benefits increased \$1.6 million, or 9%. The increase was primarily due to the personnel costs necessary to support the Company's strategic growth initiatives, as well as salary adjustments since the prior period, and increased expenses for performance-based incentive compensation and the companywide profit sharing plan.

Technology and telecommunications expense for the nine months ended September 30, 2010 increased \$457 thousand, or 20%, over the same period last year, primarily due to growth and expansion costs to support the Company's strategic initiatives, including the costs of a back-up data center, recently put into operation. The Company continually invests in technology initiatives to provide our customers with new product features, in addition to investments to maintain data security and improve overall efficiency.

Advertising and public relations expenses increased \$252 thousand, or 17%, compared to the prior period. The increase primarily resulted from advertising and public relations costs which supported the Company's expansion and business development efforts, including costs associated with the Bank's second annual Celebration of Excellence which recognized local businesses and individuals for their commitment to the communities we serve.

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For the nine months ended September 30, 2010, deposit insurance premiums decreased \$342 thousand, or 20%, due to the \$576 thousand expensed in the second quarter of 2009, related to the FDIC's special assessment which applied to all insured banks, partially offset by deposit growth over the period. Refer to item (m) "FDIC Deposit Insurance Assessment" contained in Note 1 "Summary of Significant Accounting Policies", to the Company's consolidated financial statements contained in the Company's 2009 Annual Report on Form 10-K for further discussion of the FDIC assessment charges imposed in 2009.

*Income Tax Expense*

Income tax expense for the nine months ended September 30, 2010 and 2009 was \$4 million and \$2.1 million respectively. The effective tax rate for the nine months ended September 30, 2010 and 2009 was 32.9% and 28.5%, respectively. The increase in the effective tax rate was primarily due to the higher level of taxable earnings in the current period, and the diminished impact of non-taxable income from certain tax-exempt assets on higher earnings.

**Item 3 Quantitative and Qualitative Disclosures About Market Risk**

The Company's primary market risk is interest rate risk. Oversight of interest rate risk management is centered on the Company's Asset-Liability Committee (the committee). The committee is comprised of six outside directors of the Company and three executive officers of the Company, who are also members of the Board of Directors. In addition, several directors who are not on the committee rotate in on a regular basis. Annually, the committee approves the Company's asset-liability management policy, which provides management with guidelines for controlling interest rate risk, as measured through net interest income sensitivity to changes in interest rates, within certain tolerance levels. The committee also establishes and monitors guidelines for the Company's liquidity and capital ratios.

The Company's asset-liability management strategies and guidelines are reviewed on a periodic basis by management and presented and discussed with the committee on at least a quarterly basis. These strategies and guidelines are revised based on changes in interest rate levels, general economic conditions, competition in the marketplace, the current interest rate risk position of the Company, anticipated growth and other factors.

One of the principal factors in maintaining planned levels of net interest income is the ability to design effective strategies to manage the impact of interest rate changes on future net interest income. Quarterly, management completes a net interest income sensitivity analysis, which is presented to the committee. This analysis includes a simulation of the Company's net interest income under various interest rate scenarios. Variations in the interest rate environment affect numerous factors, including prepayment speeds, reinvestment rates, maturities of investments (due to call provisions), and interest rates on various asset and liability accounts.

The Company can be subject to net interest margin (margin) compression depending on the economic environment and the shape of the yield curve. Under the Company's current balance sheet position, the Company's margin generally performs slightly better over time in a rising rate environment and a parallel yield curve shift, while it generally decreases when the yield curve is flattening, inverted or declining.



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Under a flattening yield curve scenario, margin compression occurs as the spread between the cost of funding and the yield on interest earning assets narrows. Under this scenario the degree of margin compression is highly dependent on the Company's ability to fund asset growth through lower cost deposits. However, if the curve is flattening, while short-term rates are rising, the adverse impact on margin may be somewhat delayed, as increases in the Prime Rate will initially result in the Company's asset yields re-pricing more quickly than funding costs.

Under an inverted yield curve situation, shorter-term rates exceed longer-term rates, and the impact on margin is similar but more adverse than the flat curve scenario. Again, however, the extent of the impact on margin is highly dependent on the Company's balance sheet mix.

Under a declining yield curve scenario, margin compression will eventually occur as the yield on interest earning assets decreases more rapidly than decreases in funding costs. The primary causes would be the impact of interest rate decreases (including decreases in the Prime Rate) on adjustable rate loans and the fact that decreases in deposit rates may be limited or lag decreases in the Prime Rate. The Company experienced margin compression due to the effects of a declining rate environment into early 2009 as the Federal Reserve Board reduced its Fed Funds Target Rate late in the fourth quarter of 2008 to a range of 0.0% to 0.25%. The Fed Funds Target Rate and the Prime Rate have remained unchanged since 2008 through September 30, 2010.

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The Company's margin improved during the latter half of 2009 and into mid 2010, as cost of funds continued to decline due to the extended duration of the low rate environment, while the yield on certain assets tied to the Prime Rate had already repriced downward in 2008 and early 2009. During the third quarter of 2010 the Bank's margin decreased 8 basis points as interest rates on earning assets continued to decline while deposit rates decreased at a slower rate due to competition in the marketplace for deposits.

There have been no material changes in the results of the Company's net interest income sensitivity analysis as reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. At September 30, 2010, management continues to consider the Company's primary interest rate risk exposure to be margin compression that may result from changes in interest rates and/or changes in the mix of the Company's balance sheet components. Specifically, these components include fixed versus variable rate loans and investments on the asset side, and higher cost deposits and borrowings versus lower cost deposits on the liability side.

**Item 4 Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

The Company maintains a set of disclosure controls and procedures and internal controls designed to ensure that the information required to be disclosed in reports that it files or submits to the United States Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

The Company carried out an evaluation as of the end of the period covered by this report under the supervision and with the participation of the Company's management, including its chief executive officer and chief financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b). Based upon that evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective.

**Changes in Internal Control over Financial Reporting**

There has been no change in the Company's internal control over financial reporting that has occurred during the Company's most recent fiscal quarter (i.e., the three months ended September 30, 2010) that has materially affected, or is reasonably likely to materially affect, such internal controls.

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**PART II OTHER INFORMATION**

**Item 1 - Legal Proceedings**

There are no material pending legal proceedings to which the Company or its subsidiaries are a party, other than ordinary routine litigation incidental to the business of the Company. Management does not believe resolution of any present litigation will have a material adverse effect on the consolidated financial condition or results of operations of the Company.

**Item 1A Risk Factors**

Management believes that there have been no material changes in the Company's risk factors as reported in the Annual Report on Form 10-K for the year ended December 31, 2009, other than the increased uncertainty regarding future regulatory burdens and other potential consequences resulting from the enactment of the Dodd-Frank Act, which is described in further detail in Item 2 of Part I above under the heading "Overview Opportunities and Risks".

**Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds**

The Company has not sold any equity securities that were not registered under the Securities Act of 1933 during the three months ended September 30, 2010. 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 three months ended September 30, 2010.

**Item 3 - Defaults upon Senior Securities**

Not Applicable

**Item 4 [Removed and Reserved]**

**Item 5 - Other Information**

Not Applicable

**Item 6 - Exhibits**

Exhibit No. and Description

- 31.1 Certification of Principal Executive Officer under Securities Exchange Act Rule 13a-14(a)
- 31.2 Certification of Principal Financial Officer under Securities Exchange Act Rule 13a-14(a)
- 32 Certification of Principal Executive Officer and Principal Financial Officer under 18 U.S.C. § 1350 Furnished Pursuant to Securities Exchange Act Rule 13a-14(b)

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**SIGNATURES**

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

ENTERPRISE BANCORP, INC.

DATE: November 9, 2010

By:

/s/ James A. Marcotte  
James A. Marcotte  
Executive Vice President,  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)