ENTERPRISE BANCORP INC /MA/
Form 10-Q
November 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period from to

Commission File Number 0-21021

Enterprise Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Massachusetts (State or other jurisdiction of incorporation or organization)	**04-3308902** (IRS Employer Identification No.)
222 Merrimack Street, Lowell, Massachusetts (Address of principal executive offices)	**01852** (Zip code)

Registrant s telephone number, including area code:**(978) 459-9000**

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.

x Yes o No

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

Large accelerate filer o Accelerated filer x Non-accelerated filer o

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

o Yes x No

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: November 7, 2006**,** Common Stock - Par Value $0.01: **7,706,402** shares outstanding

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ENTERPRISE BANCORP, INC.

Consolidated Balance Sheets
September 30, 2006 and December 31, 2005
(unaudited)

(Dollars in thousands)	**September 30, 2006**	**December 31, 2005**
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 28,408	$ 32,950
Short-term investments	20,856	5,431
Total cash and cash equivalents	49,264	38,381
Investment securities at fair value	142,936	156,521
Loans, less allowance for loan losses of $12,721 at September 30, 2006 and $12,050 at December 31, 2005	733,841	687,676
Premises and equipment	13,848	11,530
Accrued interest receivable	5,615	4,888
Deferred income taxes, net	6,241	6,200
Bank-owned life insurance	12,074	3,877
Prepaid expenses and other assets	1,959	2,392
Income taxes receivable	842	748
Core deposit intangible, net of amortization	509	608
Goodwill	5,656	5,656
Total assets	$ 972,785	$ 918,477
Liabilities and Stockholders Equity		
Liabilities		
Deposits	$ 867,917	$ 775,387
Borrowed funds	9,967	58,639
Junior subordinated debentures	10,825	10,825
Accrued expenses and other liabilities	7,580	4,624
Accrued interest payable	2,433	1,172
Total liabilities	898,722	850,647
Commitments and Contingencies		
Stockholders Equity		
Preferred stock, $0.01 par value per share; 1,000,000 shares authorized; no shares issued		
Common stock $0.01 par value per share; 10,000,000 shares authorized; 7,702,702 and 7,594,268 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively	77	76
Additional paid-in capital	25,463	24,253
Retained earnings	49,120	44,034
Accumulated other comprehensive loss	(597)	(533)
Total stockholders equity	74,063	67,830
Total liabilities and stockholders equity	$ 972,785	$ 918,477

See accompanying notes to the unaudited consolidated financial statements.

ENTERPRISE BANCORP, INC.

Consolidated Statements of Income
Three and Nine months ended September 30, 2006 and 2005
(unaudited)

(Dollars in thousands, except per share data)	Three Months Ended Sept. 30, 2006	Three Months Ended Sept. 30, 2005	Nine Months Ended Sept. 30, 2006	Nine Months Ended Sept. 30, 2005
Interest and dividend income:				
Loans	$ 13,991	$ 10,627	$ 39,802	$ 29,171
Investment securities	1,510	1,714	4,558	5,360
Total short-term investments	97	41	257	213
Total interest and dividend income	15,598	12,382	44,617	34,744
Interest expense:				
Deposits	4,722	2,135	12,021	5,714
Borrowed funds	95	121	726	312
Junior subordinated debentures	294	294	883	883
Total interest expense	5,111	2,550	13,630	6,909
Net interest income	10,487	9,832	30,987	27,835
Provision for loan losses	375	360	892	835
Net interest income after provision for loan losses	10,112	9,472	30,095	27,000
Non-interest income:				
Investment advisory fees	730	588	1,994	1,678
Deposit service fees	454	435	1,281	1,242
Net gains on sales of investment securities	28	22	19	227
Gains on sales of loans	39	98	117	195
Other income	605	605	1,694	1,451
Total non-interest income	1,856	1,748	5,105	4,793
Non-interest expense:				
Salaries and employee benefits	4,835	4,736	14,964	13,534
Occupancy expenses	1,539	1,372	4,474	4,126
Audit, legal and other professional fees	406	405	1,224	1,170
Advertising and public relations	326	206	955	653
Supplies and postage	235	256	636	664
Investment advisory and custodial expenses	130	119	364	352
Other operating expenses	609	591	1,915	1,762
Total non-interest expense	8,080	7,685	24,532	22,261
Income before income taxes	3,888	3,535	10,668	9,532
Income tax expense	1,437	1,282	3,979	3,447
Net income	$ 2,451	$ 2,253	$ 6,689	$ 6,085
Basic earnings per share	$ 0.32	$ 0.30	$ 0.88	$ 0.82
Diluted earnings per share	$ 0.31	$ 0.29	$ 0.86	$ 0.79
Basic weighted average common shares outstanding	7,691,407	7,515,734	7,644,641	7,437,712
Diluted weighted average common shares outstanding	7,840,578	7,731,416	7,811,668	7,675,956

See accompanying notes to the unaudited consolidated financial statements.

ENTERPRISE BANCORP, INC.

Consolidated Statement of Changes in Stockholders Equity

Nine months ended September 30, 2006

(unaudited)

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive Loss	Total Stockholders Equity
Balance at December 31, 2005	$ 76	$ 24,253	$ 44,034		$ (533)	$ 67,830
Comprehensive income						
Net income			6,689	$ 6,689		6,689
Other comprehensive loss, net				(64)	(64)	(64)
Total comprehensive income				$ 6,625		
Tax benefit from exercise of stock options		20				20
Common stock dividend paid ($0.21 per share)			(1,603)			(1,603)
Common stock issued under dividend reinvestment plan		708				708
Stock-based compensation(1)		228				228
Stock options exercised	1	254				255
Balance at September 30, 2006	$ 77	$ 25,463	$ 49,120		$ (597)	$ 74,063
Disclosure of other comprehensive loss:						
Gross unrealized holding losses on securities arising during the period				$ (88)		
Income tax benefit				35		
Net unrealized holding losses, net of tax				(53)		
Less: Reclassification adjustment for net gains included in net income:						
Net realized gains on sales of securities during the period				19		
Income tax expense				(8)		
Reclassification adjustment, net of tax				11		
Other comprehensive loss, net of reclassification				$ (64)		

(1) Stock-based compensation represents the expense associated with the vesting of stock option awards and restricted stock awards. Director stock compensation will be included upon the issuance of shares in December of each year.

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2006 and 2005

(unaudited)

(Dollars in thousands)	**September 30, 2006**	**September 30, 2005**
Cash flows from operating activities:		
Net income	$ 6,689	$ 6,085
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	892	835
Depreciation and amortization	1,910	2,097
Amortization of intangible assets	99	99
Stock-based compensation expense	347	135
Net gains on sales of investment securities	(19)	(227)
Gains on sales of loans	(117)	(195)
Income on bank-owned life insurance, net	(201)	(63)
(Increase) decrease in:		
Loans held for sale, net of gain	(273)	296
Accrued interest receivable	(727)	(732)
Prepaid expenses and other assets	433	5,421
Deferred income taxes		(712)
Increase (decrease) in:		
Accrued expenses and other liabilities	2,899	3,688
Accrued interest payable	1,261	(223)
Change in income taxes	(94)	813
Net cash provided by operating activities	13,099	17,317
Cash flows from investing activities:		
Net decrease in other short-term investments		8,200
Proceeds from sales of investment securities	8,569	1,405
Proceeds from maturities, calls and pay-downs of investment securities	15,744	24,997
Purchase of investment securities	(10,967)	(12,170)
Net increase in loans	(46,667)	(95,211)
Additions to premises and equipment, net	(4,137)	(1,629)
Proceeds from bank-owned life insurance policy withdrawals	1,901	
Purchases of bank-owned life insurance	(9,897)	(939)
Net cash used in investing activities	(45,454)	(75,347)
Cash flows from financing activities:		
Net increase in deposits	92,530	42,970
Net increase (decrease) in borrowed funds	(48,672)	12,971
Cash dividends paid	(1,603)	(1,788)
Proceeds from issuance of common stock	708	871
Proceeds from exercise of stock options	255	339
Tax benefit from exercise of stock options	20	
Net cash provided by financing activities	43,238	55,363
Net increase/(decrease) in cash and cash equivalents	10,883	(2,667)
Cash and cash equivalents at beginning of period	38,381	57,270
Cash and cash equivalents at end of period	$ 49,264	$ 54,603
Supplemental financial data:		
Cash Paid For:		
Interest	$ 12,369	$ 7,132
Income taxes	4,053	3,372

See accompanying notes to the unaudited consolidated financial statements.

ENTERPRISE BANCORP, INC.

Notes to Unaudited Consolidated Financial Statements

(1) Organization of Holding Company

Enterprise Bancorp, Inc. (the company) is a Massachusetts corporation organized at the direction of Enterprise Bank and Trust Company, (the bank), for the purpose of becoming the holding company for the bank. The bank, a Massachusetts trust company, has three wholly owned subsidiaries, Enterprise Insurance Services, LLC, Enterprise Investment Services, LLC, and Enterprise Security Corporation, organized for the purposes of engaging in insurance sales activities, offering non-deposit investment products and services and investing in equity securities on its own behalf and not as a broker, respectively.

(2) Basis of Presentation

The accompanying unaudited consolidated financial statements and these notes should be read in conjunction with the company s December 31, 2005 audited consolidated financial statements and notes thereto contained in the company s 2005 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2006. 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 2005 annual report.

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 fiscal 2005 information has been reclassified to conform to the 2006 presentation.

On May 3, 2006, the company announced a two-for-one stock split in the form of a stock dividend payable to shareholders of record as of June 15, 2006. On June 30, 2006 the company issued 3,842,015 shares related to this dividend. All share and per share amounts have been retroactively adjusted to reflect the stock dividend for all periods presented.

(3) Stock-Based Compensation

The company currently has three individual stock incentive plans (the 1988 plan, the 1998 plan as amended in 2001, and the 2003 plan). No additional options or other rights of any kind may be granted under the 1988 plan. The remaining plans permit the Board of Directors under various terms to grant both incentive and non-qualified stock options, stock appreciation rights and other rights for the purchase of newly issued shares of common stock to officers and other employees, directors and consultants. These plans also allow for the issuance of new shares of common stock with or without restrictions, to officers and other employees, directors and consultants. The plans allow for the issuance of a cumulative total of 2,024,746 new shares of common stock. As of September 30, 2006, 1,589,878 shares, net of forfeited and expired shares, have been issued, granted or awarded and 434,868 shares remain available for future grants under these plans.

To date the company has utilized the plans to issue stock option awards and restricted stock awards to officers and other employees, and stock compensation to directors. No options or other awards of any kind have been granted to consultants. Total stock-based compensation expense related to these plans was $95 thousand and $347 thousand for the three and nine months ended September 30, 2006, respectively. The total recognized tax benefit related to stock based compensation expense was $30 thousand and $101 thousand, for the three and nine months ended September 30, 2006, respectively.

Stock Option Awards

Prior to January 1, 2006, the company accounted for stock-based compensation plans using the intrinsic value method under which no compensation cost was recorded if, at the grant date, the exercise price of the options was equal to or greater than the fair market value of the company s common stock. However, the company supplementally disclosed pro forma net income and earnings per share amounts as if the fair value based method of accounting had been applied to its stock-based compensation.

On January 1, 2006, the company adopted Financial Accounting Standards No. 123(R) Share-Based Payment (SFAS 123(R)), using the modified version of the prospective application method. Pursuant to this transition method, beginning in 2006 the company s financial statements include stock-based compensation expense for the portion of stock option awards, net of estimated forfeitures, for which the requisite service has been rendered during the period for (1) stock options awards outstanding on January 1, 2006 and (2) stock awards issued subsequent to January 1, 2006. The compensation expense has been based on the grant-date fair value estimate of the awards as calculated under the original provisions of SFAS 123 for the pro forma disclosures. The company will recognize the remaining compensation expense for the portion of outstanding awards and compensation expense for any future awards, net of estimated forfeitures, as the requisite service is rendered (i.e., on a straight-line basis over the remaining vesting period of each grant).

In addition, as SFAS 123(R) requires that the stock-based compensation expense recognized in earnings be based on the amount of awards ultimately expected to vest, a forfeiture assumption should be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Prior to the adoption of SFAS 123(R), the company was not estimating forfeitures, but was rather adjusting pro forma compensation cost as actual forfeitures occurred, as permitted by SFAS 123. There is no cumulative effect of a change in accounting principle recognized in income at the time of adoption of SFAS 123(R) as the stock-based compensation expense recognized in income prior to adoption was immaterial and therefore the adjustment to reflect estimated forfeitures related to this expense was immaterial. Forfeitures are estimated based on historical experience.

As a result of adopting SFAS 123(R), the company recognized stock-based compensation expense related to stock option awards of $52 thousand and $191 thousand for the three and nine months ended September 30, 2006, respectively. Accordingly, income before taxes and net income for the three months ended September 30, 2006 were $52 thousand and $39 thousand lower, respectively, and for the nine months ended September 30, 2006 were $191 thousand and $153 thousand lower, respectively, than if the company had continued to account for stock-based compensation using the intrinsic value method. The impact on basic and diluted earnings per share for the three months ended September 30, 2006 was a reduction of $0.01 and $0.00 respectively. The impact on both basic and diluted earnings per share for the nine months ended September 30, 2006 was a reduction of $0.02. In addition, prior to the adoption of SFAS 123(R), the company presented the tax benefit of stock option exercises as operating cash flows. Upon the adoption of SFAS 123(R), tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options in the consolidated statement of income are classified as financing cash flows.

As of September 30, 2006, there was $484 thousand of unrecognized stock-based compensation expense, net of estimated forfeitures, related to non-vested stock options. That cost is expected to be recognized over a weighted average period of 2.6 years.

In accordance with the modified prospective transition method, the company s Consolidated Financial Statements for prior periods have not been restated to reflect the impact of SFAS 123(R) or SFAS 123. The pro forma table below reflects net income, basic and diluted earnings per share for the three and nine months ended September 30, 2005 had the company determined stock-based compensation expense based on the fair value at the grant date for its options under SFAS 123:

(Dollars in thousands, except per share data)	**Three months ended Sept. 30, 2005**		**Nine months ended Sept. 30, 2005**	
Net income as reported	$	2,253	$	6,085
SFAS 123 compensation cost, net of tax	(109	)	(191	)
Pro forma net income	$	2,144	$	5,894
Basic earnings per share as reported	$	0.30	$	0.82
Pro forma basic earnings per share	$	0.29	$	0.79
Diluted earnings per share as reported	$	0.29	$	0.79
Pro forma diluted earnings per share	$	0.28	$	0.77

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Stock option transactions during the nine months ended September 30, 2006 are summarized as follows:

	Shares	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Life	Aggregate Intrinsic Value
Outstanding at December 31, 2005	759,478	$ 11.35	4.62	
Granted	9,000	16.91		
Exercised	(67,875)	4.51		
Forfeited	(5,696)	13.94		
Outstanding at September 30, 2006	694,907	12.07	4.27	$ 2,670,730
Vested and Exercisable at September 30, 2006	457,342	$ 10.63	3.37	$ 2,405,546

The aggregate intrinsic value in the table above represents the difference between the closing price of the company s common stock on September 30, 2006 and the exercise price, multiplied by the number of options. If the closing price was less than the exercise price of the option, no intrinsic value was assigned to the grant. The intrinsic value of options vested and exercisable represents the total pretax intrinsic value that would have been received by the option holders had all in-the-money vested option holders exercised their options on September 30, 2006. The intrinsic value will change based on the fair market value of the company s stock.

Total intrinsic value of options exercised for the three and nine months ended September 30, 2006 was $23 thousand and $815 thousand, respectively. Cash received from option exercises was $28 thousand and $255 thousand for the three and nine months ended September 30, 2006, respectively. Cash received from option exercises for the three and nine months ended September 30, 2005 was $5 thousand and $339 thousand, respectively. The actual tax benefit arising during the period for the tax deduction from the disqualifying disposition of shares acquired upon exercise was $6 thousand and $20 thousand for the three and nine months ended September 30, 2006, respectively. In accordance with SFAS 123(R), this excess tax benefit has been classified under the heading Cash flows from financing activities in the Consolidated Statement of Cash Flows.

All options that have been granted under the plans generally become exercisable at the rate of 25% a year. In addition, options granted since June 2002 provide for full vesting upon attainment of age 62 while remaining employed with the bank. All options granted prior to 1998 expire 10 years from the grant date. Options granted from 1998 through 2004 expire 7 years from the grant date, and options granted in 2005 and 2006 expire 8 years from the grant date.

Under the terms of the plans, incentive stock options may not be granted at less than 100% of the fair market value of the shares on the date of grant and may not have a term of more than ten years. Any shares of common stock reserved for issuance pursuant to options granted under the 1998 and 2003 plans that are returned to the company unexercised shall remain available for issuance under such plans. For participants owning 10% or more of the company s outstanding common stock (of which there are currently none), incentive stock options may not be granted at less than 110% of the fair market value of the shares on the date of grant.

During 2005, management replaced the Binomial option valuation model (a lattice style model) with the Black-Scholes option valuation model. The company has determined that option values calculated prior to 2005 under the Binomial model are not materially different from those that would have been calculated using the Black-Scholes model.

There were 9,000 options granted during the nine months ended September 30, 2006. The per share weighted average fair value of stock options granted in 2006 was determined to be $3.79. The weighted average fair value of the options was determined to be 22% of the market value of the stock at the date of grant. The average assumptions used in the model for the 2006 grants for the risk-free interest rate, expected volatility, dividend yield and expected life in years were 4.91%, 16%, 1.66% and 6, respectively. There were 236,300 options granted during the nine months ended September 30, 2005. The per share weighted average fair value of stock options granted in 2005 was determined to be $2.79. The weighted average fair value of the options was determined to be 20% of the market value of the stock at the date of grant. The average assumptions used in the model for the 2005 grants for the risk-free interest rate, expected volatility, dividend yield and expected life in years were 4.12%, 15%, 1.67% and 6, respectively. Refer to notes 1 and 9 to the consolidated financial statements contained in the company s Annual

Report on Form 10-K for the year ended December 31, 2005 for assumptions used to estimate the fair value of options granted prior to 2005.

The expected volatility is the anticipated variability in the company s share price over the expected life of the option. The company s shares began trading on a public exchange in February 2005 and limited trading has occurred. Management determined the company s expected volatility by reviewing the historical volatility of peer financial institutions and a banking index, in addition to reviewing the company s own limited history.

The expected life represents the period of time that the option is expected to be outstanding. The company utilized the simplified method and under this method, the expected term equals the vesting term plus the contractual term divided by 2.

The dividend yield is the company s annualized dividend rate divided by its share price.

The risk-free rate is based on the U.S. Treasury rate in effect at the time of grant for a period equivalent to the expected life of the option.

Restricted Stock Awards

The company has granted one restrictive stock award, comprised of 17,500 shares, in September 2005. There were no restricted stock awards granted or forfeited during the nine months ended September 30, 2006. The restricted stock award allows for the receipt of dividends, and the voting of all shares, whether or not vested, throughout the vesting period. The shares granted vest twenty percent per year starting on the first anniversary date of the award. The weighted-average grant date fair value of the restricted stock awarded was $14.25 per share.

As of September 30, 2006, 3,500 shares have vested and 14,000 remain non-vested. For the three months ended September 30, 2006 and 2005, compensation expense recognized in association with the restricted stock award amounted to $12 and $4 thousand, respectively. For the nine months ended September 30, 2006, and 2005 compensation expense recognized in association with the restricted stock award amounted to $37 and $4 thousand, respectively. As of September 30, 2006, there was $195 thousand of related unrecognized compensation expense. That cost is expected to be recognized over a weighted average period of 4.0 years.

Director Stock Compensation

The members of the company s Board of Directors are offered the choice to receive shares of the company s common stock in lieu of cash compensation for attendance at Board and Board Committee meetings. The issuance of the new shares related to director compensation occurs in December of each year. For the year 2006, Directors will be granted shares of common stock in lieu of cash fees at the per share price of $15.79, which reflects the value of the common stock on January 3, 2006, based on the average of the high and low trade prices of the common stock on the NASDAQ Global Market on that date (split adjusted).

Director compensation expense amounted to $55 thousand for the three months ended September 30, 2006, compared to $59 thousand for the three months ended September 30, 2005. Included in the expense for the three months ended September 30, 2006 were cash fees of $31 thousand, which represented approximately 1,927 shares to be issued at the end of the fiscal year. Included in the expense for the three months ended September 30, 2005 were cash fees of $39 thousand, which represented approximately 2,596 shares that were issued in December 2005.

Director compensation expense amounted to $181 thousand for the nine months ended September 30, 2006, compared to $188 thousand for the nine months ended September 30, 2005. Included in the expense for the nine months ended September 30, 2006 were cash fees of $119 thousand, which represented approximately 7,506 shares to be issued at the end of the fiscal year. Included in the expense for the nine months ended September 30, 2005 were cash fees of $131 thousand, which represented approximately 8,794 shares that were issued in December 2005.

(4) Supplemental Retirement Plan

The following table illustrates the net periodic benefit cost for the supplemental executive retirement plan as of September 30, 2006:

(Dollars in thousands)	Three months ended September 30, 2006	Nine months ended September 30, 2006
Service cost	$ 135	$ 404
Interest cost	22	66
Net periodic benefit cost	$ 157	$ 470

The plan was established on July 15, 2005. The company anticipates accruing an additional $157 thousand to the plan during the remainder of 2006.

(5) Critical Accounting Estimates

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, 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.

As discussed in the company s 2005 Annual Report on Form 10-K, the two 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 and the impairment valuation of goodwill. Refer to note 1 to the consolidated financial statements contained in the company s 2005 Annual Report on Form 10-K for significant accounting policies.

(6) 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 for the three and nine months ended September 30th and the effect of those shares on earnings:

	Three months ended Sept. 30,		Nine months ended Sept. 30,	
	2006	2005	2006	2005
Basic weighted average common shares outstanding	7,691,407	7,515,734	7,644,641	7,437,712
Dilutive shares	149,171	215,682	167,027	238,244
Diluted weighted average common shares outstanding	7,840,578	7,731,416	7,811,668	7,675,956
Basic earnings per share	$ 0.32	$ 0.30	$ 0.88	$ 0.82
Effect of dilutive shares	(0.01)	(0.01)	(0.02)	(0.03)
Diluted earnings per share	$ 0.31	$ 0.29	$ 0.86	$ 0.79

At September 30, 2006, there were 16,000 outstanding stock options, which were excluded from the calculation of diluted earnings per share due to the exercise price exceeding the average market price. These options, which were not dilutive at that date, may potentially dilute earnings per share in the future.

(7) 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 credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. If the letter of credit is drawn upon, the company creates a loan for the customer with the same criteria associated with similar loans. The fair value of these commitments was estimated to be the fees charged to enter into similar agreements. The estimated fair value of these commitments carried on the balance sheet was $52 thousand and $64 thousand at September 30, 2006 and 2005, respectively. These amounts are amortized to income over the life of the letters of credit, typically one year.

The company generally originates fixed rate residential mortgage loans with the anticipation of selling such loans. The company generally does not pool mortgage loans for sale but instead sells the loans on an individual basis and generally does not retain the servicing of these loans. 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. At September 30, 2006, the estimated fair value of the company s derivative instruments was considered to be immaterial.

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 2005 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 conta 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, market expansion and opportunities, the interest rate environment, credit risk and the level of future non-performing assets and charge-offs, potential asset and deposit growth, future non-interest expenditures and non-interest income growth, and borrowing capacity are forward-looking statements. The company wishes to caution readers that such forward-looking statements reflect numerous assumptions and involve a number of risks and uncertainties that may adversely affect the company s future results. The following important factors, among others, could cause the company s results for subsequent periods to differ materially from those expressed in any forward-looking statement made herein: (i) changes in interest rates could negatively impact net interest income; (ii) changes in the business cycle and downturns in the local, regional or national economies, including deterioration in the local real estate market, could negatively impact credit and/or asset quality and result in credit losses and increases in the company s reserve for loan losses; (iii) changes in consumer spending could negatively impact the company s credit quality and financial results; (iv) increasing competition from larger regional and out-of-state banking organizations as well as non-bank providers of various financial services could adversely affect the company s competitive position within its market area and reduce demand for the company s products and services; (v) deterioration of securities markets could adversely affect the value or credit quality of the company s assets and the availability of funding sources necessary to meet the company s liquidity needs; (vi) changes in technology could adversely impact the company s operations and increase technology-related expenditures; (vii) increases in employee compensation and benefit expenses could adversely affect the company s financial results; (viii) changes in laws and regulations that apply to the company s business and operations could increase the company s regulatory compliance costs and adversely affect the company s business environment, operations and financial results; and (ix) changes in accounting standards, policies and practices, as may be adopted or established by the regulatory agencies, the Financial Accounting Standards Board or the Public Company Accounting Oversight Board could negatively impact the company s financial results. Therefore, the company cautions readers not to place undue reliance on any such forward-looking information and statements.

Accounting Policies/Critical Accounting Estimates

The company has not changed its significant accounting and reporting policies from those disclosed in its 2005 Annual Report on Form 10-K. In applying these accounting policies, management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. As discussed in the company s 2005 Annual Report on Form 10-K, the two 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 and the impairment valuation of goodwill. Management s 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 from those estimates.

Overview

The current interest rate environment and the highly competitive marketplace continue to present a growth and earnings challenge for the banking industry. At Enterprise Bancorp, Inc., this environment has contributed to slower loan and deposit growth and continued pressure on margin from rising funding costs. Despite these economic and industry issues, the company was pleased to report net income growth of 10% and 9% for the year-to-date and quarter-to-date September 30, 2006 results.

Composition of Earnings

Net income for the nine months ended September 30, 2006 amounted to $6.689 million compared to $6.085 million for the same period in 2005, an increase of 10%. Diluted earnings per share were $0.86 for the nine months ended September 30, 2006 compared to $0.79 for the same period in 2005, an increase of 9%. All prior period per share amounts have been adjusted to reflect the two-for-one stock split paid on June 30, 2006 in the form of a stock dividend.

Net income for the three months ended September 30, 2006 was $2.451 million, compared to $2.253 million during the third quarter of 2005, an increase of 9%. Diluted earnings per share were $0.31 for the quarter compared to $0.29 for third quarter 2005, an increase of 7%.

The company s earnings are largely dependent on its net interest income, which is the difference between interest income on loans and investments and interest expense on deposits and borrowings. The re-pricing frequency of these 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.

The company s net income growth continues to result primarily from increases in net interest income performance, partially offset by increases in non-interest expense. Net interest income for the nine months ended September 30, 2006 amounted to $31.0 million compared to $27.8 million for the same period in 2005, an increase of 11%. The primary driver of net interest income growth over this period was loan growth, which increased 12% since September 30, 2005.

Net interest margin, the spread earned between interest-earning assets and the company s funding sources, primarily deposits, was 4.79% for both the nine months ended September 30, 2006 and 2005. However, net interest margin for the three months ended September 30, 2006 was lower at 4.76% compared to 4.83% and 4.90% for the three months ended June 30, 2006 and September 30, 2005, respectively, reflecting the effects of a prolonged flat yield curve and increased competition.

Non-interest expense amounted to $24.5 million for the nine months ended September 30, 2006 compared to $22.3 million for the same period in 2005, an increase of 10%, and reflected the strategic and operational costs, such as salaries and benefits, occupancy and marketing/public relations, necessary to support the company s continued growth.

Non-interest income was $5.1 million for the nine months ended September 30, 2006, an increase of $312 thousand or 7% over the comparable nine month period in 2005. The increase consisted primarily of strong growth in investment advisory fees and from other income, primarily tax credit income and bank-owned life insurance.

The provision for loan losses, which is impacted by asset quality and loan growth, amounted to $892 thousand for the current year-to-date results compared to $835 thousand in the comparable period in 2005. Asset quality remained favorable during the year-to-date period with net charge-offs of 0.03% of average total loans or $221 thousand. The allowance for loan losses to total loans ratio was 1.70% at September 30, 2006 compared to 1.72% at December 31, 2005. The company s management of credit risk is reviewed in more detail in this Item 2, under the heading Asset Quality and the Allowance for Loan Losses.

Financial Position

Total assets amounted to $972.8 million at September 30, 2006, an increase of 6% since December 31, 2005.

The company s core asset strategy is to grow loans, primarily commercial loans. Total loans increased 7% since December 31, 2005 compared to 17% for the same period in 2005 and amounted to $746.6 million or 77% of total assets. Commercial loans amounted to $636.8 million or 85% of total loans.

The investment portfolio is the other key component of the company s earning assets and is primarily used to invest excess funds, provide liquidity and to manage the company s asset-liability position. Total investments amounted to $142.9 million at September 30, 2006, or 15% of total assets. The portfolio has declined 9% since December 31, 2005 as investment portfolio cash flow (proceeds from sales, maturities, calls and principal paydowns) has been utilized to fund loan growth.

From a funding perspective, management s strategy is to grow low cost deposits (primarily checking accounts). Asset growth in excess of low cost deposits is then funded through higher cost deposits (certificates of deposit and money market / savings products), brokered deposits, repurchase agreements, Federal Home Loan Bank of Boston borrowings (FHLB borrowings), and investment portfolio cash flow.

Prior to the fourth quarter of 2005, the company s funding needs were met primarily through internally generated low and high cost commercial and retail deposits. In the fourth quarter of 2005, a combination of strong commercial loan growth and slower deposit growth, resulted in the company increasing its external funding use, primarily through brokered deposits and FHLB borrowings.

At September 30, 2006, non-brokered deposit growth was $18.9 million, or 2%, since December 31, 2005, compared to $43.0 million, or 6%, for the comparable nine month period in 2005. The company utilized non-brokered deposits along with brokered deposits, repurchase agreements, FHLB borrowings, and investment portfolio cash flow to fund loan growth of $46.8 million or 7%.

At September 30, 2006, the company had $83.6 million in brokered term deposits (brokered CDs) and $3.3 million in FHLB borrowings compared to $10.0 million in brokered CDs and $57.9 million in FHLB borrowings at December 31, 2005.

At September 30, 2006, total deposits, which included brokered CDs, amounted to $867.9 million, representing 12% growth over December 31, 2005. Total deposits, excluding brokered CDs, amounted to $784.3 million at September 30, 2006, representing 2% growth over December 31, 2005.

Opportunities and Risks

The company s primary market is the Merrimack Valley and North Central regions of Massachusetts and the South Central region of New Hampshire. Management believes the company s business model, strong service culture, skilled management team and brand name create opportunities for the company to be the leading provider of banking and investment management services in its growing market area. Management continually strives to differentiate the company from competitors by providing highly competitive commercial banking, investment, and insurance products delivered through prompt and personal service based on management s familiarity and understanding of the banking and other financial service needs of its customers, which include businesses, professionals, and consumers.

Management recognizes that substantial competition exists in the marketplace and views this as a key business risk. Market competition includes the expanded commercial lending capabilities of credit unions, the shift to commercial lending by traditional savings banks, the presence of large regional and national commercial banks, as well as the products offered by non-bank financial service competitors.

Despite these challenges, the company has been successful in growing its commercial loan portfolio. Management believes this growth is the result of ongoing business development efforts and continued market expansion within existing and into new markets. The company has fourteen branch locations and continues to look for market and branch opportunities that will increase long-term franchise value and shareholder returns. Such expansion typically increases the company s operating expenses, primarily in salary and benefits, marketing, and occupancy, before the growth benefits are fully realized in those markets.

In addition to growth and competition, the company s significant challenges continue to be the effective management of credit, interest rate and operational risk.

Credit risk management is reviewed below in this Item 2 under the heading Asset Quality and the Allowance for Loan Losses.

Interest rate risk management is reviewed under Item 3, Quantitative and Qualitative Disclosures About Market Risk.

Operational risk management is also a key component of the company s risk management process, particularly as it relates to technology administration, information security, and business continuity.

Management utilizes a combination of third party security assessments, key technologies and ongoing internal evaluations in order to continually monitor and safeguard information on its operating systems and that of third party service providers. The company contracts with outside parties to perform a broad scope of both internal and external security assessments on a regular basis. These third parties test the company s security controls and network configuration, and assess internal practices and other key items. The company also utilizes firewall technology and an intrusion detection system to protect against unauthorized access and commercial software that continuously scans for computer viruses on the company s information systems. The company maintains an Information Security and Technology Practices policy applicable to all employees. The policy outlines the employee s responsibilities and key components of the company s Information Security and Technology Practices Program, which include the following: identification and assessment of risk; institution of policies and procedures to manage and control the risk; risk assessment of outsourced service providers; development of strategic security contingency plans; training of all officers and employees; and reporting to the Board of Directors. Significant technology issues, related changes in risk and results of third party security assessments are reported to the Board s Banking Technology and Audit Committees. The Board, through these committees, reviews the status of the Information Security and Technology Practices Program and makes adjustments to the policy as deemed necessary.

The company has a Business Continuity Plan that consists of the information and procedures required to enable rapid recovery from an occurrence that would disable the company for an extended period. The plan establishes responsibility for assessing a disruption of business, contains alternative strategies for the continuance of critical business functions, assigns responsibility for restoring services, and sets priorities by which critical services will be restored.

Financial Condition

Total assets increased $54.3 million, or 6%, over December 31, 2005, to $972.8 million at September 30, 2006. The increase was primarily attributable to increases in total loans and short-term investments.

Short-term investments

As of September 30, 2006, short-term investments amounted to $20.9 million, or 2% of total assets compared to $5.4 million, or 1% of total assets, at December 31, 2005. The increase in short-term investments resulted from temporary deposit inflows at the end of September. Short-term investments carried as cash equivalents consist of overnight and term federal funds sold and money market mutual funds.

Investments

At September 30, 2006, the investment portfolio s fair market value was $142.9 million, representing a decline of $13.6 million since December 31, 2005. The fair market value of the investment portfolio represented 15% and 17% of the total assets at September 30, 2006 and December 31, 2005 respectively. The decline in the investment portfolio over the prior period was due to the cash flows being utilized primarily to fund loan growth rather than reinvest back into the portfolio.

The following table summarizes the fair market value of investments at the dates indicated:

(Dollars in thousands)	**September 30, 2006**	**December 31, 2005**
Federal agency obligations (1)	$15,272	$15,202
Collateralized mortgage obligations and other mortgage backed securities (CMO/MBS)	64,295	77,143
Municipal securities	54,830	54,915
Equity securities	6,684	5,056
Available-for-sale securities	$141,081	$152,316
Certificates of deposit	1,015	1,000
Federal Home Loan Bank stock (2)	840	3,205
Total investments	$142,936	$156,521

(1) Federal agency obligations include securities issued by government-sponsored enterprises such as Fannie Mae, Freddie Mac, and the FHLB. These securities do not represent obligation of the US government and are not backed by the full faith and credit of the United States Treasury.

(2) The bank is required to purchase FHLB stock in association with outstanding advances from the FHLB; this stock is classified as a restricted investment and carried at cost.

From time-to-time the company may pledge investments from the portfolio as collateral for various municipal deposit accounts, repurchase agreements and treasury, tax and loan deposits. The fair value of securities pledged as collateral was $25.9 million and $14.4 million at September 30, 2006 and December 31, 2005 respectively. Securities designated as qualified collateral for FHLB borrowing capacity amounted to $54.5 million and $81.2 million at September 30, 2006 and December 31, 2005 respectively.

The net unrealized loss on the portfolio at September 30, 2006 was $1.2 million compared to a net unrealized loss of $1.1 million at December 31, 2005. The decrease in fair market value was primarily due to higher market interest rates in the current period over the prior periods. The net unrealized gains/losses in the company s fixed income portfolio fluctuate as interest rates rise and fall. Due to the fixed rate nature of the portfolio, as rates rise, or the securities approach maturity, the market value of the portfolio declines, and as rates fall the value of the portfolio rises. The net unrealized gains/losses in the company s equities portfolio fluctuate based on the performance of the individual equities that comprise the portfolio.

Unrealized gains or losses will only be recognized in the statements of income if the securities are sold. However, if an unrealized loss on a fixed income or equity security is deemed to be other-than-temporary, the company marks the investment down to its carrying value through a charge to earnings.

Loans

Total loans were $746.6 million, or 77% of total assets, at September 30, 2006, an increase of $46.8 million, or 7% compared to December 31, 2005.

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, 2006 Amount	Percent		December 31, 2005 Amount	Percent	
Commercial real estate	$ 356,290	47.7	%	$ 326,963	46.6	%
Commercial and industrial	162,375	21.7	%	165,982	23.7	%
Commercial construction	118,129	15.8	%	108,048	15.4	%
Total Commercial loans	$ 636,794	85.2	%	$ 600,993	85.7	%
Residential mortgages	59,415	7.9	%	47,207	6.7	%
Residential construction	4,390	0.6	%	4,154	0.6	%
Home equity	42,274	5.6	%	44,444	6.4	%
Consumer	4,241	0.6	%	3,986	0.6	%
Loans held for sale	657	0.1	%	267	0.0	%
Gross loans	$ 747,771	100.0	%	$ 701,051	100.0	%
Deferred fees, net	(1,209)			(1,325)		
Total loans	746,562			699,726		
Allowance for loan losses	(12,721)			(12,050)		
Net loans	$ 733,841			$ 687,676		

The company s primary lending focus is on the development of high quality commercial real estate, commercial construction and commercial and industrial lending relationships with businesses, corporations, partnerships, non-profit organizations, professionals and individuals.

Commercial real estate loans were $356.3 million at September 30, 2006, compared to $327.0 million at December 31, 2005, an increase of $29.3 million or 9%. Commercial real estate loans are typically secured by apartment buildings, office or mixed-use facilities, strip shopping malls or other commercial property.

Commercial and industrial loans totaled $162.4 million at September 30, 2006, compared to $166.0 million at December 31, 2005, a decrease of $3.6 million or 2%. Commercial loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), term loans, and revolving lines of credit. Also included in commercial loans are loans under various U.S. Small Business Administration programs amounting to $9.0 million at September 30, 2006 and $8.2 million at December 31, 2005.

Commercial construction loans amounted to $118.1 million at September 30, 2006, compared to $108.0 million at December 31, 2005, an increase of $10.1 million or 9%. 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.

At September 30, 2006 the company had commercial loan balances participated out to various banks amounting to $8.6 million, compared to $9.0 million at December 31, 2005. These balances participated out to other institutions are not carried as assets on the company s financial statements. Loans originated by other banks in which the company is the participating institution are carried at the company s pro rata share of ownership and amounted to $16.4 million and $18.8 million at September 30, 2006 and December 31, 2005, respectively. The company performs an independent credit analysis of each commitment prior to participation in the loan.

Asset Quality and the Allowance for Loan Losses

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, the continuity of borrowers management teams and the credit management process.

Management regularly monitors these factors, as well as levels of non-accrual loans, levels of charge-offs and recoveries, peer results, levels and composition of outstanding loans and known and inherent risks in the loan portfolio, through ongoing credit reviews by the credit department, an external loan review service, reviews by members of senior management and the Loan and Executive Committees of the Board of Directors.

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The credit risk inherent in the loan portfolio is quantified through the allowance for loan losses, which is primarily increased through the provision for loan losses as a direct charge to earnings. Management determined that the allowance for loan losses of $12.7 million, or 1.70% of total loans at September 30, 2006, was adequate to absorb reasonably anticipated losses due to the credit risk associated with the loan portfolio at that date.

There have been no material changes to the company s 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, 2005.

The following table sets forth non-performing assets at the dates indicated:

(Dollars in thousands)	**September 30, 2006**		**December 31, 2005**		**September 30, 2005**	
Non-accrual loans	$ 1,966		$ 1,475		$ 1,751	
Accruing loans > 90 days past due	10		1		15	
Total non-performing loans	1,976		1,476		1,766	
Other real estate owned						
Total non-performing assets	$ 1,976		$ 1,476		$ 1,766	
Total Loans	$ 746,562		$ 699,726		$ 665,570	
Allowance for loan losses	$ 12,721		$ 12,050		$ 11,759	
Non-performing assets: Total assets	0.20	%	0.16	%	0.19	%
Non-performing loans: Total loans	0.26	%	0.21	%	0.27	%
Loans 60-89 days past due: Total loans	0.02	%	0.01	%	0.13	%
Allowance for loan losses: Non-performing loans	643.78	%	816.40	%	665.86	%
Allowance for loan losses: Total loans	1.70	%	1.72	%	1.77	%

Total non-performing loans were $2.0 million at September 30, 2006 compared to $1.5 million and $1.8 million at December 31, 2005 and September 30, 2005, respectively. Loans for which management considers it probable that not all contractual principal and interest will be collected in accordance with the original loan terms are designated as impaired loans. 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. Total impaired loans were $1.9 million at September 30, 2006 compared to $1.5 million and $1.4 million at December 31, 2005 and September 30, 2005, respectively.

The ratio of non-performing loans to total loans remained relatively consistent at 0.26% as of September 30, 2006, compared to 0.21% and 0.27% at December 31, 2005 and September 30, 2005, respectively. Short-term fluctuations are not uncommon with this ratio and the increase since December 2005 is not considered significant. The classification of a loan as non-performing does not necessarily indicate that loan principal and interest will be ultimately 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.

The ratio of delinquent loans 60-89 days past due as a percentage of total loans increased to 0.02% at September 30, 2006, from 0.01% at December 31, 2005 and decreased from 0.13% at September 30, 2005. Management does not consider the increase to be significant.

Management closely monitors the credit quality of individual delinquent and non-performing relationships, industry concentrations, the local 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 deterioration in the local, regional or national economic conditions could negatively impact the company s level of non-performing assets in the future.

The allowance for loan losses to total loan ratio was 643.78% at September 30, 2006 compared to 816.40% and 665.86% at December 31, and September 30, 2005, respectively. The ratio is consistent with September 30, 2005 and has decreased since December 31, 2005. The December ratio reflects the low level of non-performing loans at that time.

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

(Dollars in thousands)	Nine months ended September 30, 2006	2005
Balance at beginning of year	$ 12,050	$ 10,923
Charged off	(420)	(99)
Recovered	199	100
Net loans (charged off)/recovered	(221)	1
Provision charged to operations	892	835
Balance at September 30	$ 12,721	$ 11,759
Annualized net loans charged-off: Average loans outstanding	(0.04)%	0.00 %

Net loans (charged-off)/recovered during the nine months ended September 30, 2006 and 2005 were ($221 thousand) and $1 thousand, respectively. The provision for loan losses for the nine months ended September 30, 2006 and 2005 was $892 thousand and $835 thousand, respectively. The provision reflects management s estimate of loan loss reserves necessary to support the level of credit risk inherent in the portfolio during the period.

Deposits

Total deposits amounted to $867.9 million at September 30, 2006 compared to $775.4 million at December 31, 2005. The increase of $92.5 million, or 12%, primarily resulted from an increase in brokered CDs of $73.6 million and temporary deposit inflows at the end of September. Total non-brokered deposits grew 2% through September 30, 2006 compared to December 31, 2005.

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, 2006 Amount	Percent	December 31, 2005 Amount	Percent
Demand deposits	$ 168,289	19.4 %	$ 173,804	22.4 %
Interest bearing checking	164,258	18.9 %	171,611	22.1 %
Total checking	332,547	38.3 %	345,415	44.5 %
Retail savings/money markets	134,412	15.5 %	151,969	19.6 %
Commercial savings/money markets	136,416	15.7 %	115,126	14.9 %
Total savings/money markets	270,828	31.2 %	267,095	34.5 %
Certificates of deposits	180,955	20.9 %	152,889	19.7 %
Total non-brokered deposits	784,330	90.4 %	765,399	98.7 %
Brokered certificates of deposits	83,587	9.6 %	9,988	1.3 %
Total deposits	$ 867,917	100.0 %	$ 775,387	100.0 %

Borrowed Funds

Borrowed funds, consisting of securities sold under agreements to repurchase (repurchase agreements) and FHLB borrowings amounted to $10.0 million at September 30, 2006 compared to $58.6 million at December 31, 2005. The decrease in the balance at September 30, 2006 primarily resulted from the increased use of brokered CDs, beginning in the fourth quarter of 2005, as an alternative funding source under the company s liquidity management strategy.

Accounting Rule Changes

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The provisions of FIN 48 are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. Management does not anticipate that the adoption of FIN 48 will have a material impact on the company s financial position or results of operation.

In September 2006 the FASB s Emerging Issues Task Force reached a consensus regarding Issue No. 06-4 (EITF 06-4) Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements. The Task Force affirmed that an employer should recognize a liability for future benefits associated with an endorsement split-dollar life insurance arrangement that provides a benefit to an employee that extends to postretirement periods. The liability and related compensation cost are to be determined in accordance with the appropriate previously issued financial standards. The Task Force concluded that this Issue should be effective through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption, or (b) a change in accounting principle through retrospective application to all prior periods. The Task Force reached a consensus that this Issue should be effective for fiscal years beginning after December 15, 2007. Management has not yet determined the impact that adoption EITF No. 06-4 will have on the company s financial position or results of operation.

In September 2006, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 provides interpretive guidance regarding the approach companies must use to quantify the materiality of financial misstatements after considering all relevant quantitative and qualitative factors. The approach requires assessing the impact of correcting misstatements, including the carryover and reversing effects of cumulative prior year misstatements, on the current financial statements. SAB 108 permits companies to apply its provisions by either restating prior financial statements or recording the cumulative effect of initially applying the approach as adjustments to the carrying values of assets and liabilities, with an offsetting adjustment to retained earnings, as of the beginning of the fiscal year of adoption. SAB 108 is required to be applied in the company s annual financial statements covering the fiscal year ending December 31, 2006. Management does not anticipate that the application of SAB 108 will have an impact on the company s financial position or results of operation.

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. Liquidity policies are set and monitored by the company s Asset-Liability Committee of the Board of Directors. The company s liquidity is maintained by projecting cash needs, balancing maturing assets with maturing liabilities, monitoring various liquidity ratios, monitoring deposit flows, maintaining liquidity within the investment portfolio and maintaining borrowing capacity in the brokered CD market and at the FHLB.

The company s asset-liability management objectives are to maintain liquidity, provide and enhance access to a diverse and stable source of funds, provide competitively priced and attractive products to customers, conduct funding at a low cost relative to current market conditions and engage in sound balance sheet management strategies.

The company funds earning assets with deposits, brokered CDs, repurchase agreements, FHLB borrowings, commercial lines of credit, junior subordinated debentures and earnings. In the fourth quarter of 2005, the company began using brokered CDs as an alternative to FHLB borrowings. The advantage of brokered CD funding is that no collateral is required. A disadvantage is that funding usually takes a week to complete, whereas FHLB borrowings are usually immediately available.

At September 30, 2006, the bank had the capacity to borrow up to $444 million in additional funds. Management believes that the company has adequate liquidity to meet its commitments.

Capital Resources and Dividends

As of September 30, 2006, both the company and the bank qualify as well capitalized under applicable Federal Reserve Board and FDIC regulations. 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, 2006 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 Amount	Ratio		Minimum Capital for Capital Adequacy Purposes Amount	Ratio		Minimum Capital To Be Well Capitalized Amount	Ratio	
Total Capital (to risk weighted assets)	$ 88,633	11.22	%	$ 63,220	8.00	%	$ 79,026	10.00	%
Tier 1 Capital (to risk weighted assets)	$ 78,635	9.95	%	$ 31,610	4.00	%	$ 47,415	6.00	%
Tier 1 Capital (to average assets)	$ 78,635	8.32	%	$ 37,788	4.00	%	$ 47,235	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%.

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.

Prior to 2006, dividends were paid once a year. In 2006, the company began paying quarterly dividends. Quarterly dividends of $0.07 per share were paid in March, June and September. Shareholders utilized the DRP to reinvest $708 thousand, of the $1.6 million paid by the company during the nine months ended September 30, 2006, into 43,544 shares of the company s common stock.

On October 17, 2006, the company announced a quarterly dividend of $0.07 to be paid on December 1, 2006 to shareholders of record as of November 10, 2006. On an annualized basis, year-to-date dividends represent a 17% increase over the prior year s annual dividend.

On June 30, 2006, the company issued 3,842,015 shares in a two-for-one stock split paid in the form of a stock dividend.

Results of Operations

Three Months Ended September 30, 2006 vs. Three Months Ended September 30, 2005

Unless otherwise indicated, the reported results are for the three months ended September 30, 2006 with the comparable period and prior period being the three months ended September 30, 2005.

The company reported third quarter 2006 net income of $2.451 million compared to $2.253 million during the third quarter of the prior year, an increase of 9%. Diluted earnings per share were $0.31 for the quarter compared to $0.29 for the prior period, an increase of 7%.

Net Interest Income

The company s net interest income was $10.5 million, an increase of $655 thousand, or 7%. Total interest and dividend income for the 2006 period increased by $3.2 million, while total interest expense for the period increased $2.6 million.

Tax equivalent net interest margin decreased to 4.76% for the quarter ending September 30, 2006 from a margin of 4.90% in the prior period. The 14 basis point decrease was primarily due to an increase of 106 basis points in the cost of funds resulting from the use of higher costing deposits and borrowed funds and the increase in market interest rates, partially offset by an increase in the yield on interest earning assets, of 90 basis points, resulting from recent rising market rates, particularly the prime lending rate.

Interest Income

Interest income amounted to $15.6 million, an increase of $3.2 million, or 26%, compared to $12.4 million in the prior period. The increase resulted primarily from a 90 basis point increase in the average tax equivalent yield on interest earning assets and to a slightly lesser degree, from a 9% increase in the average balance of interest earning assets.

The primary factor in the increase in the average tax equivalent yield on interest earning assets was the 88 basis point increase in loan yields to 7.48%, due to higher market rates during the period. The growth in the average balance of interest earning assets was primarily due to a $102.5 million, or 16%, increase in the average loan balance. Interest income on loans amounted to $14.0 million, an increase of $3.4 million over the prior period.

The tax equivalent yield realized on investments increased 33 basis points to 4.82%, due to increases in market interest rates, slower prepayments and the maturity of lower yielding securities. The average balance of investment securities and short-term investments (together investments) decreased $25.7 million, or 14%, to $153.5 million. This decrease was primarily due to maturities and paydowns of investments, which were redeployed to fund loan growth. Investment income amounted to $1.6 million, a decrease of $148 thousand compared to the same period in the prior year.

Interest Expense

Interest expense amounted to $5.1 million, an increase of $2.6 million compared to the prior period. The increase resulted primarily from a 106 basis point increase in the average cost of funds on deposits and borrowings, due to increased market rates, and a 9% increase in the average balance of deposits and borrowings, primarily in higher costing CD products.

Interest expense on interest checking, savings and money market accounts increased $559 thousand over the comparable period, to $1.8 million. This increase resulted from a 61 basis point increase in the average cost of interest checking, savings and money market accounts. This increase in interest expense was partially offset by a slight reduction in the average balance on these accounts.

Interest expense on certificates of deposit increased $2.0 million over the comparable period, to $2.9 million. The average balance of certificates of deposit increased $121.0 million, or 86%, over the prior period to $261.7 million. The increase in the average CD balance resulted primarily from the increase in brokered CDs that the company utilized as an alternative to FHLB borrowings, and to a lesser degree to internally generated CD growth. Brokered CD balances averaged $82.3 million and $0 for the quarters ended September 30, 2006 and 2005, respectively. The average cost of CDs also increased 197 basis points over the prior period, due to higher market rates, consumer price sensitivity and the higher costing brokered CD balances.

Interest expense on borrowed funds, consisting of FHLB borrowings and repurchase agreements, decreased $26 thousand from the same period last year. The average balance of borrowed funds, primarily FHLB borrowings, decreased $6.3 million to $7.3 million, as the company began to utilized brokered CDs in the fourth quarter of 2005 and decreased FHLB borrowings. The average cost of borrowed funds increased 163 basis points due to an increase in market interest rates.

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, 2006 and September 30, 2005, respectively. 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 year average rate); (2) interest rate (change in average interest rate multiplied by prior year average balance); and (3) rate and volume (the remaining difference).

AVERAGE BALANCES, INTEREST AND AVERAGE INTEREST RATES

	Three Months Ended September 30, 2006			**Three Months Ended September 30, 2005**			**Changes due to**			
(Dollars in thousands)	**Average Balance**	**Interest**	**Yield/ Rate(2)**	**Average Balance**	**Interest**	**Yield/ Rate(2)**	**Total**	**Volume**	**Rate**	**Rate/ Volume**
Assets:										
Loans (1)	$ 741,793	$ 13,991	7.48 %	$ 639,264	$ 10,627	6.60 %	$ 3,364	$ 1,706	$ 1,418	$ 240
Investments (2) (3)	153,530	1,607	4.82 %	179,264	1,755	4.49 %	(148)	(289)	148	(7)
Total interest earnings assets	895,323	15,598	7.03 %	818,528	12,382	6.13 %	3,216	1,417	1,566	233
Other assets	58,690			54,199						
Total assets	$ 954,013			$ 872,727						
Liabilities and stockholders equity:										
Int chkg, savings and money market	$ 428,550	1,841	1.70 %	$ 468,411	1,282	1.09 %	559	(110)	720	(51)
Certificates of deposits (4)	261,706	2,881	4.37 %	140,719	853	2.40 %	2,028	732	699	597
Borrowed funds	7,301	95	5.16 %	13,602	121	3.53 %	(26)	(56)	56	(26)
Junior subordinated debentures	10,825	294	10.88 %	10,825	294	10.88 %				
Total interest bearing deposits and borrowings	708,382	5,111	2.86 %	633,557	2,550	1.60 %	2,561	566	1,475	520
Net interest rate spread (2)			4.17 %			4.53 %				
Demand deposits	166,519			167,693						
Total deposits and borrowings	874,901	5,111	2.32 %	801,250	2,550	1.26 %				
Other liabilities	6,862			6,636						
Total liabilities	881,763			807,886						
Stockholders equity	72,250			64,841						
Total liabilities and stockholders equity	$ 954,013			$ 872,727						
Net interest income		$ 10,487			$ 9,832		$ 655	$ 851	$ 91	$ (287)
Net interest margin (2)			4.76 %			4.90 %				

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

(2) Average investment balances are presented at average amortized cost and average interest rates are presented on a tax equivalent basis. The tax equivalent effect, which was not included in the interest amount above, was $241 and $258 for the periods ended September 30, 2006 and September 30, 2005, respectively.

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

(4) Certificates of deposits include brokered and non-brokered CDs.

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Provision for Loan Loss

The provision for loan losses was $375 thousand for the three months ended September 30, 2006 and $360 thousand for the same period in 2005.

The provision reflects management s ongoing assessments of the allowance for loan losses, estimates of the credit risk inherent in the portfolio, and the level of net charge-offs during the period.

There have been no material changes to the company s 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, 2005. 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 - Asset Quality and the Allowance for Loan Losses above and in the company s 2005 Annual Report on Form 10-K.

Non-Interest Income

Non-interest income increased $108 thousand, or 6%, over the comparable period, to $1.9 million. The increase was primarily attributable to increases in investment advisory fees, partially offset by a decrease in net gains on sales of loans.

Investment advisory fees increased by $142 thousand, or 24%, for the three months ended September 30, 2006 compared to the same period in 2005. The change resulted from new business generated and a restructured fee schedule which was put in place in 2005.

Net gain on sales of loans decreased $59 thousand for the three months ended September 30, 2006 over the same period in 2005. This decrease was due to a reduction in the volume of fixed rate residential mortgage loans originated and subsequently sold compared to the prior period. Fixed rate residential mortgage originations were higher in the prior period due to the lower interest rates during that period.

Non-Interest Expense

Non-interest expense increased $395 thousand, or 5%, compared to the prior period and amounted to $8.1 million. The increase was primarily attributable to increases in salaries and employee benefits, occupancy expenses, and advertising and public relations expenses.

Salaries and employee benefits increased $99 thousand, or 2%, compared to the prior period. The increase primarily resulted from staffing increases necessary to support the company s strategic growth initiatives, salary adjustments and the additional expense related to employee stock compensation, but were partially offset by a reduction in accruals related to performance-based incentive compensation.

Occupancy expenses increased $167 thousand, or 12%, over the comparable period. The increase primarily resulted from infrastructure expenditures necessary to support the company s growth.

Advertising and public relations expenses increased $120 thousand, or 58%, compared to the prior period. The increase was primarily related to additional advertising due to market expansion.

Results of Operations
Nine Months Ended September 30, 2006 vs. Nine Months Ended September 30, 2005

Unless otherwise indicated, the reported results are for the nine months ended September 30, 2006 with the comparable period and prior year being the nine months ended September 30, 2005.

The company reported net income of $6.689 million compared to $6.085 million in the prior year, an increase of 10%. Diluted earnings per share were $0.86 for the nine months ended September 30, 2006 compared to $0.79 for the prior year, an increase of 9%.

Net Interest Income

The company s net interest income was $31.0 million, an increase of $3.2 million or 11%. The increase in net interest income was due primarily to a 20% increase in average loan balances. Total interest and dividend income for the 2006 period increased by $9.9 million, while total interest expense for the period increased $6.7 million.

Tax equivalent net interest margin was 4.79% for the nine months ended September 30, 2006 and 2005. The 2006 year to date net interest margin reflects a slight decrease in the margin from 4.82% for the year ended December 31, 2005. The year to date tax equivalent net interest margin through September 30, 2006 was impacted by a 90 basis point increase in the yield earned on interest earning assets, essentially offset by a 94 basis point increase in the average cost of total deposits and borrowing. The increases were due primarily to increases in market interest rates and the competitive deposit environment.

Interest Income

Interest income amounted to $44.6 million, an increase of $9.9 million, or 28%, compared to $34.7 million in the prior year. The increase resulted from both an 11% increase in the average balance of interest earning assets and a 90 basis point increase in the average tax equivalent yield on interest earning assets.

The primary factor in the average interest earning assets growth was an increase of $120.7 million, or 20%, in average loan balances to $726.3 million. Higher market rates during the period resulted in average loan yields increasing 89 basis points over the prior year to 7.33%. Interest income on loans amounted to $39.8 million, an increase of $10.6 million over the prior year.

The benefit derived from growth in the average loan balance, was partially offset by a decrease of $34.0 million, or 18%, in the average balance of investment securities and short-term investments (together investments) to $158.3 million for the period ended September 30, 2006. This decrease was primarily due to maturities and paydowns of investments, which were utilized to fund loan growth. However, the tax equivalent yield realized on investments increased 27 basis points to 4.67%, due to increases in market interest rates, slower prepayments and the maturity of lower yielding securities. Investment income amounted to $4.8 million, a decrease of $758 thousand compared to the same period in the prior year.

Interest Expense

Interest expense amounted to $13.6 million, an increase of $6.7 million compared to $6.9 million in the prior year. The increase resulted primarily from a 94 basis point increase in the average cost of funds on deposits and borrowings, due to increased market rates and to a lesser degree to a $79.6 million increase in the average balance of deposits and borrowings, primarily in the higher costing CD products.

Interest expense on interest checking, savings and money market accounts increased $1.8 million over the prior year, to $5.2 million. This increase primarily resulted from a 60 basis point increase in the cost of average interest checking, savings and money market accounts. This increase in interest expense was somewhat offset by a slight reduction in the average balance on these accounts of $22.3 million for the nine months ended September 30, 2006. The average balance of $437.1 million comprised 51% of average total deposits and borrowings, compared to 59% in the prior year period.

Interest expense on certificates of deposits increased $4.5 million over the prior year, to $6.8 million. The average balance of certificates of deposit increased $89.8 million, or 65%, to $227.8 million. The increase in the average CD balance resulted primarily from the increase in brokered CDs that the company utilized as an alternative to FHLB borrowings and to a lesser degree to internally generated CD growth. Brokered CD balances averaged $58.4 million and $0 for the nine months ended September 30, 2006 and 2005, respectively. The average cost of total CDs increased 180 basis points over the prior year, due to higher market rates, consumer price sensitivity and the higher costing brokered CD balances.

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Interest expense on borrowed funds, consisting of FHLB borrowings and repurchase agreements, increased $414 thousand over the comparable period. The average balance of borrowed funds, primarily FHLB borrowings, increased $7.7 million to $21.3 million, as the company utilized borrowings as another funding vehicle to support growth in the loan portfolio. The use of brokered CDs as an alternative to FHLB borrowings began in the fourth quarter of 2005. The average cost of borrowed funds increased 149 basis points due to the increase in market interest rates.

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 affected interest income and expense during the nine months ended September 30, 2006 and September 30, 2005, respectively. 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 year average rate); (2) interest rate (change in average interest rate multiplied by prior year average balance); and (3) rate and volume (the remaining difference).

AVERAGE BALANCES, INTEREST AND AVERAGE INTEREST RATES

(Dollars in thousands)	Nine Months Ended September 30, 2006 Average Balance	Interest	Yield/ Rate (2)	Nine Months Ended September 30, 2005 Average Balance	Interest	Yield/ Rate (2)	Changes due to Total	Volume	Rate	Rate/ Volume
Assets:										
Loans (1)	$ 726,263	$ 39,802	7.33%	$ 605,611	$ 29,171	6.44%	$ 10,631	$ 5,812	$ 4,031	$ 788
Investments (2) (3)	158,277	4,815	4.67%	192,300	5,573	4.40%	(758)	(1,123)	389	(24)
Total interest earnings assets	884,540	44,617	6.85%	797,911	34,744	5.95%	9,873	4,689	4,420	764
Other assets	53,797			52,671						
Total assets	$ 938,337			$ 850,582						
Liabilities and stockholders equity:										
Int chkg, savings and money market	$ 437,068	5,223	1.60%	$ 459,421	3,451	1.00%	1,772	(167)	2,062	(123)
Certificates of deposits (4)	227,780	6,798	3.99%	138,023	2,263	2.19%	4,535	1,470	1,858	1,207
Borrowed funds	21,335	726	4.55%	13,635	312	3.06%	414	176	152	86
Junior subordinated debentures	10,825	883	10.88%	10,825	883	10.88%				
Total interest bearing deposits and borrowings	697,008	13,630	2.61%	621,904	6,909	1.48%	6,721	1,479	4,072	1,170
Net interest rate spread (2)			4.24%			4.47%				
Demand deposits	164,383			159,886						
Total deposits and borrowings	861,391	13,630	2.12%	781,790	6,909	1.18%				
Other liabilities	6,581			5,375						
Total liabilities	867,972			787,165						
Stockholders equity	70,365			63,417						
Total liabilities and stockholders equity	$ 938,337			$ 850,582						
Net interest income		$ 30,987			$ 27,835		$ 3,152	$ 3,210	$ 348	$ (406)
Net interest margin (2)			4.79%			4.79%				

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

(2) Average investment balances are presented at average amortized cost and average interest rates are presented on a tax equivalent basis. The tax equivalent effect, which was not included in the interest amount above, was $725 and $779 for the periods ended September 30, 2006 and September 30, 2005, respectively.

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

(4) Certificates of deposits include brokered and non-brokered CDs.

Provision for Loan Loss

The provision for loan losses was $892 thousand for the nine months ended September 30, 2006 and $835 thousand for the same period in 2005.

The provision reflects management s ongoing assessments of the allowance for loan losses, estimates of the credit risk inherent in the portfolio, and the level of net charge-offs during the period.

There have been no material changes to the company s 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, 2005. 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 - Asset Quality and the Allowance for Loan Losses above and in the company s 2005 Annual Report on Form 10-K.

Non-Interest Income

Non-interest income increased $312 thousand, or 7%, over the comparable period, to $5.1 million. The increase was primarily attributable to increases in investment advisory fees and other income, offset by a decrease in net gains on sales of investment securities.

Investment advisory fees increased by $316 thousand, or 19%, for the nine months ended September 30, 2006 compared to the same period in 2005. The change resulted from new business generated, and a restructured fee schedule which was put in place in 2005.

The other income category includes electronic banking fees, commercial letter of credit fees, check printing fees, income related to bank-owned life insurance, purchased state tax credits, and miscellaneous income. Increases in other income over the prior year related to $177 thousand in bank-owned life insurance, income of $62 thousand from the purchase of state tax credits and $59 thousand in income generated from the commercial sweep product. These increases were partially offset by decreases in merchant and electronic banking fee income in the current year, due to the 2005 sale of a merchant credit card services portfolio.

Net gains on sales of investment securities decreased $208 thousand and were $19 thousand for the current period compared to $227 thousand in the prior year.

Non-Interest Expense

Non-interest expense increased $2.3 million, or 10%, compared to the prior year and amounted to $24.5 million. The increase was primarily attributable to increases in salaries and employee benefits, occupancy and advertising and public relations expenses.

Salaries and employee benefits increased $1.4 million, or 11%, compared to the prior year. The increase primarily resulted from staffing increases necessary to support the company s strategic growth initiatives, salary adjustments and the additional expense related to employee stock compensation, but were partially offset by a reduction in accruals related to performance-based incentive compensation.

Occupancy expenses increased $348 thousand, or 8%, over the prior year. The increase primarily resulted from infrastructure expenditures necessary to support the company s growth.

Advertising and public relations expenses increased $302 thousand, or 46%, compared to the prior year. The increase was primarily related to additional advertising due to market expansion and the company s branding initiative that began in the latter half of 2005.

Item 3 Quantitative and Qualitative Disclosures About Market Risk

The company s primary market risk is interest rate risk and *interest rate risk management* is centered on the company s Asset-Liability Committee (the committee). The committee is comprised of five 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 policy, which provides management with guidelines for controlling interest rate risk, as measured through net interest income sensitivity, within certain tolerance levels. The committee also establishes and monitors guidelines for the company s liquidity and capital ratios.

The asset-liability strategies are reviewed on a periodic basis by management and presented and discussed with the committee on at least a quarterly basis. The asset-liability 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. At least four times per year, 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. Management utilizes a static balance sheet, instantaneous rate shock, and parallel shift methodology in conducting the simulations. 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.

In addition, on an annual basis management runs several alternative simulations used to further evaluate the interest rate sensitivity inherent in the existing balance sheet. These simulations include an Economic Value of Equity (EVE) analysis in which the balance sheet is marked to market and then shocked up and down by 200 basis points. EVE is performed to evaluate the sensitivity of the company s net equity to changing interest rate environments. The company also runs simulations that include balance sheet growth and certain alternative curve scenarios such as steep, flat or inverted yield curves, again to further evaluate or enhance, the quarterly simulations.

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, 2005.

At September 30, 2006 management considers 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.

Under the company s current balance sheet position, margin generally performs better in a rising rate environment, while it generally decreases when the yield curve is flat, inverted or declining.

Under a flat 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.

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 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 in timely alerting them to material information relating to the company (including its consolidated subsidiaries) required to be included in the company s periodic SEC filings.

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, 2006) that has materially affected, or is reasonably likely to materially affect, such internal controls.

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 believes the results of any current pending litigation would be immaterial to 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, 2005.

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, 2006. 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, 2006.

Item 3 - Defaults upon Senior Securities

Not Applicable

Item 4 - Submission of Matters to a Vote of Security Holders

Not Applicable

Item 5 - Other Information

Not Applicable

Item 6 - Exhibits

Exhibit No. and Description

10.52 Enterprise Bank and Trust Company Executive Supplemental Life Insurance Plan, adopted April 5, 2006

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)

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, 2006	By: /s/ James A. Marcotte James A. Marcotte Executive Vice President, Treasurer and Chief Financial Officer (Principal Financial Officer)

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