ENTERPRISE BANCORP INC /MA/
Form 10-Q
May 12, 2008

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 **March 31, 2008**

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	**04-3308902**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

222 Merrimack Street, Lowell, Massachusetts **01852**
(Address of principal executive offices) (Zip code)

(978) 459-9000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes o No

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

Large accelerate filer o Accelerated filer x
Non-accelerated filer o (Do not check if smaller reporting company) Smaller reporting company 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: May 1, 2008 Common Stock - Par Value $0.01: 7,956,187 shares outstanding

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ENTERPRISE BANCORP, INC.

Consolidated Balance Sheets

(unaudited)

(Dollars in thousands)	**March 31, 2008**	**December 31, 2007**
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 35,386	$ 24,930
Short-term investments	5,647	7,788
Total cash and cash equivalents	41,033	32,718
Investment securities at fair value	145,140	145,517
Loans, less allowance for loan losses of $13,886 at March 31, 2008 and $13,545 at December 31, 2007	846,776	820,274
Premises and equipment	19,763	19,296
Accrued interest receivable	5,766	5,777
Deferred income taxes, net	7,304	7,722
Bank-owned life insurance	12,876	12,736
Prepaid expenses and other assets	2,786	7,250
Income taxes receivable	58	378
Core deposit intangible, net of amortization	309	342
Goodwill	5,656	5,656
Total assets	$ 1,087,467	$ 1,057,666
Liabilities and Stockholders Equity		
Liabilities		
Deposits	$ 905,587	$ 868,786
Borrowed funds	72,589	81,429
Junior subordinated debentures	10,825	10,825
Accrued expenses and other liabilities	6,709	6,245
Accrued interest payable	3,176	3,369
Total liabilities	998,886	970,654
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; 20,000,000 shares authorized; 7,956,187 and 7,912,715 shares issued and outstanding at March 31, 2008 and December 31, 2007, respectively	80	79
Additional paid-in capital	28,660	28,051
Retained earnings	58,820	58,527
Accumulated other comprehensive income	1,021	355
Total stockholders equity	88,581	87,012

Total liabilities and stockholders equity	$	1,087,467	$	1,057,666

See accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Consolidated Statements of Income

(unaudited)

(Dollars in thousands, except per share data)	**Three months ended March 31, 2008**	**March 31, 2007**
Interest and dividend income:		
Loans	$ 14,562	$ 14,269
Investment securities	1,535	1,321
Short-term investments	62	31
Total interest and dividend income	16,159	15,621
Interest expense:		
Deposits	5,363	5,058
Borrowed funds	586	233
Junior subordinated debentures	294	294
Total interest expense	6,243	5,585
Net interest income	9,916	10,036
Provision for loan losses	317	83
Net interest income after provision for loan losses	9,599	9,953
Non-interest income:		
Investment advisory fees	820	778
Deposit service fees	877	637
Bank-owned life insurance	154	148
Net gains on sales of investment securities	47	53
Gains on sales of loans	31	40
Other income	468	422
Total non-interest income	2,397	2,078
Non-interest expense:		
Salaries and employee benefits	5,350	5,335
Occupancy expenses	1,621	1,618
Audit, legal and other professional fees	407	296
Advertising and public relations	367	279
Supplies and postage	235	233
Investment advisory and custodial expenses	114	123
Other operating expenses	937	636
Total non-interest expense	9,031	8,520
Income before income taxes	2,965	3,511
Income tax expense	948	1,289
Net income	$ 2,017	$ 2,222
Basic earnings per share	$ 0.25	$ 0.29
Diluted earnings per share	$ 0.25	$ 0.28

Basic weighted average common shares outstanding	7,937,988	7,747,985
Diluted weighted average common shares outstanding	7,980,505	7,879,334

See accompanying notes to the unaudited consolidated financial statements.

ENTERPRISE BANCORP, INC.

Consolidated Statement of Changes in Stockholders Equity

(unaudited)

Three months ended March 31, 2008

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive Income	Total Stockholders Equity
Balance at December 31, 2007	$ 79	$ 28,051	$ 58,527		$ 355	$ 87,012
Cumulative-effect adjustment for adoption of new accounting principle (post retirement obligation)			(1,010)			(1,010)
Comprehensive income						
Net income			2,017	$ 2,017		2,017
Other comprehensive income, net				666	666	666
Total comprehensive income				$ 2,683		
Tax benefit from exercise of stock options		2				2
Common stock dividend paid ($0.09 per share)			(714)			(714)
Common stock issued under dividend reinvestment plan	1	256				257
Stock-based compensation		261				261
Stock options exercised		90				90
Balance at March 31, 2008	$ 80	$ 28,660	$ 58,820		$ 1,021	$ 88,581
Disclosure of other comprehensive income:						
Gross unrealized holding gains on securities arising during the period				$ 1,131		
Income tax				(434)		
Net unrealized holding gains, net of tax				697		
Reclassification adjustment for net gains included in net income:						
Net realized gains on sales of securities during the period				(47)		
Income tax expense				16		
Reclassification adjustment, net of tax				(31)		
Other comprehensive income, net of reclassification				$ 666		

See the accompanying notes to the unaudited consolidated financial statements

ENTERPRISE BANCORP, INC.

Consolidated Statements of Cash Flows

(unaudited)

(Dollars in thousands)	Three months ended March 31, 2008	March 31, 2007
Cash flows from operating activities:		
Net income	$ 2,017	$ 2,222
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	317	83
Depreciation and amortization	540	685
Amortization of intangible assets	33	33
Stock-based compensation expense	137	184
Mortgage loans originated for sale	(4,307)	(4,355)
Proceeds from mortgage loans sold	3,838	3,927
Gains on sales of loans	(31)	(40)
Net gains on sales of investment securities	(47)	(53)
Income on bank-owned life insurance, net	(140)	(135)
Change in income taxes	697	1,054
Decrease (Increase) in:		
Accrued interest receivable	11	(420)
Prepaid expenses and other assets	4,087	(1,029)
(Decrease) Increase in:		
Accrued expenses and other liabilities	(380)	(2,091)
Accrued interest payable	(193)	70
Net cash provided by operating activities	6,579	135
Cash flows from investing activities:		
Proceeds from sales of investment securities		1,576
Proceeds from maturities, calls and pay-downs of investment securities	10,882	3,366
Purchase of investment securities	(9,304)	(2,319)
Purchase of tax credits		(1,735)
Net increase in loans	(26,319)	(18,700)
Additions to premises and equipment, net	(1,119)	(369)
Net cash used in investing activities	(25,860)	(18,181)
Cash flows from financing activities:		
Net increase in deposits	36,801	14,027
Net (decrease) increase in borrowed funds	(8,840)	63
Cash dividends paid	(714)	(619)
Proceeds from issuance of common stock	257	267
Proceeds from exercise of stock options	90	107
Tax benefit from exercise of stock options	2	
Net cash provided by financing activities	27,596	13,845
Net (decrease) increase in cash and cash equivalents	8,315	(4,201)
Cash and cash equivalents at beginning of period	32,718	50,887
Cash and cash equivalents at end of period	$ 41,033	$ 46,686
Supplemental financial data:		
Cash Paid For: Interest	$ 6,436	$ 5,515
Income taxes	250	235

See accompanying notes to the unaudited consolidated financial statements.

ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements

(1) Organization of Holding Company

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

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

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

The company s deposit accounts are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (the FDIC) up to the maximum amount provided by law. The FDIC and the Massachusetts Commissioner of Banks (the Commissioner) have regulatory authority over the bank.

The business and operations of the company are subject to the regulatory oversight of the Board of Governors of the Federal Reserve System (the Federal Reserve Board). The Commissioner also retains supervisory jurisdiction over the company.

(2) Basis of Presentation

The accompanying unaudited consolidated financial statements and these notes should be read in conjunction with the company s December 31, 2007 audited consolidated financial statements and notes thereto contained in the company s 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 14, 2008. 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 2007 Annual Report on Form 10-K.

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

Certain fiscal 2007 information has been reclassified to conform to the 2008 presentation.

(3) Critical Accounting Estimates

In preparing the consolidated financial statements in conformity with U.S. generally accepted accounting principles, management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. These estimates and assumptions affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ should the assumptions and estimates used change over time due to changes in circumstances.

As discussed in the company s 2007 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 company s consolidated financial statements included in the company s 2007 Annual Report on Form 10-K for significant accounting policies.

ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements

(4) Accounting for Income Taxes

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

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

The company did not have any unrecognized tax benefits accrued as income tax liabilities or receivables or as deferred tax items at March 31, 2008. The Company s tax years ending December 31, 2004 and later are open to federal and state income tax examinations.

(5) Stock-Based Compensation

The company has not significantly changed the general terms and conditions related to stock compensation from those disclosed in the company s 2007 Annual Report on Form 10-K.

Total stock-based compensation expense, which includes *stock option awards* and *restricted stock awards* to officers and other employees, and *director stock compensation* in lieu of cash fees to directors, was $137 thousand and $184 thousand for the three months ended March 31, 2008 and 2007, respectively.

The company recognized stock-based compensation expense related to stock option awards of $84 thousand for the three months ended March 31, 2008, compared to $131 thousand for the same period in 2007. Stock-based compensation expense recognized in association with a restricted stock award amounted to $12 thousand for both the three month periods ended March 31, 2008 and 2007. Stock-based compensation expense related to Directors election to receive shares of common stock in lieu of cash fees for attendance at Board and Board Committee meetings amounted to $41 thousand for both the three months ended March 31, 2008 and 2007. In January 2008, 10,739 shares of common stock were issued to directors in lieu of cash fees related to 2007 annual directors stock-based compensation expense of $165 thousand.

There were 132,000 stock option awards granted to employees during the three months ended March 31, 2008 and 124,100 stock options granted during the three months ended March 31, 2007. The options become exercisable at the rate of 25% per year and provide for full vesting upon attainment of age 62 while remaining employed with the bank. Options granted in 2008 and 2007 expire seven years from the date of grant.

The per share weighted average fair value of stock options granted in 2008 was determined to be $2.47. The weighted average fair value of the options was determined to be 19% of the market value of the stock at the date of grant. The assumptions used in the valuation model for determining weighted average fair value of the 2008 stock option grants for the risk-free interest rate, expected volatility, dividend yield and expected life in years were 2.61%, 25%, 2.82% and 5.5 years, respectively.

The per share weighted average fair value of stock options granted in 2007 was determined to be $3.69. 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 assumptions used in the valuation model for determining weighted average fair value of the 2007 stock option grants for the risk-free interest rate, expected volatility, dividend yield and expected life in years were 4.42%, 21%, 2.03% and 5.5 years, respectively.

Refer to note 9 Stock Based Compensation Plans in the company s 2007 Annual Report on Form 10-K for a description of the assumptions used in the valuation model.

ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements

(6) Supplemental Retirement Plan and Other Postretirement Benefit Obligation

The following table illustrates the net periodic benefit cost for the supplemental executive retirement plan for the three months ended March 31, 2008 and 2007:

(Dollars in thousands)

	2008	2007
Service cost	$ 85	$ 138
Interest cost	41	32
Net periodic benefit cost	$ 126	$ 170

The company anticipates accruing an additional $377 thousand to the plan during the remainder of 2008.

On January 1, 2008, the company adopted the Financial Accounting Standards Board s Emerging Issues Task Force Issue No. 06-4 (EITF No. 06-4) Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements. EITF No. 06-4 requires that an employer 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. Upon adoption of EITF No. 06-4, the company recorded a cumulative-effect adjustment to retained earnings of $1.0 million. The benefit expense of postretirement cost of insurance for split dollar insurance coverage amounted to $20 thousand for the three months ended March 31, 2008.

(7) 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 months ended March 31st and the effect of those shares on earnings:

	Three months ended March 31,	
	2008	2007
Basic weighted average common shares outstanding	7,937,988	7,747,985
Dilutive shares	42,517	131,349

Diluted weighted average common shares outstanding		7,980,505		7,879,334
Basic earnings per share	$	0.25	$	0.29
Effect of dilutive shares		0.00		(0.01)
Diluted earnings per share	$	0.25	$	0.28

At March 31, 2008, there were additional options outstanding to purchase up to 523,118 shares which were excluded from the calculation of diluted earnings per share due to the exercise price of these options exceeding the average market price of the company s common stock. These options, which were not dilutive at that date, may potentially dilute earnings per share in the future.

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Notes to the Unaudited Consolidated Financial Statements

(8) Fair Value Measurements

On January 1, 2008 the company adopted the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157). This Statement provides a single definition of fair value and establishes a framework for measuring fair value in generally accepted accounting principles, with the intention of increasing consistency and comparability in fair value measurements. The application of this Statement expanded disclosure requirements about fair value measurements. However, the adoption of SFAS No. 157 did not require any new fair value measurements, as the Statement applies under other existing accounting pronouncements that require or permit fair value measurements. In accordance with FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157, the company has deferred the application of SFAS No. 157 to non-financial assets such as goodwill and real property held for sale, and non-financial liabilities until January 1, 2009.

SFAS No. 157 defines the fair value to be the price which a seller would receive in an orderly transaction between market participants (an exit price). This Statement also establishes a fair value hierarchy segregating fair value measurements using three levels of inputs: (Level 1) quoted market prices in active markets for identical assets or liabilities; (Level 2) significant other observable inputs, including quoted prices for similar items in active markets, quoted prices for identical or similar items in market that are not active, inputs such as interest rates and yield curves, volatilities, prepayment speeds, credit risks and default rates which provide a reasonable basis for fair value determination or inputs derived principally from observed market data; (Level 3) significant unobservable inputs for situations in which there is little, if any, market activity for the asset or liability. Unobservable inputs must reflect reasonable assumptions that market participants would use in pricing the asset or liability, which are developed on the basis of the best information available under the circumstances.

The following table summarizes significant assets and liabilities carried at fair value at March 31, 2008 (there were no items measured using level 3 inputs):

		Fair Value Measurements using:	
(Dollars in thousands)	**Fair Value**	**(level 1)**	**(level 2)**
Assets measured on a recurring basis:			
Available for sale securities (1)	$ 141,245	$ 7,277	$ 133,968
Assets measured on a non-recurring basis:			
Impaired loans (2)	$ 571		571

(1) Investment securities that are considered available for sale are carried at fair value in accordance with SFAS No. 115 (as amended). The company utilizes third-party pricing vendors to provide valuations on its fixed income securities. These vendors generally determine fair value prices based upon pricing matrices utilizing observable market data inputs for similar or benchmark securities. The company s equity portfolio fair value is measured based on quoted market prices for the shares. Net unrealized appreciation and depreciation on investments available for sale, net of applicable income taxes, are reflected as a component of accumulated other comprehensive income. The bank is required to purchase Federal Home Loan Bank of Boston (FHLB) stock in association with outstanding advances from the FHLB; this stock is classified as a restricted investment and carried at cost.

(2) Impaired loan balances in the table above represent those collateral dependent impaired loans where management has estimated the credit loss by comparing the loan s carrying value against the expected realizable fair value of the collateral, in accordance with SFAS No. 114

(as amended). A specific allowance is assigned to the impaired loan for the amount of estimated credit loss. The increase in specific allowances assigned to collateral dependent impaired loans was $103 thousand for the three months ended March 31, 2008.

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, and accordingly these fair values measures are deemed to be SFAS No. 157 Level 2 measurements. In accordance with FASB Interpretation No. 45, the estimated fair values of these commitments are carried on the balance sheet as a liability and amortized to income over the life of the letters of credit, which are typically one year. At March 31, 2008 and December 31, 2007, the estimated fair value of these commitments was immaterial.

Interest rate lock commitments related to the origination of mortgage loans that will be sold are considered derivative instruments. The company estimates the fair value of these derivatives using the difference between the guaranteed interest rate in the commitment and the current market interest rate. To reduce the net interest rate exposure arising from its loan sale activity, the company enters into the commitment to sell these loans at essentially the same time that the interest rate lock commitment is quoted on the origination of the loan. The commitments to sell loans are also considered derivative instruments, with estimated fair values based on changes in current market rates. These commitments represent the company s only derivative instruments and are accounted for in accordance with SFAS No. 133 (as amended). The fair values of the company s derivative instruments are deemed to be SFAS No. 157 Level 2 measurements. At March 31, 2008 and December 31, 2007, 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 2007Annual 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 stat contained in Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 3 Quantitative and Qualitative Disclosures About Market Risk, including, but not limited to, statements related to management s views on the banking environment and the economy, competition and market expansion opportunities, the interest rate environment, credit risk and the level of future non-performing assets and charge-offs, potential asset and deposit growth, future non-interest expenditures and non-interest income growth, and borrowing capacity are forward-looking statements. The company wishes to caution readers that such forward-looking statements reflect numerous assumptions and involve a number of risks and uncertainties that may adversely affect the company s future results. The following important factors, among others, could cause the company s results for subsequent periods to differ materially from those expressed in any forward-looking statement made herein: (i) changes in interest rates could negatively impact net interest income; (ii) changes in the business cycle and downturns in the local, regional or national economies, including deterioration in the local real estate market, could negatively impact credit and/or asset quality and result in credit losses and increases in the company s 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 (the FASB) 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.

Overview

The company reported net income for the three months ended March 31, 2008 of $2.0 million compared to $2.2 million for the same period in 2007, a decrease of 9%. Diluted earnings per share were $0.25 for the quarter compared to $0.28 for the same period in 2007, a decrease of 11%.

As with many banks, the recent rapid interest-rate decreases pressured the company s margins. The Federal Reserve dropped the Fed Funds rate 300 basis points since mid-September 2007, including 200 basis points in the first quarter of 2008. These rate cuts have reduced interest earned on many of the company s assets during the current quarter. Although the company s funding costs have also declined as a result of such rate cuts, these costs have declined at a much slower pace due to the competition in the marketplace for funding.

Composition of Earnings

The decrease in net income resulted primarily from a decrease in net-interest income, an increase in the provision for loan losses and an increase in non-interest expenses, partially offset by an increase in non-interest income and a decrease in the bank s effective tax rate.

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. Net interest income for the quarter ended March 31, 2008 amounted to $9.9 million, representing a $120 thousand decrease from the same period in 2007.

Net interest margin, the spread earned between interest-earning assets and the company s funding sources, primarily deposits, was 4.10% for the quarter ended March 31, 2008 compared to 4.29% and 4.53% for the quarters ended December 31, and March 31, 2007, respectively. The decrease in margin resulted from asset yields re-pricing downward due to recent rate reductions in the market, while deposit and funding costs have re-priced downward at a slower rate due to the current credit markets and a highly-competitive marketplace for deposits. 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.

Non-interest income was $2.4 million for the quarter ended March 31, 2008, an increase of $319 thousand, or 15%, over the same period in 2007. The growth resulted primarily from increases of $240 thousand in deposit-service fees and $42 thousand in investment-advisory fees.

Non-interest expense amounted to $9.0 million for the quarter ended March 31, 2008 compared to $8.5 million for the same period in 2007, an increase of 6%. The increases were predominantly in advertising and public relations, consulting expenses related to process improvements, and increased deposit insurance premiums due to the FDIC assessment changes which applied to all banks.

The provision for loan losses, which is impacted by asset quality and loan growth, amounted to $317 thousand for the quarter ended March 31, 2008 compared to $83 thousand in the first quarter of 2007. The increased provision is primarily due to loan growth during the quarter. Net recoveries were $24 thousand during the quarter. The allowance for loan losses to total loans ratio was 1.61% at March 31, 2008 compared to 1.62% at December 31, 2007. The company s management of credit risk is reviewed in more detail under the heading Credit Risk/Asset Quality and the Allowance for Loan Losses contained in the Financial Condition section of this Item 2.

Sources and Uses of Funds

The company s primary sources of funds are deposits, brokered certificates of deposit (brokered CDs), borrowings from the Federal Home Loan Bank of Boston (the FHLB), repurchase agreements, current earnings and proceeds from the sales, maturities and paydowns on loans and investment securities. The company uses funds to originate loans, purchase investment securities, conduct operations, expand the branch network, and pay dividends to shareholders.

Total assets amounted to $1.087 billion at March 31, 2008, an increase of 3% since December 31, 2007. The company s core asset strategy is to grow loans, primarily commercial loans. Total loans increased 3% since December 31, 2007 and amounted to $860.7 million or 79% of total assets. Commercial loans amounted to $733.8 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. The fair value of total investments amounted to $145.1 million at March 31, 2008, or 13% of total assets, and has decreased $377 thousand since December 31, 2007.

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

At March 31, 2008, total deposits, which include brokered CDs, amounted to $905.6 million, representing 4% growth over December 31, 2007. Total deposits, excluding brokered CDs, increased $55.1 million, or 7%, since December 31, 2007. The deposit growth was primarily in the certificates of deposit, money market accounts and investment savings balances as customers, sensitive to the market rate decreases, have sought higher yielding competitive deposit products.

As deposit balances increased during the quarter, the company reduced the balances of brokered CD s and borrowed funds. At March 31, 2008, the company had $52.4 million in brokered CDs and $72.6 million in borrowed funds (repurchase agreements and FHLB borrowings), reductions of 26% and 11%, respectively, since December 31, 2007.

Opportunities and Risks

Management remains committed to long-term strategies of geographic market expansion and growth within the company s core banking businesses of commercial lending, investment advisory services, and deposit services, while maintaining its commitment to asset quality.

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

Larger banks have certain competitive advantages over the company, including the ability to make larger loans to a single borrower than is possible for the company. The greater financial resources of larger banks also allow them to offer a broad range of automated banking services, to maintain numerous branch offices and to mount extensive advertising and promotional campaigns. Competition for loans, investment advisory assets and deposits also comes from other businesses that provide financial services, including consumer finance companies, mortgage brokers, private lenders, insurance companies, securities brokerage firms, institutional mutual funds, and internet based banks. Advances in, and the increased use of, technology, such as internet banking and electronic transaction processing, are expected to have a significant impact on the future competitive landscape confronting financial institutions.

Management continually strives to differentiate the company and provide a unique customer experience through highly competitive commercial lending and deposit services, investment advisory and management services, and insurance products delivered through consistent, responsive and personal service based on an understanding of the financial service needs of its customers. The company continually examines new products and technologies in order to maintain a highly competitive mix of product offerings and to target product lines to customer needs.

The company has not and does not intend to originate mortgage loans that are considered sub-prime and the company has not purchased sub-prime mortgage-backed securities for the company s investment portfolio. However, what has been called the sub-prime mortgage crisis, may have far-reaching and as yet unknown long-term consequences in the financial services industry and the economy in general. As such, any long-term continuation of these current industry trends or possible subsequent effects could weaken the local economy and negatively impact the company s financial condition and performance in a variety of ways even though the company itself has no direct exposure to sub-prime mortgages in either a lending or investment capacity.

Management believes that the company is well positioned, both financially and strategically, to capitalize on market opportunities created by the challenging banking landscape within the financial service industry and by the customer dissatisfaction with larger banks. Management believes the company s business model, strong service culture, experienced lending 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 actively seeks to strengthen the company s position through the pursuit of strategic growth within existing and into neighboring markets. Management 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.

Despite these competitive challenges, the company has been successful in growing its core banking businesses. Management believes this growth is the result of a solid reputation within its market area, ongoing business development efforts and continued market expansion. The company currently has fourteen branch locations and a fifteenth branch facility is currently under construction in the city of Methuen, Massachusetts and is expected to open in late spring 2008. The company is also currently in the process of obtaining regulatory approvals to establish a branch to be located in the southern New Hampshire town of Derry, which will be the company s second New Hampshire branch office and is anticipated to open in early 2009.

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

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

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

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

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

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

Refer to Item 1A. Risk Factors included in the company s 2007 Annual Report on Form 10-K for additional factors that could adversely affect the company s future results of operations and financial condition.

Financial Condition

Total assets increased $29.8 million, or 3%, over December 31, 2007, to $1.087 billion at March 31, 2008. The increase was primarily attributable to increases in total loans funded primarily through deposit growth.

Short-term investments

As of March 31, 2008, short-term investments amounted to $5.6 million, a decrease of $2.1 million compared to December 31, 2007. Short-term investments carried as cash equivalents consist of overnight and term federal funds sold and money market mutual funds. The balance of these investments will fluctuate depending on the short-term deposit inflows and the immediate liquidity needs of the company.

Investments

At March 31, 2008, the investment portfolio s fair market value was $145.1 million, representing a decline of $377 thousand since December 31, 2007. The fair market value of the investment portfolio represented 13% of total assets at March 31, 2008 and 14% at December 31, 2007. As of the periods indicated below, all investment securities (other than FHLB stock) were classified as available for sale and were carried at fair market value.

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

(Dollars in thousands)	March 31, 2008	December 31, 2007	March 31, 2007
Federal agency obligations (1)	$ 4,526	$ 12,543	$ 10,403
Collateralized mortgage obligations and other mortgage backed securities (CMO/MBS)	65,288	62,218	58,847
Municipal securities	64,154	60,049	48,245
Fixed income securities	$ 133,968	$ 134,810	$ 117,495
Equity securities	7,277	6,812	9,217
Federal Home Loan Bank stock (2)	3,895	3,895	1,609
Certificates of deposit			1,033
Total investments	$ 145,140	$ 145,517	$ 129,354

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(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 obligations of the U.S. 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.

See Note 8, Fair Value Measurements to the Unaudited Consolidated Financial Statements for further information regarding the company s fair value measurements for available for sale securities.

During the three months ended March 31, 2008, the total principal paydowns, calls and maturities amounted to $10.9 million. These portfolio outflows were partially utilized to purchase $9.4 million in securities and to fund loan growth over the period. The net unrealized gain on the portfolio at March 31, 2008 was $1.5 million compared to a net unrealized gain of $382 th