

ENTERPRISE BANCORP INC /MA/
Form 10-K
March 16, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from to

Commission file number 0-21021

Enterprise Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Massachusetts

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

04-3308902

(IRS Employer Identification No.)

222 Merrimack Street, Lowell, Massachusetts

(Address of principal executive offices)

01852

(Zip code)

Registrant's telephone number, including area code

(978) 459-9000

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

Common Stock, \$.01 par value per share

(Title of each class)

Nasdaq Global Market

(Name of exchange on which registered)

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

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NONE
(Title of Class)

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated 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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid price and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter. \$96,255,023, as of June 30, 2006

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: March 5, 2007, Common Stock - Par Value \$0.01: 7,767,580 shares outstanding

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the issuer's proxy statement for its annual meeting of stockholders to be held on May 1, 2007 are incorporated by reference in Part III of this Form 10-K. Such information incorporated by reference shall not be deemed to specifically incorporate by reference the information referred to in Item 402(a) (8) of Regulation S-K.

ENTERPRISE BANCORP, INC.

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PART I

Item 1. Business

THE COMPANY

General

Enterprise Bancorp, Inc. (the "company") is a Massachusetts corporation, which operates as the parent holding company of Enterprise Bank and Trust Company (the "bank"). Substantially all of the company's operations are conducted through 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.

Through the bank and its subsidiaries, the company offers a range of commercial and consumer loan and deposit 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 headquarters are located at 222 Merrimack Street in Lowell, Massachusetts. The company's primary market area is the Merrimack Valley and North Central regions of Massachusetts and South Central New Hampshire. The company has fourteen full service branch banking offices located in the Massachusetts cities and towns of Andover, Billerica, Chelmsford, Dracut, Fitchburg, Leominster, Lowell, Tewksbury, and Westford; and in Salem, New Hampshire which serve those cities and towns as well as the surrounding communities. The company recently received regulatory approval to establish a new branch in the city of Methuen, Massachusetts, and expects to open the facility for business in late 2007.

The company endeavors to expand market share in existing markets and to pursue strategic growth through expansion into neighboring markets. 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 commercial 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, responsive and personal service based on management's familiarity and understanding of the banking and other financial service needs of its customers. Management seeks to hire, develop and retain highly motivated top professionals who understand the communities in which the bank operates as well as the local banking environment.

Lending

General

The company specializes in lending to business entities, non-profit organizations, professionals and individuals. The company's primary lending focus is on the development of high quality commercial lending relationships achieved through active business development efforts, strong community involvement and focused marketing strategies. Loans made by the company to businesses include commercial mortgage loans, construction loans, secured and unsecured commercial loans and lines, and standby letters of credit. The company also originates equipment lease financing for businesses. Loans made to individuals include residential mortgage loans, home equity loans, residential construction loans, secured and unsecured personal loans and lines of credit and mortgage loans on investment and vacation properties.

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

In addition, a management loan review committee, consisting of senior lending officers and loan review personnel, is responsible for setting loan policy and procedures, as well as reviewing loans on the company's internal watch asset list and classified loan report. A loan committee, consisting of seven outside members of the board of directors, and two executive officers who are also members of the board of directors, reviews current portfolio statistics, new credits, construction loan reviews, loan delinquencies, allowance for loan losses and watched assets, as well as current market conditions and issues relating to the construction and real estate development industry.

The company has also established an internal credit review committee, consisting of senior lending officers and loan review personnel. The committee meets on an as needed basis to review loan requests related to borrowing relationships of certain levels, as well as other borrower relationships recommended for discussion by committee members. The company's executive committee of the board of directors also approves loan relationships exceeding certain prescribed limits.

At December 31, 2006, the bank's statutory lending limit, based on 20% of capital, to any individual borrower was approximately \$17.4 million, subject to certain exceptions provided under applicable law.

Commercial Real Estate, Commercial and Construction Loans

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

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

Commercial construction loans include the development of residential housing and condominium projects, the development of commercial and industrial use property and loans for the purchase and improvement of raw land. The company's construction lenders work to cultivate long-term relationships with established developers. The company limits the amount of financing provided to any single developer for the construction of properties built on a speculation basis. Funds for construction projects are disbursed as pre-specified stages of construction are completed. Regular site inspections are performed, either by experienced construction lenders on staff or by independent outside inspection companies, at each construction phase, prior to advancing additional funds. Commercial construction loans generally have terms of one to three years.

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

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

Residential Loans

The company originates conventional mortgage loans on one-to-four family residential properties. These properties may serve as the borrower's primary residence, second homes or investment properties. Loan to value limits vary up to 97%, with mortgage insurance coverage required for loan-to-value ratios greater than 80% based on program parameters. In addition the company provides financing for the construction of owner occupied residences.

Residential mortgage loans made by the company have terms of up to 30 years at either fixed or adjustable rates of interest. Fixed and adjustable rate residential mortgage loans are generally originated using underwriting standards and standard documentation allowing their sale in the secondary market. Depending on the current interest rate environment, management projections of future interest rates and the overall asset-liability management program of the company, management may elect to sell or hold residential loan production for the company's portfolio. The company generally does not pool mortgage loans for sale, but instead sells the loans on an individual basis. The company may retain or sell the servicing when selling the loans. All loans sold are currently sold without recourse.

Home Equity Loans and Lines of Credit

Home equity loans are originated for the company's portfolio for one-to-four family residential properties with maximum original loan to values ratios generally up to 80% of the assessed or appraised value of the property securing the loan. Home equity loan payments consist of monthly principal and interest based on amortizations ranging from three to fifteen years and are generally offered at fixed rates of interest.

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

Consumer Loans

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

Risk Elements and Allowance for Loan Losses

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

Investment Activities

The company's investment activity is an integral part of the overall asset-liability management program of the company. The investment function provides readily available funds to support loan growth as well as to meet withdrawals and maturities of deposits and attempts to provide maximum return consistent with liquidity constraints and general prudence, including diversification and safety of investments. The securities in which the company may invest are limited by regulation. In addition, the company has an internal investment policy which restricts investments to the following categories: U.S. treasury securities, federal agency obligations (obligations issued by government sponsored enterprises that are not backed by the full faith and credit of the United States government), mortgage-backed securities (MBS's), including collateralized mortgage obligations (CMO's), and state, county and municipal securities (Municipals), all of which must be considered investment grade by a recognized rating service. The company also invests in certificates of deposit and, within prescribed regulatory limits, in publicly traded equity securities and registered mutual funds. The bank is also 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.

The short-term investments classified as cash equivalents may be comprised of short-term U.S. Agency Discount Notes, money market mutual funds and overnight or short-term federal funds sold. Other short-term investments not classified as cash equivalents may consist of auction rate preferred securities, which typically have redemption (auction) dates of up to forty-nine days, but cannot readily be converted to cash at par value until the next successful auction. The investment policy also limits the categories within the investment portfolio to particular percentages of the total portfolio and to certain percentages of total assets and/or capital. The effect of changes in interest rates, principal payments and market values are considered when purchasing securities.

Investment transactions, portfolio allocations and projected cash flows are prepared monthly and presented to the company's Asset-Liability Committee of the Board of Directors (ALCO) on a periodic basis. ALCO is comprised of five outside directors and three executive officers of the company who are also directors, with various management liaisons. In addition, several directors who are not on the committee rotate in on a regular basis. ALCO performs an in-depth review of the company's asset-liability strategy. The credit rating of each debt security or obligation in the portfolio is closely monitored by management and presented, at least annually, to the ALCO, along with a detailed evaluation of the company's municipal securities portfolio.

Source of Funds

Deposits

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

Terms on certificates of deposit range from overnight to thirty months. The company has offered premium rates on specially designated products from time to time in order to promote new branches and to attract customers. In addition, the company may use brokered certificates of deposit as an alternative to borrowing funds from the FHLB.

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

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

Borrowed Funds

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

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

Junior Subordinated Debentures

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

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

Investment Advisory Group

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

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

Enterprise Insurance Services

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

Internet Banking

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

Company Website

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

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

Competition

The company faces strong competition to attract deposits and to generate loans. National and larger regional banks have a local presence in the Merrimack Valley and North Central regions of Massachusetts and in South Central New Hampshire. Numerous local savings banks, commercial banks, cooperative banks, credit unions and savings and loan associations have one or more offices in the company's market area. Larger banks have certain competitive advantages over the company, including the ability to make larger loans to a single borrower than is possible for the company. The greater financial resources of larger banks also allow them to offer a broad range of automated banking services, to maintain numerous branch offices and to mount extensive advertising and promotional campaigns. Competition for loans and deposits also comes from other businesses that provide financial services, including consumer finance companies, mortgage brokers, insurance companies, securities brokerage firms, institutional mutual funds, private lenders and internet-only based banks. Advances in, and the increased use of, technology, such as Internet banking and electronic item processing, are expected to have a significant impact on the future competitive landscape confronting financial institutions.

Notwithstanding the substantial competition with which the company is faced, management believes that the company has established a solid reputation within its market area. The company's officers and directors have substantial business and personal ties in the cities and towns in which the company operates. The company believes that it has differentiated itself from competitors by providing customers with personal and responsive service based on management's familiarity and understanding of such customers' banking and investment management needs. The company continually examines new products and technologies in order to maintain a highly competitive mix of offerings and to target product lines to customer needs.

Management actively seeks to strengthen its position, by capitalizing on the market opportunities, and the continuing pursuit of growth within existing and neighboring markets. The company recently received regulatory approval to establish its fifteenth branch in the city of Methuen, Massachusetts. This will be the company's sixth new branch location since 2002.

To the extent that changes in the regulation of financial services may further increase competition, these changes could result in the company paying increased interest rates to obtain deposits while receiving lower interest rates on its loans. Under such circumstances, the company's net interest margin would decline.

See also "Supervision and Regulation" below, for further discussion on how new laws and regulations may effect the company's competitive position.

Supervision and Regulation

General

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

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

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

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

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

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

Currently pending legislative proposals at both the federal level and in various states, including Massachusetts, would further address data breaches affecting consumer financial information and could impose additional operational and reporting obligations on banks and their affiliates.

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

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

Regulation of the Holding Company

The company is a registered bank holding company under the federal Bank Holding Company Act of 1956, as amended (the *Bank Holding Company Act*). The business and operations of the company are subject to the supervision and examination of the Board of Governors of the Federal Reserve System (the *Federal Reserve Board*) and the company files reports with the Federal Reserve Board as required under the *Bank Holding Company Act*. Under applicable Massachusetts law, the company is also subject to the supervisory jurisdiction of the Massachusetts Commissioner of Banks (the *Commissioner*).

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

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

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

Regulation of the Bank

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

The regulations of these agencies govern many aspects of the bank's business, including permitted investments, the opening and closing of branches, the amount of loans which can be made to a single borrower, mergers, appointment and conduct of officers and directors, capital levels and terms of deposits. The Federal Reserve Board also requires the bank to maintain minimum reserves on its deposits. Federal and state regulators can impose sanctions on the bank and its management if the bank engages in unsafe or unsound practices or otherwise fails to comply with regulatory standards. Various other federal and state laws and regulations, such as truth-in-lending and truth-in-savings statutes, the Equal Credit Opportunity Act, the Bank Secrecy Act, the Real Estate Settlement Procedures Act, the Community Reinvestment Act, Check 21 and the FACT Act, also govern the bank's activities and operations.

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

Deposit Insurance Assessment

As of January 1, 2007, the bank is subject to a revised deposit insurance assessment system as implemented by the FDIC in accordance with the requirements of the Federal Deposit Insurance Reform Act of 2005 (the Deposit Insurance Reform Act). Under the former system for assessing deposit insurance premiums on federally insured banks and thrifts, the bank had no current obligation to pay any deposit insurance premium based on its designation as well capitalized.

Effective January 1, 2007, the new deposit insurance assessment rates will be determined based upon a combination of an institution's financial ratios and supervisory factors. Under the new deposit insurance assessment system, even the highest risk-rated (i.e., least risk) banks and thrifts are subject to some level of assessment payable to the FDIC's Deposit Insurance Fund. There are four established risk categories under the new assessment rules. The bank anticipates that it will qualify as a Risk Category I (least risk) institution with an assessment rate in a range of 5 to 7 basis points of the bank's deposit assessment base, as defined by the FDIC. Based upon an analytic tool provided by the FDIC, the bank anticipates that its projected calculated assessment rate for 2007 will be at the lower end of this range.

Under the Deposit Insurance Reform Act, eligible insured depository institutions, such as the bank, will share in a one-time assessment credit pool of approximately \$4.7 billion, effectively reducing the amount these institutions will be required to submit as an overall assessment. As indicated in the final rule regarding this credit published in October 2006, the FDIC provided the bank with a preliminary Statement of One-Time Credit. The bank's portion of the one-time assessment credit as indicated on that statement is approximately \$333 thousand.

The FDIC will apply the bank's one-time assessment credit against the bank's payment of future deposit insurance assessments. The company anticipates that the credit will offset more than half of the bank's deposit insurance assessments for fiscal year 2007.

Dividends

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

Capital Resources

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

The Company

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

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

The Bank

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

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

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

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

Patents, Trademarks, etc.

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

Employees

At December 31, 2006, the company employed 282 full-time equivalent employees, including 100 officers. None of the company's employees are presently represented by a union or covered by a collective bargaining agreement. Management believes its employee relations to be excellent.

Item 1A. Risk Factors

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

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

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

The Company is Subject to Interest Rate Risk

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

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

The Company is Subject to Lending Risk

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

The company's loan portfolio consists primarily of commercial real estate, commercial and industrial and construction loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. The underlying commercial real estate values and customer payment expectations on such loans can be more easily influenced by adverse conditions in the real estate market or in the economy in general. Commercial construction financing involves a higher degree of risk than long term financing on existing occupied real estate. An underestimation of the actual costs necessary to complete a construction project would require the company to advance funds beyond the original commitment in order to finish the development. Any significant deterioration in the company's commercial loan portfolio or underlying collateral values could have a material adverse effect on the company's financial condition and results of operations.

See the discussion under the heading "Loans" included in the section entitled "Financial Condition", which is contained in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations", for further information regarding the company's commercial loan portfolio.

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

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

The Company's Allowance for Loan Losses May Be Insufficient

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

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

The Company Operates in a Highly Competitive Industry and Market Area

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

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

The Company is Subject to Extensive Government Regulation and Supervision

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

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

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

Management regularly reviews and updates the company's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the company's business, results of operations and financial condition.

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

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

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

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

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

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

Increased Reliance on Borrowings as a Source of Funds Could Adversely Affect the Company's Profitability

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

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

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

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

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

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

The Company's Relies on Independent Service Providers

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

The Company Continually Encounters Technological Change

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

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

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

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

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

Directors and Executive Officers own a significant portion of common stock

The company's directors and executive officers as a group beneficially own approximately 30% of the company's outstanding common stock as of December 31, 2006. As a result of this combined ownership interest, the directors and executive officers have the ability, if they vote their shares in a like manner, to significantly influence the outcome of all matters submitted to shareholders for approval, including the election of directors.

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

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

Additional Factors Described Elsewhere in This Report

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

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

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

The following table sets forth general information related to facilities owned or used by the company as of December 31, 2006.

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

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

(2) The Park Street lease expires in August 2007 and will not be renewed. This temporary location housed the Andover branch prior to the opening of the permanent 6-8 High St. location in December, 2006.

See note 4, Premises and Equipment, to the consolidated financial statements in Item 8 for further information regarding the company's lease obligations.

Item 3. Legal Proceedings

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

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

There were no matters submitted to a vote of security holders during the quarter ended December 31, 2006.

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

In February 2005 the company's common stock began trading on the NASDAQ® Stock Market, under the symbol EBTC. Prior to this date there had been no established public trading market for the company's common stock. Although periodically there had been private trades of the company's common stock, prior to its trading on the NASDAQ Stock Market, the company cannot state with certainty the sales price at which such transactions occurred. The following table sets forth sales volume and price information, to the best of management's knowledge, for the common stock of the company for the periods indicated.

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

Fiscal Year	Trading Volume	Share Price High	Share Price Low
2006:			
4th Quarter	114,460	\$ 16.99	\$ 15.25
3rd Quarter	68,485	21.00	15.10
2nd Quarter	97,886	17.82	15.10
1st Quarter	119,230	17.31	15.26
2005:			
4th Quarter	122,914	\$ 16.00	\$ 13.58
3rd Quarter	107,150	15.05	14.00
2nd Quarter	137,206	15.75	13.48
1st Quarter	195,850	25.20	13.50

As of March 5, 2007, there were 731 registered shareholders of the company's common stock and 7,767,580 shares of the company's common stock outstanding.

Dividends

In 2006, the company began paying quarterly dividends. Quarterly dividends of \$0.07 per share were paid in March, June, September and December. Total 2006 quarterly dividends represent an increase of 17% compared to the annual dividend of \$0.24 paid in 2005.

The company maintains a dividend reinvestment plan (the "DRP"). The DRP enables stockholders, at their discretion, to elect to reinvest dividends paid on their shares of the company's common stock by purchasing additional shares of common stock from the company at a purchase price equal to fair market value. Shareholders utilized the DRP to reinvest \$944 thousand, of the \$2.1 million total quarterly dividends paid by the company in 2006, into 58,623 shares of the company's common stock.

On January 16, 2007, the company announced a quarterly dividend of \$0.08, paid on March 1, 2007 to shareholders of record as of February 8, 2007. On an annualized basis, this quarterly dividend represents a 14% increase over the 2006 dividend rate.

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

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

Securities Authorized for Issuance under Equity Compensation Plans

The following table provides information as of December 31, 2006 with respect to the company's 1988 Stock Option Plan, Amended and Restated 1998 Stock Incentive Plan and 2003 Stock Incentive Plan, as amended, which together constitute all of the company's existing equity compensation plans that have been previously approved by the company's stockholders. The company does not have any existing equity compensation plans, including any existing individual equity compensation arrangements, which have not been previously approved by the company's stockholders.

Plan Category	Number of Securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of Securities remaining available for future issuance under equity compensation plans (excluding securities reflected in second column from left)
Equity compensation plans approved by security holders	675,450	\$ 12.80	448,618
Equity compensation plans not approved by security holders	-0-	-0-	-0-
TOTAL	675,450	\$ 12.80	448,618

Performance Graph

The following graph compares the cumulative total return (which assumes the reinvestment of all dividends) on the company's common stock with the cumulative total return reflected by a broad based equity market index and an appropriate published industry index. This graph shows the changes over the five-year period ended on December 31, 2006 in the value of \$100 invested in (i) the company's common stock, (ii) the Standard & Poors 500 Index and (iii) the NASDAQ Bank Index. As of February 14, 2005, the company's shares began trading on the NASDAQ National Market (now the Nasdaq Global Market) under the trading symbol EBTC. Prior to February 14, 2005, there was no active trading market for the company's common stock, although shares were traded periodically on a privately negotiated basis. For each year prior to 2005 shown on the graph, the increase in the value of the company's common stock is based on the actual prices known to the company at which shares of the common stock were traded as of the most recent date prior to December 31 of each of these earlier periods. For purposes of the graph, the reinvestment of dividends paid prior to 2005 is based upon the annual valuation analysis of the company's common stock that was formerly undertaken in the years prior to the company's listing on the NASDAQ National Market pursuant to the company's administration of its dividend reinvestment plan.

	2001	2002	2003	2004	2005	2006
Enterprise Bancorp	\$ 100.00	\$ 117.89	\$ 141.46	\$ 173.74	\$ 174.36	\$ 183.67
S&P 500	\$ 100.00	\$ 77.90	\$ 100.24	\$ 111.15	\$ 116.61	\$ 135.02
NASDAQ Bank	\$ 100.00	\$ 106.95	\$ 142.29	\$ 161.73	\$ 158.61	\$ 180.53

Sales of Unregistered Securities and Repurchases of Shares

The company has not sold any equity securities that were not registered under the Securities Exchange Act of 1934 during the year ended December 31, 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 fiscal quarter ended December 31, 2006.

Item 6. Selected Financial Data

(Dollars in thousands, except per share data)	Year Ended December 31,				
	2006	2005	2004	2003	2002
EARNINGS DATA					
Net interest income	\$ 41,560	\$ 38,102	\$ 32,120	\$ 28,352	\$ 28,055
Provision for loan losses	1,259	1,135	1,650	1,075	1,325
Net interest income after provision for loan losses	40,301	36,967	30,470	27,277	26,730
Non-interest income	7,020	6,244	6,071	6,580	5,577
Net gains (losses) on sales of investment securities	(204)	191	906	2,150	1,341
Non-interest expense	32,540	30,235	25,687	23,342	24,947
Income before income taxes	14,577	13,167	11,760	12,665	8,701
Income tax expense	5,343	4,753	4,253	5,720	2,395
Net income	\$ 9,234	\$ 8,414	\$ 7,507	\$ 6,945	\$ 6,306
COMMON SHARE DATA(1)					
Basic earnings per share	\$ 1.21	\$ 1.13	\$ 1.03	\$ 0.97	\$ 0.90
Diluted earnings per share	1.18	1.09	0.99	0.94	0.87
Book value per share at year end	9.98	8.93	8.36	7.60	7.09
Dividends paid per share	\$ 0.280	\$ 0.240	\$ 0.215	\$ 0.190	\$ 0.165
Basic weighted average shares outstanding	7,661,178	7,468,498	7,294,760	7,131,504	6,989,636
Diluted weighted average shares outstanding	7,821,297	7,690,526	7,613,196	7,424,770	7,223,424
YEAR END BALANCE SHEET AND OTHER DATA					
Total assets	\$ 979,259	\$ 918,477	\$ 848,171	\$ 751,545	\$ 721,430
Loans serviced for others	21,659	22,938	35,067	27,474	24,995
Investment assets under management	502,059	424,953	363,250	375,297	317,394
Total assets under management	\$ 1,502,977	\$ 1,366,368	\$ 1,246,488	\$ 1,154,316	\$ 1,063,819
Total loans	\$ 761,113	\$ 699,726	\$ 570,459	\$ 488,839	\$ 414,123
Allowance for loan losses	12,940	12,050	10,923	9,986	9,371
Investment securities at fair value	131,540	156,521	187,601	196,308	239,096
Total short-term investments	15,304	5,431	40,290	14,000	
Deposits	867,522	775,387	768,644	660,824	638,052
Borrowed funds	15,105	58,639	3,651	21,424	17,233
Junior subordinated debentures	10,825	10,825	10,825	10,825	10,825
Total stockholders' equity	77,043	67,830	61,684	54,750	50,080
RATIOS					
Return on average total assets	0.98	% 0.97	% 0.95	% 0.96	% 0.95
Return on average stockholders' equity	12.89	% 13.10	% 12.99	% 13.52	% 13.69
Allowance for loan losses to total loans	1.70	% 1.72	% 1.91	% 2.04	% 2.26
Stockholders' equity to total assets	7.87	% 7.39	% 7.27	% 7.28	% 6.94
Dividend payout ratio	23.14	% 21.24	% 20.87	% 19.59	% 18.33

(1) All share and per share amounts have been retroactively adjusted to reflect the two-for-one stock split, paid in the form of a stock dividend in June 2006, for all periods presented.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's discussion and analysis should be read in conjunction with the company's consolidated financial statements and notes thereto, contained in Item 8, the information contained in the description of the company's business in Item 1 and other financial and statistical information contained in this annual report.

Special Note Regarding Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements concerning plans, objectives, future events or performance and assumptions and other statements that are other than statements of historical fact. Forward-looking statements may be identified by reference to a future period or periods or by use of forward-looking terminology such as anticipates, believes, expects, intends, may, plans, pursue, views and similar terms or expressions. Various statements are contained in Item 1 Business, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 7A

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

Critical Accounting Estimates

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

Allowance for Loan Losses

The allowance for loan losses is an estimate of credit losses inherent in the loan portfolio. The company's allowance is accounted for in accordance with SFAS No. 114, as amended by SFAS No. 118, *Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures*, and SFAS No. 5, *Accounting for Contingencies*. The allowance for loan losses is established through a provision for loan losses, a direct charge to earnings. Loan losses are charged against the allowance when management believes that the collectability of the loan principal is unlikely. Recoveries on loans previously charged off are credited to the allowance. The company maintains the allowance at a level that it deems adequate to absorb all reasonably anticipated losses from specifically known and other credit risks associated with the portfolio.

The company uses a systematic process to measure the amount of estimated loan loss exposure inherent in the portfolio for purposes of establishing a sufficient allowance for loan losses. The methodology relies on a combination of qualitative and quantitative factors, including loan reviews of large and higher risk credits, industry concentrations, results of regulatory examinations, historical charge-off and recovery experience, the growth, composition and size of the loan portfolio, trends in delinquencies and non-performing loans, the strength of the local and national economy, interest rates and other changes in the portfolio.

The foundation of the process is an ongoing internal credit rating and review system conducted by the company's credit department, which takes into consideration the borrower's financial condition, the borrower's performance with respect to loan terms and the adequacy of collateral. In addition, the company contracts annually with an external loan review firm to review commercial loans on a semi-annual basis. Loans which are evaluated to be of weaker credit quality are considered *classified* and are reviewed on a more regular basis by management.

The company accounts for impaired loans in accordance with the terms of SFAS 114. Individual commercial loans deemed to be impaired are analyzed for loss exposure using one of the acceptable methods prescribed in the accounting standard, while portfolios of more homogenous populations of loans, such as residential mortgages and consumer loans, are analyzed at a group level.

On a quarterly basis the company prepares an estimate of the necessary reserves. Except for loans specifically identified as impaired, the estimate is a two-tiered approach that allocates loan loss reserves to *classified* loans by credit rating and to non-classified loans by credit type. The general loss allocations take into account the quantitative and qualitative factors identified above.

The adequacy of the allowance for loan losses is reviewed and evaluated on a regular basis by an internal management committee, a sub-committee of the board of directors and the full board itself.

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

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

Impairment Review of Goodwill and Other Intangible Assets

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

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

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

Based on these impairment reviews the company determined that goodwill and core deposit intangible assets were not impaired at December 31, 2006.

Overview

The current interest rate environment and the highly competitive marketplace continue to present a growth and earnings challenge for the banking industry. This environment has contributed to slower loan and deposit growth for the company and continued pressure on the company's net interest margin from rising funding costs. Despite these economic and industry issues, the company reported net income growth of 10% and 9% for the December 31, 2006 year-to-date and quarter-to-date results, respectively.

Composition of Earnings

The company had net income of \$9.234 million for the year ended December 31, 2006 compared to \$8.414 million during the year ended December 31, 2005, an increase of 10%. Diluted earnings per share were \$1.18 for the current year compared to \$1.09 for 2005, an increase of 8%. 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 fourth quarter ended December 31, 2006 amounted to \$2.545 million compared to \$2.329 million for the same period in 2005, an increase of 9%. Diluted earnings per share were \$0.32 for the quarter ended December 31, 2006 compared to \$0.30 for the same period in 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 7A, Quantitative and Qualitative Disclosures About Market Risk.

The company's net income growth continues to result primarily from increases in net interest income, partially offset by increases in non-interest expense. Net interest income for the year ended December 31, 2006 amounted to \$41.6 million compared to \$38.1 million for the same period in 2005, an increase of 9%. The primary driver of net interest income growth over the period was loan growth, which increased 9% since December 31, 2005. Net interest margin, the spread earned between interest-earning assets and the company's funding sources, primarily deposits, was 4.78% for the year ended December 31, 2006 compared to 4.82% for the same period in 2005. From a quarterly perspective, the margin was 4.74% for the three months ended December 31, 2006 compared to 4.76% and 4.90% for the three month periods ended September 30, 2006 and December 31, 2005, respectively. The decrease in margin reflects both the flat yield curve and the highly-competitive marketplace currently in existence.

Non-interest expense amounted to \$32.5 million for the year ended December 31, 2006 compared to \$30.2 million for the same period in 2005, an increase of 8%, and reflected the strategic and operational costs necessary to support the company's continued growth.

Increases were predominantly in salary and benefits, occupancy costs and advertising and public relations, partially offset by a reduction in performance-based incentive compensation.

The year-end results also include non-interest income of \$6.8 million, an increase of \$381 thousand or 6% over the prior year. The growth resulted primarily from an increase of 18% in investment advisory fees and a full year of bank-owned life insurance income. The increase in non-interest income was partially offset by a reduction in net gains (losses) on sales of investment securities, which amounted to net losses of \$204 thousand for the year ended 2006 compared to net gains of \$191 thousand for the same period in 2005.

The provision for loan losses, which is impacted by asset quality and loan growth, amounted to \$1.259 million for the year ended December 31, 2006 compared to \$1.135 million in the prior year end. Asset quality remained favorable during the year with net charge-offs of 0.05% of average total loans or \$369 thousand. The allowance for loan losses to total loans ratio was 1.70% at December 31, 2006 compared to 1.72% at December 31, 2005.

Sources and Uses of Funds

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

Total assets amounted to \$979.3 million at December 31, 2006, an increase of 7% since December 31, 2005. The company's core asset strategy is to grow loans, primarily commercial loans. Total loans increased 9% since December 31, 2005 compared to 23% for the same period in 2005 and amounted to \$761.1 million, or 78% of total assets. Commercial loans amounted to \$647.6 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 \$131.5 million at December 31, 2006, or 13% of total assets. The portfolio has declined 16% 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). Prior to the fourth quarter of 2005, the company's funding needs were met primarily through internally generated low cost and higher costing commercial and retail deposits (certificates of deposit, money market and savings products) and investment portfolio cash flow. In the fourth quarter of 2005, a combination of strong commercial loan growth and slower deposit growth, resulted in the company increasing its use of external funding sources, primarily brokered deposits and FHLB borrowings.

At December 31, 2006, total deposits, which included brokered CDs, amounted to \$867.5 million, representing 12% growth over December 31, 2005. Total deposits, excluding brokered CDs, amounted to \$802.6 million at December 31, 2006, representing growth of \$37.2 million, or 5% over December 31, 2005, compared to a reduction of \$3.2 million, or 0.4%, for 2005 over 2004. The company utilized non-brokered deposits along with brokered deposits, repurchase agreements, FHLB borrowings, and investment portfolio cash flow to fund loan growth of \$61.4 million in 2006.

At December 31, 2006, the company had \$64.9 million in brokered term deposits (brokered CDs) and \$10.3 million in FHLB borrowings compared to \$10.0 million in brokered CDs and \$57.9 million in FHLB borrowings at December 31, 2005.

Opportunities and Risks

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 the Financial Condition section of this Item 7 under the headings Risk Elements/Asset Quality and Allowance for Loan Losses.

Interest rate risk management is reviewed under Item 7A, 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. 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 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.

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

Financial Condition

Total assets increased \$60.8 million, or 7%, over the prior year, to \$979.3 million at December 31, 2006. The increase was primarily attributable to an increase in total loans of \$61.4 million, or 9% and consisted primarily of commercial real estate growth. Total investments (investment securities and total short-term investments) decreased by \$15.1 million, or 9%. Premises and equipment, BOLI, prepaid expenses and other assets increased by \$12.4 million.

The company's outstanding funding obligations increased \$48.6 million at December 31, 2006 compared to December 31, 2005 and consisted of \$867.5 million in deposits including \$64.9 million in brokered certificates of deposits, \$15.1 million in borrowed funds and \$10.8 million in junior subordinated debentures. The increase in funding was used to fund loan growth.

Loans

Total loans were \$761.1 million, or 78% of total assets, at December 31, 2006, compared with \$699.7 million, or 76% of total assets, at December 31, 2005. The company attributes the \$61.4 million or 9%, increase in loans outstanding to its seasoned lending team, the company's sales and service culture and geographic expansion.

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)	December 31, 2006		2005		2004		2003		2002	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial real estate	\$ 368,621	48.3 %	\$ 326,963	46.6 %	\$ 257,657	45.1 %	\$ 224,450	45.8 %	\$ 177,827	42.8 %
Commercial & industrial	164,865	21.6 %	165,982	23.7 %	142,909	25.0 %	132,313	27.0 %	122,144	29.4 %
Commercial construction	114,078	15.0 %	108,048	15.4 %	80,597	14.1 %	50,699	10.3 %	28,441	6.8 %
Total Commercial	647,564	84.9 %	600,993	85.7 %	481,163	84.2 %	407,462	83.1 %	328,412	79.0 %
Residential mortgages	61,854	8.1 %	47,207	6.7 %	40,654	7.1 %	39,465	8.0 %	44,742	10.8 %
Residential construction	3,981	0.5 %	4,154	0.6 %	2,848	0.5 %	3,488	0.8 %	4,447	1.1 %
Home equity	44,038	5.8 %	44,444	6.4 %	42,823	7.5 %	35,139	7.2 %	29,937	7.2 %
Consumer	4,307	0.6 %	3,986	0.6 %	4,139	0.7 %	4,558	0.9 %	5,075	1.2 %
Loans held for sale	549	0.1 %	267	0.0 %	101	0.0 %	262	0.0 %	2,865	0.7 %
Gross loans	762,293	100.0 %	701,051	100.0 %	571,728	100.0 %	490,374	100.0 %	415,478	100.0 %
Deferred fees, net	(1,180)		(1,325)		(1,269)		(1,535)		(1,355)	
Total loans	761,113		699,726		570,459		488,839		414,123	
Allowance for loan losses	(12,940)		(12,050)		(10,923)		(9,986)		(9,371)	
Net loans	\$ 748,173		\$ 687,676		\$ 559,536		\$ 478,853		\$ 404,752	

The following table sets forth the scheduled maturities of commercial real estate, commercial & industrial and commercial construction loans in the company's portfolio at December 31, 2006. The table also sets forth the dollar amount of loans which are scheduled to mature after one year which have fixed or adjustable rates.

(Dollars in thousands)	Commercial real estate	Commercial & industrial	Commercial construction
Amounts due:			
One year or less	\$ 25,331	\$ 86,669	\$ 77,556
After one year through five years	16,527	44,468	21,745
Beyond five years	326,763	33,728	14,777
	\$ 368,621	\$ 164,865	\$ 114,078
Interest rate terms on amounts due after one year:			
Fixed	\$ 26,470	\$ 31,897	\$ 11,073
Adjustable	316,820	46,299	25,449

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

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

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During 2006, commercial real estate loans increased \$41.7 million, or 13%. 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 decreased by \$1.1 million, or 1%. These loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), term loans, and revolving lines of credit. Also included in commercial and industrial loans are loans under various U.S. Small Business Administration programs. Commercial construction loans increased \$6.0 million, or 6%. Commercial construction loans include the development of residential housing and condominium projects, the development of commercial and industrial use property and loans for the purchase and improvement of raw land.

Residential real estate loans, residential construction and home equity mortgages combined, increased by \$14.4 million, or 15%, and consumer loans increased \$321 thousand or 8% since December 31, 2005.

At December 31, 2006 the company had commercial loan balances participated out to various banks amounting to \$8.2 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 prorata share of ownership and amounted to \$18.3 million and \$18.8 million at December 31, 2006 and 2005, respectively.

Risk Elements/Asset Quality

Inherent in the lending process is the risk of loss. Commercial lending may entail significant additional risks compared to residential mortgage lending. Loan size is typically larger and payment expectations on such loans can be more easily influenced by adverse conditions in the real estate market or in the economy in general. Commercial construction financing involves a higher degree of risk than long term financing on existing occupied real estate. An underestimation of the actual costs necessary to complete the project would require the company to advance funds beyond the original commitment in order to finish the development. If projected cash flows to be derived from the loan collateral or the values of the collateral prove to be inaccurate, for example because of unprojected additional costs or slow unit sales, the collateral may have a value that is insufficient to ensure full repayment. While the company endeavors to minimize this risk, management recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio.

The company's credit risk management function focuses on a wide variety of factors, including, among others, current and expected economic conditions, the real estate market, the financial condition of borrowers, the ability of borrowers to adapt to changing conditions or circumstances affecting their business and the continuity of borrowers' management teams.

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 Committee of the Board of Directors and the full Board of Directors.

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

Impaired loans are individually significant loans for which management considers it probable that not all amounts due in accordance with original contractual terms will be collected. Impaired loans are accounted for, except those loans that are accounted for at the lower of cost or fair value, at the present value of the expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, in the case of collateral dependent loans, the lower of the fair value of the collateral or the recorded amount of the loans.

Impaired loans exclude large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, loans that are measured at fair value and leases as defined in SFAS No. 114.

Management considers the payment status, net worth and earnings potential of the borrower, and the value and cash flow of the collateral as factors to determine if a loan will be paid in accordance with its contractual terms. Management does not set any minimum delay of payments as a factor in reviewing for impaired classification. Impaired loans are charged off when management believes that the collectability of the loan's principal is remote.

Restructured loans are those where interest rates and/or principal payments have been restructured to defer or reduce payments as a result of financial difficulties of the borrower. Restructured loans are generally included in the impaired loan category.

The company uses an asset classification system, which classifies loans depending on risk of loss characteristics. The classifications range from substantially risk free for the highest quality loans and loans that are secured by cash collateral, to the most severe classifications of substandard, doubtful and loss based on criteria established under banking regulations. Loans classified as substandard include those characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have all the weaknesses inherent in a substandard rated loan with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Loans classified as loss are generally considered uncollectible at present, although long term recovery of part or all of loan proceeds may be possible. These loss loans would require a specific loss reserve or charge-off.

Despite prudent loan underwriting, adverse changes within the bank's market area, or deterioration in local, regional or national economic conditions, could negatively impact the company's level of non-performing assets in the future.

Overall, asset quality at December 31, 2006 remained relatively consistent with the prior year and non-performing assets are considered to be at low levels.

The following table sets forth information regarding non-performing assets, restructured loans and delinquent loans 30-89 days past due as to interest or principal, held by the company at the dates indicated:

(Dollars in thousands)	December 31,		2004	2003	2002
	2006	2005			
Non-accrual loans	\$ 1,785	\$ 1,475	\$ 2,140	\$ 2,983	\$ 1,915
Accruing loans > 90 days past due	7	1			2
Total non-performing loans	1,792	1,476	2,140	2,983	1,917
Other real estate owned					
Total non-performing assets	\$ 1,792	\$ 1,476	\$ 2,140	\$ 2,983	\$ 1,917
Accruing restructured loans not included above	\$ 128	\$ 82	\$ 26	\$ 2,370	\$ 2,086
Delinquent loans 30-89 days past due	5,715	963	4,325	2,510	1,287
Non-performing loans to total loans	0.24	% 0.21	% 0.38	% 0.61	% 0.46
Non-performing assets to total assets	0.18	% 0.16	% 0.25	% 0.40	% 0.26
Loans 30-89 days past due to total loans	0.75	% 0.14	% 0.76	% 0.51	% 0.31

Non-performing assets were \$1.8 million at December 31, 2006, compared to \$1.5 million at December 31, 2005, an increase of \$316 thousand, or 21%. The ratio of non-performing loans as a percentage of total loans outstanding increased to 0.24% from 0.21% as of those same dates.

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 \$1.8 million and \$1.5 million at December 31, 2006 and 2005, respectively. Impaired loans included in non-accrual loans were \$1.7 million and \$1.4 million as of December 31, 2006 and 2005, respectively.

There were no other real estate owned balances during the years ended December 31, 2006 or 2005.

Total restructured loans outstanding as of December 31, 2006 and 2005 were \$653 thousand and \$211 thousand, respectively. Restructured loans included in non-performing assets amounted to \$525 thousand and \$129 thousand at December 31, 2006 and 2005, respectively. Accruing restructured loans as of December 31, 2006 and 2005 were \$128 thousand and \$82 thousand, respectively.

The ratio of delinquent loans 30-89 days past due as a percentage of total loans increased to 0.75% at December 31, 2006, from 0.14% at December 31, 2005. The ratio of delinquent loans to total loans will fluctuate due to the timing of customer payments, generally the largest concentration of these loans fall into the 30 - 40 day past due category, as was the case at December 31, 2006. Short-term fluctuations are not uncommon within this category and the increase is not considered significant.

At December 31, 2006, the company classified \$6.7 million and \$0 as substandard and doubtful loans, respectively. Included in the substandard category is \$1.4 million in non-performing loans. The remaining balance of substandard loans is performing but possesses potential weaknesses and, as a result, could become non-performing loans in the future.

The classification of a loan or other asset 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.

Allowance for Loan Losses

The allowance for loan losses is an estimate of credit risk inherent in the loan portfolio. The allowance for loan losses is established through a provision for loan losses, a direct charge to earnings. Loan losses are charged against the allowance when management believes that the collectability of the loan principal is unlikely. Recoveries on loans previously charged off are credited to the allowance. The company maintains the allowance at a level that it deems adequate to absorb all reasonably anticipated losses from specifically known and other credit risks associated with the portfolio. The credit risk of the portfolio depends on a wide variety of factors.

In making its assessment on the adequacy of the allowance, management considers several quantitative and qualitative factors that could have an effect on the credit quality of the portfolio, including the level of non-performing loans, net charge-offs, loan growth, expansion in geographic market area, economic trends and comparison to industry peers, among other factors.

The allowance for loan loss to total loans ratio of 2.26% at December 31, 2002 reflected an increase in the provisions for loan losses made after 9/11, which increased the ratio from 1.99% at December 31, 2001. The increase resulted from expected economic weakness and anticipated credit quality deterioration. However, in the ensuing periods credit quality remained stable and beginning in 2003 it began to improve measurably. Consequently, the loan loss reserve ratio declined beginning in 2003.

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

(Dollars in thousands)	Years Ended December 31,					
	2006	2005	2004	2003	2002	
Average loans outstanding	\$ 732,813	\$ 625,403	\$ 527,903	\$ 448,178	\$ 395,356	
Balance at beginning of year	\$ 12,050	\$ 10,923	\$ 9,986	\$ 9,371	\$ 8,547	
Charged off loans:						
Commercial real estate	200					
Commercial and industrial	241	70	901	628	532	
Construction						
Residential mortgage						
Home equity	68					
Consumer	70	57	84	55	216	
Total charged off	579	127	985	683	748	
Commercial real estate				2		
Commercial and industrial	182	102	259	193	193	
Construction						
Residential mortgage					43	
Home equity						
Consumer	28	17	13	28	11	
Total recoveries	210	119	272	223	247	
Net loans charged off	369	8	713	460	501	
Provision charged to operations	1,259	1,135	1,650	1,075	1,325	
Balance at December 31	\$ 12,940	\$ 12,050	\$ 10,923	\$ 9,986	\$ 9,371	
Net loans charged off to average total loans	0.05	% 0.00	% 0.14	% 0.10	% 0.13	%
Net loans charged off to allowance for loan loss	2.85	% 0.07	% 6.53	% 4.61	% 5.35	%
Allowance for loan losses to total loans	1.70	% 1.72	% 1.91	% 2.04	% 2.26	%
Allowance for loan losses to non performing loans	722.10	% 816.40	% 510.42	% 334.76	% 488.84	%
Recoveries to charge offs	36.27	% 93.70	% 27.61	% 32.65	% 33.02	%

The following table sets forth the allocation of the company's allowance for loan losses amongst the categories of loans and the percentage of loans in each category to gross loans for the periods ending on the respective dates indicated:

(Dollars in thousands)	December 31, 2006			2005			2004			2003			2002		
	Allowance allocation	Loan category as % of gross loans		Allowance allocation	Loan category as % of gross loans		Allowance allocation	Loan category as % of gross loans		Allowance allocation	Loan category as % of gross loans		Allowance allocation	Loan category as % of gross loans	
Comm'l real estate	\$ 6,502	48.3 %		\$ 5,598	46.6 %		\$ 5,617	45.1 %		\$ 4,855	45.8 %		\$ 4,087	42.8 %	
Comm'l industrial	2,929	21.6 %		2,899	23.7 %		2,925	25.0 %		3,409	27.0 %		3,650	29.4 %	
Comm'l constr.	2,423	15.0 %		2,309	15.4 %		1,613	14.1 %		1,141	10.3 %		711	6.8 %	
Resid: mortg, cnstr and HELOC's	925	14.5 %		817	13.7 %		699	15.1 %		529	16.0 %		838	19.8 %	
Consumer	112	0.6 %		102	0.6 %		69	0.7 %		52	0.9 %		85	1.2 %	
Unallocated	49			325											
Total	\$ 12,940	100.0 %		\$ 12,050	100.0 %		\$ 10,923	100.0 %		\$ 9,986	100.0 %		\$ 9,371	100.0 %	

The allocation of the allowance for loan losses above reflects management's judgment of the relative risks of the various categories of the company's loan portfolio. This allocation should not be considered an indication of the future amounts or types of possible loan charge-offs.

The allowance for loan loss to total loans ratio was 1.70% at December 31, 2006 and was consistent with the December 31, 2005 result of 1.72%. There were no significant changes in credit quality, the company's underwriting, or the allowance assessment methodology.

Based on the foregoing, as well as management's judgment as to the risks inherent in the loan portfolio, the company's allowance for loan losses is deemed adequate to absorb reasonably anticipated losses from specifically known and other credit risks associated with the portfolio as of December 31, 2006.

Short-Term Investments

As of December 31, 2006, total short-term investments amounted to \$15.3 million, or 1.6% of total assets, compared to \$5.4 million, or 0.6% of total assets, at December 31, 2005. Short-term investments carried as cash equivalents at December 31, 2006 and 2005 consisted of overnight and term federal funds sold and money market mutual funds. From time to time, the company may invest in auction rate preferred securities with redemption options (auction dates) every forty-nine days, but which cannot readily be converted to cash at par value until the next successful auction. These investments are not cash equivalents and would be classified as other short-term investments. The company had no other short-term investments at December 31, 2006 or 2005.

Investment Securities

At December 31, 2006 and 2005, all investment securities (other than FHLB stock) were classified as available for sale and were carried at fair market value. At December 31, 2006, the investment portfolio represented 13% of total assets.

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

(Dollars in thousands)	December 31, 2006	2005	2004
Federal agency obligations(1)	\$ 10,405	\$ 15,202	\$ 29,206
Collateralized mortgage obligations and other Mortgage backed securities (CMO/MBS)	61,431	77,143	98,890
Municipal securities	48,762	54,915	55,578
Fixed income securities	120,598	147,260	183,674
Certificates of deposit	1,033	1,000	1,000
Federal Home Loan Bank stock(2)	1,428	3,205	1,340
Equity securities	8,481	5,056	1,587
Total investments	\$ 131,540	\$ 156,521	\$ 187,601

(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.

The net unrealized gain or loss in the company's fixed income portfolio fluctuates as interest rates rise and fall. Due to the fixed rate nature of this portfolio, as rates rise the value of the portfolio declines, and as rates fall the value of the portfolio rises. The unrealized gains on fixed income investments will also decline as the securities approach maturity. The net unrealized gain or loss on equity securities will change based on changes in the market value of the individual securities and mutual funds in the portfolio. The unrealized gain or loss will only be realized if the securities are sold.

As of December 31, 2006, the net unrealized losses in the investment portfolio were \$163 thousand compared to the net unrealized losses of \$1.1 million at December 31, 2005. The change consists of a reduction in the net unrealized losses on fixed income securities of \$432 thousand and an increase in the net unrealized gains on equity securities of \$491 thousand. The change in the net unrealized losses on fixed income securities resulted from tighter market spreads in the CMO portfolio and from losses realized on the sales of securities in 2006. The increase in equity securities unrealized gains resulted from strong equity markets.

During 2006 the company recognized \$204 thousand in net losses on sales of \$19.9 million of securities. Included in the sales proceeds were approximately \$11 million in securities sold in December 2006 that resulted in losses of approximately \$300 thousand.

The securities sold in December were originally purchased during the low interest rate periods of 2003 and 2004. These securities had unrealized losses at September 30, 2006 and at that time management had the ability and intent to hold the securities until the unrealized losses reversed. However, during December 2006, management re-evaluated its intent to hold these particular securities and decided to sell based on the expectation of improving net interest income in subsequent reporting periods through reinvestment at higher yields or through paydowns of borrowed funds and brokered deposits.

At December 31, 2006, management had the intent and ability to hold the remaining \$1.7 million of unrealized losses in the fixed income portfolio until they reverse. The unrealized losses typically reverse as the securities approach maturity or as interest rates decline.

Principal paydowns, calls and maturities totaled \$20.1 million during the current period, and were primarily comprised of prepayments in the mortgage backed securities portfolio. The proceeds from the sales and paydowns were partially utilized to purchase \$14.3 million of investments, primarily U.S agency, municipals, mortgage backed securities and equities, with the remainder utilized to fund loan growth.

The contractual maturity distribution at amortized cost, as of December 31, 2006, of the fixed income securities above with the weighted average yield for each category is set forth below:

(Dollars in thousands)	Under 1 Year		>1 3 Years		>3 5 Years		>5 10 Years		Over 10 Years	
	Balance	Yield	Balance	Yield	Balance	Yield	Balance	Yield	Balance	Yield
Agency obligations	\$ 21	5.23	% \$ 6,419	4.43	% \$ 4,041	4.89	% \$		\$	
CMO/MBS	3	6.11	% 289	4.88	%		23,964	4.22	% 38,357	4.39 %
Municipals(1)	4,088	3.22	% 12,341	4.50	% 12,105	5.55	% 17,275	7.06	% 2,573	7.98 %
	\$ 4,112	3.23	% \$ 19,049	4.48	% \$ 16,146	5.38	% \$ 41,239	5.41	% \$ 40,930	4.62 %

(1) Municipal security yields and total yields are shown on a tax equivalent basis.

Scheduled contractual maturities may not reflect the actual maturities of the investments. CMO/MBS are shown at their final maturity. However, due to prepayments and amortization the actual CMO/MBS cash flows may be faster than presented above. Similarly, included in the agency and municipal categories are \$35.4 million in securities which can be called before maturity. Actual maturity of these callable securities could be shorter if market interest rates decline further. Management considers these factors when evaluating the net interest margin in the company's asset-liability management program.

Bank Owned Life Insurance (BOLI)

Beginning in 2005, the company purchased BOLI as an investment, utilizing the earnings on BOLI to offset the cost of the company's benefit plans. During 2006 and 2005, the company made net BOLI purchases of \$8.0, and \$1.9 million, respectively. Additionally, in 2005 approximately \$1.9 million in life insurance policies were assigned to the bank as part of a restructuring of executive supplemental retirement programs. The cash surrender value of BOLI was \$12.2 million and \$3.9 million at December 31, 2006 and 2005, respectively. The company recorded income from the BOLI policies, net of related expenses, of \$339 thousand in 2006 and \$87 thousand for 2005.

Further information regarding the company's retirement benefit plans, is contained in note 10 Employee Benefit Plans to the Consolidate Financial Statements, under the heading Supplemental Retirement Plan.

Deposits

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

(Dollars in thousands)	December 31, 2006			December 31, 2005			December 31, 2004		
	Amount	%		Amount	%		Amount	%	
Demand deposits	\$ 169,910	19.6	%	\$ 173,804	22.4	%	\$ 172,949	22.5	%
Interest bearing checking	179,533	20.7	%	171,611	22.1	%	170,224	22.1	%
Total checking	349,443	40.3	%	345,415	44.5	%	343,173	44.6	%
Retail savings/money markets	141,202	16.3	%	151,969	19.6	%	172,748	22.5	%
Commercial savings/money markets	125,584	14.5	%	115,126	14.9	%	120,461	15.7	%
Total savings/money markets	266,786	30.8	%	267,095	34.5	%	293,209	38.2	%
Certificates of deposit	186,349	21.4	%	152,889	19.7	%	132,262	17.2	%
Total non brokered deposits	802,578	92.5	%	765,399	98.7	%	768,644	100.0	%
Brokered certificates of deposit	64,944	7.5	%	9,988	1.3	%			
Total deposits	\$ 867,522	100.0	%	\$ 775,387	100.0	%	\$ 768,644	100.0	%

Total deposits increased \$92.1 million, or 12%, to \$867.5 million at December 31, 2006, from \$775.4 million at December 31, 2005. Total deposits at December 31, 2004 were partially inflated by a \$32 million demand deposit received in late December 2004 and withdrawn in early January 2005. Excluding that deposit, growth was 5.3% at December 31, 2005 compared to December 31, 2004.

Total deposits as a percentage of total assets were 89% at December 31, 2006 compared to 84% at December 31, 2005.

Checking deposits increased \$4.0 million, or 1.0%, at December 31, 2006 compared to December 31, 2005 and accounted for 40% of total deposits at December 31, 2006. This was a decline compared to 45% of total deposits at December 31, 2005. The decline in concentration and slight increase in balances reflects current market conditions in which depositors are interest rate sensitive and are minimizing funds in lower cost checking products.

Savings and money market accounts decreased by \$309 thousand at December 31, 2006 compared to December 31, 2005. The decline was less than one percent and, like the change in checking deposits, reflects the current interest sensitivity of depositors seeking higher yields.

Higher cost certificates of deposit increased by \$88.4 million, or 54%, and reflects the trend of depositors shifting excess funds to higher yielding term products.

Included in the December 31, 2006 total deposit balance were \$64.9 million in brokered certificates of deposit compared to \$10.0 million at December 31, 2005. The company uses brokered certificates of deposit as an alternative to borrowing funds from the FHLB.

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The table below sets forth a comparison of the company's average deposits and average rates paid for the periods indicated, as well as the percentage of each deposit category to total average deposits. The annualized average rate on total deposits reflects both interest bearing and non-interest bearing deposits.

(Dollars in thousands)	Year ended December 31,				2005				2004			
	Average Balance	Average Rate	% of Deposits		Average Balance	Average Rate	% of Deposits		Average Balance	Average Rate	% of Deposits	
Demand	\$ 165,957		19.9 %	%	\$ 163,429		21.4 %	%	\$ 143,441		20.2 %	%
Interest Chkg	159,009	0.80	% 19.0	%	167,178	0.53	% 21.9	%	153,085	0.30	% 21.6	%
Savings	167,353	2.05	% 20.0	%	176,143	1.37	% 23.1	%	156,483	1.13	% 22.0	%
Money market	109,783	2.25	% 13.1	%	115,422	1.41	% 15.2	%	121,513	1.24	% 17.1	%
	436,145	1.65	% 52.1	%	458,743	1.08	% 60.2	%	431,081	0.87	% 60.7	%
Certificates of Deposit	173,433	3.78	% 20.7	%	139,775	2.34	% 18.4	%	135,611	1.92	% 19.1	%
Brokered CDs	61,082	5.12	% 7.3	%	82	5.90	%					
Total	\$ 836,617	2.02	% 100.0	%	\$ 762,029	1.08	% 100.0	%	\$ 710,133	0.89	% 100.0	%

The increase in the average rate paid on total deposit accounts to 2.02% for 2006, from 1.08%, for 2005, resulted primarily from increasing yields on all categories of deposits attributable to increases in market interest rates during the period and from the increase use of brokered certificates of deposits as an alternative to FHLB borrowings.

Demand and interest checking accounts decreased 2% on an average balance basis and accounted for 39% of average total deposits. Management views the continued growth of low cost checking accounts as a key component of the company's business strategy.

Borrowed Funds

Total borrowed funds, consisting of securities sold to customers under agreements to repurchase (repurchase agreements) and FHLB borrowings, amounted to \$25.9 million at December 31, 2006, a decrease of \$43.5 million from December 31, 2005. The decrease resulted from the increased use of brokered certificates of deposits in lieu of FHLB borrowings during the year.

At December 31, 2006, outstanding FHLB advances amounted to \$10.3 million with a weighted average rate of 5.20%, compared to \$57.9 million with a weighted average rate of 4.17% at December 31, 2005.

The outstanding balance of FHLB borrowings at December 31, 2006 was composed of \$7.0 million in overnight advances, at a rate of 5.06%, \$2.8 million of short-term advances, maturing in less than 6 months at a rate of 5.43%, and \$470 thousand of longer-term advances maturing in 6.5 years, at a rate of 5.94%.

Maximum amounts outstanding at any month end during 2006, 2005, and 2004 were \$31.9 million, \$59.0 million and \$20.7 million respectively.

At December 31, 2006, the bank had the ability to borrow an additional \$63.1 million from the FHLB.

Repurchase agreements outstanding at December 31, 2006 were \$4.8 million, with a weighted average interest rate of 4.82% and original terms from one to six months. The outstanding balance under repurchase agreements at December 31, 2005 was \$706 thousand, with a weighted average rate of 1.90%.

Maximum amounts outstanding under repurchase agreements at any month end during 2006, 2005, and 2004 were \$6.7 million, \$6.4 million, and \$14.5 million, respectively.

The table below shows the comparison of the company's average repurchase agreements and FHLB advances and average rates paid for the periods indicated.

(Dollars in thousands)	Year ended December 31, 2006			2005			2004		
	Average Balance	Average Rate		Average Balance	Average Rate		Average Balance	Average Rate	
Repurchase agreements	\$ 2,325	4.41	%	\$ 2,823	2.59	%	\$ 2,867	1.62	%
FHLB advances	17,100	4.71	%	19,250	3.85	%	5,018	1.71	%
Total	\$ 19,425	4.67	%	\$ 22,073	3.69	%	\$ 7,885	1.67	%

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. The company's liquidity is maintained by projecting cash needs, monitoring various liquidity ratios, monitoring deposit flows, maintaining liquidity within the investment portfolio and maintaining borrowing capacity.

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. Funds gathered are used to support current asset levels and to take advantage of selected leverage opportunities. The company's primary sources of funds are deposits, borrowed funds and stockholders' equity. In January 2007, the company pledged additional loans as collateral to the FHLB and increased its available borrowing capacity to \$125.1 million. See the discussion above under the heading "Borrowed Funds" regarding outstanding FHLB advances.

Management believes that the company has adequate liquidity to meet its commitments.

Capital Adequacy

The company is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory and possible additional discretionary, supervisory actions by regulators, which, if undertaken, could have a material adverse effect on the company's consolidated financial condition. At December 31, 2006 the capital levels of both the company and the bank complied with all applicable minimum capital requirements of the Federal Reserve Board and the FDIC, respectively, and both qualified as "well-capitalized" under applicable Federal Reserve Board and FDIC regulations.

For additional information regarding the capital requirements applicable to the company and the bank and their respective capital levels at December 31, 2006, see the section entitled "Capital Resources" contained in Item 1 "Business" and note 8, "Stockholders' Equity", to the consolidated financial statements contained in Item 8.

Contractual Obligations and Commitments

The company is required to make future cash payments under various contractual obligations. These obligations include the repayment of short and long-term borrowings and long-term subordinated debentures, payment of fixed-cash supplemental retirement benefits, payments under non-cancelable operating leases for various premises, and payments due under agreements to purchase goods and future services from a variety of vendors.

The company is also party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to originate loans, commitments to sell loans, standby letters of credit and unadvanced loans and lines of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets. The contract amounts of these instruments reflect the extent of involvement the company has in the particular classes of financial instruments.

The following table summarizes the contractual cash obligations and commitments at December 31, 2006.

(Dollars in thousands)	Payments Due By Period				
	Total	With in 1 Year	>1 3 Years	>3 5 Years	After 5 Years
Contractual Cash Obligations:					
Repurchase agreements	4,835	4,835			
FHLB borrowings	\$ 10,270	\$ 9,800	\$	\$	\$ 470
Junior subordinated debentures	10,825				10,825
Supplemental retirement plans	5,516		279	520	4,717
Operating lease obligations	3,258	1,036	1,150	522	550
Vendor contracts	6,369	4,012	1,897	448	12
Total contractual obligations	\$ 41,073	\$ 19,683	\$ 3,326	\$ 1,490	\$ 16,574

	Commitment Expiration By Period				
	Total	With in 1 Year	>1 3 Years	>3 5 Years	After 5 Years
Other Commitments:					
Unadvanced loans and lines	\$ 247,210	\$ 165,687	\$ 26,521	\$ 8,165	\$ 46,837
Standby letters of credit	17,618	11,765	5,600	253	
Commitments to originate loans	51,568	51,568			
Commitments to sell loans	2,156	2,156			
Total commitments	\$ 318,552	\$ 231,176	\$ 32,121	\$ 8,418	\$ 46,837

Investment Assets Under Management

The company provides a wide range of investment management services. These services include management of equity, fixed income, balanced and strategic cash management portfolios through the company's investment advisory group. The market value of each of these components is affected by fluctuation in the financial markets.

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

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

(Dollars in thousands)	December 31,		
	2006	2005	2004
Investment advisory assets	\$ 401,269	\$ 346,322	\$ 315,320
Commercial sweep accounts	100,790	78,631	47,930
Investment assets under management	\$ 502,059	\$ 424,953	\$ 363,250

Investment assets under management increased by \$77.1 million, or 18%, from \$425.0 million at December 31, 2005 to \$502.1 million at December 31, 2006. The increase was due to an increase in investment management and trust assets of \$54.9 million and in commercial sweep accounts of \$22.2 million. The increase in investment management and trust assets was primarily due to growth from new business and general increases in investment market value due to higher market interest rates.

The commercial sweep account balance generally fluctuates in accordance with the cash needs of the bank's customers. At December 31, 2006 the balance amounted to \$100.8 million compared to \$78.6 million at December 31, 2005. The \$22.2 million increase over the prior year end resulted from sales growth and a migration from deposit balances due to customer sensitivity for higher earning products.

Results of Operations

Rate/Volume Analysis

The following table sets forth the extent to which changes in interest rates and changes in the average balances of interest-earning assets and interest-bearing liabilities have affected interest income and expense during the years ended December 31, 2006 and 2005. 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).

(Dollars in thousands)	December 31, 2006 vs. 2005		Rate/ Volume	Total	2005 vs. 2004		Rate/ Volume	Total
	Volume	Rate			Volume	Rate		
Interest Income								
Loans	\$ 7,057	\$ 5,066	\$ 900	\$ 13,023	\$ 5,957	\$ 2,428	\$ 418	\$ 8,803
Investments (1)	(1,297)	485	(6)	(818)	(959)	714	(20)	(265)
Total	5,760	5,551	894	12,205	4,998	3,142	398	8,538
Interest Expense								
Int Chkg/Savings/MM	(244)	2,615	(131)	2,240	241	905	48	1,194
Certificates of deposit	2,215	2,503	1,696	6,414	82	570	27	679
Borrowed funds	(98)	216	(25)	93	237	159	287	683
Total	1,873	5,334	1,540	8,747	560	1,634	362	2,556
Change in net interest income	\$ 3,887	\$ 217	\$ (646)	\$ 3,458	\$ 4,438	\$ 1,508	\$ 36	\$ 5,982

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

The table on the following page presents the company's average balance sheet, net interest income and average rates for the years ended December 31, 2006, 2005 and 2004.

Average Balances, Interest and Average Yields

	Year ended December 31, 2006			Year ended December 31, 2005			Year ended December 31, 2004			
(Dollars in thousands)	Average Balance	Interest	Average Yield(2)	Average Balance	Interest	Average Yield(2)	Average Balance	Interest	Average Yield(2)	
Assets:										
Loans (1)	\$ 732,813	\$ 54,106	7.38	%\$ 625,403	\$ 41,083	6.57	%\$ 527,903	\$ 32,280	6.11	%
Investments (2) (3)	157,224	6,405	4.69	% 186,503	7,223	4.43	% 209,942	7,488	4.09	%
Total interest earnings assets	890,037	60,511	6.91	% 811,906	48,306	6.08	% 737,845	39,768	5.54	%
Other assets	55,464			53,273			52,675			
Total assets	\$ 945,501			\$ 865,179			\$ 790,520			
Liabilities and stockholders' equity:										
Int Chkg, Savings and money market	\$ 436,145	7,175	1.65	%\$ 458,743	4,935	1.08	%\$ 431,081	3,741	0.87	%
Certificates of deposit(4)	234,515	9,691	4.13	% 139,857	3,277	2.34	% 135,611	2,598	1.92	%
Borrowed funds	19,425	908	4.67	% 22,073	815	3.69	% 7,885	132	1.67	%
Junior subordinated debentures	10,825	1,177	10.88	% 10,825	1,177	10.88	% 10,825	1,177	10.88	%
Total interest bearing deposits, borrowed funds and debentures	700,910	18,951	2.70	% 631,498	10,204	1.62	% 585,402	7,648	1.31	%
Net interest rate spread (2)			4.21	%		4.46	%		4.23	%
Demand deposits	165,957			163,429			143,441			
Total deposits, borrowed funds and debentures	866,867	18,951	2.19	% 794,927	10,204	1.28	% 728,843	7,648	1.05	%
Other liabilities	7,021			6,041			3,881			
Total liabilities	873,888			800,968			732,724			
Stockholders' equity	71,613			64,211			57,796			
Total liabilities and stockholders' equity	\$ 945,501			\$ 865,179			\$ 790,520			
Net interest income		\$ 41,560			\$ 38,102			\$ 32,120		
Net interest margin (2)			4.78	%		4.82	%		4.50	%

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

(2) Average balances are presented at average amortized cost and average yields are presented on a tax equivalent basis. The tax equivalent effect, which is not included in the interest amounts above, was \$962, \$1,038, and \$1,107 for the years ended December 31, 2006, 2005 and 2004, respectively.

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

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

COMPARISON OF YEARS ENDED DECEMBER 31, 2006 AND 2005

Unless otherwise indicated, the reported results are for the year ended December 31, 2006 with the comparable year or prior year being the year ended December 31, 2005.

Net Income

The company had net income in 2006 of \$9.2 million compared to \$8.4 million for 2005, an increase of 10%. Earnings per share for 2006 were \$1.21 and \$1.18 on a basic and diluted basis, compared to \$1.13 and \$1.09 in the prior year, increases of 7% and 8%, respectively.

Net Interest Income

The company's net interest income was \$41.6 million for the year ended December 31, 2006, an increase of \$3.5 million, or 9%, over the prior year. The primary driver of the increase was a \$107.4 million, or 17%, increase in average loan balances, partially offset by funding costs rising more rapidly than asset yields during the year (i.e., net interest margin decreased).

Net Interest Margin

Tax equivalent net interest margin (margin) decreased by 4 basis points, to 4.78% for the year ended December 31, 2006, compared to 4.82% for the prior year. The decrease in margin was due to an 83 basis point increase in the yield on interest earning assets, exceeded by a 91 basis point increase in the total cost of deposits and borrowed funds (cost of funds). The primary reason for the yield increases were higher market interest rates during the period. The increase in cost of funds exceeded asset yields mainly due to the flat yield curve and the timing of rate adjustments. Asset yields re-priced more quickly than funding costs over the current rising rate cycle that began in mid 2004. On an incremental basis, funding cost increases caught up to the previously realized asset yield increases in the latter half of 2006.

Total Interest Income

Total interest income for the year ended December 31, 2006 was \$60.5 million, an increase of \$12.2 million, or 25%, over the prior year. The increase resulted from an increase in the average balance of interest earning assets of \$78.1 million, or 10%, to \$890.0 million for the year ended December 31, 2006, and an increase in the average tax equivalent yield on interest earning assets of 83 basis points, to 6.91%.

Interest income on loans increased by \$13.0 million, or 32%, for the year ended December 31, 2006 to \$54.1 million. For the year ended December 31, 2006, the average loan balance increased by \$107.4 million, or 17%, while the average rate earned on loans increased by 81 basis points to 7.38%. The increase in loan yield was driven by the higher market rates, as variable rate loans indexed to Prime re-priced to the higher market rates over the period.

Income on investment securities and total short-term investments (together, investments) declined by \$818 thousand, to \$6.4 million for the year ended December 31, 2006. The average balance of investments decreased by \$29.3 million, or 16%, for the year ended December 31, 2006, compared to the prior year, as investment cash flow was primarily redeployed to fund loan growth. The average tax equivalent yield on investments increased by 26 basis points, to 4.69%, for the year ended December 31, 2006 compared to the average tax equivalent yield of 4.43% for the prior year.

Total Interest Expense

Total interest expense for the year ended December 31, 2006 was \$19.0 million compared to \$10.2 million for the year ended December 31, 2005, an increase of \$8.7 million or 86%. The increase resulted primarily from a 108 basis point increase in the average interest rate paid on interest bearing liabilities, to 2.70%, for the year ended December 31, 2006, and to a lesser extent, from the \$69.4 million, or 11%, increase in the average balance of interest-bearing deposits, borrowed funds and debentures, to \$700.9 million for the year ended December 31, 2006.

Interest expense on deposits increased by \$8.7 million, or 105%, to \$16.9 million for the year ended December 31, 2006. The average balance of savings, checking and money market deposit accounts decreased by \$22.6 million, or 5%, to \$436.1 million for the year ended December 31, 2006, while the average interest rate paid on such deposit accounts increased 57 basis points over the prior year.

The average balance on certificates of deposit increased by \$94.7 million, or 68% over the prior year, to \$234.5 million for the year ended December 31, 2006. The increase resulted from customers seeking higher rate deposit products as interest rates rose in 2005 and 2006. Also, in late 2005 the company began to utilize brokered certificates of deposit as an alternative funding source. The average balance in brokered certificates of deposit increased \$61.0 million in 2006 compared to 2005. The average interest rate on certificates of deposit increased 179 basis points for the year ended December 31, 2006 compared to the year ended December 31, 2005. The increase in deposit rates during the period was primarily due to higher market rates and the increased use of brokered deposits, which are generally more rate sensitive than internally generated deposits.

Interest expense on borrowed funds, consisting of FHLB borrowings and term repurchase agreements, increased by \$93 thousand over the prior year. The average balance of borrowed funds for the year ended December 31, 2006 decreased by \$2.6 million, to \$19.4 million. The average cost of borrowed funds increased 98 basis points, to 4.67%, for the year ended December 31, 2006, due to the increase in market interest rates.

The interest expense and average rate on junior subordinated debentures was \$1.2 million and 10.88%, respectively, for both years ended December 31, 2006 and 2005.

The average balance of non-interest bearing deposits increased by \$2.5 million, or 2%, for the year ended December 31, 2006. The total cost of funds (cost of interest bearing liabilities and non-interest bearing deposits) was 2.19% for the year ended December 31, 2006, compared to 1.28% for the same period ended December 31, 2005.

Provision for Loan Losses

The provision for loan losses was \$1.3 million and \$1.1 million for the years ended December 31, 2006 and 2005, respectively. Net charge-offs for 2006 were \$369 thousand compared to net charge-offs of \$8 thousand for 2005. The provision reflects management's ongoing assessment of the adequacy of the allowance for loan losses to support the estimated credit risk in the loan portfolio, including the real estate values and economic conditions in New England and, in particular, the Merrimack Valley and the North Central regions of Massachusetts and South Central New Hampshire, the level of non-accrual loans, levels of charge-offs and recoveries during the period, growth of outstanding loans and inherent risks in the nature of the loan portfolio. Despite the growth in the company's loan portfolio, there have been no material changes to the company's underwriting practices or the methodology used to estimate loan loss exposure. The provision for loan losses is a significant factor in the company's operating results.

See Risk Elements/Asset Quality and Allowance for Loan Losses under the heading, Financial Condition, in this Item 7 above, for further information regarding the provision for loan losses.

Non-Interest Income

Non-interest income was \$6.8 million for the year ended December 31, 2006, an increase of \$381 thousand compared to 2005. The primary components of the increase were increases in investment advisory fees and other income, partially offset by losses on sales of investment securities. The changes are discussed in detail below.

The following table sets forth the components of non-interest income and the related changes for the periods indicated.

(Dollars in thousands)	Year Ended December 31,		Change
	2006	2005	
Investment advisory fees	\$ 2,662	\$ 2,262	\$ 400
Deposit service fees	1,757	1,671	86
Bank-owned life insurance income	391	88	303
Net gains (losses) on sales of Investment securities	(204)	191	(395)
Gains on sales of loans	147	246	(99)
Other income	2,063	1,977	86
Total non-interest income	\$ 6,816	\$ 6,435	\$ 381

Investment advisory fees increased by \$400 thousand, or 17.7%, in 2006 compared to 2005. The increase resulted from new business generated in 2006 and 2005 and an increase in fees earned per average asset due to the company's restructured fee schedule implemented in mid-2005. The year to date balances of average investment advisory assets increased by \$40.7 million, or 13%, from \$326.0 million for 2005 to \$366.8 million for 2006.

Income from BOLI amounted to \$391 thousand and increased \$303 thousand in 2006 compared to 2005. The increase resulted from a full year of activity and from additional purchases in 2006. The average balance was \$8.4 million for the year ended December 31, 2006 compared to \$2.6 million for the same period in 2005, reflecting purchases made in 2005 and 2006.

Net gains (losses) on the sales of investment securities amounted to a loss of \$204 thousand and a gain of \$191 thousand for the years ended December 31, 2006 and 2005, respectively. The net loss in 2006 and net gain in 2005 resulted from sales of \$19.9 million and \$1.5 million, respectively, in those periods. The net losses realized in 2006 primarily resulted from management's decision to sell a portion of the fixed income portfolio in December based on the expectation of improving net interest income in subsequent reporting periods through reinvestment at higher yields or through paydowns of borrowed funds and brokered deposits.

Non-Interest Expense

Non-interest expense was \$32.5 million for the year ended December 31, 2006 an increase of \$2.3 million, or 8%, compared to 2005. The primary components of the increase were salaries and benefits, occupancy costs, advertising and public relations and other operating expenses. The changes are discussed in detail below.

The following table sets forth the components of non-interest expense and the related changes for the periods indicated.

(Dollars in thousands)	Year Ended December 31,		Change
	2006	2005	
Salaries and employee benefits	\$ 19,169	\$ 18,326	\$ 843
Occupancy expenses	6,095	5,537	558
Audit, legal and other professional fees	1,826	1,680	146
Advertising and public relations	1,372	875	497
Supplies and postage	874	862	12
Investment advisory and custodial expenses	500	505	(5)
Other operating expenses	2,704	2,450	254
Total non-interest expense	\$ 32,540	\$ 30,235	\$ 2,305

Salaries and benefits expense totaled \$19.2 million for the year ended December 31, 2006, compared with \$18.3 million for 2005, an increase of \$843 thousand, or 5%. The increase was due to additional staffing necessary to support the company's strategic growth initiatives, annual compensation adjustments and corresponding increases in health insurance premiums and the additional expense related to employee stock compensation. Performance based incentive compensation, a component of salary and benefit expense,

decreased by \$1.4 million in 2006. Excluding this reduction, salary and benefit expense increased \$2.2 million, or 13%, over the prior year.

Occupancy expenses totaled \$6.1 million, an increase of \$558 thousand, or 10%, compared to the prior year, primarily due to ongoing occupancy cost increases and facility expansion necessary to support the company's growth and strategic initiatives.

Advertising and public relations expense increased \$497 thousand and amounted to \$1.4 million in 2006. The increase resulted primarily from the company's branding initiatives, business development efforts and community relations.

Other operating expenses increased \$254 thousand, or 10%, to \$2.7 million in 2006. The increases in this category were due primarily to the company's growth and related increases in business development costs, courier services, staff development initiatives, and expense related to BOLI, partially offset by reductions in ATM network/ telecommunication charges and security related expenses.

Income Tax Expense

Income tax expense and the effective tax rate for the year ended December 31, 2006 and December 31, 2005 were \$5.3 million and 36.7%, and \$4.8 million and 36.1%, respectively. The effective rates for 2006 and 2005 reflect normal activity with the decrease from the statutory rate of 40.93% due primarily to the effect of interest income earned on tax-exempt municipal securities.

COMPARISON OF YEARS ENDED DECEMBER 31, 2005 AND 2004

Unless otherwise indicated, the reported results are for the year ended December 31, 2005 with the comparable year or prior year being the year ended December 31, 2004.

Net Income

The company had net income in 2005 of \$8.4 million compared to \$7.5 million for 2004, an increase of 12%. Earnings per share for 2005 were \$1.13 and \$1.09 on a basic and diluted basis, compared to \$1.03 and \$0.99 in the prior year, increases of 9.7% and 10.1%, respectively.

Net Interest Income

The company's net interest income was \$38.1 million for the year ended December 31, 2005, an increase of \$6.0 million, or 19%, over the prior year. The primary driver of the increase was a \$97.5 million, or 19%, increase in average loan balances and, to a slightly lesser degree, the increase in net interest margin during the period. Loan growth and higher market rates primarily led to the \$8.5 million increase in total interest income over the prior year. Loan growth was funded primarily through lower cost and non-interest bearing deposit growth, proceeds from maturities and paydowns of investments, and an increase in borrowed funds during the fourth quarter of 2005. Total interest expense increase by \$2.6 million over the prior year, due primarily to the increase in market rates and a \$46.1 million, or 8%, increase in the average balance of total interest bearing deposits, borrowed funds and debentures.

Net Interest Margin

Tax equivalent net interest margin (margin) increased by 32 basis points, to 4.82% for the year ended December 31, 2005, compared to 4.50% for 2004. The increase in margin was due to the 54 basis point increase in the yield on interest earning assets, partially offset by a 23 basis point increase in the total cost of funds. The primary reason for these yield increases was the higher market interest rates during the period, especially the prime lending rate (Prime), which increased 325 basis points since June 2004.

Total Interest Income

Total interest income for the year ended December 31, 2005 was \$48.3 million, an increase of \$8.5 million, or 22%, over the prior year. The increase resulted from an increase in the average balance of interest earning assets of \$74.1 million, or 10%, to \$811.9 million for the year ended December 31, 2005, and an increase in the average tax equivalent yield on interest earning assets of 54 basis points, to 6.08%.

Interest income on loans increased by \$8.8 million, or 27%, for the year ended December 31, 2005 to \$41.1 million. For the year ended December 31, 2005, the average loan balance increased by \$97.5 million, or 19%, while the average rate earned on loans increased by 46 basis points to 6.57%. The increase in loan yield was driven by the higher market rates, as variable rate loans indexed to Prime repriced to the higher market rates over the period.

Income on investment securities and total short-term investments (together, investments) declined by \$265 thousand, to \$7.2 million for the year ended December 31, 2005. The average balance of investments decreased by \$23.4 million, or 11%, for the year ended December 31, 2005, compared to the prior year, as proceeds from maturities and paydowns were redeployed to fund loan growth. The average tax equivalent yield on investments increased by 34 basis points, to 4.43%, for the year ended December 31, 2005 compared to the average tax equivalent yield of 4.09% for the year ended December 31, 2004.

Total Interest Expense

Total interest expense for the year ended December 31, 2005 was \$10.2 million compared to \$7.6 million for the year ended December 31, 2004, an increase of \$2.6 million or 33%. The increase resulted primarily from a 31 basis point increase in the average interest rate paid on interest bearing liabilities, to 1.62%, for the year ended December 31, 2005, and to a lesser extent, from the \$46.1 million, or 8%, increase in the average balance of interest-bearing deposits, borrowed funds and debentures, to \$631.5 million for the year ended December 31, 2005.

Interest expense on deposits increased by \$1.9 million, or 30%, to \$8.2 million for the year ended December 31, 2005. The average balance of savings, checking and money market deposit accounts increased by \$27.7 million, or 6%, to \$458.7 million for the year ended December 31, 2005, while the average interest rate paid on such deposit accounts increased 21 basis points over the prior year. The average balance on certificates of deposit increased by \$4.2 million, or 3% over the prior year, to \$139.9 million for the year ended December 31, 2005. The average interest rate on certificates of deposit increased 42 basis points for the year ended December 31, 2005 compared to the year ended December 31, 2004. The increase in deposit rates was due to the higher market rates during the period.

Interest expense on borrowed funds, consisting of FHLB borrowings and repurchase agreements, increased by \$683 thousand over the prior year to \$815 thousand. The average balance of borrowed funds for the year ended December 31, 2005 increased by \$14.2 million, to \$22.1 million compared to \$7.9 million for the prior year. The increase in average borrowed funds consisted of increases in FHLB borrowing, primarily in the fourth quarter of 2005, as slower deposit growth necessitated the alternate funding. The average cost of borrowed funds increased 202 basis points, to 3.69%, for the year ended December 31, 2005, due to the increase in market interest rates. The interest expense and average rate on junior subordinated debentures was \$1.2 million and 10.88%, respectively, for both years ended December 31, 2005 and 2004.

The average balance of non-interest bearing deposits, a key component of the company's net interest margin increased by \$20.0 million, or 14%, for the year ended December 31, 2005. The total cost of funds (cost of interest bearing liabilities and non-interest bearing deposits) was 1.28% for the year ended December 31, 2005, compared to 1.05% for the same period ended December 31, 2004.

Provision for Loan Losses

The provision for loan losses was \$1.1 million and \$1.7 million for the years ended December 31, 2005 and 2004, respectively. The larger provision in 2004 primarily resulted from charge-offs that occurred during the first quarter of that year. Net charge-offs for 2005 were \$8 thousand, compared to net charge-offs for 2004 of \$713 thousand. The provision reflects management's ongoing assessment of the adequacy of the allowance for loan losses to support the estimated credit risk in the loan portfolio, including the real estate values and economic conditions in New England and, in particular, the Merrimack Valley and the North Central regions of Massachusetts and South Central New Hampshire, the level of non-accrual loans, levels of charge-offs and recoveries during the period, growth of outstanding loans and inherent risks in the nature of the loan portfolio. Despite the growth in the company's loan portfolio, there have been no material changes to the company's underwriting practices or the methodology used to estimate loan loss exposure. The provision for loan losses is a significant factor in the company's operating results.

See Risk Elements/Asset Quality and Allowance for Loan Losses under the heading, Financial Condition, in this Item 7 above, for further information regarding the provision for loan losses.

Non-Interest Income

Non-interest income was \$6.4 million for the year ended December 31, 2005, a decrease of \$542 thousand compared to 2004. The primary components of the decrease compared to the prior year were decreases in the gains realized from the sales of investment securities and loans, which collectively declined \$852 thousand, and the decrease of \$387 thousand in deposit servicing fee income, partially offset by the \$539 thousand increase in other income. The changes are discussed in detail below.

The following table sets forth the components of non-interest income and the related changes for the periods indicated.

(Dollars in thousands)	Year Ended December 31,		Change
	2005	2004	
Investment advisory fees	\$ 2,262	\$ 2,104	\$ 158
Deposit service fees	1,671	2,058	(387)
Net gains on sales of investment securities	191	906	