ENTERPRISE BANCORP INC /MA/
Form 10-Q
August 08, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2007

or

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

For the transition period from to

Commission File Number 0-21021

Enterprise Bancorp, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

x Yes o No

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

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

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

o Yes x No

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: July 31, 2007, Common Stock - Par Value $0.01: 7,841,424 shares outstanding

ENTERPRISE BANCORP, INC.

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ENTERPRISE BANCORP, INC.

Consolidated Balance Sheets

(unaudited)

(Dollars in thousands)	June 30, 2007	December 31, 2006
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 44,081	$ 35,583
Short-term investments	29,388	15,304
Total cash and cash equivalents	73,469	50,887
Investment securities at fair value	137,449	131,540
Loans, less allowance for loan losses of $13,117 at June 30, 2007 and $12,940 at December 31, 2006	781,528	748,173
Premises and equipment	15,707	16,015
Accrued interest receivable	5,590	5,464
Deferred income taxes, net	7,119	6,861
Bank-owned life insurance	12,483	12,212
Prepaid expenses and other assets	5,021	1,976
Core deposit intangible, net of amortization	409	475
Goodwill	5,656	5,656
Total assets	$ 1,044,431	$ 979,259
Liabilities and Stockholders Equity		
Liabilities		
Deposits	$ 938,881	$ 867,522
Borrowed funds	5,413	15,105
Junior subordinated debentures	10,825	10,825
Accrued expenses and other liabilities	4,791	6,567
Income taxes payable	100	92
Accrued interest payable	3,101	2,105
Total liabilities	963,111	902,216
Commitments and Contingencies		
Stockholders Equity		
Preferred stock, $0.01 par value per share; 1,000,000 shares authorized; no shares issued		
Common stock $0.01 par value per share; 20,000,000 shares authorized; 7,839,424 and 7,722,288 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	78	77
Additional paid-in capital	27,101	25,806
Retained earnings	54,425	51,127
Accumulated other comprehensive (loss) / income	(284)	33
Total stockholders equity	81,320	77,043
Total liabilities and stockholders equity	$ 1,044,431	$ 979,259

See accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Consolidated Statements of Income

(unaudited)

(Dollars in thousands, except per share data)	Three Months Ended June 30, 2007	2006	Six Months Ended June 30, 2007	2006
Interest and dividend income:				
Loans	$ 14,571	$ 13,329	$ 28,840	$ 25,811
Investment securities	1,367	1,482	2,688	3,048
Total short-term investments	35	67	66	160
Total interest and dividend income	15,973	14,878	31,594	29,019
Interest expense:				
Deposits	5,447	3,984	10,505	7,299
Borrowed funds	173	190	406	631
Junior subordinated debentures	295	295	589	589
Total interest expense	5,915	4,469	11,500	8,519
Net interest income	10,058	10,409	20,094	20,500
Provision for loan losses	52	244	135	517
Net interest income after provision for loan losses	10,006	10,165	19,959	19,983
Non-interest income:				
Investment advisory fees	817	637	1,595	1,266
Deposit service fees	523	412	1,027	827
Bank-owned life insurance	148	41	296	82
Net gains/(losses) on sales of investment securities	425	(39)	478	(9)
Gains on sales of loans	59	34	99	78
Other income	543	505	1,098	1,027
Total non-interest income	2,515	1,590	4,593	3,271
Non-interest expense:				
Salaries and employee benefits	5,307	5,007	10,642	10,129
Occupancy expenses	1,735	1,511	3,353	2,935
Audit, legal and other professional fees	496	303	792	625
Advertising and public relations	295	384	557	629
Supplies and postage	249	176	482	401
Investment advisory and custodial expenses	129	116	252	234
Other operating expenses	753	759	1,406	1,521
Total non-interest expense	8,964	8,256	17,484	16,474
Income before income taxes	3,557	3,499	7,068	6,780
Income tax expense	1,239	1,317	2,528	2,542
Net income	$ 2,318	$ 2,182	$ 4,540	$ 4,238
Basic earnings per share	$ 0.30	$ 0.29	$ 0.58	$ 0.56
Diluted earnings per share	$ 0.29	$ 0.28	$ 0.58	$ 0.54
Basic weighted average common shares outstanding	7,797,414	7,637,860	7,772,836	7,620,871
Diluted weighted average common shares outstanding	7,897,422	7,797,892	7,888,515	7,796,826

See accompanying notes to the unaudited consolidated financial statements.

ENTERPRISE BANCORP, INC.

Consolidated Statement of Changes in Stockholders Equity

(unaudited)

Six months ended June 30, 2007

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at December 31, 2006	$ 77	$ 25,806	$ 51,127		$ 33	$ 77,043
Comprehensive income						
Net income			4,540	$ 4,540		4,540
Other comprehensive income, net				(317)	(317)	(317)
Total comprehensive income				$ 4,223		
Common stock dividend paid ($0.16 per share)			(1,242)			(1,242)
Common stock issued under dividend reinvestment plan		530				530
Stock-based compensation		398				398
Stock options exercised	1	367				368
Balance at June 30, 2007	$ 78	$ 27,101	$ 54,425		$ (284)	$ 81,320
Disclosure of other comprehensive income (loss):						
Gross unrealized holding losses on securities arising during the period				$ (97)		
Income tax benefit				91		
Net unrealized holding losses, net of tax				(6)		
Reclassification adjustment for net gains included in net income:						
Net realized gains on sales of securities during the period				478		
Income tax expense				(167)		
Reclassification adjustment, net of tax				311		
Other comprehensive loss, net of reclassification				$ (317)		

See the accompanying notes to the unaudited consolidated financial statements

ENTERPRISE BANCORP, INC.

Consolidated Statements of Cash Flows

(unaudited)

(Dollars in thousands)	Six months ended June 30, 2007	June 30, 2006
Cash flows from operating activities:		
Net income	$ 4,540	$ 4,238
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	135	517
Depreciation and amortization	1,344	1,266
Amortization of intangible assets	66	66
Stock-based compensation expense	320	252
Net (gains)/losses on sales of investment securities	(478)	9
Gains on sales of loans	(99)	(78)
Income on bank-owned life insurance, net	(271)	(55)
(Increase) decrease in:		
Loans held for sale, net of gain	23	(598)
Accrued interest receivable	(126)	(243)
Prepaid expenses and other assets	(829)	77
Increase (decrease) in:		
Accrued expenses and other liabilities	(1,816)	136
Accrued interest payable	996	670
Change in income taxes	8	(63)
Net cash provided by operating activities	3,813	6,194
Cash flows from investing activities:		
Proceeds from sales of investment securities	4,608	3,220
Proceeds from maturities, calls and pay-downs of investment securities	8,360	10,462
Purchase of investment securities	(19,004)	(4,595)
Purchase of tax credits	(1,735)	
Net increase in loans	(33,680)	(32,445)
Additions to premises and equipment, net	(1,103)	(2,671)
Purchases of bank-owned life insurance		(9,897)
Net cash used in investing activities	(42,554)	(35,926)
Cash flows from financing activities:		
Net increase in deposits	71,359	115,092
Net increase (decrease) in borrowed funds	(9,692)	(54,595)
Cash dividends paid	(1,242)	(1,066)
Proceeds from issuance of common stock	530	471
Proceeds from exercise of stock options	368	227
Tax benefit from exercise of stock options		14
Net cash provided by financing activities	61,323	60,143
Net (decrease) / increase in cash and cash equivalents	22,582	30,411
Cash and cash equivalents at beginning of period	50,887	38,381
Cash and cash equivalents at end of period	$ 73,469	$ 68,792
Supplemental financial data:		
Cash Paid For:		
Interest	$ 10,504	$ 7,849
Income taxes	2,522	2,590
Supplemental schedule of non-cash investing activity:		
Transfer from loans to Other Real Estate Owned	$ 266	

See accompanying notes to the unaudited consolidated financial statements.

ENTERPRISE BANCORP, INC.

Notes to Unaudited Consolidated Financial Statements

(1) Organization of Holding Company

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

(2) Basis of Presentation

The accompanying unaudited consolidated financial statements and these notes should be read in conjunction with the company s December 31, 2006 audited consolidated financial statements and notes thereto contained in the company s 2006 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 16, 2007. Interim results are not necessarily indicative of results to be expected for the entire year. The company has not changed its significant accounting and reporting policies from those disclosed in its 2006 annual report.

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

Certain fiscal 2006 information has been reclassified to conform to the 2007 presentation.

(3) Critical Accounting Estimates

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

As discussed in the company s 2006 Annual Report on Form 10-K, the two most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses and the impairment valuation of goodwill. Refer to note 1 to the company s consolidated financial statements included in the company s 2006 Annual Report on Form 10-K for significant accounting policies.

(4) Accounting for Uncertainty in Income Taxes

In July the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - An interpretation of FASB Statement No 109 (FIN 48). The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 did not have a material impact on the company s financial position or results of operation.

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

The company did not have any unrecognized tax benefits accrued as income tax liabilities or receivables or as deferred tax items at June 30, 2007 or December 31, 2006. The Company is subject to federal and state income tax examinations for tax years beginning after December 31, 2002.

(5) Stock-Based Compensation

The company has not significantly changed the general terms and conditions related to stock compensation from those disclosed in the company s 2006 Annual Report on Form 10-K.

Total stock-based compensation expense, which includes *stock option awards* and *restricted stock awards* to officers and other employees, and *director stock compensation* in lieu of cash fees to directors, was $136 thousand and $134 thousand for the three months ended June 30, 2007 and 2006, respectively and $320 thousand and $252 thousand for the six months ended June 30, 2007 and 2006, respectively.

The company recognized stock-based compensation expense related to stock option awards of $75 thousand and $206 thousand for the three and six months ended June 30, 2007, compared to $70 thousand and $139 thousand for the same periods in 2006. Stock-based compensation expense recognized in association with a restricted stock award amounted to $13 and $25 thousand for the three month and six month periods ended June 30, 2007 and 2006. Stock-based compensation expense related to Directors election to receive shares of common stock in lieu of cash fees for attendance at Board and Board Committee meetings amounted to $48 thousand and $89 thousand for the three and six months ended June 30, 2007, compared to $51 thousand and $88 thousand for the same periods in 2006. In January 2007, 10,575 shares of common stock were issued to directors in lieu of cash fees related to 2006 annual directors stock-based compensation expense of $167 thousand.

There were 3,500 and 127,600 stock option awards granted to employees during the three and six months periods ended June 30, 2007, respectively. No options were granted during the same periods ended June 30, 2006. The options become exercisable at the rate of 25% per year and expire seven years from the date of grant. In addition, the options provide for full vesting upon attainment of age 62 while remaining employed with the bank, or upon a change in control of the company.

The per share weighted average fair value of stock options granted in 2007 was determined to be $3.69. The weighted average fair value of the options was determined to be 22% of the market value of the stock at the date of grant. The assumptions used in the valuation model for determining weighted average fair value of the 2007 stock option grants for the risk-free interest rate, expected volatility, dividend yield and expected life in years were 4.43%, 21%, 2.03% and 5.5 years, respectively.

Refer to note 9 Stock Based Compensation Plans in the company s 2006 Annual Report on Form 10-K for a description of the assumptions used in the valuation model.

(6) Supplemental Retirement Plan

The following table illustrates the net periodic benefit cost for the supplemental executive retirement plan for the three months and six months ended June 30, 2007 and June 30, 2006:

	Three months ended June 30,		**Six months ended June 30,**	
(Dollars in thousands)	**2007**	**2006**	**2007**	**2006**
Service Cost	$ 138	$ 135	$ 276	$ 269
Interest Cost	32	22	64	44
Net periodic benefit cost	$ 170	$ 157	$ 340	$ 313

The company anticipates accruing an additional $339 thousand to the plan during the remainder of 2007.

(7) Earnings Per Share

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

The table below presents the increase in average shares outstanding, using the treasury stock method, for the diluted earnings per share calculation for the three and six months ended June 30th and the effect of those shares on earnings:

	Three months ended June 30,		Six months ended June 30,	
	2007	**2006**	**2007**	**2006**
Basic weighted average common shares outstanding	7,797,414	7,637,860	7,772,836	7,620,871
Dilutive shares	100,008	160,032	115,679	175,955
Diluted weighted average common shares outstanding	7,897,422	7,797,892	7,888,515	7,796,826
Basic earnings per share	$ 0.30	0.29	$ 0.58	0.56
Effect of dilutive shares	(0.01)	(0.01)		(0.02)
Diluted earnings per share	$ 0.29	0.28	$ 0.58	0.54

At June 30, 2007, there were additional options outstanding to purchase up to 142,425 shares which were excluded from the calculation of diluted earnings per share due to the exercise price of these options exceeding the average market price of the company s common stock. These options, which were not dilutive at that date, may potentially dilute earnings per share in the future.

(8) Guarantees and Commitments

Standby letters of credit are conditional commitments issued by the company to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. If the letter of credit is drawn upon the company creates a loan for the customer with the same criteria associated with similar loans. The fair value of these commitments was estimated to be the fees charged to enter into similar agreements. The estimated fair value of these commitments carried on the balance sheet was $35 thousand and $72 thousand at June 30, 2007 and 2006, respectively. These amounts are amortized to income over the life of the letters of credit, typically one year.

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 strategy 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. Interest rate lock commitments related to the origination of mortgage loans that will be sold are considered derivative instruments. The company estimates the fair value of these derivatives using the difference between the guaranteed interest rate in the commitment and the current market interest rate. To reduce the net interest rate exposure arising from its loan sale activity, the company enters into the commitment to sell these loans at essentially the same time that the interest rate lock commitment is quoted on the origination of the loan. The commitments to sell loans are also considered derivative instruments, with estimated fair values based on changes in current market rates. At June 30, 2007, the estimated fair value of the company s derivative instruments was considered to be immaterial.

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

Management s discussion and analysis should be read in conjunction with the company s consolidated financial statements and notes thereto contained in this report and the company s 2006 Annual Report on Form 10-K.

Special Note Regarding Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements concerning plans, objectives, future events or performance and assumptions and other statements that are other than statements of historical fact. Forward-looking statements may be identified by reference to a future period or periods or by use of forward-looking terminology such as anticipates , believes , expects , intends , may , plans , pursue , views and similar terms or expressions. Various stat contained in Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 3 Quantitative and Qualitative Disclosures About Market Risk, including, but not limited to, statements related to management s views on the banking environment and the economy, competition and market expansion opportunities, the interest rate environment, credit risk and the level of future non-performing assets and charge-offs, potential asset and deposit growth, future non-interest expenditures and non-interest income growth, and borrowing capacity are forward-looking statements. The company wishes to caution readers that such forward-looking statements reflect numerous assumptions and involve a number of risks and uncertainties that may adversely affect the company s future results. The following important factors, among others, could cause the company s results for subsequent periods to differ materially from those expressed in any forward-looking statement made herein: (i) changes in interest rates could negatively impact net interest income; (ii) changes in the business cycle and downturns in the local, regional or national economies, including deterioration in the local real estate market, could negatively impact credit and/or asset quality and result in credit losses and increases in the company s reserve for loan losses; (iii) changes in consumer spending could negatively impact the company s credit quality and financial results; (iv) increasing competition from larger regional and out-of-state banking organizations as well as non-bank providers of various financial services could adversely affect the company s competitive position within its market area and reduce demand for the company s products and services; (v) deterioration of securities markets could adversely affect the value or credit quality of the company s assets and the availability of funding sources necessary to meet the company s liquidity needs; (vi) changes in technology could adversely impact the company s operations and increase technology-related expenditures; (vii) increases in employee compensation and benefit expenses could adversely affect the company s financial results; (viii) changes in laws and regulations that apply to the company s business and operations could increase the company s regulatory compliance costs and adversely affect the company s business environment, operations and financial results; and (ix) changes in accounting standards, policies and practices, as may be adopted or established by the regulatory agencies, the Financial Accounting Standards Board (the FASB)or the Public Company Accounting Oversight Board could negatively impact the company s financial results. Therefore, the company cautions readers not to place undue reliance on any such forward-looking information and statements.

Overview

Composition of Earnings

The current flat interest rate environment continues to negatively impact margins and challenge earnings growth for the banking industry. At Enterprise Bancorp, Inc., this environment has contributed to slower loan and negative low cost deposit growth and continued pressure on the company s net interest margin from rising funding costs.

The company reported net income growth of 6% for the three months ended June 30, 2007 compared to the same quarter in the prior year. Net income for the current quarter ended June 30, 2007 amounted to $2.318 million compared to $2.182 million for the same period in 2006. Diluted earnings per share were $0.29 for the quarter compared to $0.28 for the same period in 2006, an increase of 4%.

Net income for the six months ended June 30, 2007 amounted to $4.540 million compared to $4.238 million for the same period in 2006, an increase of 7%. Diluted earnings per share were $0.58 for the six months ended June 30, 2007 compared to $0.54 for the same period in 2006, an increase of 7%.

Net income growth resulted primarily from an increase in non-interest income and a decrease in the provision for loan losses, partially offset by an increase in non-interest expense and a decrease in net interest income.

- *Quarter-to-date*

The company s earnings are largely dependent on its net interest income, which is the difference between interest income on loans and investments and interest expense on deposits and borrowings. Net interest income for the quarter ended June 30, 2007 amounted to $10.1 million, representing a $351 thousand, or 3%, decrease from the same period in 2006.

Net interest margin, the difference between interest earned on assets less the cost of funding (primarily deposits) divided by average interest earning assets, was 4.51% for the quarter ended June 30, 2007 compared to 4.59% and 4.83% for the quarters ended March 31, 2007 and June 30, 2006, respectively. The decrease in net interest margin resulted from both the flat yield curve and a highly-competitive marketplace.

Non-interest income was $2.5 million for the quarter ended June 30, 2007, an increase of $925 thousand, or 58%, over the same period in 2006. The growth resulted primarily from an increase of $464 thousand in gains on sales of securities, and from increases of $180 thousand in investment advisory fees, $107 thousand in bank-owned life insurance income and $111 thousand in deposit-service fees.

Non-interest expense amounted to $9.0 million for the quarter ended June 30, 2007 compared to $8.3 million for the same period in 2006, an increase of 9%. The increases were predominantly in occupancy and compensation-related costs which supports the company s growth.

The provision for loan losses, which is impacted by asset quality and loan growth, amounted to $52 thousand for the quarter ended June 30, 2007 compared to $244 thousand in the first quarter of 2006. The reduced provision reflects continued favorable asset quality. The allowance for loan losses to total loans ratio was 1.65% at June 30, 2007 compared to 1.70% at December 31, 2006. The company s management of credit risk is reviewed in more detail under the heading Asset Quality and the Allowance for Loan Losses contained in the Financial Condition section of this Item 2.

- *Year-to-date*

Net interest income for the six months ended June 30, 2007 amounted to $20.1 million, a $406 thousand, or 2%, decrease from the same period in 2006. Net interest margin was 4.55% for the six months ended June 30, 2007 compared to 4.81% for the same period ended June 30, 2006.

Non-interest income was $4.6 million for the six months ended June 30, 2007, an increase of $1.3 million, or 40%, over the same period in 2006. The growth resulted primarily from an increase of $487 thousand in gains on sales of securities, which occurred mainly in the second quarter, and from increases of $329 thousand in investment advisory fees, $214 thousand in bank-owned life insurance income and $200 thousand in deposit-service fees.

Non-interest expense amounted to $17.5 million for the six months ended June 30, 2007 compared to $16.5 million for the same period in 2006, an increase of 6%. The increase was mainly in occupancy and compensation-related costs which supports the company s growth.

The provision for loan losses for the six months ended June 30, 2007 amounted to $135 compared to $517 thousand for the same period in 2006, a decrease of $382 thousand. As noted above, the reduced provision reflects continued favorable asset quality during the period.

Sources and Uses of Funds

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

Total assets amounted to $1.044 billion at June 30, 2007, an increase of 7% since December 31, 2006. The company s core asset strategy is to grow loans, primarily commercial loans. Total loans increased 4% since December 31, 2006 and amounted to $794.6 million, or 76% of total assets. Commercial loans amounted to $675.7 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 $137.4 million at June 30, 2007, or 13% of total assets, and have increased $5.9 million since December 31, 2006.

Management s primary strategy for funding assets growth is through low cost deposits (primarily checking accounts). Asset growth in excess of low cost deposits is typically funded through higher cost deposits (certificates of deposit and money market / savings products), brokered deposits, repurchase agreements, FHLB borrowings, and investment portfolio cash flow. Over the past eighteen months the company has increased its use of brokered term deposits (brokered CDs) and internally generated certificates of deposit as an alternative funding source, as the rate environment has continued to impact the company s ability to generate growth in lower costing deposits. Lower costing deposits declined by $7.6 million, or 2%, since December 31, 2006 and by $9.2 million, or 2%, since December 31, 2005.

At June 30, 2007, total deposits, which included brokered CDs, amounted to $938.9 million, representing 8% growth over December 31, 2006. Total deposits, excluding brokered CDs, amounted to $818.8 million at June 30, 2007, representing a 2% increase since December 31, 2006. At June 30, 2007, the company had $120.1 million in brokered CDs and $2.3 million in FHLB borrowings compared to $64.9 million in brokered CDs and $10.3 million in FHLB borrowings at December 31, 2006.

Opportunities and Risks

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

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

Despite these competitive challenges, the company has been successful in growing its commercial banking services. 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; its fifteenth branch facility is currently under construction in the city of Methuen, Massachusetts and is anticipated to open in early 2008. The company 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 interest rate, credit and operational risk.

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

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

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.

Financial Condition

Total assets increased $65.2 million, or 7%, over December 31, 2006, to $1.044 billion at June 30, 2007. The increase was primarily attributable to increases in total loans and short-term investments.

Short-term investments

As of June 30, 2007, short-term investments amounted to $29.4 million compared to $15.3 million at December 31, 2006. Short-term investments represented 3% of total assets at June 30, 2007, compared to 2% at December 31, 2006. Short-term investments carried as cash equivalents consisted of overnight federal funds sold and money market mutual funds.

Investments

At June 30, 2007, the investment portfolio s fair market value was $137.5 million, representing an increase of $5.9 million since December 31, 2006. The fair market value of the investment portfolio represented 13% of total assets at both June 30, 2007 and December 31, 2006.

During the six months ended June 30, 2007, the company sold $4.6 million in equity investments based on management s decision to take advantage of certain investment opportunities and to reallocate funds within the equity portfolio, in addition, during this period, the company received $8.4 million in principal paydowns, calls and maturities. These proceeds were used to purchase $19.0 million in securities, primarily within the equity and municipal securities portfolios.

The net unrealized loss on the portfolio at June 30, 2007 was $738 thousand compared to a net unrealized loss of $163 thousand at December 31, 2006. 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 fall the value of the portfolio rises, and as rates rise, the value of the portfolio declines. The unrealized gains or loss 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. Unrealized gains or losses will only be recognized in the statements of income if the securities are sold. However, if an unrealized loss on a fixed income or equity security is deemed to be other-than-temporary, the company marks the investment down to its carrying value through a charge to earnings.

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

(Dollars in thousands)	June 30, 2007	December 31, 2006	June 30, 2006
Federal agency obligations(1)	$ 10,365	$ 10,405	$ 14,986
Collateralized mortgage obligations and other mortgage backed securities (CMO/MBS)	59,992	61,431	66,831
Municipal securities	55,945	48,762	55,180
Available-for-sale fixed income securities	$ 126,302	$ 120,598	$ 136,997
Equity securities	9,538	8,481	6,243
Federal Home Loan Bank stock(2)	1,609	1,428	1,267
Certificates of deposit		1,033	1,000
Total investments	$ 137,449	$ 131,540	$ 145,507

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

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

From time to time the company may pledge investments from the portfolio as collateral for various municipal deposit accounts, repurchase agreements and treasury, tax and loan deposits. The fair value of securities pledged as collateral was $25.2 million and $27.1 million at June 30, 2007 and December 31, 2006 respectively. Securities designated as qualified collateral for FHLB borrowing capacity amounted to $46.7 million and $46.2 million at June 30, 2007 and December 31, 2006 respectively.

Loans

The company specializes in lending to business entities, non-profit organizations, professionals and individuals. The company s primary lending focus is on the development of high quality commercial relationships 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 of credit, 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.

Total loans were $794.6 million at June 30, 2007, an increase of $33.5 million, or 4%, compared to December 31, 2006. Total loans represented 76% of total assets at both June 30, 2007 and December 31, 2006.

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)	June 30, 2007 Amount	Percent		December 31, 2006 Amount	Percent		June 30, 2006 Amount	Percent	
Commercial real estate	$ 381,203	48.0	%	$ 368,621	48.3	%	$ 341,368	46.5	%
Commercial and industrial	175,971	22.1	%	164,865	21.6	%	164,061	22.4	%
Commercial construction	118,482	14.9	%	114,078	15.0	%	120,692	16.4	%
Total Commercial loans	$ 675,656	85.0	%	$ 647,564	84.9	%	$ 626,121	85.3	%
Residential mortgages	67,026	8.4	%	61,854	8.1	%	55,248	7.5	%
Residential construction	4,847	0.5	%	3,981	0.5	%	4,264	0.6	%
Home equity	43,093	5.4	%	44,038	5.8	%	43,673	6.0	%
Consumer	4,653	0.6	%	4,307	0.6	%	3,815	0.5	%
Loans held for sale	625	0.1	%	549	0.1	%	943	0.1	%

Gross loans	$	795,900	100	%	$	762,293	100.0	%	$	734,064	100.0	%
Deferred fees, net	(1,255	)			(1,180	)			(1,298	)		
Total loans	794,645				761,113				732,766			
Allowance for loan losses	(13,117	)			(12,940	)			(12,486	)		
Net loans	$	781,528			$	748,173			$	720,280		

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Commercial real estate loans were $381.2 million at June 30, 2007, compared to $368.6 million at December 31, 2006, an increase of $12.6 million, or 3%. Commercial real estate loans are typically secured by apartment buildings, office or mixed-use facilities, strip shopping malls or other commercial property.

Commercial and industrial loans totaled $176.0 million at June 30, 2007, compared to $164.9 million at December 31, 2006, an increase of $11.1 million, or 7%. Commercial loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), term loans, revolving lines of credit and loans under various U.S. Small Business Administration programs. These commercial credits may be unsecured loans or lines to financially strong borrowers, secured in whole or in part by real estate unrelated to the principal purpose of the loan or secured by inventories, equipment or receivables, and are generally guaranteed by the principals of the borrower.

Commercial construction loans amounted to $118.5 million at June 30, 2007, compared to $114.1 million at December 31, 2006. Commercial construction loans include the development of residential housing and condominium projects, the development of commercial and industrial use property and loans for the purchase and improvement of raw land.

At June 30, 2007, the company had commercial loan balances participated out to various banks amounting to $6.5 million, compared to $8.2 million at December 31, 2006. 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 in the loan portfolio at the company s pro rata share of ownership and amounted to $16.0 million and $18.3 million at June 30, 2007 and December 31, 2006, respectively. The company performs an independent credit analysis of each commitment prior to participation in any loan.

Loans designated as qualified collateral for FHLB borrowing capacity amounted to $156.5 million and $42.5 million at June 30, 2007 and December 31, 2006, respectively. In January 2007, the company increased its FHLB borrowing capacity by pledging additional commercial real estate, home equity and multi-family loans as collateral to the FHLB.

Asset Quality and the Allowance for Loan Losses

The company s credit risk management function focuses on a wide variety of factors, including, among others, current and expected economic conditions and trends, 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, growth and composition of the loan portfolio, expansion in geographic market areas, comparison to industry peers and known and inherent risks in the 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.

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.

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, some of which are outlined above. There were no significant changes in credit quality, the company s underwriting, or the allowance assessment methodology used to estimate loan loss exposure as reported in the company s Annual Report on Form 10-K for the year ended December 31, 2006.

The allowance for loan losses to total loans ratio was 1.65% at June 30, 2007 compared to 1.70% at December 31, 2006. Based on the foregoing, as well as management s judgment as to the risks inherent in the loan portfolio, the company s allowance for loan losses was deemed adequate to absorb reasonably anticipated losses from specifically known and other credit risks associated with the portfolio as of June 30, 2007.

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

(Dollars in thousands)	June 30, 2007	December 31, 2006	June 30, 2006
Non-accrual loans	$ 3,056	$ 1,785	$ 1,999
Accruing loans > 90 days past due	1	7	
Total non-performing loans	3,057	1,792	1,999
Other real estate owned	266		
Total non-performing assets	$ 3,323	$ 1,792	$ 1,999
Total Loans	$ 794,645	$ 761,113	$ 732,766
Allowance for loan losses	$ 13,117	$ 12,940	$ 12,486
Allowance for loan losses: Total loans	1.65 %	1.70 %	1.70 %
Allowance for loan losses: Non-performing loans	429.08 %	722.10 %	624.61 %
Non-performing loans: Total loans	0.38 %	0.24 %	0.27 %
Non-performing assets: Total assets	0.32 %	0.18 %	0.20 %
Loans 30-89 days past due: Total loans	0.54 %	0.75 %	0.40 %

Total non-performing assets were $3.3 million, or 0.32% of total assets, at June 30, 2007 compared to $1.8 million and $2.0 million at December 31, 2006 and June 30, 2006, respectively, representing 0.18% and 0.20% of total assets at those respective dates. The December 31, 2006 ratio represents a historically low level in the non-performing assets to total assets ratio. The increase since December was mainly due to four relationships added to non-accrual status during the period amounting to approximately $1.7 million, partially offset by principal paydowns. Overall, non-performing assets are still considered to be at low levels at June 30, 2007.

The ratio of non-performing loans to total loans increased to 0.38% as of June 30, 2007, compared to 0.24% and 0.27% at December 31, 2006 and June 30, 2006, respectively. The increase since December was mainly due to the four relationships referred to above amounting to 0.21% of total loans at June 30, 2007. Management does not consider the increase since December to be indicative of deterioration in the credit quality of the general loan portfolio.

Loans for which management considers it probable that not all contractual principal and interest will be collected in accordance with the original loan terms are designated as impaired loans. The majority of impaired loans are included within the non-accrual balances; however, not every loan in non-accrual status has been designated as impaired. 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. Total impaired loans were $2.9 million at June 30, 2007 compared to $1.8 million and $2.0 million at December 31, 2006 and June 30, 2006, respectively.

The ratio of delinquent loans 30-89 days past due, but still accruing, as a percentage of total loans decreased to 0.54% at June 30, 2007, from 0.75% at December 31, 2006 and increased from 0.40% at June 30, 2006. The ratio of delinquent loans to total loans will fluctuate due to the timing of customer payments. The largest concentration of these loans is generally less than 40 days past due, as was the case at June 30, 2007 at which time approximately 90% of delinquent loans were included in the 30 40 day past due category.

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

The following tables summarize the activity in the allowance for loan losses for the periods indicated:

(Dollars in thousands)	Six months ended June 30, 2007	2006
Balance at beginning of year	$ 12,940	$ 12,050
Charged off	(108)	(141)
Recovered	150	60
Net loans recovered/(charged off)	42	(81)
Provision charged to operations	135	517
Balance at June 30	$ 13,117	$ 12,486
Annualized net loans recovered/(charged off): Average loans outstanding	0.01 %	(0.02)%

Net loans recovered during the six months ended June 30, 2007 were $42 thousand compared to net charge offs of $81 thousand during the same period ended June 30, 2006. The provision reflects management s estimate of loan loss reserves necessary to support the level of credit risk inherent in the portfolio during the period. The provision for loan losses, which is impacted by asset quality and loan growth, amounted to $135 thousand and $517 thousand for the quarters ended June 30, 2007 and 2006 respectively. The reduced provision reflects net recoveries, the level of loan growth and the continued favorable asset quality during the period.

Deposits

Total deposits amounted to $938.9 million at June 30, 2007 compared to $867.5 million at December 31, 2006. The increase of $71.4 million, or 8%, primarily resulted from an increase in brokered CDs of $55.1 million.

The highly-competitive marketplace and the flat rate environment contributed to a net decline in lower costing deposit products. In order to sustain loan growth, the company has continued to strategically utilize both internally generated CDs and brokered CDs as an alternative to funding through higher costing FHLB advances and other borrowing sources.

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

(Dollars in thousands)	June 30, 2007 Amount	Percent	December 31, 2006 Amount	Percent	June 30, 2006 Amount	Percent
Demand	$ 170,403	18.1 %	$ 169,910	19.6 %	$ 170,148	19.1 %
Interest bearing checking	173,395	18.5 %	179,533	20.7 %	184,487	20.7 %
Total checking	343,798	36.6 %	349,443	40.3 %	354,635	39.8 %
Retail savings/money markets	141,418	15.1 %	141,202	16.3 %	144,538	16.2 %
Commercial savings/money markets	135,531	14.4 %	125,584	14.5 %	135,150	15.2 %
Total savings/money markets	276,949	29.5 %	266,786	30.8 %	279,688	31.4 %
Certificates of deposit	198,040	21.1 %	186,349	21.4 %	177,633	20.0 %
Total non-brokered deposits	818,787	87.2 %	802,578	92.5 %	811,956	91.2 %
Brokered certificates of deposit	120,094	12.8 %	64,944	7.5 %	78,523	8.8 %
Total deposits	$ 938,881	100 %	$ 867,522	100.0 %	$ 890,479	100.0 %

Borrowed Funds

Borrowed funds, consisting of securities sold under agreements to repurchase (repurchase agreements) and FHLB borrowings, amounted to $5.4 million at June 30, 2007 compared to $15.1 million at December 31, 2006. Total repurchase agreements declined by $1.8 million since December 31, 2006 and were $3.1 million at June 30, 2007. Total FHLB borrowings declined by $7.9 million since December 31, 2006 and amounted to $2.3 million at June 30, 2007.

At June 30, 2007, the bank had the capacity to borrow additional funds from the FHLB of up to $132.8 million. Management believes that the company has adequate liquidity to meet its commitments.

Liquidity

Liquidity is the ability to meet cash needs arising from, among other things, fluctuations in loans, investments, deposits and borrowings. Liquidity management is the coordination of activities so that cash needs are anticipated and met readily and efficiently. Liquidity policies are set and monitored by the company s Asset-Liability Committee of the Board of Directors. The company s liquidity is maintained by projecting cash needs, balancing maturing assets with maturing liabilities, monitoring various liquidity ratios, monitoring deposit flows, maintaining liquidity within the investment portfolio and maintaining borrowing capacity in the brokered CD market and at the FHLB.

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

The company funds earning assets with deposits, brokered CDs, repurchase agreements, FHLB borrowings, commercial lines of credit, junior subordinated debentures and earnings.

Capital Resources

As of June 30, 2007, both the company and the bank qualify as well capitalized under applicable regulations of the Board of Governors of the Federal Reserve System (the Federal Reserve Board) and the Federal Deposit Insurance Corporation. To be categorized as well capitalized, the company and the bank must maintain minimum total, Tier 1 and, in the case of the bank, leverage capital ratios as set forth in the table below.

The company s actual capital amounts and ratios are presented as of June 30, 2007 in the table below. The bank s capital amounts and ratios do not differ materially from the amounts and ratios presented for the company.

(Dollars in thousands)	Actual Amount	Ratio	Minimum Capital for Capital Adequacy Purposes Amount	Ratio	Minimum Capital To Be Well Capitalized Amount	Ratio
Total Capital (to risk weighted assets)	$ 96,675	11.28 %	$ 68,560	8.00 %	$ 85,700	10.00 %
Tier 1 Capital (to risk weighted assets)	85,445	9.97 %	34,280	4.00 %	51,420	6.00 %
Tier 1 Capital (to average assets)	85,445	8.81 %	38,800	4.00 %	48,500 *	5.00 %*

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

The company maintains a dividend reinvestment plan (the DRP). The DRP enables stockholders, at their discretion, to elect to reinvest dividends paid on their shares of the company s common stock by purchasing additional shares of common stock from the company at a purchase price equal to fair market value. Shareholders utilized the DRP to invest $263 thousand of the $623 thousand cash dividend paid through June 30, 2007, into 16,461 shares of the company s common stock.

On July 17, 2007, the company announced a quarterly dividend of $0.08 to be paid on September 4, 2007 to shareholders of record as of August 14, 2007. The quarterly dividend represents a 14% increase over the 2006 dividend rate.

Results of Operations

Three Months Ended June 30, 2007 vs. three Months Ended June 30, 2006

Unless otherwise indicated, the reported results are for the three months ended June 30, 2007 with the comparable period and prior period being the three months ended June 30, 2006.

The company reported second quarter 2007 net income of $2.318 million compared to $2.182 million during the second quarter of the prior year, an increase of 6%. Diluted earnings per common share were $0.29 for the quarter compared to $0.28 for the prior period, an increase of 4%.

Net Interest Income

The company s net interest income was $10.1 million for the three months ended June 30, 2007, a decrease of $351 thousand compared to $10.4 million for the prior period. Total interest and dividend income for the 2007 period increased by $1.1 million, while total interest expense increased by $1.4 million over the prior period.

Net Interest Margin

Tax equivalent net interest margin decreased to 4.51% for the quarter ending June 30, 2007 from 4.83% in the prior year. The 32 basis point decrease was primarily due to an increase of 56 basis points in the total cost of funds due to an increase in funding through higher-costing certificates of deposit, partially offset by an increase in the yield on interest earning assets of 23 basis points due to higher market rates during the period.

Interest Income

Interest income amounted to $16.0 million, an increase of $1.1 million, or 7%, compared to $14.9 million in the prior period. The increase resulted primarily from a $32.8 million, or 4%, increase in the average balance of interest earning assets and, to a lesser extent, a 23 basis point increase in the average tax equivalent yield on interest earning assets.

Average loan balances increased $53.1 million, or 7%, compared to the prior period, amounting to $780.3 million, while the average balance of investment securities and short-term investments (together investments) decreased by $20.3 million, or 13%, to $136.8 million for the three months ended June 30, 2007. The decrease in average investment balances was primarily due to paydowns, calls, maturities and sales of investments since June 30, 2006, the proceeds of which were redeployed to fund loan growth over the period.

This shift in average balances from lower yielding investments into higher yielding loans, coupled with higher market interest rates over the period, resulted in the 23 basis point increase in the average tax equivalent yield on interest earning assets to 7.09%, with loan yields increasing 14 basis points to 7.49% and the tax equivalent yield realized on investments increasing 27 basis points to 4.83%. These yield increases were due to loan growth and loans repricing at the higher market rates and the sales of lower yielding securities in the fourth quarter of 2006.

Total interest income on loans amounted to $14.6 million, an increase of $1.2 million compared to the same period in the prior year, due primarily to growth in average balances and to a lesser degree to the increase in rates. Total investment income amounted to $1.4 million, a decrease of $147 thousand compared to the same period in the prior year, due primarily to the decrease in the average investment balances.

Interest Expense

Interest expense amounted to $5.9 million, an increase of $1.4 million, or 32%, compared to the prior period. The increase resulted primarily from a 56 basis point increase in the average cost of total deposits, borrowed funds and debentures to 2.65% compared to 2.09% in the comparable period. This increase in cost of funds was primarily due to the increased market rates and the shift in funding sources from lower costing deposits to higher costing certificates of deposits, as well as the overall 4% increase in the average balance of total funding sources.

Interest expense on interest checking, savings and money market accounts increased $248 thousand over the comparable period, to $2.0 million. This increase resulted from a 34 basis point increase in the average cost of interest checking, savings and money market accounts to 1.96%, due to higher market interest rates. This increase in interest expense was partially offset by a reduction in the average balance of these accounts of $25.2 million over the prior period, to $419.4 million for the three month period ended June 30, 2007.

Interest expense on certificates of deposit (CDs) increased $1.2 million over the comparable period, to $3.4 million. The average balance of CDs increased $67.2 million, or 31%, over the comparable period in the prior year to $287.9 million. The increase in the average CD balance resulted from a $46.2 million, or 88%, increase in the average balance of brokered CDs that the company utilized as an alternative to FHLB borrowings, and a $21.0 million, or 13%, increase in internally generated CD growth. The average cost of CDs also increased to 4.74%, an increase of 77 basis points over the prior year, due to higher market rates, consumer price sensitivity and the higher costing brokered CD balances.

Interest expense on borrowed funds, consisting of FHLB borrowings and repurchase agreements, decreased $17 thousand over the same period last year. The average balance of borrowed funds, primarily FHLB borrowings, decreased $2.6 million to $13.3 million. The average cost of borrowed funds increased 43 basis points to 5.23%, due to an increase in market interest rates.

The average balance of non-interest bearing demand deposits remained relatively consistent and represented 18% and 19% of total average funding for the three months ended June 30, 2007 and 2006, respectively.

The following table sets forth the extent to which changes in interest rates and changes in the average balances of interest-earning assets and interest-bearing liabilities have affected interest income and expense during the three months ended June 30, 2007 and June, 2006, respectively. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to: (1) volume (change in average portfolio balance multiplied by prior period average rate); (2) interest rate (change in average interest rate multiplied by prior period average balance); and (3) rate

and volume (the remaining difference).

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AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS

	Three Months Ended June 30, 2007			Three Months Ended June 30, 2006			Changes due to			
(Dollars in thousands)	Average Balance	Interest	Average Yield	Average Balance	Interest	Average Yield	Total	Volume	Rate	Rate/ Volume
Assets:										
Loans(1)	$ 780,337	14,571	7.49 %	$ 727,278	13,329	7.35 %	$ 1,242	972	254	16
Investments(2)(3)	136,792	1,402	4.83 %	157,066	1,549	4.56 %	(147)	(231)	106	(22)
Total interest earnings assets	917,129	15,973	7.09 %	884,344	14,878	6.86 %	1,095	741	360	(6)
Other assets	65,843			49,983						
Total assets	$ 982,972			$ 934,327						
Liabilities and stockholders equity:										
Int chkg, savings and money market	$ 419,398	2,048	1.96 %	$ 444,920	1,800	1.62 %	248	(103)	377	(26)
Certificates of deposit(4)	287,882	3,399	4.74 %	220,644	2,184	3.97 %	1,215	666	424	125
Borrowed funds	13,265	173	5.23 %	15,871	190	4.80 %	(17)	(31)	17	(3)
Junior subordinated debentures	10,825	295	10.88 %	10,825	295	10.88 %				
Total interest-bearing deposits, borrowed funds and debentures	731,370	5,915	3.24 %	692,260	4,469	2.59 %	1,446	532	818	96
Net interest rate spread(2)			3.85 %			4.27 %				
Demand deposits	162,519			165,488						
Total deposits, borrowed funds and debentures	893,889	5,915	2.65 %	857,748	4,469	2.09 %				
Other liabilities	8,603			6,512						
Total liabilities	902,492			864,260						
Stockholders equity	80,480			70,067						
Total liabilities and stockholders equity	$ 982,972			$ 934,327						
Net interest income		10,058			$ 10,409		$ (351)	209	(458)	(102)
Net interest margin(2)			4.51 %			4.83 %				

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

(2) Average investment balances are presented at average amortized cost and average interest rates are presented on a tax equivalent basis. The tax equivalent effect, which was not included in the interest amount above, was $251 and $243 for the periods ended June 30, 2007 and June 30, 2006, respectively.

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

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

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Provision for Loan Loss

The provision for loan losses was $52 thousand compared to $244 thousand for the prior year. The reduced provision reflects the continued favorable asset quality during the period, net recoveries, and level of loan growth. The provision reflects management s estimate of loan loss reserves necessary to support the level of credit risk inherent in the portfolio during the period.

There have been no material changes to the company s allowance for loan loss methodology used to estimate loan loss exposure as reported in the company s Annual Report on Form 10-K for the year ended December 31, 2006. The provision for loan losses is a significant factor in the company s operating results.

For further discussion regarding the provision for loan losses and management s assessment of the adequacy of the allowance for loan losses see Financial Condition - Asset Quality and the Allowance for Loan Losses above and Risk Elements/Asset Quality and Allowance for Loan Losses in the Financial Condition section of Management s Discussion and Analysis of Financial Condition and Results of Operations in the company s 2006 Annual Report on Form 10-K.

Non-Interest Income

Non-interest income increased $925 thousand, or 58%, to $2.5 million. The increase was primarily attributable to increases in gains on security sales, investment advisory fees, deposit-service fees and bank-owned life insurance income.

Net gains on sales of investment securities amounted to $425 thousand for the three months ended June 30, 2007, compared to net losses of $39 thousand in the comparable period. These gains/losses were realized on the sales of $3.0 million and $2.8 million during the three months ended June 30 2007 and 2006, respectively. The realized gains in the current period resulted from sales in the equity portfolio based on management s decision to take advantage of certain investment opportunities and a reallocation within the equity portfolio during these periods.

Investment advisory fees increased by $180 thousand, or 28%, for the three months ended June 30, 2007 compared to the same period in 2006. The change resulted from new business generated and increases in the value of assets under management due to increases in market values.

Deposit-service fees increased by $111 thousand, or 27%, over the prior period due to an increase in transaction activity on commercial deposit accounts.

Bank-owned life insurance income increased by $107 thousand, or 261%, over the prior period due to income on additional policies purchased the second quarter of 2006.

Non-Interest Expense

Non-interest expense increased $708 thousand, or 9%, compared to the prior year and amounted to $9.0 million for the period ended June 30, 2007. The increase was primarily attributable to increases in salaries and employee benefits, occupancy expenses and other professional fees.

Salaries and employee benefits increased $300 thousand, or 6%, compared to the prior year, amounting to $5.3 million for the three months ended June 30, 2007. The increase primarily resulted from staffing increases necessary to support the company s strategic growth initiatives, salary adjustments and corresponding increases in health insurance premiums and taxes, partially offset by a reduction in accruals related to performance-based incentive compensation.

Occupancy expense increased by $224 thousand, or 15%, to $1.7 million primarily due to ongoing increases in maintenance and service costs, and facility expansion necessary to support the company s growth and strategic initiatives.

Audit, Legal and other professional fees increased by $193 thousand, or 64%, to $496 thousand primarily due to other professional fees associated with a bank-wide efficiency initiative which began during the quarter.

Results of Operations

Six Months Ended June 30, 2007 vs. Six Months Ended June 30, 2006

Unless otherwise indicated, the reported results are for the six months ended June 30, 2007 with the comparable period and prior year being the six months ended June 30, 2006.

The company reported net income of $4.540 million compared to $4.238 million in the prior year, an increase of 7%. Diluted earnings per common share were $0.58 for the six months ended June 30, 2007 compared to $0.54 for the prior year, an increase of 7%.

Net Interest Income

The company s net interest income was $20.1 million for the six months ended June 30, 2007, a decrease of $406 thousand compared to $20.5 million for the prior year. Total interest and dividend income for the 2007 period increased by $2.6 million, while total interest expense increased by $3.0 million over the prior year.

Net Interest Margin

Tax equivalent net interest margin decreased to 4.55% for the six months ending June 30, 2007 from 4.81% in the prior year. The 26 basis point decrease was primarily due to an increase of 60 basis points in the total cost of funds due to an increase in funding through higher-costing certificates of deposit, partially offset by an increase in the yield on interest earning assets of 33 basis points due to higher market rates during the period.

Interest Income

Interest income amounted to $31.6 million, an increase of $2.6 million, or 9%, compared to $29.0 million in the prior year. The increase resulted primarily from a $32.0 million, or 4%, increase in the average balance of interest earning assets and, to a lesser extent, a 33 basis point increase in the average tax equivalent yield on interest earning assets.

Average loan balances increased $57.9 million, or 8%, compared to the prior year, amounting to $776.3 million, while the average balance of investment securities and short-term investments (together investments) decreased by $25.9 million, or 16%, to $134.8 million for the six months ended June 30, 2007. The decrease in average investment balances was primarily due to paydowns, calls, maturities and sales of investments since June 30, 2006, the proceeds of which were redeployed to fund loan growth over the period.

This shift in average balances from lower yielding investments into higher yielding loans, coupled with the higher market interest rates over the period, resulted in the 33 basis point increase in the average tax equivalent yield on interest earning assets to 7.09%, with loan yields increasing 24 basis points to 7.49% and the tax equivalent yield realized on investments increasing 21 basis points to 4.80%. These yield increases were due to loan growth and loans repricing at the higher market rates and the sales of lower yielding securities in the fourth quarter of 2006.

Total interest income on loans amounted to $28.9 million, an increase of $3.0 million compared to the same period in the prior year, due primarily to growth in average balances and to a lesser degree to the increase in yields. Total investment income amounted to $2.8 million, a decrease of $454 thousand compared to the same period in the prior year, due primarily to the decrease in the average investment balances.

Interest Expense

Interest expense amounted to $11.5 million, an increase of $3.0 million, or 35%, compared to the prior year. The increase resulted primarily from a 60 basis point increase in the average cost of total deposits, borrowed funds and debentures to 2.61% compared to 2.01% in the comparable period. This increase in cost of funds was primarily due to the increased market rates and the shift in funding sources from lower costing deposits to higher costing certificates of deposits, as well as the overall 4% increase in the average balance of total deposits, borrowed funds and debentures.

Interest expense on interest checking, savings and money market accounts increased $648 thousand over the comparable period, to $4.0 million. This increase resulted from a 39 basis point increase in the average cost of interest checking, savings and money market accounts to 1.93%, due to higher market interest rates. This increase in interest expense was partially offset by a reduction in the average balance of these accounts of $20.3 million, to $421.0 million for the six month period ended June 30, 2007.

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Interest expense on certificates of deposit (CDs) increased $2.6 million over the comparable period, to $6.5 million. The average balance of CDs increased $68.7 million, or 33%, over the comparable period in the prior year to $279.3 million. The increase in the average CD balance resulted from a $42.6 million, or 91%, increase in the average balance of brokered CDs that the company utilized as an alternative to FHLB borrowings, and a $26.4 million, or 16%, increase in internally generated CD growth. The average cost of CDs also increased to 4.68%, an increase of 91 basis points over the comparable period in the prior year, due to higher market rates, consumer price sensitivity and the higher costing brokered CD balances.

Interest expense on borrowed funds, consisting of FHLB borrowings and repurchase agreements, decreased $225 thousand over the same period last year. The average balance of borrowed funds, primarily FHLB borrowings, decreased $12.8 million to $15.6 million, as the company began its expanded use of brokered CDs and decreased use of FHLB borrowings. The average cost of borrowed funds increased 72 basis points to 5.25%, due to an increase in market interest rates.

The average balance of non-interest bearing demand deposits remained relatively consistent and represented 18% and 19% of total average deposits and borrowings for the six months ended June 30, 2007 and 2006, respectively.

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 six months ended June 30, 2007 and June, 2006, respectively. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to: (1) volume (change in average portfolio balance multiplied by prior year average rate); (2) interest rate (change in average interest rate multiplied by prior year average balance); and (3) rate and volume (the remaining difference)

AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS

(Dollars in thousands)	Six Months Ended June 30, 2007 Average Balance	Interest	Average Yield	Six Months Ended June 30, 2006 Average Balance	Interest	Average Yield	Changes due to Total	Volume	Rate	Rate/ Volume
Assets:										
Loans(1)	$ 776,256	$ 28,840	7.49 %	$ 718,370	$ 25,811	7.25 %	$ 3,029	2,081	855	93
Investments(2)(3)	134,818	2,754	4.80 %	160,689	3,208	4.59 %	(454)	(594)	169	(29)
Total interest earnings assets	911,074	31,594	7.09 %	879,059	29,019	6.76 %	2,575	1,487	1,024	64
Other assets	64,590			51,310						
Total assets	$ 975,664			$ 930,369						
Liabilities and stockholders equity:										
Int chkg, savings and money market	$ 421,023	4,029	1.93 %	$ 441,397	3,381	1.54 %	648	(156)	854	(50)
Certificates of deposit(4)	279,250	6,476	4.68 %	210,536	3,918	3.75 %	2,558	1,278	971	309
Borrowed funds	15,598	406	5.25 %	28,468	631	4.47 %	(225)	(285)	110	(50)
Junior subordinated debentures	10,825	589	10.88 %	10,825	589	10.88 %				
Total interest-bearing deposits, borrowed funds and debentures	726,696	11,500	3.19 %	691,226	8,519	2.48 %	2,981	837	1,935	209
Net interest rate spread(2)			3.90 %			4.28 %				
Demand deposits	161,269			163,297						
Total deposits, borrowed funds and debentures	887,965	11,500	2.61 %	854,523	8,519	2.01 %				
Other liabilities	8,422			6,424						
Total liabilities	896,387			860,947						
Stockholders equity	79,277			69,422						
Total liabilities and stockholders equity	$ 975,664			$ 930,369						
Net interest income		$ 20,094			$ 20,500		$ (406)	650	(911)	(145)
Net interest margin(2)			4.55 %			4.81 %				

(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 interest rates are presented on a tax equivalent basis. The tax equivalent effect, which was not included in the interest amount above, was $481 and $483 for the periods ended June 30, 2007 and June 30, 2006, respectively.

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

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

Provision for Loan Loss

The provision for loan losses was $135 thousand compared to $517 thousand for the prior year. The reduced provision reflects the continued favorable asset quality during the period, net recoveries and the level of loan growth. The provision reflects management s estimate of loan loss reserves necessary to support the level of credit risk inherent in the portfolio during the period.

There have been no material changes to the company s allowance for loan loss methodology used to estimate loan loss exposure as reported in the company s Annual Report on Form 10-K for the year ended December 31, 2006. The provision for loan losses is a significant factor in the company s operating results.

For further discussion regarding the provision for loan losses and management s assessment of the adequacy of the allowance for loan losses see Financial Condition - Asset Quality and the Allowance for Loan Losses above and Risk Elements/Asset Quality and Allowance for Loan Losses in the Financial Condition section of Management s Discussion and Analysis of Financial Condition and Results of Operations in the company s 2006 Annual Report on Form 10-K.

Non-Interest Income

Non-interest income increased $1.3 million, or 40%, to $4.6 million. The increase was primarily attributable to increases in gains on security sales, investment advisory fees, bank-owned life insurance income and deposit-service fees.

Net gains on sales of investment securities amounted to $478 thousand for the six months ended June 30, 2007, compared to net losses of $9 thousand in the comparable period. These gains/losses were realized on the sales of $4.6 million and $3.2 million during the six months ended June 30 2007 and 2006, respectively. The realized gains in the current period resulted from sales in the equity portfolio, which occurred mainly in the second quarter of the year, based on management s decision to take advantage of certain investment opportunities and a reallocation within the equity portfolio during these periods.

Investment advisory fees increased by $329 thousand, or 26%, for the six months ended June 30, 2007 compared to the same period in 2006. The change resulted from new business generated and increases in the value of assets under management due to increases in market values.

Bank-owned life insurance income increased by $214 thousand, or 261%, over the prior period due to income on additional policies purchased the second quarter of 2006.

Deposit-service fees increased by $200 thousand, or 24%, over the prior period due to an increase in transaction activity on commercial deposit accounts.

Non-Interest Expense

Non-interest expense increased $1.0 million, or 6%, compared to the prior year and amounted to $17.5 million for the period ended June 30, 2007. The increase was primarily attributable to increases in salaries and employee benefits, occupancy and other professional fees.

Salaries and employee benefits increased $513 thousand, or 5%, compared to the prior year, amounting to $10.6 million for the six months ended June 30, 2007. The increase primarily resulted from staffing increases necessary to support the company s strategic growth initiatives, salary adjustments and corresponding increases in health insurance premiums and taxes, and employee stock compensation expense, partially offset by a reduction in accruals related to performance-based incentive compensation.

Occupancy expense increased by $418 thousand, or 14%, to $3.4 million primarily due to ongoing increases in maintenance and service costs, and facility expansion necessary to support the company s growth and strategic initiatives.

Audit, Legal and other professional fees increased by $167 thousand, or 27%, to $792 thousand primarily due to other professional fees associated with a bank-wide efficiency initiative which began during the second quarter of 2007.

Accounting Policies/Critical Accounting Estimates

The company has not changed its significant accounting and reporting policies from those disclosed in its 2006 Annual Report on Form 10-K. In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. These estimates and assumptions affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ should the assumptions and estimates used change over time.

As discussed in the company s 2006 Annual Report on Form 10-K, the two most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses and the impairment valuation of goodwill. Refer to note 1 to the company s consolidated financial statements included in the company s 2006 Annual Report on Form 10-K for significant accounting policies.

Accounting Rule Changes

In September 2006 the FASB s Emerging Issues Task Force reached a consensus regarding Issue No. 06-4 (EITF No. 06-4) Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements. The Task Force affirmed that an employer should recognize a liability for future benefits associated with an endorsement split-dollar life insurance arrangement that provides a benefit to an employee that extends to postretirement periods. The liability and related compensation cost are to be determined in accordance with the appropriate previously issued financial standards. The Task Force concluded that this Issue should be effective through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption, or (b) a change in accounting principle through retrospective application to all prior periods. The Task Force reached a consensus that this Issue should be effective for fiscal years beginning after December 15, 2007. Management is in the process of determining the impact that adoption of EITF No. 06-4 will have on the company s financial position and results of operation.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157). This Statement provides a single definition of fair value based on the exchange price notion and establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), with the intention to increase consistency and comparability in fair value measurements. This Standard also expands the required disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice related to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. This Statement establishes a fair value hierarchy segregating fair value measurements using (Level 1) quoted market prices in active markets for identical assets or liabilities; (Level 2) significant other observable inputs; (Level 3) significant unobservable inputs. The expanded disclosures focus on the inputs used to measure fair value and the effects of the measurements on earnings within Level 3 of the fair value hierarchy. SFAS No. 157 is effective for fiscal years that begin after November 15, 2007, and interim periods within those fiscal years. Management does not anticipate that the adoption of SFAS No. 157 will have a material impact on the company s financial position or results of operation.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment for FASB Statement No. 115 . This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement allows the fair value option to be applied to eligible items, irrevocably, on an instrument by instrument basis with unrealized gains and losses on the instruments reported in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years that begin after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 157. This statement permits application to eligible items existing at the effective date (or early adoption date). Management expects to adopt SFAS No 159 as of the effective date and does not anticipate that the adoption will have a material impact on the company s financial position or results of operation.

Item 3 Quantitative and Qualitative Disclosures About Market Risk

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

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

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

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

There have been no material changes in the results of the company s net interest income sensitivity analysis as reported in the company s Annual Report on Form 10-K for the year ended December 31, 2006. At June 30, 2007 management considers the company s primary interest rate risk exposure to be margin compression that may result from changes in interest rates and/or changes in the mix of the company s balance sheet components. Specifically, these components include fixed versus variable rate loans and investments on the asset side, and higher cost deposits and borrowings versus lower cost deposits on the liability side.

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

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

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

Under a declining yield curve scenario, margin compression will eventually occur as the yield on interest earning assets decreases more rapidly than decreases in funding costs. The primary causes would be the impact of interest rate decreases (including decreases in the prime rate) on adjustable rate loans and the fact that decreases in deposit rates may be limited.

The company is currently experiencing aspects of the flat and inverted yield curve scenarios. The Federal Open Market Committee of the Federal Reserve Board has not adjusted the fed funds target rate since June of 2006 after increasing the rate 425 basis points over a two-year period. Initially, the company s net interest margin increased as loan yields re-priced more quickly than did liabilities. Once the Federal Reserve Board stopped increasing rates however, liability costs increased more

rapidly than loan yields, resulting in a decreasing net interest margin. The increase in funding costs has been further intensified by market competition and heightened interest sensitivity by depositors, further narrowing margin spread.

Item 4 Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

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

Changes in Internal Control over Financial Reporting

There has been no change in the company s internal control over financial reporting that has occurred during the company s most recent fiscal quarter (i.e., the three months ended June 30, 2007) that has materially affected, or is reasonably likely to materially affect, such internal controls.

PART II OTHER INFORMATION

Item 1 - Legal Proceedings

There are no material pending legal proceedings to which the company or its subsidiaries are a party, other than ordinary routine litigation incidental to the business of the company. Management believes the results of any current pending litigation would be immaterial to the consolidated financial condition or results of operations of the company.

Item 1A Risk Factors

Management believes that there have been no material changes in the company s risk factors as reported in the Annual Report on Form 10-K for the year ended December 31, 2006.

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

The company has not sold any equity securities that were not registered under the Securities Act of 1933 during the three months ended June 30, 2007. Neither the company nor any affiliated purchaser (as defined in the SEC s Rule 10b-18(a)(3)) has repurchased any of the company s outstanding shares, nor caused any such shares to be repurchased on its behalf, during the three months ended June 30, 2007.

Item 3 - Defaults upon Senior Securities

Not Applicable

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

At the annual meeting of shareholders, held on May 1, 2007, holders of the company s common stock elected all of the Board s nominees to the Board of Directors, approved amendments of the company s Restated Articles of Organization to increase the number of shares of common stock that the company is authorized to issue from 10,000,000 shares to 20,000,000 shares, and ratified the appointment of KPMG LLP as the company s independent registered public accounting firm for the fiscal year ending December 31, 2007. Votes were cast as follows:

1. To elect five Directors of the company, each for a three-year term:

Nominee	For	Withheld
Nancy L. Donahue	7,184,612	95,327
George L. Duncan	7,275,902	4,038
Eric W. Hanson	7,273,598	6,341
Carol L. Reid	7,227,812	52,127
Michael A. Spinelli	7,225,812	54,127

2. To amend the company s Restated Articles of Organization:

For	Against	Abstain
7,139,651	114,597	25,691

3. To ratify the Audit Committee s appointment of KPMG LLP as the company s independent registered public accounting firm for the fiscal year ending December 31, 2007.

For	Against	Abstain
7,177,619	71,947	30,373

Item 5 - Other Information

Not Applicable

Item 6 - Exhibits

Exhibit No. and Description

3.1 Articles of Amendment to Restated Articles of Organization of the company, as filed with Massachusetts Secretary of State on May 18, 2007.

31.1 Certification of Principal Executive Officer under Securities Exchange Act Rule 13a-14(a)

31.2 Certification of Principal Financial Officer under Securities Exchange Act Rule 13a-14(a)

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

SIGNATURES

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

ENTERPRISE BANCORP, INC.

DATE: August 8, 2007

By: /s/ James A. Marcotte
James A. Marcotte

Executive Vice President,
Chief Financial Officer and Treasurer
(Principal Financial Officer)

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