

ENTERPRISE BANCORP INC /MA/

Form 10-Q

November 08, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2013

Commission File Number: 001-33912

Enterprise Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Massachusetts

(State or other jurisdiction of
incorporation or organization)

04-3308902

(I.R.S. Employer Identification No.)

222 Merrimack Street, Lowell, Massachusetts

(Address of principal executive offices)

(978) 459-9000

(Registrant's telephone number, including area code)

01852

(Zip code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

As of November 4, 2013, there were 9,966,167 shares of the issuer's common stock outstanding- Par Value \$0.01 per share

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PART I-FINANCIAL INFORMATION

Item 1 - Financial Statements

ENTERPRISE BANCORP, INC.

Consolidated Balance Sheets

(Dollars in thousands)	September 30, 2013 (Unaudited)	December 31, 2012
Assets		
Cash and cash equivalents:		
Cash and due from banks	\$48,960	\$38,007
Interest-earning deposits	33,944	12,218
Fed funds sold	26,003	2,510
Total cash and cash equivalents	108,907	52,735
Investment securities at fair value	195,418	184,464
Federal Home Loan Bank Stock	4,324	4,260
Loans held for sale	1,061	8,557
Loans, less allowance for loan losses of \$25,999 at September 30, 2013 and \$24,254 at December 31, 2012, respectively	1,446,697	1,335,401
Premises and equipment	28,860	27,206
Accrued interest receivable	5,835	5,828
Deferred income taxes, net	13,489	12,548
Bank-owned life insurance	15,789	15,443
Prepaid income taxes	736	174
Prepaid expenses and other assets	5,777	13,454
Goodwill	5,656	5,656
Total assets	\$1,832,549	\$1,665,726
Liabilities and Stockholders' Equity		
Liabilities		
Deposits	\$1,653,947	\$1,475,027
Borrowed funds	1,880	26,540
Junior subordinated debentures	10,825	10,825
Accrued expenses and other liabilities	17,393	13,182
Accrued interest payable	267	603
Total liabilities	\$1,684,312	\$1,526,177
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; 9,964,730 issued and outstanding at September 30, 2013 (including 169,693 shares of unvested participating restricted awards) and 9,676,477 shares issued and outstanding at December 31, 2012 (including 154,186 shares of unvested participating restricted awards)	100	97
Additional paid-in-capital	52,092	48,194
Retained earnings	93,815	87,159
Accumulated other comprehensive income	2,230	4,099
Total stockholders' equity	\$148,237	\$139,549
Total liabilities and stockholders' equity	\$1,832,549	\$1,665,726

See the 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 September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Interest and dividend income:				
Loans and loans held for sale	\$17,104	\$16,324	\$50,130	\$48,510
Investment securities	823	833	2,427	2,467
Other interest-earning assets	19	25	40	68
Total interest and dividend income	17,946	17,182	52,597	51,045
Interest expense:				
Deposits	1,013	1,228	3,043	4,133
Borrowed funds	6	12	92	41
Junior subordinated debentures	294	294	883	883
Total interest expense	1,313	1,534	4,018	5,057
Net interest income	16,633	15,648	48,579	45,988
Provision for loan losses	583	800	1,900	2,150
Net interest income after provision for loan losses	16,050	14,848	46,679	43,838
Non-interest income:				
Investment advisory fees	1,102	925	3,163	2,880
Deposit and interchange fees	1,229	1,153	3,518	3,281
Income on bank-owned life insurance, net	111	122	346	384
Net gains on sales of investment securities	83	38	1,031	197
Gains on sales of loans	171	211	728	669
Other income	472	536	1,574	1,500
Total non-interest income	3,168	2,985	10,360	8,911
Non-interest expense:				
Salaries and employee benefits	8,548	8,190	25,247	23,534
Occupancy and equipment expenses	1,449	1,400	4,508	4,244
Technology and telecommunications expenses	1,085	1,122	3,441	3,198
Advertising and public relations expenses	481	408	2,047	1,694
Audit, legal and other professional fees	439	336	1,264	1,306
Deposit insurance premiums	287	283	820	843
Supplies and postage expenses	232	232	719	659
Investment advisory and custodial expenses	134	110	394	319
Other operating expenses	1,126	929	3,256	3,003
Total non-interest expense	13,781	13,010	41,696	38,800
Income before income taxes	5,437	4,823	15,343	13,949
Provision for income taxes	1,904	1,760	5,298	4,808
Net income	\$3,533	\$3,063	\$10,045	\$9,141
Basic earnings per share	\$0.36	\$0.32	\$1.02	\$0.96
Diluted earnings per share	\$0.35	\$0.32	\$1.01	\$0.95
Basic weighted average common shares outstanding	9,932,060	9,613,386	9,824,984	9,567,294
Diluted weighted average common shares outstanding	10,026,588	9,692,290	9,909,019	9,639,122

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.
 Consolidated Statements of Comprehensive Income
 (Unaudited)

(Dollars in thousands)	Three months ended September 30,		Nine months ended September 30,		
	2013	2012	2013	2012	
Net income	\$3,533	\$3,063	\$10,045	\$9,141	
Other comprehensive (loss) income, net of taxes:					
Gross unrealized holding (losses) gains on investments arising during the period	431	861	(1,955	) 1,677
Income tax benefit (expense)	(136) (307) 748	(594)
Net unrealized holding (losses) gains, net of tax	295	554	(1,207	) 1,083
Less: Reclassification adjustment for net gains included in net income					
Net realized gains on sales of securities during the period	83	38	1,031	197	
Income tax expense	(30) (12) (369) (68)
Reclassification adjustment for gains realized, net of tax	53	26	662	129	
Total other comprehensive (loss) income	242	528	(1,869	) 954
Comprehensive income	\$3,775	\$3,591	\$8,176	\$10,095	

See the accompanying notes to the unaudited consolidated financial statements.

ENTERPRISE BANCORP, INC.

Consolidated Statement of Changes in Stockholders' Equity

(Unaudited)

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at December 31, 2012	\$97	\$48,194	\$87,159	\$ 4,099	\$139,549
Net income			10,045		10,045
Other comprehensive loss, net				(1,869)	(1,869)
Tax benefit from exercise of stock options		24			24
Common stock dividend paid (\$0.345 per share)			(3,389)		(3,389)
Common stock issued under dividend reinvestment plan	1	947			948
Stock-based compensation	1	1,273			1,274
Stock options exercised, net	1	1,654			1,655
Balance at September 30, 2013	\$100	\$52,092	\$93,815	\$ 2,230	\$148,237

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.
 Consolidated Statements of Cash Flows
 (Unaudited)

	Nine months ended September 30,	
(Dollars in thousands)	2013	2012
Cash flows from operating activities:		
Net income	\$10,045	\$9,141
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,900	2,150
Depreciation and amortization	3,686	3,291
Stock-based compensation expense	1,239	956
Mortgage loans originated for sale	(31,751	) (35,041
Proceeds from mortgage loans sold	39,975	35,085
Net gains on sales of loans	(728	) (669
Net gains on sales of OREO	(121	) (45
Net gains on sales of investments	(1,031	) (197
Income on bank-owned life insurance, net	(346	) (384
OREO fair value adjustment	23	—
Changes in:		
Accrued interest receivable	(7	) (9
Prepaid expenses and other assets	6,686	(1,807
Deferred income taxes	176	(245
Accrued expenses and other liabilities	3,599	(1,568
Accrued interest payable	(336	) (428
Net cash provided by operating activities	33,009	10,230
Cash flows from investing activities:		
Proceeds from sales of investment securities available for sale	8,293	3,240
Net proceeds (purchase) from FHLB capital stock	(64	) 480
Proceeds from maturities, calls and pay-downs of investment securities	13,730	22,332
Purchase of investment securities	(35,301	) (70,115
Net increase in loans	(113,364	) (54,719
Additions to premises and equipment, net	(4,281	) (2,730
Proceeds from OREO sales and payments	652	885
Purchase of OREO	—	(245
Net cash used in investing activities	(130,335	) (100,872
Cash flows from financing activities:		
Net increase in deposits	178,920	137,268
Net decrease in borrowed funds	(24,660	) (1,500
Cash dividends paid	(3,389	) (3,155
Proceeds from issuance of common stock	948	956
Proceeds from the exercise of stock options	1,655	211
Tax benefit from the exercise of stock options	24	1
Net cash provided by financing activities	153,498	133,781
Net increase in cash and cash equivalents	56,172	43,139
Cash and cash equivalents at beginning of period	52,735	39,131
Cash and cash equivalents at end of period	\$108,907	\$82,270

Supplemental financial data:

Cash Paid For: Interest	\$4,354	\$5,485
Cash Paid For: Income Taxes	5,634	5,485

Supplemental schedule of non-cash investing activity:

Purchase of investment securities not yet settled	400	5,548
Transfer from loans to other real estate owned	168	400
Capital expenditures incurred not yet paid	247	—

See accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements

(1) Organization of Holding Company and Basis of Presentation

The accompanying unaudited consolidated financial statements and these notes should be read in conjunction with the December 31, 2012 audited consolidated financial statements and notes thereto contained in the 2012 Annual Report on Form 10-K of Enterprise Bancorp, Inc. (the "Company" or "Enterprise"), a Massachusetts corporation, as filed with the Securities and Exchange Commission (the "SEC") on March 15, 2013. The Company has not changed its reporting policies from those disclosed in its 2012 Annual Report on Form 10-K.

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and the instructions for Form 10-Q through the rules and interpretive releases of the SEC under federal securities law. In the opinion of management, the accompanying unaudited consolidated interim 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 unaudited consolidated interim financial statements. Certain previous year amounts in the unaudited consolidated interim financial statements and accompanying footnotes have been reclassified to conform to the current year's presentation. Interim results are not necessarily indicative of results to be expected for the entire year.

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

The Bank's subsidiaries include Enterprise Insurance Services, LLC and Enterprise Investment Services, LLC, organized under the laws of the State of Delaware for the purposes of engaging in insurance sales activities and offering non-deposit investment products and services, respectively. In addition, the Bank has the following subsidiaries that are incorporated in the Commonwealth of Massachusetts and classified as security corporations in accordance with applicable Massachusetts General Laws: Enterprise Security Corporation; Enterprise Security Corporation II; and Enterprise Security Corporation III, which hold various types of qualifying securities. The security corporations are limited to conducting securities investment activities that the Bank itself would be allowed to conduct under applicable laws.

Pursuant to the Accounting Standards Codification ("ASC") Topic 810 "Consolidation of Variable Interest Entities," issued by the Financial Accounting Standards Board ("FASB") (originally issued as Financial Interpretation No. 46R) in December 2003, the Company carries Junior Subordinated Debentures as a liability on its consolidated financial statements, along with the related interest expense. The debentures were issued by a statutory business trust (the "Trust") created by the Company in March 2000 under the laws of the State of Delaware, and the trust preferred securities issued by the Trust, and the related non-interest expense, are excluded from the Company's consolidated financial statements.

Comprehensive income is defined as all changes to equity except investments by and distributions to stockholders. Net income is one component of comprehensive income, with other components referred to in the aggregate as other comprehensive income. The Company's only other comprehensive income component is the net unrealized holding gains or losses on investments available-for-sale. Pursuant to Accounting Standards Update ("ASU") No. 2013-02, Comprehensive Income (Topic 220): Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income, the Company initially excludes these unrealized holding gains and losses from net income; however, they are later reported as reclassifications out of accumulated other comprehensive income into net income when the securities

are sold. When securities are sold, the reclassification of realized gains and losses on available-for-sale securities are included on the Consolidated Statements of Income under the "non-interest income" subheading on the line item "net gains on sales of investment securities" and the related income tax expense is included in the line item "provision for income taxes," both of which are also detailed on the Consolidated Statements of Comprehensive Income under the subheading "reclassification adjustment for net gains included in net income."

The Company has 21 full service branches serving the Merrimack Valley and North Central regions of Massachusetts and Southern New Hampshire. The Company is currently constructing a branch office in Nashua, NH with an anticipated opening in the fourth quarter of 2013. Through the Bank and its subsidiaries, the Company offers a range of commercial and consumer loan products, deposit and cash management products, investment advisory and wealth management, and insurance services. The services offered through the Bank and subsidiaries are managed as one strategic unit and represent the Company's only reportable operating segment.

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

(2) Critical Accounting Estimates

As discussed in the Company's 2012 Annual Report on Form 10-K, the three most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, impairment review of investment securities and the impairment review of goodwill. Refer to Note 1, "Summary of Significant Accounting Policies," to the Company's consolidated financial statements included in the Company's 2012 Annual Report on Form 10-K for significant accounting policies. The Company has not changed its significant accounting policies from those disclosed in its 2012 Annual Report filed on Form 10-K.

In preparing the consolidated financial statements in conformity with GAAP, 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 values of assets and liabilities as of the balance sheet date and income and expenses for the period then ended. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates should the assumptions and estimates used change over time due to changes in circumstances. Changes in those estimates resulting from continuing change in the economic environment and other factors will be reflected in the financial statements and results of operations in future periods.

(3) Recent Accounting Pronouncements

In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220): Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income. The new amendment requires an organization to present the effects on the income statement of significant amounts reclassified out of accumulated other comprehensive income or cross-reference to other disclosures currently required under GAAP for certain items. The new amended standard is effective for annual periods beginning after December 15, 2012, and interim periods within those annual periods. As this ASU addresses only disclosure requirements, the adoption in the first quarter of 2013 did not have a material impact on the Company's financial statements. See Note 1, "Organization of Holding Company and Basis of Presentation," for the disclosure of the effects of amounts reclassified out of accumulated other comprehensive income.

(4) Investments

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

(Dollars in thousands)	September 30, 2013			Fair Value
	Amortized cost	Unrealized gains	Unrealized losses	
Federal agency obligations ⁽¹⁾	\$63,043	\$174	\$33	\$63,184
Federal agency mortgage backed securities (MBS) ⁽¹⁾	56,772	568	1,329	56,011
Municipal securities	57,442	1,781	327	58,896
Corporate bonds	4,763	23	55	4,731
Certificates of deposit	693	—	6	687
Total fixed income securities	182,713	2,546	1,750	183,509
Equity investments	9,324	2,605	20	11,909
Total available for sale securities, at fair value	\$192,037	\$5,151	\$1,770	\$195,418

(Dollars in thousands)	December 31, 2012			Fair Value
	Amortized cost	Unrealized gains	Unrealized losses	
Federal agency obligations ⁽¹⁾	\$65,247	\$438	\$—	\$65,685
Federal agency mortgage backed securities (MBS) ⁽¹⁾	48,429	1,287	42	49,674
Municipal securities	53,437	3,103	17	56,523
Corporate bonds	1,905	15	6	1,914
Total fixed income securities	169,018	4,843	65	173,796
Equity investments	9,080	1,622	34	10,668
Total available for sale securities, at fair value	\$178,098	\$6,465	\$99	\$184,464

These categories may include investments issued or guaranteed by government sponsored enterprises such as Fannie Mae (FNMA), Freddie Mac (FHLMC), Ginnie Mae (GNMA), Federal Farm Credit Bank, or one of several ⁽¹⁾ Federal Home Loan Banks. All agency MBS/Collateralized Mortgage Obligations ("CMOs") investments owned by the Company are backed by residential mortgages.

Included in the carrying amount of the federal agency MBS category were CMOs totaling \$18.9 million and \$23.6 million at September 30, 2013 and December 31, 2012, respectively.

Certificates of Deposit (CDs) represent term deposits issued by banks that are subject to FDIC insurance and purchased on the open market. The Company utilizes these CDs as an alternative investment option to holding short-term excess cash in lower yielding overnight deposit accounts. These securities have maturities of less than a year and the market value approximates the carrying value.

At September 30, 2013, the equity portfolio consisted primarily of investments in a diversified group of mutual funds, with a small portion of the portfolio (approximately 14%) invested in exchange traded funds or individual common stock of entities in the financial services industry.

The net unrealized gain or loss in the Company's fixed income portfolio fluctuates as market interest rates rise and fall. Due to the fixed rate nature of this portfolio, as market rates fall, the value of the portfolio rises, and as market

rates rise, the value of the portfolio declines. The unrealized gains or losses on fixed income investments will also decline as the securities approach maturity, or if the issuer is credit impaired. Unrealized gains or losses will be recognized in the statements of

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income if the securities are sold. However, if an unrealized loss on the fixed income portfolio is deemed to be other than temporary, the credit loss portion is charged to earnings and the noncredit portion is recognized in accumulated other comprehensive income. Net unrealized appreciation and depreciation on investments available for sale, net of applicable income taxes, are reflected as a component of accumulated other comprehensive income.

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

Management regularly reviews the portfolio for securities with unrealized losses that are other-than-temporarily impaired. During the nine months ended September 30, 2013 and 2012, the Company did not record any fair value impairment charges on its investments. As of September 30, 2013, there were a total of 66 investments (fixed income and equity, excluding CDs), with a fair market value of \$57.6 million, in an unrealized loss position totaling \$1.8 million. As of September 30, 2013, these unrealized loss positions were less than twelve months in duration. Management attributes these unrealized losses to increases in current market yields compared to the yields at the time the investments were purchased by the Company, and management does not consider these investments to be other-than-temporarily impaired at September 30, 2013 because the decline in market value is not attributable to credit quality for fixed income securities, or a fundamental deterioration in the equity fund or issuers, and because the Company does not intend to, and it is more likely than not that it will not be required to, sell those investments prior to a market price recovery or maturity.

In assessing MBS investments and Federal Agency obligations, the contractual cash flows of these investments are guaranteed by an agency of the U.S. Government, and the agency that issued these securities is sponsored by the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the par value of the Company's investments. Management's assessment of other fixed income investments within the portfolio includes reviews of market pricing, ongoing credit quality evaluations, assessment of the investment's materiality, and duration of the unrealized loss position. In addition, the Company utilizes an outside registered investment adviser to manage the corporate and municipal bond portfolios, within prescribed guidelines set by management. At September 30, 2013, the Company's corporate and municipal bond portfolios did not contain any securities below investment grade, as reported by major credit rating agencies. For equities and funds, management's assessment includes the severity of the declines, whether it is unlikely that the security or fund will completely recover its unrealized loss within a reasonable time period and if the equity security or fund exhibits fundamental deterioration.

The small portion of the portfolio invested in short-term CDs was also in an unrealized loss position at September 30, 2013 due to market rates. The unrealized loss was not considered to be material and the securities are expected to be settled at par value at maturity.

The contractual maturity distribution at September 30, 2013 of total fixed income investments, excluding CDs which mature in less than one year, is as follows:

	Within One Year		After One, But Within Five Years		After Five, But within Ten Years		After Ten Years	
	Amortized Cost	Yields	Amortized Cost	Yields	Amortized Cost	Yields	Amortized Cost	Yields
At amortized cost:								
Federal agency obligations	\$ 15,507	0.79 %	\$ 47,536	0.90 %	\$ —	— %	\$ —	— %
MBS	—	— %	37	1.51 %	11,978	2.85 %	44,757	2.32 %
Municipal securities	2,836	2.12 %	17,558	2.90 %	30,692	4.43 %	6,356	6.24 %
Corporate bonds	—	— %	3,288	2.61 %				