

ENTERPRISE FINANCIAL SERVICES CORP

Form 10-Q

November 08, 2007

---

**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, 2007

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-15373

**ENTERPRISE FINANCIAL SERVICES CORP**

**Incorporated in the State of Delaware  
I.R.S. Employer Identification # 43-1706259  
Address: 150 North Meramec  
Clayton, MO 63105  
Telephone: (314) 725-5500**

---

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, and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

Large accelerated filer: ☐

Accelerated filer: ☒

Non-accelerated filer: ☐

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 1, 2007, the Registrant had 12,427,583 shares of outstanding common stock.

---

---

---

**ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES  
TABLE OF CONTENTS**

**PART I - FINANCIAL INFORMATION**

Page

Item 1. Financial Statements

Consolidated Balance Sheets (Unaudited)	1
Consolidated Statements of Income (Unaudited)	2
Consolidated Statements of Shareholders' Equity (Unaudited)	3
Consolidated Statements of Comprehensive Income (Unaudited)	3
Consolidated Statements of Cash Flows (Unaudited)	4
Notes to Consolidated Unaudited Financial Statements	5
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3. Quantitative and Qualitative Disclosures About Market Risk	26
Item 4. Controls and Procedures	27
<b>PART II - OTHER INFORMATION</b>	
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	27
Item 6. Exhibits	28
Signatures	29
Certifications	30

**PART I - ITEM 1 - FINANCIAL STATEMENTS**  
**ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES**  
Consolidated Balance Sheets

<i>(In thousands)</i>	(Unaudited) At September 30, 2007	(Audited) At December 31, 2006
<b>Assets</b>		
Cash and due from banks	\$ 47,593	\$ 41,558
Federal funds sold	2,585	7,066
Interest-bearing deposits	1,100	1,669
Total cash and cash equivalents	51,278	50,293
Investments in debt and equity securities available for sale, at estimated fair value	122,204	111,210
Loans held for sale	1,117	2,602
Portfolio loans	1,558,885	1,311,723
Less: Allowance for loan losses	19,754	16,988
Portfolio loans, net	1,539,131	1,294,735
Other real estate	857	1,500
Fixed assets, net	22,487	17,050
Accrued interest receivable	9,756	7,995
Goodwill	55,661	29,983

## Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

Intangibles, net	6,463	5,789
Prepaid expenses and other assets	19,305	14,430
<b>Total assets</b>	<b>\$ 1,828,259</b>	<b>\$ 1,535,587</b>
<b>Liabilities and Shareholders' Equity</b>		
Deposits:		
Demand	\$ 212,903	\$ 234,849
Interest-bearing transaction accounts	120,069	111,725
Money market accounts	584,287	553,251
Savings	11,939	3,696
Certificates of deposit:		
\$100 and over	371,335	296,916
Other	145,902	115,071
<b>Total deposits</b>	<b>1,446,435</b>	<b>1,315,508</b>
Subordinated debentures	56,807	35,054
Federal Home Loan Bank advances	131,746	26,995
Other borrowings	6,613	9,757
Notes payable	4,000	4,000
Accrued interest payable	4,156	3,468
Accounts payable and accrued expenses	9,259	7,811
<b>Total liabilities</b>	<b>1,659,016</b>	<b>1,402,593</b>
Minority interest in equity of consolidated subsidiary	-	-
Shareholders' equity:		
Common stock, \$.01 par value;		
30,000,000 shares authorized; 12,416,317 and		
11,539,539 shares issued, respectively	124	115
Treasury stock, at cost; 28,000 and 0 shares, respectively	(642)	-
Additional paid in capital	103,566	78,026
Retained earnings	66,268	55,445
Accumulated other comprehensive loss	( 73)	( 592)
<b>Total shareholders' equity</b>	<b>169,243</b>	<b>132,994</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,828,259</b>	<b>\$ 1,535,587</b>

See accompanying notes to consolidated financial statements

**ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES**  
Consolidated Statements of Income (Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
<i>(In thousands, except per share data)</i>				
Interest income:				
Interest and fees on loans	\$ 30,415	\$ 24,847	\$ 86,542	\$ 63,288
Interest on debt and equity securities:				
Taxable	1,139	1,087	3,398	3,132

## Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

Nontaxable	9	9	25	26
Interest on federal funds sold	93	310	230	755
Interest on interest-bearing deposits	15	9	47	31
Dividends on equity securities	136	102	358	220
Total interest income	31,807	26,364	90,600	67,452
Interest expense:				
Interest-bearing transaction accounts	803	634	2,363	1,657
Money market accounts	6,037	5,104	17,509	13,436
Savings	37	17	96	42
Certificates of deposit:				
\$100 and over	4,854	3,993	13,674	8,390
Other	2,098	1,275	5,912	2,508
Subordinated debentures	1,038	624	2,822	1,692
Federal Home Loan Bank advances	1,042	683	3,024	2,195
Notes payable and other borrowings	93	195	350	294
Total interest expense	16,002	12,525	45,750	30,214
Net interest income	15,805	13,839	44,850	37,238
Provision for loan losses	600	240	2,165	1,777
Net interest income after provision for loan losses	15,205	13,599	42,685	35,461
Noninterest income:				
Wealth Management revenue	3,495	3,468	9,916	10,018
Service charges on deposit accounts	839	603	2,302	1,636
Other service charges and fee income	225	157	675	419
Gain on sale of mortgage loans	34	95	229	165
Gain (loss) on sale of other real estate	7	-	(5)	-
Miscellaneous income	38	2	325	16
Total noninterest income	4,638	4,325	13,442	12,254
Noninterest expense:				
Employee compensation and benefits	7,523	6,754	21,972	18,398
Occupancy	995	737	2,898	1,957
Furniture and equipment	370	317	1,055	806
Data processing	488	386	1,403	1,010
Meals and entertainment	303	366	1,191	981
Amortization of intangibles	410	336	1,194	792
Other	2,113	2,056	6,720	5,622
Total noninterest expense	12,202	10,952	36,433	29,566
Minority interest in net income of consolidated subsidiary	-	(434)	-	(826)
Income before income tax expense	7,641	6,538	19,694	17,323
Income tax expense	2,642	2,357	7,022	6,242
Net income	\$ 4,999	\$ 4,181	\$ 12,672	\$ 11,081
Per share amounts:				
Basic earnings per share	\$ 0.40	\$ 0.37	\$ 1.04	\$ 1.03
Basic weighted average common shares outstanding	12,380	11,397	12,189	10,787
Diluted earnings per share	\$ 0.40	\$ 0.35	\$ 1.01	\$ 0.99
Diluted weighted average common shares outstanding	12,652	11,823	12,522	11,190

See accompanying notes to consolidated financial statements

**ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES**  
Consolidated Statements of Shareholders' Equity (Unaudited)

	Common stock		Additional paid in capital		Retained earnings	Accumulated other comprehensive income (loss)	Treasury Shares
<i>(in thousands, except shares)</i>	Shares	Amount					
<b>Balance December 31, 2006</b>	11,539,539	\$ 115	\$ 78,026	\$ 55,445	\$ (592)		
Net income	-	-	-	12,672	-	-	-
Change in fair value of investment securities, net of tax	-	-	-	-	519	-	-
Total comprehensive income	-	-	-	-	-	-	-
Cumulative effect of adoption of FIN 48	-	-	-	138	-	-	-
Dividends declared (\$0.1575 per share)	-	-	-	(1,987)	-	-	-
Common stock issued under stock option plans, net of restricted share unit cancellations	124,271	1	1,385	-	-	-	-
Purchase of Treasury Stock	-	-	-	-	-	-	28,000
Income tax benefit from stock options exercised and vesting of restricted share units	-	-	340	-	-	-	-
Acquisition of Clayco Banc Corporation	698,733	6	21,192	-	-	-	-
Additional contingent shares issued in connection with acquisition of NorthStar	49,416	1	1,283	-	-	-	-
Issuance of common stock shares under director stock plan	4,358	1	130	-	-	-	-
Noncash compensation attributed to stock option grants	-	-	275	-	-	-	-
Noncash compensation attributed to restricted share units	-	-	935	-	-	-	-
<b>Balance September 30, 2007</b>	12,416,317	124	103,566	66,268	(73)	28,000	

See accompanying notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income (Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
<i>(in thousands)</i>	2007	2006	2007	2006
Net income	\$ 4,999	\$ 4,181	\$ 12,672	\$ 11,081
Other comprehensive income:				
Unrealized gain on investment securities arising during the period, net of tax	410	908	519	204
Unrealized gain on cash flow type derivative instruments arising during the period, net of tax	-	-	-	263
Total comprehensive income	410	908	519	467
	\$ 5,409	\$ 5,089	\$ 13,191	\$ 11,548

See accompanying notes to consolidated financial statements.

**ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES**  
Consolidated Statements of Cash Flows (Unaudited)

<i>(in thousands)</i>	Nine months ended September 30,	
	2007	2006
<b>Cash flows from operating activities:</b>		
Net income	\$ 12,672	\$ 11,081
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	1,806	1,193
Provision for loan losses	2,165	1,777
Net (accretion) amortization of debt and equity securities	(139)	57
Amortization of intangible assets	1,194	792
Mortgage loans originated	(66,825)	(43,348)
Proceeds from mortgage loans sold	68,539	41,257
Gain on sale of mortgage loans	(229)	(165)
Loss on sale of other real estate	5	-
Excess tax benefits of share-based compensation	(340)	(274)
Share-based compensation	1,210	685
Changes in:		
Accrued interest receivable	(702)	(949)
Accrued interest payable and other liabilities	(2,025)	(1,059)
Other, net	(1,751)	(1,135)
Net cash provided by operating activities	15,580	9,912
<b>Cash flows from investing activities:</b>		
Cash paid for acquisition, net of cash and cash equivalents received	(7,873)	(7,323)
Net increase in loans	(82,270)	(101,278)
Purchases of available for sale debt and equity securities	(42,853)	(40,676)
Proceeds from redemption of equity securities	10,459	6,341
Proceeds from maturities and principal paydowns on available for sale debt and equity securities	41,041	63,496
Purchase of limited partnership interests	(929)	-
Proceeds from sales of other real estate	4,878	-
Recoveries of loans previously charged off	278	288
Purchases of fixed assets	(2,985)	(5,043)
Net cash used in investing activities	(80,254)	(84,195)
<b>Cash flows from financing activities:</b>		
Net decrease in noninterest-bearing deposit accounts	(37,097)	(23,965)
Net increase in interest-bearing deposit accounts	17,069	32,016
Proceeds from issuance of subordinated debentures	18,557	4,124
Paydown of subordinated debentures	(4,124)	-
Proceeds from Federal Home Loan Bank advances	1,035,325	718,533
Repayments of Federal Home Loan Bank advances	(960,155)	(708,955)
Net decrease in other borrowings	(3,144)	(8,041)
Proceeds from notes payable	2,750	10,000
Repayments on notes payable	(2,750)	(5,500)
Cash dividends paid on common stock	(1,987)	(1,460)

## Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

Excess tax benefits of share-based compensation	340	274
Proceeds from the issuance of common stock	131	86
Common stock repurchased	(642)	-
Proceeds from the exercise of common stock options	1,386	946
Net cash provided by financing activities	65,659	18,058
Net increase (decrease) in cash and cash equivalents	985	(56,225)
Cash and cash equivalents, beginning of year	50,293	118,911
<b>Cash and cash equivalents, end of period</b>	<b>\$ 51,278</b>	<b>\$ 62,686</b>
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 45,062	\$ 30,037
Income taxes	6,235	5,447
Noncash transactions:		
Common stock issued for acquisition	\$ 22,482	23,482
Transfer to other real estate owned in settlement of loans	3,457	-

See accompanying notes to consolidated financial statements.

4

### ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES Notes to Consolidated Financial Statements

#### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The more significant accounting policies used by the Company in the preparation of the consolidated financial statements are summarized below:

##### Basis of Financial Statement Presentation

Enterprise Financial Services Corp (the "Company" or "EFSC") is a financial holding company that provides a full range of banking and wealth management services to individuals and corporate customers located in the St. Louis and Kansas City metropolitan markets through its banking subsidiaries, Enterprise Bank & Trust (the "Bank") and Great American Bank ("Great American"). In addition, the Company owns 60% of Millennium Brokerage Group, LLC ("Millennium") through its wholly-owned subsidiary, Millennium Holding Company, Inc. Millennium is headquartered in Nashville, Tennessee and operates life insurance advisory and brokerage operations from thirteen offices serving life agents, banks, CPA firms, property and casualty groups, and financial advisors in 49 states.

On July 5, 2006, EFSC acquired NorthStar Bancshares Inc. and its wholly owned subsidiary, NorthStar Bank NA (collectively referred to as "NorthStar"). NorthStar was merged into and with Enterprise Bank & Trust on October 6, 2006. For more information, please refer to Note 2 Acquisitions below.

On February 28, 2007, EFSC completed its acquisition of Clayco Banc Corporation ("Clayco") and its wholly owned subsidiary, Great American Bank. For more information, please refer to Note 2 Acquisitions below.

In September 2007, the Company began repurchasing shares of its common stock. The Company intends to hold repurchased shares in treasury for general corporate purposes. Treasury shares are accounted for under the cost method and are included as a component of stockholders' equity.

The consolidated financial statements of the Company and its subsidiaries have been prepared in accordance with U.S. Generally Accepted Accounting Principles ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. They do not include all information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

The consolidated financial statements include the accounts of the Company, Bank (100% owned), Great American (100% owned) and Millennium (60% owned). Acquired businesses are included in the consolidated financial statements from the date of acquisition. All material intercompany accounts and transactions have been eliminated. Minority ownership interests are reported in our Consolidated Balance Sheets. The minority ownership interest of our earnings or loss, net of tax, is classified as "Minority interest in net income of consolidated subsidiary" in our Consolidated Statements of Income. For more information, please refer to "Minority Interest in Net Income of Consolidated Subsidiary" discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this report.

Operating results for the three and nine month periods ended September 30, 2007 are not necessarily indicative of the results that may be expected for any other interim period or for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. Certain reclassifications have been made to prior year balances to conform to the current year presentation. Such reclassifications had no effect on previously reported consolidated net income or shareholders' equity.

### **New Accounting Standards**

The Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an Interpretation of FAS No. 109, *Accounting for Income Taxes* on January 1, 2007. As a result of the implementation, the Company recognized a \$138,000 decrease in the liability for unrecognized tax benefits, which was accounted for as an increase to the January 1, 2007 balance of retained earnings. At January 1, 2007, the Company had \$2.1 million of unrecognized tax benefits, \$1.4 million of which would affect the effective tax rate if recognized. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense and classifies such interest and penalties in the liability for unrecognized tax benefits. As of September 30, 2007, the Company had approximately \$418,000 accrued for interest and penalties. During the third quarter of 2007, the Company reversed \$67,500 of various tax benefits related to certain federal tax items. The Company believes it is reasonably possible that an additional \$375,000 in unrecognized tax benefits primarily related to certain state tax items will be recognized during the fourth quarter of 2007 as a result of the expiration of certain statutes of limitations.

---

The tax years 2003 through 2006 remain open to examination by the state taxing jurisdictions to which the Company is subject. The tax years 2004 through 2006 remain open to examination by the federal taxing authorities to which the Company is subject.

In September 2006, the FASB issued FAS No. 157, *Fair Value Measurements*. FAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting standards, and expands disclosures about fair value measurements. FAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect that the adoption of FAS No. 157 will have a material impact on our financial condition or results of operations.

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. FAS No. 159 provides an option to report selected financial assets and liabilities at fair value. FAS No. 159 requires additional information that will help investors and other users of financial statements to more easily understand the effect of an entity's choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the entity has chosen to use fair value on the face of the balance sheet. FAS No. 159 does not eliminate disclosure requirements included in other accounting standards.

FAS No. 159 is effective as of the beginning of the fiscal year for fiscal years beginning after November 15, 2007. Early adoption is permitted provided, among other things, an entity elects to adopt within the first 120 days of that fiscal year. We did not early adopt FAS No. 159 and are currently evaluating the impact it might have on our consolidated financial statements upon adoption.

### **NOTE 2—ACQUISITIONS**

#### **Acquisition of Clayco Banc Corporation**

On February 28, 2007, the Company completed its acquisition of 100% of the total outstanding common stock of Kansas City-based Clayco Banc Corporation and its wholly owned subsidiary Great American Bank for \$37.0



## Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

million in EFSC common stock (60%) and cash (40%). The acquisition served to expand the Company's banking franchise in the greater Kansas City area. The purchase price for Clayco consisted of:

- \$14.8 million in cash;
- 731,692 shares of EFSC common stock valued at \$22.2 million based on the average closing share price of EFSC common stock, as quoted on NASDAQ, for the 20 trading days ending five days prior to the acquisition date.

On February 26, 2007, the Company issued \$14.0 million of trust preferred securities ("TRUPS") through a newly formed affiliated statutory trust, as further discussed in Note 9 – Subordinated Debentures below. The TRUPS proceeds were used to fund the cash portion of the Clayco transaction.

At the time of the acquisition, on a consolidated basis, Clayco had assets of \$201.9 million, loans, net of unearned discount, of \$167.0 million, deposits of \$150.7 million and shareholders' equity of \$12.8 million. The assets acquired and liabilities assumed were recorded at their estimated fair value on the acquisition date. The fair value adjustments represent current estimates and are subject to further adjustments as the valuation data is finalized. Goodwill, which is not deductible for tax purposes, was \$25.5 million. Core deposit intangibles were approximately \$1.9 million and will be amortized over ten years utilizing an accelerated method. Core deposit intangibles are not deductible for tax purposes.

Statement of Position 03-3 ("SOP 03-3") *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* applies to entities that acquire loans with evidence of deterioration of credit quality for which it is probable, at acquisition, that the acquiring enterprise will be unable to collect all contractually required payments receivable. At the time of acquisition, there were no loans with evidence of deterioration of credit quality within the scope of SOP 03-3.

### **Acquisition of NorthStar Bancshares, Inc.**

On July 5, 2006, the Company acquired NorthStar. As part of the acquisition, \$4.5 million of the \$36.0 purchase price was deposited into a "Reserved Credit Escrow" account pending the collection of certain loans. These amounts were considered "contingent consideration" under U.S. GAAP and therefore, were not recorded in common stock or additional paid in capital until the contingency was resolved. The Reserved Credit Escrow amount had scheduled release dates in January and July 2007 based on the receipt of principal payments or proceeds from the sale of several identified loans and other real estate. In January 2007, no proceeds were released. In July 2007, \$1.3 million of the escrow was released to the selling stockholders of NorthStar. This consisted of 49,416 shares of Enterprise common stock and \$6,400 in cash. The remaining balance of the escrow was released to Enterprise. With the contingency resolved, the Company has recorded the additional common stock, paid in capital and related goodwill.

6

---

### **NOTE 3 – GOODWILL AND INTANGIBLE ASSETS**

The tables below present an analysis of the goodwill and intangible asset activity for the periods presented.

<i>(in thousands)</i>	Goodwill
Balance at December 31, 2006	\$ 29,983
Acquisition-related adjustments (1)	470
Goodwill from purchase of Clayco	25,208
Balance at September 30, 2007	\$ 55,661

(1) Includes additional purchase accounting adjustments on the Clayco and NorthStar acquisitions necessary to reflect additional valuation data since the acquisition date. Also refer to contingent share discussion in Note 2.

Customer  
&  
trade name

<i>(in thousands)</i>		Core deposit	Intangibles, net
	intangibles	intangibles	
Balance at December 31, 2006	\$ 3,636	\$ 2,153	\$ 5,789
Intangibles from purchase of Clayco	-	1,868	1,868
Amortization expense	(684)	(510)	(1,194)
Balance at September 30, 2007	\$ 2,952	\$ 3,511	\$ 6,463

The following table reflects the expected amortization schedule for the intangible assets (in thousands) at September 30, 2007.

Year	Amount
2007 remaining	\$ 410
2008	1,590
2009	1,513
2010	1,422
2011	446
After 2011	1,082
	\$ 6,463

7

#### NOTE 4 EARNINGS PER SHARE

Net income per share is calculated as follows:

<i>(in thousands, except per share data)</i>	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Net income, as reported	\$ 4,999	\$ 4,181	\$ 12,672	\$ 11,081
Weighted average common shares outstanding	12,380	11,397	12,189	10,787
Additional dilutive common stock equivalents	272	426	333	403
Diluted shares outstanding	12,652	11,823	12,522	11,190
Basic earnings per share	\$ 0.40	\$ 0.37	\$ 1.04	\$ 1.03
Diluted earnings per share	\$ 0.40	\$ 0.35	\$ 1.01	\$ 0.99

For the three months ended September 30, 2007 and 2006 approximately 376,000 and 0 common stock equivalents, respectively, were excluded from the earnings per share calculation because their effect would have been anti-dilutive. For the nine months ended September 30, 2007 and 2006 approximately 24,000 and 0 common stock equivalents, respectively, were excluded from the earnings per share calculation because their effect would have been anti-dilutive.

#### NOTE 5 SHARE-BASED COMPENSATION

The Company maintains a number of share-based incentive programs, which are discussed in more detail in Note 17 of the Company's Annual Report on Form 10-K for the year ended December 31, 2006. The share-based compensation expense that was charged against income was \$577,000 and \$1,321,000 for the three and nine months ended September 30, 2007, respectively. For the three and nine months ended September 30, 2006, the share-based compensation expense charged against income was \$403,000 and \$852,000, respectively. The total

Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

income tax benefit recognized in the income statement for share-based compensation arrangements was \$340,000 and \$274,000 for the nine months ended September 30, 2007 and 2006, respectively.

The fair value of stock options granted in the nine months ended September 30, 2007 and 2006 is estimated based on the date of grant using the Black-Scholes option pricing model with the following average assumptions:

	Nine months ended September 30,	
	2007	2006
Risk-free interest rate	5.2%	4.4%
Expected dividend rate	0.6%	0.6%
Expected volatility	36.0%	50.5%
Expected term (years)	6.0	10.0
Weighted per share average fair value at grant date	\$ 10.73	\$ 13.94

8

*Employee Stock Options and Stock Settled Stock Appreciation Rights*

Stock options were granted to key employees with exercise prices equal to the market price of the Company's stock at the date of grant and have 10-year contractual terms. Stock options have a vesting schedule of between three to five years. In addition, in June 2007, the Company granted stock-settled stock appreciation rights ("SSAR") to key employees. The SSARs are subject to continued employment, have a 10-year contractual term and vest ratably over five years beginning on December 15, 2007. Neither stock options or SSARs carry voting or dividend rights until exercised. There were no options granted during the third quarters of 2007 or 2006.

	Three months ended September 30,		Nine months ended September 30,	
(in thousands, except grant date fair value)	2007	2006	2007	2006
Weighted average grant date fair value of options	\$ -	\$ -	\$ 10.73	\$ 13.94
Compensation expense	177	(4)	275	20
Intrinsic value of option exercises on date of exercise	141	497	1,809	1,191
Cash received from the exercise of stock options	159	436	1,125	1,481

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
(Dollars in thousands, except share data)				
Outstanding at December 31, 2006	805,137	\$ 12.21	-	
Granted	196,102	25.70	-	
Exercised	(103,659)	10.86	-	
Forfeited	-	-	-	
Outstanding at September 30, 2007	897,580	\$ 15.31	5.9 years	\$ 8,102
Exercisable at September 30, 2007	688,633	\$ 12.18	4.8 years	\$ 8,374
Vested and expected to vest at September 30, 2007	855,870	\$ 14.81	5.9 years	\$ 8,157

At September 30, 2007, there was \$117,000 and \$1,402,000 of total unrecognized compensation cost related to stock options and SSARs, respectively, which is expected to be recognized over a weighted average period of approximately 2.0 years and 4.2 years, respectively.

*Restricted Stock Units*

As part of a long-term incentive plan, the Company issues restricted share units ("RSUs") to employees. RSUs are subject to continued employment and vest ratably over five years. RSUs do not carry voting or dividend rights until vesting. Compensation expense related to RSUs was \$367,000 and \$331,000 for the three months ended September 30, 2007 and 2006, respectively. Compensation expense related to RSUs was \$935,000 and \$696,000 for the nine months ended September 30, 2007 and 2006, respectively. At September 30, 2007, there was \$3.8 million of total unrecognized compensation cost related to nonvested RSUs, which is expected to be recognized over a weighted average period of approximately 3.4 years.

	Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2006	160,475	\$ 22.67
Granted	77,938	25.36
Vested	-	-
Forfeited	(11,987)	15.58
Outstanding at September 30, 2007	226,426	23.97

9

*Director - Stock Appreciation Rights*

At December 31, 2006, there were no stock appreciation rights ("SARS") outstanding pursuant to the Stock Appreciation Rights Plan for the Directors. As a result, there will be no expense related to SARS in 2007. For the three and nine months ended September 30, 2006, expenses to record the market value of the SARS were \$32,000 and \$54,000, respectively.

*Stock Plan for Non-Management Directors*

In April 2006, the Company adopted a Stock Plan for Non-Management Directors, which provides for issuing shares of common stock to non-employee directors as compensation in lieu of cash. Shares granted under this plan may be subject to resale restrictions ("restricted stock"). The plan was approved by the shareholders and allows up to 100,000 shares to be awarded. Shares are issued twice a year and compensation expense is recorded as the shares are earned, therefore, there is no unrecognized compensation cost related to this plan. Share-based compensation expense for the directors was \$33,000 and \$41,000 for the three months ended September 30, 2007 and 2006, respectively. Share-based compensation expense for the directors was \$111,000 and \$70,000 for the nine months ended September 30, 2007 and 2006, respectively.

*Moneta Plan*

As of December 31, 2006, the fair value of all options granted pursuant to an agreement with Moneta Group ("Moneta") had been recognized; therefore, there is no unrecognized compensation cost. During the first nine months of 2006, the Company recognized \$13,000 in Moneta option-related expenses.

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
(Dollars in thousands, except share data)				
Outstanding at December 31, 2006	165,823	\$ 12.69		
Granted	-	-		
Exercised	(20,532)	12.68		
Forfeited	-	-		
Outstanding at September 30, 2007	145,291	\$ 12.69	2.3 years	\$ 1,692
Exercisable at September 30, 2007	143,115	\$ 12.67	2.1 years	\$ 1,670

Vested and expected to vest at September 30, 2007	145,291	\$ 12.69	2.3 years	\$ 1,692
---	---------	----------	-----------	----------

**NOTE 6 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

The Bank utilizes interest rate swap derivatives to manage its interest rate risks from certain recorded financial assets and liabilities. These derivatives are utilized when they can be demonstrated to effectively hedge a designated asset or liability and such asset or liability exposes the Bank to interest rate risk. The accounting policies associated with derivative financial instruments are discussed further in Note 7 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

The Bank accounts for its derivatives under SFAS No. 149, *An Amendment of Statement 133 on Derivative Instruments and Hedging Activities* and SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. These Standards require recognition of all derivatives as either assets or liabilities in the balance sheet and require measurement of those instruments at fair value through adjustments to other comprehensive income, current earnings, or both, as appropriate.

**Cash Flow Hedges**

Previously, the Bank entered into interest rate swap agreements to convert floating-rate loan assets to fixed rates. At September 30, 2007, the Bank had no outstanding cash flow hedges. Interest rate swaps with notional amounts of \$30.0 million and \$40.0 million under which the Bank received a fixed rate of 5.3425% and 5.4150% matured in March and April 2006, respectively. The net cash flows related to cash flow hedges decreased interest income on loans by \$0 and \$410,000 in the three and nine months ended September 30, 2006, respectively.

**Fair Value Hedges**

Previously, the Bank entered into interest rate swap agreements to convert the fixed interest rate on certain brokered CDs to a variable interest rate. At September 30, 2007, the Bank had no outstanding fair value hedges. One swap with a notional amount of \$10.0 million, under which the Bank received a fixed rate of 2.90%, matured in February 2007. Two swaps, each with a \$10.0 million notional amount, under which the Bank received fixed rates of 2.30% and 2.45%, matured in February and April 2006, respectively. The net cash flows related to fair value hedges increased interest expense on certificates of deposit by \$0 and \$41,000 in the three and nine months ended September 30, 2007, respectively. The net cash flows related to fair value hedges increased interest expense on certificates of deposit by \$69,000 and \$299,000 in the three and nine months ended September 30, 2006, respectively.

10

**Non-Designated Hedges**

The Bank has entered into interest rate swap agreements with the objective of converting long-term fixed rates on certain loans to a variable interest rate. At September 30, 2007, the Bank had one outstanding non-designated hedge with a notional amount of \$5.4 million. The swap agreements provide for the Bank to pay a fixed rate of interest equal to that of the loan and to receive a variable rate of interest based on a spread to one-month LIBOR. The non-designated hedges and related loans are accounted for at fair value. All changes in fair value are measured on a quarterly basis. For the three and nine months ended September 30, 2007, the change in fair value of the underlying swap decreased interest income by \$6,400 and \$10,000, respectively.

Under the swap agreements the Bank is to pay or receive interest monthly. The cash flows related to a forward rate lock hedge did not start until August 2007. One interest rate swap with a notional amount of \$1.8 million was terminated in March 2007. The net cash flows related to these hedges increased interest income on loans by \$900 and \$700 in the three and nine months ended September 30, 2007, respectively. The net cash flows related to these hedges decreased interest income on loans by \$500 and \$1,800 in the three and nine months ended September 30, 2006, respectively.

	September 30, 2007	December 31, 2006
(in thousands)		
<b>Fair Value Hedges</b>		
Notional amount	\$ -	\$ 10,000

Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

Weighted average pay rate	-	%	5.32	%
Weighted average receive rate	-	%	2.90	%
Weighted average maturity in months	-		2	
Unrealized loss related to interest rate swaps	\$	-	\$	(35)
<b>Non-Designated Hedges</b>				
Notional amount	\$	5,420	\$	7,324
Weighted average pay rate	8.31	%	7.96	%
Weighted average receive rate	8.12	%	7.95	%
Weighted average maturity in months	72		79	
Unrealized loss related to interest rate swaps	\$	(131)	\$	(119)

The notional amounts of derivative financial instruments do not represent amounts exchanged by the parties, and therefore, are not a measure of the Bank's credit exposure through its use of these instruments. The credit exposure represents the accounting loss the Bank would incur in the event the counterparties failed completely to perform according to the terms of the derivative financial instruments and if the collateral held to support the credit exposure was of no value. At September 30, 2007 and December 31, 2006, in connection with our interest rate swap agreements; we had pledged investment securities available for sale with a fair value of \$0 and \$2.5 million, respectively. At September 30, 2007 and December 31, 2006, we had accepted, as collateral in connection with our interest rate swap agreements, cash of \$0 and \$196,300.

#### NOTE 7 DISCLOSURES ABOUT FINANCIAL INSTRUMENTS

The Company issues financial instruments with off balance sheet risk in the normal course of the business of meeting the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments may involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the consolidated balance sheets.

The Company's extent of involvement and maximum potential exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for financial instruments included on its consolidated balance sheets. At September 30, 2007, no amounts have been accrued for any estimated losses for these financial instruments.

11

The following table summarizes the contractual amount of off-balance-sheet financial instruments at the dates indicated below.

	September 30, 2007	December 31, 2006
<i>(in thousands)</i>		
Commitments to extend credit	\$ 511,806	\$ 480,071
Standby letters of credit	34,239	39,587
Private equity funds	1,325	250

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments usually have fixed expiration dates or other termination clauses and may require payment of a fee. Of the total commitments to extend credit at September 30, 2007 and December 31, 2006, approximately \$50.1 million and \$35.9 million, respectively, represents fixed rate loan commitments. Since certain of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon

## Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, premises and equipment, and real estate.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These standby letters of credit are issued to support contractual obligations of the Company's customers. The credit risk involved in issuing letters of credit is essentially the same as the risk involved in extending loans to customers. The approximate remaining terms of standby letters of credit range from 1 month to 5 years at September 30, 2007.

### NOTE 8 SEGMENT REPORTING

Management segregates the Company into three distinct businesses for evaluation purposes. The three segments are Banking, Wealth Management, and Corporate and Intercompany. The segments are evaluated separately on their individual performance, as well as their contribution to the Company as a whole. The financial information for each business segment reflects that information which is specifically identifiable or which is allocated based on an internal allocation method.

The majority of the Company's assets and income result from the Banking segment. This segment consists of the Bank, excluding the trust division of the Bank (Enterprise Trust), and Great American.

The Wealth Management segment includes Enterprise Trust and Millennium. Enterprise Trust provides estate planning, investment management and retirement planning, as well as consulting on management compensation, strategic planning and management succession issues. Millennium operates life insurance advisory and brokerage operations from thirteen offices serving life agents, banks, CPA firms, property and casualty groups, and financial advisors in 49 states.

The Corporate and Intercompany segment includes the general corporate expenses of the parent only along with the subordinated debentures and intersegment eliminations.

12

Following are the financial results for the Company's operating segments.

#### Balance Sheet Information

#### At September 30, 2007

<i>(in thousands)</i>	Banking	Wealth Management	Corporate and Intercompany	Total
Loans, less unearned loan fees	\$ 1,558,885	\$ -	\$ -	\$ 1,558,885
Goodwill	45,368	10,293	-	55,661
Intangibles, net	3,511	2,952	-	6,463
Deposits	1,448,501	-	(2,066)	1,446,435
Borrowings	138,359	-	60,807	199,166
Total Assets	1,805,487	16,674	6,098	1,828,259

#### At December 31, 2006

Loans, less unearned loan fees	\$ 1,311,723	\$ -	\$ -	\$ 1,311,723
Goodwill	19,690	10,293	-	29,983
Intangibles, net	2,153	3,636	-	5,789
Deposits	1,319,201	-	( 3,693)	1,315,508
Borrowings	36,752	-	39,054	75,806
Total Assets	1,517,617	16,991	979	1,535,587

#### Income Statement Information

#### Three months ended September 30, 2007

<i>(in thousands)</i>	Banking	Wealth Management	Corporate and Intercompany	Total
-----------------------	---------	----------------------	----------------------------------	-------

Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

Net interest income (expense)	\$ 16,811	\$ 35	\$ (1,041)	\$ 15,805
Provision for loan losses	600	-	-	600
Noninterest income	1,100	3,507	31	4,638
Noninterest expense	8,927	2,447	828	12,202
Income (loss) before income tax expense	8,384	1,095	( 1,838)	7,641
Income tax expense (benefit)	3,098	394	( 850)	2,642
Net income (loss)	\$ 5,286	\$ 701	\$ (988)	\$ 4,999

**Three months ended September 30, 2006**

	Banking	Wealth Management	Corporate and Intercompany	Total
Net interest income (expense)	\$ 14,528	\$ 26	\$ (715)	\$ 13,839
Provision for loan losses	240	-	-	240
Noninterest income	841	3,469	15	4,325
Noninterest expense	7,831	2,152	969	10,952
Minority interest	-	( 434)	-	( 434)
Income (loss) before income tax expense	7,298	909	( 1,669)	6,538
Income tax expense (benefit)	2,631	327	( 601)	2,357
Net income (loss)	\$ 4,667	\$ 582	\$ (1,068)	\$ 4,181

**Nine months ended September 30, 2007**

	Banking	Wealth Management	Corporate and Intercompany	Total
Net interest income (expense)	\$ 47,633	\$ 97	\$ (2,880)	\$ 44,850
Provision for loan losses	2,165	-	-	2,165
Noninterest income	3,174	9,928	340	13,442
Noninterest expense	25,987	7,937	2,509	36,433
Income (loss) before income tax expense	22,655	2,088	( 5,049)	19,694
Income tax expense (benefit)	8,291	752	( 2,021)	7,022
Net income (loss)	\$ 14,364	\$ 1,336	\$ (3,028)	\$ 12,672

**Nine months ended September 30, 2006**

	Banking	Wealth Management	Corporate and Intercompany	Total
Net interest income (expense)	\$ 38,917	\$ 77	\$ (1,756)	\$ 37,238
Provision for loan losses	1,777	-	-	1,777
Noninterest income	2,203	10,018	33	12,254
Noninterest expense	20,249	6,611	2,706	29,566
Minority interest	-	( 826)	-	( 826)
Income (loss) before income tax expense	19,094	2,658	( 4,429)	17,323
Income tax expense (benefit)	6,878	957	( 1,593)	6,242
Net income (loss)	\$ 12,216	\$ 1,701	\$ (2,836)	\$ 11,081

**NOTE 9 SUBORDINATED DEBENTURES**

At December 31, 2006, the Company had \$35.0 million in five wholly-owned statutory business trusts. These trusts issued securities that were sold to third parties. The sole purpose of the trusts was to invest the proceeds



in junior subordinated debentures of the Company that have terms identical to the trust securities. Following is a summary of business trusts and underlying subordinated debentures issued, acquired and redeemed throughout 2007.

#### **EFSC Capital Trust VI**

On February 26, 2007, EFSC Statutory Capital Trust VI ( EFSC Trust VI ), a newly formed Delaware statutory trust and subsidiary of EFSC, issued 14,000 fixed rate Trust Preferred Securities at \$1,000 per share to a Trust Preferred Securities Pool. The proceeds were invested in junior subordinated debentures of the Company. The net proceeds to the Company from the sale of the junior subordinated debentures, were approximately \$14.0 million. The rate is fixed at 6.573% for five years. Following the five-year period, the floating rate will be equal to three-month LIBOR + 1.60%. Interest is payable quarterly beginning March 31, 2007. The TRUPS are fully, irrevocably and unconditionally guaranteed on a subordinated basis by the Company. The TRUPS mature on March 30, 2037. The maturity date may be shortened to a date not earlier than March 30, 2012 if certain conditions are met. The TRUPS are classified as subordinated debentures and the distributions are recorded as interest expense in the Company s consolidated financial statements. The proceeds from the offering were used to partially fund the acquisition of Clayco as discussed in Note 2   Acquisitions of this filing.

#### **Clayco Statutory Trust I and II**

On February 28, 2007, as part of the Clayco acquisition, the Company acquired Clayco Statutory Trust I ( Clayco Trust I ) valued at \$3.2 million and Clayco Statutory Trust II ( Clayco Trust II ) valued at \$4.1 million. Clayco Trust I consists of 3,000 floating rate Trust Preferred Securities. The floating rate for Clayco Trust I is equal to three-month LIBOR + 2.85%. It matures on December 17, 2033. If certain conditions are met, the maturity date may be shortened to a date not earlier December 17, 2008. Clayco Trust II consists of 4,000 floating rate Trust Preferred Securities with a floating rate equal to three-month LIBOR + 1.83%. The maturity dates may be shortened to a date not earlier than September 15, 2010 if certain conditions are met. These TRUPS are fully, irrevocably and unconditionally guaranteed on a subordinated basis by the Company. These TRUPS are classified as subordinated debentures and the distributions are recorded as interest expense in the Company s financial statements.

#### **EFSC Capital Trust VII**

On September 20, 2007, EFSC Statutory Capital Trust VII ( EFSC Trust VII ), a newly formed Delaware statutory trust and subsidiary of EFSC, issued 4,000 floating rate Trust Preferred Securities at \$1,000 per share to a Trust Preferred Securities Pool. The proceeds were invested in junior subordinated debentures of the Company. The net proceeds to the Company from the sale of the junior subordinated debentures, were approximately \$4.0 million. The floating rate will be equal to three-month LIBOR + 2.25%. Interest is payable quarterly beginning December 15, 2007. The TRUPS are fully, irrevocably and unconditionally guaranteed on a subordinated basis by the Company. The TRUPS mature on December 15, 2037. The maturity date may be shortened to a date not earlier than December 15, 2012 if certain conditions are met. The TRUPS are classified as subordinated debentures and the distributions are recorded as interest expense in the Company s consolidated financial statements. The proceeds from the offering were used to refinance EFSC Capital Trust I which was redeemed on September 30, 2007.

#### **EFSC Capital Trust I**

On September 30, 2007, ESFC Capital Trust I, a statutory trust and subsidiary of EFSC, redeemed all of its \$4 million variable rate trust preferred securities and its variable rate common securities. At the time of the redemption, the Company recognized an \$82,000 charge in noninterest expense for unamortized debt issuance costs related to this instrument. The redeemed trust preferred securities were originally issued in 2002 and were paying a rate of LIBOR + 3.65%.

---

## **ITEM 2: MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### ***Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995***

*Readers should note that in addition to the historical information contained herein, some of the information in this report contains forward-looking statements within the meaning of the federal securities laws. Forward-looking statements typically are identified with use of terms such as  may,   will,   expect,   anticipate,   estimate,   potential,   could,  and similar words, although some forward-looking statements are expressed differently. You should be aware that the Company s actual results could differ materially from those*

*contained in the forward-looking statements due to a number of factors, including: burdens imposed by federal and state regulation, including changes in accounting regulation or standards of banks; credit risk; exposure to general and local economic conditions; risks associated with rapid increase or decrease in prevailing interest rates; consolidation within the banking industry; competition from banks and other financial institutions; our ability to attract and retain relationship officers and other key personnel; and technological developments. Any of these factors could cause the Company's actual results to differ from those set forth in the forward-looking statements.*

*Other factors that could cause results to differ from expected results include the acquisitions of Millennium, NorthStar and Great American, any of which could result in costs and expenses that are greater, or benefits that are less, than we currently anticipate, or the assumption of unanticipated liabilities.*

*In addition to the foregoing, readers should refer to the risk factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2006. Readers are cautioned not to place undue reliance on our forward-looking statements, which reflect management's analysis only as of the date of the statements. The Company does not intend to publicly revise or update forward-looking statements to reflect events or circumstances that arise after the date of this report. Readers should carefully review all disclosures we file from time to time with the Securities and Exchange Commission which are available on our website at [www.enterprisebank.com](http://www.enterprisebank.com).*

## **INTRODUCTION**

The following discussion describes significant changes in the financial condition of the Company that have occurred during the first nine months of 2007 compared to the financial condition as of December 31, 2006. In addition, this discussion summarizes the significant factors affecting the consolidated results of operations, liquidity and cash flows of the Company for the three and nine months ended September 30, 2007 compared to the same period in 2006. This discussion should be read in conjunction with the accompanying consolidated financial statements included in this report and our Annual Report of Form 10-K for the year ended December 31, 2006.

## **CRITICAL ACCOUNTING POLICIES**

The impact and any associated risks related to the Company's critical accounting policies on business operations are discussed throughout "Management's Discussion and Analysis of Financial Condition and Results of Operations," where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Management believes there have been no material changes to our critical accounting policies.

## **EXECUTIVE SUMMARY**

Net income for the three and nine months ended September 30, 2007 was \$5.0 million and \$12.7 million, an increase of 20% and 14%, respectively, compared to \$4.2 million and \$11.1 million for the same periods in 2006. Fully diluted earnings per share for the quarter were \$0.40, a 14% increase from the third quarter of 2006. Fully diluted earnings per share for the first nine months of 2007 were \$1.01 compared to \$0.99 for the same period of 2006.

During the third quarter of 2007, we purchased 28,000 shares of our common stock to be held as Treasury stock. This purchase was made under a stock buyback program approved by our Board of Directors. Total shares outstanding were 12.4 million at September 30, 2007 compared to 11.5 million one year ago, as we have issued nearly 700,000 shares related to our Kansas City-based acquisition of Great American in February 2007.

Noninterest income increased \$313,000, or 7%, from \$4.3 million in third quarter 2006 to \$4.6 million in the same quarter of 2007. For the nine months ended September 30, 2007, noninterest income was \$13.4 million compared to \$12.3 million for the same period in 2006. The increase includes \$268,000 of Miscellaneous Income from the sale of a holding company investment in an investment management firm.

---

Noninterest expenses were \$12.2 million in the third quarter of 2007 compared to \$11.0 million for the same quarter of 2006, an increase of \$1.2 million, or 11%. Noninterest expenses were \$36.4 million for the nine months ended September 30, 2007, an increase of \$6.9 million, or 23%, over the same period of 2006. The acquisition of

Great American along with increases in Millennium expenses contributed approximately \$3.0 million of the year over year increase. The Company added new talent and infrastructure to support its expansion in Mortgage, Wealth Management and Treasury Management. In addition, we have been particularly pleased with several new high-level bankers recruited to our Kansas City team as we deploy to our broadened platform there. During third quarter 2007, we recognized an \$82,000 charge in noninterest expense for unamortized debt issuance costs related to the redemption of a trust preferred security. For the nine months ended September 30, 2007, the Company's efficiency ratio was 63%, flat with 2006, and 60% for the nine months of 2006.

The provision for income taxes was \$2.6 million and \$7.0 million for the three and nine months ended September 30, 2007 compared to \$2.4 million and \$6.2 million for the same periods in 2006. The effective tax rate for the three and nine months ended September 30, 2007 was 34.6% and 35.7% compared to 36.1% and 36.0% for the three and nine months ended September 30, 2006. During the third quarter of 2007, we reversed \$67,500 of various tax benefits related to certain federal tax items. The third quarter of 2007 also included \$121,000 of federal tax benefits related to low income housing tax credits from a Limited Partnership we recently invested in.

## **BANKING**

This section contains a discussion of acquisitions, loans, deposits, net interest margin and noninterest income and noninterest expense of our Banking business. The discussion of net interest income and margin analysis, including average balance sheets, also includes the impact of the Company's subordinated debentures.

### ***Acquisitions***

On February 28, 2007 the Company completed its acquisition of Kansas City-based Clayco Banc Corporation and its wholly owned subsidiary, Great American Bank. Results for Great American are included in the consolidated financial results of the Company since that date. Please refer to Note 2 – Acquisitions in this filing for more information related to the acquisition. Since July 2006, we have nearly tripled our market position in Kansas City through the NorthStar and Clayco acquisitions, as well as organic growth.

### ***Loan growth***

Including Great American, portfolio loans grew by \$247 million from December 31, 2006 and were up \$289 million or 23% from September 30, 2006. As reported last quarter, excluding Great American, during the first six months of 2007, we generated a record \$297 million in gross loan fundings – the highest level in the Company's history. However, payoffs and line paydowns offset all but \$21 million of the gross amount. While competition in both our markets remains intense, since June 2007, the volume of payoffs has slowed substantially. As a result, portfolio loans grew \$58 million during the third quarter of 2007. Net loan growth was split evenly between our two markets of St. Louis and Kansas City and consisted primarily of commercial and industrial and commercial real estate loans.

### ***Deposit growth***

Including Great American, deposits were up \$131 million, or 10%, from December 31, 2006 and \$164 million, or 13%, from September 30, 2006.

We continue to pursue our strategy of obtaining lower cost transaction and relationship-based accounts primarily through our treasury management products and services. In addition, we are closely monitoring our deposit rates compared to our competitors and are making adjustments as market conditions permit. Treasury management pipelines remain strong and typical seasonal increases in deposits are expected as we move into the fourth quarter.

Our deposit mix remains favorable with demand deposit accounts representing 15% of average deposits in a competitive deposit rate environment. In addition, we plan to continue utilizing Federal Home Loan Bank (FHLB) advances along with brokered certificates of deposit to fund shortfalls due to loan demand. Through September 30, 2007, we have utilized approximately \$78 million in short-term FHLB advances and \$9 million net in short-term brokered certificates of deposit. In third quarter 2007, we replaced several maturing short-term brokered certificates of deposits with \$30 million of longer term, callable brokered certificates of deposit. The cost of the call feature was deemed appropriate to protect us from falling interest rates. We have the option of calling the brokered certificates of deposit after February 2008. If long-term rates increase in the future, there will be no need to call these certificates of deposit because our rate will be lower. If long-term rates fall over time, we can call the certificates of deposit and reissue them at a lower rate. At September 30, 2007 brokered certificates of deposit represent just 10% of total deposits.

### **Net Interest Income**

Despite the prolonged inverted yield curve and adjusting for the temporary margin impact of nonperforming loans, our rate margin is stabilizing. Our disciplined loan pricing, ability to manage deposit costs more in line with short term interest rate trends and the declining impact of maturing certificates of deposit have contributed to the stabilization.

#### *Three months ended September 30, 2007 and 2006*

Net interest income (on a tax-equivalent basis) was \$16.1 million for the quarter ended September 30, 2007, compared to \$14.1 million for the same period of 2006, an increase of 14%. Total interest income increased \$5.5 million while total interest expense increased \$3.5 million.

Average interest-earning assets increased \$244 million, or 17% to \$1.646 billion for the quarter ended September 30, 2007 compared to \$1.402 billion for the same period in 2006. During the same period, average loans increased \$267 million, or 21%, from \$1.261 billion to \$1.528 billion. For the third quarter of 2007, interest income on loans increased \$5.4 million from growth and \$220,000 due to the impact of rates, for a net increase of \$5.6 million versus third quarter of 2006.

For the quarter ended September 30, 2007, average interest-bearing liabilities increased \$231 million, or 20% to \$1.383 billion compared to \$1.152 billion for the quarter ended September 30, 2006. The growth in interest-bearing liabilities resulted from a \$197 million increase in interest-bearing core deposits, a \$10 million decrease in brokered certificates of deposit, a \$23 million increase in subordinated debentures, and a \$21 million increase in borrowed funds including FHLB advances. We are meeting loan funding shortfalls with FHLB advances and brokered certificates of deposit. For the third quarter of 2007, interest expense on interest-bearing liabilities increased \$2.7 million due to growth while the impact of rising rates increased interest expense on interest-bearing liabilities by \$811,000 versus third quarter of 2006.

The benefits of aggressively managing our deposit costs, reducing non-performing assets and continued discipline in loan pricing are being realized as the net interest rate margin (on a tax-equivalent basis) increased 0.06% from the second quarter of 2007 to 3.87% . The net interest rate margin was 3.99% for the third quarter of 2006. The decline was primarily due to the increasing cost of deposits that more than offset higher earning asset yields. Additionally, higher levels of subordinated debentures associated with the acquisition of Clayco negatively impacted the margin.

#### *Nine months ended September 30, 2007 and 2006*

Net interest income (on a tax-equivalent basis) was \$45.6 million for the nine months ended September 30, 2007, compared to \$37.9 million for the same period of 2006, an increase of 20%. Total interest income increased \$23.3 million while total interest expense increased \$15.5 million.

Average interest-earning assets increased \$328 million, or 26%, to \$1.586 billion for the nine months ended September 30, 2007 compared to \$1.258 billion for the same period in 2006. During the same period, average loans increased \$344 million, or 31%, from \$1.122 billion to \$1.466 billion.

For the nine months ended September 30, 2007, average interest-bearing liabilities increased \$312 million, or 31%, to \$1.332 billion compared to \$1.020 billion for the nine months ended September 30, 2006.

The net interest rate margin (on a tax-equivalent basis) was 3.85% for the first nine months of 2007, compared to 4.03% in the same period of 2006. Reasons for the changes in yields and cost of funds are similar to those described above.

### **Average Balance Sheet**

The following table presents, for the periods indicated, certain information related to our average interest-earning assets and interest-bearing liabilities, as well as, the corresponding interest rates earned and paid, all on a tax equivalent basis.

Three months ended September 30,

Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

(in thousands)	Average Balance	2007 Interest Income/ Expense	Average Yield/ Rate	Average Balance	2006 Interest Income/ Expense	Average Yield/ Rate
<b>Assets</b>						
Interest-earning assets:						
Taxable loans (1)	\$ 1,495,181	\$ 29,958	7.95%	\$ 1,228,450	\$ 24,414	7.88%
Tax-exempt loans(2)	33,178	714	8.54	32,282	677	8.32
Total loans	1,528,359	30,672	7.96	1,260,732	25,091	7.90
Taxable investments in debt and equity securities	108,642	1,275	4.66	114,933	1,190	4.11
Non-taxable investments in debt and equity securities(2)	951	14	5.84	1,120	13	4.61
Short-term investments	7,745	107	5.48	25,321	319	5.00
Total securities and short-term investments	117,338	1,396	4.72	141,374	1,522	4.27
Total interest-earning assets	1,645,697	32,068	7.73	1,402,106	26,613	7.53
Non-interest earning assets:						
Cash and due from banks	41,326			46,840		
Other Assets	112,825			72,854		
Allowance for loan losses	(19,609)			(17,547)		
Total Assets	\$ 1,780,239			1,504,253		
<b>Liabilities and Shareholders' Equity</b>						
Interest-bearing liabilities:						
Interest-bearing transaction accounts	\$ 123,212	\$ 803	2.59%	\$ 98,658	\$ 634	2.55%
Money market accounts	574,165	6,037	4.17	501,959	5,104	4.03
Savings	12,970	37	1.13	4,685	17	1.44
Certificates of deposit	525,078	6,952	5.25	443,288	5,267	4.71
Total interest-bearing deposits	1,235,425	13,829	4.44	1,048,590	11,022	4.17
Subordinate Debentures	57,166	1,038	7.20	33,844	624	7.31
Borrowed Funds	89,976	1,135	5.00	69,229	879	5.04
Total interest-bearing liabilities	1,382,567	16,002	4.59	1,151,663	12,525	4.31
Noninterest bearing liabilities:						
Demand deposits	218,071			213,953		
Other liabilities	12,291			10,952		
Total liabilities	1,612,929			1,376,568		
Shareholders' equity	167,310			127,685		
Total liabilities & shareholders' equity	\$ 1,780,239			\$ 1,504,253		
Net interest income		\$ 16,066			\$ 14,088	
Net interest spread			3.14%			3.22%
Net interest rate margin (3)			3.87			3.99

- (1) Average balances include non-accrual loans. The income on such loans is included in interest but is recognized only upon receipt. Loan fees, prior to deferral adjustment, included in interest income are approximately \$731,000 and \$667,000 for the quarters ended September 30, 2007, and 2006, respectively.
- (2) Non-taxable income is presented on a fully tax-equivalent basis using the combined statutory federal and state income tax in effect for the year. The tax-equivalent adjustments were \$261,000 and \$249,000 for the quarters ended September 30, 2007 and 2006, respectively.
- (3) Net interest income divided by average total interest-earning assets.

Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

(in thousands)	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
<b>Assets</b>						
Interest-earning assets:						
Taxable loans (1)	\$ 1,431,746	\$ 85,180	7.95%	\$ 1,095,196	\$ 62,174	7.59%
Tax-exempt loans(2)	34,078	2,128	8.35	27,190	1,740	8.56
Total loans	1,465,824	87,308	7.96	1,122,386	63,914	7.61
Taxable investments in debt and equity securities	112,092	3,756	4.48	112,076	3,353	4.00
Non-taxable investments in debt and equity securities(2)	932	40	5.74	1,148	41	4.77
Short-term investments	6,743	277	5.49	22,319	786	4.71
Total securities and short-term investments	119,767	4,073	4.55	135,543	4,180	4.12
Total interest-earning assets	1,585,591	91,381	7.71	1,257,929	68,094	7.24
Non-interest earning assets:						
Cash and due from banks	42,866			43,711		
Other Assets	103,077			53,307		
Allowance for loan losses	(18,944)			(15,023)		
Total Assets	\$ 1,712,590			1,339,924		
<b>Liabilities and Shareholders' Equity</b>						
Interest-bearing liabilities:						
Interest-bearing transaction accounts	\$ 120,790	\$ 2,363	2.62%	\$ 102,561	\$ 1,657	2.16%
Money market accounts	553,271	17,509	4.23	480,072	13,436	3.74
Savings	11,250	96	1.14	4,214	42	1.33
Certificates of deposit	504,374	19,586	5.19	332,641	10,898	4.38
Total interest-bearing deposits	1,189,685	39,554	4.45	919,488	26,033	3.79
Subordinate Debentures	52,385	2,822	7.20	31,912	1,692	7.09
Borrowed Funds	89,966	3,374	5.01	69,131	2,489	4.81
Total interest-bearing liabilities	1,332,036	45,750	4.59	1,020,531	30,214	3.96
Noninterest bearing liabilities:						
Demand deposits	213,003			203,613		
Other liabilities	9,968			9,055		
Total liabilities	1,555,007			1,233,199		
Shareholders' equity	157,583			106,725		
Total liabilities & shareholders' equity	\$ 1,712,590			\$ 1,339,924		
Net interest income		\$ 45,631			\$ 37,880	
Net interest spread			3.12%			3.28%
Net interest rate margin (3)			3.85			4.03

- (1) Average balances include non-accrual loans. The income on such loans is included in interest but is recognized only upon receipt. Loan fees, prior to deferral adjustment, included in interest income are approximately \$2,352,000 and \$1,698,000 for the nine months ended September 30, 2007, and 2006, respectively.
- (2) Non-taxable income is presented on a fully tax-equivalent basis using the combined statutory federal and state income tax in effect for the year. The tax-equivalent adjustments were \$781,000 and \$642,000 for the nine months ended September 30, 2007 and 2006, respectively.
- (3) Net interest income divided by average total interest-earning assets.

19

### Rate/Volume

The following table sets forth, on a tax-equivalent basis for the periods indicated, a summary of the changes in interest income and interest expense resulting from changes in yield/rates and volume.

2007 Compared to 2006  
3 month 9 month

Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

(in thousands)	Increase (decrease) due to			Increase (decrease) due to		
	Volume(1)	Rate(2)	Net	Volume(1)	Rate(2)	Net
<b>Interest earned on:</b>						
Taxable loans	\$ 5,342	\$ 202	\$ 5,544	\$ 19,899	\$ 3,107	\$ 23,006
Nontaxable loans (3)	19	18	37	431	(43)	388
Taxable investments in debt and equity securities	(68)	153	85	-	403	403
Nontaxable investments in debt and equity securities (3)	(2)	3	1	(9)	8	(1)
Short-term investments	(240)	28	(212)	(622)	113	(509)
Total interest-earning assets	\$ 5,051	\$ 404	\$ 5,455	\$ 19,699	\$ 3,588	\$ 23,287
<b>Interest paid on:</b>						
Interest-bearing transaction accounts	\$ 160	\$ 9	\$ 169	\$ 323	\$ 383	\$ 706
Money market accounts	754	179	933	2,193	1,880	4,073
Savings	25	(5)	20	61	(7)	54
Certificates of deposit	1,041	644	1,685	6,394	2,294	8,688
Subordinated debentures	424	(10)	414	1,103	27	1,130
Borrowed funds	262	(6)	256	777	108	885
Total interest-bearing liabilities	2,666	811	3,477	10,851	4,685	15,536
Net interest income	\$ 2,385	\$ (407)	\$ 1,978	\$ 8,848	\$ (1,097)	\$ 7,751

(1) Change in volume multiplied by yield/rate of prior period.

(2) Change in yield/rate multiplied by volume of prior period.

(3) Non taxable income is presented on a fully tax-equivalent basis using the combined statutory federal and state income tax rate in effect for each year.

NOTE: The change in interest due to both rate and volume has been allocated to rate and volume changes in proportion to the relationship of the absolute dollar amounts of the change in each.

**Provision for loan losses and nonperforming loans**

The provision for loan losses in the third quarter of 2007 was \$600,000, compared to \$240,000 in the same quarter of 2006. Higher absolute nonperforming loan levels coupled with higher net loan growth drove the increase in the provision levels in the third quarter compared to the prior year. The provision for loan losses in the first nine months of 2007 was \$2.2 million compared to \$1.8 million for the same period in 2006. The allowance for loan losses as a percentage of total loans was 1.27% at September 30, 2007 compared to 1.30% at December 31, 2006. One year ago, the allowance for loan losses rose to 1.40% as a result of conforming adjustments made to risk ratings for NorthStar bank's loan portfolio. Management believes that the allowance for loan losses is adequate.

During the third quarter of 2007, the Company had net charge-offs of \$549,000, or 0.14% annualized. For the first nine months of 2007, net charge-offs were \$1.4 million or 0.13% annualized compared to \$31,000 for the same period of 2006.

Nonperforming loans decreased \$4.2 million from June 30, 2007. The decrease was primarily due to the sale of collateral on two troubled credits at no loss to the Bank. At September 30, 2007, nonperforming loans were \$8.5 million, or 0.55%, of total loans. This compares to 0.84% of total loans at June 30, 2007 and 0.49% at December 31, 2006. At September 30, 2007, of the total nonperforming loans, \$7.1 million, or 83%, relates to seven residential homebuilders in St. Louis and Kansas City. The largest of these loans is \$2.7 million and several are below \$400,000. Management believes we are well secured with respect to these loans and does not expect significant losses on the existing nonperforming loans.

## Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

The St. Louis and Kansas City housing markets, like those in most of the US, remain under pressure. We do not expect this condition to improve for the next 12 to 18 months. As noted, over 80% of Enterprise's non-performing assets are related to this sector. The Company's exposure to the sector is, in the aggregate, approximately 10% of our total portfolio of loans. Accordingly, while our exposure to this troubled sector compared to many banks is relatively small, we do expect the total of non-performing assets to increase in absolute dollar terms over the next few quarters but to remain at manageable levels in relation to our total loan portfolio balances.

The following table summarizes changes in the allowance for loan losses for the periods presented.

<i>(in thousands)</i>	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
Allowance at beginning of period	\$ 19,703	\$ 14,449	\$ 16,988	\$ 12,990
Acquired allowance for loan losses	-	3,069	2,010	3,069
Loans charged off:				
Commercial and industrial	29	17	238	317
Real estate:				
Commercial	65	-	65	-
Construction	445	-	516	-
Residential	101	-	759	-
Consumer and other	27	2	109	2
Total loans charged off	667	19	1,687	319
Recoveries of loans previously charged off:				
Commercial and industrial	71	63	189	268
Real estate:				
Commercial	-	-	15	1
Construction	25	-	25	-
Residential	2	1	15	16
Consumer and other	20	2	34	3
Total recoveries of loans	118	66	278	288
Net loan chargeoffs (recoveries)	549	(47)	1,409	31
Provision for loan losses	600	240	2,165	1,777
Allowance at end of period	\$ 19,754	\$ 17,805	\$ 19,754	\$ 17,805
Average loans	\$ 1,528,359	\$ 1,260,732	\$ 1,465,824	\$ 1,122,386
Total portfolio loans	1,558,885	1,269,391	1,558,885	1,269,391
Nonperforming loans	8,542	6,214	8,542	6,214
Net chargeoffs to average loans annualized	0.14 %	(0.01) %	0.13 %	0.00 %
Allowance for loan losses to loans	1.27	1.40	1.27	1.40

The following table presents the categories of nonperforming assets and certain ratios as of the dates indicated.

<i>(in thousands)</i>	September 30, 2007	December 31, 2006
Non-accrual loans	\$ 8,542	\$ 6,363
Loans past due 90 days or more and still accruing interest	-	112
Restructured loans	-	-



# Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

Total nonperforming loans	8,542	6,475
Foreclosed property	857	1,500
Total nonperforming assets	\$ 9,399	\$ 7,975
Total assets	\$ 1,828,259	\$ 1,535,587
Total loans	1,558,885	1,311,723
Total loans plus foreclosed property	1,559,742	1,313,223
Nonperforming loans to loans	0.55 %	0.49 %
Nonperforming assets to loans plus foreclosed property	0.60	0.61
Nonperforming assets to total assets	0.51	0.52
Allowance for loan losses to nonperforming loans	231.00 %	264.00 %

The following is a summary of the Company's credit management policies and procedures.

The Company's credit management policies and procedures focus on identifying, measuring, and controlling credit exposure. These procedures employ a lender-initiated system of rating credits, which is ratified in the loan approval process and subsequently tested through independent internal loan reviews and regulatory bank examinations. The system requires rating all loans at the time they are made, at each renewal date and as conditions warrant.

Downgrades of loan risk ratings may be initiated by the responsible loan officer, internal loan review, or the credit analyst department at any time. Upgrades of certain risk ratings may only be made with the concurrence of the Senior Credit Administration Officer, Chief Credit Officer and Loan Review Officer.

In determining the allowance and the related provision for loan losses, three principal elements are considered:

1. specific allocations based upon probable losses identified during a monthly review of the loan portfolio;
2. allocations based principally on the Company's risk rating formulas; and
3. an unallocated allowance based on subjective factors.

Based on quantitative and qualitative analysis of the above elements, provisions are made to the allowance for loan losses. Such provisions are reflected in our consolidated statements of income. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

## **Noninterest Income**

Noninterest income increased \$286,000, or 7.0% from third quarter 2006 to third quarter 2007. On a year-to-date basis, noninterest income increased \$1.3 million, or 11%. Increases in service charges on deposit accounts were primarily due to incremental activity of Great American along with increased account activity. These increases were somewhat offset by a rising earnings credit rate on commercial accounts. Other service charges and fee income increases were the result of higher fee volumes on debit cards, merchant processing and health savings accounts along with Great American deposit fee income.

The gain on sale of mortgage loans decreased in third quarter 2007 compared to the same quarter of 2006 due to less refinancing and slower home sales in our markets.

## **Noninterest Expense - Banking**

Noninterest expenses in our Banking business increased \$1.1 million from \$7.8 million in the third quarter of 2006 to \$8.9 million in the same quarter of 2007. Approximately \$848,000 of the increase was related to Great American (including amortization of intangibles.)

Increases in employee compensation and benefits of \$410,000 were related to Great American. Excluding these expenses, employee compensation and benefits in the Bank increased \$215,000. The increase is due to salaries and related benefits of new associates in various areas of our organization including Mortgage and other support areas. Approximately \$112,000 of the remaining increase is related to vesting of restricted share units and compensation related to newly issued stock-settled stock appreciation rights in our performance-based long-term incentive program. The costs were partially offset by declines in our variable-pay bonus pool.

Increases in occupancy expense were the result of rent increases on various Company facilities, incremental expenses related to Great American, and Support Center leasehold improvements.

Data processing expenses increased due to upgrades to the Company's main operating system, licensing fee increases for our core banking system as a result of our increased asset size and increased maintenance fees for various Company systems. Costs incurred to upgrade NorthStar technology to our platform were capitalized and are being amortized according to the Company's depreciation policies. To-date, no significant costs have been incurred to upgrade Great American to our platform since the actual conversion to the Bank's systems will not occur until sometime in 2008.

Increase in Other noninterest expense includes \$239,000 of incremental Great American expenses (including \$85,000 for amortization of intangibles.) Excluding these expenses, other noninterest expense in the Bank decreased \$136,000 due to a decline in general operating expenses.

Noninterest expenses in our Banking business were \$26.0 million in the nine months ended September 30, 2007, an increase of \$5.7 million, or 28%, over the same period of 2006. Approximately \$2.0 million of the increase was related to Great American.

## **WEALTH MANAGEMENT**

This section contains a discussion of our Wealth Management business, which is comprised of Millennium and Enterprise Trust. Wealth Management is considered a core strategic line of business consistent with our Company mission of "guiding our clients to a lifetime of financial success." It is a major driver of fee income and is intended to help us diversify our dependency on bank spread incomes.

Wealth Management revenue of \$3.5 million was unchanged from third quarter 2006 to the third quarter of 2007. Enterprise Trust revenues grew 6%, or \$100,000 while Millennium's revenues declined 4%, or \$72,000. For the nine months ended September 30, 2007, Wealth Management revenue decreased \$102,000, or 1%, from \$10.0 million to \$9.9 million. Enterprise Trust revenues grew 7%, or \$347,000, while Millennium's revenues declined by 9%, or \$449,000.

### ***Millennium Brokerage Group***

After amortization of intangibles, the cost of related debt, and minority interest, Millennium posted pre-tax earnings of \$619,000 in the third quarter of 2007 compared to \$474,000 in the same quarter of 2006. For the nine months ended September 30, 2007, Millennium's pre-tax earnings were \$791,000 compared to \$1.4 million in the same period of 2006. As further described below in Minority Interest, through September 30, 2007, the Company has accrued 100% of Millennium's earnings. Although paid premiums are up 23% over 2006 year-to-date levels, Millennium's revenue and margin have been lower in 2007. The two items that have had the most significant impact on Millennium's revenue and margin compression are:

- Shift in carrier mix – Throughout 2007, more business has been placed with certain carriers whose contractual payouts to Millennium are lower than other carriers, thus impacting Millennium's revenue on this business. The decision on where to place business is based on several factors, including overall consumer value, product features, and carrier service levels.
- Producer mix – During 2007, more production has come from producers who earn higher payouts from Millennium, thus lowering Millennium's net revenue.

Millennium's noninterest expenses were \$1.0 million in the third quarter of 2007 compared to \$806,000 for the same period of 2006, an increase of \$216,000, or 27%. The increase is due to increases in salaries and related benefits of new associates in Finance, Sales and Underwriting as the unit continues to build out its national platform. The remaining increase is due to increases in insurance expense, meals and entertainment and various taxes. Noninterest expenses for the first nine months of 2007 were \$3.5 million compared to \$2.5 million for the same period of 2007.

*Minority Interest in Net Income of Consolidated Subsidiary*

In 2005, the Company acquired a 60% controlling interest in Millennium. The Company records the 40% non-controlling interest in Millennium, related to Millennium's results of operations, in minority interest on the consolidated statements of income. Contractually, the Company is entitled to a priority return of 23.1% pre-tax on its current \$15 million investment in Millennium before the minority interest holders are entitled to any distributions. The Company adjusted minority interest by \$503,000, during the quarter compared to \$86,000 for the same quarter of 2006 in order to recognize its priority return in line with its contractual rights. Year to date, the Company has adjusted minority interest by \$975,000.

**Enterprise Trust**

Enterprise Trust pre-tax earnings were \$318,000 in the third quarter of 2007 compared to \$277,000 for the same quarter of 2006, an increase of 15%. For the nine months ended September 30, 2007, pre-tax earnings for Enterprise Trust were \$822,000 compared to \$750,000 for the same period of 2006, an increase of 10%.

Assets under administration in Enterprise Trust have increased 11%, or \$166 million in the twelve months since September 30, 2006. Since December 31, 2006, assets under administration in Enterprise Trust have increased \$100 million from \$1.635 billion to \$1.735 billion at September 30, 2007.

As previously discussed, Enterprise Trust is expected to begin operating under a new national trust charter sometime in early 2008. In conjunction with the new charter, the unit is rolling out new pricing strategies and service lines intended to better serve the majority of our clients and prospects. Management believes these new initiatives will provide increased leverage and additional fee income for our Trust business.

**LIQUIDITY AND CAPITAL RESOURCES**

The objective of liquidity management is to ensure the Company has the ability to generate sufficient cash or cash equivalents in a timely and cost-effective manner to meet its commitments as they become due. Funds are available from a number of sources, such as from the core deposit base and from loans and securities repayments and maturities. Liquidity is also provided from sales of the securities portfolio, lines of credit with major banks, the Federal Reserve and the FHLB, the ability to acquire large and brokered deposits and the ability to sell loan participations to other banks.

The Company's liquidity management framework includes measurement of several key elements, such as the loan to deposit ratio, wholesale deposits as a percentage of total deposits, and various dependency ratios used by banking regulators. The Company's liquidity framework also incorporates contingency planning to assess the nature and volatility of funding sources and to determine alternatives to these sources.

Strong capital ratios, credit quality and core earnings are essential to retaining cost-effective access to the wholesale funding markets. Deterioration in any of these factors could have an impact on the Company's ability to access these funding sources and, as a result, these factors are monitored on an ongoing basis as part of the liquidity management process.

While core deposits and loan and investment repayments are principal sources of liquidity, funding diversification is another key element of liquidity management. Diversity is achieved by strategically varying depositor types, terms, funding markets, and instruments.

The parent company's liquidity is managed to provide the funds necessary to pay dividends to shareholders, service debt, invest in subsidiaries as necessary, and satisfy other operating requirements. The parent company's primary funding sources to meet its liquidity requirements are dividends from subsidiaries, borrowings against its \$15 million line of credit with a major bank, and proceeds from the issuance of equity (i.e. stock option exercises). Another source of funding for the parent company includes the issuance of subordinated debentures. As of September 30, 2007, the Company had \$55 million of outstanding subordinated debentures as part of eight Trust Preferred Securities Pools. Three of these debentures were related to the Clayco acquisition; two were acquired in the acquisition and one was issued to partially fund the acquisition. These securities are classified as debt but are included in regulatory capital and the related interest expense is tax-deductible, which makes them a very attractive source of funding.

Investment securities are an important tool to the Company's liquidity objective. As of September 30, 2007, the entire investment portfolio was available for sale. Of the \$122 million investment portfolio available for sale, \$43

million was pledged as collateral for public deposits, treasury, tax and loan notes, and other requirements. The remaining securities could be pledged or sold to enhance liquidity if necessary.

The Bank and Great American have a variety of funding sources available to increase financial flexibility. At September 30, 2007, under blanket loan pledges, absent being in default of their respective credit agreements, the Bank had \$93 million available from the FHLB of Des Moines and Great American had \$20 million available from the FHLB of Topeka. In addition, the Bank also had \$186 million available from the Federal Reserve Bank under pledged loan agreements. The Bank also has access to over \$70 million in overnight federal funds lines from various banking institutions, while Great American had \$21 million available in the form of overnight federal funds lines from various banking institutions. Finally, because both the Bank and Great American plan to remain [well-capitalized], they have the ability to sell certificates of deposit through various national or regional brokerage firms, if needed.

Over the normal course of business, the Company enters into certain forms of off-balance sheet transactions, including unfunded loan commitments and letters of credit. These transactions are managed through the Company's various risk management processes. Management considers both on-balance sheet and off-balance sheet transactions in its evaluation of the Company's liquidity. The Company has \$512 million in unused loan commitments as of September 30, 2007. While this commitment level would be very difficult to fund on a short term basis given the Company's current liquidity resources, our experience is that the nature of these commitments are such that the likelihood of such a funding demand is very low.

The Company and its banking affiliates are subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and its banking affiliates must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The banking affiliate's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its banking affiliates to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of September 30, 2007 and December 31, 2006, that the Company and its banking affiliates meet all capital adequacy requirements to which they are subject.

As of September 30, 2007 and December 31, 2006, both banking affiliates were categorized as [well capitalized] under the regulatory framework for prompt corrective action. To be categorized as [well capitalized], banks must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios.

The following table summarizes the Company's risk-based capital and leverage ratios at the dates indicated.

	At September 30, 2007	At December 31, 2006
<i>(in thousands)</i>		
Tier I capital to risk weighted assets	9.85%	9.60%
Total capital to risk weighted assets	11.05%	10.83%
Leverage ratio (Tier I capital to average assets)	9.32%	8.87%
Tangible capital to tangible assets	6.07%	6.48%
Tier I capital	\$ 162,347	\$ 131,869
Total risk-based capital	\$ 182,100	\$ 148,856

**ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The disclosures set forth in this item are qualified by the section captioned "Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995" included in Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations of this report and other cautionary statements set forth elsewhere in this report.

Market risk arises from exposure to changes in interest rates and other relevant market or price risks. The Company faces market risk in the form of interest rate risk through transactions other than trading activities. Market risk from these activities, in the form of interest rate risk, is measured and managed through a number of methods. The Company uses financial modeling techniques to measure interest rate risk. These techniques measure the sensitivity of future earnings due to changing interest rate environments. Guidelines established by the Asset/Liability Management Committees and approved by the Boards of Directors are used to monitor exposure of earnings at risk. General interest rate movements are used to develop sensitivity as the banking affiliate feels it has no primary exposure to a specific point on the yield curve. These limits are based on the banking affiliate's exposure to a 100 bp and 200 bp immediate and sustained parallel rate move, either upward or downward.

The following table represents the estimated interest rate sensitivity and periodic and cumulative gap positions calculated as of September 30, 2007.

<i>(in thousands)</i>	Year 1	Year 2	Year 3	Year 4	Year 5	Beyond 5 years or no stated maturity
<b>Interest-Earning Assets</b>						
Investments in debt and equity securities	\$ 7,607	\$ 47,432	\$ 41,313	\$ 5,242	\$ 6,482	\$ 1,000
Interest-bearing deposits	1,100	-	-	-	-	-
Federal funds sold	2,585	-	-	-	-	-
Loans (1)	1,079,102	154,606	167,277	61,769	53,814	4,000
Loans held for sale	1,117	-	-	-	-	-
Total interest-earning assets	\$ 1,091,511	\$ 202,038	\$ 208,590	\$ 67,011	\$ 60,296	\$ 5,000
<b>Interest-Bearing Liabilities</b>						
Savings, NOW and Money market deposits	\$ 716,295	\$ -	\$ -	\$ -	\$ -	\$ -
Certificates of deposit	382,637	61,769	46,296	20,928	5,193	-
Subordinated debentures	32,064	-	-	10,310	14,433	-
Other borrowings	95,614	16,550	12,000	300	7,000	1,000
Total interest-bearing liabilities	\$ 1,226,610	\$ 78,319	\$ 58,296	\$ 31,538	\$ 26,626	\$ 1,000
<b>Interest-sensitivity GAP</b>						
GAP by period	\$ (135,099)	\$ 123,719	\$ 150,294	\$ 35,473	\$ 33,670	\$ 4,000
Cumulative GAP	\$ (135,099)	\$ (11,380)	\$ 138,914	\$ 174,387	\$ 208,057	\$ 25,000
Ratio of interest-earning assets to interest-bearing liabilities						
Periodic	0.89	2.58	3.58	2.12	2.26	2.00
Cumulative GAP	0.89	0.99	1.10	1.13	1.15	1.10

(1) Adjusted for the impact of the interest rate swaps.

**ITEM 4: CONTROLS AND PROCEDURES**

## Edgar Filing: ENTERPRISE FINANCIAL SERVICES CORP - Form 10-Q

As of September 30, 2007, under the supervision and with the participation of the Company's Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), management has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based on that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of September 30, 2007, to ensure that information required to be disclosed in the Company's periodic SEC filings is processed, recorded, summarized and reported when required. There were no changes during the period covered by this Quarterly Report on Form 10-Q in the Company's internal controls that have materially affected, or are reasonably likely to materially affect, those controls.

### **PART II - OTHER INFORMATION**

#### **ITEM 2: UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS**

Issuer purchases of equity securities (1):

	(a)	(b)	(c)	(d)
Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced program	Maximum number of shares that may be purchased under the program
September 1, 2007 through September 30, 2007	28,000	\$ 22.86	28,000	

(1) On August 27, 2007, the Company's Board of Directors authorized a stock repurchase program of up to 625,000 shares, or approximately 5.00%, of the Company's outstanding common stock in the open market or in privately negotiated transactions. The new authorization replaces the previous repurchase program approved in 2004. The new program expires in August 2008. All repurchased shares are being held as Treasury stock.

27

#### **ITEM 6: EXHIBITS**

Exhibit Number	Description
3(ii)	Form of Bylaws as amended (incorporated herein by reference to Exhibit 3.1 on the Registrant's Current Report on Form 8-K, filed on September 26, 2007).
4.1	Registrant hereby agrees to furnish to the Commission, upon request, the instruments defining the rights of holders of each issue of long-term debt of Registrant and its consolidated subsidiaries.
*31.1	Chief Executive Officer's Certification required by Rule 13(a)-14(a).
*31.2	Chief Financial Officer's Certification required by Rule 13(a)-14(a).
**32.1	Chief Executive Officer Certification pursuant to 18 U.S.C. § 1350, as adopted pursuant to section § 906 of the Sarbanes-Oxley Act of 2002.
**32.2	Chief Financial Officer Certification pursuant to 18 U.S.C. § 1350, as adopted pursuant to section § 906 of the Sarbanes-Oxley Act of 2002.

\* Filed herewith

\*\* Furnished herewith. Notwithstanding any incorporation of this Quarterly Statement on Form 10-Q in any other filing by the Registrant, Exhibits furnished herewith and designated with two (\*\*) shall not be deemed incorporated by reference to any other filing unless specifically otherwise set forth herein.

28

---

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Clayton, State of Missouri on the day of November 8, 2007.

**ENTERPRISE FINANCIAL SERVICES CORP**

By: /s/ Kevin C. Eichner  
Kevin C. Eichner  
Chief Executive Officer

By: /s/ Frank H. Sanfilippo  
Frank H. Sanfilippo  
Chief Financial Officer

29

---