

ENTERPRISE FINANCIAL SERVICES CORP  
Form 10-Q  
May 09, 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 March 31, 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 May 4, 2007, the Registrant had 12,533,947 shares of outstanding common stock.

---

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

	<u>Page</u>
<b>PART I - FINANCIAL INFORMATION</b>	
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	23
Item 4. Controls and Procedures	24
<b>PART II - OTHER INFORMATION</b>	
Item 6. Exhibits	25
Signatures	26
Certifications	28

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

<i>(In thousands)</i>	(Unaudited) At March 31, 2007	(Audited) At December 31, 2006
<b>Assets</b>		
Cash and due from banks	\$ 41,846	\$ 41,558
Federal funds sold	6,992	7,066
Interest-bearing deposits	1,144	1,669
Total cash and cash equivalents	49,982	50,293
Investments in debt and equity securities available for sale, at estimated fair value	119,056	111,210
Loans held for sale	4,650	2,602
Portfolio loans	1,492,460	1,311,723
Less: Allowance for loan losses	19,220	16,988
Portfolio loans, net	1,473,240	1,294,735
Other real estate	1,064	1,500
Fixed assets, net	22,777	17,050
Accrued interest receivable	8,843	7,995
Goodwill	55,284	29,983
Intangibles, net	7,293	5,789
Prepaid expenses and other assets	14,434	14,430
Total assets	\$ 1,756,623	\$ 1,535,587
<b>Liabilities and Shareholders' Equity</b>		
Deposits:		
Demand	\$ 214,965	\$ 234,849
Interest-bearing transaction accounts	123,848	111,725
Money market accounts	568,668	553,251
Savings	13,563	3,696
Certificates of deposit:		
\$100 and over	361,476	296,916
Other	163,584	115,071
Total deposits	1,446,104	1,315,508

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

Subordinated debentures	56,807	35,054
Federal Home Loan Bank advances	75,387	26,995
Other borrowings	8,036	9,757
Notes payable	4,750	4,000
Accrued interest payable	4,067	3,468
Accounts payable and accrued expenses	2,770	7,811
<b>Total liabilities</b>	<b>1,597,921</b>	<b>1,402,593</b>
Minority interest in equity of consolidated subsidiary	-	-
Shareholders' equity:		
Common stock, \$0.01 par value; authorized 20,000,000 shares; issued and outstanding 12,339,696 shares at March 31, 2007 and 11,539,539 shares at December 31, 2006.	123	115
Additional paid in capital	100,901	78,026
Retained earnings	58,066	55,445
Accumulated other comprehensive loss	( 388)	( 592)
<b>Total shareholders' equity</b>	<b>158,702</b>	<b>132,994</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,756,623</b>	<b>\$ 1,535,587</b>

See accompanying notes to consolidated financial statements

1

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

<i>(In thousands, except per share data)</i>	Three months ended March 31,	
	2007	2006
<b>Interest income:</b>		
Interest and fees on loans	\$ 26,583	\$ 18,016
<b>Interest on debt and equity securities:</b>		
Taxable	1,096	1,024
Nontaxable	8	9
Interest on federal funds sold	53	335
Interest on interest-bearing deposits	18	6
Dividends on equity securities	90	39
<b>Total interest income</b>	<b>27,848</b>	<b>19,429</b>
<b>Interest expense:</b>		
Interest-bearing transaction accounts	750	455
Money market accounts	5,771	3,965
Savings	22	9
<b>Certificates of deposit:</b>		
\$100 and over	4,023	2,165
Other	1,636	606
Subordinated debentures	765	522
Federal Home Loan Bank borrowings	820	389
Notes payable and other borrowings	142	61

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

Total interest expense	13,929	8,172
Net interest income	13,919	11,257
Provision for loan losses	850	800
Net interest income after provision for loan losses	13,069	10,457
Noninterest income:		
Wealth Management income	2,963	3,319
Service charges on deposit accounts	659	501
Other service charges and fee income	207	126
Loss on sale of other real estate	(3)	-
Gain on sale of mortgage loans	65	23
Miscellaneous income	8	8
Total noninterest income	3,899	3,977
Noninterest expense:		
Employee compensation and benefits	7,308	5,801
Occupancy	878	611
Furniture and equipment	315	250
Data processing	424	309
Other	2,936	2,323
Total noninterest expense	11,861	9,294
Minority interest in net income of consolidated subsidiary	(157)	(453)
Income before income tax expense	4,950	4,687
Income tax expense	1,792	1,689
Net income	\$ 3,158	\$ 2,998
Per share amounts:		
Basic earnings per share	\$ 0.27	\$ 0.29
Basic weighted average common shares outstanding	11,835	10,465
Diluted earnings per share	\$ 0.26	\$ 0.28
Diluted weighted average common shares outstanding	12,198	10,856

See accompanying notes to consolidated financial statements.

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

	Accumulated		
	Common stock	Retained	other Total

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

<i>(in thousands, except shares)</i>	Shares	Amount	Additional		shareholders'	
			paid	comprehensive	income	equity
			in capital	earnings	(loss)	
<b>Balance December 31, 2006</b>	11,539,539	\$ 115	\$ 78,026	\$ 55,445	\$ (592)	\$ 132,994
Net income	-	-	-	3,158	-	3,158
Change in fair value of investment securities, net of tax	-	-	-	-	204	204
Total comprehensive income						3,362
Dividends declared (\$0.0525 per share)	-	-	-	(675)	-	(675)
Common stock issued under stock option plans, net of restricted share unit cancellations	98,741	1	1,056	-	-	1,057
Income tax benefit from stock options exercised and vesting of restricted share units	-	-	265	-	-	265
Acquisition of Clayco Banc Corporation	698,733	7	21,193	-	-	21,200
Cumulative effect of adoption of FIN 48			-	138		138
Issuance of common stock shares	2,683	-	87	-	-	87
Noncash compensation attributed to stock option grants	-	-	22	-	-	22
Noncash compensation attributed to restricted share units	-	-	252	-	-	252
<b>Balance March 31, 2007</b>	12,339,696	\$ 123	\$ 100,901	\$ 58,066	\$ (388)	\$ 158,702

Consolidated Statements of Comprehensive Income (Unaudited)

<i>(in thousands)</i>	Three months ended March 31,	
	2007	2006
Net income	\$ 3,158	\$ 2,998
Other comprehensive income:		
Unrealized (loss) gain on investment securities arising during the period, net of tax	204	(203)
Unrealized gain on cash flow type derivative instruments arising during the period, net of tax	-	313
Total comprehensive income	204	110
	\$ 3,362	\$ 3,108

See accompanying notes to consolidated financial statements.

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

<i>(in thousands)</i>	Three months ended March 31,	
	2007	2006
<b>Cash flows from operating activities:</b>		
Net income	\$ 3,158	\$ 2,998
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	527	361
Provision for loan losses	850	800
Net amortization of debt and equity securities	(5)	(15)
Amortization of intangible assets	364	228
Mortgage loans originated	(19,587)	(11,713)
Proceeds from mortgage loans sold	17,604	12,049
Gain on sale of mortgage loans	(65)	(23)
Loss on sale of other real estate	3	-
Excess tax benefits of share-based compensation	(265)	(37)
Share-based compensation	274	123
Changes in:		
Accrued interest receivable	211	(315)
Accrued interest payable and other liabilities	(4,774)	(2,707)
Other, net	(886)	(30)
Net cash (used in) provided by operating activities	(2,591)	1,719
<b>Cash flows from investing activities:</b>		
Cash paid for acquisition, net of cash and cash equivalents received	(7,885)	-
Net increase in loans	(12,932)	(63,705)
Purchases of available for sale debt and equity securities	(4,716)	(35,978)
Proceeds from redemption of equity securities	2,953	-
Proceeds from maturities and principal paydowns on available for sale debt and equity securities	12,950	60,901
Proceeds from sales of other real estate	693	-
Recoveries of loans previously charged off	85	174
Purchases of fixed assets	(1,996)	(3,709)
Net cash used in investing activities	(10,848)	(42,317)
<b>Cash flows from financing activities:</b>		
Net decrease in non-interest bearing deposit accounts	(35,035)	(36,328)
Net increase (decrease) in interest bearing deposit accounts	15,113	(38,286)
Proceeds from issuance of subordinated debentures	14,433	-
Proceeds from Federal Home Loan Bank advances	310,101	93,533
	(291,246)	(47,048)

Repayments of Federal Home Loan Bank  
advances

Net (decrease) increase in other borrowings	(1,525)	374
Proceeds from notes payable	750	-
Paydowns on notes payable	(197)	(1,500)
Cash dividends paid on common stock	(675)	(471)
Excess tax benefits of share-based compensation	265	37
Proceeds from the issuance of common stock	87	-
Proceeds from the exercise of common stock options	1,057	104
Net cash provided by (used in) financing activities	13,128	(29,585)
Net decrease in cash and cash equivalents	(311)	(70,183)
Cash and cash equivalents, beginning of year	50,293	118,911
<b>Cash and cash equivalents, end of period</b>	<b>\$ 49,982</b>	<b>\$ 48,728</b>

Supplemental disclosures of cash flow  
information:

Cash paid during the period for:		
Interest	\$ 13,179	\$ 8,537
Income taxes	3,138	304
Noncash transactions:		
Common stock issued for acquisition	21,200	-
Transfer to other real estate owned in settlement of loans	200	-

See accompanying notes to consolidated financial  
statements.

## 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 & casualty groups, and financial advisors in 49 states.

On July 5, 2006, EFSC completed its acquisition of 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.

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].

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 month period ended March 31, 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 provision of Financial Accounting Standards Board (["FASB"]) issued 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 March 31, 2007, the Company had approximately \$375,000 accrued for the payment of interest and penalties. The Company believes it is reasonably possible that \$470,000 in unrecognized tax benefits primarily related to certain state tax items will be recognized during 2007 as a result of the expiration of certain statutes of limitations. This amount excludes any federal income tax impact.

The tax years 2003 through 2006 remain open to examination by the major taxing jurisdictions to which the Company is subject.

---

Pursuant to recent Securities Exchange Commission (["SEC"]) guidance, the Company did not provide the tabular reconciliation disclosures required by FIN 48. The Company will provide all required FIN 48 disclosures in our 2007 Annual Report on Form 10-K.

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 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 unregistered 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;

All shares issued by EFSC were issued in reliance upon exemptions from registration set forth in Section 4(2) of the Securities Act of 1933, as amended, and Rule 506 promulgated under said Act. As a result, the shares issued for the acquisition are "restricted securities" and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements.

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 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 stockholders' 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 \$25.2 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.

As part of the acquisition agreement, \$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 are considered "contingent consideration" under U.S. GAAP and therefore, will not be recorded in common stock or additional paid in capital until the contingency is resolved. The Reserved Credit Escrow amount has 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. Any amounts in the Reserved Credit Escrow which have not been disbursed to the selling stockholders of NorthStar will be released to Enterprise.

---

## NOTE 3 GOODWILL AND INTANGIBLE ASSETS

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

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

<i>(in thousands)</i>	Goodwill
Balance at December 31, 2006	\$ 29,983
Acquisition-related adjustments (1)	93
Goodwill from purchase of Clayco Banc Corporation	25,208
Balance at March 31, 2007	\$ 55,284

(1) Includes additional purchase accounting adjustments on the Millennium and Northstar acquisition necessary to reflect additional valuation data since the acquisition date.

<i>(in thousands)</i>	Customer & trade name intangibles	Core deposit intangible	Net intangible
Balance at December 31, 2006	3,636	2,153	5,789
Intangibles from purchase of Clayco Banc Corporation	-	1,868	1,868
Amortization expense	(228)	(136)	(364)
Balance at March 31, 2007	\$ 3,408	3,885	\$ 7,293

The following table reflects the expected amortization schedule for the intangible assets (in thousands) at March 31, 2007.

Year	Amount
2007 remaining	\$ 1,240
2008	1,590
2009	1,513
2010	1,422
2011	446
After 2011	1,082
	\$ 7,293

7

**NOTE 4 EARNINGS PER SHARE**

The following table shows the components of basic and diluted earnings per share for the periods indicated.

<i>(in thousands, except per share data)</i>	Three months ended March 31,	
	2007	2006
<b>Basic</b>		
Net income, as reported	\$ 3,158	\$ 2,998
Weighted average common shares outstanding	11,835	10,465
Basic earnings per share	\$ 0.27	\$ 0.29
<b>Diluted</b>		
Net income	\$ 3,158	\$ 2,998
	\$ 3,158	\$ 2,998
Weighted average common shares outstanding	11,835	10,465

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

Effect of dilutive stock options and restricted stock units	363	391
Diluted weighted average common shares outstanding	12,198	10,856
Diluted earnings per share	\$ 0.26	\$ 0.28

**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 \$314,000 and \$152,000 for the three months ended March 31, 2007 and 2006, respectively. The total income tax benefit recognized in the income statement for share-based compensation arrangements was \$265,000 and \$37,000 for the three months ended March 31, 2007 and 2006, respectively.

The fair value of stock options granted in the quarters ended March 31, 2007 and 2006 is estimated based on the date of grant using the Black-Scholes option pricing model with the following average assumptions:

	Three months ended March 31,	
	2007	2006
Risk-free interest rate	4.7%	4.4%
Expected dividend rate	0.6%	0.6%
Expected volatility	39.2%	50.5%
Expected term (years)	6 years	10 years

8

*Employee Stock Options*

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.

	Three months ended March 31, 2007	
<i>(in thousands, except grant date fair value)</i>	2007	2006
Weighted average grant date fair value of options	\$ 13.08	\$ 13.94
Compensation expense	22	7
Intrinsic value of option exercises on date of exercise	1,441	1,200
Cash received from the exercise of stock options	825	705

<i>(Dollars in thousands, except share data)</i>	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregat Intrinsic Value
Outstanding at December 31, 2006	805,137	\$ 12.21	-	
Granted	2,900	30.17	-	
Exercised	(80,944)	10.20	-	
Forfeited	-	-	-	
Outstanding at March 31, 2007	727,093	\$ 12.51	5.4 years	\$ 11
Exercisable at March 31, 2007	710,948	\$ 12.21	5.3 years	\$ 11
Vested and expected to vest at March 31, 2007	727,093	\$ 12.51	5.4 years	\$ 11

At March 31, 2007, there was \$150,000 of total unrecognized compensation cost related to stock options, which is expected to be recognized over a weighted average period of approximately 2.5 years.

#### 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. Sales of the units are restricted prior to vesting. Compensation expense related to RSUs was \$252,000 and \$113,000 for the quarters ended March 31, 2007 and 2006, respectively. At March 31, 2007, there was \$3,167,000 of total unrecognized compensation cost related to nonvested RSUs, which is expected to be recognized over a weighted average period of approximately 3.5 years.

	Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2006	160,475	\$ 22.67
Granted	-	-
Vested	-	-
Forfeited	(5,444)	21.80
Outstanding at March 31, 2007	155,031	22.70

#### Stock Appreciation Rights

Expense to record the market value of the stock appreciation rights ("SARS") was \$0 and \$28,450 for the three months ended March 31, 2007 and 2006, respectively. At December 31, 2006, there were no other SARS outstanding.

#### Stock Plan for Non-Management Directors

In 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. In January 2007, the Company issued 2,683 shares of restricted stock at a fair value of \$32.58 per share. Compensation expense related to those shares was recorded in 2006. Share-based compensation expense for the directors was \$41,000 and \$0 for the quarters ended March 31, 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 quarter of 2006, the Company recognized \$4,300 in Moneta option-related expenses.

(Dollars in thousands, except share data)	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2006	165,823	\$ 12.66		
Granted	-	-		
Exercised	(17,732)	13.05		
Forfeited	-	-		
Outstanding at March 31, 2007	148,091	\$ 12.61	2.9 years	\$ 2,2

Exercisable at March 31, 2007	143,739	\$	12.61	2.8 years	\$	2,2
Vested and expected to vest at March 31, 2007	148,091	\$	12.61	2.9 years	\$	2,2

**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 swaps to convert floating-rate loan assets to fixed rates. As of March 31, 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 \$338,000 in the first quarter of 2006.

*Fair Value Hedges*

The Bank has entered into interest rate swap agreements with the objective of converting the fixed interest rate on certain brokered CDs to a variable interest rate. The swap agreements provide for the Bank to pay a variable rate of interest based on a spread to the one or three-month LIBOR and to receive a fixed rate of interest equal to that of the brokered CD (hedged instrument.) Fair value hedges are accounted for at fair value. All changes in fair value are measured on a quarterly basis.

Amounts to be paid or received are accounted for on an accrual basis and recognized as interest expense of the related liability. The net cash flows related to fair value hedges increased interest expense on certificates of deposit by \$41,000 and \$157,000 during the first quarter of 2007 and 2006, respectively. 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. At March 31, 2007, the Bank had no outstanding fair value hedges.

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. 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.

Under the swap agreements the Bank is to pay or receive interest monthly. The net cash flows related to these hedges decreased interest income on loans by \$200 during the first quarter of 2007. One swap agreement is a forward rate lock hedging against rate increases through August 2007. As a result, the cash flows for this swap will not begin until August 2007. One interest rate swap with a notional amount of \$1.8 million was terminated in March 2007.

The following table summarizes the Bank's derivative instruments at the periods indicated below.

March 31,	December 31,
-----------	--------------

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

<i>(in thousands)</i>	2007		2006	
<b>Fair Value Hedges</b>				
Notional amount	\$	-	\$	10,000
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	\$	5,431	\$	7,324
Weighted average pay rate		8.31 %		7.96 %
Weighted average receive rate		8.32 %		7.95 %
Weighted average maturity in months		78		79
Unrealized loss related to interest rate swaps	\$	(108)	\$	(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 March 31, 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 March 31, 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 Bank 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 Bank uses the same credit policies in making commitments and conditional obligations as it does for financial instruments included on its consolidated balance sheets. At March 31, 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 periods indicated below.

<i>(in thousands)</i>	March 31, 2007	December 31, 2006
Commitments to extend credit	\$ 470,905	\$ 480,071
Standby letters of credit	36,709	39,587
Private equity bank fund	250	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 March 31, 2007 and December 31, 2006, approximately \$40.2 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



**Income Statement Information**

<i>(in thousands)</i>	<b>Three months ended March 31, 2007</b>				Total
	Banking	Wealth Management	Corporate and Intercompany		
Net interest income	\$ 14,695	\$ 26	\$ (802)	\$	
Provision for loan losses	850	-	-		
Noninterest income	906	2,963	30		
Non interest expense	8,306	2,720	835		
Minority interest	-	(157)	-		
Income (loss) before income tax expense	6,444	112	(1,607)		
Income tax expense (benefit)	2,331	40	(579)		
Net income (loss)	\$ 4,114	\$ 71	\$ (1,028)	\$	

	<b>Three months ended March 31, 2006</b>				Total
	Banking	Wealth Management	Corporate and Intercompany		
Net interest income	\$ 11,753	\$ 22	\$ (518)	\$	
Provision for loan losses	800	-	-		
Noninterest income	644	3,319	14		
Non interest expense	6,135	2,309	850		
Minority interest	-	(453)	-		
Income (loss) before income tax expense	5,462	579	(1,354)		
Income tax expense (benefit)	1,968	208	(487)		
Net income (loss)	\$ 3,494	\$ 371	\$ (867)	\$	

13

**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 new business trust and underlying subordinated debentures issued and acquired during the first quarter of 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

## 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).*

14

---

### **INTRODUCTION**

The following discussion describes significant changes in the financial condition of the Company that have occurred during the first three months of 2007 compared to 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 months ended March 31, 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 months ended March 31, 2007 was \$3.2 million, an increase of 5%, compared to \$3.0 million for the same period in 2006. Fully diluted earnings per share for the three months ended March 31, 2007 was \$0.26 compared to \$0.28 for the same period in 2006. In addition to strong loan growth and an increase in Trust profitability, major drivers in the quarter included the increased share counts (due to our recent acquisitions), margin compression due to a prolonged inverted yield curve and related competitive pressures, an increase in non-performing loans, and a decrease in Millennium profits.

Earnings per share for the current-year period reflect the impact of a 915,000 share increase in the number of shares outstanding issued to acquire NorthStar in July 2006 and 699,000 shares issued to acquire Clayco in February 2007.

**Banking** □ On February 28, 2007 the Company completed its acquisition of Kansas City-based Clayco Banc Corporation and its wholly owned subsidiary, Great American Bank. Clayco's results 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. Over the last three quarters, we have tripled our market position in Kansas City through the NorthStar and Clayco acquisitions as well as organic growth.

- **Loans** □ The Bank's loan pipeline and new fundings were strong in the first quarter of 2007, however, this was partially offset by some payoffs and line paydowns. Using average portfolio loans for the first quarter of 2007 and excluding the Clayco acquisition impact, loans grew 14% annualized from the average portfolio loans in the fourth quarter of 2006. We continue to experience strong loan and deposit pricing competition in both markets and are steadfast in our intent to remain disciplined in our loan pricing practices in order to maintain margins. Including Clayco, portfolio loans were up \$181 million or 14% from December 31, 2006. The Bank's portfolio loans grew by \$15 million from December 31, 2006 and were up \$260 million or 24% from March 31, 2006. At March 31, 2007, portfolio loans related to Clayco were \$166 million.
- **Deposits** □ Including Clayco, deposits were up \$131 million, or 10% from December 31, 2006. Consistent with our historical trend, we experienced seasonal deposit runoff, but at lower levels. Deposits in the Bank decreased by \$20 million from December 31, 2006 compared to a \$75 million decrease in first quarter of 2006. Bank deposits were up \$253 million or 24% from March 31, 2006. At March 31, 2007, deposits related to Clayco were \$151 million, including \$26 million of brokered certificates of deposit.

We continue to pursue our strategy of obtaining lower cost transaction and relationship-based accounts primarily through our treasury management products and services. The combined bank deposit mix remains favorable with demand deposits accounts representing 16% of average deposits in a competitive deposit rate environment. In addition, we plan to continue utilizing Federal Home Loan Bank (□FHLB□) advances and short-term brokered certificates of deposit to fund shortfalls due to loan demand. Through March 31, 2007, we have utilized approximately \$75 million in short-term FHLB advances and \$17 million net in short-term brokered certificates of deposit to fund loan demand.

- **Asset Quality** □ The Bank's asset performance statistics weakened slightly but overall asset quality remains solid. During the first quarter of 2007, we incurred net charge-offs of \$628,000 or 0.19% of average loans (annualized.) Non-performing loans were \$9.9 million or 0.66% of portfolio loans. At March 31, 2007, the allowance for loan losses was \$19.0 million, or 1.29%, of portfolio loans compared to \$17.0 million, or 1.30%, at December 31, 2006 and \$14 million, or 1.31% at March 31, 2006.

15

---

- **Net Interest Rate Margin** □ The tax-equivalent net interest rate margin was 3.86% for the first quarter of 2007 compared to 3.99% for the same period in 2006. The 0.13% decline was primarily due to the increasing cost of deposits that more than offset higher earning asset yields and volumes, along with interest reversals on nonperforming loans during the first quarter of 2007. Additionally, higher levels of subordinated debentures associated with the acquisition of Clayco negatively impacted the margin. Though down somewhat from the prior year, our margin remains respectable in comparison to the commercial bank sector as a whole.

**Wealth Management** □ The Wealth Management line of business did not meet our expectations for the first quarter despite increased Trust profitability.

- **Revenue** □ Wealth Management revenue decreased by \$356,000, or 11%, from \$3.3 million in first quarter 2006 to \$3.0 million in the first quarter of 2007. The decline in revenue was due to \$464,000 of lower Millennium commissions partially offset by \$108,000 of revenue increases in the Trust division. The Millennium life sales pipeline has, however, been strong as evidenced by a 29% increase in paid premium for the quarter. Assets under administration in the Trust division increased \$25 million from \$1.635

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

billion at December 31, 2006 to \$1.660 billion at March 31, 2007. Assets from new clients were offset by flat to declining asset values in existing client portfolios.

- Earnings □ After amortization of intangibles, the cost of related debt, and minority interest, Millennium posted a pre-tax loss of \$229,000 in the first quarter versus pre-tax earnings of \$292,000 in the same quarter of 2006. Pre-tax earnings of our Trust business were \$217,000 in the first quarter of 2007, an increase of 45% over first quarter of 2006. These earnings are being driven by strong operating leverage as increased revenues have a disproportionate effect on profits due to the relatively high fixed cost ratio of this business.

### RESULTS OF OPERATIONS ANALYSIS

#### Net Interest Income

The Bank's balance sheet and resulting net interest income remains essentially neutral to changes in interest rates.

Net interest income (on a tax-equivalent basis) was \$14.2 million for the three months ended March 31, 2007, compared to \$11.5 million for the same period of 2006, an increase of 24%. Total interest income increased \$8.5 million while total interest expense increased \$5.8 million.

Organic loan growth in the Bank along with the addition of NorthStar in July 2006 and Great American on February 28, 2007 has driven a 28%, or \$322 million, increase in interest-earning assets from March 31, 2006 to March 31, 2007. Over that timeframe, average loans increased \$347 million, or 34%, from \$1.022 billion to \$1.369 billion. For the first quarter of 2007, interest income on loans increased \$6.3 million from growth and \$2.1 million due to the impact of rates, for a net increase of \$8.5 million versus first quarter of 2006.

For the quarter ended March 31, 2007, average interest-bearing liabilities increased \$305 million, or 33% to \$1.240 billion compared to \$935 million for the quarter ended March 31, 2006. The growth in interest-bearing liabilities resulted from a \$169 million increase in interest-bearing core deposits, an \$88 million increase in brokered certificates of deposit, a \$12 million increase in subordinated debentures, and a \$36 million increase in borrowed funds including FHLB advances. As previously discussed, we are pursuing lower cost transaction and relationship-based accounts primarily through our treasury management products and services and meeting loan funding shortfalls with FHLB advances and short-term brokered certificates of deposit. The changes in balances noted also includes the acquisition of NorthStar in July 2006. Demand deposit accounts, which are non interest-bearing, represented 16% of average total deposits at March 31, 2007. For first quarter of 2007, interest expense on interest-bearing liabilities increased \$3.4 million due to this growth while the impact of rising rates increased interest expense on interest-bearing liabilities by \$2.4 million versus first quarter of 2006.

The net interest rate margin (on a tax-equivalent basis) was 3.86% for the first quarter of 2006, compared to 3.99% in the same quarter of 2006. The decline was primarily due to the increasing cost of deposits that more than offset higher earning asset yields and volumes along with interest reversals on nonperforming loans during the first quarter of 2007. Additionally, higher levels of subordinated debentures associated with the acquisition of Clayco negatively impacted the margin.

16

#### 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 March 31,				
	2007		2006		
(in thousands)	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense
<b>Assets</b>					
Interest-earning assets:					
Taxable loans (1)	\$ 1,338,754	\$ 26,166	7.93%	\$ 997,342	\$ 17,676

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

Tax-exempt loans (2)	30,553	652	8.65	25,032	531
<b>Total loans</b>	<b>1,369,307</b>	<b>26,818</b>	<b>7.94</b>	<b>1,022,374</b>	<b>18,207</b>
Taxable investments in debt and equity securities	111,696	1,185	4.30	110,705	1,064
Non-taxable investments in debt and equity securities (2)	890	12	5.47	1,202	14
Short-term investments	5,300	72	5.51	31,108	341
<b>Total securities and short-term investments</b>	<b>117,886</b>	<b>1,269</b>	<b>4.37</b>	<b>143,015</b>	<b>1,419</b>
<b>Total interest-earning assets</b>	<b>1,487,193</b>	<b>28,087</b>	<b>7.66</b>	<b>1,165,389</b>	<b>19,626</b>
<b>Non-interest-earning assets:</b>					
Cash and due from banks	44,523			41,969	
Other assets	87,304			41,660	
Allowance for loan losses	(17,754)			(13,327)	
<b>Total assets</b>	<b>\$ 1,601,266</b>			<b>\$ 1,235,691</b>	

**Liabilities and Shareholders' Equity**

Interest-bearing liabilities:

Interest-bearing transaction accounts	\$ 112,617	\$ 750	2.70%	\$ 104,479	\$ 455
Money market accounts	545,977	5,771	4.29	473,058	3,965
Savings	7,175	22	1.24	3,731	9
Certificates of deposit	453,213	5,659	5.06	281,504	2,771
<b>Total interest-bearing deposits</b>	<b>1,118,982</b>	<b>12,202</b>	<b>4.42</b>	<b>862,772</b>	<b>7,200</b>
Subordinated debentures	43,028	765	7.21	30,930	522
Borrowed funds	78,231	962	4.99	41,775	450
<b>Total interest-bearing liabilities</b>	<b>1,240,241</b>	<b>13,929</b>	<b>4.55</b>	<b>935,477</b>	<b>8,172</b>

Noninterest-bearing liabilities:

Demand deposits	208,195			197,262	
Other liabilities	9,316			8,614	
<b>Total liabilities</b>	<b>1,457,752</b>			<b>1,141,353</b>	
Shareholders' equity	143,514			94,338	
<b>Total liabilities &amp; shareholders' equity</b>	<b>\$ 1,601,266</b>			<b>\$ 1,235,691</b>	

<b>Net interest income</b>		<b>\$ 14,158</b>			<b>\$ 11,454</b>
Net interest spread			3.11%		
Net interest rate margin (3)			3.86		

(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 \$779,000 and \$501,000 for the quarters ended March 31, 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 rate in effect for each year. The tax-equivalent adjustments reflected in the above table are approximately \$239,000 and \$197,000 for the quarters ended March 31, 2007, and 2006, respectively.

(3) Net interest income divided by average total interest-earning assets.

17

**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.

(in thousands)	2007 compared to 2006		
	Volume (1)	Rate (2)	Net
Interest earned on:			

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

Loans	\$6,529	\$1,961	\$8,490
Nontaxable loans (3)	118	3	121
Taxable investments in debt and equity securities	10	111	121
Nontaxable investments in debt and equity securities (3)	(4)	2	(2)
Short-term investments	(336)	67	(269)
Total interest-earning assets	\$6,317	\$2,144	\$8,461
Interest paid on:			
Interest-bearing transaction accounts	\$ 37	\$ 258	\$ 295
Money market accounts	670	1,136	1,806
Savings	10	3	13
Certificates of deposit	2,005	883	2,888
Subordinated debentures	214	29	243
Borrowed funds	440	72	512
Total interest-bearing liabilities	3,376	2,381	5,757
Net interest income	\$2,941	\$ (237)	\$2,704

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

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

(3) Nontaxable 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.**

The provision for loan losses in the first quarter of 2007 was \$850,000, compared to \$800,000 in the same quarter of 2006. The increase in provision was due to higher non-performing asset levels offset by lower loan growth. During the first quarter of 2007, the Company had charge-offs of \$628,000, or 0.19% annualized. The charge-offs represent two credits that were previously classified as non-performing and for which loss reserves had been specifically allocated.

The allowance for loan losses as a percentage of total loans was 1.29% at March 31, 2007 compared to 1.30% at December 31, 2006 and 1.31% at March 31, 2006. Management believes that the allowance for loan losses is adequate.

Non-performing loans were \$9.9 million or 0.66% of total loans at March 31, 2007 versus 0.49% at December 31, 2006 and 0.13% at March 31, 2006. At March 31, 2007, one builder relationship, represented almost 50% of the non-performing loans and management believes we are well secured with real estate. The remaining non-performing loans represent fourteen different relationships.

During the first quarter of 2007, three properties held as foreclosed real estate were sold. Two of these properties were related to the NorthStar acquisition. No gain or loss was recorded on the sale of those properties; instead a value adjustment was recorded as allowed within the one-year timeframe. An additional property, formerly in the NorthStar portfolio, was foreclosed and sold for a \$3,000 realized loss. The remaining foreclosed real estate, valued at \$1.1 million, consists of nine single family residences and lots in Kansas City that were former NorthStar loan relationships. All properties are presently being marketed for resale either by residential real estate firms or through our network of residential builders.

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

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

<i>(in thousands)</i>	Three months ended March 31,	
	2007	2006
Allowance at beginning of period	\$ 16,988	\$ 12,990
Acquired allowance for loan losses	2,010	-
Loans charged off:		
Commercial and industrial	206	-
Real estate:		
Commercial	-	-
Construction	5	-
Residential	500	-
Consumer and other	3	-
Total loans charged off	714	-
Recoveries of loans previously charged off:		
Commercial and industrial	47	159
Real estate:		
Commercial	16	1
Construction	-	-
Residential	13	14
Consumer and other	10	-
Total recoveries of loans	86	174
Net loan chargeoffs (recoveries)	628	(174)
Provision for loan losses	850	800
Allowance at end of period	\$ 19,220	\$ 13,964
Average loans	\$ 1,369,307	\$ 1,022,374
Total portfolio loans	1,492,460	1,066,084
Nonperforming loans	9,855	1,353
Net chargeoffs (recoveries) to average loans	0.19 %	(0.02) %
Allowance for loan losses to loans	1.29	1.31

19

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

<i>(in thousands)</i>	March 31,	December 31,
	2007	2006
Non-accrual loans	\$ 9,855	\$ 6,363
Loans past due 90 days or more and still accruing interest	-	112
Restructured loans	-	-
Total nonperforming loans	9,855	6,475
Foreclosed property	1,064	1,500
Total nonperforming assets	\$ 10,919	\$ 7,975
Total assets	\$ 1,756,623	\$ 1,535,587
Total loans	1,492,460	1,311,723

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

Total loans plus foreclosed property	1,493,524	1,313,223
Nonperforming loans to loans	0.66 %	0.49 %
Nonperforming assets to loans plus foreclosed property	0.73	0.61
Nonperforming assets to total assets	0.62	0.52
Allowance for loan losses to nonperforming loans	195.00 %	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 in 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

Excluding the effect of Wealth Management (as described in the Executive Summary), noninterest income increased \$278,000, or 42% from first quarter 2006 to first quarter 2007. Increases in service charges on deposit accounts were primarily due to incremental activity of NorthStar 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 NorthStar deposit fee income. In addition, our International Banking operation, which was formed in mid-2006 become fully operational in first quarter 2007.

Our mortgage operations had a good first quarter as evidenced by higher gain on sale of mortgage loans.

Noninterest income should increase in 2007 due to NorthStar, Great American, International Banking, and Mortgage.

### Noninterest Expense

Noninterest expenses increased \$2.6 million from \$9.3 million in the first quarter of 2006 to \$11.9 million in the same quarter of 2007. Approximately \$1.1 million and \$322,000 of the increase was related to NorthStar and Great American, respectively (including amortization of intangibles.) Millennium expenses increased \$355,000 from the first quarter of 2006.

For the quarter, our efficiency ratio, which expresses noninterest expense as a percentage of net interest income and other income, moved from 61.0% in the first quarter of 2006 to 66.6% for first quarter of 2007. This was due to the increase in expenses from acquisitions and various growth initiatives combined with the decline in noninterest income.

Quarter over quarter increases in employee compensation and benefits of \$175,000, \$526,000 and \$157,000 were related to Millennium, NorthStar and Great American, respectively. Excluding these expenses, employee compensation and benefits increased 12%, or \$650,000. The increase is due to salaries and related benefits of new associates in various areas of our organization including International banking, Wholesale, Mortgage, Wealth management and other support areas. Approximately \$139,000 of the remaining increase is related to vesting of restricted share units in our performance-based long-term incentive program. The costs were offset by declines in wealth management commissions and our variable-pay bonus pool.

Increases in occupancy expense were the result of rent increases on various Company facilities, incremental expenses related to NorthStar and 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. Expenses incurred to upgrade NorthStar technology to our platform were capitalized and are being amortized according to the Company's depreciation policies.

The quarter over quarter increase in Other noninterest expense includes \$73,000 of incremental Great American expenses (including \$28,000 for amortization of intangibles.) Other noninterest expenses also includes \$195,000 of incremental expenses related to NorthStar (including \$108,000 for amortization of intangibles.) The remaining increase in other noninterest expense is related to increases in travel, meals and entertainment, charitable contributions and loan-related expenses along with increases in general operating expenses such as telephone, marketing, postage, and courier charges.

#### **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. No priority return adjustments were made to minority interest in the first quarter of 2007 or 2006.

#### **Income Taxes**

The provision for income taxes was \$1.8 million for the three ended March 31, 2007 compared to \$1.7 million for the same period in 2006. The effective tax rate for the three months ended March 31, 2007 was 36.2% compared to 36.0% for the same period in 2006.

#### **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 Federal Home Loan Bank, 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 March 31, 2007, the Company has \$55 million of outstanding subordinated debentures as part of seven 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 March 31, 2007, the entire investment portfolio was available for sale. Of the \$119 million investment portfolio available for sale, \$45 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 has a variety of funding sources (in addition to key liquidity sources, such as core deposits, loan repayments, loan participations sold, and investment portfolio sales) available to increase financial flexibility. At March 31, 2007, under blanket loan pledges, absent being in default of their respective credit agreements, the Bank had \$143 million available from the Federal Home Loan Bank of Des Moines and Great American had \$32 million available from the Federal Home Loan Bank of Topeka. The Bank also had \$178 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 purchased 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 \$471 million in unused loan commitments as of March 31, 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 March 31, 2007 and December 31, 2006, that the Company and its banking affiliates meet all capital adequacy requirements to which they are subject.

As of March 31, 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 March 31,	At December 31,
--	--------------	--------------------

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

<i>(in thousands)</i>	2007	2006
Tier I capital to risk weighted assets	9.50%	9.60%
Total capital to risk weighted assets	10.85%	10.83%
Leverage ratio (Tier I capital to average assets)	9.72%	8.87%
Tangible capital to tangible assets	5.71%	6.48%
Tier I capital	\$ 149,614	\$ 131,869
Total risk-based capital	\$ 170,786	\$ 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.

23

The following table represents the estimated interest rate sensitivity and periodic and cumulative gap positions calculated as of March 31, 2007.

<i>(in thousands)</i>	Year 1	Year 2	Year 3	Year 4	Year 5	Beyond 5 years or no stated maturity	Total
<b>Interest-Earning Assets</b>							
Investments in debt and equity securities	\$ 35,105	\$ 37,127	\$ 29,031	\$ 4,870	\$ 1,004	\$ 11,919	\$ 119,056
Interest-bearing deposits	1,144	-	-	-	-	-	1,144
Federal funds sold	6,992	-	-	-	-	-	6,992
Loans (1)	979,272	179,882	158,576	74,223	54,842	45,665	1,492,460
Loans held for sale	4,650	-	-	-	-	-	4,650
Total interest-earning assets	\$ 1,027,163	\$ 217,009	\$ 187,607	\$ 79,093	\$ 55,846	\$ 57,584	\$ 1,624,302
<b>Interest-Bearing Liabilities</b>							
Savings, NOW and Money market deposits	\$ 706,079	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 706,079
Certificates of deposit	421,391	40,311	36,759	15,922	10,272	405	525,060
Subordinated debentures	32,064	-	-	10,310	-	14,433	56,807
Other borrowings	39,786	13,508	10,850	5,800	300	17,929	88,173
Total interest-bearing liabilities	\$ 1,199,320	\$ 53,819	\$ 47,609	\$ 32,032	\$ 10,572	\$ 32,767	\$ 1,376,119
<b>Interest-sensitivity GAP</b>							
GAP by period	\$ (172,157)	\$ 163,190	\$ 139,998	\$ 47,061	\$ 45,274	\$ 24,817	\$ 248,183

Cumulative GAP	\$ (172,157)	\$ (8,967)	\$ 131,031	\$ 178,092	\$ 223,366	\$ 248,183	\$ 248,183
Ratio of interest-earning assets to interest-bearing liabilities							
Periodic	0.86	4.03	3.94	2.47	5.28	1.76	1.18
Cumulative GAP	0.86	0.99	1.10	1.13	1.17	1.18	1.18

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

#### ITEM 4: CONTROLS AND PROCEDURES

As of March 31, 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 March 31, 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.

24

---

## **PART II**

#### ITEM 6: EXHIBITS

Exhibit Number	Description
*3.1	Amendment to the Certificate of Incorporation filed on April 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.

25

---

## **SIGNATURES**

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

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 May 9, 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