ENTERPRISE FINANCIAL SERVICES CORP
Form 10-Q
November 05, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2012.

[ ] 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 [X] No [ ]

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

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

Large accelerated filer o Accelerated filer R Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

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

As of October 30, 2012, the Registrant had 17,963,888 shares of outstanding common stock.

This document is also available through our website at http://www.enterprisebank.com.

ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES
TABLE OF CONTENTS

	Page
PART I - FINANCIAL INFORMATION	
Item 1. Financial Statements	
Condensed Consolidated Balance Sheets (Unaudited)	1
Condensed Consolidated Statements of Operations (Unaudited)	2
Condensed Consolidated Statements of Comprehensive Income (Unaudited)	3
Condensed Consolidated Statements of Shareholders' Equity (Unaudited)	4
Condensed Consolidated Statements of Cash Flows (Unaudited)	5
Notes to Condensed Consolidated Financial Statements (Unaudited)	6
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	29
Item 3. Quantitative and Qualitative Disclosures About Market Risk	47
Item 4. Controls and Procedures	48
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings	49
Item 1A. Risk Factors	50
Item 6. Exhibits	51
Signatures	52

PART 1 – ITEM 1 – FINANCIAL STATEMENTS
ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES
Condensed Consolidated Balance Sheets (Unaudited)

(In thousands, except share and per share data)	September 30, 2012	December 31, 2011
Assets		
Cash and due from banks	$28,964	$20,791
Federal funds sold	30	143
Interest-bearing deposits (including $3,800 and $2,650 pledged as collateral)	56,681	167,209
Total cash and cash equivalents	85,675	188,143
Interest-bearing deposits greater than 90 days	1,000	1,502
Securities available for sale	610,357	593,182
Mortgage loans held for sale	8,245	6,494
Portfolio loans not covered under FDIC loss share	1,987,166	1,897,074
Less: Allowance for loan losses	34,222	37,989
Portfolio loans not covered under FDIC loss share, net	1,952,944	1,859,085
Portfolio loans covered under FDIC loss share, net of the allowance for loan losses ($11,102 and $1,635, respectively)	210,331	298,975
Portfolio loans, net	2,163,275	2,158,060
Other real estate not covered under FDIC loss share	12,549	17,217
Other real estate covered under FDIC loss share	18,810	36,471
Other investments, at cost	16,362	14,527
Fixed assets, net	21,469	18,986
Accrued interest receivable	10,481	9,193
State tax credits, held for sale, including $25,069 and $26,350 carried at fair value, respectively	65,873	50,446
FDIC loss share receivable	75,851	184,554
Goodwill	30,334	30,334
Intangibles, net	7,846	9,285
Other assets	65,565	59,385
Total assets	$3,193,692	$3,377,779
Liabilities and Shareholders' Equity		
Demand deposits	$621,070	$585,479
Interest-bearing transaction accounts	259,902	253,504
Money market accounts	975,216	1,084,304
Savings	81,552	51,145
Certificates of deposit:		
$100 and over	420,672	550,535
Other	192,521	266,386
Total deposits	2,550,933	2,791,353
Subordinated debentures	85,081	85,081
Federal Home Loan Bank advances	126,000	102,000
Other borrowings	147,104	154,545
Accrued interest payable	1,377	1,762
Other liabilities	15,681	3,473
Total liabilities	2,926,176	3,138,214
Shareholders' equity:		
	33,914	33,293

Preferred stock, $0.01 par value;		
5,000,000 shares authorized; 35,000 shares issued and outstanding		
Common stock, $0.01 par value; 30,000,000 shares authorized; 18,039,710 and 17,849,862 shares issued, respectively	180	178
Treasury stock, at cost; 76,000 shares	(1,743)	(1,743)
Additional paid in capital	172,545	169,138
Retained earnings	53,232	35,097
Accumulated other comprehensive income	9,388	3,602
Total shareholders' equity	267,516	239,565
Total liabilities and shareholders' equity	$3,193,692	$3,377,779

See accompanying notes to condensed consolidated financial statements.

1

ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES
Condensed Consolidated Statements of Operations (Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
(In thousands, except per share data)	2012	2011	2012	2011
Interest income:				
Interest and fees on loans	$39,886	$30,983	$111,519	$93,565
Interest on debt securities:				
Taxable	2,628	2,853	7,440	8,666
Nontaxable	264	184	734	449
Interest on federal funds sold	—	—	—	1
Interest on interest-bearing deposits	53	166	195	427
Dividends on equity securities	43	99	230	269
Total interest income	42,874	34,285	120,118	103,377
Interest expense:				
Interest-bearing transaction accounts	182	211	566	606
Money market accounts	1,024	2,004	3,694	6,210
Savings	68	35	209	53
Certificates of deposit:				
$100 and over	1,691	2,297	5,500	6,959
Other	597	855	2,103	2,708
Subordinated debentures	982	1,128	3,111	3,375
Federal Home Loan Bank advances	721	881	2,327	2,669
Notes payable and other borrowings	125	105	362	316
Total interest expense	5,390	7,516	17,872	22,896
Net interest income	37,484	26,769	102,246	80,481
Provision for loan losses not covered under FDIC loss share	1,048	5,400	2,841	13,300
Provision for loan losses covered under FDIC loss share	10,889	2,672	13,380	2,947
Net interest income after provision for loan losses	25,547	18,697	86,025	64,234
Noninterest income:				
Wealth Management revenue	1,825	1,832	5,525	5,173
Service charges on deposit accounts	1,456	1,332	4,199	3,663
Other service charges and fee income	676	464	1,848	1,105
Gain on sale of other real estate	739	517	3,152	1,039
Gain on state tax credits, net	256	1,368	1,180	2,510
Gain on sale of investment securities	—	768	1,156	1,448
Change in FDIC loss share receivable	1,912	1,513	(6,738)	1,148
Miscellaneous income	968	932	2,338	1,821
Total noninterest income	7,832	8,726	12,660	17,907
Noninterest expense:				
Employee compensation and benefits	11,441	9,329	32,956	26,282
Occupancy	1,399	1,306	4,162	3,586
Furniture and equipment	384	431	1,234	1,216
Data processing	881	642	2,530	1,872
FDIC and other insurance	862	828	2,658	3,183
Loan legal and other real estate expense	1,187	1,576	5,216	7,267
Other	5,128	4,190	15,304	10,885
Total noninterest expense	21,282	18,302	64,060	54,291

Income before income tax expense	12,097	9,121	34,625	27,850
Income tax expense	4,167	3,289	11,744	9,633
Net income	$7,930	$5,832	$22,881	$18,217
Net income available to common shareholders	$7,282	$5,200	$20,948	$16,329
Earnings per common share				
Basic	$0.41	$0.29	$1.17	$1.00
Diluted	0.39	0.29	1.14	0.98

See accompanying notes to condensed consolidated financial statements.

2

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

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2012	2011	2012	2011
Net income	$7,930	$5,832	$22,881	$18,217
Other comprehensive income, net of tax:				
Unrealized gain (loss) on investment securities arising during the period, net of tax	3,248	(261)	6,526	6,302
Less reclassification adjustment for realized gain on sale of securities included in net income, net of tax	—	(491)	(740)	(926)
Reclassification of cash flow hedge, net of tax	—	(28)	—	(85)
Total other comprehensive income (loss)	3,248	(780)	5,786	5,291
Total comprehensive income	$11,178	$5,052	$28,667	$23,508

See accompanying notes to condensed consolidated financial statements.

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

(in thousands, except per share data)	Preferred Stock	Common Stock	Treasury Stock	Additional paid in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balance January 1, 2012	$33,293	$ 178	$(1,743)	$169,138	$35,097	$ 3,602	$ 239,565
Net income	—	—	—	—	22,881	—	22,881
Change in fair value of available for sale securities, net of tax	—	—	—	—	—	6,526	6,526
Reclassification adjustment for realized gain on sale of securities included in net income, net of tax	—	—	—	—	—	(740)	(740)
Total comprehensive income							28,667
Cash dividends paid on common shares, $0.1575 per share	—	—	—	—	(2,813)	—	(2,813)
Cash dividends paid on preferred stock	—	—	—	—	(1,312)	—	(1,312)
Preferred stock accretion of discount	621	—	—	—	(621)	—	—
Issuance under equity compensation plans, net, 189,848 shares	—	2	—	1,530	—	—	1,532
Share-based compensation	—	—	—	1,791	—	—	1,791
Excess tax benefit related to equity compensation plans	—	—	—	86	—	—	86
Balance September 30, 2012	$33,914	$ 180	$(1,743)	$172,545	$53,232	$ 9,388	$ 267,516

(in thousands, except per share data)	Preferred Stock	Common Stock	Treasury Stock	Additional paid in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balance January 1, 2011	$32,519	$ 150	$(1,743)	$133,673	$15,775	$ (573)	$ 179,801
Net income	—	—	—	—	18,217	—	18,217
Change in fair value of available for sale securities, net of tax	—	—	—	—	—	6,302	6,302
Reclassification adjustment for realized gain on sale of securities included in net income, net of tax	—	—	—	—	—	(926)	(926)
Reclassification of cash flow hedge, net of tax	—	—	—	—	—	(85)	(85)
Total comprehensive income							23,508
Cash dividends paid on common shares, $0.1575 per share	—	—	—	—	(2,644)	—	(2,644)
Cash dividends paid on preferred stock	—	—	—	—	(1,313)	—	(1,313)
Preferred stock accretion of discount	575	—	—	—	(575)	—	—
	—	1	—	1,368	—	—	1,369

Issuance under equity compensation plans, net, 109,812 shares							
Issuance under public stock offering 2,743,900 shares	—	27	—	32,581	—	—	32,608
Share-based compensation	—	—	—	1,120	—	—	1,120
Excess tax benefit related to equity compensation plans	—	—	—	22	—	—	22
Balance September 30, 2011	$33,094	$178	$(1,743)	$168,764	$29,460	$4,718	$234,471

See accompanying notes to condensed consolidated financial statements.

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

	Nine months ended September 30,	
(in thousands)	2012	2011
Cash flows from operating activities:		
Net income	$22,881	$18,217
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	1,944	2,057
Provision for loan losses	16,221	16,247
Deferred income taxes	(1,982)	5,091
Net amortization of debt securities	5,839	3,983
Amortization of intangible assets	1,440	490
Gain on sale of investment securities	(1,156)	(1,448)
Mortgage loans originated for sale	(71,085)	(48,772)
Proceeds from mortgage loans sold	68,987	49,147
Gain on sale of other real estate	(3,152)	(1,039)
Gain on state tax credits, net	(1,180)	(2,510)
Excess tax benefit of share-based compensation	(86)	(22)
Share-based compensation	1,791	1,120
Valuation adjustment on other real estate	2,201	3,261
Net accretion of loan discount and indemnification asset	(18,754)	(10,964)
Changes in:		
Accrued interest receivable	(1,288)	165
Accrued interest payable	(385)	(501)
Prepaid FDIC insurance	1,837	2,336
Other assets	1,298	(6,294)
Other liabilities	12,567	(5,558)
Net cash provided by operating activities	37,938	25,006
Cash flows from investing activities:		
Cash received from acquisition of Legacy Bank	—	8,926
Cash received from acquisition of The First National Bank of Olathe	—	112,778
Net increase in loans	(10,478)	(84,022)
Net cash proceeds received from FDIC loss share receivable	85,173	35,932
Proceeds from the sale of debt and equity securities, available for sale	110,876	84,456
Proceeds from the maturity of debt and equity securities, available for sale	91,498	122,934
Proceeds from the redemption of other investments	6,296	5,774
Proceeds from the sale of state tax credits held for sale	4,408	8,045
Proceeds from the sale of other real estate	44,273	27,429
Payments for the purchase/origination of:		
Available for sale debt and equity securities	(214,935)	(255,210)
Other investments	(8,138)	(1,361)
State tax credits held for sale	(18,577)	—
Fixed assets	(4,433)	(416)
Net cash provided by investing activities	85,963	65,265
Cash flows from financing activities:		
Net increase in noninterest-bearing deposit accounts	35,591	101,351
Net decrease in interest-bearing deposit accounts	(276,011)	(204,372)
Proceeds from Federal Home Loan Bank advances	157,500	—
Repayments of Federal Home Loan Bank advances	(133,500)	(23,254)

Net decrease in other borrowings	(7,440)	(20,332)
Cash dividends paid on common stock	(2,813)	(2,645)
Excess tax benefit of share-based compensation	86	22
Cash dividends paid on preferred stock	(1,312)	(1,313)
Issuance of common stock	—	32,608
Proceeds from the issuance of equity instruments	1,530	1,369
Net cash used in financing activities	(226,369)	(116,566)
Net decrease in cash and cash equivalents	(102,468)	(26,295)
Cash and cash equivalents, beginning of period	188,143	293,668
Cash and cash equivalents, end of period	$85,675	$267,373
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$17,487	$23,442
Income taxes	10,953	16,871
Noncash transactions:		
Transfer to other real estate owned in settlement of loans	$19,799	$20,287
Sales of other real estate financed	5,264	2,135

See accompanying notes to condensed consolidated financial statements.

ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used by Enterprise Financial Services Corp (the “Company” or “Enterprise”) in the preparation of the condensed consolidated financial statements are summarized below:

Business and Consolidation

Enterprise 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, Kansas City and Phoenix metropolitan markets through its banking subsidiary, Enterprise Bank & Trust (the “Bank”).

Operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for any other interim period or for the year ending December 31, 2012. 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, 2011.

Basis of Financial Statement Presentation

The condensed consolidated financial statements of the Company and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America (“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 annual financial statements. The condensed consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All intercompany accounts and transactions have been eliminated. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain 2011 amounts in the consolidated financial statements have been reclassified to conform to the 2012 presentation. These reclassifications have no effect on Net income or Shareholders' equity as previously reported.

NOTE 2 - EARNINGS PER SHARE

Basic earnings per common share data is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Common shares outstanding include common stock and restricted stock awards where recipients have satisfied the vesting terms. Diluted earnings per common share gives effect to all dilutive potential common shares outstanding during the period using the treasury stock method and the if-converted method for convertible securities related to the issuance of trust preferred securities.

The following table presents a summary of per common share data and amounts for the periods indicated.

	Three months ended September 30,		Nine months ended September 30,	
(in thousands, except per share data)	2012	2011	2012	2011
Net income as reported	$7,930	$5,832	$22,881	$18,217
Preferred stock dividend	(436)	(437)	(1,312)	(1,313)
Accretion of preferred stock discount	(212)	(195)	(621)	(575)
Net income available to common shareholders	$7,282	$5,200	$20,948	$16,329
Impact of assumed conversions				
Interest on 9% convertible trust preferred securities, net of income tax	371	371	1,113	1,113
Net income available to common shareholders and assumed conversions	$7,653	$5,571	$22,061	$17,442
Weighted average common shares outstanding	17,876	17,741	17,829	16,322
Incremental shares from assumed conversions of convertible trust preferred securities	1,439	1,439	1,439	1,439
Additional dilutive common stock equivalents	100	22	34	20
Weighted average diluted common shares outstanding	19,415	19,202	19,302	17,781
Basic earnings per common share:	$0.41	$0.29	$1.17	$1.00
Diluted earnings per common share:	$0.39	$0.29	$1.14	$0.98

For the three months ended September 30, 2012 and 2011, the amount of common stock equivalents that were excluded from the earnings per share calculations because their effect was anti-dilutive was 1.0 million (including 324,074 common stock warrants) and 744,632 common stock equivalents (including 324,074 common stock warrants), respectively. For the nine months ended September 30, 2012 and 2011, the amount of common stock equivalents that were excluded from the earnings per share calculations because their effect was anti-dilutive was 1.0 million (including 324,074 common stock warrants) and 888,821 (including 324,074 common stock warrants), respectively.

NOTE 3 - INVESTMENTS

The following table presents the amortized cost, gross unrealized gains and losses and fair value of securities available-for-sale:

(in thousands)	September 30, 2012 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Obligations of U.S. Government sponsored enterprises	$124,721	$3,284	$—	$128,005
Obligations of states and political subdivisions	43,720	2,429	(360)	45,789
Residential mortgage-backed securities	426,992	9,773	(202)	436,563
	$595,433	$15,486	$(562)	$610,357

(in thousands)	December 31, 2011 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Obligations of U.S. Government sponsored enterprises	$126,305	$678	$(66)	$126,917
Obligations of states and political subdivisions	38,489	1,729	(381)	39,837
Residential mortgage-backed securities	422,761	5,269	(1,602)	426,428
	$587,555	$7,676	$(2,049)	$593,182

At September 30, 2012, and December 31, 2011, there were no holdings of securities of any one issuer in an amount greater than 10% of shareholders' equity, other than the U.S. government agencies and sponsored enterprises. The residential mortgage-backed securities are all issued by U.S. government sponsored enterprises. Available for sale securities having a fair value of $271.8 million and $287.8 million at September 30, 2012, and December 31, 2011, respectively, were pledged as collateral to secure deposits of public institutions and for other purposes as required by law or contract provisions.

The amortized cost and estimated fair value of debt securities classified as available for sale at September 30, 2012, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The weighted average life of the mortgage-backed securities is approximately 3 years.

(in thousands)	Amortized Cost	Estimated Fair Value
Due in one year or less	$2,299	$2,325
Due after one year through five years	118,719	122,152
Due after five years through ten years	42,958	45,014
Due after ten years	4,465	4,303
Mortgage-backed securities	426,992	436,563
	$595,433	$610,357

The following table represents a summary of available-for-sale investment securities that had an unrealized loss:

	September 30, 2012					
	Less than 12 months		12 months or more		Total	
(in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of the state and political subdivisions	$540	$2	$3,388	$358	$3,928	$360
Residential mortgage-backed securities	16,764	71	9,161	131	25,925	202
	$17,304	$73	$12,549	$489	$29,853	$562

	December 31, 2011					
	Less than 12 months		12 months or more		Total	
(in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. government sponsored enterprises	$23,389	$66	$—	$—	$23,389	$66
Obligations of the state and political subdivisions	1,503	8	3,027	373	4,530	381
Residential mortgage-backed securities	86,954	1,598	4,203	4	91,157	1,602
	$111,846	$1,672	$7,230	$377	$119,076	$2,049

The unrealized losses at both September 30, 2012, and December 31, 2011, were primarily attributable to changes in market interest rates since the securities were purchased. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) the present value of the cash flows expected to be collected compared to the amortized cost of the security, (2) duration and magnitude of the decline in value, (3) the financial condition of the issuer or issuers, (4) structure of the security and (5) the intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value. At September 30, 2012, management performed its quarterly analysis of all securities with an unrealized loss and concluded no individual securities were other-than-temporarily impaired.

The gross gains and gross losses realized from sales of available-for-sale investment securities were as follows:

	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2012	2011	2012	2011
Gross gains realized	$—	$768	$1,399	$1,448
Gross losses realized	—	—	(243)	—
Proceeds from sales	—	49,033	110,876	84,456

NOTE 4 - PORTFOLIO LOANS NOT COVERED BY LOSS SHARE ("Non-covered")

Below is a summary of Non-covered loans by category at September 30, 2012, and December 31, 2011:

(in thousands)	September 30, 2012	December 31, 2011
Real Estate Loans:		
Construction and Land Development	$146,236	$140,147
Commercial real estate - Investor Owned	476,501	477,154
Commercial real estate - Owner Occupied	325,379	334,416
Residential real estate	146,940	171,034
Total real estate loans	$1,095,056	$1,122,751
Commercial and industrial	880,394	763,202
Consumer & other	11,694	11,459
Portfolio Loans	$1,987,144	$1,897,412
Unearned loan costs, net	22	(338)
Portfolio loans, including unearned loan costs	$1,987,166	$1,897,074

The Company grants commercial, residential, and consumer loans primarily in the St. Louis, Kansas City and Phoenix metropolitan areas. The Company has a diversified loan portfolio, with no particular concentration of credit in any one economic sector; however, a substantial portion of the portfolio is concentrated in and secured by real estate. The ability of the Company’s borrowers to honor their contractual obligations is partially dependent upon the local economy and its effect on the real estate market.

A summary of the year-to-date activity in the allowance for loan losses and the recorded investment in Non-covered loans by portfolio class and category based on impairment method through September 30, 2012, and at December 31, 2011, is as follows:

(in thousands)	Commercial & Industrial	Commercial Real Estate Owner Occupied	Commercial Real Estate Investor Owned	Construction and Land Development	Residential Real Estate	Consumer & Other	Qualitative Adjustment	Total
Allowance for Loan Losses:								
Balance at December 31, 2011	$11,945	$6,297	$6,751	$ 5,847	$3,931	$14	$ 3,204	$37,989
Provision charged to expense	929	1,231	216	269	(555)	—	(372)	1,718
Losses charged off	(585)	(746)	(185)	(856)	(362)	—	—	(2,734)
Recoveries	96	2	15	152	356	2	—	623
Balance at March 31, 2012	$12,385	$6,784	$6,797	$ 5,412	$3,370	$16	$ 2,832	$37,596
Provision charged to expense	(3,201)	(744)	3,518	442	(189)	3	246	75
Losses charged off	(406)	(739)	(108)	(502)	(216)	—	—	(1,971)
Recoveries	203	5	15	97	284	—	—	604
Balance at June 30, 2012	$8,981	$5,306	$10,222	$ 5,449	$3,249	$19	$ 3,078	$36,304
Provision charged to expense	(204)	(738)	604	2,551	(1,202)	4	33	1,048
Losses charged off	(1,479)	(625)	(639)	(949)	(282)	—	—	(3,974)
Recoveries	142	1	14	15	672	—	—	844
Balance at September 30, 2012	$7,440	$3,944	$10,201	$ 7,066	$2,437	$23	$ 3,111	$34,222

(in thousands)	Commercial & Industrial	Commercial Real Estate Owner Occupied	Commercial Real Estate Investor Owned	Construction and Land Development	Residential Real Estate	Consumer & Other	Qualitative Adjustment	Total
Balance September 30, 2012								
Allowance for Loan Losses - Ending Balance:								
Individually evaluated for impairment	$1,165	$ 379	$2,199	$ 2,538	$506	$—	$ —	$6,787
	6,275	3,565	8,002	4,528	1,931	23	3,111	27,435

Collectively evaluated for impairment								
Total	$7,440	$ 3,944	$10,201	$ 7,066	$2,437	$23	$ 3,111	$34,222
Loans - Ending Balance:								
Individually evaluated for impairment	$2,849	$ 5,584	$9,647	$ 10,095	$3,883	$—	$ —	$32,058
Collectively evaluated for impairment	877,545	319,795	466,854	136,141	143,057	11,716	—	1,955,108
Total	$880,394	$ 325,379	$476,501	$ 146,236	$146,940	$11,716	$ —	$1,987,166
Balance at December 31, 2011								
Allowance for Loan Losses - Ending Balance:								
Individually evaluated for impairment	$3,214	$ 1,377	$2,315	$ 2,927	$896	$—	$ —	$10,729
Collectively evaluated for impairment	8,731	4,920	4,436	2,920	3,035	14	3,204	27,260
Total	$11,945	$ 6,297	$6,751	$ 5,847	$3,931	$14	$ 3,204	$37,989
Loans - Ending Balance:								
Individually evaluated for impairment	$5,634	$ 4,572	$11,127	$ 14,767	$5,522	$—	$ —	$41,622
Collectively evaluated for impairment	757,568	329,844	466,027	125,380	165,512	11,121	—	1,855,452
Total	$763,202	$ 334,416	$477,154	$ 140,147	$171,034	$11,121	$ —	$1,897,074

11

A summary of Non-covered loans individually evaluated for impairment by category at September 30, 2012, and December 31, 2011, is as follows:

(in thousands)	September 30, 2012 Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial & Industrial	$4,081	$291	$2,558	$2,849	$1,165	$6,322
Real Estate:						
Commercial - Owner Occupied	6,154	2,875	2,709	5,584	379	8,653
Commercial - Investor Owned	14,053	1,865	7,782	9,647	2,199	9,793
Construction and Land Development	13,192	748	9,347	10,095	2,538	11,295
Residential	4,164	1,705	2,178	3,883	506	4,800
Consumer & Other	—	—	—	—	—	—
Total	$41,644	$7,484	$24,574	$32,058	$6,787	$40,863

(in thousands)	December 31, 2011 Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial & Industrial	$7,517	$128	$ 5,506	$5,634	$3,214	$6,571
Real Estate:						
Commercial - Owner Occupied	5,099	—	4,572	4,572	1,377	2,711
Commercial - Investor Owned	15,676	914	10,213	11,127	2,315	10,562
Construction and Land Development	19,685	1,628	13,139	14,767	2,927	16,114
Residential	6,465	2,211	3,311	5,522	896	9,588
Consumer & Other	—	—	—	—	—	—
Total	$54,442	$4,881	$ 36,741	$41,622	$10,729	$45,546

There were no loans over 90 days past due and still accruing interest at September 30, 2012. If interest on impaired loans would have been accrued based upon the original contractual terms, such income would have been $708,000 and $2.2 million for the three and nine months ended September 30, 2012, respectively. The cash amount collected and recognized as interest income on impaired loans was $120,000 and $361,000 for the three and nine months ended September 30, 2012, respectively. The amount recognized as interest income on impaired loans continuing to accrue interest was $174,000 and $412,000 for the three and nine months ended September 30, 2012, respectively. At September 30, 2012, there were $543,000 of unadvanced commitments on impaired loans. Other Liabilities include approximately $98,000 for estimated losses attributable to the unadvanced commitments on impaired loans.

The recorded investment in impaired Non-covered loans by category at September 30, 2012, and December 31, 2011, is as follows:

	September 30, 2012			
(in thousands)	Non-accrual	Restructured	Loans over 90 days past due and still accruing interest	Total
Commercial & Industrial	$2,849	$—	$—	$2,849
Real Estate:				
Commercial - Investor Owned	9,647	—	—	9,647
Commercial - Owner Occupied	5,377	207	—	5,584
Construction and Land Development	7,286	2,809	—	10,095
Residential	2,187	1,696	—	3,883
Consumer & Other	—	—	—	—
Total	$27,346	$4,712	$—	$32,058

	December 31, 2011			
(in thousands)	Non-accrual	Restructured	Loans over 90 days past due and still accruing interest	Total
Commercial & Industrial	$4,475	$1,159	$—	$5,634
Real Estate:				
Commercial - Investor Owned	6,647	4,480	—	11,127
Commercial - Owner Occupied	4,129	443	—	4,572
Construction and Land Development	10,335	3,677	755	14,767
Residential	5,299	223	—	5,522
Consumer & Other	—	—	—	—
Total	$30,885	$9,982	$755	$41,622

The recorded investment by category for the Non-covered loans that have been restructured for the three and nine months ended September 30, 2012, is as follows:

	Three months ended September 30, 2012			Nine months ended September 30, 2012		
(in thousands, except for number of loans)	Number of Loans	Pre-Modification Outstanding Recorded Balance	Post-Modification Outstanding Recorded Balance	Number of Loans	Pre-Modification Outstanding Recorded Balance	Post-Modification Outstanding Recorded Balance
Commercial & Industrial	1	$ 150	$ —	—	$ —	$ —
Real Estate:						
Commercial - Owner Occupied	1	207	207	1	207	207
Commercial - Investor Owned	—	—	—	—	—	—
Construction and Land Development	—	—	—	2	4,341	2,809
Residential	—	—	—	1	1,696	1,696

Consumer & Other	—	—	—	—	—	—
Total	2	$ 357	$ 207	4	$ 6,244	$ 4,712

The restructured Non-covered loans primarily resulted from interest rate concessions. As of September 30, 2012, the Company has allocated $791,000 of specific reserves to the loans that have been restructured.

The recorded investment by category for the Non-covered loans that have been restructured and subsequently defaulted for the three and nine months ended September 30, 2012, is as follows:

	Three months ended September 30, 2012		Nine months ended September 30, 2012	
(in thousands, except for number of loans)	Number of Loans	Recorded Balance	Number of Loans	Recorded Balance
Commercial & Industrial	1	$150	2	$166
Real Estate:				
Commercial - Owner Occupied	—	—	—	—
Commercial - Investor Owned	—	—	—	—
Construction and Land Development	—	—	—	—
Residential	—	—	—	—
Consumer & Other	—	—	—	—
Total	1	$150	2	$166

The aging of the recorded investment in past due Non-covered loans by portfolio class and category at September 30, 2012, and December 31, 2011, is shown below.

	September 30, 2012				
(in thousands)	30-89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total
Commercial & Industrial	$704	$862	$1,566	$878,828	$880,394
Real Estate:					
Commercial - Owner Occupied	—	344	344	325,035	325,379
Commercial - Investor Owned	15	4,509	4,524	471,977	476,501
Construction and Land Development	596	5,306	5,902	140,334	146,236
Residential	703	890	1,593	145,347	146,940
Consumer & Other	5	—	5	11,711	11,716
Total	$2,023	$11,911	$13,934	$1,973,232	$1,987,166

	December 31, 2011				
(in thousands)	30-89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total
Commercial & Industrial	$4,521	$792	$5,313	$757,889	$763,202
Real Estate:					
Commercial - Owner Occupied	1,945	1,522	3,467	330,949	334,416
Commercial - Investor Owned	2,308	4,209	6,517	470,637	477,154
Construction and Land Development	1,356	9,786	11,142	129,005	140,147
Residential	299	4,137	4,436	166,598	171,034
Consumer & Other	—	—	—	11,121	11,121
Total	$10,429	$20,446	$30,875	$1,866,199	$1,897,074

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, and current economic factors among other factors. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

- Grades 1, 2, and 3 - These grades include loans to borrowers with a continuous record of strong earnings, sound balance sheet condition and capitalization, ample liquidity with solid cash flow and whose management team has experience and depth within their industry.
- Grade 4– This grade includes loans to borrowers with positive trends in profitability, satisfactory capitalization and balance sheet condition, and sufficient liquidity and cash flow.
- Grade 5 – This grade includes loans to borrowers that may display fluctuating trends in sales, profitability, capitalization, liquidity, and cash flow.
- Grade 6– This grade includes loans to borrowers where an adverse change or perceived weakness has occurred, but may be correctable in the near future. Alternatively, this rating category may also include circumstances where the company is starting to reverse a negative trend or condition, or have recently been upgraded from a 7, 8, or 9 rating.
- Grade 7 – Watch credits are companies that have experienced financial setback of a nature that are not determined to be severe or influence ‘ongoing concern’ expectations. Borrowers within this category are expected to turnaround within a 12-month period of time. Although possible, no loss is anticipated, due to strong collateral and/or guarantor support.

- Grade 8 – Substandard credits will include those companies that are characterized by significant losses and sustained downward trends in balance sheet condition, liquidity, and cash flow. Repayment reliance may have shifted to secondary sources. Collateral exposure may exist and additional reserves may be warranted.
- Grade 9 – Doubtful credits include borrowers that may show deteriorating trends that are unlikely to be corrected. Collateral values may appear insufficient for full recovery, therefore requiring a partial charge-off, or debt renegotiation with the borrower. Borrower may have declared bankruptcy or bankruptcy is likely in the near term. All doubtful rated credits will be on non-accrual.

The recorded investment by risk category of the Non-covered loans by portfolio class and category at September 30, 2012, which is based upon the most recent analysis performed, and December 31, 2011 is as follows:

	September 30, 2012				
(in thousands)	Pass (1-6)	Watch (7)	Substandard (8)	Doubtful (9)	Total
Commercial & Industrial	$824,351	$37,878	$18,165	$—	$880,394
Real Estate:					
Commercial - Owner Occupied	279,806	30,850	14,379	344	325,379
Commercial - Investor Owned	387,509	54,161	34,831	—	476,501
Construction and Land Development	101,683	15,101	28,944	508	146,236
Residential	130,212	4,967	11,761	—	146,940
Consumer & Other	11,660	6	50	—	11,716
Total	$1,735,221	$142,963	$108,130	$852	$1,987,166

	December 31, 2011				
(in thousands)	Pass (1-6)	Watch (7)	Substandard (8)	Doubtful (9)	Total
Commercial & Industrial	$683,239	$50,197	$27,229	$2,537	$763,202
Real Estate:					
Commercial - Owner Occupied	276,802	40,207	16,225	1,182	334,416
Commercial - Investor Owned	405,686	56,370	14,894	204	477,154
Construction and Land Development	91,286	27,056	21,461	344	140,147
Residential	148,309	4,814	16,419	1,492	171,034
Consumer & Other	11,112	9	—	—	11,121
Total	$1,616,434	$178,653	$96,228	$5,759	$1,897,074

NOTE 5 - PORTFOLIO LOANS COVERED BY LOSS SHARE ("Covered loans")

Purchased loans acquired in our FDIC-assisted transactions, are recorded at estimated fair value on their purchase date without a carryover of the related allowance for loan losses. Purchased credit-impaired loans are loans that have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration as of the purchase date may include factors such as past due and non-accrual status. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the non-accretable yield. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges or a reclassification of the difference from non-accretable to accretable with a positive impact on interest income, prospectively. Further, any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized into interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows. Acquired loans that have common risk

characteristics are aggregated into pools. The Company remeasures contractual and expected cash flows, at the pool-level, on a quarterly basis.

Inputs to the determination of expected cash flows include contractual cash flows, cumulative default and prepayment data as well as loss severity and recovery lag information. Cumulative default and prepayment data are calculated via a transition matrix. The transition matrix is a matrix of probability values that specifies the probability of a loan pool transitioning into a loss given its delinquency state (e.g. 0-30 days past due, 31 to 60 days, etc.) at the remeasurement date. Loss severity factors are based upon industry data along with actual charge-off data within the loan pools and recovery lags are based upon industry data along with experience with the collateral within the loan pools.

Covered loans are also subject to the Company’s internal and external credit review and are risk rated using the same criteria as loans originated by the Company. However, risk ratings are not always a clear indicator of the Company's losses on acquired loans as a majority of the losses are recoverable from the FDIC under the loss-sharing agreements.

Below is a summary of Covered loans by category at September 30, 2012, and December 31, 2011:

(in thousands)	September 30, 2012		December 31, 2011	
	Weighted-Average Risk Rating	Recorded Investment Covered Loans	Weighted-Average Risk Rating	Recorded Investment Covered Loans
Real Estate Loans:				
Construction and Land Development	7.13	$38,620	7.22	$65,990
Commercial real estate - Investor Owned	6.00	64,287	6.12	75,093
Commercial real estate - Owner Occupied	6.60	44,307	6.03	63,101
Residential real estate	5.67	46,426	4.81	56,828
Total real estate loans		$193,640		$261,012
Commercial and industrial	6.93	26,209	6.61	36,423
Consumer & other	4.33	1,584	4.14	3,175
Portfolio Loans		$221,433		$300,610

Outstanding balances on purchased loans from the FDIC were $338.2 million and $496.2 million as of September 30, 2012, and December 31, 2011, respectively.

Below is a summary of the activity in the allowance for loan losses for Covered loans at September 30, 2012, and September 30, 2011:

(in thousands)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Balance at beginning of period	$1,889	$—	$1,635	$—
Provision charged to expense	10,889	2,672	13,380	2,947
Loans charged off	(1,627)	(103)	(3,689)	(378)
Recoveries	10	—	16	—
Other	(59)	—	(240)	—
Balance at end of period	$11,102	$2,569	$11,102	$2,569

17

The aging of the recorded investment in past due Covered loans by portfolio class and category at September 30, 2012, and December 31, 2011, is shown below.

	September 30, 2012				
(in thousands)	30-89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total
Commercial & Industrial	$3,325	$4,378	$7,703	$18,506	$26,209
Real Estate:					
Commercial - Owner Occupied	—	6,590	6,590	37,717	44,307
Commercial - Investor Owned	375	2,180	2,555	61,732	64,287
Construction and Land Development	1,884	21,830	23,714	14,906	38,620
Residential	609	2,634	3,243	43,183	46,426
Consumer & Other	11	2	13	1,571	1,584
Total	$6,204	$37,614	$43,818	$177,615	$221,433

	December 31, 2011				
(in thousands)	30-89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total
Commercial & Industrial	$879	$9,867	$10,746	$25,677	$36,423
Real Estate:					
Commercial - Owner Occupied	1,438	9,684	11,122	51,979	63,101
Commercial - Investor Owned	2,530	7,021	9,551	65,542	75,093
Construction and Land Development	2,842	28,745	31,587	34,403	65,990
Residential	1,634	3,341	4,975	51,853	56,828
Consumer & Other	236	7	243	2,932	3,175
Total	$9,559	$58,665	$68,224	$232,386	$300,610

The accretable yield is accreted into interest income over the estimated life of the acquired loans using the effective yield method. Other adjustments to the accretable yield include changes in the estimated remaining life of the acquired loans, changes in expected cash flows and changes of indices for acquired loans with variable interest rates.

Changes in the accretable yield for purchased loans were as follows for the nine months ended September 30, 2012, and 2011:

(in thousands)	September 30, 2012	September 30, 2011
Balance at beginning of period	$63,335	$46,460
Additions	—	40,380
Accretion	(36,225)	(15,337)
Reclassifications from nonaccretable difference	74,758	5,160
Other	(6,423)	(34,228)
Balance at end of period	$95,445	$42,435

Other changes in the accretable yield include the impact of cash flow timing estimates, changes in variable interest rates, and other non-credit related adjustments. For the three months ended and nine months ended September 30, 2012, the Bank received payments of $15.2 million and $85.2 million, respectively, for loss share claims under the

terms of the FDIC shared-loss agreements.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

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 under commitments to extend credit and standby letters of credit in the event of nonperformance by the other party to the financial instrument 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, 2012, there were $543,000 of unadvanced commitments on impaired loans. Other liabilities include approximately $98,000 for estimated losses attributable to the unadvanced commitments on impaired loans.

The contractual amounts of off-balance-sheet financial instruments as of September 30, 2012, and December 31, 2011, are as follows:

(in thousands)	September 30, 2012	December 31, 2011
Commitments to extend credit	$724,517	$547,657
Standby letters of credit	43,383	43,973

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, may have significant usage restrictions, and may require payment of a fee. Of the total commitments to extend credit at September 30, 2012, and December 31, 2011, approximately $66.3 million and $75.7 million, respectively, represent fixed rate loan commitments. Since certain of the commitments may expire without being drawn upon or may be revoked, 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 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. Included in the September 30, 2012 commitments to extend credit are $106 million of lines with significant usage restrictions.

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 term of standby letters of credit range from 6 months to 5 years at September 30, 2012.

Contingencies

The Company and its subsidiaries are, from time to time, parties to various legal proceedings arising out of their businesses. Other than those described below, management believes that there are no such proceedings pending or threatened against the Company or its subsidiaries which, if determined adversely, would have a material adverse effect on the business, consolidated financial condition, results of operations or cash flows of the Company or any of its subsidiaries.

Distinctive Notes
The Bank, along with other co-defendants has been named as a defendant in two lawsuits filed by persons alleging to be clients of the Bank’s Trust division who invested in promissory notes (the "Distinctive Notes") issued by Distinctive Properties (UK) Limited (“Distinctive Properties”), a company involved in the purchase and development of real estate

in the United Kingdom. The Company is unable to estimate a reasonably possible loss for the cases described below because the proceedings are in early stages and there are significant factual issues to be determined and resolved in each case. The Company denies plaintiffs' allegations and intends to vigorously defend the lawsuits.

Rosemann, et al. v. Martin Sigillito, et al.
In one of the lawsuits, the plaintiffs allege that the investments in the Distinctive Notes were part of a multi-million dollar Ponzi scheme. Plaintiffs allege to hold such promissory notes in accounts with the Trust division and that, among other things, the Bank was negligent, breached its fiduciary duties and breached its contracts. Plaintiffs also allege that the Bank violated the Racketeer Influenced and Corrupt Organizations Act ("RICO"). Upon the Bank's motion, the Court dismissed the plaintiffs' claim that the Bank violated its fiduciary duties. Plaintiffs, in the aggregate, are seeking damages from defendants, including the Bank, in excess of $44.0 million as well as their costs and attorneys' fees and trebled damages under RICO.

The case was stayed while criminal proceedings against Sigillito were completed. After a four week trial, Sigillito was found guilty of 20 counts of wire fraud, mail fraud, conspiracy, and money laundering. Following the verdict, the judge lifted the stay and set the case for a four week jury trial starting August 26, 2013. Discovery is currently proceeding.

BJD, LLC and Barbara Dunning v. Enterprise Bank & Trust, et. al.
The Bank has also been named as a defendant in this case, relating to BJD's investment in the Distinctive Notes. Plaintiffs allege that the Bank, and the other defendants breached their fiduciary duties and were negligent in allowing plaintiffs to invest in the Distinctive Notes because the loan program was allegedly never funded and the assets of the borrower did not exist or were overvalued. Plaintiffs are seeking approximately $800,000 in damages, 9% interest, punitive damages, attorneys' fees and costs. Like Rosemann, this case was stayed while the Sigillito criminal case was pending. The court has now granted the Bank's motion to compel arbitration and stay proceedings. Arbitration proceedings are not yet underway.

William Mark Scott v. Enterprise Financial Services Corp, et. al.
On April 10, 2012, a putative class action was filed in the United States District Court for the Eastern District of Missouri captioned William Mark Scott v. Enterprise Financial Services Corp, Peter F. Benoist, and Frank H. Sanfilippo. The complaint asserts claims for violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 on behalf of a putative class of purchasers of the Company's stock between April 20, 2010 and January 25, 2012, inclusive. The complaint alleges, among other things, that defendants made false and misleading statements and "failed to disclose that the Company was improperly recording income on loans covered under loss share agreements with the FDIC" and that, as a result, "the Company's financial statements were materially false and misleading at all relevant times." The action seeks unspecified damages and costs and expenses. The Company is unable to estimate a reasonably possible loss for the case because the proceeding is in an early stage and there are significant factual issues to be determined and resolved. The Company denies plaintiffs' allegations and intends to vigorously defend the lawsuit.

NOTE 7 - DERIVATIVE FINANCIAL INSTRUMENTS

The Company is a party to various derivative financial instruments that are used in the normal course of business to meet the needs of its clients and as part of its risk management activities. These instruments include interest rate swaps and option contracts and foreign exchange forward contracts. The Company does not enter into derivative financial instruments for trading or speculative purposes.

Interest rate swap contracts involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying principal amounts. The Company enters into interest rate swap contracts on behalf of its clients and also utilizes such contracts to reduce or eliminate the exposure to changes in the cash flows or fair value of hedged assets or liabilities due to changes in interest rates. Interest rate option contracts consist of caps and provide for the transfer or reduction of interest rate risk in exchange for a fee. Foreign exchange forward contracts are agreements between two parties to exchange a specified amount of one currency for another currency at a specified foreign exchange

rate on a future date. The Company enters into foreign exchange forward contracts with their clients and enters into an offsetting foreign exchange contract with established financial institution counterparties.

All derivative financial instruments, whether designated as hedges or not, are recorded on the consolidated balance sheet at fair value within Other assets or Other liabilities. The accounting for changes in the fair value of a derivative in the consolidated statement of operations depends on whether the contract has been designated as a hedge and qualifies for hedge accounting. At September 30, 2012, and December 31, 2011, the Company did not have any derivatives designated as cash flow or fair value hedges.

Using derivative instruments means assuming counterparty credit risk. Counterparty credit risk relates to the loss the Company could incur if a counterparty were to default on a derivative contract. Notional amounts of derivative financial instruments do not represent credit risk, and are not recorded in the consolidated balance sheet. They are used merely to express the volume of this activity. The overall credit risk and exposure to individual counterparties is monitored. The Company does not anticipate nonperformance by any counterparties. The amount of counterparty credit exposure is the unrealized gains, if any, on such derivative contracts along with the value of foreign exchange forward contracts. At September 30, 2012, the Company had $3.4 million of counterparty credit exposure on derivatives. At September 30, 2012, and December 31, 2011, the Company had pledged cash of $3.8 million and $2.7 million, respectively, as collateral in connection with our interest rate swap agreements.

Risk Management Instruments. The Company enters into certain derivative contracts to economically hedge state tax credits and certain loans.

- Economic hedge of state tax credits. In November 2008, the Company paid $2.1 million to enter into a series of interest rate caps in order to economically hedge changes in fair value of the State tax credits held for sale. In February 2010, the Company paid $751,000 for an additional series of interest rate caps. See Note 8—Fair Value Measurements for further discussion of the fair value of the state tax credits.
- Economic hedge of prime based loans. Previously, the Company had two outstanding interest rate swap agreements whereby the Company paid a variable rate of interest equivalent to the prime rate and received a fixed rate of interest. The swaps were designed to hedge the cash flows associated with a portion of prime based loans and had been designated as cash flow hedges. However, in December 2008, due to a variable rate differential, the Company concluded the cash flow hedges would not be prospectively effective and the hedges were dedesignated. The swaps were terminated in February 2009. The unrealized gain prior to dedesignation was included in Accumulated other comprehensive income and is being amortized over the expected life of the related loans. For the three months ended September 30, 2011, $44,000 was reclassified into Miscellaneous income. For the nine months ended September 30, 2011, $132,000 was reclassified into Miscellaneous income. At December 31, 2011, there were no additional amounts remaining in Accumulated other comprehensive income to be reclassified into operations.

The table below summarizes the notional amounts and fair values of the derivative instruments used to manage risk.

			Asset Derivatives (Other Assets)		Liability Derivatives (Other Liabilities)	
	Notional Amount		Fair Value		Fair Value	
(in thousands)	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
Non-designated hedging instruments						
Interest rate cap contracts	$49,050	$ 80,050	$14	$ 94	$—	$ —

The following table shows the location and amount of gains and losses related to derivatives used for risk management purposes that were recorded in the condensed consolidated statements of operations for the three and nine months ended September 30, 2012 and 2011.

(in thousands)	Location of Gain or (Loss) Recognized in Operations on Derivative	Amount of Gain or (Loss) Recognized in Operations on Derivative Three months ended September 30, 2012	2011	Amount of Gain or (Loss) Recognized in Operations on Derivative Nine months ended September 30, 2012	2011
Non-designated hedging instruments					
Interest rate cap contracts	Gain on state tax credits, net	$(14)	$(176)	$(79)	$(410)
Interest rate swap contracts	Miscellaneous income	—	44	—	132

Client-Related Derivative Instruments. As an accommodation to certain customers, the Company enters into interest rate swaps to economically hedge changes in fair value of certain loans. During the second quarter of 2012, the Company entered into foreign exchange forward contracts with clients and entered into offsetting foreign exchange forward contracts with established financial institution counterparties. The table below summarizes the notional amounts and fair values of the client-related derivative instruments.

(in thousands)	Notional Amount September 30, 2012	December 31, 2011	Asset Derivatives (Other Assets) Fair Value September 30, 2012	December 31, 2011	Liability Derivatives (Other Liabilities) Fair Value September 30, 2012	December 31, 2011
Non-designated hedging instruments						
Interest rate swap contracts	$142,773	$ 65,077	$2,265	$ 1,095	$2,626	$ 1,796
Foreign exchange forward contracts	1,142	—	1,142	—	1,142	—

Changes in the fair value of client-related derivative instruments are recognized currently in operations. The following table shows the location and amount of gains and losses recorded in the condensed consolidated statements of operations for the three and nine months ended September 30, 2012 and 2011.

(in thousands)	Location of Gain or (Loss) Recognized in Operations on Derivative	Amount of Gain or (Loss) Recognized in Operations on Derivative Three months ended September 30, 2012	2011	Amount of Gain or (Loss) Recognized in Operations on Derivative Nine months ended September 30, 2012	2011
Non-designated hedging instruments					
Interest rate swap contracts	Interest and fees on loans	$(103)	$(160)	$(354)	$(451)

22

NOTE 8 - FAIR VALUE MEASUREMENTS

Below is a description of certain assets and liabilities measured at fair value.

The following table summarizes financial instruments measured at fair value on a recurring basis as of September 30, 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

	September 30, 2012			
(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Assets				
Securities available for sale				
Obligations of U.S. Government sponsored enterprises	$—	$128,005	$—	$128,005
Obligations of states and political subdivisions	—	42,742	3,047	45,789
Residential mortgage-backed securities	—	436,563	—	436,563
Total securities available for sale	$—	$607,310	$3,047	$610,357
Portfolio loans	—	12,891	—	12,891
State tax credits held for sale	—	—	25,069	25,069
Derivative financial instruments	—	3,421	—	3,421
Total assets	$—	$623,622	$28,116	$651,738
Liabilities				
Derivative financial instruments	$—	$3,768	$—	$3,768
Total liabilities	$—	$3,768	$—	$3,768

- Securities available for sale. Securities classified as available for sale are reported at fair value utilizing Level 2 and Level 3 inputs. The Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions. At September 30, 2012, Level 3 securities available for sale consist primarily of three Auction Rate Securities.
- Portfolio Loans. Certain fixed rate portfolio loans are accounted for as trading instruments and reported at fair value. Fair value on these loans is determined using a third party valuation model with observable Level 2 market data inputs.
- State tax credits held for sale. At September 30, 2012, of the $65.9 million of state tax credits held for sale on the condensed consolidated balance sheet, approximately $25.1 million were carried at fair value. The remaining $40.8 million of state tax credits were accounted for at cost.

The fair value of the state tax credits carried at fair value increased $257,000 for the quarter ended September 30, 2012 compared to $975,000 for the same period in 2011. These fair value changes are included in Gain on state tax credits, net in the condensed consolidated statements of operations.

The Company is not aware of an active market that exists for the 10-year streams of state tax credit financial instruments. However, the Company’s principal market for these tax credits consists of Missouri state residents who buy these credits and from local and regional accounting firms who broker them. As such, the Company employed a discounted cash flow analysis (income approach) to determine the fair value.

The fair value measurement is calculated using an internal valuation model with observable market data including discounted cash flows based upon the terms and conditions of the tax credits. Assuming that the

underlying project remains in compliance with the various federal and state rules governing the tax credit program, each project will generate about 10 years of tax credits. The inputs to the fair value calculation include: the amount of tax credits generated each year, the anticipated sale price of the tax credit, the timing of the sale and a discount rate. The discount rate is defined as the LIBOR swap curve at a point equal to the remaining life in years of credits plus a 205 basis point spread. With the exception of the discount rate, the other inputs to the fair value calculation are observable and readily available. The discount rate is considered a Level 3 input because it is an “unobservable input” and is based on the Company’s assumptions. An increase in the discount rate utilized would generally result in a lower estimated fair value of the tax credits. Alternatively, a decrease in the discount rate utilized would generally result in a higher estimated fair value of the tax credits. Given the significance of this input to the fair value calculation, the state tax credit assets are reported as Level 3 assets.

- Derivatives. Derivatives are reported at fair value utilizing Level 2 inputs. The Company obtains counterparty quotations to value its interest rate swaps and caps. In addition, the Company validates the counterparty quotations with third party valuation sources. Derivatives with negative fair values are included in Other liabilities in the consolidated balance sheets. Derivatives with positive fair value are included in Other assets in the consolidated balance sheets.

Level 3 financial instruments

The following table presents the changes in Level 3 financial instruments measured at fair value on a recurring basis as of September 30, 2012.

- Purchases, sales, issuances and settlements, net. There were no Level 3 purchases during the quarter ended September 30, 2012.
- Transfers in and/or out of Level 3. The transfer out of Level 3 is related to a newly issued mortgage-backed security purchased in the fourth quarter of 2011 which was originally priced using Level 3 assumptions. In the first quarter of 2012, a third party pricing service, utilizing Level 2 assumptions, became available as more data was available on the new security.

	Securities available for sale, at fair value			
	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2012	2011	2012	2011
Beginning balance	$3,042	$2,994	$6,763	$7,520
Total gains (losses):				
Included in other comprehensive income	5	5	20	34
Purchases, sales, issuances and settlements:				
Purchases	—	4,983	—	4,983
Transfer in and/or out of Level 3	—	—	(3,736)	(4,555)
Ending balance	$3,047	$7,982	$3,047	$7,982
Change in unrealized gains relating to assets still held at the reporting date	$5	$5	$20	$34

	State tax credits held for sale			
	Three months ended September 30,		Nine months ended September 30,	
(in thousands)	2012	2011	2012	2011
Beginning balance	$24,836	$29,247	$26,350	$31,576
Total gains:				
Included in earnings	264	1,211	994	2,020
Purchases, sales, issuances and settlements:				
Sales	(31)	(964)	(2,275)	(4,102)
Ending balance	$25,069	$29,494	$25,069	$29,494
Change in unrealized gains relating to assets still held at the reporting date	$257	$975	$439	$1,009

From time to time, the Company measures certain assets at fair value on a nonrecurring basis. These include assets that are measured at the lower of cost or fair value that were recognized at fair value below cost at the end of the period. The following table presents financial instruments and non-financial assets measured at fair value on a non-recurring basis as of September 30, 2012.

(in thousands)	(1) Total Fair Value	(1) Quoted Prices in Active Markets for Identical Assets (Level 1)	(1) Significant Other Observable Inputs (Level 2)	(1) Significant Unobservable Inputs (Level 3)	Total (losses) gains for the three months ended September 30, 2012	Total (losses) gains for the nine months ended September 30, 2012
Impaired loans	$7,905	$—	$—	$7,905	$(3,974)	$(8,679)
Other real estate	8,454	—	—	8,454	(387)	(2,201)
Total	$16,359	$—	$—	$16,359	$(4,361)	$(10,880)

(1) The amounts represent only balances measured at fair value during the period and still held as of the reporting date.

Impaired loans are reported at the fair value of the underlying collateral. Fair values for impaired loans are obtained from current appraisals by qualified licensed appraisers or independent valuation specialists. Other real estate owned is adjusted to fair value upon foreclosure of the underlying loan. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value less costs to sell. Fair value of other real estate is based upon the current appraised values of the properties as determined by qualified licensed appraisers and the Company’s judgment of other relevant market conditions. Certain state tax credits are reported at cost.

Following is a summary of the carrying amounts and fair values of the Company’s financial instruments on the consolidated balance sheets at September 30, 2012, and December 31, 2011.

	September 30, 2012		December 31, 2011	
(in thousands)	Carrying Amount	Estimated fair value	Carrying Amount	Estimated fair value
Balance sheet assets				
Cash and due from banks	$28,964	$28,964	$20,791	$20,791
Federal funds sold	30	30	143	143
Interest-bearing deposits	57,681	57,681	168,711	168,711
Securities available for sale	610,357	610,357	593,182	593,182
Other investments, at cost	16,362	16,362	14,527	14,527
Loans held for sale	8,245	8,245	6,494	6,494
Derivative financial instruments	3,421	3,421	1,189	1,189
Portfolio loans, net	2,163,275	2,169,718	2,158,060	2,163,723
State tax credits, held for sale	65,873	71,482	50,446	50,446
Accrued interest receivable	10,481	10,481	9,193	9,193
Balance sheet liabilities				
Deposits	2,550,933	2,562,601	2,791,353	2,804,044
Subordinated debentures	85,081	41,919	85,081	42,252
Federal Home Loan Bank advances	126,000	135,388	102,000	110,575

Other borrowings	147,104	147,111	154,545	154,561
Derivative financial instruments	3,768	3,768	1,796	1,796
Accrued interest payable	1,377	1,377	1,762	1,762

For information regarding the methods and assumptions used to estimate the fair value of each class of financial instruments for which it is practical to estimate such value, refer to Note 19–Fair Value Measurements in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

The following table presents the level in the fair value hierarchy for the estimated fair values of only the Company's financial instruments that are not already on the condensed consolidated balance sheets at fair value at September 30, 2012, and December 31, 2011.

	Estimated Fair Value Measurement at Reporting Date Using			Balance at September 30, 2012
(in thousands)	Level 1	Level 2	Level 3	
Financial Assets:				
Portfolio loans, net	$—	$—	$2,169,421	$2,169,421
State tax credits, held for sale	$—	$—	$46,413	$46,413
Financial Liabilities:				
Deposits	1,937,740	—	624,861	2,562,601
Subordinated debentures	—	—	41,919	41,919
Federal Home Loan Bank advances	—	—	135,388	135,388
Other borrowings	—	—	147,111	147,111

	Estimated Fair Value Measurement at Reporting Date Using			Balance at December 31, 2011
(in thousands)	Level 1	Level 2	Level 3	
Financial Assets:				
Portfolio loans, net	$—	$—	$2,163,121	$2,163,121
State tax credits, held for sale	$—	$—	$24,096	$24,096
Financial Liabilities:				
Deposits	1,974,432	—	829,612	2,804,044
Subordinated debentures	—	—	42,252	42,252
Federal Home Loan Bank advances	—	—	110,575	110,575
Other borrowings	—	—	154,561	154,561

NOTE 9 - SEGMENT REPORTING

The Company has two primary operating segments, Banking and Wealth Management, which are delineated by the products and services that each segment offers. The segments are evaluated separately on their individual performance, as well as their contribution to the Company as a whole.

The Banking operating segment consists of a full-service commercial bank, with locations in St. Louis, Kansas City, and Phoenix. The majority of the Company's assets and income result from the Banking segment. All banking locations have the same product and service offerings, have similar types and classes of customers and utilize similar service delivery methods. Pricing guidelines and operating policies for products and services are the same across all regions.
The Banking operating segment also includes activities surrounding the assets acquired under FDIC loss share agreements.

The Wealth Management segment includes the Trust division of the Bank and the state tax credit brokerage activities. The Trust division provides estate planning, investment management, and retirement planning as well as consulting on

management compensation, strategic planning and management succession issues. State tax credits are part of a fee initiative designed to augment the Company’s wealth management segment and banking lines of business.

The Corporate segment's principal activities include the direct ownership of the Company's banking subsidiary and the issuance of debt and equity. Its principal source of liquidity is dividends from its subsidiaries and stock option exercises.

The financial information for each business segment reflects that information which is specifically identifiable or which is allocated based on an internal allocation method. There were no material intersegment revenues among the three segments. Management periodically makes changes to methods of assigning costs and income to its business segments to better reflect operating results. When appropriate, these changes are reflected in prior year information presented below.

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

(in thousands)	Banking	Wealth Management	Corporate and Intercompany	Total
Balance Sheet Information	September 30, 2012			
Portfolio loans	$2,208,599	$—	$—	$2,208,599
Goodwill	30,334	—	—	30,334
Intangibles, net	7,846	—	—	7,846
Deposits	2,535,930	30,688	(15,685)	2,550,933
Borrowings	215,051	60,553	82,581	358,185
Total assets	3,075,740	96,660	21,292	3,193,692
	December 31, 2011			
Portfolio loans	$2,197,684	$—	$—	$2,197,684
Goodwill	30,334	—	—	30,334
Intangibles, net	9,285	—	—	9,285
Deposits	2,773,482	39,440	(21,569)	2,791,353
Borrowings	213,480	45,565	82,581	341,626
Total assets	3,278,328	90,068	9,383	3,377,779
Income Statement Information	Three months ended September 30, 2012			
Net interest income (expense)	$38,627	$(252)	$(891)	$37,484
Provision for loan losses	11,937	—	—	11,937
Noninterest income	5,418	2,088	326	7,832
Noninterest expense	18,063	1,968	1,251	21,282
Income (loss) before income tax expense (benefit)	14,045	(132)	(1,816)	12,097
	Three months ended September 30, 2011			
Net interest income (expense)	$28,105	$(304)	$(1,032)	$26,769
Provision for loan losses	8,072	—	—	8,072
Noninterest income	5,105	3,201	420	8,726
Noninterest expense	15,454	2,016	832	18,302
Income (loss) before income tax expense (benefit)	9,684	881	(1,444)	9,121
Income Statement Information	Nine months ended September 30, 2012			
Net interest income (expense)	$105,646	$(566)	$(2,834)	$102,246
Provision for loan losses	16,221	—	—	16,221

Noninterest income	5,571	6,718	371	12,660
Noninterest expense	54,424	5,761	3,875	64,060
Income (loss) before income tax expense (benefit)	40,572	391	(6,338)	34,625
	Nine months ended September 30, 2011			
Net interest income (expense)	$84,511	$(941)	$(3,089)	$80,481
Provision for loan losses	16,247	—	—	16,247
Noninterest income	9,721	7,683	503	17,907
Noninterest expense	45,639	5,914	2,738	54,291
Income (loss) before income tax expense (benefit)	32,346	828	(5,324)	27,850

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Some of the information in this report contains "forward-looking statements" within the meaning of and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements typically are identified with use of terms such as "may," "might," "will, "should," "expect," "plan," "anticipate," "b "estimate," "predict," "potential," "could," "continue" and the negative of these terms and similar words, although some forward-looking statements are expressed differently. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. You should be aware that our actual results could differ materially from those contained in the forward-looking statements due to a number of factors, including, but not limited to: credit risk; changes in the appraised valuation of real estate securing impaired loans; outcomes of litigation and other contingencies; exposure to general and local economic conditions; risks associated with rapid increases or decreases 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; burdens imposed by federal and state regulation; changes in regulatory capital requirements; changes in accounting regulation or standards applicable to banks; and other risks discussed under the caption "Risk Factors" of our most recently filed Form 10-K and subsequent Forms 10-Q, all of which could cause the Company's actual results to differ from those set forth in the forward-looking statements.

Readers are cautioned not to place undue reliance on our forward-looking statements, which reflect management's analysis and expectations only as of the date of such statements. Forward-looking statements speak only as of the date they are made, and the Company does not intend, and undertakes no obligation, to publicly revise or update forward-looking statements after the date of this report, whether as a result of new information, future events or otherwise, except as required by federal securities law. You should understand that it is not possible to predict or identify all risk factors. 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.

Introduction

The following discussion describes the significant changes to the financial condition of the Company that have occurred during the first nine months of 2012 compared to the financial condition as of December 31, 2011. In addition, this discussion summarizes the significant factors affecting the results of operations, liquidity and cash flows of the Company for the three and nine months ended September 30, 2012, compared to the same periods in 2011. This discussion should be read in conjunction with the accompanying consolidated financial statements included in this report and our Annual Report on Form 10-K for the year ended December 31, 2011.

Executive Summary

The Company reported net income of $7.9 million for the three months ended September 30, 2012, compared to net income of $5.8 million for the same period in 2011. After deducting dividends on preferred stock, the Company reported net income per fully diluted share of $0.39, compared to net income of $0.29 per fully diluted share for the prior year period.

Net income for the nine months ended September 30, 2012 was $22.9 million compared to net income of $18.2 million for the same period in 2011. After deducting dividends on preferred stock, the Company reported net income per fully diluted share of $1.14, compared to net income of $0.98 per fully diluted share for the prior year period.

Below are highlights of our Banking and Wealth Management segments. For more information on our segments, see Note 9 –Segment Reporting.

29

Banking Segment

- Loans - Portfolio loans totaled $2.2 billion at September 30, 2012, flat with December 31, 2011 and September 30, 2011. Loans covered under FDIC shared loss agreements ("Covered loans") were $221.4 million at September 30, 2012, a decrease of $79.2 million or 26% from December 31, 2011 and a decrease of $105.5 million or 32% from September 30, 2011. The decrease is due to principal paydowns and loans that paid off.

Portfolio loans excluding covered loans ("Noncovered loans") increased $90.1 million or 5% from December 31, 2011. Commercial & Industrial loans increased $117.2 million or 15% and Construction Real Estate loans increased $6.1 million or 4%, while Residential Real Estate loans decreased $24.1 million or 14%. Noncovered loans increased $119.2 million