

ENTERPRISE FINANCIAL SERVICES CORP  
Form 10-Q  
November 09, 2006

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

**FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2006

**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**

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**Securities registered pursuant to Section 12(b) of the Act:**  
None

**Securities registered pursuant to Section 12(g) of the Act:**  
Common Stock, par value \$.01 per share

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

Yes No

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

Large accelerated filer:  Accelerated filer:  Non-accelerated filer:

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

Yes No

As of November 7, 2006, the Registrant had 11,658,593 of outstanding common stock.

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

| <i>(In thousands)</i>   | At September 30,<br>2006 | At December 31,<br>2005 |
|---|--------------------------|-------------------------|
|   | (Unaudited)              | (Audited)               |
| <b>Assets</b>   |                          |                         |
| Cash and due from banks   | \$ 54,513                | \$ 54,118               |
| Federal funds sold  | 6,959                    | 64,709                  |
| Interest-bearing deposits   | 1,214                    | 84                      |
| <b>Total cash and cash equivalents</b>  | <b>62,686</b>            | <b>118,911</b>          |
| Investments in debt and equity securities available for sale, at estimated fair value | 114,860                  | 135,559                 |
| Loans held for sale   | 5,268                    | 2,761                   |
| Portfolio loans   | 1,269,391                | 1,002,379               |
| Less: Allowance for loan losses   | 17,805                   | 12,990                  |
| <b>Portfolio loans, net</b>   | <b>1,251,586</b>         | <b>989,389</b>          |
| Other real estate   | 1,182                    |                         |
| Fixed assets, net   | 15,295                   | 10,276                  |
| Accrued interest receivable   | 7,343                    | 5,598                   |
| Goodwill  | 29,804                   | 12,042                  |
| Intangibles, net  | 6,125                    | 4,548                   |
| Prepaid expenses and other assets   | 14,026                   | 7,884                   |
| <b>Total assets</b>   | <b>\$ 1,508,175</b>      | <b>\$ 1,286,968</b>     |
| <b>Liabilities and Shareholders Equity</b>  |                          |                         |
| Deposits:   |                          |                         |
| Demand  | \$ 222,668               | \$ 229,325              |
| Interest-bearing transaction accounts   | 101,262                  | 108,712                 |
| Money market accounts   | 503,019                  | 479,507                 |
| Savings   | 4,388                    | 3,679                   |
| Certificates of deposit:  |                          |                         |
| \$100 and over  | 342,590                  | 229,839                 |
| Other   | 108,023                  | 65,182                  |
| <b>Total deposits</b>   | <b>1,281,950</b>         | <b>1,116,244</b>        |
| Subordinated debentures   | 35,054                   | 30,930                  |
| Federal Home Loan Bank advances   | 38,162                   | 28,584                  |
| Other borrowings  | 7,731                    | 6,847                   |
| Notes payable   | 6,000                    | 1,500                   |
| Accrued interest payable  | 2,881                    | 2,704                   |
| Accounts payable and accrued expenses   | 8,227                    | 7,221                   |
| <b>Total liabilities</b>  | <b>1,380,005</b>         | <b>1,194,030</b>        |
| Minority interest in equity of consolidated subsidiary                                | 5                        | 333                     |
| <b>Shareholders equity:</b>   |                          |                         |
|   | 115                      | 105                     |

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Common stock, \$.01 par value; authorized 20,000,000 shares; issued and outstanding 11,451,940 shares at September 30, 2006 and 10,458,852 at December 31, 2005.

|                                      |                     |                     |
|--------------------------------------|---------------------|---------------------|
| Additional paid in capital           | 77,149              | 53,218              |
| Unearned compensation                |                     | (1,531)             |
| Retained earnings                    | 51,571              | 41,950              |
| Accumulated other comprehensive loss | (670)               | (1,137)             |
|                                      | <u>128,165</u>      | <u>92,605</u>       |
| Total shareholders' equity           |                     |                     |
|                                      | <u>\$ 1,508,175</u> | <u>\$ 1,286,968</u> |

See accompanying notes to consolidated financial statements

## ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES

Consolidated Statements of Income (unaudited)

| <i>(In thousands, except per share data)</i>                      | Three months ended September 30, |               | Nine months ended September 30, |               |
|---|----------------------------------|---------------|---------------------------------|---------------|
|   | 2006                             | 2005          | 2006                            | 2005          |
| <b>Interest income:</b>   |                                  |               |                                 |               |
| Interest and fees on loans  | \$ 24,847                        | \$ 16,461     | \$ 63,288                       | \$ 45,772     |
| <b>Interest on debt and equity securities:</b>                    |                                  |               |                                 |               |
| Taxable   | 1,087                            | 692           | 3,132                           | 2,072         |
| Nontaxable  | 9                                | 10            | 26                              | 30            |
| Interest on federal funds sold                                    | 310                              | 419           | 755                             | 506           |
| Interest on interest-bearing deposits                             | 9                                | 5             | 31                              | 6             |
| Dividends on equity securities                                    | 102                              | 24            | 220                             | 111           |
| <b>Total interest income</b>                                      | <b>26,364</b>                    | <b>17,611</b> | <b>67,452</b>                   | <b>48,497</b> |
| <b>Interest expense:</b>  |                                  |               |                                 |               |
| Interest-bearing transaction accounts                             | 634                              | 281           | 1,657                           | 652           |
| Money market accounts   | 5,104                            | 2,942         | 13,436                          | 7,031         |
| Savings   | 17                               | 8             | 42                              | 23            |
| <b>Certificates of deposit:</b>                                   |                                  |               |                                 |               |
| \$100 and over  | 3,993                            | 2,013         | 8,390                           | 4,799         |
| Other   | 1,275                            | 511           | 2,508                           | 1,105         |
| Subordinated debentures   | 624                              | 317           | 1,692                           | 866           |
| Federal Home Loan Bank advances                                   | 683                              | 343           | 2,195                           | 1,241         |
| Notes payable and other borrowings                                | 195                              | 37            | 294                             | 96            |
| <b>Total interest expense</b>                                     | <b>12,525</b>                    | <b>6,452</b>  | <b>30,214</b>                   | <b>15,813</b> |
| <b>Net interest income</b>  | <b>13,839</b>                    | <b>11,159</b> | <b>37,238</b>                   | <b>32,684</b> |
| Provision for loan losses   | 240                              | 408           | 1,777                           | 1,420         |
| <b>Net interest income after provision for loan losses</b>        | <b>13,599</b>                    | <b>10,751</b> | <b>35,461</b>                   | <b>31,264</b> |
| <b>Noninterest income:</b>  |                                  |               |                                 |               |
| Wealth Management revenue   | 3,468                            | 1,472         | 10,018                          | 4,155         |
| Service charges on deposit accounts                               | 603                              | 533           | 1,636                           | 1,553         |
| Other service charges and fee income                              | 157                              | 119           | 419                             | 348           |
| Gain on sale of mortgage loans                                    | 95                               | 145           | 165                             | 247           |
| Gain on sale of other real estate                                 |                                  | 91            |                                 | 91            |
| Loss on sale of securities  |                                  | (85)          |                                 | (85)          |
| Miscellaneous income  | 2                                | 2             | 16                              | 29            |
| <b>Total noninterest income</b>                                   | <b>4,325</b>                     | <b>2,277</b>  | <b>12,254</b>                   | <b>6,338</b>  |
| <b>Noninterest expense:</b>                                       |                                  |               |                                 |               |
| Employee compensation and benefits                                | 6,754                            | 5,503         | 18,398                          | 16,103        |
| Occupancy   | 737                              | 568           | 1,957                           | 1,652         |
| Furniture and equipment   | 317                              | 212           | 806                             | 572           |
| Data processing   | 386                              | 264           | 1,010                           | 737           |
| Other   | 2,758                            | 1,978         | 7,395                           | 5,349         |
| <b>Total noninterest expense</b>                                  | <b>10,952</b>                    | <b>8,525</b>  | <b>29,566</b>                   | <b>24,413</b> |
| <b>Minority interest in net income of consolidated subsidiary</b> | <b>(434)</b>                     |               | <b>(826)</b>                    |               |

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|   |          |          |           |          |
|---|----------|----------|-----------|----------|
| Income before income tax expense                            | 6,538    | 4,503    | 17,323    | 13,189   |
| Income tax expense  | 2,357    | 1,625    | 6,242     | 4,723    |
| Net income  | \$ 4,181 | \$ 2,878 | \$ 11,081 | \$ 8,466 |
| Per share amounts:  |          |          |           |          |
| Basic earnings per share                                    | \$ 0.37  | \$ 0.29  | \$ 1.03   | \$ 0.85  |
| Basic weighted average common shares outstanding            | 11,397   | 10,083   | 10,787    | 10,017   |
| Diluted earnings per share                                  | \$ 0.35  | \$ 0.27  | \$ 0.99   | \$ 0.80  |
| Diluted weighted average common shares outstanding          | 11,823   | 10,782   | 11,190    | 10,668   |
| See accompanying notes to consolidated financial statements |          |          |           |          |

**ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES**  
Consolidated Statements of Shareholders' Equity and Comprehensive Income  
For the Nine Months ended September 30, 2006 (unaudited)

| <i>(in thousands, except shares)</i>                                    | Common Stock      |               | Additional<br>Paid<br>in Capital | Unearned<br>Compensation | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income (loss) | Total<br>shareholders<br>equity |
|---|-------------------|---------------|----------------------------------|--------------------------|----------------------|--|---------------------------------|
|   | Shares            | Amount        |                                  |                          |                      |  |                                 |
| <b>Balance December 31, 2005</b>  | 10,458,852        | \$ 105        | \$ 53,218                        | \$ (1,531)               | \$ 41,950            | \$ (1,137)   | \$ 92,605                       |
| Net income  |                   |               |                                  |                          | 11,081               |  | 11,081                          |
| Unrealized gain on securities, net of tax                               |                   |               |                                  |                          |                      | 204  | 204                             |
| Unrealized gain on cash flow hedges, net of tax                         |                   |               |                                  |                          |                      | 263  | 263                             |
| <b>Total comprehensive income</b>                                       |                   |               |                                  |                          |                      |  | <b>11,548</b>                   |
| Dividends declared (\$0.045 per share)                                  |                   |               |                                  |                          | (1,460)              |  | (1,460)                         |
| Stock options exercised, including related tax benefit                  | 77,636            | 1             | 1,218                            |                          |                      |  | 1,219                           |
| Restricted stock unit activity  | (2,073)           |               | (44)                             |                          |                      |  | (44)                            |
| Acquisition of NorthStar Bancshares, Inc.                               | 914,144           | 9             | 23,473                           |                          |                      |  | 23,482                          |
| Issuance of common stock shares   | 3,381             |               | 86                               |                          |                      |  | 86                              |
| Noncash compensation attributed to stock option grants                  |                   | 33            |                                  |                          |                      |  | 33                              |
| Noncash compensation attributed to restricted share units               |                   |               | 696                              |                          |                      |  | 696                             |
| Reclassification of unearned compensation to additional paid in capital |                   |               | (1,531)                          | 1,531                    |                      |  |                                 |
| <b>Balance September 30, 2006</b>                                       | <b>11,451,940</b> | <b>\$ 115</b> | <b>\$ 77,149</b>                 | <b>\$</b>                | <b>\$ 51,571</b>     | <b>\$ (670)</b>  | <b>\$ 128,165</b>               |

See accompanying notes to consolidated financial statements.

## ENTERPRISE FINANCIAL SERVICES CORP AND SUBSIDIARIES

Consolidated Statements of Cash Flows (unaudited)

| <i>(in thousands)</i>  | Nine months ended September 30, |           |
|--|---------------------------------|-----------|
|  | 2006                            | 2005      |
| <b>Cash flows from operating activities:</b>   |                                 |           |
| Net income   | \$ 11,081                       | \$ 8,466  |
| Adjustments to reconcile net income to net cash from operating activities:                       |                                 |           |
| Depreciation   | 1,193                           | 807       |
| Provision for loan losses  | 1,777                           | 1,420     |
| Net amortization of debt and equity securities   | 57                              | 427       |
| Amortization of intangible assets  | 792                             | 135       |
| Loss on sale of available for sale investment securities   |                                 | 85        |
| Mortgage loans originated  | (43,348)                        | (48,834)  |
| Proceeds from mortgage loans sold  | 41,257                          | 49,184    |
| Gain on sale of mortgage loans   | (165)                           | (247)     |
| Gain on sale of other real estate  |                                 | (91)      |
| Excess tax benefit for nonqualified stock options  | (274)                           | 336       |
| Noncash compensation for stock option grants & restricted share units                            | 685                             | 440       |
| Changes in:  |                                 |           |
| Accrued interest receivable  | (949)                           | (877)     |
| Accrued interest and other liabilities   | (1,059)                         | 296       |
| Other, net   | (1,135)                         | 45        |
|  | 9,912                           | 11,592    |
| <b>Cash flows from investing activities:</b>   |                                 |           |
| Cash paid for acquisition, net of cash and cash equivalents received                             | (7,323)                         |           |
| Net increase in loans  | (101,278)                       | (78,626)  |
| Purchases of available for sale debt and equity securities                                       | (40,676)                        | (25,611)  |
| Proceeds from sales of available for sale debt securities  |                                 | 19,274    |
| Proceeds from redemption of equity securities  | 6,341                           | 4,665     |
| Proceeds from maturities and principal paydowns on available for sale debt and equity securities | 63,496                          | 25,423    |
| Proceeds from sales of other real estate   |                                 | 229       |
| Recoveries of loans previously charged off   | 288                             | 409       |
| Purchases of fixed assets  | (5,043)                         | (2,863)   |
|  | (84,195)                        | (57,100)  |
| <b>Cash flows from financing activities:</b>   |                                 |           |
| Net (decrease) increase in non-interest bearing deposit accounts                                 | (23,965)                        | 9,441     |
| Net increase in interest bearing deposit accounts  | 32,016                          | 73,896    |
| Proceeds from issuance of subordinated debentures  | 4,124                           |           |
| Proceeds from Federal Home Loan Bank advances  | 718,533                         | 301,200   |
| Repayments of Federal Home Loan Bank advances  | (708,955)                       | (282,750) |
| Decrease in other borrowings   | (8,041)                         | (2,640)   |
| Proceeds from notes payable  | 10,000                          |           |
| Paydowns on notes payable  | (5,500)                         | (250)     |
| Cash dividends paid on common stock  | (1,460)                         | (1,056)   |
| Excess tax benefit for nonqualified stock options  | 274                             |           |
| Proceeds from the issuance of common stock   | 86                              |           |
| Proceeds from the exercise of common stock options   | 946                             | 3,111     |
|  | 18,058                          | 100,952   |



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|  |                   |                   |
|--|-------------------|-------------------|
| Net (decrease) increase in cash and cash equivalents         | (56,225)          | 55,444            |
| Cash and cash equivalents, beginning of year                 | 118,911           | 28,480            |
|  | <u>          </u> | <u>          </u> |
| <b>Cash and cash equivalents, end of period</b>              | <b>\$ 62,686</b>  | <b>\$ 83,924</b>  |
|  | <u>          </u> | <u>          </u> |
| Supplemental disclosures of cash flow information:           |                   |                   |
| Cash paid during the period for:                             |                   |                   |
| Interest   | \$ 30,037         | \$ 15,397         |
| Income taxes   | 5,447             | 4,736             |
|  | <u>          </u> | <u>          </u> |
| Noncash transactions:  |                   |                   |
| Common stock issued for acquisition of business              | \$ 23,482         |                   |
| 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 subsidiary, Enterprise Bank & Trust (the Bank). 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. For more information, please refer to Note 2 Acquisitions included in this filing.

In addition, as of October 21, 2005, 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.

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), NorthStar (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 Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations included in this filing.

Operating results for the three and nine month periods ended September 30, 2006 are not necessarily indicative of the results that may be expected for any other interim period or for the year ending December 31, 2006. 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, 2005. 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

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation 48, *Accounting for Uncertainty in Income Taxes*, an Interpretation of FAS No. 109, *Accounting for Income Taxes*. The interpretation defines the threshold for recognizing the financial impact of uncertain tax positions in accordance with FAS 109. A company would be required to recognize, in its financial statements, the best estimate of the impact of a tax position only if that position is more-likely-than-not of being sustained on audit based solely on the technical merits of the position on the reporting date. In evaluating whether the more-likely-than-not recognition threshold has been met, the Interpretation would require the presumption that the tax position will be evaluated during an audit by taxing authorities. The term more-likely-than-not is defined as a likelihood of more than 50 percent. Individual tax positions that fail to meet the recognition threshold will generally result in either (a) a reduction in the deferred tax asset or an increase in a deferred tax liability or (b) an increase in a liability for income taxes payable or the reduction of an income tax refund receivable. The impact may also include both (a) and (b). This Interpretation also provides guidance on disclosure, accrual of interest and penalties, accounting in interim periods, and transition. The Interpretation is effective for reporting periods beginning after December 15, 2006. The Company is evaluating the Interpretation and is presently unable to determine its overall impact on the Company's consolidated financial statements or results of operations.

## NOTE 2 ACQUISITIONS

### Acquisition of NorthStar Bancshares

On July 5, 2006, the Company completed its acquisition of 100% of the total outstanding common stock of Kansas City-based NorthStar Bancshares, Inc and its wholly owned subsidiary NorthStar Bank NA for \$36 million in EFSC common stock (80%) and cash (20%). The acquisition served to expand the Company's banking franchise in the greater Kansas City area. The purchase price for the NorthStar business consisted of:

- \$8.0 million in cash;
- 1,091,500 unregistered shares of EFSC common stock valued at \$28.0 million based on the average closing share price of EFSC common stock, as quoted on NASDAQ, for the 20 trading days ending two days prior to the acquisition date;
- the assumption by EFSC of a line of credit note of NorthStar, in the principal amount of \$3.2 million, which was paid in full by EFSC on the closing date.

While the stated purchase price of NorthStar Bancshares, Inc. was \$36 million, approximately \$4.5 million of the consideration is considered contingent and is held in an escrow account pending the collection of certain loans. This effectively reduced loans and other real estate owned and increased goodwill on the balance sheet by the same amount. In accordance with generally accepted accounting principles, approximately 177,000 shares of EFSC stock in the escrow account have not been credited to shareholders' equity or in company average shares when reporting fully diluted earnings per share. 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.

The cash portion of the transaction was funded through internally generated funds and borrowing on the Company's line of credit. Subsequently, on July 28, 2006, the Company issued \$4 million of trust preferred securities (TRUPS) through a newly formed affiliated statutory trust, as further discussed in Note 9 Subordinated Debentures of this filing. The TRUPS proceeds were used to pay off a portion of the line of credit borrowing.

At the time of the acquisition, on a consolidated basis, NorthStar Bancshares, Inc. had assets of \$187.5 million, loans, net of unearned discount, of \$167.2 million, deposits of \$158.5 million and stockholders' equity of \$18.8 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 \$17.6 million. Core deposit intangibles were approximately \$2.4 million and will be amortized over ten years utilizing an accelerated method. Core deposit intangibles are not deductible for tax purposes. NorthStar was merged into and with Enterprise Bank & Trust on October 6, 2006. Please refer to the Form 8-K filed by the Company on July 5, 2006 for more information.

### Acquisition and Integration Costs

As of the consummation date, the Company accrued certain costs associated with the acquisition. As of September 30, 2006, the accrued balance was \$366,000 and is primarily related to amounts required to terminate several information technology contracts. We expect to terminate the contracts and make the majority of these payments by December 31, 2006. As the obligation to make these payments was accrued at the consummation date, such payments will not have any impact on the consolidated statements of income. The acquisition costs are reflected in Accounts payable and accrued expenses in the consolidated balance sheets.

Through September 30, 2006, the Bank has also incurred approximately \$60,000 of integration costs associated with the acquisition that have been expensed in the consolidated statements of income. These costs relate principally to additional costs incurred in conjunction with the information technology conversion of NorthStar.

### Reserved Credit Escrow

As part of the acquisition agreement, \$4.5 million of the purchase price was deposited into a Reserved Credit Escrow account. These funds are being held until the Bank or NorthStar receives principal payments or proceeds from the sale of several identified loans and other real estate. 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 will be released as follows:

- Six months after closing (January 5, 2007), a pro rata amount of any proceeds collected on the escrowed loans will be paid to the NorthStar Bancshares shareholders.

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Twelve months after closing (July 5, 2007), the remaining portion of any proceeds collected on the escrowed loans will be paid to the NorthStar Bancshares shareholders.

The Reserved Credit Escrow amount was split between Loans and Other Real Estate. It is considered to be our best estimate, or fair value, of the specific assets. As a result, the Loan and Other Real Estate amounts in the opening balance sheet were reduced by escrow amounts.

**Impact of Allowance for Loan Losses**

At the acquisition date, NorthStar allowance for loan losses was \$3.1 million. NorthStar's allowance for loan losses as a percentage of total loans was 1.85%. As a result, the allowance for loan losses for the Company, which includes both the Bank and NorthStar increased 10 basis points from 1.30% at June 30, 2006 to 1.40% at September 30, 2006.

**Statement of Position 03-3 ( SOP 03-3 ) Accounting for Certain Loans or Debt Securities Acquired in a Transfer**

SOP 03-3 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. Components of SOP 03-3 include:

Loan loss allowance is not established at acquisition on these loans.

Future loan loss allowances should only reflect those losses incurred by the acquiring enterprise after acquisition.

After acquisition, SOP 03-3 requires the acquiring enterprise to recognize as interest income on a level-yield basis over the life of the loan (accrutable yield) the excess of all cash flows expected at acquisition over the initial investment in the loan.

The Company has applied SOP 03-3 through the establishment of the Reserved Credit Escrow for loans with evidence of deterioration of credit quality.

**NOTE 3 GOODWILL AND INTANGIBLE ASSETS**

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

| <i>(in thousands)</i>              | Three months ended September 30, |          | Nine months ended September 30, |          |
|------------------------------------|----------------------------------|----------|---------------------------------|----------|
|                                    | 2006                             | 2005     | 2006                            | 2005     |
| Balance, beginning of period       | \$ 12,004                        | \$ 1,938 | \$ 12,042                       | \$ 1,938 |
| Acquisition-related adjustments(1) | 227                              |          | 189                             |          |
| Goodwill acquired during period    | 17,573                           |          | 17,573                          |          |
| Balance, end of period             | \$ 29,804                        | \$ 1,938 | \$ 29,804                       | \$ 1,938 |

(1) Acquisition-related adjustments include additional purchase accounting adjustments on the Millennium 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, 2005      | \$ 4,548                          | \$                      | \$ 4,548       |
| Intangible acquired during period |                                   | 2,369                   | 2,369          |
| Amortization expense              | (684)                             | (108)                   | (792)          |
| Balance at end of period          | \$ 5,232                          | 2,261                   | \$ 6,125       |

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The following table reflects the expected amortization schedule for the intangible assets (in thousands) at September 30, 2006.

| Year           | Amount   |
|----------------|----------|
| 2006 remaining | \$ 336   |
| 2007           | 1,321    |
| 2008           | 1,278    |
| 2009           | 1,235    |
| 2010           | 1,179    |
| After 2010     | 775      |
|                | \$ 6,125 |

**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 September 30, |          | Nine months ended September 30, |          |
|---|----------------------------------|----------|---------------------------------|----------|
|   | 2006                             | 2005     | 2006                            | 2005     |
| <b>Basic</b>  |                                  |          |                                 |          |
| Net income, as reported   | \$ 4,181                         | \$ 2,878 | \$ 11,081                       | \$ 8,466 |
| Weighted average common shares outstanding                                    | 11,397                           | 10,083   | 10,787                          | 10,017   |
| Basic earnings per share  | \$ 0.37                          | \$ 0.29  | \$ 1.03                         | \$ 0.85  |
| <b>Diluted</b>  |                                  |          |                                 |          |
| Net income  | \$ 4,181                         | \$ 2,878 | \$ 11,081                       | \$ 8,466 |
| Expense related to dilutive stock options and appreciation rights, net of tax |                                  |          |                                 | 17       |
|   | \$ 4,181                         | \$ 2,878 | \$ 11,081                       | \$ 8,483 |
| Weighted average common shares outstanding                                    | 11,397                           | 10,083   | 10,787                          | 10,017   |
| Effect of dilutive stock options and restricted stock units                   | 426                              | 699      | 403                             | 650      |
| Diluted weighted average common shares outstanding                            | 11,823                           | 10,782   | 11,190                          | 10,668   |
| Diluted earnings per share  | \$ 0.35                          | \$ 0.27  | \$ 0.99                         | \$ 0.80  |

For the nine months ended September 30, 2005, 3,361 stock appreciation rights were excluded from the earnings per share calculation because their effect was anti-dilutive.

**NOTE 5 SHARE-BASED COMPENSATION**

The Company maintains a number of stock-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, 2005. Prior to fiscal 2006, the Company applied the intrinsic value-based method, as outlined in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, ( APB No. 25 ) and related interpretations, in accounting for stock options granted under these programs. Under the intrinsic value-based method, no compensation expense was recognized if the exercise price of the Company's employee stock options equaled the market price of the underlying stock on the date of the grant. Accordingly, prior to fiscal year 2006, no compensation cost was recognized in the accompanying consolidated statements of income on stock options granted to employees, since all options granted under the Company's share incentive programs had an exercise price equal to the market

value of the underlying common stock on the date of the grant.

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Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R ( SFAS No. 123R ) Share-based Payment. This statement replaces SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB No. 25. SFAS No. 123R requires that all stock-based compensation be recognized as an expense in the financial statements and that such cost be measured at the fair value of the award. This statement was adopted using the modified prospective method, which requires the Company to recognize compensation expense on a prospective basis. Therefore, prior period financial statements have not been restated. Under this method, in addition to reflecting compensation expense for new share-based awards, expense is also recognized to reflect the remaining service period of awards that had been included in pro forma disclosures in prior periods. SFAS No. 123R also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows. For the nine months ended September 30, 2006 and 2005, the Company recognized a tax benefit of \$274,000 and \$336,000, respectively, related to the exercise of non-qualified stock options as a component of paid-in capital. For the three and nine months ended September 30, 2005, the following table includes the disclosures required by Statement 123R and illustrates the pro forma impact on net income and earnings per share as if SFAS 123R had been applied to all outstanding awards for that period. The impact of adopting SFAS 123R increased the compensation expense in the third quarter and first nine months of 2006 by \$13,000 and \$39,000, respectively, before income taxes, and had less than a \$0.01 impact on basic and diluted earnings per share.

|  | Three months ended<br>September 30, |       | Nine months ended<br>September 30, |       |
|--|-------------------------------------|-------|------------------------------------|-------|
|  | 2005                                |       | 2005                               |       |
| <i>(In thousands, except per share data)</i>   |                                     |       |                                    |       |
| Net income, as reported  | \$                                  | 2,878 | \$                                 | 8,466 |
| Add total stock-based employee compensation expense included in reported net income, net of tax                            |                                     | 80    |                                    | 265   |
| Deduct total stock-based employee compensation expense determined under fair-value-based method for all awards, net of tax |                                     | (82)  |                                    | (269) |
| Pro forma net income   | \$                                  | 2,876 | \$                                 | 8,462 |
| <b>Earnings per share:</b>   |                                     |       |                                    |       |
| <b>Basic:</b>  |                                     |       |                                    |       |
| As reported  | \$                                  | 0.29  | \$                                 | 0.85  |
| Pro forma  |                                     | 0.29  |                                    | 0.84  |
| <b>Diluted:</b>  |                                     |       |                                    |       |
| As reported  | \$                                  | 0.27  | \$                                 | 0.80  |
| Pro forma  |                                     | 0.27  |                                    | 0.80  |

**Stock Options**

|                                   | Number Of<br>Shares | Average<br>Exercise<br>Price | Weighted<br>Average<br>Contractual<br>Term<br><br>(in years) | Remaining<br>Intrinsic<br>Value<br><br>(in thousands) |
|-----------------------------------|---------------------|------------------------------|--|---|
| Outstanding at December 31, 2005  | 901,528             | \$ 12.03                     |  |   |
| Granted                           | 3,850               | 22.73                        |  |   |
| Exercised                         | (65,634)            | 12.95                        |  |   |
| Forfeited                         |                     |                              |  |   |
| Outstanding at September 30, 2006 | 839,744             | \$ 12.01                     | 5.65   | \$ 15,832   |
| Exercisable at September 30, 2006 | 826,432             | \$ 11.90                     | 5.80   | \$ 15,666   |



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The Company awarded 3,850 and 5,000 options, respectively during the nine months ended September 30, 2006 and 2005. The fair value of stock options granted in the three and nine months ended September 30, 2006 and 2005 is estimated on the date of grant using the Black-Scholes option pricing model with the following average assumptions:

|   | Three months ended September<br>30, |      | Nine months ended September 30, |         |
|---|-------------------------------------|------|---------------------------------|---------|
|   | 2006                                | 2005 | 2006                            | 2005    |
| Risk-free interest rate                           |                                     |      | 4.36%                           | 4.36%   |
| Expected dividend rate                            |                                     |      | 0.60%                           | 0.60%   |
| Expected volatility                               |                                     |      | 50.45%                          | 37.65%  |
| Expected life (years)                             |                                     |      | 10                              | 10      |
| Weighted-average grant-date fair value of options |                                     |      | \$ 13.94                        | \$ 9.68 |

### Restricted Stock Units

|                               | Number<br>Of Shares | Weighted<br>Average<br>Grant Date<br>Fair Value |
|-------------------------------|---------------------|---|
| Unvested at December 31, 2005 | 95,613              | \$ 19.04  |
| Granted                       | 115,008             | 25.57   |
| Vested                        | (385)               | 27.39   |
| Forfeited                     | (2,713)             | 18.75   |
|                               | 207,523             | \$ 22.65  |

Compensation expense related to restricted stock units ( RSUs ) was \$696,000 in the first nine months of 2006. As of September 30, 2006, the total unrecognized compensation expense related to non-vested stock awards, including restricted stock units, was \$3.9 million and the related weighted average period over which it is expected to be recognized is approximately 4 years.

### Stock Appreciation Rights

Expense to record the market value of the stock appreciation rights ( SARS ) was \$54,000 and \$40,000 for the nine months ended September 30, 2006 and 2005, respectively. During third quarter of 2006, the Bank paid \$12,780 for vested SARS.

### Moneta Plan

The Company recognized option-related expenses of \$13,000 and \$26,000 for the nine months ended September 30, 2006 and 2005, respectively with respect to options granted pursuant to an agreement with Moneta Group ( Moneta ). During second quarter of 2006, 13,502 Moneta options were exercised with a weighted average price of \$10.71.

### NOTE 6 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Bank utilizes interest rate swap derivatives as one method to manage some of its interest rate risks from 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, 2005.

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. Interest rate swaps with notional amounts of \$30 million and \$40 million under which the Bank received a fixed rate of 5.3425% and 5.4150% matured in March and April 2006, respectively. As of September 30, 2006, the Bank has no outstanding cash flow hedges.

The net cash flows related to cash flow hedges decreased interest income on loans by \$0 and \$410,000 for the three and nine months ended September 30, 2006, respectively. The net cash flows related to cash flow hedges decreased interest income on loans by \$186,000 and \$257,000 for the three and nine months ended September 30, 2005, respectively.

Cash flow hedges are accounted for at fair value. The effective portion of the change in the cash flow hedge's gain or loss is reported as a component of other comprehensive income, net of taxes. The ineffective portion of the change in the cash flow hedge's gain or loss is recorded in earnings on each quarterly measurement date. At December 31, 2005 deferred losses of \$263,000, net of tax, related to cash flow hedges were recorded in accumulated other comprehensive income. All cash flow hedges were effective, therefore, no gain or loss was recorded in earnings.

**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 and loans 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 London Interbank Offered Rate (LIBOR) and to receive a fixed rate of interest equal to that of the brokered CD or loan (hedged instrument.)

**Brokered CD interest rate swaps** - Under this swap agreement the Bank is to pay or receive interest semiannually. 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 these hedges increased interest expense on certificates of deposit by \$69,000 and \$299,000 for the three and nine months ended September 30, 2006, respectively. The net cash flows related to fair value hedges increased interest expense on certificates of deposit by \$116,000 and \$226,000 for three and nine months ended September 30, 2005, respectively. In addition, two swaps, each with a \$10 million notional amount, under which the Bank received a fixed rate of 2.30% and 2.45% matured in February and April 2006, respectively. At inception of the CD, the Company paid broker placement fees by reducing the proceeds received from the issued CD. The fees did not affect the inception value of the interest rate swap. Placement fees are capitalized and amortized into interest expense over the life of the CD in a manner similar to debt issuance costs.

**Loans** 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 \$500 and \$1,700 for the three and nine months ended September 30, 2006, respectively. One swap agreement is a forward rate lock hedging against rate increases between now and early 2007. As a result, the cash flows for this swap will not begin until early 2007.

Fair value hedges are accounted for at fair value. At inception, each hedging transaction is evaluated against the eight criteria applicable to fair value hedges pursuant to paragraph 68 of SFAS No. 133. No ineffectiveness is assumed for those swaps that qualify for the shortcut method under SFAS No. 133. As a result, changes in the fair value of the swaps directly offset changes in the fair value of the underlying hedged item (i.e., brokered CDs or loans). All changes in fair value are measured on a quarterly basis. For the three and nine months ended September 30, 2006, there was ineffectiveness of approximately \$35,700 in losses recorded in earnings related to fair value hedges that did not qualify for the shortcut method.

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

| <i>(in thousands)</i>                          | <b>September 30,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|--|-------------------------------|------------------------------|
| <b>Cash Flow Hedges</b>                        |                               |                              |
| Notional amount                                | \$                            | \$ 70,000                    |
| Weighted average pay rate                      |                               | % 7.25%                      |
| Weighted average receive rate                  |                               | % 5.39%                      |
| Weighted average maturity in months            |                               | 3                            |
| Unrealized loss related to interest rate swaps | \$                            | \$ (395)                     |
| <b>Fair Value Hedges</b>                       |                               |                              |
| Notional amount                                | \$ 17,355                     | \$ 30,000                    |
| Weighted average pay rate                      | 6.16%                         | 4.42%                        |
| Weighted average receive rate                  | 5.04%                         | 2.55%                        |
| Weighted average maturity in months            | 38                            | 6                            |
| Unrealized loss related to interest rate swaps | \$ (218)                      | \$ (341)                     |

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 the collateral held to support the credit exposure was of no value. At September 30, 2006 and December 31, 2005, in connection with our interest rate swap agreements, we had pledged investment securities available for sale with a fair value of \$2.5 million and \$5.0 million, respectively. At September 30, 2006 and December 31, 2005, we had accepted, as collateral in connection with our interest rate swap agreements, cash of \$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 September 30, 2006, no amounts have been accrued for any estimated losses for these financial instruments.

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

| <i>(in thousands)</i>        | <b>September 30,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|------------------------------|-------------------------------|------------------------------|
| Commitments to extend credit | \$ 457,915                    | \$ 346,205                   |
| Standby letters of credit    | 37,717                        | 28,013                       |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments usually have fixed expiration dates or other termination clauses and may require payment of a fee. Of the total commitments to extend credit at September 30, 2006 and December 31, 2005, approximately \$34.7 million and \$10.5 million, respectively, represents fixed rate loan commitments. Since certain of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank 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.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These standby letters of credit are issued to support contractual obligations of the Bank's customers. The credit risk involved in issuing letters of credit is essentially the same as the risk involved in extending loans to customers. The approximate remaining terms of standby letters of credit range from 1 month to 5 years at September 30, 2006.

**NOTE 8 SEGMENT REPORTING**

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

The majority of the Company's assets and income result from the Banking segment. The Bank is a full-service commercial bank with four St. Louis locations and two locations in the Kansas City region. The NorthStar acquisition added four more branches in the Kansas City region.

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

The Corporate and Intercompany segment includes the holding company and subordinated debentures. The Company incurs general corporate expenses and owns the Bank and a 60% controlling ownership of Millennium.

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

**Balance Sheet Information**

| <i>(in thousands)</i> | At September 30, 2006 |                   |                            |              |
|-----------------------|-----------------------|-------------------|----------------------------|--------------|
|                       | Banking               | Wealth Management | Corporate and Intercompany | Total        |
| Portfolio loans       | \$ 1,269,391          | \$                | \$                         | \$ 1,269,391 |
| Goodwill              | 19,511                | 10,293            |                            | 29,804       |
| Deposits              | 1,284,416             |                   | (2,466)                    | 1,281,950    |
| Borrowings            | 45,892                |                   | 41,054                     | 86,946       |
| Total assets          | 1,490,615             | 16,515            | 1,045                      | 1,508,175    |

| <i>(in thousands)</i> | At December 31, 2005 |                   |                            |              |
|-----------------------|----------------------|-------------------|----------------------------|--------------|
|                       | Banking              | Wealth Management | Corporate and Intercompany | Total        |
| Portfolio loans       | \$ 1,002,379         | \$                | \$                         | \$ 1,002,379 |
| Goodwill              | 1,938                | 10,104            |                            | 12,042       |
| Deposits              | 1,117,110            |                   | (866)                      | 1,116,244    |
| Borrowings            | 35,431               |                   | 32,430                     | 67,861       |
| Total assets          | 1,269,212            | 16,253            | 1,503                      | 1,286,968    |

**Income Statement Information**

| <i>(in thousands)</i>                   | Three months ended September 30, 2006 |                   |                            |           |
|---|---------------------------------------|-------------------|----------------------------|-----------|
|   | Banking                               | Wealth Management | Corporate and Intercompany | Total     |
| Net interest income                     | \$ 14,528                             | \$ 26             | \$ (715)                   | \$ 13,839 |
| Provision for loan losses               | 240                                   |                   |                            | 240       |
| Noninterest income                      | 841                                   | 3,469             | 15                         | 4,325     |
| Noninterest expense                     | 7,831                                 | 2,152             | 969                        | 10,952    |
| Minority interest                       |                                       | (434)             |                            | (434)     |
| Income (loss) before income tax expense | 7,298                                 | 909               | (1,669)                    | 6,538     |
| Income tax expense (benefit)            | 2,631                                 | 327               | (601)                      | 2,357     |
| Net income (loss)                       | \$ 4,667                              | \$ 582            | \$ (1,068)                 | \$ 4,181  |

| <i>(in thousands)</i>                   | Three months ended September 30, 2005 |                   |                            |           |
|---|---------------------------------------|-------------------|----------------------------|-----------|
|   | Banking                               | Wealth Management | Corporate and Intercompany | Total     |
| Net interest income                     | \$ 11,448                             | \$ 18             | \$ (307)                   | \$ 11,159 |
| Provision for loan losses               | 408                                   |                   |                            | 408       |
| Noninterest income                      | 791                                   | 1,472             | 14                         | 2,277     |
| Noninterest expense                     | 6,305                                 | 1,318             | 902                        | 8,525     |
| Minority interest                       |                                       |                   |                            |           |
| Income (loss) before income tax expense | 5,526                                 | 172               | (1,195)                    | 4,503     |
| Income tax expense (benefit)            | 2,004                                 | 63                | (442)                      | 1,625     |
| Net income (loss)                       | \$ 3,522                              | \$ 109            | \$ (753)                   | \$ 2,878  |

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Nine months ended September 30, 2006

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

Nine months ended September 30, 2005

|   |           |        |            |           |
|---|-----------|--------|------------|-----------|
| Net interest income                     | \$ 33,472 | \$ 53  | \$ (841)   | \$ 32,684 |
| Provision for loan losses               | 1,420     |        |            | 1,420     |
| Noninterest income                      | 2,121     | 4,155  | 62         | 6,338     |
| Noninterest expense                     | 18,205    | 3,612  | 2,596      | 24,413    |
| Minority interest                       |           |        |            |           |
| Income (loss) before income tax expense | 15,968    | 596    | (3,375)    | 13,189    |
| Income tax expense (benefit)            | 5,742     | 215    | (1,233)    | 4,723     |
| Net income (loss)                       | \$ 10,226 | \$ 381 | \$ (2,142) | \$ 8,466  |

## NOTE 9 SUBORDINATED DEBENTURES

### Trust Preferred Securities - EFSC Capital Trust V

On July 28, 2006, EFSC Statutory Capital Trust V ( EFSC Trust V ), a newly formed Delaware statutory trust and subsidiary of EFSC, issued 4,000 floating rate Trust Preferred Securities at \$1,000 per share to a Trust Preferred Securities Pool. The floating rate is equal to three-month LIBOR + 1.60%, and is payable quarterly beginning September 15, 2006. The TRUPS are fully, irrevocably and unconditionally guaranteed on a subordinated basis by the Company. The proceeds were invested in junior subordinated debentures of the Company. The net proceeds to the Company from the sale of the junior subordinated debentures, were approximately \$4 million. The TRUPS mature on September 15, 2036. The maturity date may be shortened to a date not earlier than September 15, 2011 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 NorthStar as discussed in Note 2 Acquisitions of this filing.

## 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; all of which 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 acquisition of Millennium and the integration of our recent acquisition of NorthStar, both 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 of Form 10-K for the year ended December 31, 2005. Readers are cautioned not to place undue reliance on our forward-looking statements, which reflect management's analysis only as of the date of the statements. The Company does not intend to publicly revise or update forward-looking statements to reflect events or circumstances that arise after the date of this report. Readers should carefully review all disclosures we file from time to time with the Securities and Exchange Commission which are available on our website at [www.enterprisebank.com](http://www.enterprisebank.com).*

### **Introduction**

The following discussion describes significant changes in the financial condition of the Company that have occurred during the first nine months of 2006 compared to December 31, 2005. In addition, this discussion summarizes the significant factors affecting the consolidated results of operations, liquidity and cash flows of the Company for the three and nine months ended September 30, 2006 compared to the three and nine months ended September 30, 2005. 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, 2005.

### **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 of Form 10-K for the year ended December 31, 2005.

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

## Results of Operations

Net income for the three and nine months ended September 30, 2006 was \$4.2 million and \$11.1 million, an increase of 45% and 31%, respectively, compared to \$2.9 million and \$8.5 million for the same periods in 2005. Fully diluted earnings per share for the three and nine months ended September 30, 2006 were \$0.35 and \$0.99, an increase of 30% and 24%, respectively, compared to \$0.27 and \$0.80 for the same periods in 2005.

On July 5, 2006 the Company completed its acquisition of NorthStar. NorthStar's results are included in the consolidated financial results of the Company since that date. The purchase expanded our footprint in Kansas City, which was essential for us to become a larger player in that market. Subsequent to announcing the acquisition, two senior bankers in the Kansas City market agreed to join our team. These staffing additions along with the existing NorthStar associates and four additional locations are expected to provide a stronger platform for our banking and wealth management businesses in Kansas City. Please refer to Note 2 Acquisitions in this filing for more information related to the acquisition.

## Financial Condition

Including NorthStar, portfolio loans were up \$267 million or 27% from December 31, 2005. The Bank's portfolio loans grew by \$116 million or 15% annualized growth rate from December 31, 2005 and were up \$141 million or 14% from September 30, 2005. At September 30, 2006, portfolio loans related to NorthStar were \$151 million. The NorthStar loan balance excludes \$3.4 million of loans that have been escrowed pending the collection of principal for certain loans. See Note 2 Acquisitions in this filing for more information.

The growth in loans in the first nine months of 2006 was strong in both of our primary markets and is in part a result of the addition of experienced relationship managers in both St. Louis and Kansas City. The Bank continues to experience strong loan and deposit pricing competition in both markets. We continue to monitor competitive trends and intend to remain disciplined in our pricing practices in order to maintain margins.

Including NorthStar, deposits were up \$166 million, or 15% from December 31, 2005. The Bank's deposits increased by \$10 million or 1% from December 31, 2005 and were up \$103 million or 10% from September 30, 2005. At September 30, 2006, deposits related to NorthStar were \$156 million, including \$61 million of Brokered CD's. We are intentionally not pursuing client-based higher rate certificate of deposits in our markets given the current interest rate environment, but continue to pursue lower cost transaction and relationship-based accounts primarily through our treasury management products and services. We believe this may result in lower deposit growth than in the prior year. The combined bank deposit mix remains favorable with demand deposits accounts representing 17% of total deposits in a competitive deposit rate environment.

We plan to continue utilizing FHLB advances and short-term brokered certificates of deposit to fund shortfalls due to loan demand. Through September 30, 2006, we have utilized approximately \$11 million in short-term FHLB advances and \$30 million net in short-term brokered certificates of deposit to fund the loan demand.

## Net Interest Income

Net interest income is the primary source of the Company's revenue. Net interest income is the difference between interest income on interest-earning assets, such as loans and securities, and the interest expense on interest-bearing deposits and other borrowings, used to fund interest-earning and other assets. The amount of net interest income is affected by changes in interest rates and by the amount and composition of interest-earning assets and interest-bearing liabilities. Additionally, net interest income is impacted by the sensitivity of the balance sheet to changes in interest rates, which factors in characteristics such as the fixed or variable nature of the financial instruments, contractual maturities, and repricing frequencies.

Net interest spread and net interest rate margin are utilized to measure and explain changes in net interest income. Interest rate spread is the difference between the yield on interest-earning assets and the rate paid for interest-bearing liabilities that fund those assets. The net interest rate margin is expressed as the percentage of net interest income to average interest-earning assets. The net interest rate margin exceeds the interest rate spread because noninterest-bearing sources of funds (net free funds), principally demand deposits and shareholders' equity, also support interest-earning assets.

The Company's balance sheet and resulting net interest income is essentially neutral to changes in interest rates. The shift in our loan portfolio over the past year toward a 50/50 split on fixed/floating percentages, along with higher levels of variable rate liabilities has naturally increased our protection against falling rates, which management deems prudent given the current economic environment.



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Net interest income (on a tax-equivalent basis) was \$14.1 million for the three months ended September 30, 2006, compared to \$11.3 million for the same period of 2005, an increase of 24%. Including NorthStar, average

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interest-earning assets increased \$286 million, or 22% to \$1.401 billion for the quarter ended September 30, 2006 compared to \$1.115 billion for the same period in 2005. For the quarter ended September 30, 2006, average interest-bearing liabilities (including NorthStar) increased \$282 million, or 32% to \$1.152 billion compared to \$869 million for the quarter ended September 30, 2005.

The net interest rate margin (on a tax-equivalent basis) was 3.99% for the third quarter of 2006, compared to 4.03% in the same quarter of 2005. The margin was negatively impacted by a refinement in the methodology of deferring direct loan origination costs. This subsequently resulted in additional amortization costs and reduced the loan yield and net interest rate margin by approximately 17 basis points and 16 basis points, respectively. Excluding this refinement, the net interest margin would have been 4.15% in the third quarter of 2006.

We continue to benefit from the repositioning of a portion of the investment portfolio during the second half of 2005, which has led to an increase in the yield on securities. Competitor pricing and the interest rate environment continue to drive the cost of funds increases in money market and certificate of deposit rates.

Net interest income (on a tax-equivalent basis) was \$37.9 million for the nine months ended September 30, 2006, compared to \$33.1 million for the same period of 2005, an increase of 14%. Including NorthStar, average interest-earning assets for the nine months ended September 30, 2006 were \$1.257 billion, an increase of \$184 million, or 17% over \$1.073 billion, for the same period in 2005.

Average interest-bearing liabilities (including NorthStar) increased \$187 million, or 22% to \$1.021 billion for the nine months ended September 30, 2006 compared to \$834 million for the nine months ended September 30, 2005.

Net interest rate margin (on a tax-equivalent basis) was 4.03% for the first nine months of 2006, down from 4.13% in the first nine months of 2005. Increases in yields and cost of funds are similar to those described above. Excluding the refinement for deferring direct loan origination costs, the net interest margin would have been 4.19% in the first nine months of 2006.

For more information see the Rate/Volume table below.

**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.

| <i>(in thousands)</i>                                    | Three months ended September 30, |                                |                           |                     |                                |                           |
|--|----------------------------------|--------------------------------|---------------------------|---------------------|--------------------------------|---------------------------|
|  | 2006                             |                                |                           | 2005                |                                |                           |
|  | Average<br>Balance               | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate | Average<br>Balance  | Interest<br>Income/<br>Expense | Average<br>Yield/<br>Rate |
| <b>Assets</b>  |                                  |                                |                           |                     |                                |                           |
| Interest-earning assets:                                 |                                  |                                |                           |                     |                                |                           |
| Taxable loans (1)  | \$ 1,228,450                     | \$ 24,414                      | 7.88%                     | \$ 953,578          | \$ 16,176                      | 6.73%                     |
| Tax-exempt loans(2)                                      | 32,282                           | 677                            | 8.32                      | 19,359              | 445                            | 9.12                      |
| <b>Total loans</b>                                       | <b>1,260,732</b>                 | <b>25,091</b>                  | <b>7.90</b>               | <b>972,937</b>      | <b>16,621</b>                  | <b>6.78</b>               |
| Taxable investments in debt and equity securities        | 114,933                          | 1,190                          | 4.11                      | 90,045              | 717                            | 3.16                      |
| Non-taxable investments in debt and equity securities(2) | 1,120                            | 13                             | 4.61                      | 1,521               | 15                             | 3.91                      |
| Short-term investments                                   | 23,921                           | 319                            | 5.29                      | 50,005              | 424                            | 3.36                      |
| <b>Total securities and short-term investments</b>       | <b>139,974</b>                   | <b>1,522</b>                   | <b>4.31</b>               | <b>141,571</b>      | <b>1,156</b>                   | <b>3.24</b>               |
| <b>Total interest-earning assets</b>                     | <b>1,400,706</b>                 | <b>26,613</b>                  | <b>7.54</b>               | <b>1,114,508</b>    | <b>17,777</b>                  | <b>6.33</b>               |
| Non-interest-earning assets:                             |                                  |                                |                           |                     |                                |                           |
| Cash and due from banks                                  | 48,240                           |                                |                           | 34,622              |                                |                           |
| Other assets   | 72,854                           |                                |                           | 23,220              |                                |                           |
| Allowance for loan losses                                | (17,547)                         |                                |                           | (13,009)            |                                |                           |
| <b>Total assets</b>                                      | <b>\$ 1,504,253</b>              |                                |                           | <b>\$ 1,159,341</b> |                                |                           |
| <b>Liabilities and Shareholders Equity</b>               |                                  |                                |                           |                     |                                |                           |
| Interest-bearing liabilities:                            |                                  |                                |                           |                     |                                |                           |
| Interest-bearing transaction accounts                    | \$ 98,658                        | \$ 634                         | 2.55%                     | \$ 84,379           | \$ 281                         | 1.32%                     |
| Money market accounts                                    | 501,959                          | 5,104                          | 4.03                      | 437,374             | 2,942                          | 2.67                      |
| Savings  | 4,685                            | 17                             | 1.44                      | 4,533               | 8                              | 0.70                      |
| Certificates of deposit                                  | 443,288                          | 5,267                          | 4.71                      | 285,998             | 2,524                          | 3.50                      |
| <b>Total interest-bearing deposits</b>                   | <b>1,048,590</b>                 | <b>11,022</b>                  | <b>4.17</b>               | <b>812,284</b>      | <b>5,755</b>                   | <b>2.81</b>               |
| Subordinated debentures                                  | 33,844                           | 624                            | 7.31                      | 20,620              | 317                            | 6.10                      |
| Borrowed funds   | 69,229                           | 879                            | 5.04                      | 36,351              | 380                            | 4.15                      |
| <b>Total interest-bearing liabilities</b>                | <b>1,151,663</b>                 | <b>12,525</b>                  | <b>4.31</b>               | <b>869,255</b>      | <b>6,452</b>                   | <b>2.94</b>               |
| Noninterest-bearing liabilities:                         |                                  |                                |                           |                     |                                |                           |
| Demand deposits  | 213,953                          |                                |                           | 199,787             |                                |                           |
| Other liabilities  | 10,952                           |                                |                           | 7,804               |                                |                           |
| <b>Total liabilities</b>                                 | <b>1,376,568</b>                 |                                |                           | <b>1,076,846</b>    |                                |                           |
| Shareholders equity                                      | 127,685                          |                                |                           | 82,495              |                                |                           |
| <b>Total liabilities &amp; shareholders equity</b>       | <b>\$ 1,504,253</b>              |                                |                           | <b>\$ 1,159,341</b> |                                |                           |

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|                             |           |           |
|-----------------------------|-----------|-----------|
| Net interest income         | \$ 14,088 | \$ 11,325 |
| Net interest spread         | 3.23%     | 3.39%     |
| Net interest rate margin(3) | 3.99%     | 4.03%     |

- 
- (1) Average balances include non-accrual loans. The income on such loans is included in interest but is recognized only upon receipt. Loan fees, prior to deferral adjustment, included in interest income are approximately \$667,000 and \$414,000 for the quarters ended September 30, 2006 and 2005, 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 were \$249,000 and \$166,000 for the quarters ended September 30, 2006 and 2005, respectively.
  - (3) Net interest income divided by average total interest-earning assets.

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Nine months ended September 30,

| (in thousands)   | 2006                |                         |                    | 2005                |                         |                    |
|--|---------------------|-------------------------|--------------------|---------------------|-------------------------|--------------------|
|  | Average Balance     | Interest Income/Expense | Average Yield/Rate | Average Balance     | Interest Income/Expense | Average Yield/Rate |
| <b>Assets</b>  |                     |                         |                    |                     |                         |                    |
| Interest-earning assets:                                 |                     |                         |                    |                     |                         |                    |
| Taxable loans (1)  | \$ 1,095,196        | \$ 62,174               | 7.59%              | \$ 940,099          | \$ 44,999               | 6.40%              |
| Tax-exempt loans(2)                                      | 27,190              | 1,740                   | 8.56               | 18,145              | 1,207                   | 8.89               |
| <b>Total loans</b>                                       | <b>1,122,386</b>    | <b>63,914</b>           | <b>7.61</b>        | <b>958,244</b>      | <b>46,206</b>           | <b>6.45</b>        |
| Taxable investments in debt and equity securities        | 112,076             | 3,353                   | 4.00               | 91,690              | 2,183                   | 3.18               |
| Non-taxable investments in debt and equity securities(2) | 1,148               | 41                      | 4.77               | 1,545               | 47                      | 4.07               |
| Short-term investments                                   | 21,509              | 786                     | 4.89               | 21,881              | 512                     | 3.13               |
| <b>Total securities and short-term investments</b>       | <b>134,733</b>      | <b>4,180</b>            | <b>4.15</b>        | <b>115,116</b>      | <b>2,742</b>            | <b>3.18</b>        |
| <b>Total interest-earning assets</b>                     | <b>1,257,119</b>    | <b>68,094</b>           | <b>7.24</b>        | <b>1,073,360</b>    | <b>48,948</b>           | <b>6.10</b>        |
| Non-interest-earning assets:                             |                     |                         |                    |                     |                         |                    |
| Cash and due from banks                                  | 44,522              |                         |                    | 33,867              |                         |                    |
| Other assets   | 53,306              |                         |                    | 21,767              |                         |                    |
| Allowance for loan losses                                | (15,023)            |                         |                    | (12,641)            |                         |                    |
| <b>Total assets</b>                                      | <b>\$ 1,339,924</b> |                         |                    | <b>\$ 1,116,353</b> |                         |                    |
| <b>Liabilities and Shareholders Equity</b>               |                     |                         |                    |                     |                         |                    |
| Interest-bearing liabilities:                            |                     |                         |                    |                     |                         |                    |
| Interest-bearing transaction accounts                    | \$ 102,561          | \$ 1,657                | 2.16%              | \$ 84,882           | \$ 652                  | 1.03%              |
| Money market accounts                                    | 480,072             | 13,436                  | 3.74               | 422,026             | 7,031                   | 2.23               |
| Savings  | 4,214               | 42                      | 1.33               | 4,464               | 23                      | 0.69               |
| Certificates of deposit                                  | 332,641             | 10,898                  | 4.38               | 250,275             | 5,904                   | 3.15               |
| <b>Total interest-bearing deposits</b>                   | <b>919,488</b>      | <b>26,033</b>           | <b>3.79</b>        | <b>761,647</b>      | <b>13,610</b>           | <b>2.39</b>        |
| Subordinated debentures                                  | 31,912              | 1,692                   | 7.09               | 20,620              | 866                     | 5.62               |
| Borrowed funds   | 69,131              | 2,489                   | 4.81               | 51,808              | 1,337                   | 3.45               |
| <b>Total interest-bearing liabilities</b>                | <b>1,020,531</b>    | <b>30,214</b>           | <b>3.96</b>        | <b>834,075</b>      | <b>15,813</b>           | <b>2.53</b>        |
| Noninterest-bearing liabilities:                         |                     |                         |                    |                     |                         |                    |
| Demand deposits  | 203,613             |                         |                    | 196,839             |                         |                    |
| Other liabilities  | 9,055               |                         |                    | 6,667               |                         |                    |
| <b>Total liabilities</b>                                 | <b>1,233,199</b>    |                         |                    | <b>1,037,581</b>    |                         |                    |
| Shareholders equity                                      | 106,725             |                         |                    | 78,772              |                         |                    |
| <b>Total liabilities &amp; shareholders equity</b>       | <b>\$ 1,339,924</b> |                         |                    | <b>\$ 1,116,353</b> |                         |                    |
| <b>Net interest income</b>                               |                     | <b>\$ 37,880</b>        |                    |                     | <b>\$ 33,135</b>        |                    |
| <b>Net interest spread</b>                               |                     |                         | <b>3.28%</b>       |                     |                         | <b>3.57%</b>       |
| <b>Net interest rate margin(3)</b>                       |                     |                         | <b>4.03%</b>       |                     |                         | <b>4.13%</b>       |

- 
- (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 \$1,698,000 and \$1,154,000 for the nine months ended September 30, 2006 and 2005, 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 were \$642,000 and \$451,000 for the nine months ended September, 2006 and 2005, respectively.
  - (3) Net interest income divided by average total interest-earning assets.

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**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.

| <i>(in thousands)</i>                                    | 2006 Compared to 2005                 |                 |                 |                                       |                 |                  |
|--|---------------------------------------|-----------------|-----------------|---------------------------------------|-----------------|------------------|
|  | 3 month<br>Increase (decrease) due to |                 |                 | 9 month<br>Increase (decrease) due to |                 |                  |
|  | Volume(1)                             | Rate(2)         | Net             | Volume(1)                             | Rate(2)         | Net              |
| <b>Interest earned on:</b>                               |                                       |                 |                 |                                       |                 |                  |
| Loans  | \$ 5,165                              | \$ 3,073        | \$ 8,238        | \$ 8,073                              | \$ 9,102        | \$ 17,175        |
| Nontaxable loans (3)                                     | 274                                   | (42)            | 232             | 581                                   | (48)            | 533              |
| Taxable investments in debt and equity securities        | 227                                   | 246             | 473             | 543                                   | 627             | 1,170            |
| Nontaxable investments in debt and equity securities (3) | (5)                                   | 3               | (2)             | (13)                                  | 7               | (6)              |
| Short-term investments                                   | (281)                                 | 176             | (105)           | (9)                                   | 283             | 274              |
| <b>Total interest-earning assets</b>                     | <b>\$ 5,380</b>                       | <b>\$ 3,456</b> | <b>\$ 8,836</b> | <b>\$ 9,175</b>                       | <b>\$ 9,971</b> | <b>\$ 19,146</b> |
| <b>Interest paid on:</b>                                 |                                       |                 |                 |                                       |                 |                  |
| Interest-bearing transaction accounts                    | \$ 55                                 | \$ 298          | \$ 353          | \$ 160                                | \$ 845          | \$ 1,005         |
| Money market accounts                                    | 484                                   | 1,678           | 2,162           | 1,078                                 | 5,327           | 6,405            |
| Savings  |                                       | 9               | 9               | (1)                                   | 20              | 19               |
| Certificates of deposit                                  | 1,683                                 | 1,060           | 2,743           | 2,289                                 | 2,705           | 4,994            |
| Subordinated debentures                                  | 234                                   | 73              | 307             | 559                                   | 267             | 826              |
| Borrowed funds   | 403                                   | 96              | 499             | 528                                   | 625             | 1,153            |
| <b>Total interest-bearing liabilities</b>                | <b>2,859</b>                          | <b>3,214</b>    | <b>6,073</b>    | <b>4,613</b>                          | <b>9,789</b>    | <b>14,402</b>    |
| <b>Net interest income</b>                               | <b>\$ 2,521</b>                       | <b>\$ 242</b>   | <b>\$ 2,763</b> | <b>\$ 4,562</b>                       | <b>\$ 182</b>   | <b>\$ 4,744</b>  |

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

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

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

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

**Provision for loan losses.** The provision for loan losses in the third quarter of 2006 was \$240,000, compared to \$408,000 in the same quarter of 2005. The decline in provision was due to lower loan growth during the quarter. The allowance for loan losses as a percentage of total loans was 1.40% at September 30, 2006 compared to 1.30% at December 31, 2005 and 1.35% at September 30, 2005. The increase is primarily the result of the effects of combining the NorthStar loan portfolio and related allowance for loan losses into that of the Bank. Management believes that the allowance for loan losses is adequate.

Asset quality is solid. Non-performing loans were \$6.2 million or 0.49% of total loans at September 30, 2006 versus 0.18% at September 30, 2005 and 0.14% basis points at December 31, 2005. Twelve loan relationships, six of which relate to NorthStar, were placed on non-accrual status during the quarter. The non-performing loans consist of individual borrowing relationships with cash flow constraints. There are no industry specific concentrations and no single credit relationship represents more than \$2 million.

Foreclosed real estate valued at \$1.2 million represents three NorthStar properties that either had been foreclosed or were in the process of foreclosure at the acquisition date. These properties consist of completed residential structures and improved lots, as well as, commercial

property. All properties are presently being marketed for resale either by residential real estate firms or by us utilizing our network of residential builders.



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

| <i>(in thousands)</i>                       | Three months ended<br>September 30, |                  | Nine months ended<br>September 30, |                  |
|---|-------------------------------------|------------------|------------------------------------|------------------|
|   | 2006                                | 2005             | 2006                               | 2005             |
| Allowance at beginning of period            | \$ 14,449                           | \$ 12,769        | \$ 12,990                          | \$ 11,665        |
| Acquired allowance for loan losses          | 3,069                               |                  | 3,069                              |                  |
| Loans charged off:                          |                                     |                  |                                    |                  |
| Commercial and industrial                   | 17                                  |                  | 317                                | 67               |
| Real estate:                                |                                     |                  |                                    |                  |
| Commercial                                  |                                     | 144              |                                    | 244              |
| Construction                                |                                     |                  |                                    |                  |
| Residential                                 |                                     |                  |                                    |                  |
| Consumer and other                          | 2                                   | 1                | 2                                  | 15               |
| <b>Total loans charged off</b>              | <b>19</b>                           | <b>145</b>       | <b>319</b>                         | <b>326</b>       |
| Recoveries of loans previously charged off: |                                     |                  |                                    |                  |
| Commercial and industrial                   | 63                                  | 110              | 268                                | 187              |
| Real estate:                                |                                     |                  |                                    |                  |
| Commercial                                  |                                     |                  | 1                                  | 73               |
| Construction                                |                                     |                  |                                    |                  |
| Residential                                 | 1                                   | 16               | 16                                 | 130              |
| Consumer and other                          | 2                                   | 10               | 3                                  | 19               |
| <b>Total recoveries of loans</b>            | <b>66</b>                           | <b>136</b>       | <b>288</b>                         | <b>409</b>       |
| <b>Net loans charged off (recoveries)</b>   | <b>(47)</b>                         | <b>9</b>         | <b>31</b>                          | <b>(83)</b>      |
| Provision for loan losses                   | 240                                 | 408              | 1,777                              | 1,420            |
| <b>Allowance at end of period</b>           | <b>\$ 17,805</b>                    | <b>\$ 13,168</b> | <b>\$ 17,805</b>                   | <b>\$ 13,168</b> |
| Average loans                               | \$ 1,260,732                        | \$ 972,937       | \$ 1,122,386                       | \$ 958,244       |
| Total portfolio loans                       | 1,269,391                           | 976,804          | 1,269,391                          | 976,804          |
| Net recoveries to average loans             | (0.01)%                             | 0.00%            | 0.00%                              | (0.01)%          |
| Allowance for loan losses to loans          | 1.40                                | 1.35             | 1.40                               | 1.35             |

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The Bank had no loans 90 days past due still accruing interest at September 30, 2006 or December 31, 2005. The following table presents the categories of nonperforming assets and certain ratios as of the dates indicated.

| <i>(in thousands)</i>                                      | September 30,<br>2006 | December 31,<br>2005 |
|--|-----------------------|----------------------|
| Non-accrual loans  | \$ 6,214              | \$ 1,421             |
| Loans past due 90 days or more and still accruing interest |                       |                      |
| Restructured loans   |                       |                      |
| <b>Total nonperforming loans</b>                           | <b>6,214</b>          | <b>1,421</b>         |
| Foreclosed property  | 1,182                 |                      |
| <b>Total non performing assets</b>                         | <b>\$ 7,396</b>       | <b>\$ 1,421</b>      |
| <b>Total assets</b>  | <b>\$ 1,508,175</b>   | <b>\$ 1,286,968</b>  |
| Total loans  | 1,269,391             | 1,002,379            |
| Total loans plus foreclosed property                       | 1,270,573             | 1,002,379            |
| Nonperforming loans to loans                               | 0.49%                 | 0.14%                |
| Nonperforming assets to loans plus foreclosed property     | 0.58                  | 0.14                 |
| Nonperforming assets to total assets                       | 0.49                  | 0.11                 |
| Allowance for loan losses to non-performing loans          | 286.53%               | 914.00%              |

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, 2005.

### Noninterest Income

Wealth Management revenue increased \$2.0 million, or 136%, from \$1.5 million in the third quarter of 2005 to \$3.5 million for the same period of 2006. The increase includes \$1.9 million of commission income earned by Millennium in the third quarter of 2006. Excluding one-time insurance gains, organic revenue from the Company's Trust operations increased 17% over third quarter of 2005. The Company's ratio of fee income to total revenue was 24% versus 17% in the same period of 2005 as the Wealth Management segment continues to expand in line with the Company's income diversification strategies.

Wealth Management assets under administration were \$1.57 billion at September 30, 2006, a 21% increase over one year ago after adjusting for the \$250 million in common trust fund assets that were distributed in December 2005 in accordance with a related contract.

For the nine months ended September 30, 2006, noninterest income was \$12.3 million compared to \$6.3 million for the same period in 2005. Wealth management revenue increased \$5.9 million, or 141%, to \$10.0 million for the nine month period ended September 30, 2006, compared

to \$4.2 million for the same period in 2005 as a result of the reasons stated above.

Service charges on deposit accounts continue to be unchanged year over year due to a rising earnings credit rate on commercial accounts, which was offset by increased account activity.

### **Noninterest Expense**

Our efficiency ratio, which expresses noninterest expense as a percentage of net interest income and other income, was 60.3% for third quarter of 2006, improved from 63.5% in the same quarter of 2005.

Noninterest expenses increased \$2.4 million from \$8.5 million in the third quarter of 2005 to \$11.0 million in the same quarter of 2006. Approximately \$806,000 of the increase was related to the addition of Millennium (including amortization of intangibles.) An additional \$1.1 million of the increase was related to NorthStar (including amortization of intangibles.)

Quarter over quarter increases in employee compensation and benefits of \$369,000 and \$540,000 were related to Millennium and NorthStar, respectively. Excluding Millennium and NorthStar, employee compensation and benefits increased 6.2%, or \$342,000. The increase is due to the salaries and related benefits of new senior level banking associates along with new associates in various areas of our organization including marketing, wealth management and other support areas. The additional costs are offset by declines in wealth management commissions and the deferral of direct loan origination costs.

The addition of Millennium and NorthStar contributed \$57,000 and \$120,000, respectively, to the increase in occupancy expense.

Furniture and equipment increases were due to the new St. Charles bank location, Millennium, NorthStar and the expansion of the Operations Center.

Data processing expenses increased due to upgrades to the Company's AS400, 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 have been capitalized and will be amortized according to the Company's depreciation policies.

Other noninterest expense includes \$354,000 for Millennium expenses (including \$228,000 for amortization of intangibles.) Other noninterest expenses also includes \$282,000 for NorthStar expenses (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.

Noninterest expenses were \$29.6 million in the nine months ended September 30, 2006, an increase of \$5.2 million, or 21%, over the same period of 2005. Approximately \$2.5 million, or 48%, of the increase was related to the addition of Millennium (including amortization of intangibles.) NorthStar represented \$1.1 million of the increase (including amortization of intangibles.) On a year-to-date basis, our efficiency ratio was 59.7% and improved from 62.6% in the first nine months of 2005.

### **Minority Interest in Net Income of Consolidated Subsidiary**

On October 21, 2005, the Company acquired a 60% controlling interest in Millennium. The Company records the 40% non-controlling interest in Millennium, related to Millennium's results of operations, in minority interest on the consolidated statements of income. Contractually, the Company is entitled to a priority return of 23.1% pre-tax on its current \$15 million investment in Millennium before the minority interest holders are entitled to any distributions. The Company adjusted minority interest by \$86,000 during the quarter in order to recognize its priority return in line with its contractual rights. Year to date, the Company has adjusted minority interest by \$544,000. In effect, rather than receiving 40% of the earnings during the first nine months, the minority interest holders accrued 25%, while the Company accrued 75%. Millennium's business continued to expand despite operational issues with certain consolidating carriers and a tighter underwriting environment. Case submissions were up substantially in August and September. Assuming that this trend continues and normal progression of submitted cases to paid status, we would expect Millennium to have a strong fourth quarter.

### **Income Taxes**

The provision for income taxes was \$2.4 million and \$6.2 million for the three and nine months ended September 30, 2006 compared to \$1.6 million and \$4.7 million for the same periods in 2005. The effective tax rates for the

three and nine months ended September 30, 2006 were 36.1% and 36.0%, respectively. The effective tax rates for the three and nine months ended September 30, 2005 were 36.1% and 35.8%, respectively.

### **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 the Bank as necessary, and satisfy other operating requirements. The parent company's primary funding sources to meet its liquidity requirements are dividends from subsidiaries, borrowings against its \$15 million line of credit with a major bank, and proceeds from the issuance of equity (i.e. stock option exercises). Another source of funding for the parent company includes the issuance of subordinated debentures. As of September 30, 2006, the Company has \$34 million of outstanding subordinated debentures as part of five Trust Preferred Securities Pools. These securities are classified as debt but are included in regulatory capital and the related interest expense is tax-deductible, which makes them a very attractive source of funding.

Investment securities are an important tool to the Company's liquidity objective. As of September 30, 2006, the entire investment portfolio was available for sale. Of the \$115 million investment portfolio available for sale, \$27.5 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 September 30, 2006, on a combined basis, the Bank and NorthStar, had \$157 million available from the Federal Home Loan Bank of Des Moines under blanket loan pledges, absent the Bank or NorthStar being in default of their respective credit agreements, and \$161 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 NorthStar had \$13 million available in the form of overnight federal funds lines from various banking institutions. Finally, because the Bank plans to remain a well-capitalized institution, it has 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 \$458 million in unused loan commitments as of September 30, 2006. While this commitment level would be very difficult to fund on a short term basis given the Company's current liquidity resources, our experience is that the nature of these commitments are such that the likelihood of such a funding demand is very low.

The Company and its banking affiliates are subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and its banking affiliates must meet specific capital guidelines that involve quantitative measures of

assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The banking affiliate's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its banking affiliates to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of September 30, 2006 and December 31, 2005, that the Company and its banking affiliates meet all capital adequacy requirements to which they are subject.

As of September 30, 2006 and December 31, 2005, 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.

| <i>(in thousands)</i>                             | At September<br>30,<br>2006 | At December<br>31,<br>2005 |
|---|-----------------------------|----------------------------|
| Tier I capital to risk weighted assets            | 9.53%                       | 10.31%                     |
| Total capital to risk weighted assets             | 10.78%                      | 11.55%                     |
| Leverage ratio (Tier I capital to average assets) | 8.64%                       | 8.75%                      |
| Tangible capital to tangible assets               | 6.26%                       | 5.98%                      |
| Tier I capital                                    | \$ 126,965                  | \$ 107,538                 |
| Total risk-based capital                          | \$ 143,639                  | \$ 120,528                 |

### 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.

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The following table represents the estimated interest rate sensitivity and periodic and cumulative gap positions calculated as of September 30, 2006.

| (in thousands)  | Year 1              | Year 2            | Year 3            | Year 4            | Year 5           | Beyond 5<br>years or no<br>stated<br>maturity | Total               |
|---|---------------------|-------------------|-------------------|-------------------|------------------|---|---------------------|
| <b>Interest-Earning Assets</b>  |                     |                   |                   |                   |                  |   |                     |
| Investments in debt and equity securities                               | \$ 2,047            | \$ 35,604         | \$ 38,016         | \$ 28,923         | \$ 3,176         | \$ 7,094                                      | \$ 114,860          |
| Interest-bearing deposits   | 1,214               |                   |                   |                   |                  |   | 1,214               |
| Federal funds sold  | 6,959               |                   |                   |                   |                  |   | 6,959               |
| Loans   | 805,386             | 157,112           | 101,698           | 92,271            | 69,277           | 43,647  | 1,269,391           |
| Loans held for sale   | 5,268               |                   |                   |                   |                  |   | 5,268               |
| <b>Total interest-earning assets</b>                                    | <b>\$ 820,874</b>   | <b>\$ 192,716</b> | <b>\$ 139,714</b> | <b>\$ 121,194</b> | <b>\$ 72,453</b> | <b>\$ 50,741</b>                              | <b>\$ 1,397,692</b> |
| <b>Interest-Bearing Liabilities</b>                                     |                     |                   |                   |                   |                  |   |                     |
| Savings, NOW and Money market deposits                                  | \$ 608,669          | \$                | \$                | \$                | \$               | \$  | \$ 608,669          |
| Certificates of deposit   | 345,608             | 58,329            | 16,461            | 23,293            | 6,922            |   | 450,613             |
| Subordinated debentures   | 24,744              |                   |                   |                   | 10,310           |   | 35,054              |
| Other borrowings  | 21,982              | 150               | 5,050             | 5,650             | 1,100            | 17,961  | 51,893              |
| <b>Total interest-bearing liabilities</b>                               | <b>\$ 1,001,003</b> | <b>\$ 58,479</b>  | <b>\$ 21,511</b>  | <b>\$ 28,943</b>  | <b>\$ 18,332</b> | <b>\$ 17,961</b>                              | <b>\$ 1,146,229</b> |
| <b>Interest-sensitivity GAP</b>   |                     |                   |                   |                   |                  |   |                     |
| GAP by period   | \$ (180,129)        | \$ 134,237        | \$ 118,203        | \$ 92,251         | \$ 54,121        | \$ 28,656                                     | \$ 251,463          |
| Cumulative GAP  | \$ (180,129)        | \$ (45,892)       | \$ 72,311         | \$ 164,562        | \$ 218,683       | \$ 251,463                                    | \$ 251,463          |
| <b>Ratio of interest-earning assets to interest-bearing liabilities</b> |                     |                   |                   |                   |                  |   |                     |
| Periodic  | 0.82                | 3.30              | 6.50              | 4.19              | 3.95             | 2.83  | 1.22                |
| Cumulative GAP  | 0.82                | 0.96              | 1.07              | 1.15              | 1.20             | 1.22  | 1.22                |

**ITEM 4: CONTROLS AND PROCEDURES**

As of September 30, 2006, under the supervision and with the participation of the Company's Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), management has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based on that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of September 30, 2006, 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 or in the other factors that have materially affected, or are reasonably likely to materially affect, those controls.

**PART II**

**ITEM 1: LEGAL PROCEEDINGS**

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The Company and its subsidiaries are, from time to time, parties to various legal proceedings arising out of their businesses. 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, financial condition, results of operations or cash flows of the Company or any of its subsidiaries.

### **ITEM 1A: RISK FACTORS**

There have not been any material changes in the risk factors disclosure from that contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.



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

- a) On July 5, 2006, the Company issued 1,091,500 of unregistered common stock in conjunction with the acquisition of NorthStar. 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. Of such shares, approximately 274,000 shares are being retained in escrow pending resolution of certain matters under the agreement.
- b) Not applicable.
- c) The Company has authorized the repurchase of up to 500,000 shares of its common stock. There were no repurchases of the Company's common stock during the quarter ended September 30, 2006.

**ITEM 3: DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4: SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS**

None.

**ITEM 5: OTHER INFORMATION**

None.

**ITEM 6: EXHIBITS**

| <b>Exhibit Number</b> | <b>Description</b>   |
|-----------------------|--|
| *4.1                  | Indenture dated July 28, 2006 between Registrant and Wilmington Trust Company relating to Floating Rate Junior Subordinate Deferrable Interest Debenture due September 15, 2036. |
| *4.2                  | Floating Rate Junior Subordinate Deferrable Interest Debenture due September 15, 2036.   |
| *4.3                  | Amended and Restated Declaration of Trust of EFSC Capital Trust V dated July 28, 2006.   |
| *4.4                  | Guarantee Agreement between Registrant and Wilmington Trust dated July 28, 2006.   |
| *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                                       |

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\* Filed herewith

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Clayton, State of Missouri on the day of November 9, 2006.

**ENTERPRISE FINANCIAL SERVICES CORP**

By: /s/ Kevin C. Eichner

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Kevin C. Eichner  
Chief Executive Officer

By: /s/ Frank H. Sanfilippo

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Frank H. Sanfilippo  
Chief Financial Officer