ENERGY FOCUS, INC/DE
Form 10-K
March 27, 2013

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

FORM 10-K

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012

o 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 0-24230

ENERGY FOCUS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	94-3021850
(State of incorporation)	(I.R.S. Employer Identification No.)

32000 Aurora Road
Solon, Ohio 44139
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: 440.715.1300

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

Securities registered pursuant to Section 12(g) of the Exchange Act:

Title of Each Class
Common Stock, Par Value $0.0001

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act of 1933. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes o No þ

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

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

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

Approximate aggregate market value (on basis of closing bid price) of voting stock held by non-affiliates as of June 29, 2012 $9,432,366

Number of the registrant's shares of common stock outstanding as of March 27, 2013: 44,698,650

Portions of the Proxy Statement for the 2013 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission are incorporated by reference into Part III of this report.

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PART I

Forward-Looking Statements

All references to “Energy Focus,” “we,” “us,” “our,” or “the Company” means Energy Focus, Inc. and its subsidiaries, except where it is made clear that the term means only the parent company.

Statements and information included in this Annual Report on Form 10-K that are not purely historical are forward-looking statements. Forward-looking statements in this Report on Form 10-K include statements regarding Energy Focus’ expectations, intentions, beliefs, and strategies regarding the future, including but not limited to; growth in the markets into which Energy Focus sells; conditions of the lighting industry and the economy in general; statements as to our competitive position; future operating results; net sales growth; expected operating expenses; gross product margin improvement; sources of net sales; anticipated revenue from government contracts; product development and enhancements; liquidity, ability to generate cash and cash reserves; our reliance upon a limited number of customers; our accounting policies; the effect of recent accounting announcements; the development and marketing of new products; relationships with customers and distributors; relationships with, dependence upon, and the ability to obtain components from suppliers; as well as our remarks concerning our ability to compete in certain markets; the evolution and future size of those markets; seasonal fluctuations; plans for and expected benefits of outsourcing and offshore manufacturing; trends in the price and performance of fiber optic lighting products; the benefits and performance of our lighting products; the adequacy of our current facilities; our strategy with regard to protecting our proprietary technology; and our ability to retain qualified employees.

When used in this report, the words “believes,” “expects,” “anticipates,” “intends,” “assumes,” “estimates,” “evaluates,” “opini “forecasts,” “may,” “could,” “future,” “forward,”, “plans”, “potential,” “probable,” and similar expressions are intended to ider forward-looking statements.

These forward-looking statements involve risks and uncertainties. We may make other forward-looking statements from time to time, including in press releases and public conference calls and webcasts. All forward-looking statements made by Energy Focus are based on information available to us at the time the statements are made, and we assume no obligation to update any forward-looking statements. It is important to note that the forward-looking statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those included in such forward-looking statements. Some of these risks and uncertainties are discussed below in “Item 1A. Risk Factors” of this Form 10-K.

Energy Focus ®, EFO®, Fiberstars®, BritePak®, EFO-Ice®, and Intellitube® are our registered trademarks. We may also refer to trademarks of other corporations and organizations in this document.

Item 1. Business

Energy Focus, Inc. and its subsidiaries ("Energy Focus"), designs, develops, manufactures, and markets energy-efficient lighting products, and is a leading provider of turnkey, energy-efficient, lighting solutions in the governmental and public sector market, general commercial market, and the pool market. Energy Focus' lighting technology offers significant energy savings, heat dissipation and maintenance cost benefits over conventional lighting for multiple applications. The Company was founded in 1985 as Fiberstars, Inc., and changed its name to Energy Focus, Inc. and incorporated in Delaware in May 2007.

Overview

We engage in the design, development, manufacturing, marketing, and installation of energy-efficient lighting systems and solutions where we serve two segments:

- Solutions providing turnkey, high-quality, energy-efficient lighting application alternatives primarily to the existing public-sector building market; and
- Product providing military, general commercial and industrial lighting and pool lighting offerings, each of which markets and sells energy-efficient lighting systems.

We continue to evolve our business strategy to include providing our customers with turnkey, comprehensive energy-efficient general lighting solutions, which use, but are not limited to, our patented and proprietary technology. Our products segment include light-emitting diode ("LED"), fiber optic, high-intensity discharge ("HID"), fluorescent tube and other highly energy-efficient lighting technologies. Typical savings related to our current technology of the Company approximates 80% in electricity costs, while providing full-spectrum light closely simulating daylight colors. Our strategy also incorporates continued investment into the research of new and emerging energy sources including LED and solar energy applications.

Our long-term strategy is to penetrate the $100 billion existing building and $300 million U.S. military lighting markets by providing turnkey, comprehensive energy-efficient lighting solutions, which utilize our proprietary energy-efficient lighting products. In March of 2012, we announced a cooperation agreement with Communal International Ltd. to develop the Asian Market for the Company's LED products. We will continue to focus on markets where the benefits of our lighting solutions offerings, combined with our technology, are most compelling. These markets include schools, universities, hospitals, office buildings, parking garages, supermarkets, museums, cold storage facilities and manufacturing environments. The passage of the Energy Savings Performance Contracts legislation in nearly all the states and the Energy Independence and Security Act of 2007 by Congress created a natural market for our energy-efficient products. Under this Act, all incandescent light bulbs are mandated by federal law to utilize 25% to 30% less energy than today's products by the years 2012 through 2014. Since many of our products are approximately 80% more efficient than incandescent bulbs, our focus is to increase the public's awareness and knowledge of our technology and to establish comprehensive distribution channels so that demand can be fulfilled quickly.

Our strengths, which provide a strategic competitive advantage, include the following:

- fundamental intellectual property and trade secrets in non-imaging optics and coatings,
- a broad and intimate understanding of lighting technologies,
- proven ability to develop systems which efficiently create, transport, and display light,
- a superior understanding of the existing building market drivers and the evolution towards "green" lighting products and energy-efficient lighting systems that maximize customer ROI,
- core competencies in execution of all facets of solutions sales, and
- strong relationships with the federal government for research and development.

Our tactical approach to implement our long term strategy includes:

- intensifying our focus on the existing building market by adding sales associates to expand our customer base,
- developing mainstream lighting technologies that directly compete against linear fluorescent general illumination lamps, and
- continuing to increase our value added to our customers and increase gross margins.

We expect that these actions will result in the following outcomes:

- sales growth and improved financial performance,
- sales of military grade LED lighting products for the U.S. Armed Forces,
- the formation of a streamlined organization that is focused on creating economic value through energy-efficient products and solutions for existing building owners, and
- development of mainstream lighting products for the existing building market that are not currently available and are differentiated by their performance, energy consumption, longevity, and controllability.

During 2011, we made major progress in our plan to reposition the Company for growth and profitability. This plan involved three major areas of focus, which included:

- Dramatic reduction of operating expenses.
- Receipt of a $23.1 million order for the U.S. Navy to retrofit approximately 7% of the Naval fighting fleet with LED lighting products, including Intellitube® lamps. We invoiced the U.S. Navy $1.9 million through December 2011 for products and services related to this contract.
- Added sales resources and broadened our customer base at Stones River Companies, LLC ("SRC") during 2011, which helped us grow our lighting retrofit business by 10% in 2012.

During 2012, we continued to focus on these areas and reduced our spending in sales and marketing and general and administrative expenses by 8% from 2011. We shipped an additional $2.5 million against the U.S. Navy Contract, and grew total sales by 16% from 2011.

Our Products

We produce, source, and/or market a wide variety of lighting technologies to serve two general markets: commercial buildings and pool lighting. Our offerings include the following products:

- 25 Families of LED lamps and fixtures to serve the U.S. Navy,
- LED docklights,
- LED parking garage lamps and fixtures,
- LED cold storage globe lamps and LED fiber optic lighting systems,
- LED landscape fixtures,
- LED retrofit kits for HID applications,
- LED replacements for linear fluorescent lamps, and
- LED lamps and fixtures.

In addition, we also sell customized components such as underwater lenses, color-changing LED lighting fixtures, and lighted water features, including waterfalls and laminar-flow water fountains. Furthermore, we continue to aggressively penetrate the government and military lighting markets. In this regard, we have many products being actively marketed to the United States federal government agencies through the General Services Administration website, https://www.GSAAdvantage.gov.

The key features of our products are as follows:

- Many of our products meet the lighting efficiency standards mandated for the year 2020.
- Our products qualify for federal and state tax incentives for commercial and residential consumers in certain states.
- Many of our products make use of proprietary optical and electronics delivery systems which enable high efficiencies with superior lighting qualities.

Sales, Marketing, and Distribution of our Offerings Portfolio

Products

Our products are sold through a combination of direct sales employees, independent sales representatives, and various distributors in different geographic markets throughout the world. Our distributors' obligation to us is not contingent upon the resale of our products and, as such, does not prohibit revenue recognition. We also distribute our products through our SRC subsidiary.

Within the commercial and pool lighting business units, we continue to focus on general contractors and specifiers especially in the retail, hospitality, museum, and health care markets. Our lighting retrofit subsidiary, SRC, is heavily targeting the existing public building market and will provide an additional sales channel for our products for quick, energy-efficient upgrades.

Solutions

Our solutions-based sales are designed to enhance total value by providing turnkey, high-quality, energy-efficient lighting application alternatives that positively impact customers' profitability, the environment, and the communities served. These solutions are sold through our SRC subsidiary and include not only our proprietary energy-efficient lighting solutions, but also sourced lighting systems, energy audits and service agreements.

Through SRC, we target the existing public building market, particularly health care and hospitals, schools and universities, governments and municipalities, museums, hospitality and casinos, as well as industry and manufacturing. SRC's direct customers are large national ESCOs that provide energy-efficient upgrades around the country. Also within the solutions business unit, we serve multi-location food retailers, cold storage facilities, retailers, and industrial/commercial real estate companies.

Concentration of Sales

In 2012, our ten largest customers accounted for approximately 62% of our net sales. TLC Investments, LLC ("TLC"), accounted for approximately 15% of our consolidated net sales and 42% of our solutions segment net sales. Johnson Controls, Inc. accounted for approximately 10% of our consolidated net sales, and 11% of our product segment sales. Additionally, the U.S. Navy accounted for approximately 13% of our product segment sales, and Trane and Ameresco, Inc. ("Ameresco") accounted for approximately 24% and 19% of our solutions segment sales.

In 2011, our ten largest customers accounted for approximately 56% of our net sales. Ameresco accounted for approximately 15% of our consolidated net sales and 40% of our solutions segment net sales.

In 2010, our ten largest customers accounted for approximately 64% of our net sales. In 2010, two customers, Ameresco and Woodstone Energy, LLC ("Woodstone"), made up 20% and 17%, respectively, of consolidated net sales. Ameresco contributed 35% and Woodstone contributed 30% of our solutions segment net sales. The former Vice President of SRC, who resigned on December 31, 2011, was a minority owner of Woodstone and TLC. See Note 14, Related Party Transactions, for further information.

Manufacturing and Suppliers

We produce our lighting systems through a combination of internal and outsourced manufacturing and assembly operations. Our internal lighting system manufacturing consists primarily of fiber processing, final assembly, testing, and quality control. We use independent contractors to manufacture some components and sub-assemblies, and have worked with a number of our vendors to design custom components to meet our specific needs. We manage inventories of domestically produced component parts on a just-in-time basis, when practicable. Our quality assurance program provides for testing of all sub-assemblies at key stages in the assembly process as well as testing of finished products.

Many of our products are manufactured by third-party suppliers resulting in significant cost savings. Under a Production Share Agreement, we conduct contract manufacturing and assembly in Mexico through North American Production Sharing, Inc. and Industrias Unidas de BC, SA de CV ("NAPS"). Under this agreement, NAPS provides administrative and manufacturing services, including labor services and the use of manufacturing facilities in Mexico, for the manufacturing and assembly of certain fiber optic and LED lighting systems, equipment and related components. We also perform final assembly of products acquired from China, India, Japan and Taiwan. These suppliers generally supply products on a purchase order basis.

Research and Development

Research and development has remained a key focus of our Company; accordingly, we have committed substantial resources to this endeavor. Our research and development team is dedicated to continuous improvement and innovation of our current lighting technologies, including LED, fiber optics and HID systems.

Research and development expense, net of credits from the government, for the year ended December 31, 2012 was $368 thousand. Research and development income, net of expenses, for the years ended December 31, 2011 and 2010

was $515 thousand and $202 thousand, respectively.

Our recent achievements include:

2012: We were awarded $2.4 million in research contracts and grants. We were awarded approximately $0.9 million to develop next generation lighting for future U.S. Navy vessels. Like our smaller berth light that has been sailing in the Virginia Class Nuclear submarines for almost two years, this next generation lighting will utilize a larger version of our optical wave guide technology. In January, we were awarded $0.1 million in a subcontract under the Defense Advanced Research Projects Agency ("DARPA") on the Manufacturable Gradient Index Optics Phase 2 BAA, where in part, we explored further optical advancements to Intellitube® technology. In November, we were awarded a $0.2 million Phase I Small Business Innovation Research ("SBIR") contract from the Department of Energy ("DoE") for "Lighting Controls Software for Self-Commissioning and Optimized Energy Savings," where we further develop the ultra low cost sensor network to compliment Intellitube®, the Company's LED based fluorescent replacement technology. In December, we learned that we were selected to receive funding for at least a $1.2 million award by the Executive Control Board of the National Shipbuilding Research Program ("NSRP") for the development of a "New Best" LED lighting solution for the U.S. Navy's 2-bulb fluorescent fixture. NSRP is a collaboration of U.S. Shipyards that focus on common issues with a goal of reducing the cost of acquiring, operating and maintaining Navy Ships. This new best solution utilizes our existing Intellitube® product.

2011: We were awarded $26.1 million in government supply contracts and in research contracts and grants in 2011. In March 2011, we received a $1.0 million grant from the State of Ohio Third Frontier to develop a photovoltaic "wall-pack" unit for outdoor LED lighting. In April 2011, we received a Phase 2 Small Business Technology Transfer ("STTR") grant for $0.6 million from the National Aeronautics and Space Administration ("NASA") for "Innovative Solid State Lighting Replacements for Industrial and Test Facility Locations." In May 2011, we received a $0.4 million increase in funding for the "Very High Efficiency Solar Cell ("VHESC") program. In July 2011, we received a $1.0 million grant from the State of Ohio Third Frontier to develop an ultra-low cost light sensor to compliment Intellitube®. In August 2011 we received a $23.1 million supply contract to provide LED fixtures and our proprietary Intellitube® LED lamps for use on the U.S. Navy Fleet. The government has the right to change quantities throughout the life of this supply contract.

2010: We were awarded $3.0 million in research contracts and grants in 2010. These included three awards totaling $1.6 million announced in January 2010. Two of these awards, "Explosion-Proof Solid State Lighting for Extreme Environments" and "A Spectrally Dynamic Berth Light for Active Circadian Cycle Management," are Phase 2 SBIR grants from DARPA. The third award, "Innovative Solid State Lighting Replacements for Industrial and Test Facility Locations," is a Phase 1 STTR program grant received from the NASA. A DoE award for $1.0 million to develop high performance Sol-Gel coatings for lighting and solar applications was announced in August 2010. An additional $0.4 million in Department of Defense funding to advance Energy Focus' LED Intellitube® technology and applications was announced also in August 2010. In addition, we completed qualification of seven families of solid state lighting fixtures developed under Naval Sea Systems Command ("NAVSEA") and DARPA contracts. The Company is currently shipping these products to the U. S. Navy.

Intellectual Property

We have a policy of seeking to protect our intellectual property through patents, license agreements, trademark registrations, confidential disclosure agreements and trade secrets, as management deems appropriate. Our intellectual property portfolio consists of 79 issued United States and foreign patents of which 54 are currently in force, various pending United States patent applications, and various pending Patent Cooperation Treaty patent applications filed with the World Intellectual Property Organization that serves as the basis for national patent filings in countries of interest. Our issued patents expire at various times between September 2014 and May 2031. Generally, the term of patent protection is twenty years from the earliest effective filing date of the patent application. There can be no assurance; however, that our issued patents are valid or that any patents applied for will be issued, and that our competitors or customers will not copy aspects of our lighting systems or obtain information that we regard as proprietary. There can also be no assurance that others will not independently develop products similar to ours. The laws of some foreign countries in which we sell or may sell our products do not protect proprietary rights to products to the same extent as the laws of the United States.

During 2012, we retained the services of an independent financial advisory firm to determine the fair market value of certain patents and related patent applications, trade secrets and know-how that we own. This intellectual property directly or indirectly relates to the current and anticipated Intellitube® products. The valuation, dated November 30, 2012, was conducted in accordance with the Statement on Standards for Valuation Services promulgated by the American Institute of Certified Public Accounts and concluded that the estimated fair market value of the assets under review was approximately $70 million.

Backlog

We typically ship standard products within a few days after receipt of an order. Custom products are shipped within 30-60 days of receipt of an order. Generally, there is not a significant backlog of orders. Our products segment backlog at the end of 2012 was $1.2 million, compared to $1.9 million at the end of 2011. Our solutions segment

backlog on awarded contracts totaled approximately $1.3 million compared to $2.0 million at the end of 2011. Revenues from our 2012 backlog will be recognized over the course of 2013, as the services are performed or the materials are delivered.

Competition

Our commercial lighting products compete against a variety of lighting products, including conventional light sources such as incandescent light bulbs, metal halide lamps, LEDs, compact fluorescent lamps, competitive fiber optic lighting systems, and decorative lighting technologies. Our ability to compete depends substantially upon the superior performance and lower lifecycle cost of our products and services. Principal competitors in our markets include large lamp manufacturers, lighting fixture companies, distributors, lighting retrofit companies, and Energy Service Companies ("ESCOs") whose financial resources may substantially exceed ours. These competitors may introduce new or improved products that may reduce or eliminate some of the competitive advantage of our products. We anticipate that the primary competition to our products will come from new technologies that offer increased energy efficiency, lower maintenance costs, and/or lower heat radiation. In certain applications, we compete with LED systems produced by large lighting companies such as Philips and General Electric. In traditional commercial lighting applications, we compete primarily with local and regional lighting manufacturers that, in many cases, are more established in their local markets than our Company. In traditional commercial lighting, fiber optic lighting products are offered by a number of smaller companies, some of which compete aggressively on price. Some of these competitors offer products with performance characteristics similar to those of our products. Additionally, some conventional lighting companies now manufacture or license fiber optic lighting systems that compete with our products.

Our pool lighting products compete with other sources of in-pool lighting, including colored and color-changing underwater lighting, and pool accent lighting. Principal competitive factors include price, performance, ease of installation, and maintenance requirements. In the pool lighting market, we face competition from suppliers and distributors who bundle lighting and non-lighting products and sell these packages to pool builders and installers. In addition, we face competition directly from manufacturers who produce their own lighting systems and components. In this market, competitive products are offered by Pentair's American Products Division, a major manufacturer of pool equipment and supplies, as well as Next Step Products LLC. In the spa lighting business, spa manufacturers install LED lighting systems during the manufacturing process.

Our SRC solutions business competes against other lighting retrofit companies, as well as some traditional ESCOs that self-perform the lighting component of their projects. We compete primarily on the basis of financial impact, technology, light quality and design, client relationships, lighting application knowledge, energy efficiency, customer service and marketing support.

Insurance and Bonding

All of our properties and equipment are covered by insurance and we believe that such insurance is adequate. In addition, we maintain general liability and workers compensation insurance in amounts that we believe are consistent with our risk of loss and industry practice. In regards to our solution segment, we are often required to provide various types of surety bonds as an additional level of security of our performance. We have a surety arrangement with one surety for which we provide cash collateral relating to our surety bonding program. We believe that this cash collateral is sufficient to support our current bonding requirements.

Employees

As of December 31, 2012, we had 71 associates, 14 of whom are located in the United Kingdom and 57 in the United States. None of our associates are subject to any collective bargaining agreement.

Business Segments

We have two reportable segments: products and solutions. The products segment includes pool lighting, general commercial lighting, government products, and research and development services, each of which markets and sells lighting systems. Our products are sold primarily in North America, Europe, and the Far East through a combination of direct sales employees, independent sales representatives and various distributors. Our solutions segment provides turnkey, high-quality, energy-efficient lighting application alternatives, which are designed to enhance total value by positively impacting customers' profitability, the environment and the communities served. These solutions are sold in North America through our direct sales employees, as well as our SRC subsidiary, and include not only our proprietary energy-efficient lighting solutions, but also sourced lighting systems, energy audits and service agreements.

Available Information

Our Web site is located at http://www.efoi.com. We make available free of charge, on or through our Web site, our annual, quarterly, and current reports, as well as any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission ("SEC"). Information contained on our Web site is not part of this report.

Item 1A. Risk Factors

We have a history of operating losses and may incur losses in the future, and our auditors have issued a "Going Concern" opinion.

We have experienced net losses of $5.7 million, $6.1 million and $8.5 million for the years ended December 31, 2012, 2011 and 2010, respectively. As of December 31, 2012, we had an accumulated deficit of $80.6 million. Although management continues to address many of the legacy issues that have historically burdened our financial performance, we still face challenges in order to reach profitability. In order for us to attain profitability and growth, we will need to successfully address these challenges, including improvement in gross margins, execution of our marketing and sales plans for our turnkey energy-efficient lighting solutions business, the development of new technologies into sustainable product lines, the continuation of cost reductions throughout our organization, and continued improvements in our supply chain performance.

Although we are optimistic about reaching profitability, there is a risk that our business may not be as successful as we envision. Our independent public accounting firm has issued an opinion in connection with our 2012 Annual Report on Form 10-K raising substantial doubt as to our ability to continue as a going concern. This opinion stems from our historically poor operating performance, and our historical inability to generate sufficient cash flow to meet obligations and sustain operations without obtaining additional external financing. Although we are optimistic about obtaining the funding necessary for us to continue as a going concern, there can be no assurances that this objective will be successful. As such, we will continue to review and pursue selected external funding sources, if necessary, to execute these objectives including, but not limited to, the following:

- obtain financing from traditional or non-traditional investment capital organizations or individuals,
- potential sale or divestiture of one or more operating units, and
- obtain funding from the sale of our common stock or other equity or debt instruments.

Obtaining financing through the above-mentioned mechanisms contains risks, including:

- loans or other debt instruments may have terms and/or conditions, such as interest rate, restrictive covenants and control or revocation provisions, which are not acceptable to management or our Board of Directors,
- the current environment in capital markets combined with our capital constraints may prevent us from being able to obtain adequate debt financing,
- financing may not be available for parties interested in pursuing the acquisition of one or more of our operating units, and
- additional equity financing may not be available to us in the current capital environment and could lead to further dilution of shareholder value for current shareholders of record.

Depressed general economic conditions may adversely affect our operating results and financial condition.

Our business is sensitive to changes in general economic conditions, both inside and outside the United States. An economic downturn may adversely impact our business. In our legacy businesses, sales of our lighting products depend significantly upon the level of new building construction, which is affected by housing market trends, interest rates and the weather. Sales of our pool and spa lighting products depend substantially upon the level of new pool construction, which is also affected by housing market and construction trends. In addition, due to the seasonality of construction and the sales of swimming pool and lighting products, our revenue and income have tended to be significantly lower in the first quarter of each year. We may experience substantial fluctuations in our operating results from period to period as a consequence of these factors. Slow growth in the economy or an economic downturn could adversely affect our ability to meet our working capital requirements and growth objectives, or could

otherwise adversely affect our business, financial condition and results of operations. As a result, any general or market-specific economic downturns, particularly those affecting new building construction and renovation, or that cause end-users to reduce or delay their purchases of lighting products, services, or retrofit activities, would have a material adverse effect on our business, cash flows, financial condition and results of operations.

If we are unable to respond effectively as new lighting technologies and market trends emerge, our competitive position and our ability to generate revenue and profits may be harmed.

To be successful, we will need to keep pace with rapid changes in LED technology, changing customer requirements, new product introductions by competitors and evolving industry standards, any of which could render our existing products obsolete if we fail to respond in a timely manner. Development of new products incorporating advanced technology is a complex process subject to numerous uncertainties. We have previously experienced, and could in the future, experience delays in the introduction of new products. If effective new sources of light other than LED's are discovered, our current products and technologies could become less competitive or obsolete. If others develop innovative proprietary lighting technology that is superior to ours, or if we fail to accurately anticipate technology and market trends, respond on a timely basis with our own development of new products and enhancements to existing products, and achieve broad market acceptance of these products and enhancements, our competitive position may be harmed and we may not achieve sufficient growth in our net sales to attain or sustain profitability.

If we are not able to compete effectively against companies with greater resources, our prospects for future success will be jeopardized.

The lighting industry is highly competitive. In the high performance lighting markets in which we sell our advanced lighting systems, our products compete with lighting products utilizing traditional lighting technology provided by many vendors. Additionally, in the advanced lighting markets in which we have primarily competed to date, competition has largely been fragmented among a number of small manufacturers. However, some of our competitors, particularly those that offer traditional lighting products, are larger companies with greater resources to devote to research and development, manufacturing and marketing.

Moreover, in the general lighting market, we expect to encounter competition from an even greater number of companies. Our competitors are expected to include the large, established companies in the general lighting industry, such as General Electric, Osram Sylvania and Royal Philips Electronics. Each of these competitors has undertaken initiatives to develop LED technology. These companies have global marketing capabilities and substantially greater resources to devote to research and development and other aspects of the development, manufacture and marketing of LED lighting products than we possess. The relatively low barriers to entry into the lighting industry and the limited proprietary nature of many lighting products also permit new competitors to enter the industry easily.

In each of our markets, we also anticipate the possibility that LED manufacturers, including those that currently supply us with LEDs, may seek to compete with us. Our competitors' lighting technologies and products may be more readily accepted by customers than our products. Additionally, to the extent that competition in our markets intensifies, we may be required to reduce our prices in order to remain competitive. If we do not compete effectively, or if we reduce our prices without making commensurate reductions in our costs, our net sales and profitability and our future prospects for success may be harmed.

If we are unable to obtain and adequately protect our intellectual property rights, our ability to commercialize our products could be substantially limited.

We consider our technology and processes proprietary. If we are not able to adequately protect or enforce the proprietary aspects of our technology, competitors may utilize our proprietary technology. As a result, our business, financial condition and results of operations could be adversely affected. We protect our technology through a combination of patent, copyright, trademark and trade secret laws, employee and third-party nondisclosure agreements, and similar means. Despite our efforts, other parties may attempt to disclose, obtain or use our technologies. Our competitors may also be able to independently develop products that are substantially equivalent or superior to our products or slightly modify our patents. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. As a result, we may not be able to protect our proprietary rights adequately in the United States or abroad.

We have engaged in litigation in the past and litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Litigation may also be necessary to defend against claims of infringement or invalidity by others. An adverse outcome in litigation or any similar proceedings could subject us to significant liabilities, require us to license disputed rights from others or require us to cease marketing or using certain products or technologies. We may not be able to obtain any licenses on acceptable terms, if at all. We also may have to indemnify certain customers if it is determined that we have infringed upon or misappropriated another party's intellectual property. The cost of addressing any intellectual property litigation claim, both in legal fees and expenses, and the diversion of management resources, regardless of whether the claim is valid, could be significant and could materially harm our business, financial condition and results of operations.

If critical components that we currently purchase from a small number of third-party suppliers become unavailable or third-party manufacturers otherwise experience delays, we may incur delays in shipment, which would damage our business.

We depend on others to manufacture a significant portion of the component parts incorporated into our products. We purchase our component parts from third-party manufacturers that serve the advanced lighting systems market and believe that alternative sources of supply are readily available for most component parts. However, consolidation in the lighting industry could result in one or more current suppliers being acquired by a competitor, rendering us unable to continue purchasing necessary amounts of key components at competitive prices.

In an effort to reduce manufacturing costs, we have outsourced the production of certain parts and components, as well as finished goods in our product lines, to a number of overseas suppliers. While we believe alternative sources for the production of these products are available, we have selected these particular manufacturers based on their ability to consistently produce these products per our specifications, ensuring the best quality product at the most cost effective price. We depend on our suppliers to satisfy performance and quality specifications and to dedicate sufficient production capacity within scheduled delivery times. Although we maintain contracts with selected suppliers, we may be vulnerable to unanticipated price increases, payment term changes and product shortages. Accordingly, the loss of all or one of these suppliers or delays in obtaining shipments could have a material adverse effect on our operations until such time as an alternative supplier could be found. We may be subject to various import duties applicable to materials manufactured in foreign countries and may be affected by various other import and export restrictions, as well as other considerations or developments impacting upon international trade, including economic or political instability, shipping delays and product quotas. These international trade factors will, under certain circumstances, have an impact on the cost of components, which will have an impact on the cost to us of the manufactured product and the wholesale and retail prices of our products.

If the companies to which we outsource the manufacture of our products fail to meet our requirements for quality, quantity, and timeliness, our revenue and reputation in the marketplace could be harmed.

We outsource a significant portion of the manufacture and assembly of our products. We currently depend on a small number of contract manufacturers to manufacture our products at plants in various locations throughout the world, primarily in the United States, Mexico, China and Taiwan. These manufacturers supply most of the necessary raw materials and provide all necessary facilities and labor to manufacture our products. We currently do not have long-term contracts with all of these manufacturers. If these companies were to terminate their arrangements with us without adequate notice, or fail to provide the required capacity and quality on a timely basis, we would be unable to manufacture and ship our lighting products until replacement manufacturing services could be obtained. To qualify a new contract manufacturer, familiarize it with our products, quality standards and other requirements, and commence volume production is a costly and time-consuming process. If it became necessary to do so, we may not be able to establish alternative manufacturing relationships on acceptable terms.

Our reliance on contract manufacturers involves certain additional risks, including the following:

- lack of direct control over production capacity and delivery schedules,
- lack of direct control over quality assurance, manufacturing yields, and production costs,
- risk of loss of inventory while in transit from China, Mexico and Taiwan, and
- risks associated with international commerce, particularly with China, Mexico and Taiwan, including unexpected changes in legal and regulatory requirements, changes in tariffs and trade policies, risks associated with the protection of intellectual property and political and economic instability.

Any interruption in our ability to manufacture and distribute products could result in delays in shipment, lost sales, reductions in revenue and damage to our reputation in the market, all of which would adversely affect our business.

We depend on independent distributors and sales representatives for a substantial portion of our net sales, and the failure to manage our relationships with these third parties, or the termination of these relationships, could cause our net sales to decline and harm our business.

We rely significantly on indirect sales channels to market and sell our products. Most of our products are sold through third-party independent distributors and sales representatives. In addition, these parties provide technical sales support to end-users. Our current agreements within these sales channels are non-exclusive with regard to lighting products in general, but exclusive with respect to LED lighting and fiber optic products. We anticipate that any such agreements we enter into in the future will be on similar terms. Furthermore, our agreements are generally short-term, and can be cancelled by these sales channels without significant financial consequence. We cannot control how these sales channels perform and cannot be certain that we or end-users will be satisfied by their performance. If these distributors and sales representatives significantly change their terms with us, or change their historical pattern of ordering products from us, there could be a significant impact on our net sales and profits.

Our products could contain defects or they may be installed or operated incorrectly, which could reduce sales of those products or result in claims against us.

Despite product testing, defects may be found in our existing or future products. This could result in, among other things, a delay in the recognition or loss of net sales, loss of market share or failure to achieve market acceptance. These defects could cause us to incur significant warranty, support and repair costs, divert the attention of our engineering personnel from our product development efforts, and harm our relationship with our customers. The occurrence of these problems could result in the delay or loss of market acceptance of our lighting products and would likely harm our business. Some of our products use line voltages (such as 120 or 240 AC), or are designed for

installation in environments such as swimming pools and spas, which involve enhanced risk of electrical shock, injury or death in the event of a short circuit or other malfunction. Defects, integration issues or other performance problems in our lighting products could result in personal injury or financial or other damages to end-users or could damage market acceptance of our products. Our customers and end-users could also seek damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend.

If we are unable to accurately estimate the risks, revenues or costs associated with a project, we may achieve a lower than expected profit or incur a loss on that project.

For the solutions segment of our business, we generally enter into fixed price contracts. Fixed price contracts require us to perform a contract for a specified price regardless of our actual costs. As a result, the profit that we realize on a contract is dependent on the extent to which we successfully manage our costs. Cost overruns, whether due to inefficiency, inaccurate estimates or other factors, result in lower profit or a loss on a project. A majority of our contracts are based on cost estimates that are subject to a number of assumptions. If our estimates of the risks, revenues or costs prove inaccurate or circumstances change, we may incur a lower profit or a loss on that project.

Additionally, we recognize certain contract revenues, including revenues from our solutions segment, using the percentage-of-completion method. Under this method, percentage-of-completion is determined by relating the actual cost of the work performed to date to the current estimated total cost of the respective contracts. When the estimate on a contract indicates a loss, we record the entire loss during the accounting period in which it is estimable. In the ordinary course of business, at a minimum on a quarterly basis, we prepare updated estimates of the total forecasted revenue, cost and profit or loss for each contract. The cumulative effect of revisions in estimates of the total forecasted revenue and costs during the course of the work is reflected in the accounting period in which the facts that caused the revision become known. To the extent that these revisions result in a reduction in revenue, we recognize a credit or a charge against current earnings, which could be material.

Our business may suffer if we fail to comply with government contracting laws and regulations.

We derive a portion of our revenues from direct and indirect sales to U.S., state, local, and foreign governments and their respective agencies. Such contracts are subject to various procurement laws and regulations, and contract provisions relating to their formation, administration and performance. Failure to comply with these laws, regulations or provisions in our government contracts could result in the imposition of various civil and criminal penalties, termination of contracts, forfeiture of profits, suspension of payments, or suspension from future government contracting. If our government contracts are terminated, if we are suspended from government work, or if our ability to compete for new contracts is adversely affected, our business could suffer.

An inability to obtain bonding could limit the number of solutions segment projects we are able to pursue.

As is customary in the construction business, we are often required to provide surety bonds to secure our performance under construction contracts. Our ability to obtain surety bonds primarily depends upon our capitalization, working capital, past performance, management expertise and other external factors, including the overall capacity of the surety market. Surety companies consider such factors in relation to the amount of our backlog and their underwriting standards, which may change from time to time. The surety industry has undergone significant changes with several companies withdrawing completely from the industry or significantly reducing their bonding commitment. In addition, certain reinsurers of security risk have limited their participation in this market. Therefore, we could be unable to obtain surety bonds when required, which could adversely affect our future results of operations and revenues.

We have international sales and are subject to risks associated with operating in international markets.

For the years ending December 31, 2012, net sales of our products outside of the United States represented 10% of our total net sales. We generally provide technical expertise and limited marketing support, while our independent international distributors generally provide sales staff, local marketing, and product services. We believe our international distributors are better able to service international markets due to their understanding of local market conditions and best business practices. International business operations are subject to inherent risks, including,

among others:

- unexpected changes in regulatory requirements, tariffs, and other trade barriers or restrictions,
- potentially adverse tax consequences,
- the burdens of compliance with a wide variety of foreign laws,
- import and export license requirements and restrictions of the United States and each other country in which we operate,
- exposure to different legal standards and reduced protection for intellectual property rights in some countries,
- currency fluctuations and restrictions, and
- political, social, and economic instability, including war and the threat of war, acts of terrorism, pandemics, boycotts, curtailment of trade or other business restrictions.

We may not fully recognize the anticipated revenue reported in our backlog.

The contracts we enter into for our solutions segment can be relatively large and typically range in the amount of $0.1 million to as much as $4.0 million. As of December 31, 2012, our solutions segment backlog of uncompleted work was $1.3 million. We include a project in our backlog when a contract is awarded or a letter of intent is obtained. The revenue projected in our backlog may not be realized or may not result in the revenue or profits expected. If a project included in our backlog is canceled, suspended or the scope of work is reduced, it would result in a reduction to our backlog, which could affect the revenues and profits realized. If a customer should cancel a project, we may be reimbursed for costs expended to date but would have no contractual right to the total projected revenues included in our backlog. Cancellations or delays of significant projects could have a material adverse effect on future revenues, profits and cash flows.

If we are unable to attract or retain qualified personnel, our business and product development efforts could be harmed.

To a large extent, our future success will depend on the continued contributions of certain employees, such as our current Chief Executive Officer, Chief Financial Officer and Chief Operating Officer. These and other key employees may be difficult to replace. Our future success will also depend on our ability to attract and retain qualified technical, sales, marketing, and management personnel, for whom competition is very intense. The loss of, or failure to attract, hire and retain any such persons could delay product development cycles, disrupt our operations, or otherwise harm our business or results of operations. We have been successful in hiring experienced energy solutions salespeople from leading firms in the industry, but if these individuals are not successful in achieving our expectations, then planned sales may not occur and the anticipated net sales may not be realized.

A significant portion of our business is dependent upon the existence of government funding, which may not be available into the future and could result in a significant reduction in sales and could cause significant harm to our business.

A significant portion of our research and development efforts have been supported directly by government funding and were contracted for short periods, usually one to two years. Further, a significant portion of net sales generated by SRC are derived from state government funding and supported by federal government funding. If government funding is reduced or eliminated, there is no guarantee that we would be able to continue to fund our activities in these areas at their current levels, if at all. If we are unable to maintain our access to government funding in these areas, there could be a significant impact on our net sales and profits.

We believe that certification and compliance issues are critical to adoption of our lighting systems, and failure to obtain such certification or compliance would harm our business.

We are required to comply with certain legal requirements governing the materials in our products. Although we are not aware of any efforts to amend any existing legal requirements or implement new legal requirements in a manner with which we cannot comply, our net sales might be adversely affected if such an amendment or implementation were to occur.

Moreover, although not legally required to do so, we strive to obtain certification for substantially all our products. In the United States, we seek certification on substantially all of our products from Underwriters Laboratories (UL®) or Intertek Testing Services (ETL®). Where appropriate in jurisdictions outside the United States and Europe, we seek to obtain other similar national or regional certifications for our products. Although we believe that our broad knowledge and experience with electrical codes and safety standards have facilitated certification approvals, we cannot ensure that we will be able to obtain any such certifications for our new products or that, if certification standards are amended, that we will be able to maintain such certifications for our existing products. Moreover, although we are not aware of any effort to amend any existing certification standard or implement a new certification standard in a manner that would render us unable to maintain certification for our existing products or obtain ratification for new products, our net sales might be adversely affected if such an amendment or implementation were to occur.

We incur significant costs as a result of being a public company and our management is required to devote substantial time and financial resources to meet compliance obligations.

As a public company reporting to the Securities and Exchange Commission, we incur significant legal, accounting, investor relations, board compensation and other expenses. We are subject to the reporting requirements of the Securities Exchange Act of 1934, and the Sarbanes-Oxley Act of 2002, including section 404 that requires that we

annually evaluate and report on our systems of internal controls. In the future, there may be material weaknesses in our internal controls that would be required to be reported in future Annual Reports on Form 10-K and/or Quarterly Reports on Form 10-Q. A negative reaction by the equity markets to the reporting of a material weakness could cause our stock price to decline.

We could issue additional common stock or may need to request our shareholders to authorize additional shares of common stock, which might dilute the book value and market for our common stock.

We are authorized to issue 100,000,000 shares of common stock, of which 44.7 million shares were issued and outstanding, as of March 15, 2013. An additional 32 million shares have been reserved for issuance upon exercise of stock options. warrants or conversion of convertible debt. If or when these securities are exercised into shares of our common stock, the number of our shares of common stock outstanding will increase. Increases in our outstanding shares, and any sales of shares, could have an adverse affect on the trading activity and market price of our common stock. Our Board of Directors has the authority, without action or vote of our shareholders, to issue a sizeable part of our authorized but unissued shares. Such stock issuances could be made at a price that reflects a discount or a premium from the then-current trading price of our common stock. In addition, in order to raise capital or acquire businesses in the future, we may need to issue additional securities or promissory notes that are convertible or exchangeable for shares of our common stock. These issuances would dilute shareholders' percentage ownership interest, which would have the effect of reducing influence on matters on which our shareholders vote, and might dilute the book value of our common stock. Shareholders may incur additional dilution if holders of stock options, whether currently outstanding or subsequently granted, exercise those options, or if warrant holders exercise warrants purchasing shares of our common stock. If an insufficient amount of authorized, but unissued shares of common stock exists to issue in the future in connection with subsequent equity financing or acquisition transactions, we may be required to ask our shareholders to authorize additional shares before undertaking, or as a condition to completing, a financing or acquisition transaction. We cannot be assured that our shareholders would authorize an increase in the number of shares of our common stock.

As a "thinly-traded" stock, large sales can and have placed negative pressure on our common stock price.

Our common stock trades Over-The-Counter under the symbol EFOI. Despite certain increases of trading volume, from time to time we experience periods when our common stock could be considered "thinly-traded." Additionally, we have entered into in the past or may enter into in the future, financing or acquisition transactions resulting in a large number of newly issued shares that become immediately tradable or tradable simultaneously in the future. These factors coupled with a limited number of market makers impairs the liquidity of our stock, not only the number of shares that can be bought and sold, but also the through possible delays in the timing of transactions, and lower prices for our common stock than might otherwise prevail. This could make it difficult or impossible for an investor to sell shares of our common stock within a desired timeframe or to obtain a desired price.

In addition, from time to time, certain of our shareholders may be eligible to sell all, or a portion of, their shares of common stock by means of ordinary brokerage transactions in the open market pursuant to Rule 144, promulgated under the Securities Act of 1933, or under effective resale prospectuses. Any substantial sale of our common stock pursuant to Rule 144 or any resale prospectus may have an adverse affect on the market price of our securities.

We may be subject to legal claims against us or claims by us which could have a significant impact on our resulting financial performance.

At any given time, we may be subject to litigation, the disposition of which may have an adverse affect upon our business, financial condition, or results of operation. Information regarding our current legal proceedings is presented below in Part I, Item 3.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our principal executive offices are located in approximately a 25,000 square foot facility in Solon, Ohio, under a lease agreement expiring on April 30, 2014. See Note 9, Commitments and Contingencies, to the Consolidated Financial Statements for additional information.

We also have leased facilities in Nashville, Tennessee, Pleasanton, California, and Berkshire, United Kingdom. In addition, we have a contract manufacturing facility near Tijuana, Mexico. We believe that our current facilities are adequate to support our current and anticipated operations.

Item 3. Legal Proceedings

From time to time, we may be involved in legal proceedings arising from the normal course of business. As of the date of this report, we have not received notice of any new legal proceedings.

Item 4. Submission of Matters to a Vote of Security Holders

During the fourth quarter of the year ended December 31, 2012, there were no matters submitted to a vote of security holders.

Executive Officers of the Registrant

The following is the name, age, and present position of each of our executive officers, as well as all prior positions held by each of them during the last five years and when each of them was first elected or appointed as an executive officer.

Name	Age	Current Position and Business Experience
Joseph G. Kaveski	52	Chief Executive Officer and Director – May 2008 to present. Prior to joining Energy Focus, Mr. Kaveski led his own strategic consulting business, TGL Company. As a consultant, he worked with equity investors and publicly traded companies on strategic initiatives and planning. Other corporations Mr. Kaveski has worked for include Johnson Controls, Inc. where he was Vice President of Energy Management Services and Strategic Projects.
Eric W. Hilliard	45	Chief Operating Officer and Vice President – November 2006 to present. Prior to joining Energy Focus, Mr. Hilliard served in Business and Operations Management at Saint Gobain's Aerospace Flight Structures Division from 2002 to 2006 overseeing the global sales and operations for composite flight structure components to customers such as Embraer, Gulfstream and EADS. Other career assignments include Goodrich Aerospace, Chemical Leaman, and the HJ Heinz Company serving in operational and international roles throughout his career.
Mark J. Plush	63	Chief Financial Officer and Vice President of Finance– July 2011 to present. Prior to joining Energy Focus, Mr. Plush served as Vice President and Chief Financial Officer with Keithley Instruments from 1998 to 2010.
Roger F. Buelow	40	Chief Technology Officer and Vice President – July 2005 to present. Vice President of Engineering from February 2003 to July 2005. Prior to joining Energy Focus, Mr. Buelow was the Director of Engineering at Unison Fiber Optic Lighting Systems, LLC, and was with GE Lighting.

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Our common stock is traded Over-The-Counter under the symbol EFOI. The following table sets forth the high, low, and close market prices per share for our common stock as reported by NASDAQ:

	High	Low	Close
First quarter 2012	$ 0.72	$ 0.16	$ 0.42
Second quarter 2012	0.44	0.23	0.24
Third quarter 2012	0.29	0.21	0.24
Fourth quarter 2012	0.27	0.16	0.16
First quarter 2011	$ 1.35	$ 0.91	$ 1.22
Second quarter 2011	1.16	0.38	0.48
Third quarter 2011	0.69	0.35	0.36
Fourth quarter 2011	0.47	0.17	0.20

In the second quarter of 2011, the NASDAQ Listing Qualifications Department notified the Company that the bid price of our common stock had closed at less than $1.00 per share over the previous 30 consecutive business days, and provided us with 180 days, or until November 14, 2011, to regain compliance with the NASDAQ Capital Marketing listing rule. On November 14, 2011, the Company's stock had not traded above $1.00 per share, and the Company was not in compliance with a second rule; shareholders' equity was less than $5 million. Our stock began being listed on the Over The Counter Bulletin Board ("OTCBB") at the opening of the markets on November 29, 2011. On December 15, 2011, NASDAQ announced that the Company's stock was delisted.

Effective January 15, 2013, the Company's common stock was deleted from OTCBB, as it became ineligible for quotation due to quoting inactivity under SEC Rule 15c2-11.

Market prices during the timeframe when the Company's common stock traded on the OTCBB reflect inter-dealer prices, without retail markup, markdown or commission and may not necessarily represent actual transactions.

Stockholders

There were approximately 124 holders of record of our common stock as of March 7, 2013, however, a large number of our shareholders hold their stock in "street name" in brokerage accounts. Therefore, they do not appear on the shareholder list maintained by our transfer agent.

Dividends

We have not declared or paid any cash dividends, and do not anticipate paying cash dividends in the foreseeable future.

Shares Authorized for Issuance under Equity Compensation Plans

The following table details information regarding our existing equity compensation plans as of December 31, 2012:

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	2,184,583	2.20	3,345,667(1)

(1) Includes 123,867 shares available for issuance under the 1994 Employee Stock Purchase Plan.

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Item 6. Selected Financial Data

The Selected Consolidated Financial Data set forth below have been derived from our Consolidated Financial Statements. It should be read in conjunction with the information appearing under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Item 7 of this report and the Consolidated Financial Statements and related notes found in Item 8 of this report.

SELECTED CONSOLIDATED FINANCIAL DATA
(IN THOUSANDS, EXCEPT PER SHARE DATA)

YEARS ENDED DECEMBER 31,	2012	2011	2010	2009	2008		
OPERATING SUMMARY							
—	—	5,848	—	5,848			
Other comprehensive income	—	—	—	—	—	1,757	1,757
Cash dividends paid on common shares, $0.0525 per share	—	—	—	—	(1,043)	—	(1,043)
Issuance under equity compensation plans, 94,047 shares, net	—	1	—	(630)	—	—	(629)
Trust preferred securities conversion 287,852 shares	—	3	—	4,999	—	—	5,002
Share-based compensation	—	—	—	735	—	—	735
Excess tax benefit related to equity compensation plans	—	—	—	74	—	—	74
Balance March 31, 2014	$ —	$ 198	$ (1,743)	$ 205,436	$ 90,181	$(2,623)	$291,449

See accompanying notes to consolidated financial statements.

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

	Three months ended March 31,			
(in thousands)	2015		2014	
Cash flows from operating activities:				
Net income	$9,346		$5,848	
Adjustments to reconcile net income to net cash provided by operating activities				
Depreciation	489		533	
Provision for loan losses	(1,690	)	4,331	
Deferred income taxes	(152	)	1,032	
Net amortization of debt securities	851		951	
Amortization of intangible assets	284		383	
Gain on sale of investment securities	(23	)	—	
Mortgage loans originated for sale	(31,603	)	(10,050	)
Proceeds from mortgage loans sold	27,767		10,008	
Gain on sale of other real estate	(20	)	(683	)
Gain on state tax credits, net	(674	)	(497	)
Excess tax benefit of share-based compensation	(153	)	(74	)
Share-based compensation	768		735	
Valuation adjustment on other real estate	41		344	
Net accretion of loan discount and indemnification asset	(1,390	)	(4,096	)
Changes in:				
Accrued interest receivable	(104	)	(173	)
Accrued interest payable	2		(83	)
Other assets	(1,666	)	(6,621	)
Other liabilities	(3,681	)	(9,285	)
Net cash used by operating activities	(1,608	)	(7,397	)
Cash flows from investing activities:				
Net decrease (increase) in loans	3,443		(23,344	)
Net cash proceeds received from FDIC loss share receivable	1,395		2,255	
Proceeds from the sale of securities, available for sale	41,069		—	
Proceeds from the paydown or maturity of securities, available for sale	10,715		10,278	
Proceeds from the paydown or maturity of securities, held to maturity	515		—	
Proceeds from the redemption of other investments	19,593		1,118	
Proceeds from the sale of state tax credits held for sale	4,066		3,294	
Proceeds from the sale of other real estate	2,896		3,014	
Payments for the purchase/origination of:				
Available for sale debt and equity securities	(59,869	)	(29,853	)
Other investments	(9,975	)	(3,457	)
State tax credits held for sale	(3,112	)	—	
Fixed assets	(648	)	(381	)
Net cash provided (used) by investing activities	10,088		(37,076	)
Cash flows from financing activities:				
Net increase (decrease) in noninterest-bearing deposit accounts	38,066		(40,971	)
Net increase (decrease) in interest-bearing deposit accounts	145,054		(41,863	)
Proceeds from Federal Home Loan Bank advances	302,000		80,000	
Repayments of Federal Home Loan Bank advances	(440,000	)	—	
Proceeds from notes payable	—		(3,900	)

Net decrease in other borrowings	(53,019)	(20,113)
Cash dividends paid on common stock	(1,051)	(1,043)
Excess tax benefit of share-based compensation	153	74
Proceeds from the issuance of equity instruments, net	(1,046)	(629)
Net cash used by financing activities	(9,843)	(28,445)
Net decrease in cash and cash equivalents	(1,363)	(72,918)
Cash and cash equivalents, beginning of period	100,696	210,569
Cash and cash equivalents, end of period	$99,333	$137,651
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$3,105	$3,741
Income taxes	3,500	8,549
Noncash transactions:		
Transfer to other real estate owned in settlement of loans	$890	$4,721
Sales of other real estate financed	—	495
Issuance of common stock from Trust Preferred Securities conversion	—	5,002

See accompanying notes to consolidated financial statements.

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Business and Consolidation

Enterprise is a financial holding company that provides a full range of banking and wealth management services to individuals and corporate customers located in the St. Louis, Kansas City and Phoenix metropolitan markets through its banking subsidiary, Enterprise Bank & Trust (the "Bank").

Operating results for the three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for any other interim period or for the year ending December 31, 2015. 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, 2014.

Basis of Financial Statement Presentation

The condensed consolidated financial statements of the Company and its subsidiaries have been prepared in accordance with the accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The condensed consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All intercompany accounts and transactions have been eliminated. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

NOTE 2 - EARNINGS PER SHARE

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

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

	Three months ended March 31,	
(in thousands, except per share data)	2015	2014
Net income as reported	$9,346	$5,848
Impact of assumed conversions		
Interest on 9% convertible trust preferred securities, net of income tax	—	66
Net income available to common shareholders and assumed conversions	$9,346	$5,914
Weighted average common shares outstanding	19,934	19,521
Incremental shares from assumed conversions of convertible trust preferred securities	—	230
Additional dilutive common stock equivalents	223	198
Weighted average diluted common shares outstanding	$20,157	$19,949
Basic earnings per common share:	$0.47	$0.30
Diluted earnings per common share:	$0.46	$0.30

The calculation of diluted earnings per common share for the three months ended March 31, 2015, and 2014, excludes the impact of 0.3 million common stock equivalents, because their effect was anti-dilutive.

NOTE 3 - INVESTMENTS

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

(in thousands)	March 31, 2015 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Obligations of U.S. Government-sponsored enterprises	$99,643	$1,256	$—	$100,899
Obligations of states and political subdivisions	33,965	1,441	(359)	35,047
Agency mortgage-backed securities	270,455	4,470	(810)	274,115
Total securities available for sale	$404,063	$7,167	$(1,169)	$410,061
Held to maturity securities:				
Obligations of states and political subdivisions	$14,883	$2	$(109)	$14,776
Agency mortgage-backed securities	30,680	355	—	31,035
Total securities held to maturity	$45,563	$357	$(109)	$45,811

(in thousands)	December 31, 2014 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Obligations of U.S. Government-sponsored enterprises	$91,355	$624	$(153)	$91,826
Obligations of states and political subdivisions	33,997	1,300	(416)	34,881
Agency mortgage-backed securities	271,430	3,577	(1,568)	273,439
Total securities available for sale	$396,782	$5,501	$(2,137)	$400,146
Held to maturity securities:				
Obligations of states and political subdivisions	$14,900	$—	$(325)	$14,575
Agency mortgage-backed securities	31,085	150	(15)	31,220
Total securities held to maturity	$45,985	$150	$(340)	$45,795

At March 31, 2015, and December 31, 2014, there were no holdings of securities of any one issuer in an amount greater than 10% of shareholders' equity, other than the U.S. Government agencies and sponsored enterprises. The agency mortgage-backed securities are all issued by U.S. Government-sponsored enterprises. Available for sale securities having a fair value of $251.4 million and $315.8 million at March 31, 2015, and December 31, 2014, respectively, were pledged as collateral to secure deposits of public institutions and for other purposes as required by law or contract provisions.

The amortized cost and estimated fair value of debt securities at March 31, 2015, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The weighted average life of the mortgage-backed securities is approximately 4 years.

(in thousands)	Available for sale		Held to maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$4,331	$4,382	$—	$—
Due after one year through five years	100,610	102,383	662	664
Due after five years through ten years	25,767	26,561	12,963	12,875
Due after ten years	2,900	2,620	1,258	1,237
Mortgage-backed securities	270,455	274,115	30,680	31,035
	$404,063	$410,061	$45,563	$45,811

The following table represents a summary of investment securities that had an unrealized loss:

(in thousands)	March 31, 2015					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government-sponsored enterprises	$—	$—	$—	$—	$—	$—
Obligations of states and political subdivisions	14,982	127	4,321	341	19,303	468
Agency mortgage-backed securities	28,750	179	21,868	631	50,618	810
	$43,732	$306	$26,189	$972	$69,921	$1,278

(in thousands)	December 31, 2014					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government-sponsored enterprises	$5,399	$10	$24,852	$143	$30,251	$153
Obligations of states and political subdivisions	16,827	343	5,349	398	22,176	741
Agency mortgage-backed securities	26,367	56	97,054	1,527	123,421	1,583
	$48,593	$409	$127,255	$2,068	$175,848	$2,477

The unrealized losses at both March 31, 2015, and December 31, 2014, were primarily attributable to changes in market interest rates since the securities were purchased. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include among other considerations (1) the present value of the cash flows expected to be collected compared to the amortized cost of the security, (2) duration and magnitude of the decline in value, (3) the financial condition of the issuer or issuers, (4) structure of the security, and (5) the intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value. At March 31, 2015, management performed its quarterly analysis of all securities with an unrealized loss and concluded no individual securities were other-than-temporarily impaired.

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

	Three months ended March 31,	
(in thousands)	2015	2014
Gross gains realized	$63	$—
Gross losses realized	(40)	—
Proceeds from sales	41,069	—

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NOTE 4 - PORTFOLIO LOANS

Below is a summary of Portfolio loans by category at March 31, 2015 and December 31, 2014:

(in thousands)	March 31, 2015	December 31, 2014
Real estate loans:		
Construction and land development	$138,924	$144,773
Commercial - Investor Owned	413,170	413,026
Commercial - Owner Occupied	368,313	357,503
Residential real estate	180,253	185,252
Total real estate loans	1,100,660	1,100,554
Commercial and industrial	1,265,104	1,270,259
Consumer and other	68,830	62,208
Portfolio loans	2,434,594	2,433,021
Unearned loan costs, net	965	895
Portfolio loans, including unearned loan costs	$2,435,559	$2,433,916

A summary of the year-to-date activity in the allowance for loan losses and the recorded investment in Portfolio loans by class and category based on impairment method through March 31, 2015, and at December 31, 2014, is as follows:

(in thousands)	Commercial & Industrial	Commercial Real Estate Owner Occupied	Commercial Real Estate Investor Owned	Construction and Land Development	Residential Real Estate	Consumer & Other	Total
Allowance for Loan Losses:							
Balance at December 31, 2014	$17,004	$3,625	$4,598	$ 1,720	$2,830	$408	$30,185
Provision charged to expense	823	(175)	(12)	914	74	(44)	1,580
Losses charged off	(1,484)	—	—	—	(1,073)	(11)	(2,568)
Recoveries	769	127	29	60	26	80	1,091
Balance at March 31, 2015	$17,112	$3,577	$4,615	$ 2,694	$1,857	$433	$30,288

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(in thousands)	Commercial & Industrial	Commercial Real Estate Owner Occupied	Commercial Real Estate Investor Owned	Construction and Land Development	Residential Real Estate	Consumer & Other	Total
Balance March 31, 2015							
Allowance for Loan Losses - Ending Balance:							
Individually evaluated for impairment	$1,196	$297	$—	$ 1,370	$—	$—	$2,863
Collectively evaluated for impairment	15,916	3,280	4,615	1,324	1,857	433	27,425
Total	$17,112	$3,577	$4,615	$ 2,694	$1,857	$433	$30,288
Loans - Ending Balance:							
Individually evaluated for impairment	$4,250	$3,380	$581	$ 6,366	$2,655	$—	$17,232
Collectively evaluated for impairment	1,260,854	364,933	412,589	132,558	177,598	69,795	2,418,327
Total	$1,265,104	$368,313	$413,170	$ 138,924	$180,253	$69,795	$2,435,559
Balance December 31, 2014							
Allowance for Loan Losses - Ending Balance:							
Individually evaluated for impairment	$704	$286	$—	$ 352	$1,052	$—	$2,394
Collectively evaluated for impairment	16,300	3,339	4,598	1,368	1,778	408	27,791
Total	$17,004	$3,625	$4,598	$ 1,720	$2,830	$408	$30,185
Loans - Ending Balance:							
Individually evaluated for impairment	$5,998	$3,384	$5,036	$ 6,866	$3,082	$—	$24,366
Collectively evaluated for impairment	1,264,261	354,119	407,990	137,907	182,170	63,103	2,409,550
Total	$1,270,259	$357,503	$413,026	$ 144,773	$185,252	$63,103	$2,433,916

A summary of Portfolio loans individually evaluated for impairment by category at March 31, 2015 and December 31, 2014, is as follows:

(in thousands)	March 31, 2015 Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and industrial	$5,141	$3,223	$1,068	$4,291	$1,196	$8,956
Real estate:						
Commercial - Owner occupied	1,383	759	560	1,319	297	649
Commercial - Investor owned	581	—	581	581	—	632
Construction and land development	7,271	3,881	2,973	6,854	1,370	6,682
Residential	3,707	—	2,696	2,696	—	2,940
Consumer and other	—	—	—	—	—	759
Total	$18,083	$7,863	$7,878	$15,741	$2,863	$20,618

(in thousands)	December 31, 2014 Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and industrial	$8,042	$2,609	$3,464	$6,073	$704	$4,136
Real estate:						
Commercial - Owner occupied	1,376	770	519	1,289	286	1,281
Commercial - Investor owned	5,036	—	5,187	5,187	—	4,375
Construction and land development	7,961	419	6,929	7,348	352	7,280
Residential	3,082	2,943	150	3,093	1,052	954
Consumer and other	—	—	—	—	—	581
Total	$25,497	$6,741	$16,249	$22,990	$2,394	$18,607

The following table presents details for past due and impaired loans:

(in thousands)	For the three months ended March 31, 2015	March 31, 2014
Total interest income that would have been recognized under original terms	$315	$320
Total cash received and recognized as interest income on non-accrual loans	27	9
Total interest income recognized on impaired loans	13	6

There were no loans over 90 days past due and still accruing interest at March 31, 2015 or December 31, 2014. At March 31, 2015, there were no unadvanced commitments on impaired loans. Other liabilities include approximately $0.2 million for estimated losses attributable to the unadvanced commitments.

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The recorded investment in impaired Portfolio loans by category at March 31, 2015 and December 31, 2014, is as follows:

	March 31, 2015			
(in thousands)	Non-accrual	Restructured	Loans over 90 days past due and still accruing interest	Total
Commercial and industrial	$4,291	$—	$—	$4,291
Real estate:				
Commercial - Investor owned	—	581	—	581
Commercial - Owner occupied	560	759	—	1,319
Construction and land development	6,854	—	—	6,854
Residential	2,696	—	—	2,696
Consumer and other	—	—	—	—
Total	$14,401	$1,340	$—	$15,741

	December 31, 2014			
(in thousands)	Non-accrual	Restructured	Loans over 90 days past due and still accruing interest	Total
Commercial and industrial	$6,073	$—	$—	$6,073
Real estate:				
Commercial - Investor owned	4,597	590	—	5,187
Commercial - Owner occupied	519	770	—	1,289
Construction and land development	7,348	—	—	7,348
Residential	3,093	—	—	3,093
Consumer and other	—	—	—	—
Total	$21,630	$1,360	$—	$22,990

The recorded investment by category for the Portfolio loans that have been restructured during the three months ended March 31, 2015 and 2014, is as follows:

	Three months ended March 31, 2015			Three months ended March 31, 2014		
(in thousands, except for number of loans)	Number of Loans	Pre-Modification Outstanding Recorded Balance	Post-Modification Outstanding Recorded Balance	Number of Loans	Pre-Modification Outstanding Recorded Balance	Post-Modification Outstanding Recorded Balance
Commercial and industrial	—	$ —	$ —	—	$ —	$ —
Real estate:						
Commercial - Owner occupied	—	—	—	2	1,292	1,042
Commercial - Investor owned	—	—	—	—	—	—
Construction and land development	—	—	—	—	—	—
Residential	—	—	—	—	—	—
Consumer and other	—	—	—	—	—	—

Total	—	$ —	$ —	2	$ 1,292	$ 1,042

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The restructured Portfolio loans primarily resulted from interest rate concessions and changing the terms of the loans. As of March 31, 2015, the Company allocated $0.3 million of specific reserves to the loans that have been restructured.

There were no Portfolio loans that were restructured and subsequently defaulted during the three months ended March 31, 2015 or 2014.

The aging of the recorded investment in past due Portfolio loans by portfolio class and category at March 31, 2015 and December 31, 2014 is shown below.

	March 31, 2015				
(in thousands)	30-89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total
Commercial and industrial	$2,931	$932	$3,863	$1,261,241	$1,265,104
Real estate:					
Commercial - Owner occupied	267	267	534	367,779	368,313
Commercial - Investor owned	—	—	—	413,170	413,170
Construction and land development	—	3,226	3,226	135,698	138,924
Residential	974	1,977	2,951	177,302	180,253
Consumer and other	18	—	18	69,777	69,795
Total	$4,190	$6,402	$10,592	$2,424,967	$2,435,559

	December 31, 2014				
(in thousands)	30-89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total
Commercial and industrial	$3,059	$232	$3,291	$1,266,968	$1,270,259
Real estate:					
Commercial - Owner occupied	766	496	1,262	356,241	357,503
Commercial - Investor owned	261	4,450	4,711	408,315	413,026
Construction and land development	702	2,524	3,226	141,547	144,773
Residential	168	—	168	185,084	185,252
Consumer and other	8	—	8	63,095	63,103
Total	$4,964	$7,702	$12,666	$2,421,250	$2,433,916

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

- Grades 1, 2, and 3 – Includes loans to borrowers with a continuous record of strong earnings, sound balance sheet condition and capitalization, ample liquidity with solid cash flow, and whose management team has experience and depth within their industry.
- Grade 4 – Includes loans to borrowers with positive trends in profitability, satisfactory capitalization and balance sheet condition, and sufficient liquidity and cash flow.
- Grade 5 – Includes loans to borrowers that may display fluctuating trends in sales, profitability, capitalization, liquidity, and cash flow.

- Grade 6 – Includes loans to borrowers where an adverse change or perceived weakness has occurred, but may be correctable in the near future. Alternatively, this rating category may also include circumstances where the

borrower is starting to reverse a negative trend or condition, or has recently been upgraded from a 7, 8, or 9 rating.

- Grade 7 – Watch credits are borrowers that have experienced financial setback of a nature that is not determined to be severe or influence 'ongoing concern' expectations. Although possible, no loss is anticipated, due to strong collateral and/or guarantor support.
- Grade 8 – Substandard credits will include those borrowers characterized by significant losses and sustained downward trends in balance sheet condition, liquidity, and cash flow. Repayment reliance may have shifted to secondary sources. Collateral exposure may exist and additional reserves may be warranted.
- Grade 9 – Doubtful credits include borrowers that may show deteriorating trends that are unlikely to be corrected. Collateral values may appear insufficient for full recovery, therefore requiring a partial charge-off, or debt renegotiation with the borrower. The borrower may have declared bankruptcy or bankruptcy is likely in the near term. All doubtful rated credits will be on non-accrual.

The recorded investment by risk category of the Portfolio loans by portfolio class and category at March 31, 2015, which is based upon the most recent analysis performed, and December 31, 2014 is as follows:

	March 31, 2015				
(in thousands)	Pass (1-6)	Watch (7)	Substandard (8)	Doubtful (9)	Total
Commercial and industrial	$1,149,860	$84,786	$29,799	$659	$1,265,104
Real estate:					
Commercial - Owner occupied	346,073	17,730	4,510	—	368,313
Commercial - Investor owned	378,017	23,581	11,572	—	413,170
Construction and land development	117,768	13,178	7,276	702	138,924
Residential	162,387	11,681	6,185	—	180,253
Consumer and other	69,473	48	274	—	69,795
Total	$2,223,578	$151,004	$59,616	$1,361	$2,435,559

	December 31, 2014				
(in thousands)	Pass (1-6)	Watch (7)	Substandard (8)	Doubtful (9)	Total
Commercial and industrial	$1,167,751	$62,315	$40,193	$—	$1,270,259
Real estate:					
Commercial - Owner occupied	334,347	18,025	5,131	—	357,503
Commercial - Investor owned	372,818	24,088	16,120	—	413,026
Construction and land development	123,260	12,993	8,520	—	144,773
Residential	168,543	11,012	5,697	—	185,252
Consumer and other	62,711	51	341	—	63,103
Total	$2,229,430	$128,484	$76,002	$—	$2,433,916

NOTE 5 - PURCHASE CREDIT IMPAIRED ("PCI") LOANS

Below is a summary of PCI loans by category at March 31, 2015 and December 31, 2014:

(in thousands)	March 31, 2015 Weighted-Average Risk Rating	March 31, 2015 Recorded Investment PCI Loans	December 31, 2014 Weighted-Average Risk Rating	December 31, 2014 Recorded Investment PCI Loans
Real estate loans:				
Construction and land development	6.26	$7,574	6.16	$7,740
Commercial - Investor Owned	7.12	37,524	7.07	39,066
Commercial - Owner Occupied	6.39	20,935	6.35	22,695
Residential real estate	5.52	24,314	5.54	25,121
Total real estate loans		90,347		94,622
Commercial and industrial	6.67	4,125	6.57	4,012
Consumer and other	5.29	316	5.39	469
Purchase credit impaired loans		$94,788		$99,103

The aging of the recorded investment in past due PCI loans by portfolio class and category at March 31, 2015 and December 31, 2014 is shown below:

	March 31, 2015				
(in thousands)	30-89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total
Commercial and industrial	$—	$6	$6	$4,119	$4,125
Real estate:					
Commercial - Owner occupied	—	3,115	3,115	17,820	20,935
Commercial - Investor owned	—	7,953	7,953	29,571	37,524
Construction and land development	396	—	396	7,178	7,574
Residential	448	2,847	3,295	21,019	24,314
Consumer and other	10	—	10	306	316
Total	$854	$13,921	$14,775	$80,013	$94,788

	December 31, 2014				
(in thousands)	30-89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total
Commercial and industrial	$—	$16	$16	$3,996	$4,012
Real estate:					
Commercial - Owner occupied	—	2,759	2,759	19,936	22,695
Commercial - Investor owned	878	6,484	7,362	31,704	39,066
Construction and land development	774	—	774	6,966	7,740
Residential	2,020	1,451	3,471	21,650	25,121
Consumer and other	—	12	12	457	469
Total	$3,672	$10,722	$14,394	$84,709	$99,103

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The following table is a rollforward of PCI loans, net of the allowance for loan losses, for the three months ended March 31, 2015 and 2014.

(in thousands)	Contractual Cashflows	Non-accretable Difference	Accretable Yield	Carrying Amount
Balance January 1, 2015	$178,145	$65,719	$28,733	$83,693
Principal reductions and interest payments	(6,148)	—	—	(6,148)
Accretion of loan discount	—	—	(3,088)	3,088
Changes in contractual and expected cash flows due to remeasurement	(12,159)	(26,187)	8,517	5,511
Reductions due to disposals	(5,623)	(1,709)	(933)	(2,981)
Balance March 31, 2015	$154,215	$37,823	$33,229	$83,163
Balance January 1, 2014	$266,068	$87,438	$53,530	$125,100
Principal reductions and interest payments	(9,849)	—	—	(9,849)
Accretion of loan discount	—	—	(4,560)	4,560
Changes in contractual and expected cash flows due to remeasurement	4,888	10,503	(5,076)	(539)
Reductions due to disposals	(14,297)	(3,142)	(2,042)	(9,113)
Balance March 31, 2014	$246,810	$94,799	$41,852	$110,159

The accretable yield is accreted into interest income over the estimated life of the acquired loans using the effective yield method.

A summary of activity in the FDIC loss share receivable for the three months ended March 31, 2015 is as follows:

(in thousands)	March 31, 2015
Balance at beginning of period	$15,866
Adjustments not reflected in income:	
Cash received from the FDIC for covered assets	(1,395)
FDIC reimbursable losses, net	(563)
Adjustments reflected in income:	
Amortization, net	900
Loan impairment	(2,589)
Reductions for payments on covered assets in excess of expected cash flows	(575)
Balance at end of period	$11,644

Outstanding customer balances on PCI loans were $127.7 million and $135.3 million as of March 31, 2015, and December 31, 2014, respectively.

NOTE 6 - COMMITMENTS AND CONTINGENCIES

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

The Company's extent of involvement and maximum potential exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments.

The Company uses the same credit policies in making commitments and conditional obligations as it does for financial instruments included on its consolidated balance sheets. At March 31, 2015, there were no unadvanced commitments on impaired loans.

The contractual amounts of off-balance-sheet financial instruments as of March 31, 2015, and December 31, 2014, are as follows:

(in thousands)	March 31, 2015	December 31, 2014
Commitments to extend credit	$995,715	$947,424
Standby letters of credit	52,981	50,108

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments usually have fixed expiration dates or other termination clauses, may have significant usage restrictions, and may require payment of a fee. Of the total commitments to extend credit at March 31, 2015, and December 31, 2014, approximately $73.0 million and $65.9 million, respectively, represent fixed rate loan commitments. Since certain of the commitments may expire without being drawn upon or may be revoked, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include accounts receivable, inventory, premises and equipment, and real estate. Other liabilities include approximately $0.2 million for estimated losses attributable to the unadvanced commitments at March 31, 2015 and December 31, 2014.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These standby letters of credit are issued to support contractual obligations of the Company's customers. The credit risk involved in issuing letters of credit is essentially the same as the risk involved in extending loans to customers. The approximate remaining term of standby letters of credit range from 1 month to 2.9 years at March 31, 2015.

Contingencies

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

NOTE 7 - DERIVATIVE FINANCIAL INSTRUMENTS

Client-Related Derivative Instruments. The Company enters into interest rate swaps to allow customers to hedge changes in fair value of certain loans. The table below summarizes the notional amounts and fair values of the client-related derivative instruments:

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	Notional Amount		Asset Derivatives (Other Assets) Fair Value		Liability Derivatives (Other Liabilities) Fair Value	
(in thousands)	March 31, 2015	December 31, 2014	March 31, 2015	December 31, 2014	March 31, 2015	December 31, 2014
Non-designated hedging instruments						
Interest rate swap contracts	$136,924	$ 141,263	$1,176	$ 907	$1,176	$ 907

Changes in the fair value of client-related derivative instruments are recognized currently in operations. For the three months ended March 31, 2015 and 2014, the gains and losses offset each other due to the Company's hedging of the client swaps.

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NOTE 8 - FAIR VALUE MEASUREMENTS

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

The following table summarizes financial instruments measured at fair value on a recurring basis as of March 31, 2015, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	March 31, 2015			
(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Assets				
Securities available for sale				
Obligations of U.S. Government-sponsored enterprises	$—	$100,899	$—	$100,899
Obligations of states and political subdivisions	—	31,976	3,071	35,047
Residential mortgage-backed securities	—	274,115	—	274,115
Total securities available for sale	$—	$406,990	$3,071	$410,061
State tax credits held for sale	—	—	10,286	10,286
Derivative financial instruments	—	1,176	—	1,176
Total assets	$—	$408,166	$13,357	$421,523
Liabilities				
Derivative financial instruments	$—	$1,176	$—	$1,176
Total liabilities	$—	$1,176	$—	$1,176

	December 31, 2014			
(in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Assets				
Securities available for sale				
Obligations of U.S. Government-sponsored enterprises	$—	$91,826	$—	$91,826
Obligations of states and political subdivisions	—	31,822	3,059	34,881
Residential mortgage-backed securities	—	273,439	—	273,439
Total securities available for sale	$—	$397,087	$3,059	$400,146
State tax credits held for sale	—	—	11,689	11,689
Derivative financial instruments	—	909	—	909
Total assets	$—	$397,996	$14,748	$412,744
Liabilities				

Derivative financial instruments	$—	$907	$—	$907
Total liabilities	$—	$907	$—	$907

- Securities available for sale. Securities classified as available for sale are reported at fair value utilizing Level 2 and Level 3 inputs. Fair values for Level 2 securities are based upon dealer quotes, market spreads, the U.S. Treasury yield curve, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions at the security level. At March 31, 2015, Level 3 securities available for sale

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consist primarily of three Auction Rate Securities that are valued based on the securities' estimated cash flows, yields of comparable securities, and live trading levels.

- Portfolio Loans. Certain fixed rate portfolio loans are accounted for as trading instruments and reported at fair value. Fair value on these loans is determined using a third party valuation model with observable Level 2 market data inputs.
- State tax credits held for sale. At March 31, 2015, of the $42.4 million of state tax credits held for sale on the condensed consolidated balance sheet, approximately $10.3 million were carried at fair value. The remaining $32.1 million of state tax credits were accounted for at cost.

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

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

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

Level 3 financial instruments

The following table presents the changes in Level 3 financial instruments measured at fair value on a recurring basis as of March 31, 2015 and 2014.

- Purchases, sales, issuances and settlements. There were no Level 3 purchases during the quarter ended March 31, 2015 or 2014.
- Transfers in and/or out of Level 3. There were no transfers in an/or out of Level 3 for the quarter ended March 31, 2015 and 2014.

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	Securities available for sale, at fair value	
	Three months ended March 31,	
(in thousands)	2015	2014
Beginning balance	$3,059	$3,040
Total gains:		
Included in other comprehensive income	12	6
Purchases, sales, issuances and settlements:		
Purchases	—	—
Transfer in and/or out of Level 3	—	—
Ending balance	$3,071	$3,046
Change in unrealized gains relating to assets still held at the reporting date	$12	$6

	State tax credits held for sale	
	Three months ended March 31,	
(in thousands)	2015	2014
Beginning balance	$11,689	$16,491
Total gains:		
Included in earnings	128	118
Purchases, sales, issuances and settlements:		
Sales	(1,531)	(1,709)
Ending balance	$10,286	$14,900
Change in unrealized gains relating to assets still held at the reporting date	$(274)	$(334)

From time to time, the Company measures certain assets at fair value on a nonrecurring basis. These include assets that are measured at the lower of cost or fair value that were recognized at fair value below cost at the end of the period.
The following table presents financial instruments and non-financial assets measured at fair value on a non-recurring basis as of March 31, 2015.

(in thousands)	(1) Total Fair Value	(1) Quoted Prices in Active Markets for Identical Assets (Level 1)	(1) Significant Other Observable Inputs (Level 2)	(1) Significant Unobservable Inputs (Level 3)	Total losses for the three months ended March 31, 2015
Impaired loans	$8,419	$—	$—	$8,419	$(2,568)
Other real estate	463	—	—	463	(41)
Total	$8,882	$—	$—	$8,882	$(2,609)

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

Impaired loans are reported at the fair value of the underlying collateral. Fair values for impaired loans are obtained from current appraisals by qualified licensed appraisers or independent valuation specialists. Other real estate owned is adjusted to fair value upon foreclosure of the underlying loan. Subsequently, foreclosed assets are carried at the

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lower of carrying value or fair value less costs to sell. Fair value of other real estate is based upon the current appraised values of the properties as determined by qualified licensed appraisers and the Company's judgment of other relevant market conditions. Certain state tax credits are reported at cost.

Following is a summary of the carrying amounts and fair values of the Company's financial instruments on the consolidated balance sheets at March 31, 2015 and December 31, 2014.

	March 31, 2015		December 31, 2014	
(in thousands)	Carrying Amount	Estimated fair value	Carrying Amount	Estimated fair value
Balance sheet assets				
Cash and due from banks	$56,420	$56,420	$42,903	$42,903
Federal funds sold	48	48	35	35
Interest-bearing deposits	43,865	43,865	63,058	63,058
Securities available for sale	410,061	410,061	400,146	400,146
Securities held to maturity	45,563	45,811	45,985	45,795
Other investments, at cost	11,719	11,719	17,037	17,037
Loans held for sale	7,843	7,843	4,033	4,033
Derivative financial instruments	1,176	1,176	909	909
Portfolio loans, net	2,488,434	2,483,751	2,487,424	2,482,700
State tax credits, held for sale	42,411	46,851	38,309	42,970
Accrued interest receivable	8,061	8,061	7,956	7,956
Balance sheet liabilities				
Deposits	2,674,631	2,677,798	2,491,510	2,494,624
Subordinated debentures	56,807	34,557	56,807	34,124
Federal Home Loan Bank advances	6,000	6,000	144,000	144,000
Other borrowings	186,864	186,937	239,883	239,950
Derivative financial instruments	1,176	1,176	907	907
Accrued interest payable	845	845	843	843

For information regarding the methods and assumptions used to estimate the fair value of each class of financial instruments for which it is practical to estimate such value, refer to Note 20-Fair Value Measurements in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

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The following table presents the level in the fair value hierarchy for the estimated fair values of only the Company's financial instruments that are not already presented on the condensed consolidated balance sheets at fair value at March 31, 2015, and December 31, 2014.

	Estimated Fair Value Measurement at Reporting Date Using			Balance at March 31, 2015
(in thousands)	Level 1	Level 2	Level 3	
Financial Assets:				
Securities held to maturity	$—	$45,811	$—	$45,811
Portfolio loans, net	—	—	2,483,751	2,483,751
State tax credits, held for sale	—	—	36,565	36,565
Financial Liabilities:				
Deposits	2,109,133	—	568,665	2,677,798
Subordinated debentures	—	34,557	—	34,557
Federal Home Loan Bank advances	—	6,000	—	6,000
Other borrowings	—	186,937	—	186,937

	Estimated Fair Value Measurement at Reporting Date Using			Balance at December 31, 2014
(in thousands)	Level 1	Level 2	Level 3	
Financial Assets:				
Securities held to maturity	$—	$45,795	$—	$45,795
Portfolio loans, net	—	—	2,482,700	2,482,700
State tax credits, held for sale	—	—	31,281	31,281
Financial Liabilities:				
Deposits	1,986,158	—	508,466	2,494,624
Subordinated debentures	—	34,124	—	34,124
Federal Home Loan Bank advances	—	144,000	—	144,000
Other borrowings	—	239,950	—	239,950

NOTE 9 - NEW AUTHORITATIVE ACCOUNTING GUIDANCE

FASB ASU 2014-09, "Revenue from Contracts with Customers" In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers". The objective of ASU 2014-09 is to establish a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and will supersede most of the existing revenue recognition guidance, including industry-specific guidance. The core principle of ASU 2014-09 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the new guidance, an entity will (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the contract's performance obligations; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 applies to all contracts with customers except those that are within the scope of other topics in the FASB Accounting Standards Codification. The new guidance is effective for annual reporting periods (including interim periods within those periods) beginning after December 15, 2016 for public companies. Early adoption is not permitted. Entities have the option of using either a full retrospective or modified approach to adopt ASU 2014-09. The Company is currently evaluating the new guidance and has not determined the impact this standard may have on its financial statements nor decided upon the method of adoption.

FASB ASU 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures" In June 2014, the FASB issued ASU No. 2014-11, "Transfers and Servicing (Topic

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860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." The objective of ASU 2014-11 is to amend the accounting for certain secured financing transactions, and requires enhanced disclosures with respect to transactions recognized as sales in which exposure to the derecognized asset is retained through a separate agreement with the counterparty. In addition, the guidance requires enhanced disclosures with respect to the types and quality of financial assets pledged in secured financing transactions. The guidance became effective in the first quarter of 2015, except for the disclosures regarding the types and quality of financial assets pledged, which will become effective in the second quarter of 2015. The adoption of the guidance did not have a material impact on the Company's consolidated balance sheets or statements of operations.

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

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

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

Introduction

The following discussion describes the significant changes to the financial condition of the Company that have occurred during the first three months of 2015 compared to the financial condition as of December 31, 2014. In addition, this discussion summarizes the significant factors affecting the results of operations, liquidity and cash flows of the Company for the three months ended March 31, 2015, compared to the same period in 2014. This discussion should be read in conjunction with the accompanying condensed consolidated financial statements included in this report and our Annual Report on Form 10-K for the year ended December 31, 2014.

Executive Summary

Below are highlights of our financial performance for the quarter ended March 31, 2015 as compared to the linked quarter ended December 31, 2014 and prior year quarter ended March 31, 2014.

(in thousands, except per share data)	For the Quarter ended March 31, 2015	December 31, 2014	March 31, 2014
EARNINGS			
Total interest income	$32,151	$34,385	$34,024
Total interest expense	3,106	3,569	3,658
Net interest income	29,045	30,816	30,366
Provision for portfolio loans	1,580	1,968	1,027
Provision (provision reversal) for purchase credit impaired loans	(3,270)	126	3,304
Net interest income after provision for loan losses	30,735	28,722	26,035
Fee income	5,043	5,790	5,277
Other noninterest income	(1,460)	(938)	(1,355)
Total noninterest income	3,583	4,852	3,922
Total noninterest expenses	19,950	24,795	21,102
Income before income tax expense	14,368	8,779	8,855
Income tax expense	5,022	2,812	3,007
Net income	$9,346	$5,967	$5,848
Basic earnings per share	$0.47	$0.30	$0.30
Diluted earnings per share	0.46	0.30	0.30
Return on average assets	1.16%	0.73%	0.77%
Return on average common equity	11.78%	7.50%	8.26%
Net interest margin (fully tax equivalent)	3.92%	4.13%	4.39%
Efficiency ratio	61.14%	69.52%	61.54%
ASSET QUALITY (1)			
Net charge-offs	$1,478	$582	$411
Nonperforming loans	15,143	22,244	15,508
Classified assets	63,001	77,898	78,018
Nonperforming loans to total loans	0.62%	0.91%	0.71%
Nonperforming assets to total assets	0.52%	0.74%	0.81%
Allowance for loan losses to total loans	1.24%	1.24%	1.28%
Net charge-offs to average loans (annualized)	0.25%	0.10%	0.08%

(1) Excludes PCI loans and other assets covered under FDIC loss share agreements, except for their inclusion in total assets.

Below are highlights of the Company's Core performance measures, which we believe are important measures of financial performance, but are non-GAAP measures. Core performance measures include contractual interest on PCI loans, but exclude incremental accretion on these loans, and exclude the Change in the FDIC receivable, gain or loss of other real estate covered under FDIC loss share agreements, and certain other income and expense items the Company believes are not indicative of or useful to measure the Company's operating performance on an ongoing basis. A reconciliation of Core performance measures has been included in this MD&A section under the caption "Use of Non-GAAP Financial Measures".

	For the Quarter ended					
(in thousands)	March 31, 2015		December 31, 2014		March 31, 2014	
CORE PERFORMANCE MEASURES (1)						
Net interest income	$25,587		$25,667		$23,702	
Provision for portfolio loans	1,580		1,968		1,027	
Noninterest income	5,839		6,438		6,201	
Noninterest expense	19,068		20,170		20,384	
Income before income tax expense	10,778		9,967		8,492	
Income tax expense	3,647		3,264		2,867	
Net income	$7,131		$6,703		$5,625	
Earnings per share	$0.35		$0.33		$0.28	
Return on average assets	0.88	%	0.82	%	0.74	%
Return on average common equity	8.99	%	8.43	%	7.94	%
Net interest margin (fully tax equivalent)	3.46	%	3.45	%	3.44	%
Efficiency ratio	60.67	%	62.83	%	68.17	%

(1) A non-GAAP measure. A reconciliation has been included in this MD&A section under the caption "Use of Non-GAAP Financial Measures."

During the quarter ended March 31, 2015, the Company noted the following:

- The Company reported net income of $9.3 million for the first three months of 2015, compared to $6.0 million in the linked fourth quarter, and $5.9 million for the same period in 2014. The increase in net income is due to a decrease in noninterest expenses from improved expense control initiatives and reversal of provision for loan losses of PCI loans due to higher expected cash flows.

- On a core basis[1], net income was $7.1 million, or $0.35 per share for the first three months of 2015, compared to $6.7 million, or $0.33 per share in the linked fourth quarter and $5.6 million, or $0.28 per share in the prior year period. The increase from the prior year was primarily due to increases in earning asset balances, driving growth in core net interest income combined with a reduction in noninterest expenses.

- Net interest income in the first quarter of 2015 decreased $1.8 million from the linked fourth quarter and $1.3 million from the prior year period due to lower balances of PCI loans, lower accelerated cash flows on PCI loans, and lower interest rates on newly originated loans. These items were partially offset by lower interest expense primarily related to the payoff of debt with higher interest rates in the prior year.

- On a core basis[1], net interest income remained stable when compared to the linked fourth quarter, and increased 8% from the prior year period due to strong portfolio loan growth and improvements in funding costs during 2014.

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The Core net interest margin[1], defined as Net interest margin (fully tax equivalent), including contractual interest on PCI loans, but excluding the incremental accretion on these loans, increased 2 basis points from

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the prior year period primarily due to the managed reductions in funding costs combined with an improved earning asset mix.

- Fee income, which primarily includes the Company's wealth management revenue, service charges and other fees on deposit accounts, sales of other real estate, and state tax brokerage activity, decreased 9% compared to the prior year period largely due to lower gains on sales of other real estate.

- Noninterest expense declined 5% and the Company's efficiency ratio improved to 61.14% compared to the prior year period. Core noninterest expenses[1] declined by 6% partially due to lower legal expenses on problem loans and overall expense management .

Balance sheet highlights

- Loans – Loans totaled $2.5 billion at March 31, 2015, including $94.8 million of purchase credit impaired ("PCI") loans. Portfolio loans excluding PCI loans increased $261.6 million, or 12%, from March 31, 2014. Commercial & Industrial loans increased $204.7 million, or 19%, Consumer and other loans increased $22.3 million, or 47%, Construction loans and Residential real estate loans increased $37.1 million, or 13%, and Commercial Real Estate decreased $2.6 million. See Item 1, Note 4 – Portfolio Loans for more information.
- Deposits – Total deposits at March 31, 2015 were $2.7 billion, an increase of $222.5 million, or 9%, from March 31, 2014 partially due to enhanced deposit gathering efforts in both commercial and business banking.
- Asset quality – Nonperforming loans, including troubled debt restructurings, were $15.1 million at March 31, 2015, compared to $15.5 million at March 31, 2014. Nonperforming loans represented 0.62% of portfolio loans at March 31, 2015 versus 0.71% at March 31, 2014. There were no portfolio loans that were 30-89 days delinquent and still accruing at March 31, 2015 or March 31, 2014.

Provision for portfolio loan losses was an expense of $1.6 million for the three months ended March 31, 2015, compared to expense of $1.0 million for the three months ended March 31, 2014. See Item 1, Note 4 – Portfolio Loans and, Provision for Loan Losses and Allowance for Loan Losses in this section for more information.

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RESULTS OF OPERATIONS

Net Interest Income

Average Balance Sheet

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

	Three months ended March 31,							
	2015				2014			
(in thousands)	Average Balance	Interest Income/Expense	Average Yield/ Rate		Average Balance	Interest Income/Expense	Average Yield/ Rate	
Assets								
Interest-earning assets:								
Taxable portfolio loans (1)	$2,391,117	$ 24,227	4.11	%	$2,107,805	$ 22,381	4.31	%
Tax-exempt portfolio loans (2)	38,405	624	6.59		37,622	665	7.17	
Purchase credit impaired loans	97,201	4,997	20.85		134,466	8,652	26.09	
Total loans	2,526,723	29,848	4.79		2,279,893	31,698	5.64	
Taxable investments in debt and equity securities	418,812	2,199	2.13		403,523	2,215	2.23	
Non-taxable investments in debt and equity securities (2)	42,968	479	4.52		44,011	484	4.46	
Short-term investments	59,312	47	0.32		121,087	66	0.22	
Total securities and short-term investments	521,092	2,725	2.12		568,621	2,765	1.97	
Total interest-earning assets	3,047,815	32,573	4.33		2,848,514	34,463	4.91	
Noninterest-earning assets:								
Cash and due from banks	48,232				15,869			
Other assets	218,347				263,606			
Allowance for loan losses	(46,025)				(43,269)			
Total assets	$3,268,369				$3,084,720			
Liabilities and Shareholders' Equity								
Interest-bearing liabilities:								
Interest-bearing transaction accounts	$484,724	$ 277	0.23	%	$214,984	$ 112	0.21	%
Money market accounts	843,245	642	0.31		939,033	742	0.32	
Savings	81,408	50	0.25		80,759	49	0.25	
Certificates of deposit	526,489	1,591	1.23		621,874	1,750	1.14	
Total interest-bearing deposits	1,935,866	2,560	0.54		1,856,650	2,653	0.58	
Subordinated debentures	56,807	302	2.16		61,362	407	2.69	
Other borrowed funds	274,022	244	0.36		250,381	598	0.97	
Total interest-bearing liabilities	2,266,695	3,106	0.56		2,168,393	3,658	0.68	
Noninterest bearing liabilities:								
Demand deposits	655,095				609,609			
Other liabilities	24,807				19,537			
Total liabilities	2,946,597				2,797,539			
Shareholders' equity	321,772				287,181			

Total liabilities & shareholders' equity	$3,268,369				$3,084,720			
Net interest income		$ 29,467				$ 30,805		
Net interest spread			3.77	%			4.23	%
Net interest margin			3.92	%			4.39	%

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(1) Average balances include non-accrual loans. Loan fees, net of amortization of deferred loan origination fees and costs, included in interest income are approximately $0.4 million and $0.2 million for the three months ended March 31, 2015 and 2014 respectively.
(2) Non-taxable income is presented on a fully tax-equivalent basis using a 38% tax rate in 2015 and 2014. The tax-equivalent adjustments were $0.4 million for the three months ended March 31, 2015 and 2014 respectively.

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.

	2015 compared to 2014 Three months ended March 31, Increase (decrease) due to		
(in thousands)	Volume(1)	Rate(2)	Net
Interest earned on:			
Taxable portfolio loans	$2,907	$(1,061)	$1,846
Tax-exempt portfolio loans (3)	14	(55)	(41)
Purchase credit impaired loans	(2,119)	(1,536)	(3,655)
Taxable investments in debt and equity securities	82	(98)	(16)
Non-taxable investments in debt and equity securities (3)	(12)	7	(5)
Short-term investments	(42)	23	(19)
Total interest-earning assets	$830	$(2,720)	$(1,890)
Interest paid on:			
Interest-bearing transaction accounts	$153	$12	$165
Money market accounts	(74)	(26)	(100)
Savings	—	1	1
Certificates of deposit	(282)	123	(159)
Subordinated debentures	(28)	(77)	(105)
Borrowed funds	51	(405)	(354)
Total interest-bearing liabilities	(180)	(372)	(552)
Net interest income	$1,010	$(2,348)	$(1,338)

(1) Change in volume multiplied by yield/rate of prior period.
(2) Change in yield/rate multiplied by volume of prior period.
(3) Nontaxable income is presented on a fully-tax equivalent basis using the combined statutory federal and state income tax rate in effect for each year.

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

Net interest income (on a tax equivalent basis) was $29.5 million for the three months ended March 31, 2015 compared to $30.8 million for the same period of 2014, a decrease of $1.3 million, or 4%. Total interest income decreased $1.9 million and total interest expense decreased $0.6 million. The tax-equivalent net interest rate margin was 3.92% for the first quarter of 2015, compared to 4.13% for the fourth quarter of 2014, and 4.39% in the first

quarter of 2014.

Interest rates remain at historically low levels and continue to negatively impact loan yields leading to lower net interest margins. As seen in the table above, changes in interest rates have led to a $1.1 million, and $1.5 million

reduction, in interest income in our portfolio and PCI loans, respectively. Additionally, the run-off of higher yielding PCI loans continue to negatively impact net interest margin leading to a $2.1 million decrease in interest income due to volume. To partially mitigate lower yields on loans, the Company has taken specific actions to lower deposit and other borrowing costs including the prepayment of $50.0 million of FHLB borrowings in December 2014.

Core net interest margin[1] was 3.46% for the quarter ended March 31, 2015, compared to 3.44% for the same prior year period. Core net interest margin[1] increased 2 basis points from the prior year quarter primarily due to the managed reductions in funding costs combined with an improved earning asset mix. These factors mitigated continued pressure in portfolio loan yields and reductions in PCI loan balances as those balances continue to run-off. Pressure on loan yields and continued reductions in PCI loan balances could lead to a decline in core net interest margin in 2015.

Purchase Credit Impaired "PCI" Contribution

The following table illustrates the financial contribution of PCI loans and other assets covered under FDIC shared loss agreements for the most recent five quarters.

	For the Quarter ended				
(in thousands)	March 31, 2015	December 31, 2014	September 30, 2014	June 30, 2014	March 31, 2014
Contractual interest income	$1,539	$1,840	$1,701	$1,878	$1,988
Accelerated cash flows and other incremental accretion	3,458	5,149	2,579	4,538	6,664
Estimated funding cost	(317)	(326)	(314)	(349)	(415)
Total net interest income	4,680	6,663	3,966	6,067	8,237
(Provision) benefit for loan losses	3,270	(126)	1,877	470	(3,304)
Gain/(loss) on sale of other real estate	(15)	195	(45)	164	131
Change in FDIC loss share receivable	(2,264)	(1,781)	(2,374)	(2,742)	(2,410)
Change in FDIC clawback liability	(412)	(141)	(1,028)	(143)	111
Other expenses	(471)	(541)	(731)	(832)	(823)
PCI assets income before income tax expense	$4,788	$4,269	$1,665	$2,984	$1,942

At March 31, 2015, the remaining accretable yield on the portfolio was estimated to be $33 million and the non-accretable difference was approximately $38 million. Absent cash flow accelerations or pool impairment, the Company currently estimates average PCI loan balances to be approximately $80 million and income before tax expense on PCI assets will be approximately $8 million to $10 million in 2015.

Noninterest Income

The following table presents a comparative summary of the major components of noninterest income.

	Three months ended March 31,			
(in thousands)	2015	2014	Increase (decrease)	
Wealth management revenue	$1,740	$1,722	$18	1 %
Service charges on deposit accounts	1,856	1,738	118	7 %
Other service charges and fee income	753	637	116	18 %
Sale of other real estate	35	552	(517)	(94)%
State tax credit activity, net	674	497	177	36 %
Miscellaneous income	781	1,055	(274)	(26)%
Core noninterest income (1)	5,839	6,201	(362)	(6)%
Gain (loss) on sale of other real estate covered under FDIC loss share agreements	(15)	131	(146)	(111)%
Gain on sale of investment securities	23	—	23	—
Change in FDIC loss share receivable	(2,264)	(2,410)	146	(6)%
Total noninterest income	$3,583	$3,922	$(339)	(9)%

(1) A non-GAAP measure. A reconciliation has been included in this MD&A section under the caption "Use of Non-GAAP Financial Measures."

Noninterest income decreased $0.3 million, or 9% in the first quarter of 2015 compared to the first quarter of 2014. Core noninterest income[1] declined slightly in the first quarter of 2015 due to lower gains on sale of other real estate than in the first quarter of 2014. Wealth management revenues were flat in the first quarter of 2015. Assets under administration at March 31, 2015 of $1.5 billion grew 2% compared to March 31, 2014.

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Noninterest Expense

The following table presents a comparative summary of the major components of noninterest expense:

(in thousands)	Three months ended March 31, 2015	2014	Increase (decrease)	
Core expenses (1):				
Employee compensation and benefits - core	$11,250	$11,522	$(272)	(2)%
Occupancy - core	1,667	1,614	53	3%
Data processing - core	1,001	1,064	(63)	(6)%
FDIC and other insurance	726	699	27	4%
Professional fees	972	1,267	(295)	(23)%
Loan, legal and other real estate expense - core	131	997	(866)	(87)%
Other - core	3,321	3,221	100	3%
Core noninterest expense (1)	19,068	20,384	(1,316)	(6)%
FDIC clawback	412	(111)	523	(471)%
Other loss share expenses	470	829	(359)	(43)%
Total noninterest expense	$19,950	$21,102	$(1,152)	(5)%

(1) A non-GAAP measure. A reconciliation has been included in this MD&A section under the caption "Use of Non-GAAP Financial Measures."

Noninterest expenses were $20.0 million for the quarter ended March 31, 2015, compared to $24.8 million for the quarter ended December 31, 2014, and $21.1 million for the quarter ended March 31, 2014. Core noninterest expenses[1], which exclude certain items and expenses directly related to PCI loans and assets covered under loss share agreements decreased to $19.1 million for the quarter ended March 31, 2015, from $20.2 million for the linked quarter and $20.4 million for the prior year period.

The Company's Core efficiency ratio[1] was 60.7% for the quarter ended March 31, 2015, compared to 62.8% for the linked quarter, and 68.2% for the prior year period, and reflects lower legal expenses on problem loans, overall expense management and revenue growth trends. Core efficiency ratio is a non-GAAP measure. The attached tables contain a reconciliation of Core efficiency ratio.

The Company anticipates total noninterest expenses to be between $19 million and $21 million per quarter for 2015.

Income Taxes

For the quarter ended March 31, 2015, the Company's income tax expense, which includes both federal and state taxes, was $5.0 million compared to $3.0 million for the same period in 2014. The combined federal and state effective income tax rates were relatively consistent at 35.0% and 34.0% for the quarters ended March 31, 2015, and 2014, respectively.

Summary Balance Sheet

(in thousands)	March 31, 2015	December 31, 2014	Increase (decrease)			
Total cash and cash equivalents	$99,333	$100,696	(1,363	)	(1.4	)%
Securities available for sale	410,061	400,146	9,915		2.5	%
Securities held to maturity	45,563	45,985	(422	)	(0.9	)%
Portfolio loans	2,435,559	2,433,916	1,643		0.1	%
Purchase credit impaired loans	94,788	99,103	(4,315	)	(4.4	)%
Total assets	3,275,295	3,277,003	(1,708	)	(0.1	)%
Deposits	2,674,631	2,491,510	183,121		7.3	%
Total liabilities	2,949,186	2,960,762	(11,576	)	(0.4	)%
Total shareholders' equity	326,109	316,241	9,868		3.1	%

Assets

Loans by Type

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

(in thousands)	March 31, 2015	December 31, 2014	Increase (decrease)			
Commercial and industrial	$1,265,104	$1,270,259	$(5,155	)	(0.4	)%
Commercial real estate - Investor owned	413,170	413,026	144		—	%
Commercial real estate - Owner occupied	368,313	357,503	10,810		3.0	%
Construction and land development	138,924	144,773	(5,849	)	(4.0	)%
Residential real estate	180,253	185,252	(4,999	)	(2.7	)%
Consumer and other	69,795	63,103	6,692		10.6	%
Portfolio loans	2,435,559	2,433,916	1,643		0.1	%
Purchase credit impaired loans	94,788	99,103	(4,315	)	(4.4	)%
Total loans	$2,530,347	$2,533,019	$(2,672	)	(0.1	)%

Portfolio loans remained stable at $2.4 billion at March 31, 2015 when compared to the linked quarter. PCI loans totaled $94.8 million at March 31, 2015, a decrease of $4.3 million, or 4.4%, from the linked fourth quarter, primarily as a result of principal paydowns and accelerated loan payoffs.

Provision and Allowance for Loan Losses

The following table summarizes changes in the allowance for loan losses arising from loans charged off and recoveries on loans previously charged off, by loan category, and additions to the allowance charged to expense.

(in thousands)	Three months ended March 31, 2015		2014	
Allowance at beginning of period, for portfolio loans	$30,185		$27,289	
Loans charged off:				
Commercial and industrial	(1,484	)	(474	)
Real estate:				
Commercial	—		(586	)
Construction and land development	—		(305	)
Residential	(1,073	)	—	
Consumer and other	(11	)	(4	)
Total loans charged off	(2,568	)	(1,369	)
Recoveries of loans previously charged off:				
Commercial and industrial	769		187	
Real estate:				
Commercial	156		42	
Construction and land development	60		688	
Residential	26		41	
Consumer and other	80		—	
Total recoveries of loans	1,091		958	
Net loan chargeoffs	(1,477	)	(411	)
Provision for loan losses	1,580		1,027	
Allowance at end of period, for portfolio loans	$30,288		$27,905	
Allowance at beginning of period, for purchase credit impaired loans	$15,410		$15,438	
Loans charged off	3		(155	)
Recoveries of loans	—		—	
Other	(518	)	(74	)
Net loan chargeoffs	(515	)	(229	)
Provision (provision reversal) for loan losses	(3,270	)	3,304	
Allowance at end of period, for purchase credit impaired loans	$11,625		$18,513	
Total allowance at end of period	$41,913		$46,418	
Excludes purchase credit impaired loans				
Average loans	$2,425,962		$2,143,449	
Total portfolio loans	2,435,559		2,173,988	
Net chargeoffs to average loans (annualized)	0.25	%	0.08	%
Allowance for loan losses to total loans	1.24		1.28	

The provision for loan losses on portfolio loans for the three months ended March 31, 2015 was $1.6 million compared to $1.0 million for the comparable 2014 period. The provision for loan losses for the three month period ended March 31, 2015 was primarily to provide for charge-offs incurred during the quarter.

For PCI loans, the Company remeasures contractual and expected cash flows periodically. When the remeasurement process results in a decrease in expected cash flows, typically due to an increase in expected credit losses, impairment is recorded through provision for loan losses. Similarly, when expected credit losses decrease in the remeasurement process, prior recorded impairment is reversed before the yield is increased prospectively. The provision for loan losses on PCI loans for the three months ended March 31, 2015 was a benefit of $3.3 million compared to provision of $3.3 million for the comparable 2014 period.

The allowance for loan losses on portfolio loans was 1.24% of total loans at March 31, 2015, and December 31, 2014, compared to 1.28% at March 31, 2014. Management believes the allowance for loan losses is adequate to absorb inherent losses in the loan portfolio and coverage trends reflect steady improvements in credit quality measures and classified loan levels. The reduction in the ratio of allowance for loan losses to total loans over the prior year period is due to continued strong credit performance, as well as continued improvement in our loss migration results.

Nonperforming assets

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

(in thousands)	March 31, 2015		December 31, 2014		March 31, 2014	
Non-accrual loans	$13,805		$20,892		$14,040	
Restructured loans	1,338		1,352		1,468	
Total nonperforming loans	15,143		22,244		15,508	
Foreclosed property (1)	2,024		1,896		10,001	
Total nonperforming assets (1)	$17,167		$24,140		$25,509	
Excludes assets covered under FDIC loss share (1)						
Total assets	$3,275,295		$3,277,003		$3,139,951	
Total portfolio loans	2,435,559		2,433,916		2,173,988	
Total loans plus foreclosed property	2,437,583		2,435,812		2,183,989	
Nonperforming loans to total loans	0.62	%	0.91	%	0.71	%
Nonperforming assets to total loans plus foreclosed property	0.70		0.99		1.17	
Nonperforming assets to total assets	0.52		0.74		0.81	
Allowance for portfolio loans to nonperforming loans	200	%	136	%	180	%

(1) Excludes purchase credit impaired loans and assets covered under FDIC shared-loss agreements, except for their inclusion in total assets.

Nonperforming loans

Nonperforming loans exclude PCI loans that are accounted for on a pool basis, as the pools are considered to be performing. See Item 1, Note 5 – Purchase Credit Impaired Loans for more information on these loans.

Nonperforming loans based on loan type were as follows:

(in thousands)	March 31, 2015	December 31, 2014	March 31, 2014
Construction and land development	$6,366	$6,866	$7,729
Commercial and industrial	4,250	5,998	4,439
Residential real estate	2,655	3,082	430
Commercial real estate	1,872	6,298	2,910
Consumer and other	—	—	—
Total	$15,143	$22,244	$15,508

The following table summarizes the changes in nonperforming loans for the quarter ending:

(in thousands)	March 31, 2015	December 31, 2014	March 31, 2014
Nonperforming loans beginning of period	$22,244	$18,212	$20,840
Additions to nonaccrual loans	9,796	12,787	2,571
Additions to restructured loans	—	—	790
Chargeoffs	(2,556)	(2,064)	(1,369)
Other principal reductions	(13,891)	(3,437)	(2,457)
Moved to other real estate	(450)	(610)	(4,722)
Moved to performing	—	(2,299)	(145)
Loans past due 90 days or more and still accruing interest	—	(345)	—
Nonperforming loans end of period	$15,143	$22,244	$15,508

Other real estate

Other real estate at March 31, 2015, was $5.6 million, compared to $24.9 million at March 31, 2014. Approximately 64% of total Other real estate, or $3.6 million, is covered by FDIC shared-loss agreements.

The following table summarizes the changes in Other real estate for the quarter ending:

(in thousands)	March 31, 2015	December 31, 2014	March 31, 2014
Other real estate beginning of period	$7,840	$11,087	$23,252
Additions and expenses capitalized to prepare property for sale	890	2,401	4,722
Writedowns in value	(224)	(468)	(536)
Sales	(2,922)	(5,180)	(2,539)
Other real estate end of period	$5,584	$7,840	$24,899

The writedowns in fair value were recorded in Loan legal and other real estate expense based on current market activity shown in the appraisals. In addition, for the three months ended March 31, 2015, the Company realized a negligible net gain on the sale of other real estate and recorded these gains as part of Noninterest income.

Liabilities

Liabilities totaled $2.9 billion at March 31, 2015, consistent with balances at December 31, 2014. Liabilities remained stable due to a $183 million increase in total deposits, offset by a decrease of $138 million in short-term Federal Home Loan Bank advances and a decrease of $53 million in other borrowings.

Deposits

(in thousands)	March 31, 2015	December 31, 2014	Increase (decrease)	
Demand deposits	$680,997	$642,930	38,067	5.92 %
Interest-bearing transaction accounts	494,228	508,941	(14,713)	(2.89)%
Money market accounts	848,139	755,569	92,570	12.25 %
Savings	85,769	78,718	7,051	8.96 %
Certificates of deposit:				
$100 and over	441,775	377,544	64,231	17.01 %
Other	123,723	127,808	(4,085)	(3.20)%
Total deposits	$2,674,631	$2,491,510	183,121	7.35 %
Non-time deposits / total deposits	79 %	80 %		
Demand deposits / total deposits	25 %	26 %		

Total deposits at March 31, 2015 were $2.7 billion, an increase of $183 million, or 7.4%, from December 31, 2014. The increase in deposits within our money market accounts reflect initiatives to enhance overall deposit levels as well as to improve our funding mix. The composition of our noninterest bearing deposits remained stable at 26% of total deposits at March 31, 2015 compared to December 31, 2014. Growth in balances and the change in composition modestly improved deposit costs during the first quarter when compared to the linked fourth quarter at 0.40%, as compared to 0.41%, and improved from the 0.44% for the prior year period.

Shareholders' Equity

Shareholders' Equity totaled $326 million at March 31, 2015, an increase of $9.9 million from December 31, 2014. Significant activity during the three months ended March 31, 2015:

- Net income of $9.3 million,
- Other comprehensive income of $1.7 million from the change in unrealized gain/loss on investment securities,
- Dividends paid on common stock of $1.1 million

Liquidity and Capital Resources

Liquidity

The objective of liquidity management is to ensure we have the ability to generate sufficient cash or cash equivalents in a timely and cost-effective manner to meet our commitments as they become due. Typical demands on liquidity are run-off from demand deposits, maturing time deposits which are not renewed, and fundings under credit commitments to customers. Funds are available from a number of sources, such as from the core deposit base and from loans and securities repayments and maturities.

Additionally, liquidity is provided from sales of the securities portfolio, fed fund lines with correspondent banks, the Federal Reserve and the FHLB, the ability to acquire large and brokered deposits, and the ability to sell loan participations to other banks. These alternatives are an important part of our liquidity plan and provide flexibility and efficient execution of the asset-liability management strategy.

The Bank's Asset-Liability Management Committee oversees our liquidity position, the parameters of which are approved by the Bank's Board of Directors. Our liquidity position is monitored monthly by producing a liquidity

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report, which measures the amount of liquid versus non-liquid assets and liabilities. Our liquidity management framework includes measurement of several key elements, such as the loan to deposit ratio, a liquidity ratio, and a dependency ratio. 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. While core deposits and loan and investment repayments are principal sources of liquidity, funding diversification is another key element of liquidity management and is achieved by strategically varying depositor types, terms, funding markets, and instruments.

Parent Company liquidity
The parent company's liquidity is managed to provide the funds necessary to pay dividends to shareholders, service debt, invest in subsidiaries as necessary, and satisfy other operating requirements. The parent company's primary funding sources to meet its liquidity requirements are dividends and payments from the Bank and proceeds from the issuance of equity (i.e. stock option exercises, stock offerings). Another source of funding for the parent company includes the issuance of subordinated debentures and other debt instruments. Management believes our current level of cash at the holding company of $12.2 million will be sufficient to meet all projected cash needs for the remainder of 2015.

As of March 31, 2015, the Company had $56.8 million of outstanding subordinated debentures as part of eight 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 an attractive source of funding.

Bank liquidity
The Bank has a variety of funding sources available to increase financial flexibility. In addition to amounts currently borrowed, at March 31, 2015, the Bank could borrow an additional $341.3 million from the FHLB of Des Moines under blanket loan pledges and has an additional $680.5 million available from the Federal Reserve Bank under a pledged loan agreement. The Bank has unsecured federal funds lines with four correspondent banks totaling $45.0 million. On December 30, 2013, the Company prepaid $30.0 million of debt with the Federal Home Loan Bank with a weighted average interest rate of 4.09% and a maturity of 3 years and incurred a prepayment penalty of $2.6 million. On December 23, 2014, the Company prepaid an additional $50.0 million of debt with the Federal Home Loan Bank with a weighted average interest rate of 3.17%, a maturity of 3 years and incurred a prepayment penalty of $2.9 million . These transactions are expected to further reduce our cost of interest bearing liabilities in future periods and will help mitigate net interest margin compression.

Investment securities are another important tool to the Bank's liquidity objectives. Of the $410.1 million of the securities available for sale at March 31, 2015, $251.4 million was pledged as collateral for deposits of public institutions, treasury, loan notes, and other requirements. The remaining $158.7 million could be pledged or sold to enhance liquidity, if necessary.

In the normal course of business, the Bank enters into certain forms of off-balance sheet transactions, including unfunded loan commitments and letters of credit. These transactions are managed through the Bank'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 Bank has $1,048.7 million in unused commitments as of March 31, 2015. While this commitment level would exhaust the majority the Company's current liquidity resources, the nature of these commitments is such that the likelihood of funding them in the aggregate at any one time is low.

Capital Resources
The Company and the Bank 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 bank affiliate 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 the Bank to maintain minimum amounts and ratios (set forth in the following table) of total, Tier 1, and Common equity tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. To be categorized as “well capitalized”, banks must maintain minimum total risk-based (10%), Tier 1 risk-based (8%), Common equity tier 1 risk-based (6.5%), and Tier 1 leverage ratios (5%). As of March 31, 2015, and December 31, 2014, the Company and the Bank met all capital adequacy requirements to which they are subject.

The Bank continues to exceed regulatory standards and met the definition of “well-capitalized” (the highest category) at March 31, 2015. Beginning with reporting for the first quarter of 2015, the Company adopted the Regulatory Capital Framework (Basel III). The Company has implemented the necessary processes and procedures to comply with Basel III.

The following table summarizes the Company's various capital ratios at the dates indicated:

(in thousands)	March 31, 2015		December 31, 2014	
Total capital to risk-weighted assets	12.88	%	13.40	%
Tier 1 capital to risk-weighted assets	11.62	%	12.14	%
Common equity tier 1 capital to risk-weighted assets[1]	9.78	%	10.15	%
Leverage ratio (Tier 1 capital to average assets)	10.76	%	10.48	%
Tangible common equity to tangible assets[2]	9.01	%	8.69	%
Tier 1 capital	$346,597		$335,220	
Total risk-based capital	383,928		369,867	

[1] Not an applicable regulatory ratio until the quarter ended March 31, 2015
[2] Not a required regulatory capital ratio

The decline in regulatory ratios at March 31, 2015 represents the impact of an increase in risk weighted assets under the Basel III guidelines. The Company believes the tangible common equity and Tier 1 common equity ratios are important measures of capital strength even though they are considered to be non-GAAP measures. The tables further within MD&A reconcile these ratios to U.S. GAAP.

Use of Non-GAAP Financial Measures:

The Company's accounting and reporting policies conform to generally accepted accounting principles ("GAAP") in the U.S. and the prevailing practices in the banking industry. However, the Company provides other financial measures, such as Core net interest margin, tangible common equity ratio and Tier 1 common equity ratio, in this filing that are considered “non-GAAP financial measures.” Generally, a non-GAAP financial measure is a numerical measure of a company's financial performance, financial position or cash flows that exclude (or include) amounts included in (or excluded from) the most directly comparable measure calculated and presented in accordance with U.S. GAAP.
The Company believes these non-GAAP financial measures and ratios, when taken together with the corresponding U.S. GAAP measures and ratios, provide meaningful supplemental information regarding the Company's performance and capital strength. The Company's management uses, and believes investors benefit from referring to, these non-GAAP measures and ratios in assessing the Company's financial and operating results and related trends and when planning and forecasting future periods. However, these non-GAAP measures and ratios should be considered in addition to, and not as a substitute for or preferable to, ratios prepared in accordance with U.S. GAAP. The Company has provided a reconciliation of, where applicable, the most comparable GAAP financial measures and ratios to the

non-GAAP financial measures and ratios, or a reconciliation of the non-GAAP calculation of the financial measure.

The Company believes the tangible common equity and Tier 1 common equity ratios are important financial measures of capital strength even though they are considered to be non-GAAP measures and provide useful information about the Company's capital adequacy. The tables below contain reconciliations of these ratios to the most comparable measure under U.S. GAAP.

Core Performance Measures

	For the Quarter ended		
(in thousands)	March 31, 2015	December 31, 2014	March 31, 2014
CORE PERFORMANCE MEASURES			
Net interest income	$29,045	$30,816	$30,366
Less: Incremental accretion income	3,458	5,149	6,664
Core net interest income	25,587	25,667	23,702
Total noninterest income	3,583	4,852	3,922
Less: Change in FDIC loss share receivable	(2,264)	(1,781)	(2,410)
Less: Gain (loss) on sale of other real estate covered under FDIC loss share	(15)	195	131
Less: Gain on sale of investment securities	23	—	—
Core noninterest income	5,839	6,438	6,201
Total core revenue	31,426	32,105	29,903
Provision for portfolio loans	1,580	1,968	1,027
Total noninterest expense	19,950	24,795	21,102
Less: FDIC clawback	412	141	(111)
Less: Other loss share expenses	470	544	829
Less: FHLB prepayment penalty	—	2,936	—
Less: Facilities disposal charge	—	1,004	—
Core noninterest expense	19,068	20,170	20,384
Core income before income tax expense	10,778	9,967	8,492
Total income tax expense	5,022	2,812	3,007
Less: Income tax expense (benefit) of PCI assets	1,375	(452)	140
Core income tax expense	3,647	3,264	2,867
Core net income	$7,131	$6,703	$5,625
Core earnings per share	$0.35	$0.33	$0.28
Core efficiency ratio	60.67%	62.83%	68.17%
Core return on average assets	0.88%	0.82%	0.74%
Core return on average common equity	8.99%	8.43%	7.94%

The Company believes Core net interest margin is an important measure of our financial performance, even though it is a non-GAAP financial measure, because it provides supplemental information by which the evaluate the impact of excess Covered loan accretion on the Company's net interest margin and the Company's operating performance on an ongoing bases, excluding such impact. The table below reconciles Core net interest margin to the most comparable number under U.S. GAAP.

Net Interest Margin to Core Net Interest Margin

	For the Quarter ended			
(in thousands)	March 31, 2015		December 31, 2014	
Net interest income (fully tax equivalent)	$29,467		$30,803	
Less: Incremental accretion income	3,457		6,664	
Core net interest income (fully tax equivalent)	$26,010		$24,139	
Average earning assets	$3,047,815		$2,848,514	
Reported net interest margin (fully tax equivalent)	3.92	%	4.39	%
Core net interest margin (fully tax equivalent)	3.46	%	3.44	%

Tangible common equity ratio

(in thousands)	March 31, 2015		December 31, 2014	
Total shareholders' equity	$326,109		$316,241	
Less: Goodwill	30,334		30,334	
Less: Intangible assets	3,880		4,164	
Tangible common equity	$291,895		$281,743	
Total assets	$3,275,295		$3,277,003	
Less: Goodwill	30,334		30,334	
Less: Intangible assets	3,880		4,164	
Tangible assets	$3,241,081		$3,242,505	
Tangible common equity to tangible assets	9.01	%	8.69	%

Tier 1 common equity ratio

(in thousands)	March 31, 2015		December 31, 2014	
Total shareholders' equity	$326,109		$316,241	
Less: Goodwill	30,334		30,334	
Less: Intangible assets, net of deferred tax liabilities[1]	958		4,164	
Less: Unrealized gains	3,379		1,681	
Plus: Qualifying trust preferred securities	55,100		55,100	
Plus: Other	59		58	
Total tier 1 capital	346,597		335,220	
Less: Qualifying trust preferred securities	55,100		55,100	
Less: Other[1]	23			
Common equity tier 1 capital	$291,474		$280,120	
Total risk-weighted assets determined in accordance with prescribed regulatory requirements	$2,981,811		$2,760,729	
Common equity tier 1 capital to risk-weighted assets	9.78	%	10.15	%

[1] Beginning with quarter ended March 31, 2015, the implementation of revised regulatory capital guidelines under Basel III has resulted in differences in these items when compared to prior periods.

Critical Accounting Policies

The impact and any associated risks related to the Company's critical accounting policies on business operations are described 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 description on the application of these and other accounting policies, see the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

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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.

Interest Rate Risk
Our interest rate sensitivity management seeks to avoid fluctuating interest margins to provide for consistent growth of net interest income through periods of changing interest rates. Interest rate sensitivity varies with different types of interest-earning assets and interest-bearing liabilities. We attempt to maintain interest-earning assets, comprised primarily of both loans and investments, and interest-bearing liabilities, comprised primarily of deposits, maturing or repricing in similar time horizons in order to minimize or eliminate any impact from market interest rate changes. In order to measure earnings sensitivity to changing rates, the Company uses an earnings simulation model.

The Company determines the sensitivity of its short-term future earnings to a hypothetical plus or minus 100 to 300 basis point parallel rate shock through the use of simulation modeling. The simulation of earnings includes the modeling of the balance sheet as an ongoing entity. Future business assumptions involving administered rate products, prepayments for future rate-sensitive balances, and the reinvestment of maturing assets and liabilities are included. These items are then modeled to project net interest income based on a hypothetical change in interest rates. The resulting net interest income for the next 12-month period is compared to the net interest income amount calculated using flat rates. This difference represents the Company's earnings sensitivity to a plus or minus 100 basis points parallel rate shock.

The following table summarizes the expected impact of interest rate shocks on net interest income (due to the current level of interest rates, the 200 and 300 basis point downward shock scenarios are not shown):

Rate Shock	Annual % change in net interest income
+ 300 bp	6.4%
+ 200 bp	4.1%
+ 100 bp	1.7%
- 100 bp	-1.1%

Interest rate simulations for March 31, 2015, demonstrate that a rising rate environment will have a positive impact on net interest income.

The Company occasionally uses interest rate derivative financial instruments as an asset/liability management tool to hedge mismatches in interest rate exposure indicated by the net interest income simulation described above. At March 31, 2015, the Company had $23.8 million in notional amount of outstanding interest rate caps, to help manage interest rate risk.

ITEM 4: CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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, as of March 31, 2015. Disclosure controls and procedures include without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to the issuer’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Based on that evaluation, the CEO and CFO concluded the Company’s disclosure controls and procedures were effective as of March 31, 2015 to provide reasonable assurance of the achievement of the objectives described above.

Changes to Internal Controls

There were no changes during the period covered by this Quarterly Report on Form 10-Q in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, those controls.

PART II - OTHER INFORMATION

ITEM 1: LEGAL PROCEEDINGS

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

ITEM 1A: RISK FACTORS

For information regarding risk factors affecting the Company, please see the cautionary language regarding forward-looking statements in the introduction to Item 2 of Part I of this Report on Form 10-Q, and Part I, Item 1A of our Report on Form 10-K for the fiscal year ended December 31, 2014. There have been no material changes to the risk factors described in such Annual Report on Form 10-K.

ITEM 2: UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

The following tables provides information on repurchases by the Company of its common stock in each month of the quarter ended March 31, 2015.

Period	Total number of shares purchased (a)	Weighted-average price paid per share	Total number of shares purchased as part of publicly announces plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
January 1, 2015 through January 31, 2015	—	$ —	—	—
February 1, 2015 through February 28, 2015	—	—	—	—
March 1, 2015 through March 31, 2015	11,733	20.83	—	—
Total	11,733		—	

(a) Represents shares of the Company’s common stock shares withheld to satisfy tax withholding obligations upon the vesting of awards of restricted stock. These shares were purchased pursuant to the terms of the applicable plan and not pursuant to a publicly announced repurchase plan or program.

ITEM 6: EXHIBITS

Exhibit No.	Description
	Registrant hereby agrees to furnish to the Commission, upon request, the instruments defining the rights of holders of each issue of long-term debt of Registrant and its consolidated subsidiaries.
10.1	Form of Enterprise Financial Services Corp LTIP Grant Agreement (filed herewith).
*12.1	Computation of Ratio of Earnings to Fixed Charges and Preferred Dividends.
*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.
101	Pursuant to Rule 405 of Regulation S-T, the following financial information from the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2015, is formatted in XBRL interactive data files: (i) Consolidated Balance Sheet at March 31, 2015 and December 31, 2014; (ii) Consolidated Statement of Income for the three months ended March 31, 2015 and 2014; (iii) Consolidated Statement of Comprehensive Income for the three months ended March 31, 2015 and 2014; (iv) Consolidated Statement of Changes in Equity for the three months ended March 31, 2015 and 2014; (v) Consolidated Statement of Cash Flows for the three months ended March 31, 2015 and 2014; and (vi) Notes to Financial Statements.

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

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 April 30, 2015.

ENTERPRISE FINANCIAL SERVICES CORP

By: /s/ Peter F. Benoist
Peter F. Benoist
Chief Executive Officer

By: /s/ Keene S. Turner
Keene S. Turner
Chief Financial Officer