

EAGLE BANCORP INC
Form 10-K
March 14, 2008

[QuickLinks](#) -- Click here to rapidly navigate through this document

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2007

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from _____ to _____
Commission file number: 0-25923

Eagle Bancorp, Inc.

(Exact Name of Registrant as Specified in its Charter)

Maryland

(State or other jurisdiction of
incorporation or organization)

52-2061461

(I.R.S. Employer Identification Number)

7815 Woodmont Avenue, Bethesda, Maryland

(Address of Principal Executive Offices)

20814

(Zip Code)

Registrant's Telephone Number, including area code:

(301) 986-1800

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

Common Stock \$.01 par value

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

None

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

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

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 No

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Indicate by check mark if disclosure of delinquent filers in 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.

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

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

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

The aggregate market value of the outstanding Common Stock held by nonaffiliates as of June 30, 2007 was approximately \$135 million.

As of March 11, 2008, the number of outstanding shares of the Common Stock, \$.01 par value, of Eagle Bancorp, Inc. was 9,780,418

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held on May 22, 2008 are incorporated by reference in part III hereof.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Form 10-K Cross Reference Sheet

The following shows the location in this Annual Report on Form 10-K or the Company's Proxy Statement for the Annual Meeting of Stockholders to be held on May 22, 2008, of the information required to be disclosed by the United States Securities and Exchange Commission Form 10-K. References to pages only are to pages in this report.

- PART I**
- Item 1. Business.** See "Business" at Pages 65 through 69, "Employees" at Page 74, "Market Area and Competition" at Pages 75 through 76 and "Regulation" at Pages 76 through 81.
- Item 1A. Risk Factors.** See "Risk Factors" at Pages 69 through 74.
- Item 1B. Unresolved Staff Comments.** None.
- Item 2. Properties.** See "Properties" at Page 81 through 82.
- Item 3. Legal Proceedings.** From time to time the Company is a participant in various legal proceedings incidental to its business. In the opinion of management, the liabilities (if any) resulting from such legal proceedings will not have a material effect on the financial position of the Company.
- Item 4. Submission of Matters to a Vote of Security Holders.** No matter was submitted to a vote of the security holders of the Company during the fourth quarter of 2007.
- PART II**
- Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.** See "Market for Common Stock and Dividends" at Pages 32 through 34.
- Item 6. Selected Financial Data.** See "Six Year Summary of Financial Information" at Page 3.
- Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.** See "Management's Discussion and Analysis of Financial Condition and Results of Operation" at Pages 4 through 32.
- Item 7A. Quantitative and Qualitative Disclosures About Market Risk.** See "Interest Rate Risk Management Asset/Liability Management and Quantitative and Qualitative Disclosure About Market Risk" at Page 28 through Page 31.
- Item 8. Financial Statements and Supplementary Data.** See Consolidated Financial Statements and Notes thereto at Pages 35 through 64.
- Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.** None.
- Item 9A. Controls and Procedures.** See "Disclosure Controls and Procedures" at Page 82 and "Management Report on Internal Control Over Financial Reporting" at Page 83.
- Item 9B. Other Information.** None.
- PART III**
- Item 10. Directors, Executive Officers and Corporate Governance.** The information required by this Item is incorporated by reference to the material appearing under the captions "Election of Directors" and "Compliance with Section 16(a) of the Securities Exchange Act of 1934" in the Proxy Statement.
- The Company has adopted a code of ethics that applies to its Chief Executive Officer and Chief Financial Officer. A copy of the code of ethics will be provided to any person, without charge, upon written request directed to Zandra Nichols, Corporate Secretary, Eagle Bancorp, Inc., 7815 Woodmont Avenue, Bethesda, Maryland 20814.
- There have been no material changes in the procedures previously disclosed by which shareholders may recommend nominees to the Company's Board of Directors.
- Item 11. Executive Compensation.** The information required by this Item is incorporated by reference to the material appearing under the captions "Election of Directors Director's Compensation" and "Executive Compensation" in the Proxy Statement.
- Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.** See "Market for Common Stock and Dividends Securities Authorized for Issuance Under Equity Compensation Plans" at page. The remainder of the information required by this Item is incorporated by reference to the material appearing under the caption "Voting Securities and Principal Shareholders" in the Proxy Statement.
- Item 13. Certain Relationships and Related Transactions and Director Independence.** The information required by this Item is incorporated by reference to the material appearing under the captions "Election of Directors" and "Certain Relationships and Related Transactions" in the Proxy Statement.
- Item 14. Principal Accountant Fees and Services.** The information required by this Item is incorporated by reference to the material appearing under the caption "Independent Registered Public Accounting Firm Fees Paid to Independent Accounting Firm" in the Proxy Statement.
- PART IV**
- Item 15.**

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Exhibits, Financial Statement Schedules. See "Exhibits and Financial Statements" at Page 85.

2

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Six Year Summary of Selected Financial Data

The following table shows selected historical consolidated financial data for Eagle Bancorp (the "Company"). It should be read in conjunction with the Company's audited consolidated financial statements appearing elsewhere in this report.

	Year Ended December 31,						5 Year Compound Growth Rate
	2007	2006	2005	2004	2003	2002	
(dollars in thousands except per share data)							
Selected Balances Period End							
Total assets	\$ 846,400	\$ 773,451	\$ 672,252	\$ 553,453	\$ 442,997	\$ 347,829	19%
Total stockholders' equity	81,166	72,916	64,964	58,534	53,012	20,028	32%
Total loans	716,677	625,773	549,212	415,509	317,533	236,860	25%
Total deposits	630,936	628,515	568,893	462,287	335,514	278,434	18%
Selected Balances Averages							
Total assets	\$ 800,437	\$ 712,297	\$ 610,245	\$ 487,853	\$ 375,802	\$ 292,921	22%
Total stockholders' equity	76,760	68,973	61,563	55,507	34,028	18,381	33%
Total loans	659,204	575,854	479,311	353,537	266,811	210,303	26%
Total deposits	634,332	585,621	512,416	397,788	292,953	237,910	22%
Results of Operations							
Interest income	\$ 57,077	\$ 50,318	\$ 36,726	\$ 24,195	\$ 18,403	\$ 16,661	28%
Interest expense	23,729	17,880	8,008	4,328	3,953	5,170	36%
Net interest income	33,348	32,438	28,718	19,867	14,450	11,491	24%
Provision for credit losses	1,643	1,745	1,843	675	1,175	843	14%
Net interest income after provision for credit losses	31,705	30,693	26,875	19,192	13,275	10,648	24%
Noninterest income	5,186	3,846	3,998	3,753	2,850	2,107	20%
Noninterest expense	24,921	21,824	18,960	14,952	11,007	8,530	24%
Income before taxes	11,970	12,715	11,913	7,993	5,118	4,225	23%
Income tax expense	4,269	4,690	4,369	2,906	1,903	1,558	22%
Net income	7,701	8,025	7,544	5,087	3,215	2,667	24%
Dividends declared	2,302	2,147	1,994				
Per Share Data(1)							
Net income, basic	\$ 0.80	\$ 0.85	\$ 0.82	\$ 0.56	\$ 0.49	\$ 0.54	8%
Net income, diluted	0.78	0.81	0.77	0.53	0.46	0.51	9%
Book value	8.35	7.69	6.95	6.38	5.85	4.09	15%
Dividends declared per share	0.24	0.23	0.22				
Dividend payout ratio(2)	29.89%	27.06%	26.42%				
Financial Ratios							
Return on average assets	0.96%	1.13%	1.24%	1.04%	0.86%	0.91%	
Return on average equity	10.03%	11.63%	12.25%	9.16%	9.45%	14.51%	
Average equity to average assets	9.59%	9.68%	10.09%	11.38%	9.05%	6.28%	
Net interest margin	4.37%	4.81%	4.99%	4.35%	4.14%	4.16%	
Efficiency ratio(3)	64.67%	60.15%	57.95%	63.30%	63.62%	62.73%	

(1) Presented giving retroactive effect to stock splits in the form of 30% stock dividends paid on July 5, 2006 and February 28, 2005.

(2)

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Computed by dividing dividends declared per share by net income per share.

(3)

Computed by dividing noninterest expense by the sum of net interest income and noninterest income.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of Eagle Bancorp, Inc. (the "Company") and its subsidiaries, EagleBank (the "Bank") and Eagle Commercial Ventures ("ECV"). This discussion and analysis should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto, appearing elsewhere in this report.

This report contains forward looking statements within the meaning of the Securities Exchange Act of 1934, as amended, including statements of goals, intentions, and expectations as to future trends, plans, events or results of Company operations and policies and regarding general economic conditions. In some cases, forward looking statements can be identified by use of such words as "may", "will", "anticipate", "believes", "expects", "plans", "estimates", "potential", "continue", "should", and similar words or phrases. These statements are based upon current and anticipated economic conditions, nationally and in the Company's market, interest rates and interest rate policy, competitive factors and other conditions which, by their nature, are not susceptible to accurate forecast, and are subject to significant uncertainty. Because of these uncertainties and the assumptions on which this discussion and the forward looking statements are based, actual future operations and results in the future may differ materially from those indicated herein. Readers are cautioned against placing undue reliance on any such forward looking statements.

GENERAL

The Company is a growth oriented, one-bank holding company headquartered in Bethesda, Maryland. We provide general commercial and consumer banking services through our wholly owned banking subsidiary EagleBank, a Maryland chartered bank which is a member of the Federal Reserve System. We were organized in October 1997, to be the holding company for the Bank. The Bank was organized as an independent, community oriented, and full-service banking alternative to the super regional financial institutions, which dominate our primary market area. Our philosophy is to provide superior, personalized service to our customers. We focus on relationship banking, providing each customer with a number of services, becoming familiar with and addressing customer needs in a proactive, personalized fashion.

The Company offers a broad range of commercial banking services to our business and professional clients as well as full service consumer banking services to individuals living and/or working primarily in our service area. We emphasize providing commercial banking services to sole proprietors, small and medium-sized businesses, partnerships, corporations, non-profit organizations and associations, and investors living and working in and near our primary service area. A full range of retail banking services are offered to accommodate the individual needs of both corporate customers as well as the community we serve. These services include the usual deposit functions of commercial banks, including business and personal checking accounts, "NOW" accounts and money market and savings accounts, business, construction, and commercial loans, equipment leasing, residential mortgages and consumer loans and cash management services. We have developed significant expertise and commitment as an SBA lender, have been designated a Preferred Lender by the Small Business Administration (SBA), and are a leading community bank SBA lender in the Washington D.C. district.

PENDING ACQUISITION

In December 2007, the Company announced the signing of a definitive agreement to acquire Fidelity & Trust Financial Corporation ("Fidelity & Trust"), parent of Fidelity & Trust Bank. At September 30, 2007, Fidelity & Trust had \$452 million of assets. Fidelity & Trust Bank operates six locations, with one in Northern Virginia, three in Montgomery County, Maryland and two in the District of Columbia. The transaction is subject to regulatory and shareholder approvals and the satisfaction of other

conditions, as set forth in the merger agreement. The transaction is currently anticipated to be completed mid 2008. For further information about the proposed acquisition, please refer to "Business Pending Acquisition" at page 61.

Refer to "Note 16 of Notes to Consolidated Financial Statements" on page 54 for further information on this transaction.

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the consolidated financial statements; accordingly, as this information changes, the consolidated financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for investment securities available for sale are based either on quoted market prices or are provided by other third-party sources, when available. As of December 31, 2007, the Company had not adopted the provisions of Statement on Financial Accounting Standards ("SFAS") 157, which establishes a common definition of fair value.

The allowance for credit losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two principles of accounting: (a) Statement on Financial Accounting Standards ("SFAS") 5, "Accounting for Contingencies", which requires that losses be accrued when they are probable of occurring and are estimable and (b) SFAS No. 114, "Accounting by Creditors for Impairment of a Loan", which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, can be determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows, or values observable in the secondary markets.

Three components comprise our allowance for credit losses: a specific allowance, a formula allowance, and a nonspecific unallocated allowance. Each component of the allowance is based upon estimates that can and do change when actual events occur.

The specific allowance is used to individually allocate an allowance for loans identified as impaired. Impairment testing includes consideration of the borrower's overall financial condition, resources and payment history, support available from guarantors, and the fair market value of collateral. These factors are combined to estimate the probability and severity of inherent losses. When an impairment is identified, a specific reserve is established based upon the Company's assessment of the estimated loss embedded in the individual loan. Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, the Company does not individually evaluate consumer and residential loans for impairment.

The formula allowance is used to estimate the loss on internally risk rated loans, exclusive of those identified as impaired. Loans identified in the risk rating evaluation as meeting the criteria for substandard, doubtful, and loss classification, (classified loans), are segregated from non-classified loans within the portfolio. Unimpaired internally classified loans are stratified by loan type; with each loan type

assigned an allowance factor based upon management's estimate of the associated risk. Allowance factors increase with the worsening of internal risk ratings.

The unallocated formula allowance is used to estimate the loss associated with non-classified loans. These unclassified loans are also stratified by loan type and risk rating, and allowance factors are assigned by management based upon a number of factors, including delinquencies, loss history, changes in lending policy and procedures, changes in business and economic conditions, changes in the nature and volume of the portfolio, management expertise, concentrations within the portfolio, quality of loan review systems, competition, and legal and regulatory requirements. The factors assigned differ by loan type and internal risk rating. The unallocated allowance captures losses inherent in the portfolio which have not yet been recognized. Allowance factors and the overall size of the allowance may change from period to period based upon management's assessment of the above described factors and the relative weights given to each factor.

Management has significant discretion in making the judgments inherent in the determination of the provision and allowance for credit losses, including, in connection with the valuation of collateral, a borrower's prospects of repayment, and in establishing allowance factors on the formula allowance and nonspecific or environmental allowance components of the allowance. The establishment of allowance factors is a continuing evaluation, based on management's ongoing assessment of the global factors discussed above and their impact on the portfolio. The allowance factors may change from period to period, resulting in an increase or decrease in the amount of the provision or allowance, based upon the same volume and classification of loans. Changes in allowance factors have a direct impact on the amount of the provision, and a related, after tax effect on net income. Errors in management's perception and assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs. Alternatively, errors in management's perception and assessment of the global factors and their impact on the portfolio could result in the allowance being in excess of amounts necessary to cover losses in the portfolio, and may result in lower provision in the future. For additional information regarding the allowance for credit losses, refer to the discussion under the caption "Allowance for Credit Losses" below.

Beginning in January 2006, the Company adopted the provisions of SFAS No. 123R, which requires the expense recognition for the fair value of stock-based compensation awards, such as stock options, restricted stock units, and performance based shares and the like. This standard allows management to establish modeling assumptions as to expected stock price volatility, option terms, forfeiture rates and dividend rates which directly impact estimated fair value. The accounting standard also allows for the use of alternative option pricing models which may impact fair value as determined. The Company's practice is to utilize reasonable and supportable assumptions which are reviewed with the appropriate Board Committee.

RESULTS OF OPERATIONS

Overview

The Company reported net income of \$7.7 million for the year ended December 31, 2007, a 4% decrease from net income of \$8.0 million for the year ended December 31, 2006, as compared to \$7.5 million for the year ended December 31, 2005.

The decrease in net income for the twelve months ended December 31, 2007 can be attributed substantially to an increase in interest expense of 33% while interest income increased by 13% as compared to the same period in 2006. Net interest income showed an increase of 3% on growth in average earning assets of 13%. For the twelve months ended December 31, 2007, the Company has experienced a 44 basis point decline in its net interest margin from 4.81% in 2006 to 4.37% in 2007. This change was primarily due to reliance on more expensive sources of funds which has increased interest expense at a faster rate than increases in interest income.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Earnings per basic share were \$0.80 for the year ended December 31, 2007, as compared to \$0.85 for 2006 and \$0.82 for 2005. Earnings per diluted share were \$0.78 for the year ended December 31, 2007, as compared to \$0.81 for 2006 and \$0.77 for 2005.

For the three months ended December 31, 2007, the Company reported net income of \$2.3 million as compared to \$2.2 million for the same period in 2006. Earnings per basic share was \$0.24 and \$0.23 per diluted share for the three months ended December 31, 2007, as compared to \$0.23 per basic share and \$0.22 per diluted share for the same period in 2006.

The Company had a return on average assets of .96% and a return on average equity of 10.03% for the year of 2007, as compared to returns on average assets and average equity of 1.13% and 11.63%, respectively, for the year of 2006 and 1.24% and 12.25% respectively, for the year of 2005.

For the twelve months ended December 31, 2007, average interest bearing liabilities funding average earning assets increased to 77% as compared to 73% for the first twelve months of 2006. Additionally, while the average rate on earning assets for the twelve month period ended December 31, 2007, as compared to 2006 has increased by 2 basis points from 7.46% to 7.48%, the cost of interest bearing liabilities has increased by 44 basis points from 3.62% to 4.06%, resulting in a decline in the net interest spread of 42 basis points from 3.84% for the twelve months ended December 31, 2006 to 3.42% for the twelve months ended December 31, 2007. The 44 basis point decline in the net interest margin (from 4.81% for the twelve months ended December 31, 2006 to 4.37% for the twelve months ended December 31, 2007) has been slightly greater than the decline in the net interest spread as the Company's benefit from average noninterest bearing funding sources in 2007 declined modestly as compared to 2006. For the twelve months ended December 31, 2007, average noninterest sources funding earning assets were \$178 million as compared to \$181 million for the same period in 2006. The slight decline in noninterest funding sources has resulted in a slight decrease in the value of noninterest sources funding earning assets from 97 basis points in 2006 to 95 basis points in 2007.

Due to the need to meet loan funding objectives in excess of deposit growth, the Bank has relied to a larger extent on alternative funding sources, such as FHLB Advances and brokered deposits, the higher costs of which have contributed to a narrowing of the net interest margin. If significant reliance on alternative funding sources continues, the Company's earnings could be adversely impacted.

Loans, which generally have higher yields than securities and other earning assets, increased to 86% of average earning assets in 2007 from 85% of average earning assets for 2006. Investment securities accounted for 11% of average earning assets for both 2007 and 2006. Federal funds sold averaged 2% and 3% of average earning assets for 2007 and 2006, respectively. This decline was directly related to average loan growth over the past twelve month period exceeding the growth of average deposits and other funding sources.

For the quarter ended December 31, 2007, average interest bearing liabilities funding average earning assets increased to 73% as compared to 72% for the same period in 2006. Additionally, while the average rate on earning assets for the quarter ended December 31, 2007, as compared to the same period in 2006, has declined by 33 basis points from 7.56% to 7.23%, the cost of interest bearing liabilities has decreased by 15 basis points from 3.98% to 3.83%, resulting in a decline in the net interest spread of 17 basis points from 3.58% for the quarter ended December 31, 2006 to 3.41% for the quarter ended December 31, 2007. The net interest margin decreased 25 basis points from 4.55% for the quarter ended December 31, 2006 to 4.30% for the quarter ended December 31, 2007, a higher decline than the net interest spread as the benefit of average noninterest sources funding earning assets declined from 97 basis points for the quarter ended December 31, 2006 to 89 basis points for the quarter ended December 31, 2007.

For the quarter ended December 31, 2007 average loans increased 13% over the same period in 2006, maintaining a constant level of approximately 84% of average earning assets. Investment securities for the quarter ended December 31, 2007 amounted to 13% of average earning assets, an increase of 2% from an

average of 11% for the same period in 2006. Federal funds sold averaged 3% and 4% of average earning assets for the quarters ended December 31, 2007 and 2006, respectively.

The provision for credit losses was \$1.6 million for the year ended December 31, 2007 as compared to \$1.7 million in 2006. For the full year 2007, the Company recorded net charge-offs of \$979 thousand, as compared to \$357 thousand for the same period in 2006. The ratio of net-charge offs to average loans was .15% for 2007 and .06% for 2006. The increase in net charge-offs in 2007 is associated with one large commercial loan relationship identified in prior periods.

At December 31, 2007, the allowance for credit losses was \$8.0 million or 1.12% of total loans, as compared to \$7.4 million or 1.18% of total loans at December 31, 2006.

The provision for credit losses was \$883 thousand for the three months ended December 31, 2007 as compared to \$327 thousand for the same period in 2006, the increase being attributable to increases in environmental reserve factors associated with current economic conditions and not to any specific problem loan. For the fourth quarter of 2007, the Company recorded net charge-offs of \$250 thousand, as compared to no net charge-offs for the fourth quarter of 2006. The charge-offs in the fourth quarter of 2007 related to one problem loan relationship identified several quarters ago for which specific reserves had been established.

Total noninterest income was \$5.2 million for the year 2007 as compared to \$3.8 million for 2006, an increase of 35%. These amounts include net investment gains of \$6 thousand for the year of 2007 and \$124 thousand in 2006. Excluding securities gains, total noninterest income increased by 39%. The increase was attributed primarily to higher amounts of gains on the sale of residential mortgage loans (\$416 thousand versus \$301 thousand); higher deposit account activity fees (\$1.5 million versus \$1.4 million) and income from subordinated financing of a real estate project (\$1.2 million versus \$0). Income from subordinated financing activities can fluctuate greatly between periods, as it is based on the progress of a limited number of development projects. Refer to "Loan Portfolio" section below for further discussion of subordinated financing activity.

For the three months ended December 31, 2007, total noninterest income increased 107% to \$2.0 million as compared to \$945 thousand for the same period in 2006. Excluding securities losses of \$1 thousand during the fourth quarter of 2007 and gains of \$39 thousand for the same period in 2006, total noninterest income increased by 116%. The increase was attributed substantially to income (\$1.0 million) from the subordinated financing transaction noted above.

Total noninterest expense increased from \$21.8 million for 2006 to \$24.9 million for 2007, an increase of 14%. The primary reasons for this increase were increases in staff levels over the past twelve months and related personnel cost, occupancy cost (due in part to a new banking office and an expanded lending center facility), higher software licensing costs and expense associated with a reinstated FDIC deposit insurance assessment. The efficiency ratio which measures the level of noninterest expense to total revenue was 64.67% for 2007 as compared to 60.15% for 2006. The higher efficiency ratio relates in part to a lower net interest margin in 2007 as compared to 2006.

The efficiency ratio, improved to 59.87% for the fourth quarter of 2007, as compared to 61.57% for the fourth quarter of 2006, owing to substantial noninterest income in the final three months of 2007. For the three months ended December 31, 2007, total noninterest expense was \$6.5 million, as compared to \$5.7 million for the same period in 2006, an increase of 13%. This increase was due substantially to the same factors mentioned above which affected the increase for the full year 2007 over 2006.

Net Interest Income and Net Interest Margin

Net interest income is the difference between interest income on earning assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans and investment securities. The cost of funds represents interest expense on deposits, customer repurchase agreements and other borrowings,

which comprise federal funds purchased and advances from the Federal Home Loan Bank of Atlanta ("FHLBA"). Noninterest bearing deposits and capital are other components representing funding sources. Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income. Net interest income in 2007 was \$33.3 million compared to \$32.4 million in 2006 and \$28.7 million in 2005. For the three months ended December 31, 2007, net interest income was \$8.8 million as compared to \$8.4 million for the same period in 2006, a 5% increase.

The following table labeled "Average Balances, Interest Yields and Rates and Net Interest Margin" presents the average balances and rates of the various categories of the Company's assets and liabilities. Included in the table is a measurement of interest rate spread and margin. Interest spread is the difference (expressed as a percentage) between the interest rate earned on earning assets less the interest rate paid on interest bearing liabilities. While net interest spread provides a quick comparison of earnings rates versus cost of funds, management believes that the net interest margin provides a better measurement of performance, since the net interest margin includes the effect of noninterest bearing sources in its calculation, which are significant factors in the Company's financial performance. The net interest margin is net interest income (annualized) expressed as a percentage of average earning assets.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Average Balances, Interest Yields and Rates and Net Interest Margin

Year Ended December 31,

	2007			2006			2005		
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
(dollars in thousands)									
ASSETS:									
Interest earning assets:									
Interest bearing deposits with other banks and other short-term investments									
	\$ 4,565	\$ 293	6.42%	\$ 3,379	\$ 212	6.27%	\$ 12,168	\$ 417	3.43%
Loans(1)(2)(3)	659,204	51,931	7.88%	575,854	45,814	7.96%	479,311	33,478	6.98%
Investment securities available for sale(3)									
	85,177	4,177	4.90%	75,181	3,277	4.36%	71,438	2,424	3.39%
Federal funds sold	13,682	676	4.94%	20,271	1,015	5.01%	12,281	407	3.31%
Total interest earning assets	762,628	57,077	7.48%	674,685	50,318	7.46%	575,198	36,726	6.38%
Noninterest earning assets									
	45,217			44,090			40,073		
Less: allowance for credit losses	7,408			6,478			5,026		
Total noninterest earning assets	37,809			37,612			35,047		
TOTAL ASSETS	\$ 800,437			\$ 712,297			\$ 610,245		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Interest bearing liabilities:									
Interest bearing transaction	\$ 51,465	\$ 305	0.59%	\$ 58,675	\$ 204	0.35%	\$ 61,230	\$ 122	0.20%
Savings and money market	177,312	6,044	3.41%	152,162	5,174	3.40%	138,844	2,504	1.80%
Time deposits	270,480	13,461	4.98%	229,719	10,225	4.45%	171,827	4,837	2.82%
Total interest bearing deposits	499,257	19,810	3.97%	440,556	15,603	3.54%	371,901	7,463	2.01%
Customer repurchase agreements and federal funds purchased									
	44,992	1,887	4.19%	32,968	1,199	3.64%	29,341	350	1.19%
Other short-term borrowings	11,093	611	5.51%	12,596	639	5.07%	3,964	195	4.92%
Long term borrowings	29,033	1,421	4.89%	7,888	439	5.57%			0.00%
Total interest bearing liabilities	584,375	23,729	4.06%	494,008	17,880	3.62%	405,206	8,008	1.98%
Noninterest bearing liabilities:									
Noninterest bearing demand	135,075			145,065			140,515		
Other liabilities	4,227			4,251			2,961		
Total noninterest bearing liabilities	139,302			149,316			143,476		
Stockholders' equity	76,760			68,973			61,563		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 800,437			\$ 712,297			\$ 610,245		

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Year Ended December 31,

Net interest income	\$	33,348	\$	32,438
				\$ 28,718
Net interest spread		3.42%		3.84%
Net interest margin		4.37%		4.81%

- (1) Includes loans held for sale.
- (2) Loans placed on nonaccrual status are included in average balances. Net loan fees and late charges included in interest income on loans totaled \$1 million, \$2 million and \$1.2 million respectively for 2007, 2006, 2005 respectively.
- (3) Interest and fees on loans and investment securities available for sale exclude tax equivalent adjustments.

The rate/volume table below presents the composition of the change in net interest income for the periods indicated, as allocated between the change in net interest income due to changes in the volume of average earning assets and interest bearing liabilities, and the changes in net interest income due to changes in interest rates. As the table shows, the increase in net interest income in 2007 as compared to

2006 is due to growth in the volume of earning assets offset substantially by a decrease in the net interest margin on earning assets. For 2006 over 2005, the increase in net interest income was a function of increased volume of earning assets and a decrease in the net interest margin.

Rate/Volume Analysis of Net Interest Income

	2007 compared with 2006			2006 compared with 2005		
	Change Due to Volume	Change Due to Rate	Total Increase (Decrease)	Change Due to Volume	Change Due to Rate	Total Increase (Decrease)
(dollars in thousands)						
Interest earned on:						
Loans	\$ 6,631	\$ (514)	\$ 6,117	\$ 6,743	\$ 5,593	\$ 12,336
Investment securities	436	464	900	127	726	853
Interest bearing bank deposits	74	7	81	(301)	96	(205)
Federal funds sold	(330)	(9)	(339)	265	343	608
Total interest income	6,811	(52)	6,759	6,834	6,758	13,592
Interest paid on:						
Interest bearing transaction	(25)	126	101	(5)	87	82
Savings and money market	855	15	870	240	2,430	2,670
Time	1,814	1,422	3,236	1,630	3,758	5,388
Customer repurchase agreements	437	251	688	43	806	849
Other borrowings	1,101	(147)	954	864	19	883
Total interest expense	4,182	1,667	5,849	2,772	7,100	9,872
Net interest income	\$ 2,629	\$ (1,719)	\$ 910	\$ 4,062	\$ (342)	\$ 3,720

Provision for Credit Losses

The provision for credit losses represents the amount of expense charged to earnings to fund the allowance for credit losses. The amount of the allowance for credit losses is based on many factors which reflect management's assessment of the risk in the loan portfolio. Those factors include economic conditions and trends, the value and adequacy of collateral, volume and mix of the portfolio, performance of the portfolio, and internal loan processes of the Company and Bank.

During the year of 2007, a provision for credit losses was made in the amount of \$1.6 million and the allowance for credit losses increased \$664 thousand, including the impact of net charge-offs of \$979 thousand during the period. During the year of 2006, a provision for credit losses was made in the amount of \$1.7 million and the allowance for credit losses increased \$1.4 million, including the impact of net charge-offs of \$357 thousand during the period. The provision for credit losses of \$1.6 million for the year 2007 was similar to the provision for credit losses of \$1.7 million for the year 2006, as the overall portfolio mix of loans at year-end 2007 and 2006 was similar and the amount of loan growth was also similar. The provision for credit losses was \$1.8 million for the year 2005.

For the three months ended December 31, 2007, a provision for credit losses was made in the amount of \$883 thousand, as compared to \$327 thousand for the same period in 2006. The higher provision for the fourth quarter of 2007, relates primarily to increases in environmental reserve factors associated with current economic conditions and not to any specific problem loan. For the fourth quarter of 2007, net charge-offs amounted to \$250 thousand as compared to no net charge-offs for the same period in 2006. The charge-offs in the fourth quarter of 2007 related to one problem loan relationship identified several quarters ago for which specific reserves had been established.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

The maintenance of a high quality loan portfolio, with an adequate allowance for credit losses will continue to be a primary objective of the Company.

Noninterest Income

Total noninterest income includes service charges on deposits, gain on sale of loans, income from subordinated financing, other income and gain (loss) on investment securities.

Total noninterest income for the year ended December 31, 2007 was \$5.2 million, compared to \$3.8 million for the year ended December 31, 2006, an increase of 35%. Excluding securities gains of \$6 thousand for year ended 2007 and \$124 thousand during the same period in 2006, noninterest income increased by 39%. The increase was attributed primarily to higher amounts of gains on the sale of residential mortgage loans (\$416 thousand versus \$301 thousand), higher deposit account activity fees (\$1.5 million versus \$1.4 million) and income from subordinated financing of real estate projects (\$1.2 million versus \$0). Income from subordinated financing activities can fluctuate greatly between periods, as it is based on the progress of a limited number of development projects. Refer to "Loan Portfolio" section below for further discussion of subordinated financing activity.

Noninterest income for the fourth quarter of 2007 increased 107% to \$2.0 million from \$945 thousand for the fourth quarter of 2006. Excluding securities losses of \$1 thousand during the fourth quarter of 2007 and gains of \$39 thousand for the same period in 2006, noninterest income increased by 116%. The increase was attributed substantially to income (\$1.0 million) from a subordinated financing transaction related to a real estate development project.

For the year ended December 31, 2007 service charges on deposit accounts increased to \$1.5 million from \$1.4 million, an increase of 8%. The increase in service charges for the year was primarily related to new relationships and a full year impact of changes made in 2006 to earning credit computations. For the three months ended December 31, 2007 service charges on deposit accounts increased from \$350 thousand to \$429 thousand compared to the same period in 2006, an increase of 22%. This increase relates in part to the impact of lower interest rates in fourth quarter of 2007 as compared to 2006 on commercial deposit account fees.

Gain on sale of loans consists of SBA and residential mortgage loans. For the year ended December 31, 2007 gain on sale of loans decreased from \$1.1 million to \$1.0 million compared to the same period in 2006 or 7.0%. For the three months ended December 31, 2007 gain on loan sales decreased from \$255 thousand to \$220 thousand compared to the same period in 2006.

The Company is an active originator of SBA loans and its current practice is to sell the insured portion of those loans at a premium. Income from this source was \$620 thousand for the year ended December 31, 2007 compared to \$813 thousand for the year ended December 31, 2006. For the three months ended December 31, 2007, gains on the sale of SBA loans amounted to \$140 thousand as compared to \$124 thousand for the same period in 2006. Activity in SBA loan sales to secondary markets can vary widely from quarter to quarter. The Bank has been recognized as the leading community bank SBA lender in its marketplace and continued emphasis is anticipated. A portion of the lower SBA gains is due to lower fee margins established by the SBA.

The Company originates residential mortgage loans on a pre-sold basis, servicing released. Sales of these mortgage loans yielded gains of \$416 thousand for the year of 2007 compared to \$301 thousand in the same period in 2006. For the three months ended December 31, 2007, gains on the sale of residential mortgage loans were \$80 thousand as compared to \$131 thousand for the same three months of 2006. The Company continues its efforts to expand residential mortgage lending and associated sale of these assets on a servicing released basis. Loans sold are subject to repurchase in circumstances where documentation is not accurate or the underlying loan becomes delinquent within a specified period following sale and loan funding. The Bank considers these potential recourse provisions to be a minimal risk and to date has not been required to repurchase any loans. The Bank does not originate so called "sub-prime" loans and has no exposure to this market segment.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Other income totaled \$2.7 million, for year ended 2007 up from \$1.2 million for the same period in 2006, an increase of 117%. The primary reason for the increase is due to subordinated financing transactions. The Company provides subordinated financing for the acquisition, development and construction of real estate projects. These subordinated financings which are held by its wholly owned subsidiary ECV, generally entail a higher risk profile (including lower priority and higher loan to value ratios) than other loans made by the Bank. A portion of the amount which the Company expects to receive for such loans will be payments based on the success, sale or completion of the underlying project, and as such the income from these loans may be volatile from period to period, based on the status of such projects. For the year ended December 31, 2007 the Company recognized \$1.2 million as income from the settlement of its remaining interest in a subordinated financing transaction compared to \$0 for the same period in 2006. Income from subordinated financing activities is subject to wide variances, as it is based on the sales progress of a limited number of development projects. Refer to "Loan Portfolio" below for additional information on outstanding subordinate financing transactions. Other income also increased due to income from increases in the cash surrender value of bank owned life insurance and to increases in loan commitment fees on terminated transactions, and loan prepayment fees.

Other income totaled \$1.3 million for the fourth quarter of 2007 up from \$300 thousand for the fourth quarter of 2006, an increase of \$1.0 million. The primary reason for the increase was due to the realization of income from the subordinated financing transaction discussed above.

Net investment gains amounted to \$6 thousand and a loss of \$1 thousand for the year and quarter ended December 31, 2007, respectively, as compared to net investment gains of \$124 thousand and \$39 thousand for the year and quarter ended December 31, 2006, respectively. Investment gains and losses are typically recognized as part of the Company's asset and liability management to meet loan demand or to better manage the Bank's interest rate risk position.

Noninterest Expense

Noninterest expense consists of salaries and employee benefits, premises and equipment expenses, marketing and advertising, outside data processing, legal, accounting and professional fees and other expenses.

Total noninterest expense was \$24.9 million for the year ended December 31, 2007 compared to \$21.8 million for the year ended December 31, 2006, an increase of 14%. For the three months ended December 31, 2007, total noninterest expense was \$6.5 million versus \$5.7 million for the same period in 2006, a 13% increase.

Salaries and employee benefits were \$14.2 million for the year ended 2007, as compared to \$12.2 million for 2006, a 16% increase. For the three months ended December 31, 2007, salaries and employee benefits amounted to \$3.8 million versus \$3.2 million for the same period in 2006, a 19% increase. This increase was due to staff additions and related personnel costs, merit increases and increased benefit costs, offset by a decline in incentive based compensation. At December 31, 2007, the Company's staff numbered 175, as compared to 171 and 145 at December 31, 2006 and 2005, respectively.

Premises and equipment expenses amounted to \$4.8 million for the year ended December 31, 2007 versus \$3.8 million for the same period in 2006. This increase of 26% was due primarily to a new banking office opened in mid May 2006 and an expanded lending center facility opened in the first quarter of 2007. Additionally, ongoing operating expense increases associated with the Company's facilities, all of which are leased and increased equipment costs contributed to the overall increase in expense. For the three months ended December 31, 2007, premises and equipment expenses amounted to \$1.2 million versus \$1.0 million for the same period in 2006. The reason for the increase in expense for the three month period is the same as mentioned above for the year ended.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Advertising costs decreased from \$587 thousand in the year ended December 31, 2006 to \$465 thousand in the same period in 2007, a decrease of 21%. For the three months ended December 31, 2007, advertising expenses amounted to \$109 thousand versus \$221 thousand for the same period in 2006, a decrease of 51%. These declines were due primarily to shifting certain design work in-house, and lower levels of product advertising, including time deposit rate advertising.

Outside data processing costs were \$793 thousand for the year ended 2007, as compared to \$881 thousand in 2006, a decrease of 10%. For the three months ended December 31, 2007, outside data processing costs amounted to \$146 thousand versus \$225 thousand for the same period in 2006, a decrease of 35%. This decline in the three months and year ended December 31, 2007 as compared to 2006 was due to savings achieved from the renegotiation of the Bank's primary data processing vendor agreement.

Legal, accounting and professional fees were \$611 thousand for the year ended 2007, as compared to \$801 thousand for 2006, a 24% decrease. This decrease was due in part to consulting engagement work in 2006 related to an IT audit, and costs in 2006 related to a companywide initiative on relationship management. For the three months ended December 31, 2007, legal, accounting and professional fees amounted to \$153 thousand versus \$167 thousand for the same period in 2006, an 8% decrease. The costs related to the pending acquisition of Fidelity & Trust, which will be capitalized as of the consummation of the transaction, are not included in these expense totals.

Other expenses, increased to \$4.1 million in the year ended 2007 from \$3.5 million for the year ended December 31, 2006, or an increase of 16%. For the three months ended December 31, 2007, other expenses amounted to \$1.1 million versus \$913 thousand for the same period in 2006, an increase of 20%. The major components of costs in this category include ATM expenses, broker fees, telephone, courier, printing, business development, office supplies, charitable contributions, director fees, dues and FDIC insurance premiums. For the year ended of 2007, as compared to 2006, the significant increases in this category were primarily broker fees, internet and license agreements and the reinstated requirement that the Bank pay deposit insurance premiums. The same factors which contributed to an increase in other expenses for 2007 over 2006 mentioned above also contributed substantially to the increase in other expenses for the three months ended December 31, 2007, as compared to the same period in 2006.

Income Tax Expense

The Company recorded income tax expense of \$4.3 million in 2007 compared to \$4.7 million in 2006 and \$4.4 million in 2005, resulting in an effective tax rate of 35.7%, 36.9% and 36.7%, respectively. The lower effective tax rate for 2007 relates in part to a higher level of state tax exempt income.

BALANCE SHEET ANALYSIS

Overview

At December 31, 2007, the Company's total assets were \$846.4 million, loans were \$716.7 million, deposits were \$630.9 million, other borrowings, including customer repurchase agreements were \$128.4 million and stockholders' equity was \$81.2 million. As compared to December 31, 2006, assets grew in 2007 by \$72.9 million (9%), loans by \$90.9 million (15%), deposits by \$2.4 million (.4%), borrowings by \$60.3 million (89%) and stockholders' equity by \$8.3 million (11%).

The Company declared a cash dividend of \$0.24 per share for the year 2007 and \$0.23 per share for the year 2006.

Investment Securities Available-for-Sale (AFS) and Short-Term Investments

The AFS portfolio is comprised largely of U.S. Government agency securities (59% of AFS) with an average duration of 1.6 years. The remaining AFS securities consists of seasoned mortgage backed securities that are 100% agency issued (34% of AFS) which have an average expected lives of 2.9 years

with contractual maturities of the underlying mortgages of up to thirty years, a municipal bond issue (\$357 thousand) and equity investments (7% of AFS), a portion of which are required by regulatory mandates (Federal Reserve and Federal Home Loan Bank stocks amounting to 6% of AFS). The remaining portion of equity investments are either preferred or common stocks of three community based banking companies.

At December 31, 2007, the investment portfolio amounted to \$87.1 million as compared to a balance of \$91.1 million at December 31, 2006, a decrease of 4%. The investment portfolio is managed to achieve goals related to income, liquidity, interest rate risk management and providing collateral for customer repurchase agreements and other borrowing relationships.

The Company also has a portfolio of short-term investments utilized for asset liability management needs which consists from time-to-time of discount notes, money market investments, and other bank certificates of deposit. This portfolio amounted to \$4.5 million at December 31, 2007 as compared to \$4.9 million at December 31, 2006.

Federal funds sold amounted to \$244 thousand at December 31, 2007 as compared to \$9.7 million at December 31, 2006. These funds represent excess daily liquidity which is invested on an unsecured basis with well capitalized banks, in amounts generally limited both in the aggregate and to any one bank.

The tables below and Note 3 to the Consolidated Financial Statements provide additional information regarding the Company's investment securities available for sale. The Company classifies all its investment securities as AFS. This classification requires that investment securities be recorded at their fair value with any difference between the fair value and amortized cost (the purchase price adjusted by any accretion or amortization) reported as a component of stockholders' equity (accumulated other comprehensive income), net of deferred income taxes. At December 31, 2007, the Company had a net unrealized gain in AFS securities of \$966 thousand as compared to a net unrealized loss in AFS securities of \$420 thousand at December 31, 2006. The deferred income tax liability/benefit of these unrealized gains and losses was \$382 thousand and \$167 thousand, respectively.

The following table provides information regarding the composition of the Company's investment securities portfolio at the dates indicated. Amounts are reported at estimated fair value.

	December 31,					
	2007		2006		2005	
	Balance	Percent of Total	Balance	Percent of Total	Balance	Percent of Total
(dollars in thousands)						
U. S. Government agency securities	\$ 51,295	58.9%	\$ 58,584	64.3%	\$ 46,998	69.1%
Mortgage backed securities	29,303	33.6%	27,333	30.0%	17,240	25.3%
Municipal bonds	351	0.4%				
Federal Reserve and Federal Home Loan Bank stock	4,870	5.6%	3,829	4.2%	2,230	3.3%
Other equity investments	1,298	1.5%	1,394	1.5%	1,582	2.3%
	\$ 87,117	100%	\$ 91,140	100%	\$ 68,050	100%

The following table provides information, on an amortized cost basis, regarding the contractual maturity and weighted average yield of the investment portfolio at December 31, 2007. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Yields on tax exempt securities have not been calculated on a tax equivalent basis.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

At December 31, 2007, there were no issuers, other than the U.S. Government and its agencies, whose securities owned by the Company had a book or fair value exceeding ten percent of the Company's stockholders' equity.

	One Year or Less		After One Year Through Five Years		After Five Years Through Ten Years		After Ten Years		Total	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
(dollars in thousands)										
U. S. Government agency securities	\$ 7,999	3.89%	\$ 20,898	5.17%	\$ 21,531	5.29%			\$ 50,428	5.00%
Mortgage backed securities			5,288	3.96%	8,677	4.91%	15,253	5.56%	29,218	5.08%
Municipal bonds							357	5.69%	357	5.69%
Federal Reserve and Federal Home Loan Bank stock							4,870	5.98%	4,870	5.98%
Other equity investments							1,278	6.26%	1,278	6.26%
	<u>\$ 7,999</u>	<u>3.89%</u>	<u>\$ 26,186</u>	<u>4.93%</u>	<u>\$ 30,208</u>	<u>5.18%</u>	<u>\$ 21,758</u>	<u>3.90%</u>	<u>\$ 86,151</u>	<u>5.10%</u>

Loan Portfolio

In its lending activities, the Company seeks to develop sound relationships with clients whose businesses and individual banking needs will grow with the Bank. There has been a significant effort to grow the loan portfolio and to be responsive to the lending needs in the markets served, while maintaining sound asset quality.

Loan growth over the past year has been favorable, with loans outstanding reaching \$716.7 million at December 31, 2007, an increase of \$90.9 million or 15% as compared to \$625.8 million at December 31, 2006, and were \$549.2 million at December 31, 2005, an increase of \$76.6 million or 14% in 2006 over 2005. For the fourth quarter of 2007, the loan portfolio increased \$37.2 million (5.5%) over \$679.5 million at September 30, 2007.

The Bank is primarily commercial oriented and as can be seen in the chart below, has a large proportion of its loan portfolio related to real estate (70%) consisting of real estate-commercial, real estate-residential mortgage and construction-commercial and residential loans. Real estate also serves as collateral for loans made for other purposes, resulting in 80% of our loans being secured by real estate.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

The following table shows the trends in the composition of the loan portfolio over the past five years.

	December 31,									
	2007		2006		2005		2004		2003	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	(dollars in thousands)									
Commercial	\$ 149,332	21%	\$ 132,981	21%	\$ 118,928	22%	\$ 101,911	25%	\$ 93,112	29%
Real estate commercial(1)	392,757	55%	349,044	56%	284,667	52%	189,708	47%	142,819	45%
Real estate residential mortgage	2,160		1,523		1,130		9,230	2%	6,964	2%
Construction commercial & residential(1)	110,115	15%	86,524	14%	90,035	16%	62,745	14%	35,644	11%
Home equity	57,515	8%	50,572	8%	50,776	9%	49,632	11%	34,092	11%
Other consumer	4,798	1%	5,129	1%	3,676	1%	2,283	1%	4,902	2%
Total loans	716,677	100%	625,773	100%	549,212	100%	415,509	100%	317,533	100%
Less: Allowance for Credit Losses	(8,037)		(7,373)		(5,985)		(4,240)		(3,680)	
Net loans	\$ 708,640		\$ 618,400		\$ 543,227		\$ 411,269		\$ 313,853	

(1) Includes loans for land acquisition and owner occupied properties

As discussed under the caption "Business" and "Risk Factors", the Company has directly made higher risk loans that entail higher risks than loans made following normal underwriting practices ("higher risk loan transactions"). These higher risk loan transactions are currently made through the Company's subsidiary, ECV, which was formed in July 2006. This activity is limited as to individual transaction amount and total exposure amounts based on capital levels and is carefully monitored. Transactions are structured to provide ECV with returns commensurate to the risk through the requirement of additional interest following payoff of all loans:

For the year ended December 31, 2007, the Company recorded noninterest income from one subordinated financing transaction amounting to \$1.2 million. At December 31, 2007, the Company has no further interests or risks from that project.

At December 31, 2007, ECV has a \$1.9 million higher risk loan outstanding relating to a real estate project which is currently in a construction phase. The loan is expected to be outstanding throughout 2008, with sales completed in 2009.

Although the Company carefully underwrites each higher risk loan transaction and expects these transactions to provide additional revenues, there can be no assurance that any higher risk loan transaction, or the related loans made by the Bank, will prove profitable for the Company and Bank, that the Company and Bank will be able to receive any additional interest payments in respect of these loans, that any additional interest payments will be significant, or that the Company and Bank will not incur losses in respect of these transactions.

Loan Maturity

The following table sets forth the term to contractual maturity of the loan portfolio as of December 31, 2007.

	Due In				
	Total	One Year or Less	Over One to Five Years	Over Five to Ten Years	Over Ten Years
(dollars in thousands)					
Commercial	\$ 149,332	\$ 66,482	\$ 45,857	\$ 32,796	\$ 4,197
Real estate commercial	392,757	46,460	113,694	199,991	32,612
Real estate residential mortgage	2,160	688	1,321		151
Construction commercial and residential	110,115	54,447	24,549	23,397	7,722
Home equity	57,515	2	232	380	56,901
Other consumer	4,798	907	2,721	164	1,006
Total loans	\$ 716,677	\$ 168,986	\$ 188,374	\$ 256,728	\$ 102,589
Loans with:					
Predetermined fixed interest rate	\$ 249,717	\$ 39,286	\$ 119,822	\$ 71,649	\$ 18,960
Floating interest rate	466,960	129,700	68,552	185,079	83,629
Total loans	\$ 716,677	\$ 168,986	\$ 188,374	\$ 256,728	\$ 102,589

Loans are shown in the period based on final contractual maturity. Demand loans, having no contractual maturity and overdrafts, are reported as due in one year or less.

As noted above, a significant portion of the loan portfolio consists of commercial, construction and commercial real estate loans, primarily made in the Washington, D.C. metropolitan area and secured by real estate or other collateral in that market. Although these loans are made to a diversified pool of unrelated borrowers across numerous businesses, adverse developments in the Washington D.C. metropolitan real estate market could have an adverse impact on this portfolio of loans and the Company's income and financial position. While our basic trading area is the Washington, D.C. metropolitan area, the Bank has made loans outside that market area where the nature and quality of such loans was consistent with the Bank's lending policies.

The federal banking regulators have issued guidance for those institutions which are deemed to have concentrations in commercial real estate lending. Pursuant to the supervisory criteria contained in the guidance for identifying institutions with a potential commercial real estate concentration risk, institutions which have (1) total reported loans for construction, land development, and other land which represent in total 100% or more of an institutions total risk-based capital; or (2) total commercial real estate loans representing 300% or more of the institutions total risk-based capital and the institution's commercial real estate loan portfolio has increased 50% or more during the prior 36 months are identified as having potential commercial real estate concentration risk. Institutions which are deemed to have concentrations in commercial real estate lending are expected to employ heightened levels of risk management with respect to their commercial real estate portfolios, and may be required to hold higher levels of capital. The Company, like many community banks, has a concentration in commercial real estate loans. Management has extensive experience in commercial real estate lending, and has implemented and continues to maintain heightened portfolio monitoring and reporting, and strong underwriting criteria with respect to its commercial real estate portfolio. The Company is well capitalized. Nevertheless, it is possible that the Company could be required to maintain higher levels of capital as a result of our commercial real estate concentration, which could require us to obtain additional capital, and may adversely affect shareholder returns

At December 31, 2007, the Company had no other concentrations of loans in any one industry exceeding 10% of its total loan portfolio. An industry for this purpose is defined as a group of businesses that are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

Allowance for Credit Losses

Management has developed a comprehensive review process to monitor the adequacy of the allowance for credit losses. The review process and guidelines were developed utilizing guidance from federal banking regulatory agencies. The results of this review process, in combination with conclusions of the Bank's outside loan review consultant, support management's view as to the adequacy of the allowance as of the balance sheet date. During 2007, a provision for credit losses was made in the amount of \$1.6 million before net charge-offs of \$979 thousand. A full discussion of the accounting for allowance for credit losses is contained in Note 1 to the Consolidated Financial Statements; activity in the allowance for credit losses is contained in Note 4 to the Consolidated Financial Statements. Also, please refer to the discussion under the caption, "Critical Accounting Policies" within Management's Discussion and Analysis of Financial Condition and Results of Operation for further discussion of the methodology which management employs to maintain an adequate allowance for credit losses, and the discussion under the caption "Provision for Credit Losses".

The allowance for credit losses represented 1.12% of total loans at December 31, 2007 as compared to 1.18% at December 31, 2006. This decrease in the ratio of the allowance for credit losses was due to the charge-off of a large commercial loan relationship during 2007 that had been partially reserved at December 31, 2006.

At December 31, 2007, the Company had \$5.3 million of loans classified as nonperforming, and \$1.9 million of potential problem loans, as compared to \$2.0 million of nonperforming assets and \$4.3 million of potential problem loans at December 31, 2006. Please refer to Note 1 of the notes to the Consolidated Financial Statements under the caption "Loans" for a discussion of the Company's policy regarding impairment of loans. Please refer to "Nonperforming Assets" below for a discussion of problem and potential problem assets.

As the loan portfolio and allowance for credit losses review process continues to evolve, there may be changes to elements of the allowance and this may have an effect on the overall level of the allowance maintained. To date, the Bank has enjoyed a high quality loan portfolio with relatively low levels of net charge-offs and low delinquency rates. The maintenance of a high quality portfolio will continue to be a high priority for both management and the Board of Directors.

Management, being aware of the significant loan growth experienced by the Company and the problems which could develop in an unmonitored environment, is intent on maintaining a strong credit review system and risk rating process. The Company established a formal Credit Department in 2003 to provide independent analysis of credit requests and to manage problem credits. The Credit Department has developed and implemented additional analytical procedures for evaluating credit requests, has further refined the Company's risk rating system, and has adopted enhanced monitoring of the loan portfolio and the allowance for credit losses. The loan portfolio analysis process is ongoing and proactive in order to maintain a portfolio of quality credits and to quickly identify any weaknesses before they become more severe.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

The following table sets forth activity in the allowance for credit losses for the past five years.

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(dollars in thousands)				
Balance at beginning of year	\$ 7,373	\$ 5,985	\$ 4,240	\$ 3,680	\$ 2,766
Charge-offs:					
Commercial	(1,005)	(369)	(122)	(257)	(319)
Home equity		(15)			
Other consumer	(26)	(5)	(17)	(35)	(14)
Total charge-offs	(1,031)	(389)	(139)	(292)	(333)
Recoveries:					
Commercial	37	27	41	175	68
Other consumer	15	5		2	4
Total recoveries	52	32	41	177	72
Net charge-offs	(979)	(357)	(98)	(115)	(261)
Additions charged to operations	1,643	1,745	1,843	675	1,175
Balance at end of year	\$ 8,037	\$ 7,373	\$ 5,985	\$ 4,240	\$ 3,680

Ratio of net charge-offs during the year to average loans outstanding during the year

0.15% 0.06% 0.02% 0.03% 0.10%

The following table presents the allocation of the allowance by loan category and the percent of loans each category bears to total loans. The allocation of the allowance for the Commercial category includes a specific reserve of \$220 thousand against impaired loans relating to two SBA loans which were identified as impaired during the fourth quarter of 2007. The allocation of the allowance to each category is not necessarily indicative of future losses or charge-offs and does not restrict the usage of the allowance for any specific loan or category.

	Year Ended December 31,									
	2007		2006		2005		2004		2003	
	Amount	% of Loans	Amount	% of Loans	Amount	% of Loans	Amount	% of Loans	Amount	% of Loans
	(dollars in thousands)									
Commercial	\$ 3,300	21%	\$ 3,379	21%	\$ 2,594	22%	\$ 1,963	25%	\$ 1,689	29%
Real estate commercial	3,053	55%	2,800	56%	2,395	52%	1,426	47%	850	45%
Real estate residential mortgage	21		40		48		105	2%	38	2%
Construction commercial and residential	1,314	15%	854	14%	602	16%	431	14%	613	11%
Home equity	233	8%	176	8%	176	9%	223	11%	171	11%
Other consumer	116	1%	124	1%	84	1%	58	1%	72	2%
Unallocated					86		34		247	
Total Loans	\$ 8,037	100%	\$ 7,373	100%	\$ 5,985	100%	\$ 4,240	100%	\$ 3,680	100%

Nonperforming Assets

Edgar Filing: EAGLE BANCORP INC - Form 10-K

The Company's nonperforming assets, which are comprised of loans delinquent 90 days or more, nonaccrual loans, restructured loans and other real estate owned, totaled \$5.3 million at December 31, 2007 compared to \$2.0 million at December 31, 2006. The percentage of nonperforming assets to total assets was 0.63% at December 31, 2007 compared to 0.26% at December 31, 2006.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

The following table shows the amounts of nonperforming assets at December 31 for the past five years:

	2007	2006	2005	2004	2003
(dollars in thousands)					
Nonaccrual Loans:					
Commercial	\$ 1,174	\$ 1,976	\$ 362	\$ 156	\$ 554
Other consumer			129		100
Home equity	123				
Construction commercial and residential	3,386				
Real estate commercial	641				
Accrual loans-past due 90 days:					
Commercial		37			
Other consumer					
Real estate commercial					
Restructured loans					
Real estate owned					
Total non-performing assets	\$ 5,324	\$ 2,013	\$ 491	\$ 156	\$ 654

- (1) Gross interest income that would have been recorded in 2007 if nonaccrual loans and leases shown above had been current and in accordance with their original terms was \$128 thousand, while interest actually recorded on such loans was \$75 thousand. Please see Note 1 of the Notes to Consolidated financial Statements for a description of the Company's policy for placing loans on nonaccrual status.

Nonaccrual loans at December 31, 2007, include two related loans totaling \$4.0 million, which were placed on nonaccrual in the third quarter of 2007 and which management believes are well secured. Interest on these two related loans is being recorded on a cash basis. Nonaccrual loans at December 31, 2006 consisted primarily of one large commercial relationship amounting to \$1.9 million which had a specific reserve of \$678 thousand at December 31, 2006 and which has been charged-off as of December 31, 2007 to an amount expected to be realized.

Significant variation in the amount of nonperforming loans may occur from period to period because the amount of nonperforming loans depends largely on the condition of a small number of individual credits and borrowers relative to the total loan portfolio. The Company had no Other Real Estate Owned (OREO) or restructured loans at either December 31, 2007 or 2006. The balance of impaired loans consisting of all nonaccrual loans only, was \$5.3 million at December 31, 2007, with \$220 thousand of specific reserves compared to \$2.0 million of impaired loans at December 31, 2006 with \$678 thousand of specific reserves.

At December 31, 2007, there were \$1.9 million of performing loans considered potential problem loans, defined as loans which are not included in the 90 day past due, nonaccrual or restructured categories, but for which known information about possible credit problems causes management to be uncertain as to the ability of the borrowers to comply with the present loan repayment terms which may in the future result in disclosure in the past due, nonaccrual or restructured loan categories.

Other Earning Assets

Residential mortgage loans held for sale amounted to \$2.2 million at both December 31, 2007 and December 31, 2006. Origination and sales of these loans during 2007 was emphasized by the Company in order to enhance noninterest income, which emphasis is expected to continue in 2008. The Bank did not engage in the origination of subprime or "exotic" mortgage loans. See "Business" at page 61 for a description of the Bank's mortgage lending and brokerage activities.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Bank owned life insurance is utilized by the Company in accordance with tax regulations as part of the Company's financing of its benefit programs. At December 31, 2007 this asset amounted to \$12.0 million as compared to \$11.5 million at December 31, 2006, which reflected an increase in cash surrender values, and not new investments.

Intangible Assets

In 2005, the Company began recognizing a servicing asset for the computed value of servicing fees on the sale of the guaranteed portion of SBA loans, which is in excess of a normal servicing fee. Assumptions related to loan term and amortization are made to arrive at the initial recorded value, which is included in other assets.

For 2007, excess servicing fees of \$122 thousand were recorded, and \$141 thousand was amortized as a reduction of actual service fees collected, which is a component of other income. At December 31, 2007, the balance of excess servicing fees was \$236 thousand. For 2006, excess servicing fees of \$167 thousand were recorded, of which \$80 thousand was amortized as a reduction of actual service fees collected, which is a component of other income. At December 31, 2006, the balance of excess servicing fees was \$255 thousand.

This asset is subject to impairment testing annually.

Deposits and Other Borrowings

The principal sources of funds for the Bank are core deposits, consisting of noninterest bearing demand, interest bearing transaction, money market and savings accounts and time deposits from the local market areas surrounding the Bank's offices. The deposit base includes transaction accounts, time and savings accounts and accounts which customers use for cash management and which provide the Bank with a source of fee income and cross-marketing opportunities as well as an attractive source of lower cost funds. Time and savings accounts, including money market deposit accounts, also provide a relatively stable and low-cost source of funding.

For the year ended December 31, 2007, deposits grew just \$2.4 million, from \$628.5 million to \$630.9 million or 0.4%. Approximately 41% of the Bank's deposits at December 31, 2007 are made up of time deposits, which are generally the most expensive form of deposit because of their fixed rate and term, as compared to 42% at December 31, 2006. These deposits increased modestly, by \$4.9 million, at December 31, 2007 as compared to December 31, 2006 as the Bank utilized alternative funding sources due to lower cost. Average time deposits amounted to \$270.5 million in 2007, compared to \$229.7 million in 2006, an increase of \$40.8 million or 17%. Time deposits in denominations of \$100 thousand or more increased \$15.1 million, or 9.5%, to \$173.6 million, or 28% of total deposits at December 31, 2007, as compared to 25% at December 31, 2006. These deposits can be more volatile and more expensive than time deposits of less than \$100 thousand. However, because the Bank focuses on relationship banking, and its marketplace demographics are favorable, its historical experience has been that large time deposits have not been more volatile or significantly more expensive than smaller denomination certificates. From time to time, when appropriate in order to fund strong loan demand, the Bank accepts time deposits, generally in denominations of less than \$100 thousand from bank and credit union subscribers to a wholesale deposit rate line and also acquires brokered deposits. Wholesale deposits amounted to approximately \$10.2 million or 2% of total deposits at December 31, 2007, as compared to approximately \$18.3 million or 3% of total deposits at December 31, 2006. On an average basis, wholesale deposits amounted to \$25.9 million for 2007 (4% of average deposits) as compared to \$9.1 million in 2006 (2% of average deposits).

The following table sets forth the maturities of time deposits with balances of \$100,000 or more, which represent 28% of total time deposits as of December 31, 2007, compared to 25% at December 31, 2006.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

See Note 6 to the Consolidated Financial Statements and the Average Balances Table above for additional information regarding the maturities of time deposits and average rates paid on interest-bearing deposits.

	December 31,		
	2007	2006	2005
	(dollars in thousands)		
Three months or less	\$ 52,569	\$ 39,730	\$ 25,943
More than three months through six months	56,540	59,731	33,109
More than six months through twelve months	61,117	54,234	53,217
Over twelve months	3,359	4,800	10,302
	\$ 173,585	\$ 158,495	\$ 122,571

At December 31, 2007, the Company had approximately \$142.5 million in noninterest bearing demand deposits, representing 23% of total deposits. This compared to approximately \$139.9 million of these deposits at December 31, 2006 or 22% of total deposits. These deposits are primarily business checking accounts on which the payment of interest is prohibited by regulations of the Federal Reserve. Proposed legislation has been introduced in each of the last several sessions of Congress which would permit banks to pay interest on checking and demand deposit accounts established by businesses. If legislation effectively permitting the payment of interest on business demand deposits is enacted, of which there can be no assurance, it is likely that we may be required to pay interest on some portion of our noninterest bearing deposits in order to compete with other banks. Payment of interest on these deposits could have a significant negative impact on our net interest income and net interest margin, net income, and the return on assets and equity.

As an enhancement to the basic noninterest bearing demand deposit account, the Company offers a sweep account, or "customer repurchase agreement", allowing qualifying businesses to earn interest on short-term excess funds which are not suited for either a certificate of deposit or a money market account. The balances in these accounts were \$52.9 million at December 31, 2007 compared to \$38.1 million at December 31, 2006. Customer repurchase agreements are not deposits and are not insured but are collateralized by U.S. government agency securities. These accounts are particularly suitable to businesses with significant fluctuation in the levels of cash flows. Attorney and title company escrow accounts are an example of accounts which can benefit from this product, as are customers who may require collateral for deposits in excess of \$100 thousand but do not qualify for other pledging arrangements. This program requires the Company to maintain a sufficient investment securities level to accommodate the fluctuations in balances which may occur in these accounts.

At December 31, 2006 the Company had \$23.5 million outstanding balances under its federal funds lines of credit provided by correspondent banks, as compared to no outstandings at December 31, 2006. This increase was due to funding loan growth late in 2007. The Bank had \$52 million borrowings outstanding under its credit facility from the Federal Home Loan Bank of Atlanta, as compared to \$30 million outstandings at December 31, 2006. Outstanding advances are secured by collateral consisting of a blanket lien on qualifying loans in the Bank's commercial mortgage loan portfolio. Please refer to Note 7 to the Consolidated Financial Statements for additional information regarding the Company's short-term borrowings.

COMPARISON OF 2006 VERSUS 2005

The Company reported net income of \$8.0 million for the year ended December 31, 2006, a 6% increase over net income of \$7.5 million for the year ended December 31, 2005.

Earnings per basic share were \$0.85 for the year ended December 31, 2006, as compared to \$0.82 for the year 2005 and \$0.56 for the year 2004. Earnings per diluted share was \$0.81 for the year ended December 31, 2006, as compared to \$0.77 for the year 2005.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

The Company had a return on average assets of 1.13% and a return on average equity of 11.63% for the year of 2006, as compared to returns on average assets and average equity of 1.24% and 12.25%, respectively, for the year of 2005.

The increase in net income for the twelve months ended December 31, 2006 as compared to the same period in 2005 can be attributed substantially to an increase of 13% in net interest income, resulting from an increase of 17% in average earning assets and a decline in the net interest margin of 18 basis points. For the twelve months ended December 31, 2006, the Company experienced a decline in its net interest margin as the funding mix shifted to more interest bearing deposits and borrowed funds and as the costs of those funds increased. For the twelve months ended December 31, 2006, average interest bearing liabilities funding average earning assets increased to 73% as compared to 70% for the twelve months of 2005. Additionally, while the average rate on earning assets for the twelve month period ended December 31, 2006 as compared to 2005 increased by 108 basis points from 6.38% to 7.46%, the cost of interest bearing liabilities increased by 164 basis points from 1.98% to 3.62%, resulting in a decline in the net interest spread from 4.40% for the twelve months ended December 31, 2005 to 3.84% for the twelve months ended December 31, 2006. The 18 basis point decline in the net interest margin during the same period was less than the decline in the net interest spread as the Company benefited from a significant amount of average noninterest bearing funding sources. For the twelve months ended December 31, 2006, average noninterest sources funding earning assets was \$183 million as compared to \$170 million for the same period in 2005. The combination of higher levels of market interest rates and the increase in noninterest funding sources resulted in an increase in the value of noninterest sources funding earning assets from 59 basis points for the twelve months in 2005 to 98 basis points for the twelve months ended December 31, 2006.

Net interest income in 2006 was \$32.4 million compared to \$28.7 million in 2005 and \$19.9 million in 2004. The increase in 2006 as compared to 2005 is due to growth in the volume of earning assets offset in part by a decline in the net interest margin on earning assets.

Average loans increased to 85% of average earning assets in the year 2006 from 83% of average earning assets for the year of 2005. Average investment securities for the year of 2006 accounted for 11% of average earning assets as compared to 12% for the year of 2006.

The provision for credit losses was \$1.7 million for the year of 2006 as compared to \$1.8 million for the same period in 2005. This decline was largely attributable to a lesser amount of loan growth in the loan portfolio in 2006 as compared to 2005, offset by specific reserves being provided on a significant problem commercial loan relationship identified in August 2006. The Company had \$357 thousand of net charge-offs in the year of 2006, as compared to net charge-offs of \$98 thousand for the year of 2005.

Total noninterest income was \$3.8 million for the year 2006 as compared to \$4.0 million for 2005, a 4% decline. These amounts include net investment gains of \$124 thousand for the year of 2006 and \$279 thousand in 2005. Excluding gains on the sale of investment securities, noninterest income was \$3.7 million in both 2006 and 2005. This result was due primarily to increased revenue on deposit service charges being effectively offset by lesser amounts of gains on the sale of SBA loans and SBA service fees.

Total noninterest expenses increased from \$19.0 million for the year of 2005 to \$21.8 million for the year of 2006, an increase of 15%. The increase was attributable primarily to increases in personnel and related benefit cost increases, the cost of share based compensation under new accounting rules effective January 1, 2006 (\$345 thousand pre-tax), increased premises and equipment expenses, due in part to a new banking office and the relocation of another banking office, and to higher marketing and advertising costs, outside data processing costs and professional fees associated with a larger organization. For the year 2006, the efficiency ratio, which measures the ratio of noninterest expenses to the sum of net interest income and noninterest income (total revenue), was 60.15% as compared to 57.95% for the year of 2005.

The Company recorded income tax expense of \$4.7 million in 2006 compared to \$4.4 million in 2005, resulting in an effective tax rate of 36.9% for 2006 and 36.7% for 2005.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

At December 31, 2006, the Company's total assets were \$773.5 million, loans were \$625.8 million, deposits were \$628.5 million and stockholders' equity was \$72.9 million. As compared to December 31, 2005, assets grew in 2006 by \$101.2 million (15%), loans by \$76.6 million (14%), deposits by \$59.6 million (10%) and stockholders' equity by \$8.0 million (12%).

The Company declared a cash dividend of \$0.23 per share for the year 2006 and \$0.22 per share for the year 2005.

At December 31, 2006, the investment portfolio amounted to \$91.1 million as compared to a balance of \$68.1 million at December 31, 2005, an increase of 34%. The investment portfolio is managed to achieve goals related to income, liquidity, interest rate risk management and providing collateral for customer repurchase agreements and other borrowing relationships.

The Company also has a portfolio of short-term investments utilized for asset liability management needs which consists of discount notes, money market investments, other bank certificates of deposit and similar instruments. This portfolio amounted to \$4.9 million at December 31, 2006 as compared to \$11.2 million at December 31, 2005.

Loans outstanding reached \$625.8 million at December 31, 2006, an increase of \$76.6 million or 14% as compared to \$549.2 million at December 31, 2005.

The allowance for loan losses represented 1.18% of total loans at December 31, 2006 as compared to 1.09% at December 31, 2005. This increase in the ratio of the allowance was due to two factors as follows: additional reserves provided in the third quarter of 2006 for a large problem commercial loan relationship identified in August 2006 and to a slight increase in the environmental factors of the non-specific reserve component related to various factors including potential impacts of higher interest rates on debt service capacity and on real estate values.

At December 31, 2006, the Company had \$2.0 million of loans classified as nonperforming, and \$4.3 million of potential problem loans, as compared to \$491 thousand of nonperforming assets and \$2.9 million of potential problem loans at December 31, 2005. The percentage of nonperforming assets to total assets was 0.26% at December 31, 2006 compared to 0.07% at December 31, 2005. Non-acrual loans at December 31, 2006 consisted primarily of one large commercial relationship amounting to \$1.9 million which has been assigned a specific reserve of \$678. The Company had no Other Real Estate Owned (OREO) or restructured loans at either December 31, 2006 or 2005. The balance of impaired loans was \$2.0 million at December 31, 2006, compared to \$491 thousand of impaired loans at December 31, 2005 with specific reserves of \$200 thousand.

Residential mortgage loans held for sale decreased to \$2.2 million at December 31, 2006 from \$2.9 million at December 31, 2005.

Bank owned life insurance is utilized by the Company in accordance with tax regulations as part of the Company's financing of its benefit programs. At December 31, 2006 this asset amounted to \$11.5 million as compared to \$11.1 million at December 31, 2005, which reflected an increase in cash surrender values, and not new investments.

For the year ending December 31, 2006 deposits grew \$59.6 million, from \$568.9 million to \$628.5 million or 10%. Approximately 42% of the Bank's deposits at December 31, 2006 are made up of time deposits, which are generally the most expensive form of deposit because of their fixed rate and term as compared to 33% at December 31, 2005. These deposits had significant increases in the year ended December 31, 2006 as the Bank utilized these funding sources due to lesser growth in core non-interest and money market deposit accounts. From time to time, when appropriate in order to fund strong loan demand, the Bank accepts time deposits, generally in denominations of less than \$100 thousand from bank and credit union subscribers to a wholesale deposit rate line and may also accept brokered deposits.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Wholesale deposits amounted to approximately \$18 million or 3% of total deposits at December 31, 2006, as compared to approximately \$11 million or 2% of total deposits at December 31, 2005.

As an enhancement to the basic noninterest bearing demand deposit account, the Company offers a sweep account, or "customer repurchase agreement", allowing qualifying businesses to earn interest on short-term excess funds which are not suited for either a certificate of deposit or a money market account. The balances in these accounts were \$38 million at December 31, 2006 compared to \$32 million at December 31, 2005. Customer repurchase agreements are not deposits and are not insured but are collateralized by U.S. government agency securities.

At December 31, 2006 and December 31, 2005, the Company had no outstanding balances under its lines of credit provided by correspondent banks. The Bank had \$30 million borrowings outstanding under its credit facility from the Federal Home Loan Bank of Atlanta, as compared to no outstandings at December 31, 2005.

CONTRACTUAL OBLIGATIONS

The Company has various financial obligations, including contractual obligations and commitments that may require future cash payments. Except for its loan commitments, as shown in Note 13 to Notes to Consolidated Financial Statements Financial Instruments with Off-Balance Sheet Risk, the following table shows details on these fixed and determinable obligations in the time period indicated.

	Within One Year	One to Three Years	Three to Five Years	Over Five Years	Total
(dollars in thousands)					
Deposits without a stated maturity(1)	\$ 373,648	\$	\$	\$	\$ 373,648
Time deposits(1)	250,896	4,621	1,771		257,288
Borrowed funds(2)	98,408	20,000	10,000		128,408
Operating lease obligations(3)	2,350	4,851	3,999	4,979	16,179
Outside data processing(4)	904	1,596	1,376	287	4,163
	\$ 726,206	\$ 31,068	\$ 17,146	\$ 5,266	\$ 779,686

(1) Excludes accrued interest payable at December 31, 2007

(2) Borrowed funds include customer repurchase agreements, federal funds purchased and other short-term and long-term borrowings.

(3) In September 2006, the Bank signed a lease for approximately 7,400 square feet in a "to be constructed" office building adjacent to its headquarters building in Bethesda. The minimum lease commitment is approximately \$3.0 million and is subject to various approvals and other conditions. The table amounts include this obligation. In February 2008, the Company leased additional expansion space in its Operations Center amounting to approximately 2,000 square feet. This obligation is excluded in both the table above and the lease obligations shown in Note 5 of Notes to the Consolidated Financial Statements.

(4) The Bank has outstanding significant obligations under its current core data processing contract that expires in May 2013 and one other significant vendor arrangement that relates to data communications and data software that expires in December 2009.

OFF-BALANCE SHEET ARRANGEMENTS

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. They involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets.

The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

The Company's 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 those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. See Note 13 of the Notes to Consolidated Financial Statements for a summary list of loan commitments at December 31, 2007 and 2006.

Loan commitments represent agreements to lend to a customer as long as there is no violation of any condition established in the contract and which have been accepted in writing by the borrower. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained is based on management's credit evaluation of the borrower. Collateral obtained varies, and may include certificates of deposit, accounts receivable, inventory, property and equipment, residential and commercial real estate.

Standby letters of credit are conditional commitments issued by the Company which guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Company deems necessary. At December 31, 2007, approximately 91% of the dollar amount of standby letters of credit was collateralized.

With the exception of these off-balance sheet arrangements, the Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, capital expenditures or capital resources, that is material to investors.

LIQUIDITY MANAGEMENT

Liquidity is a measure of the Company and Bank's ability to meet loan demand and to satisfy depositor withdrawal requirements in an orderly manner. The Bank's primary sources of liquidity consist of cash and cash balances due from correspondent banks, loan repayments, federal funds sold and other short-term investments, maturities and sales of investment securities and income from operations. The Bank's investment portfolio of debt securities is held in an available-for-sale status, which allows it flexibility, subject to holdings held as collateral for customer repurchase agreements; to generate cash from sales as needed to meet ongoing loan demand. These sources of liquidity are considered primary and are supplemented by the ability of the Company and Bank to borrow funds, which are termed secondary sources. The Company maintains secondary sources of liquidity, which includes a \$15 million line of credit with a correspondent bank, secured by the stock of the Bank, against which there were no amounts outstanding at December 31, 2007. Additionally, the Bank can purchase up to \$76.5 million in federal funds on an unsecured basis and \$5.5 million on a secured basis from its correspondents, against which there were \$23.5 million outstanding at December 31, 2007. At December 31, 2007, the Bank was also eligible to make advances from the FHLB up to \$97.1 million based on collateral at the FHLB, of which it had \$52.0 million of advances outstanding at December 31, 2007. Also, the Bank may enter into repurchase agreements as well as obtaining additional borrowing capabilities from the FHLB provided adequate collateral exists to secure these lending relationships.

The loss of deposits, through disintermediation, is one of the greater risks to liquidity. Disintermediation occurs most commonly when rates rise and depositors withdraw deposits seeking higher rates in alternative savings and investment sources than the Bank may offer. The Bank was founded under a philosophy of relationship banking and, therefore, believes that it has less of an exposure to disintermediation and resultant liquidity concerns than do many banks. There is, however, a risk that some deposits would be lost if rates were to increase and the Bank elected not to remain competitive with its

deposit rates. Under those conditions, the Bank believes that it is well positioned to use other sources of funds such as FHLB borrowings, repurchase agreements and Bank lines of credit to offset a decline in deposits in the short run. Over the long-term, an adjustment in assets and change in business emphasis could compensate for a potential loss of deposits. The Bank also maintains a marketable investment portfolio to provide flexibility in the event of significant liquidity needs. The Bank Board's Asset Liability Board Committee has adopted policy guidelines which emphasize the importance of core deposits and their continued growth.

At December 31, 2007, under the Bank's liquidity formula, it had \$236 million of primary and secondary liquidity sources, which was deemed adequate to meet current and projected funding needs.

INTEREST RATE RISK MANAGEMENT

Asset/Liability Management and Quantitative and Qualitative Disclosure about Market Risk

A fundamental risk in banking is exposure to market risk, or interest rate risk, since a bank's net income is largely dependent on net interest income. The Bank's Asset Liability Committee ("ALCO") of the Board of Directors formulates and monitors the management of interest rate risk through policies and guidelines established by it and the full Board of Directors. In its consideration of risk limits, the ALCO considers the impact on earnings and capital, the level and direction of interest rates, liquidity, local economic conditions, outside threats and other factors. Banking is generally a business of managing the maturity and re-pricing mismatch inherent in its asset and liability cash flows and to provide net interest income growth consistent with the Company's profit objectives.

The Company, through its ALCO, monitors the interest rate environment in which it operates and adjusts the rates and maturities of its assets and liabilities to remain competitive and to achieve its overall financial objectives subject to established risk limits. In the current interest rate environment, the Company has been extending the duration of its investment and loan portfolios and acquiring more variable and short-term liabilities, so as to mitigate the risk to earnings and capital should interest rates decline from current levels. There can be no assurance that the Company will be able to successfully achieve its optimal asset liability mix, as a result of competitive pressures, customer preferences and the inability to perfectly forecast future interest rates.

One of the tools used by the Company to manage its interest rate risk is a static GAP analysis presented below. The Company also uses an earnings simulation model (simulation analysis) on a quarterly basis to monitor its interest rate sensitivity and risk and to model its balance sheet cash flows and its income statement effects in different interest rate scenarios. The model utilizes current balance sheet data and attributes and is adjusted for assumptions as to investment maturities (calls), loan prepayments, interest rates, the level of noninterest income and noninterest expense. The data is then subjected to a "shock test" which assumes a simultaneous change in interest rate up 100 and 200 basis points or down 100 and 200 basis points, along the entire yield curve, but not below zero. The results are analyzed as to the impact on net interest income, and net income over the next twelve and twenty four month periods and to the market value of equity impact.

For the analysis presented below, the bank modified its assumption in the third quarter of 2007 (i.e. the September 30, 2007 analysis) for the re-pricing of money market deposit accounts to reflect a change of 50 basis points in money market interest rates for each 100 basis points in market interest rates in both a decreasing and increasing interest rate shock scenario. This assumption change was based on the bank's demand for funds and its recent experience with market interest rates in the third quarter of 2007. Prior analysis assumed that money market rates were changed 100 basis points for each 100 basis points movement in general interest rates.

As quantified in the table below, the Company's analysis at December 31, 2007 shows a moderate effect on net interest income and net income (over the next 12 months) as well as to the economic value of

equity when interest rates are shocked both down 100 and 200 basis points and up 100 and 200 basis points due to the significant level of variable rate and repricable assets and liabilities. The re-pricing duration of the investment portfolio is 2.2 years, the loan portfolio 1.4 years; the interest bearing deposit portfolio 1.4 years and the borrowed funds portfolio 0.8 years.

Over the next twelve months, as denoted in the GAP table below, the Company has an excess of rate sensitive liabilities over rate sensitive assets of 6%. During the year 2007, the Company has recognized the probability of lower market interest rates and has kept its time deposit maturities short-term and its money market accounts at as low a rate as possible without incurring substantial deposit runoff. On the asset side, the duration of the loan portfolio was lengthened slightly during 2007 as more fixed and adjustable rate structures were emphasized as opposed to variable interest rate structures. Additionally, during 2007, in anticipation of lower market interest rates, investment purchases were made with longer duration to partially offset higher call risk embedded in the investment portfolio. As well, some callable investments were sold at modest gains in 2007 to mitigate call risk. At December 31, 2007 the investment portfolio's duration was 2.2 years, only slightly less than the 2.7 years at December 31, 2006.

The following table reflects the result of simulation analysis on the December 31, 2007 asset and liabilities balances:

Change in interest rates (basis points)	Percentage change in net interest income	Percentage change in net income	Percentage change in market value of portfolio equity
+200	-3.2%	-8.4%	-3.1%
+100	-1.5%	-3.9%	-1.3%
0			
-100	+1.0%	+2.6%	-2.5%
-200	+1.0%	+2.7%	-8.8%

The results of simulation are within the policy limits adopted by the Company. For net interest income, the Company has adopted a policy limit of 15% for a 100 basis point change and 20% for a 200 basis point change. For the market value of equity, the Company has adopted a policy limit of 20% for a 100 basis point change and 25% for a 200 basis point change. The change in the economic value of equity in a lower interest rate shock scenario at December 31, 2007 as compared to December 31, 2006 is due primarily to added call risk in the investment portfolio.

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or re-pricing periods, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. The effect of competition on loan and deposit pricing may vary from the assumptions used in performing the rate shock analysis. Additionally, certain assets, such as adjustable rate mortgage loans, have features that restrict changes in interest rates on a short-term basis and over the life of the loan. Further, in the event of a change in interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in calculating the tables. Finally, the ability of many borrowers to service their debt may decrease in the event of a significant interest rate increase.

GAP Analysis

Banks and other financial institutions earnings are significantly dependent upon net interest income, which is the difference between interest earned on earning assets and interest expense on interest bearing liabilities.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

In falling interest rate environments, net interest income is maximized with longer term, higher yielding assets being funded by lower yielding short-term funds, or what is referred to as a negative mismatch or GAP. Conversely, in a rising interest rate environment, net interest income is maximized with shorter term, higher yielding assets being funded by longer-term liabilities or what is referred to as a positive mismatch or GAP.

Based on the current economic environment, management has been attempting to extend the duration of assets (both investments and loans) and emphasizing the acquisition of variable rate deposits and shorter-term time deposits. The Company has also acquired low cost FHLB callable advances to better manage the net interest margin. This strategy has mitigated the Company's exposure to lower interest rates as measured at December 31, 2007 and December 31, 2006 as compared to the position at December 31, 2005. While management believes that this overall position creates a reasonable balance in managing its interest rate risk and maximizing its net interest margin within plan objectives, there can be no assurance as to actual results.

The GAP position, which is a measure of the difference in maturity and re-pricing volume between assets and liabilities, is a means of monitoring the sensitivity of a financial institution to changes in interest rates. The chart below provides an indication of the sensitivity of the Company to changes in interest rates. A negative GAP indicates the degree to which the volume of repricable liabilities exceeds repricable assets in given time periods. At December 31, 2007, the Company had a slight positive GAP position of approximately 2% of total assets out to three months and a negative cumulative GAP position of 6% out to 12 months, as compared to a three month negative GAP of 1% and a negative cumulative GAP out to 12 months of 17% at December 31, 2006 and a three month positive GAP of 5% and a negative cumulative GAP out to 12 months of 8% at September 30, 2007.

The change in the negative cumulative GAP position at December 31, 2007 as compared to December 31, 2006 (minus 6% as compared to minus 17%) was due primarily to the assumption change mentioned above in the third quarter of 2007 related to the re-pricing of money market deposit accounts (to reflect a change of 50 basis points in money market interest rates for each 100 basis points in market interest rates in both a decreasing and increasing interest rate shock scenario). The current position is within guideline limits established by ALCO.

If interest rates decline, the Company's net interest income and margin over twelve months is expected to be relatively stable because of the present slight positive mismatch position out to 90 days (2%) combined with a more competitive business environment for both deposits and loans. Because competitive market behavior does not necessarily track the trend of interest rates but at times moves ahead of financial market influences, the change in the cost of liabilities may be different than anticipated by the GAP model. If this were to occur, any benefits of a declining interest rate environment may not be in accordance with management's expectations. If interest rates decline, the Company's interest rate sensitivity position at December 31, 2007 as compared to December 31, 2006 shows a similar risk position with regard to net interest income change, which is within established policy limits established by ALCO. Management has carefully considered its strategy to maximize interest income by reviewing interest rate levels, economic indicators and call features within its investment portfolio. These factors have been discussed with the ALCO and management believes that current strategies are appropriate to current economic and interest rate trends.

GAP Table

	0-3 mos	4-12 mos	13-36 mos	37-60 mos	over 60 mos	Total Rate Sensitive	Non-sensitive	Total Assets
(dollars in thousands)								
Repriceable in:								
ASSETS:								
Investments	\$ 7,104	\$ 21,939	\$ 43,261	\$ 7,061	\$ 7,752	\$ 87,117		
Loans(1)	303,719	84,361	162,261	134,935	33,578	718,854		
Federal funds sold and other short-term investments	4,734					4,734		
Other earning assets		11,984				11,984		
Total	\$ 315,557	\$ 118,284	\$ 205,522	\$ 141,996	\$ 41,330	\$ 822,689	\$ 23,711	\$ 846,400
LIABILITIES:								
Noninterest bearing demand	\$ 5,110	\$ 15,922	\$ 42,460	\$ 42,460	\$ 36,525	\$ 142,477		
Interest bearing transaction	27,050		10,816	10,816	5,408	54,090		
Savings and money market	87,341		35,896	35,896	17,948	177,081		
Time deposits	77,969	172,926	4,620	1,773		257,288		
Customer repurchase agreements & federal funds purchased	76,408					76,408		
Other borrowings	22,000		20,000	10,000		52,000		
Total	\$ 295,878	\$ 188,848	\$ 113,792	\$ 100,945	\$ 59,881	\$ 759,344	\$ 5,890	\$ 765,234
GAP	\$ 19,679	\$ (70,564)	\$ 91,730	\$ 41,051	\$ (18,551)	\$ 63,345		
Cumulative GAP	\$ 19,679	\$ (50,885)	\$ 40,845	\$ 81,896	\$ 63,345			
Cumulative GAP as percent of total assets	2.33%	-6.01%	4.83%	9.68%	7.48%			

(1) Includes loans held for sale and non-accrual loans.

Although interest bearing transaction accounts and money market accounts (which are administered rates) are subject to re-pricing as a whole category of deposits, the Bank's GAP model has incorporated a re-pricing schedule to account for the historical lag in effecting rate changes and the amount of those rate changes relative to the amount of rate change in assets. However, this measurement of interest rate risk sensitivity represents a static position as of a single day and is not necessarily indicative of the Company's position at any other point in time, does not take into account the differences in sensitivity of yields and costs on specific assets and liabilities to changes in market rates, and it does not take into account the specific timing of when changes to a specific asset or liability will occur.

CAPITAL RESOURCES AND ADEQUACY

The assessment of capital adequacy depends on a number of factors such as asset quality, liquidity, earnings performance, changing competitive conditions and economic forces, as well as the overall level of growth. The adequacy of the Company's current and future capital needs is monitored by management on an ongoing basis. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and to absorb potential losses.

The capital position of the Company's wholly-owned subsidiary, the Bank, continues to meet regulatory requirements as a well-capitalized institution. The primary indicators relied on by bank regulators in measuring the capital position are the Tier 1 risk-based capital, total risk-based capital, and leverage ratios. Tier 1 capital consists of common and qualifying preferred stockholders' equity less goodwill and other intangibles of which the Bank has none, and for the Company a limited amount of certain other restricted core capital elements, such as qualifying trust preferred securities and minority interests in consolidated subsidiaries. Total risk-based capital consists of Tier 1 capital, qualifying subordinated

debt, and the qualifying portion of the allowance for credit losses, 100% of which qualifies at

December 31, 2007 and 2006, and for the Company, a limited extent excess amounts of restricted core capital elements. Risk-based capital ratios are calculated with reference to risk-weighted assets, which are prescribed by regulation. The Tier 1 capital to average assets ratio is often referred to as the leverage ratio.

The Company's capital ratios were all in excess of guidelines established by the Federal Reserve and the Bank's capital ratios as earlier mentioned were in excess of those required to be classified as a "well capitalized" institution under the prompt corrective action rule of the Federal Deposit Insurance Act. The Company and Bank's capital ratios at December 31, 2007 and 2006 are shown in Note 15 to the Consolidated Financial Statements.

The ability of the Company to continue to grow is dependent on its earnings and those of the Bank, the ability to obtain additional funds for contribution to the Bank's capital, through additional borrowings, through the sale of additional common stock or preferred stock, or through the issuance of additional qualifying equity equivalents, such as subordinated debt or trust preferred securities. The capital levels required to be maintained by the Company and Bank may be impacted as a result of the Bank's concentrations in commercial real estate loans. See "Regulation" and "Risk Factors".

IMPACT OF INFLATION AND CHANGING PRICES

The Consolidated Financial Statements and Notes thereto have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of operations. Unlike most industrial companies, nearly all of our assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods or services.

NEW ACCOUNTING STANDARDS

Refer to Note 1 of the Notes to Consolidated Financial Statements for statements on New Accounting Standards.

MARKET FOR COMMON STOCK AND DIVIDENDS

Market for Common Stock. The Company's common stock is listed for trading on the NASDAQ Capital Market under the symbol "EGBN". Over the twelve month period ended December 31, 2007, the average daily trading amounted to approximately 5,000 shares. No assurance can be given that a very active trading market will develop in the foreseeable future or can be maintained. The following table sets forth the high and low sale prices for the common stock during each calendar quarter during the last two fiscal years, and dividends declared during such periods, as adjusted for the 1.3 for 1 stock split paid in the form of a 30% stock dividend on July 5, 2006. As of March 11, 2008, there were 9,780,418 shares of common stock outstanding, held by approximately 1,725 beneficial shareholders, including approximately 744 shareholders of record.

Quarter	2007			2006		
	High	Low	Dividends Declared per Share	High	Low	Dividends Declared per Share
First	\$ 17.43	\$ 15.75	\$ 0.06	\$ 18.58	\$ 16.46	\$ 0.05
Second	\$ 17.00	\$ 16.25	\$ 0.06	\$ 19.92	\$ 16.95	\$ 0.06
Third	\$ 16.99	\$ 12.75	\$ 0.06	\$ 21.19	\$ 18.49	\$ 0.06
Fourth	\$ 13.95	\$ 11.26	\$ 0.06	\$ 19.14	\$ 16.78	\$ 0.06

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Dividends. The Company commenced paying a quarterly cash dividend in January 2005. While the Company has adequate liquidity at present, the payment of future cash dividends may depend upon the ability of the Bank, its principal operating business, to declare and pay dividends to the Company. Future dividends will depend primarily upon the Bank's earnings, financial condition, and need for funds, as well as governmental policies and regulations applicable to the Company and the Bank.

In June 2006, the Company declared a 1.3 for 1 stock split in the form of a 30% stock dividend, which was paid on July 5, 2006.

In January 2007, the Company established a Dividend Reinvestment Plan, pursuant to which stockholders may have dividends paid on their common stock automatically reinvested in additional shares of common stock. The price at which shares are reinvested may be at a discount of 5% from the market price, where the shares are newly issued shares purchased directly from the Company. Forty- seven thousand (47,000) shares were issued under this plan during 2007.

Regulations of the Federal Reserve Board and Maryland law place limits on the amount of dividends the Bank may pay to the Company without prior approval. Prior regulatory approval is required to pay dividends which exceed the Bank's net profits for the current year plus its retained net profits for the preceding two calendar years, less required transfers to surplus. Under Maryland law, dividends may only be paid out of retained earnings. State and federal bank regulatory agencies also have authority to prohibit a bank from paying dividends if such payment is deemed to be an unsafe or unsound practice, and the Federal Reserve Board has the same authority over bank holding companies.

The Federal Reserve Board has established guidelines with respect to the maintenance of appropriate levels of capital by registered bank holding companies. Compliance with such standards, as presently in effect, or as they may be amended from time to time, could possibly limit the amount of dividends that the Company may pay in the future. In 1985, the Federal Reserve Board issued a policy statement on the payment of cash dividends by bank holding companies. In the statement, the Federal Reserve Board expressed its view that a holding company experiencing earnings weaknesses should not pay cash dividends exceeding its net income, or which could only be funded in ways that weaken the holding company's financial health, such as by borrowing. As a depository institution, the deposits of which are insured by the FDIC, the Bank may not pay dividends or distribute any of its capital assets while it remains in default on any assessment due the FDIC. The Bank currently is not in default under any of its obligations to the FDIC.

Issuer Repurchase of Common Stock. No shares of the Company's Common Stock were repurchased by or on behalf of the Company during 2007.

Internet Access To Company Documents. The Company provides access to its SEC filings through the Bank's web site at www.eaglebankmd.com by linking to the SEC's web site. After accessing the web site, the filings are available upon selecting "Investor Relations SEC Filings." Reports available include the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after the reports are electronically filed or furnished to the SEC.

Securities Authorized for Issuance Under Equity Compensation Plans. The following table sets forth information regarding outstanding options and other rights to purchase or acquire common stock granted under the Company's compensation plans as of December 31, 2007:

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)
	(a)	(b)	(c)
Equity compensation plans approved by security holders(1)	746,944	\$ 10.07	622,870(2)
Equity compensation plans not approved by security holders	0	0	0
Total	746,944	\$ 10.07	622,870

(1) Consists of the Company's 1998 Stock Option Plan, 2006 Stock Plan and the Employee Stock Purchase Plan. Outstanding options, warrants and rights includes nominal number of shares subject to awards of SARS and shares subject to unvested performance based restricted stock awards. For additional information, see Note 11 to the Consolidated Financial Statements.

(2) Shares include 497,776 available for issuance under the 2006 Stock Option Plan and 125,094 under the Employee Stock Purchase Plan.

Stock Price Performance. The following table compares the cumulative total return on a hypothetical investment of \$100 in the Company's common stock on December 31, 2002 through December 31, 2007, with the hypothetical cumulative total return on the NASDAQ Stock Market Index (U.S. Companies) and the NASDAQ Bank Index for the comparable period, including reinvestment of dividends.

December 31,

Edgar Filing: EAGLE BANCORP INC - Form 10-K

	2002	2003	2004	2005	2006	2007
Eagle Bancorp, Inc.	\$ 100.00	\$ 129.36	\$ 150.07	\$ 222.96	\$ 220.61	\$ 155.91
Nasdaq Stock Market Index (U.S. Companies)	\$ 100.00	\$ 150.01	\$ 162.89	\$ 165.13	\$ 180.85	\$ 198.60
Nasdaq Bank Index	\$ 100.00	\$ 129.93	\$ 144.21	\$ 137.97	\$ 153.15	\$ 119.35

34

**REPORT OF STEGMAN & COMPANY
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and
Stockholders of Eagle Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Eagle Bancorp, Inc. (the "Company") and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Eagle Bancorp Inc. as of December 31, 2007 and 2006, and the results of its operations and cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Eagle Bancorp Inc's. internal control over financial reporting as of December 31, 2007, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 10, 2008 expressed an unqualified opinion.

/s/ Stegman & Company
Stegman & Company
Baltimore, Maryland
March 10, 2008

EAGLE BANCORP, INC.

Consolidated Balance Sheets

	December 31, 2007	December 31, 2006
(dollars in thousands)		
ASSETS		
Cash and due from banks	\$ 15,408	\$ 19,250
Federal funds sold	244	9,727
Interest bearing deposits with banks and other short-term investments	4,490	4,855
Investment securities available for sale, at fair value	87,117	91,140
Loans held for sale	2,177	2,157
Loans	716,677	625,773
Less allowance for credit losses	(8,037)	(7,373)
	<u>708,640</u>	<u>618,400</u>
Loans, net	708,640	618,400
Premises and equipment, net	6,701	6,954
Deferred income taxes	3,597	3,278
Bank Owned Life Insurance	11,984	11,529
Accrued interest, taxes and other assets	6,042	6,161
	<u>846,400</u>	<u>773,451</u>
TOTAL ASSETS	\$ 846,400	\$ 773,451
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Noninterest bearing demand	\$ 142,477	\$ 139,917
Interest bearing transaction	54,090	66,596
Savings and money market	177,081	159,778
Time, \$100,000 or more	173,586	158,495
Other time	83,702	103,729
	<u>630,936</u>	<u>628,515</u>
Total deposits	630,936	628,515
Customer repurchase agreements and federal funds purchased	76,408	38,064
Other short-term borrowings	22,000	8,000
Long-term borrowings	30,000	22,000
Other liabilities	5,890	3,956
	<u>765,234</u>	<u>700,535</u>
Total liabilities	765,234	700,535
STOCKHOLDERS' EQUITY		
Common stock, \$.01 par value; shares authorized 20,000,000, shares issued and outstanding 9,721,315 (2007) and 9,478,064 (2006)	97	95
Additional paid in capital	52,290	50,278
Retained earnings	28,195	22,796
Accumulated other comprehensive income (loss)	584	(253)
	<u>81,166</u>	<u>72,916</u>
Total stockholders' equity	81,166	72,916
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 846,400	\$ 773,451

See notes to consolidated financial statements.

EAGLE BANCORP, INC.

Consolidated Statements of Operations

Years Ended December 31,

2007 2006 2005

(dollars in thousands, except per share data)

	2007	2006	2005
Interest Income			
Interest and fees on loans	\$ 51,931	\$ 45,814	\$ 33,478
Taxable interest and dividends on investment securities	4,177	3,277	2,424
Interest on balances with other banks and short-term investments	293	212	417
Interest on federal funds sold	676	1,015	407
	<u>57,077</u>	<u>50,318</u>	<u>36,726</u>
Interest Expense			
Interest on deposits	19,810	15,603	7,463
Interest on customer repurchase agreements and federal funds purchased	1,887	1,199	350
Interest on short-term borrowings	611	639	195
Interest on long-term borrowings	1,421	439	
	<u>23,729</u>	<u>17,880</u>	<u>8,008</u>
Net Interest Income	<u>33,348</u>	<u>32,438</u>	<u>28,718</u>
Provision for Credit Losses	<u>1,643</u>	<u>1,745</u>	<u>1,843</u>
Net Interest Income After Provision For Credit Losses	<u>31,705</u>	<u>30,693</u>	<u>26,875</u>
Noninterest Income			
Service charges on deposits	1,491	1,386	1,153
Gain on sale of loans	1,036	1,114	1,245
Gain on sale of investment securities	6	124	279
Increase in the cash surrender value of bank owned life insurance	455	406	401
Income from subordinated financing	1,252		
Other income	946	816	920
	<u>5,186</u>	<u>3,846</u>	<u>3,998</u>
Total noninterest income	<u>5,186</u>	<u>3,846</u>	<u>3,998</u>
Noninterest Expense			
Salaries and employee benefits	14,167	12,230	10,503
Premises and equipment expenses	4,829	3,835	3,470
Marketing and advertising	465	587	473
Outside data processing	793	881	769
Legal, accounting and professional fees	611	801	759
Other expenses	4,056	3,490	2,986
	<u>24,921</u>	<u>21,824</u>	<u>18,960</u>
Total noninterest expense	<u>24,921</u>	<u>21,824</u>	<u>18,960</u>
Income Before Income Tax Expense	<u>11,970</u>	<u>12,715</u>	<u>11,913</u>

Edgar Filing: EAGLE BANCORP INC - Form 10-K

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Income Tax Expense	4,269	4,690	4,369
Net Income	\$ 7,701	\$ 8,025	\$ 7,544
Earnings Per Share			
Basic	\$ 0.80	\$ 0.85	\$ 0.82
Diluted	\$ 0.78	\$ 0.81	\$ 0.77
Dividends Declared Per Share	\$ 0.24	\$ 0.23	\$ 0.22

See notes to consolidated financial statements.

EAGLE BANCORP, INC.

Consolidated Statements of Changes in Stockholders' Equity

For The Years Ended December 31, 2007, 2006 and 2005

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
(dollars in thousands)					
Balance January 1, 2005	\$ 54	\$ 47,014	\$ 11,368	\$ 98	\$ 58,534
Comprehensive Income					
Net Income			7,544		7,544
Other comprehensive income:					
Unrealized loss on securities available for sale (net of taxes)				(549)	(549)
Less: reclassification adjustment for gains net of taxes of \$110 included in net income				(169)	(169)
Total Comprehensive Income				(718)	6,826
Cash Dividends (\$0.22 per share)			(1,994)		(1,994)
1.3 to one stock split in the form of a 30% stock dividend	17	(17)			
Cash paid in lieu of fractional shares		(4)			(4)
Exercise of options for 136,841 shares of common stock	1	1,133			1,134
Tax benefit on non-qualified options exercise		468			468
Balance December 31, 2005	72	48,594	16,918	(620)	64,964
Comprehensive Income					
Net Income			8,025		8,025
Other comprehensive income:					
Unrealized gain on securities available for sale (net of taxes)				442	442
Less: reclassification adjustment for gains net of taxes of \$49 included in net income				(75)	(75)
Total Comprehensive Income				367	8,392
Cash Dividends (\$0.23 per share)			(2,147)		(2,147)
Stock-based compensation		345			345
1.3 to one stock split in the form of a 30% stock dividend	22	(22)			
Cash paid in lieu of fractional shares		(5)			(5)
Exercise of options for 137,999 shares of common stock	1	935			936
Tax benefit on non-qualified options exercise		431			431
Balance December 31, 2006	95	50,278	22,796	(253)	72,916
Comprehensive Income					
Net Income			7,701		7,701
Other comprehensive income:					
Unrealized gain on securities available for sale (net of taxes)				841	841
Less: reclassification adjustment for gains net of taxes of \$2 included in net income				(4)	(4)
Total Comprehensive Income				837	8,538
Cash Dividends (\$0.24 per share)			(2,302)		(2,302)

Edgar Filing: EAGLE BANCORP INC - Form 10-K

	<u>Common Stock</u>	<u>Additional Paid in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Stockholders' Equity</u>
Stock-based compensation		224			224
Shares issued under dividend reinvestment plan 47,000 shares	0	689			689
Exercise of options for 196,251 shares of common stock	2	1,080			1,082
Excess tax benefits from stock-based compensation		19			19
Balance December 31, 2007	\$ 97	\$ 52,290	\$ 28,195	\$ 584	\$ 81,166

See notes to consolidated financial statements.

EAGLE BANCORP, INC.

Consolidated Statements of Cash Flows

Years Ended December 31,

	2007	2006	2005
	<u> </u>	<u> </u>	<u> </u>
	(dollars in thousands)		
Cash Flows From Operating Activities:			
Net income	\$ 7,701	\$ 8,025	\$ 7,544
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Decrease in deferred income taxes	(868)	(647)	(1,312)
Provision for credit losses	1,643	1,745	1,843
Depreciation and amortization	1,347	1,196	1,122
Gains on sale of loans	(1,036)	(1,114)	(1,245)
Origination of loans held for sale	(52,455)	(59,966)	(29,083)
Proceeds from sale of loans held for sale	53,471	61,847	29,612
Gain on sale of investment securities	(6)	(124)	(279)
Net increase in surrender value of Bank-owned life insurance	(455)	(406)	(402)
Stock-based compensation expense	224	345	
Excess tax benefit from stock-based compensation	(19)	(431)	(468)
Decrease (increase) in other assets	119	(1,857)	(1,700)
Increase (decrease) in other liabilities	1,953	(1,869)	4,408
	<u> </u>	<u> </u>	<u> </u>
Net cash provided by operating activities	11,619	6,744	10,040
	<u> </u>	<u> </u>	<u> </u>
Cash Flows From Investing Activities:			
Decrease (increase) in interest bearing deposits other banks	365	6,376	(1,637)
Purchases of available for sale investment securities	(33,695)	(48,632)	(48,336)
Proceeds from maturities of available for sale securities	9,784	20,979	31,230
Proceeds from sale/call of available for sale securities	29,326	5,277	12,275
Net increase in loans	(91,882)	(76,918)	(133,801)
Bank premises and equipment acquired	(1,094)	(2,376)	(1,170)
	<u> </u>	<u> </u>	<u> </u>
Net cash used in investing activities	(87,197)	(95,294)	(141,439)
	<u> </u>	<u> </u>	<u> </u>
Cash Flows From Financing Activities:			
Increase in deposits	2,421	59,622	106,606
Increase in customer repurchase agreements and Fed Funds	38,344	5,925	8,156
Increase (decrease) in other short-term borrowings	14,000	8,000	(6,333)
Increase in long-term borrowings	8,000	22,000	
Issuance of common stock	1,771	936	1,130
Excess tax benefit from stock-based compensation	19	431	468
Payment of dividends and payment in lieu of fractional shares	(2,302)	(2,152)	(1,998)
	<u> </u>	<u> </u>	<u> </u>
Net cash provided by financing activities	62,253	94,762	108,029
	<u> </u>	<u> </u>	<u> </u>
Net (decrease) increase in cash	(13,325)	6,212	(23,370)
Cash and cash equivalents at beginning of year	28,977	22,765	46,135
	<u> </u>	<u> </u>	<u> </u>
Cash and cash equivalents at end of year	\$ 15,652	\$ 28,977	\$ 22,765
	<u> </u>	<u> </u>	<u> </u>
Supplemental cash flows information:			
Interest paid	\$ 23,640	\$ 16,906	\$ 7,571

Edgar Filing: EAGLE BANCORP INC - Form 10-K

	2007	2006	2005
	<u> </u>	<u> </u>	<u> </u>
	<u> </u>	<u> </u>	<u> </u>
Income taxes paid	\$ 4,052	\$ 4,751	\$ 5,083
	<u> </u>	<u> </u>	<u> </u>
Non-cash Financing Activities			
Reclassification of borrowings from long-term to short-term	\$ 22,000	\$	\$
Non-cash Investing Activities			
Transfers from loans to other real estate owned	\$	\$ 257	\$

See notes to consolidated financial statements.

Eagle Bancorp, Inc.

Notes to Consolidated Financial Statements for the Years Ended

December 31, 2007, 2006 and 2005

Note 1 Significant Accounting Policies

The consolidated financial statements include the accounts of Eagle Bancorp, Inc. (the "Company") and its subsidiaries, EagleBank (the "Bank") and Eagle Commercial Ventures LLC ("ECV") with all significant intercompany transactions eliminated. The investment in subsidiaries is recorded on the Company's books (Parent Only) on the basis of its equity in the net assets of the subsidiary. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices in the banking industry. Certain reclassifications have been made to amounts previously reported to conform to the classification made in 2007. The following is a summary of the more significant accounting policies.

Nature of Operations

The Company, through its bank subsidiary, conducts a full service community banking business, primarily in Montgomery County, Maryland and Washington, D.C. The primary financial services include real estate, commercial and consumer lending, as well as traditional deposit and repurchase agreement products. The Bank is also active in the origination and sale of residential mortgage loans and the origination of small business loans. The guaranteed portion of small business loans is typically sold through the Small Business Administration, in a transaction apart from the loan's origination. The Bank offers its products and services through nine banking offices and various electronic capabilities, including remote deposit services introduced in 2006. In July 2006, the Company formed Eagle Commercial Ventures, LLC as a direct subsidiary to provide subordinated financing for the acquisition, development and construction of real estate projects, whose primary financing would be done by the Bank.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, and federal funds sold (items with an original maturity of three months or less).

Loans Held for Sale

The Company engages in sales of residential mortgage loans and the guaranteed portion of Small Business Administration ("SBA") loans originated by the Bank. Loans held for sale are carried at the lower of aggregate cost or fair value. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of these loans are recorded as a component of noninterest income in the Consolidated Statements of Operations.

The Company's current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing as of December 31, 2007 or 2006. The sale of the guaranteed portion of SBA loans on a servicing retained basis gives rise to an Excess Servicing Asset, which is computed on a loan by loan basis and which unamortized amount is included in other assets. This asset is being amortized on a straight line basis (with adjustment for prepayments) as an offset of servicing fees collected and is included in other noninterest income.

Note 1 Significant Accounting Policies (Continued)

The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 15 to 60 days. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the Company commits to sell a loan at the time the borrower commits to an interest rate with the intent that the buyer has assumed interest rate risk on the loan. As a result, the Company is not exposed to losses nor will it realize gains related to its rate lock commitments due to changes in interest rates.

The market values of rate lock commitments and best efforts contracts are not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded. Because of the high correlation between rate lock commitments and best efforts contracts, no gain or loss occurs on the rate lock commitments.

Investment Securities

The Company has no securities classified as trading nor are any investment securities classified as held-to-maturity. Marketable equity securities and debt securities not classified as held-to-maturity or trading are classified as available-for-sale. Securities available-for-sale are acquired as part of the Company's asset/liability management strategy and may be sold in response to changes in interest rates, loan demand, changes in prepayment risk and other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses being reported as accumulated other comprehensive income, a separate component of stockholders' equity, net of deferred tax. Realized gains and losses, using the specific identification method, are included as a separate component of noninterest income. Declines in the fair value of individual available-for-sale securities below their cost that are other than temporary in nature result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or a change in management's intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value.

Loans

Loans are stated at the principal amount outstanding, net of unamortized deferred costs and fees. Interest income on loans is accrued at the contractual rate on the principal amount outstanding. It is the Company's policy to discontinue the accrual of interest when circumstances indicate that collection is doubtful. Deferred fees and costs on loans originated through October 2005 are being amortized on the straight line method over the term of the loan. Deferred fees and costs on loans originated subsequent to October 2005 are being amortized on the interest method over the term of the loan. The difference between the straight line method and the interest method was considered immaterial.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Company's portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any, securing the loan. Generally, impaired loans do not include large groups of smaller balance homogeneous loans such as residential real estate and consumer type loans which loans are evaluated collectively for impairment and are generally placed on non-accrual when the loan becomes 90 days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment (ninety days or less) provided eventual collection of all amounts due is expected. The impairment

Note 1 Significant Accounting Policies (Continued)

of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on the cash basis.

Allowance for Credit Losses

The allowance for credit losses represents an amount which, in management's judgment, is adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. The adequacy of the allowance for credit losses is determined through careful and continuous review and evaluation of the loan portfolio and involves the balancing of a number of factors to establish a prudent level of allowance. Among the factors considered in evaluating the adequacy of the allowance for credit losses are lending risks associated with growth and entry into new markets, loss allocations for specific nonperforming credits, the level of the allowance to nonperforming loans, historical loss experience, economic conditions, portfolio trends and credit concentrations, changes in the size and character of the loan portfolio, and management's judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. Allowances for collateral impaired loans are generally determined based on collateral values. Loans or any portion thereof deemed uncollectible are charged against the allowance, while recoveries are credited to the allowance. Management adjusts the level of the allowance through the provision for credit losses, which is recorded as a current period operating expense. The allowance for credit losses consists of allocated and unallocated components.

The components of the allowance for credit losses represent an estimation done pursuant to either Statement of Financial Accounting Standards ("SFAS") No. 5, "*Accounting for Contingencies*," or SFAS No. 114, "*Accounting by Creditors for Impairment of a Loan*." Specific allowances are established in cases where management has identified significant conditions or circumstances related to a specific credit that management believes indicate the probability that a loss may be incurred. For potential problem credits for which specific allowance amounts have not been determined, the Company establishes allowances according to the application of credit risk factors. These factors are set by management to reflect its assessment of the relative level of risk inherent in each risk grade. A third component of the allowance computation, termed a nonspecific or environmental factors allowance, is based upon management's evaluation of various environmental conditions that are not directly measured in the determination of either the specific allowance or formula allowance. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of outside review consultants, and management's judgment with respect to various other conditions including credit administration and management and the quality of risk identification systems. Executive management reviews these environmental conditions quarterly, and documents the rationale for all changes.

Management believes that the allowance for credit losses is adequate; however, determination of the allowance is inherently subjective and requires significant estimates. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. Evaluation of the potential effects of these factors on estimated losses involves a high degree of uncertainty, including the strength and timing of economic cycles and concerns over the effects of a prolonged economic downturn in the current cycle. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Bank periodically review the Bank's loan portfolio and allowance for credit losses. Such review may result in recognition of additions to the allowance based on their judgments of information available to them at the time of their examination.

Note 1 Significant Accounting Policies (Continued)

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method for financial reporting purposes. Premises and equipment are depreciated over the useful lives of the assets, which generally range from seven years for furniture, fixtures and equipment, three to five years for computer software and hardware, and ten to forty years for buildings and building improvements. Leasehold improvements are amortized over the terms of the respective leases, which may include renewal options where management has the positive intent to exercise such options, or the estimated useful lives of the improvements, whichever is shorter. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are expensed as incurred. These costs are included as a component of premises and equipment expenses on the Consolidated Statement of Operations.

Marketing and Advertising

Marketing and advertising costs are generally expensed as incurred.

Income Taxes

Income tax expense on the Statements of Operations is based on the results of operations, adjusted for any permanent differences between items of income and deduction recognized for financial reporting purposes differently than for income tax accounting purposes. The Company has adopted the liability method of accounting for income taxes and has recorded deferred tax assets and liabilities determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary differences). Such temporary differences are measured at the enacted rates that are expected to be in effect when these timing differences reverse.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtain the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. In certain cases, the recourse to the Bank to repurchase assets may exist but be deemed immaterial based on the specific facts and circumstances.

Earnings per Common Share

Basic net income per common share is derived by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period measured. Diluted earnings per common share is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period measured including the potential dilutive effects of common stock equivalents. Earnings per common share has been adjusted to give retroactive reflect to all stock splits.

Stock-Based Compensation

Effective January 2006, in accordance with a new accounting standard (SFAS 123R), the Company records as compensation expense an amount equal to the amortization (over the remaining service period) of the fair value (computed at the date of option grant) of any outstanding stock option grants which vest subsequent to December 31, 2005. Refer to Note 11 for a description of stock-based compensation expense for the years ended December 31, 2007 and 2006.

Note 1 Significant Accounting Policies (Continued)

Through December 31, 2005, the Company adopted the disclosure-only provisions of SFAS No. 123, "*Accounting for Stock-Based Compensation*" ("SFAS 123R") and SFAS 148 "*Accounting for Stock-Based Compensation-Transition and Disclosure*" ("SFAS 148"), but applied Accounting Principles Board Opinion No. 25 and related interpretations in accounting for its stock-based compensation plans. No compensation expense related to the stock-based compensation plans was recorded during the year ended December 31, 2005.

New Accounting Pronouncements

In March 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 156, "*Accounting for Servicing of Financial Assets*". This Statement amends SFAS No. 140, "*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*", and requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable, and permits the entities to elect either fair value measurement with changes in fair value reflected in earnings or the amortization and impairment requirements of SFAS No. 140 for subsequent measurement. The subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value eliminates the necessity for entities that manage the risks inherent in servicing assets and servicing liabilities with derivatives to qualify for hedge accounting treatment and eliminates the characterization of declines in fair value as impairments or direct write-downs. This Statement is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company's servicing asset was for the computed value of servicing fees on the sale of the guaranteed portion of SBA loans. Assumptions related to loan term and amortization is made to arrive at the initial recorded value. This asset is subject to impairment testing annually. The Company does not elect to measure this asset at fair value and believes this new accounting standard had no impact on its financial condition or results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes*" ("FIN 48"). FIN 48 clarifies when tax benefits should be recorded in financial statements, requires certain disclosures of uncertain tax matters and indicates how any tax reserves should be classified in a balance sheet. FIN 48 was effective for the Company in the first quarter of fiscal 2007. The Company does not have any uncertain tax positions and this new accounting standard did not have any impact on its financial condition or results of operation.

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*" ("SFAS 157"). This statement provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS 123R and related interpretations and pronouncements that require or permit measurement similar to fair value but are not intended to measure fair value. This pronouncement is effective for fiscal years beginning after November 15, 2007. The Company is evaluating the impact of this new standard, but currently believes that adoption will not have a material impact on its financial position, results of operations, or cash flows.

In September 2006, the SEC's Office of the Chief Accountant and Divisions of Corporation Finance and Investment Management released SAB No. 108, "*Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*" ("SAB 108"), that provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. This pronouncement is effective for fiscal years ending after November 15,

Note 1 Significant Accounting Policies (Continued)

2006. The adoption of SAB 108 had no material impact on the Company's financial position, results of operations, or cash flows.

In February 2007, the FASB issued SFAS No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities"* ("SFAS 159"). SFAS 159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Such election, which may be applied on an instrument by instrument basis, is typically irrevocable once elected. Statement 159 is effective for fiscal years beginning after November 15, 2007, and early application is allowed under certain circumstances. The Company is evaluating the impact of this new standard, but currently believes that adoption will not have a material impact on its financial position, results of operations, or cash flows.

In December 2007, the FASB issued SFAS 141(R), *"Business Combinations (Revised 2007)"* ("*SFAS 141R*"). SFAS 141R replaces SFAS 141, "Business Combinations," and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, *"Accounting for Costs Associated with Exit or Disposal Activities,"* would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, *"Accounting for Contingencies."* SFAS 141R is expected to have a significant impact on the Company's accounting for business combinations closing on or after January 1, 2009.

In December 2007, the FASB issued *SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB Statement No. 51."* ("*SFAS 160*"). SFAS 160 amends Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements," to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 is effective for the Company on January 1, 2009 and is not expected to have a significant impact on the Company's financial statements.

Note 2 Cash and Due from Banks

Regulation D of the Federal Reserve Act requires that banks maintain reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. During 2007, the Bank maintained balances at the Federal Reserve (in addition to vault cash) to meet the reserve requirements as well as balances to partially compensate for services. Additionally, the Bank maintained balances with the Federal Home Loan Bank and five domestic correspondents as compensation for services they provide to the Bank.

Note 3 Investment Securities Available-for-Sale

The amortized cost and estimated fair values of investments available for sale at December 31, 2007 and 2006 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2007				
U. S. Government agency securities	\$ 50,428	\$ 885	\$ 18	\$ 51,295
Mortgage backed securities	29,218	220	135	29,303
Municipal bonds	357		6	351
Federal Reserve and Federal Home Loan Bank stock	4,870			4,870
Other equity investments	1,278	20		1,298
	<u>\$ 86,151</u>	<u>\$ 1,125</u>	<u>\$ 159</u>	<u>\$ 87,117</u>
December 31, 2006				
U. S. Government agency securities	\$ 58,803	\$ 161	\$ 380	\$ 58,584
Mortgage backed securities	27,650	69	386	27,333
Federal Reserve and Federal Home Loan Bank stock	3,829			3,829
Other equity investments	1,278	116		1,394
	<u>\$ 91,560</u>	<u>\$ 346</u>	<u>\$ 766</u>	<u>\$ 91,140</u>

Gross unrealized losses and fair value by length of time that the individual available-for-sale securities have been in a continuous unrealized loss position as of December 31, 2007 are as follows:

	Estimated Fair Value	Less than 12 months	More than 12 months	Gross Unrealized Losses
December 31, 2007				
(dollars in thousands)				
U. S. Government agency securities	\$ 5,982	\$ 6	\$ 18	\$ 18
Mortgage backed securities	11,032	6	129	135
Municipal bonds	351	6		6
	<u>\$ 17,365</u>	<u>\$ 12</u>	<u>\$ 147</u>	<u>\$ 159</u>

All of the bonds reflected in the above table (the debt instruments) are rated AAA. The debt instruments comprise 100% of the gross unrealized losses at December 31, 2007. The debt instruments have a weighted average duration of 2.2 years, low credit risk, and modest loss (approximately .2%) when compared to amortized cost. The gross unrealized gain on other equity investments represents two banking company stocks owned by the Company (parent only), one of which is not traded on an exchange. The estimated fair value is determined by broker quotes. The unrealized losses that exist on the debt securities are the result of market changes in interest rates since the original purchase. These factors coupled with the fact that the Company has both the intent and ability to hold these investments for the period of time sufficient to allow for any anticipated recovery in fair value substantiates that the unrealized losses in the available-for-sale portfolio are temporary. In addition, at December 31, 2007, the Company held \$4.9 million in equity securities in Federal Reserve Bank ("FRB") and Federal Home Loan Bank ("FHLB") stocks which are held for regulatory purposes and are not marketable.

The amortized cost and estimated fair values of investments available-for-sale at December 31, 2007 and 2006 by contractual maturity are shown below. Expected maturities will differ from contractual

Note 3 Investment Securities Available-for-Sale (Continued)

maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	2007		2006	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
(dollars in thousands)				
Amounts maturing:				
One year or less	\$ 7,999	\$ 7,985	\$ 6,305	\$ 6,284
After one year through five years	20,898	21,310	33,484	33,402
After five years through ten years	21,531	22,000	19,014	18,898
Mortgage backed securities	29,218	29,303	27,650	27,333
Municipal bonds maturing after ten years	357	351		
FRB, FHLB and other equity securities	6,148	6,168	5,107	5,223
	<u>\$ 86,151</u>	<u>\$ 87,117</u>	<u>\$ 91,560</u>	<u>\$ 91,140</u>

Realized gains on sales of investment securities were \$49 thousand and realized losses on sales of investment securities were \$43 thousand in 2007. Realized gains on sales of investment securities were \$195 thousand and realized losses on sales of investment securities were \$71 thousand in 2006. Realized gains on sales of investment securities were \$344 thousand and realized losses on sales of investment securities were \$65 thousand in 2005.

Proceeds from sales and calls of investment securities in 2007 were \$29.3 million, in 2006 were \$5.3 million, and in 2005 were \$12.3 million.

At December 31, 2007, \$55.5 million (fair value) of securities were pledged as collateral for certain government deposits, and securities sold under agreement to repurchase. The outstanding balance of no single issuer, except for U.S. Government and U.S. Government agency securities, exceeded ten percent of stockholders' equity at December 31, 2007 or 2006.

Note 4 Loans and Allowance for Credit Losses

The Bank makes loans to customers primarily in the Washington, D.C. metropolitan statistical area and surrounding communities. A substantial portion of the Bank's loan portfolio consists of loans to businesses secured by real estate and other business assets.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Note 4 Loans and Allowance for Credit Losses (Continued)

Loans, net of unamortized net deferred fees, at December 31, 2007 and 2006 are summarized by type as follows:

	<u>2007</u>	<u>2006</u>
	(dollars in thousands)	
Commercial	\$ 149,332	\$ 132,981
Real estate commercial(1)	392,757	349,044
Real estate residential mortgage	2,160	1,523
Construction commercial & residential(1)	110,115	86,524
Home equity	57,515	50,572
Other consumer	4,798	5,129
	<u>716,677</u>	<u>625,773</u>
Total loans	716,677	625,773
Less: Allowance for Credit Losses	(8,037)	(7,373)
	<u>708,640</u>	<u>618,400</u>
Loans net	\$ 708,640	\$ 618,400

(1)

Includes loans for land acquisition and owner occupied properties

Unamortized net deferred fees amounted to \$1.5 million and \$1.1 million at December 31, 2007 and 2006, respectively, of which \$509 thousand and \$512 thousand, respectively at December 31, 2007 and 2006 represented net deferred costs on home equity loans.

As of December 31, 2007 and 2006, the Bank serviced \$25.8 million and \$26.9 million, respectively, of SBA loans participations which are not reflected as loan balances on the on the Consolidated Balance Sheet.

Activity in the allowance for credit losses for the past three years is shown below.

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(dollars in thousands)		
Balance at beginning of year	\$ 7,373	\$ 5,985	\$ 4,240
Provision for credit losses	1,643	1,745	1,843
Loan charge-offs	(1,031)	(389)	(139)
Loan recoveries	52	32	41
	<u>8,037</u>	<u>7,373</u>	<u>5,985</u>
Balance at end of year	\$ 8,037	\$ 7,373	\$ 5,985

Information regarding impaired loans at December 31, 2007 and 2006 is as follows:

	<u>2007</u>	<u>2006</u>
	(dollars in thousands)	
Impaired loans with a valuation allowance	\$ 348	\$ 1,856
Impaired loans without a valuation allowance	4,975	120
	<u>5,323</u>	<u>1,976</u>
Total impaired loans	\$ 5,323	\$ 1,976
	<u>220</u>	<u>678</u>
Allowance for credit losses related to impaired loans	\$ 220	\$ 678
Allowance for credit losses related to other than impaired loans	7,817	6,695

Edgar Filing: EAGLE BANCORP INC - Form 10-K

	<u>2007</u>	<u>2006</u>
Total allowance for credit losses	\$ 8,037	\$ 7,373
Average impaired loans for the year	\$ 2,903	\$ 3,267
Interest income on impaired loans recognized on a cash basis	\$ 75	\$ 125

Note 5 Premises and Equipment

Premises and equipment include the following at December 31:

	<u>2007</u>	<u>2006</u>
	(dollars in thousands)	
Leasehold improvements	\$ 5,738	\$ 5,409
Furniture and equipment	7,507	6,877
Less accumulated depreciation and amortization	(6,544)	(5,332)
	<u> </u>	<u> </u>
Total premises and equipment, net	\$ 6,701	\$ 6,954
	<u> </u>	<u> </u>

The Company leases banking and office space in thirteen locations under non-cancelable lease arrangements accounted for as operating leases. The initial lease periods range from 5 to 10 years and provide for one or more five year renewal options. The leases in some cases provide for scheduled annual rent escalations and require that the Bank (lessee) pay certain operating expenses applicable to the leased space. Rent expense applicable to operating leases amounted to \$2.6 million in 2007, \$1.9 million in 2006, and \$1.7 million in 2005. At December 31, 2007, future minimum lease payments under non-cancelable operating leases having an initial term in excess of one year are as follows. The Company subleases two leased premises and has recorded \$63 thousand as a reduction of rent expense during 2007:

	(dollars in thousands)	
Years ending December 31:		
2008	\$	2,350
2009		2,383
2010		2,468
2011		2,162
2012		1,837
Thereafter		4,979
		<u> </u>
Total minimum lease payments	\$	16,179
		<u> </u>

Note 6 Deposits

The following table provides information regarding the Bank's deposit composition at December 31, of the years indicated and shows the average rate being paid on the interest bearing deposits in December of each year.

	<u>2007</u>		<u>2006</u>		<u>2005</u>	
	<u>Balance</u>	<u>Average Rate</u>	<u>Balance</u>	<u>Average Rate</u>	<u>Balance</u>	<u>Average Rate</u>
	(dollars in thousands)					
Noninterest bearing demand	\$ 142,477		\$ 139,917		\$ 165,103	
Interest bearing transaction	54,090	0.73%	66,596	0.44%	73,666	0.26%
Savings and money market	177,081	2.96%	159,778	3.74%	142,879	2.88%
Time, \$100,000 or more	173,586	4.63%	158,495	4.81%	122,571	3.36%
Other time	83,702	5.66%	103,729	5.20%	64,674	3.38%
	<u> </u>		<u> </u>		<u> </u>	
Total	\$ 630,936		\$ 628,515		\$ 568,893	
	<u> </u>		<u> </u>		<u> </u>	

Note 6 Deposits (Continued)

The remaining maturity of time deposits at December 31, 2007 and 2006 are as follows:

	<u>2007</u>	<u>2006</u>
	(dollars in thousands)	
Three months or less	\$ 82,289	\$ 70,408
More than three months through six months	89,737	91,540
More than six months through twelve months	78,870	91,991
Over twelve months	6,392	8,285
	<u> </u>	<u> </u>
Total	\$ 257,288	\$ 262,224
	<u> </u>	<u> </u>

Interest expense on deposits for the three years ended December 31, 2007, 2006 and 2005 is as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(dollars in thousands)		
Interest bearing transaction	\$ 305	\$ 204	\$ 122
Savings and money market	6,044	5,174	2,504
Time, \$100,000 or more	7,973	6,469	3,259
Other time	5,488	3,756	1,578
	<u> </u>	<u> </u>	<u> </u>
Total	\$ 19,810	\$ 15,603	\$ 7,463
	<u> </u>	<u> </u>	<u> </u>

Note 7 Borrowings

Information relating to short-term and long-term borrowings is as follows for the years ended December 31:

	2007		2006		2005	
	Amount	Rate	Amount	Rate	Amount	Rate
(dollars in thousands)						
Short-term:						
At Year-End:						
Federal funds purchased and securities sold under agreement to repurchase	\$ 76,408	4.45%	\$ 38,064	4.32%	\$ 32,139	2.43%
Federal Home Loan Bank current portion	22,000	4.44%	8,000	5.44		
Total	\$ 98,408		\$ 46,064		\$ 32,139	
Average for the Year:						
Federal funds purchased and securities sold under agreement to repurchase	\$ 44,992	4.19%	\$ 32,968	3.64%	\$ 29,341	1.19%
Federal Home Loan Bank current portion	11,093	5.51%	12,596	5.07%	3,964	4.92%
Maximum Month-end Balance:						
Federal funds purchased and securities sold under agreement to repurchase	\$ 76,408	4.45%	\$ 45,974	5.56%	\$ 43,485	1.75%
Federal Home Loan Bank current portion	30,000	5.44%	18,000	5.02%	6,000	3.74%
Long-term:						
At Year-End:						
Federal Home Loan Bank	\$ 30,000	4.40%	\$ 22,000	5.44%		
Average for the Year:						
Federal Home Loan Bank	\$ 29,033	4.89%	\$ 7,888	5.57%		
Maximum Month-end Balance:						
Federal Home Loan Bank	\$ 45,000	4.57%	\$ 22,000	5.44%		

The Company offers its business customers a repurchase agreement sweep account in which it collateralizes these funds with U. S. Government agency securities segregated in its investment portfolio safekeeping for this purpose. By entering into the agreement, the customer agrees to have the Bank repurchase the designated securities on the business day following the initial transaction in consideration of the payment of interest at the rate prevailing on the day of the transaction.

The Bank has commitments from correspondent banks under which it can purchase up to \$82 million in federal funds on a combination of unsecured and secured basis. Additionally, the Bank can take collateralized advances from the Federal Home Loan Bank of Atlanta ("FHLBA"). Based on collateral at the FHLB at December 31, 2007, the Bank had available borrowings of \$97 million against which it had \$52 million outstanding. The Company has a line of credit approved for \$15 million secured by stock of EagleBank against which it had no borrowings outstanding as of December 31, 2007 and 2006.

Note 8 Income Taxes

Federal and state income tax expense consists of the following for the years ended December 31:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(dollars in thousands)		
Current federal income tax	\$ 4,456	\$ 4,447	\$ 4,748
Current state income tax	681	890	933
	<u>5,137</u>	<u>5,337</u>	<u>5,681</u>
Deferred federal income tax expense (benefit)	(742)	(566)	(1,075)
Deferred state income tax expense (benefit)	(126)	(81)	(237)
	<u>(868)</u>	<u>(647)</u>	<u>(1,312)</u>
Total income tax expense	<u>\$ 4,269</u>	<u>\$ 4,690</u>	<u>\$ 4,369</u>

Temporary differences between the amounts reported in the financial statements and the tax bases of assets and liabilities result in deferred taxes. Deferred tax assets and liabilities, shown as the sum of the appropriate tax effect for each significant type of temporary difference, is presented below for the years ended December 31:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Deferred tax assets:			
Allowance for credit losses	\$ 3,251	\$ 2,831	\$ 2,127
Deferred loan fees and costs	664	489	504
Unrealized loss on securities available for sale		167	390
Share-based compensation	53	34	
Provision for vacation	39		
Deferred rent	106	64	108
	<u>4,113</u>	<u>3,585</u>	<u>3,129</u>
Deferred tax liabilities:			
Unrealized gain on securities available for sale	(382)		
Excess servicing	(95)	(101)	(65)
Premises and equipment	(39)	(206)	(210)
	<u>(516)</u>	<u>(307)</u>	<u>(275)</u>
Net deferred income tax account	<u>\$ 3,597</u>	<u>\$ 3,278</u>	<u>\$ 2,854</u>

Note 8 Income Taxes (Continued)

A reconciliation of the statutory federal income tax rate to the Company's effective income tax rate for the years ended December 31 follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Statutory federal income tax rate	35.00%	35.00%	35.00%
Increase (decrease) due to:			
State income taxes, net of federal income tax benefit	3.02	4.13	3.80
Tax exempt interest and dividend income	(2.70)	(2.15)	(2.10)
Share-based compensation expense (FAS 123R)	0.52	0.67	
Other	(0.17)	(0.77)	(0.03)
Effective tax rates	<u>35.67%</u>	<u>36.88%</u>	<u>36.67%</u>

Note 9 Net Income per Common Share

The calculation of net income per common share for the years ended December 31 was as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
(dollars and shares in thousands, except per share data)			
Basic:			
Net income allocable to common stockholders	\$ 7,701	\$ 8,025	\$ 7,544
Average common shares outstanding	9,574	9,430	9,252
Basic net income per share	<u>\$ 0.80</u>	<u>\$ 0.85</u>	<u>\$ 0.82</u>
Diluted:			
Net income allocable to common stockholders	\$ 7,701	\$ 8,025	\$ 7,544
Average common shares outstanding	9,574	9,430	9,252
Adjustment for common stock equivalents	290	418	573
Average common shares outstanding-diluted	<u>9,864</u>	<u>9,848</u>	<u>9,825</u>
Diluted net income per share	<u>\$ 0.78</u>	<u>\$ 0.81</u>	<u>\$ 0.77</u>

There were 184,482 shares, 11,837 shares and no shares for December 31, 2007, 2006 and 2005, respectively that were excluded from the diluted net income per share computation because their effects were anti-dilutive.

Note 10 Related Party Transactions

Certain directors and executive officers have had loan transactions with the Company. Such loans were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with outsiders. The following table

Note 10 Related Party Transactions (Continued)

summarizes changes in amounts of loans outstanding, both direct and indirect, to those persons during 2007 and 2006.

	<u>2007</u>	<u>2006</u>
	(dollars in thousands)	
Balance at January 1	\$ 12,921	\$ 9,830
Additions	6,011	7,241
Repayments	(729)	(4,150)
	<u> </u>	<u> </u>
Balance at December 31	\$ 18,203	\$ 12,921
	<u> </u>	<u> </u>

The Bank leases certain office space, at a current monthly base rental of \$41,936, excluding certain pass through expenses, from limited liability companies in which a trust for the benefit of an executive officer's children has an 85% interest in one instance and a 51% interest in another.

The Bank has obtained certain deposits through title company clients in which a director of the Bank has a direct interest and for which a broker fee of .50% of average deposits is paid monthly in arrears. During 2007, approximately \$28 thousand in broker fees was paid.

Also, during 2005, the Company sold interests in a limited liability company and certain related beneficial interests in real property owned by that company, which the Company acquired in lieu of foreclosure upon nonperforming loans to a third party borrower, in the amount of approximately \$3.0 million, and related deeds of trust and other collateral, to a limited liability company of which certain members of management and its board of directors have controlling financial interests. The price paid by the acquiring limited liability company was equal to the outstanding balance of the loans plus accrued but unpaid interest and fees to which the Company was entitled under the terms of the loan, and other amounts advanced by the Company, and equaled or exceeded the appraised value of the property, deeds of trust and other collateral. The Company suffered no loss in respect of the transaction or loans, and believes that the terms of the sale to the limited liability company were as favorable to the Company as those which could have been obtained from third parties, and was equal to or exceeded the market value of the property sold. Neither the Company nor the Bank financed the purchase of the property by the limited liability company, or the investment by any person in the limited liability company.

Note 11 Stock-Based Compensation

The Company maintains the 1998 Stock Option Plan ("1998 Plan") and the 2006 Stock Plan ("2006 Plan"). No additional options may be granted under the 1998 Plan. The 1998 Plan provided for the periodic granting of incentive and non-qualifying options to selected key employees and members of the Board. Option awards were made with an exercise price equal to the market price of the Company's shares at the date of grant. The option grants generally vested over a period of one to two years under the 1998 plan.

The Company adopted the 2006 Plan upon approval by shareholders at the 2006 Annual Meeting held on May 25, 2006. The 2006 Plan provides for the issuance of awards of incentive options, non-qualifying options, restricted stock and stock appreciation rights with respect to up to 650,000 shares. The purpose of the 2006 Plan is to advance the interests of the Company by providing directors and selected employees of the Bank, the Company, and their affiliates with the opportunity to acquire shares of common stock, through awards of options, restricted stock and stock appreciation rights.

The Company also maintains the 2004 Employee Stock Purchase Plan (the "ESPP"). Under the ESPP, a total of 253,500 shares of common stock, were reserved for issuance to eligible employees at a price equal to at least 85% of the fair market value of the shares of common stock on the date of grant. Grants each

Note 11 Stock-Based Compensation (Continued)

year expire no later than the last business day of January in the calendar year following the year in which the grant is made. No grants have been made under this plan in 2007.

The Company believes that awards under all plans better align the interests of its employees with those of its shareholders.

In January 2007, the Company awarded options to purchase 68,550 shares under the 2006 Plan which have a five-year term and vest over a three year period.

In January 2007, the Company awarded 20,390 stock appreciation rights to five senior officers under the 2006 Plan to be settled in the Company's common stock following a three-year service vesting period. The Company also granted performance based restricted stock, which vests at the end of a three-year period, subject to the achievement of specified goals. Restricted share units are being recognized as compensation expense over a three-year performance period based on the market value of the shares at the date of grant. This compensation expense is evaluated quarterly as to share awards, based on an assumption of achievement of target goals.

The fair value of each option grant and other equity based award is estimated on the date of grant using the Black-Scholes option pricing model with the assumptions as shown in the table below used for grants during the twelve months ended December 31, 2007, December 31, 2006 and December 31, 2005.

Following is a summary of changes in shares under option. The information excludes restricted stock awards.

	<u>Stock Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Life</u>	<u>Weighted-Average Grant Date Fair Value</u>	<u>Aggregate Intrinsic Value</u>
As of 1/1/2007					
Outstanding	899,797	\$ 8.67		\$ 3.06	
Vested	848,365	8.16		2.91	
Nonvested	51,432	17.17		5.58	
Period activity					
Issued	88,940	\$ 16.91		\$ 3.21	
Exercised	196,251	5.51		2.28	
Forfeited	15,350	16.50		3.51	
Expired	30,192	15.05		3.03	
As of 12/31/2007					
Outstanding	746,944	\$ 10.07	4.19	\$ 3.28	\$ 2,573,889
Vested	624,672	8.60	4.11	3.12	2,573,889
Nonvested	122,272	17.55	4.61	4.09	

Outstanding:

<u>Range of Exercise Prices</u>	<u>Stock Options Outstanding</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Life</u>
\$3.25 \$8.75	318,563	\$ 4.63	2.55
\$8.76 \$13.26	239,247	11.30	6.47
\$13.27 \$17.77	84,138	16.90	3.58
\$17.78 \$19.46	104,996	18.29	4.44

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Range of Exercise Prices	Stock Options Outstanding	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life
	746,944	10.07	4.19

Note 11 Stock-Based Compensation (Continued)

Exercisable:

Range of Exercise Prices	Stock Options Exercisable	Weighted-Average Exercise Price
\$3.25 \$8.75	318,563	\$ 4.63
\$8.76 \$13.26	239,247	11.30
\$13.27 \$17.77	1,273	16.38
\$17.78 \$19.46	65,589	17.92
	624,672	8.60

Assumptions:

	Year Ended 2007	Year Ended 2006	Year Ended 2005
Expected Volatility	18.5% 20.2%	21.4% 24.1%	22.9% 23.5%
Weighted-Average Volatility	19.85%	22.62%	22.94%
Expected Dividends	1.0%	1.0%	2.0%
Expected Term (In years)	3.1 3.5	0.5 3.4	1.0 10.0
Risk-Free Rate	4.78%	4.60%	4.27%
Weighted-Average Fair Value (Grant date)	\$ 3.21	\$ 4.40	\$ 3.80
Total intrinsic value of options exercised for the period January 1, 2007 through December 31, 2007:			\$ 1,596,660
Total fair value of shares vested for the period January 1, 2007 through December 31, 2007			\$ 54,386
Weighted-average period over which nonvested awards are expected to be recognized:			1.47 years

The expected lives are based on the "simplified" method allowed by SAB No. 107, whereby the expected term is equal to the midpoint between the vesting date and the end of the contractual term of the award.

Included in salaries and employee benefits the Company recognized \$45 thousand (\$0.00 per share) and \$223 thousand (\$0.02 per share) in stock-based compensation expense for the quarter and year ended December 31, 2007 as compared to \$75 thousand (\$0.01 per share) and \$345 thousand (\$0.04 per share) for the same period in 2006. As of December 31, 2007 there was \$351 thousand of total unrecognized compensation cost related to non-vested equity awards under the Company's various stock-based compensation plans. The \$351 thousand of unrecognized compensation expense is being amortized over the remaining requisite service (vesting) periods.

Prior to January 1, 2006, stock-based compensation at the Company was disclosed in a footnote, as pro-forma information, in accordance with generally accepted accounting principles as opposed to recognition within the Consolidated Statements of Operations. For the quarter and year ended December 31, 2005, the pro-forma stock-based compensation amounts were \$167 thousand (\$0.02 per share) and \$793 thousand (\$0.08 per share).

If the Company had elected to recognize compensation cost based on fair value at the grant dates for awards under the stock-based compensation plans consistent with the method prescribed by SFAS 123, net

Note 11 Stock-Based Compensation (Continued)

income and earnings per share would have been changed to the pro forma amounts as follows for the year ended December 31.

	<u>2005</u>
	(in thousands)
Net income, as reported	\$ 7,544
Less pro forma stock-based compensation expenses determined under the fair value method, net of related tax effects	(793)
Pro forma net income	\$ 6,751
Net income per share:	
Basic as reported	\$ 0.82
Basic pro forma	\$ 0.73
Diluted as reported	\$ 0.77
Diluted proforma	\$ 0.68

Note 12 Employee Benefit Plans

The Company has a qualified 401(k) Plan which covers all employees who have reached the age of 21 and have completed at least one month of service as defined by the Plan. The Company makes contributions to the Plan based on a matching formula. For years 2007, 2006 and 2005, respectively, the Company recognized \$277 thousand, \$221 thousand, and \$160 thousand in expense. These amounts are included in salaries and employee benefits in the accompanying Consolidated Statements of Operations.

Note 13 Financial Instruments with Off-Balance Sheet Risk

Various commitments to extend credit are made in the normal course of banking business. Letters of credit are also issued for the benefit of customers. These commitments are subject to loan underwriting standards and geographic boundaries consistent with the Company's loans outstanding.

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 generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Loan commitments outstanding and lines and letters of credit at December 31, 2007 and 2006 are as follows:

	<u>2007</u>	<u>2006</u>
	(dollars in thousands)	
Loan commitments	\$ 85,859	\$ 70,396
Unused lines of credit	130,998	145,985
Letters of credit	8,519	4,666

Because most of the Company's business activity is with customers located in the Washington, D.C., metropolitan area, a geographic concentration of credit risk exists within the loan portfolio, and, as such, its performance will be influenced by the economy of the region.

Note 13 Financial Instruments with Off-Balance Sheet Risk (Continued)

The Bank maintains a reserve for unfunded commitments which amounted to \$5 thousand at December 31, 2007 and \$0 thousand at December 31, 2006. These amounts are included in other liabilities. Increases and decreases to the reserve are a component of other expenses.

Note 14 Litigation

In the normal course of its business, the Company is involved in litigation arising from banking, financial, and other activities it conducts. Management, after consultation with legal counsel, does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on the Company's financial condition, operating results or liquidity.

Note 15 Regulatory Matters

The Company and 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 possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank 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 capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank and Company to maintain amounts and ratios (set forth in the table below) of total Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2006 and 2005, that the Company and Bank met all capital adequacy requirements to which they are subject.

The actual capital amounts and ratios for the Company and Bank as of December 31, 2007 and 2006 are presented in the table below:

	Company		Bank		For Capital Adequacy Purposes Ratio	To Be Well Capitalized Under Prompt Corrective Action Provisions* Ratio
	Actual Amount	Ratio	Actual Amount	Ratio		
(dollars in thousands)						
As of December 31, 2007						
Total capital (to risk weighted assets)	\$ 88,619	11.21%	\$ 82,032	10.47%	8.0%	10.0%
Tier 1 capital (to risk weighted assets)	80,582	10.20%	74,025	9.45%	4.0%	6.0%
Tier 1 capital (to average assets)	80,582	9.46%	74,025	8.77%	3.0%	5.0%
As of December 31, 2006						
Total capital (to risk weighted assets)	\$ 80,543	11.91%	\$ 72,182	10.80%	8.0%	10.0%
Tier 1 capital (to risk weighted assets)	73,170	10.82%	64,841	9.70%	4.0%	6.0%
Tier 1 capital (to average assets)	73,170	9.67%	64,841	8.66%	3.0%	5.0%

* Applies to Bank only

Bank and holding company regulations, as well as Maryland law, impose certain restrictions on dividend payments by the Bank, as well as restrict extensions of credit and transfers of assets between the Bank and the Company. At December 31, 2007, the Bank was limited from paying dividends to its parent

Note 15 Regulatory Matters (Continued)

company by the positive amount of retained earnings it held and the requirement to meet certain capital ratios. The Bank did not pay any dividends in 2007 or 2006.

Note 16 Pending Acquisitions

On December 2, 2007 the Company entered into a definitive agreement with Fidelity & Trust Financial Corporation ("Fidelity") and its subsidiary Fidelity & Trust Bank for the Company to acquire Fidelity and for Fidelity & Trust Bank to be merged into EagleBank, with EagleBank being the surviving entity.

The combination is structured as a stock-for-stock exchange, under which Fidelity's shareholders will receive 0.9202 shares of Eagle common stock for each share of Fidelity common stock owned, subject to possible reductions under certain circumstances set forth in the merger agreement. Based upon the closing stock price for Eagle Bancorp Inc. on November 30, 2007, the aggregate value of the transaction would be \$48.8 million, or \$11.51 per share of Fidelity common stock. The value of the transaction at closing may be higher or lower, depending on whether there is any change in the exchange ratio, and the changes in the value of Eagle common stock. Following the completion of the merger, Fidelity & Trust's shareholders will own approximately 28% of Eagle Bancorp's outstanding common stock, assuming no change in the exchange ratio. Two members of the Fidelity & Trust Financial Corporation Board will join the Eagle Bancorp, Inc. Board and four of their directors will join the EagleBank Board.

Eagle Bancorp, Inc. is the holding company for EagleBank which commenced operations in 1998. The bank is headquartered in Bethesda, Maryland, and conducts full service banking services through nine offices, located in Montgomery County, Maryland and Washington, D.C. The Company focuses on building relationships with businesses, professionals and individuals in its marketplace.

Fidelity & Trust Bank was founded and opened in November 2003. The Bank's mission is to provide its customers with customized banking solutions and above all, outstanding customer service.

In late December 2007, EagleBank approved a \$7 million demand line of credit to Fidelity which was secured by the stock of Fidelity & Trust Bank. At December 31, 2007, EagleBank had \$3 million advanced under the line of credit facility which is included in Loans on the Consolidated Balance Sheet. The outstanding line amount bears interest at the prime interest rate less $\frac{1}{4}\%$.

Refer to "Pending Acquisition" section on page 4 and "Business" section on page 61 for further information on this transaction.

Note 17 Fair Value of Financial Instruments

The Company discloses fair value information about financial instruments for which it is practicable to estimate the value, whether or not such financial instruments are recognized on the balance sheet. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by quoted market price, if one exists.

Quoted market prices, if available, are shown as estimates of fair value. Because no quoted market prices exist for a portion of the Company's financial instruments, the fair value of such instruments has been derived based on management's assumptions with respect to future economic conditions, the amount and timing of future cash flows and estimated discount rates. Different assumptions could significantly affect these estimates. Accordingly, the net realizable value could be materially different from the

Note 17 Fair Value of Financial Instruments (Continued)

estimates presented below. In addition, the estimates are only indicative of individual financial instrument values and should not be considered an indication of the fair value of the Company taken as a whole.

The following methods and assumptions were used to estimate the fair value of each category of financial instrument for which it is practicable to estimate value:

Cash and federal funds sold: For cash and due from banks, and federal funds sold the carrying amount approximates fair value.

Interest bearing deposits with banks: Values are estimated by discounting the future cash flows using the current rates at which similar deposits would be earning.

Investment securities: For these instruments, fair values are based on published market or dealer quotes.

Loans held for sale: fair values are at the carrying value (lower of cost or market) since such loans are typically committed to be sold (servicing released) at a profit.

Loans net of unearned interest: For variable rate loans that re-price on a scheduled basis, fair values are based on carrying values. The fair value of the remaining loans are estimated by discounting the estimated future cash flows using the current interest rate at which similar loans would be made to borrowers with similar credit ratings and for the same remaining term.

Other earning assets represent the carrying value of bank owned life insurance, whose fair value is assumed to be the current cash surrender value.

Noninterest bearing deposits: The fair value of these deposits is the amount payable on demand at the reporting date, since generally accepted accounting standards does not permit an assumption of core deposit value.

Interest bearing deposits: The fair value of interest bearing transaction, savings, and money market deposits with no defined maturity is the amount payable on demand at the reporting date, since generally accepted accounting standards does not permit an assumption of core deposit value.

The fair value of certificates of deposit is estimated by discounting the future cash flows using the current rates at which similar deposits would be accepted.

Customer repurchase agreements and other borrowings: The carrying amount for variable rate borrowings approximate the fair values at the reporting date. The fair value of fixed rate Federal Home Loan Bank advances is estimated by computing the discounted value of contractual cash flows payable at current interest rates for obligations with similar remaining terms. The fair value of variable rate Federal Home Loan Bank advances is estimated to be carrying value since these liabilities are based on a spread to a current pricing index.

Off-balance sheet items: Management has reviewed the unfunded portion of commitments to extend credit, as well as standby and other letters of credit, and has determined that the fair value of such instruments is equal to the fee, if any, collected and unamortized for the commitment made.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Note 17 Fair Value of Financial Instruments (Continued)

The estimated fair values of the Company's financial instruments at December 31, 2007 and 2006 are as follows:

	2007		2006	
	Carrying Value	Fair Value	Carrying Value	Fair Value
(dollars in thousands)				
Assets:				
Cash and due from banks	\$ 15,408	\$ 15,408	\$ 19,250	\$ 19,250
Interest bearing deposits with other banks	4,490	4,490	4,855	4,855
Federal funds sold	244	244	9,727	9,727
Investment securities	87,117	87,117	91,140	91,140
Loans held for sale	2,177	2,177	2,157	2,157
Loans	716,677	711,119	625,773	621,350
Other earning assets	11,984	11,984	11,529	11,529
Liabilities:				
Noninterest bearing deposits	142,477	142,477	139,917	139,917
Interest bearing deposits	488,459	488,617	488,598	487,919
Borrowings	128,408	129,411	68,064	68,064

Note 18 Quarterly Results of Operations (unaudited)

The following table reports quarterly results of operations (unaudited) for the years of 2007, 2006 and 2005:

	2007			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
(dollars in thousands except per share data)				
Total interest income	\$ 14,879	\$ 14,355	\$ 14,107	\$ 13,736
Total interest expense	6,036	6,017	5,909	5,767
Net interest income	8,843	8,338	8,198	7,969
Provision for credit losses	883	421	36	303
Net interest income after provision for credit losses	7,960	7,917	8,162	7,666
Noninterest income	1,960	1,032	1,196	998
Noninterest expense	6,468	6,173	6,231	6,049
Net income before income tax expenses	3,452	2,776	3,127	2,615
Income tax expense	1,166	1,021	1,149	933
Net income	\$ 2,286	\$ 1,755	\$ 1,978	\$ 1,682
Income per share				
Basic	\$ 0.24	\$ 0.18	\$ 0.21	\$ 0.18
Diluted	0.23	0.18	0.20	0.17
Dividend declared per share	0.06	0.06	0.06	0.06
2006				
(dollars in thousands except per share data)				
Total interest income	\$ 13,848	\$ 13,033	\$ 12,213	\$ 11,224
Total interest expense	5,466	4,818	4,216	3,380
Net interest income	8,382	8,215	7,997	7,844
Provision for credit losses	327	711	592	115

Edgar Filing: EAGLE BANCORP INC - Form 10-K

2006

Net interest income after provision for credit losses	8,055	7,504	7,405	7,729
Noninterest income	945	1,216	845	840
Noninterest expense	5,743	5,696	5,162	5,223
Net income before income tax expenses	3,257	3,024	3,088	3,346
Income tax expense	1,105	1,124	1,098	1,363
Net income	\$ 2,152	\$ 1,900	\$ 1,990	\$ 1,983
Income per share				
Basic	\$ 0.23	\$ 0.20	\$ 0.21	\$ 0.21
Diluted	0.22	0.19	0.20	0.20
Dividend declared per share	0.06	0.06	0.06	0.05

61

Note 18 Quarterly Results of Operations (unaudited) (Continued)

	2005			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Total interest income	\$ 10,606	\$ 9,758	\$ 8,652	\$ 7,710
Total interest expense	2,824	2,242	1,707	1,235
Net interest income	7,782	7,516	6,945	6,475
Provision for credit losses	532	424	470	417
Net interest income after provision for credit losses	7,250	7,092	6,475	6,058
Noninterest income	833	1,239	887	1,039
Noninterest expense	4,855	4,729	4,901	4,475
Net income before income tax expenses	3,228	3,602	2,461	2,622
Income tax expense	1,163	1,332	905	969
Net income	\$ 2,065	\$ 2,270	\$ 1,556	\$ 1,653
Income per share				
Basic	\$ 0.23	\$ 0.25	\$ 0.17	\$ 0.17
Diluted	0.21	0.23	0.16	0.17
Dividends declared per share	0.06	0.05	0.05	0.06

Earnings per share are calculated on a quarterly basis and may not be additive to the year-to-date amount. Income per share has been adjusted for a 1.3 for 1 stock split in the form of a 30% stock dividend paid in July 2006.

Note 19 Parent Company Financial Information

Condensed financial information for Eagle Bancorp, Inc. (Parent Company only) is as follows:

CONDENSED BALANCE SHEETS
December 31, 2007 and 2006

	2007	2006
	(dollars in thousands)	
ASSETS:		
Cash	\$ 77	\$ 170
Cash equivalents	3,830	4,377
Investment securities available for sale	1,298	1,394
Investment in subsidiaries	76,456	66,478
Other assets	213	559
TOTAL ASSETS	\$ 81,874	\$ 72,978
LIABILITIES:		
Accounts payable	\$ 72	\$ 16
Other liabilities	636	46
Total liabilities	708	62
STOCKHOLDERS' EQUITY:		
Common stock	97	95
Additional paid in capital	52,290	50,278
Retained earnings	28,195	22,796

Edgar Filing: EAGLE BANCORP INC - Form 10-K

	<u>2007</u>	<u>2006</u>
Accumulated other comprehensive (loss)	584	(253)
Total stockholders' equity	81,166	72,916
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 81,874	\$ 72,978

Note 19 Parent Company Financial Information (Continued)

CONDENSED STATEMENTS OF INCOME
For the Years Ended December 31, 2007, 2006 and 2005

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(dollars in thousands)		
INCOME:			
Other interest and dividends	\$ 301	\$ 446	\$ 475
Income from subordinate financing	1,252		
Gain on sale of investment securities		195	332
	<u>1,553</u>	<u>641</u>	<u>807</u>
EXPENSES:			
Legal and professional	118	101	89
Directors' fees	91	82	38
Other	405	369	264
	<u>614</u>	<u>552</u>	<u>391</u>
Provision for Credit Losses		(19)	5
		<u>5</u>	<u>5</u>
INCOME BEFORE INCOME TAX EXPENSE (BENEFIT) AND EQUITY IN UNDISTRIBUTED INCOME OF SUBSIDIARIES	939	108	411
INCOME TAX (BENEFIT) EXPENSE	341	(8)	123
	<u>598</u>	<u>116</u>	<u>288</u>
INCOME BEFORE EQUITY IN UNDISTRIBUTED INCOME OF SUBSIDIARIES	598	116	288
EQUITY IN UNDISTRIBUTED INCOME OF SUBSIDIARIES	7,103	7,909	7,256
	<u>7,701</u>	<u>8,025</u>	<u>7,544</u>
NET INCOME	\$ 7,701	\$ 8,025	\$ 7,544

Note 19 Parent Company Financial Information (Continued)

CONDENSED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2007, 2006 and 2005

	<u>2007</u>	<u>2006</u>	<u>2005</u>
(dollars in thousands)			
CASH FLOWS FROM OPERATING ACTIVITIES:			
NET INCOME	\$ 7,701	\$ 8,025	\$ 7,544
Adjustments to reconcile net income to net cash used in operating activities:			
Provision for credit losses		(19)	5
Gain on sale of investment securities		(195)	(332)
Equity in undistributed income of subsidiary	(7,103)	(7,909)	(7,256)
Excess tax benefit on stock-based compensation	(19)	(431)	(468)
Decrease (increase) in other assets	346	20	(542)
Increase in other liabilities	703	396	506
	<u>1,628</u>	<u>(113)</u>	<u>(543)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net decrease in loans		1,716	1,027
Purchase of available for sale investment securities		(101)	(178)
Proceeds from maturity and sales of available for sale investment securities		484	3,340
Investment in subsidiary (net)	(1,756)	(1,771)	(5,000)
	<u>(1,756)</u>	<u>328</u>	<u>(811)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issuance of common stock	1,771	936	1,130
Dividends paid	(2,302)	(2,152)	(1,998)
Excess tax benefit on stock-based compensation	19	431	468
	<u>(512)</u>	<u>(785)</u>	<u>(400)</u>
NET DECREASE IN CASH:	(640)	(570)	(1,754)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	4,547	5,117	6,871
	<u>4,547</u>	<u>5,117</u>	<u>6,871</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 3,907	\$ 4,547	\$ 5,117
	<u>\$ 3,907</u>	<u>\$ 4,547</u>	<u>\$ 5,117</u>

BUSINESS

Eagle Bancorp, Inc. (the "Company") was incorporated under the laws of the State of Maryland on October 28, 1997, to serve as the bank holding company for a newly formed Maryland chartered commercial bank. The Company was formed by a group of local businessmen and professionals with significant prior experience in community banking in the Company's market area, together with an experienced community bank senior management team. EagleBank, a Maryland chartered commercial bank which is a member of the Federal Reserve System, the Company's principal operating subsidiary, was chartered as a bank and commenced banking operations on July 20, 1998. The Bank operates from six Montgomery County offices located in Gaithersburg, Rockville (2), Bethesda, Silver Spring and Chevy Chase, Maryland and three locations in the District of Columbia, at 20th and K Streets, NW, south of Dupont Circle and near McPherson Square. The Bank actively seeks additional banking offices consistent with its strategic plan, although there can be no assurance that the Bank will establish any additional offices, or that any branch office will prove to be profitable. In July 2006, the Company formed Eagle Commercial Ventures, LLC as a direct subsidiary to provide subordinated financing for the acquisition, development and construction of real estate projects, the primary financing for which would be provided by EagleBank.

The Bank operates as a community bank alternative to the super-regional financial institutions which dominate EagleBank's primary market area. The cornerstone of the Bank's philosophy is to provide superior, personalized service to its customers. The Bank focuses on relationship banking, providing each customer with a number of services, familiarizing itself with, and addressing itself to, customer needs in a proactive, personalized fashion. Management believes that the market segments which the Bank targets, small to medium sized for profit and not for profit businesses and the consumer base of the Bank's market area demand the convenience and personal service that a smaller, independent financial institution such as the Bank can offer. It is these themes of convenience and personal service that form the basis for the Bank's business development strategies.

Pending Acquisition. On December 2, 2007, the Company and Woodmont Holdings, Inc., a newly formed, wholly owned subsidiary of the Company ("Holdings"), entered into entered into an Agreement and Plan of Merger (the "Agreement") with Fidelity & Trust and Fidelity & Trust Bank, Fidelity's wholly owned subsidiary bank ("F&T Bank"), pursuant to which Fidelity will be merged into Holdings, with Holdings surviving the merger, followed by the merger of Holdings with and into the Company with the Company surviving (the "Merger"). In connection with the Agreement, F&T Bank and the Bank entered into a Bank Merger Agreement pursuant to which F&T Bank will be merged into the Bank, with the Bank surviving.

At the effective time, and as a result of, the Merger, each outstanding share of Fidelity's common stock will be converted into the right to receive 0.9202 shares of the Company's common stock (the "Conversion Ratio"), subject to reduction in accordance with the Agreement. The Conversion Ratio would be subject to reduction based upon reductions to Fidelity's adjusted September 30, 2007 book value of \$7.50 per share for: (i) operating losses of Fidelity & Trust Mortgage Company, F&T Bank's wholly owned subsidiary ("F&T Mortgage"), expenses incurred in connection with the winding down of F&T Mortgage, and deficiencies on inter-company payments or liabilities due from F&T Mortgage to F&T Bank; (ii) losses on the sale of loans held for sale, (iii) net charge-offs, (iv) increases to the allowance for loan losses necessary to conform to Eagle's policies for such items, to the extent such increases are in the aggregate in excess of \$750,000; (v) increases to valuation adjustments for loans held for sale as determined in accordance with the Agreement; (vi) reserves for identified litigation as determined pursuant to the Agreement, in the case of (ii) (vi) to the extent such the aggregate of such amounts exceeds the amount reserved or provided for such items at September 30, 2007, and other agreed upon adjustments, provided that an adjustment will be made only to the extent the aggregate amount of the adjustment exceeds \$400,000. The revised Conversion Ratio would be determined by dividing the adjusted pro forma September 30, 2007 book value per share by \$8.15. Options to purchase shares of Fidelity

Edgar Filing: EAGLE BANCORP INC - Form 10-K

common stock which are outstanding at the effective time will be "rolled over" into options to purchase Company common stock.

At the effective time, Robert P. Pincus and one other member of the board of directors of Fidelity designated by Fidelity will join the Company's Board of Directors, and Mr. Pincus and three other members of the board of directors of F&T Bank designated by F&T Bank will join the Bank Board of Directors. Following the Effective Time, Ronald D. Paul, President and Chief Executive Officer of the Company and Chairman and Chief Executive Officer of the Bank, will also become Chairman of the Company and Mr. Pincus will become Vice Chairman of the Company and the Bank.

Consummation of the Merger is subject to various customary conditions which include: the approval by Fidelity's shareholders of the Merger; the approval by the Company's shareholders of the issuance of in excess of 20% of the shares of Company common stock as required by the rules of NASDAQ; no legal impediment to the Merger; the receipt of required regulatory approvals, including the expiration or termination of the waiting period under, the Bank Holding Company Act of 1956, the Bank Merger Act, and any other applicable law, and absence of certain material adverse changes or events. The Merger Agreement contains certain termination rights for both the Company and Fidelity, and further provides that, upon termination of the Agreement under specified circumstances, Fidelity may be required to pay the Company a termination fee of \$2,000,000.

As a result of the conversion of shares of Fidelity common stock, the Company expects that it will issue a maximum of approximately 3.87 million shares of its common stock, excluding the impact of approximately 507 thousand options to purchase Fidelity common stock which will be assumed by the Company, and assuming there is no change in the Conversion Ratio.

There can be no assurance that the acquisition and the Agreement will be consummated as planned, or that the acquisition will prove beneficial to the Company and its shareholders.

Description of Services. The Bank offers full commercial banking services to its business and professional clients as well as complete consumer banking services to individuals living and/or working in the service area. The Bank emphasizes providing commercial banking services to sole proprietorships, small and medium-sized businesses, partnerships, corporations, non-profit organizations and associations, and investors living and working in and near the Bank's primary service area. A full range of retail banking services are offered to accommodate the individual needs of both corporate customers as well as the community the Bank serves. The Bank also offers a remote deposit service which allows clients to facilitate and expedite deposit transactions through the use of electronic scanning devices.

The Bank has developed a loan portfolio consisting primarily of traditional business and real estate secured loans with a substantial portion being variable rates, where the cash flow of the borrower/borrower's business is the principal source of debt service with a secondary emphasis on collateral. Real estate loans are made generally for commercial purposes and are structured using both variable rates and fixed rates and renegotiable rates which adjust in three to five years, with maturities of five to ten years. Consumer loans are made on the traditional installment basis for a variety of purposes. The Bank has developed significant expertise and commitment as a Small Business Administration ("SBA") lender and is one of the largest community bank SBA lenders, in dollar volume, in the Washington metropolitan area.

All new business customers are screened to determine, in advance, their credit qualifications and history. This practice permits the Bank to respond quickly to credit requests as they arise.

In general, the Bank offers the following credit services:

- 1) Commercial loans for business purposes including working capital, equipment purchases, real estate, lines of credit, and government contract financing. Asset based lending and accounts receivable financing are available on a selective basis.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

- 2) Real estate loans, including construction loan financing, for business and investment purposes.
- 3) Lease financing for business equipment.
- 4) Traditional general purpose consumer installment loans including automobile and personal loans. In addition, the Bank offers personal lines of credit.
- 5) Credit card services are offered through an outside vendor.

The direct lending activities in which the Bank engages carry the risk that the borrowers will be unable to perform on their obligations. As such, interest rate policies of the Federal Reserve Board and general economic conditions, nationally and in the Bank's primary market area have a significant impact on the Bank's and the Company's results of operations. To the extent that economic conditions deteriorate, business and individual borrowers may be less able to meet their obligations to the Bank in full, in a timely manner, resulting in decreased earnings or losses to the Bank. To the extent the Bank makes fixed rate loans, general increases in interest rates will tend to reduce the Bank's spread as the interest rates the Bank must pay for deposits may increase while interest income may be unchanged. Economic conditions and interest rates may also adversely affect the value of property pledged as security for loans.

The Bank's goals are to mitigate risks in the event of unforeseen threats to the loan portfolio as a result of economic downturn or other negative influences. Plans for mitigating inherent risks in managing loan assets include; carefully enforcing loan policies and procedures, evaluating each borrower's business plan during the underwriting process and throughout the loan term, identifying and monitoring primary and alternative sources for repayment, and obtaining collateral to mitigate economic loss in the event of liquidation. Specific loan reserves are established based upon credit and/or collateral risks on an individual loan basis. A risk rating system is employed to proactively estimate loss exposure and provide a measuring system for setting general and specific reserve allocations.

Under certain circumstances, the Bank attempts to further mitigate commercial term loan losses by using loan guarantee programs offered by the SBA. The Bank has been approved for the SBA's preferred lender program ("PLP"). SBA loans made using PLP by the Bank are not subject to SBA pre-approval.

The composition of the Bank's loan portfolio is heavily commercial real estate, both owner occupied and investment real estate. At December 31, 2007, real estate commercial, real estate residential and real estate construction combined represented 70% of the loan portfolio. These loans are underwritten to mitigate lending risks typical of this type of loan such as drops in real estate values, changes in cash flow and general economic conditions. The Bank typically requires a loan to value of 80% or less and minimum cash flow debt service coverage of 1.15 to 1.0. Personal guarantees are generally required, although, may be limited. In making real estate commercial mortgage loans, the Bank generally requires that interest rates adjust not less frequently than five years.

The Bank is also an active traditional commercial lender providing loans for a variety of purposes, including cash flow, equipment and account receivable financing. This loan category represents approximately 21% of the loan portfolio at December 31, 2007 and is generally variable or adjustable rate. Commercial loans meet reasonable underwriting standards, including appropriate collateral, and cash flow necessary to support debt service. Personal guarantees are generally required, although, may be limited. SBA loans represent 8% of the commercial loan category of loans. In originating SBA loans, the Company assumes the risk of non-payment on the uninsured portion of the credit. The Company generally sells the insured portion of the loan generating noninterest income from the gains on sale, as well as servicing income on the portion participated. SBA loans are subject to the same cash flow analyses as other commercial loans. SBA loans and the Section 7A lending program in particular, are subject to a maximum loan size established by the SBA.

Approximately 8% of the loan portfolio at December 31, 2007 consists of home equity loans and lines of credit and other consumer loans. These credits, while making up a smaller portion of the loan portfolio,

demand the same emphasis on underwriting and credit evaluation as other types of loans advanced by the Bank.

At January 31, 2008, the Bank had a legal lending limit of \$12.3 million. Due to legal lending limitations, the Bank has participated portions of credits to other area banks. The Bank has also participated loans to the Company until such time as the Bank could accommodate the participation within its legal limit or the loan could be participated to another lender. No loan participations to the Company are outstanding at December 31, 2007. The ability of the Company to assist the Bank with these credits has expanded the flexibility and service the Bank can offer its customers.

From time to time the Company may make loans for its own portfolio or through its higher risk loan affiliate, Eagle Commercial Ventures, LLC ("ECV"), which operating agreement permits lending only to real estate projects where the Company's directors or lending officers have significant expertise. Such loans, which may be made to accommodate borrowers at the Bank level, may have higher risk characteristics than loans made by the Bank, such as lower priority security interests and or higher loan to value ratios. The Company seeks interest rates and overall financial compensation commensurate with the risks involved in the particular loan. One such higher risk loan transaction was fully paid at the end of 2006 and provided significant additional interest/revenue to the Company in 2007. Refer to the discussion under "Managements Discussion and Analysis Non-interest Income" and "Loan Portfolio", for further information on the Company's and ECV's higher risk lending activities.

The risk of nonpayment (or deferred payment) of loans is inherent in commercial banking. The Bank's marketing focus on small to medium-sized businesses may result in the assumption by the Bank of certain lending risks that are different from those attendant to loans to larger companies. The management and director committees of the Bank carefully evaluate all loan applications and attempt to minimize credit risk exposure by use of extensive loan application data, and approval and monitoring procedures; however, there can be no assurance that such procedures can significantly reduce such lending risks.

The Bank originates residential mortgage loans, as a correspondent lender. The loans are registered with one of the designated investors at the time of application with intentions of immediate sale to that investor on a servicing released basis. This activity is managed by utilizing the available pricing, programs and lock periods which produce market gains on the sale of the loan. Activity in the residential mortgage loan market is highly sensitive to changes in interest rates and product availability. While the Bank does have delegated underwriting authority from most of its investors, it also employs the services of a contract underwriter which has been approved by the designated investors. Because the loans are originated with investor guidelines, designated automated underwriting and product specific requirements as part of the loan application, the loans sold have a limited recourse provision. Most contracts with investors contain recourse periods that may vary from 90 days up to one year. In general, the Company may be required to repurchase a previously sold mortgage loan or indemnify the investor if there is major non-compliance with defined loan origination or documentation standards, including fraud, negligence or material misstatement in the loan documents. In addition, the Company may have an obligation to repurchase a loan if the mortgagor has defaulted early in the loan term. The potential default repurchase period is approximately twelve months after sale of the loan to the investor. To date, no such repurchases have been made. Mortgages subject to recourse are collateralized by single-family residential properties, have loan-to-value ratios of 80% or less, or have private mortgage insurance. In certain instances, the Bank may provide equity loans (second position financing) in combination with residential first mortgage lending for purchase money and refinancing purposes. The Bank also brokers loan transactions with two investors, where the Bank refers, but does not underwrite and does not close the loan transaction. In this situation the Bank has no recourse liability for the loan.

Deposit services include business and personal checking accounts, NOW accounts, tiered savings and money market account and time deposits with varying maturity structures and customer options. A complete individual retirement account ("IRA") program is available. In cooperation with Goldman Sachs

Asset Management, the bank has introduced Eagle Asset Management Account, a check writing cash management account that sweeps funds to one of several off-balance sheet investment accounts managed by Goldman Sachs.

Other services include cash management services such as electronic banking, business sweep accounts, lock box, and account reconciliation services, credit card depository, professional settlement services, including title insurance placement, safety deposit boxes and Automated Clearing House ("ACH") origination. After-hours depositories and ATM service are also available.

The Bank and Company maintain portfolios of short term investments and investment securities consisting primarily of U.S. Agency bonds and mortgage backed securities, but which also contains required equity investments related to Bank regulatory rules and membership in the Federal Reserve System and the FHLB, and municipal bonds. The Company's securities portfolio also consists of equity investments in the form of preferred and common stocks. The Company holds limited equity investments in local banking companies. These portfolios provide the following objectives: liquidity management, additional income to the Company and Bank in the form of interest and gain on sale opportunities, collateral to facilitate borrowing arrangements and assistance with meeting interest rate risk management objectives.

The Company and Bank have formalized an asset and liability management process and have a standing Committee ("ALCO") consisting both of outside and inside directors. The ALCO operates under established policies and practices, which are updated and re-approved annually. A typical Committee meeting includes discussion of current economic conditions and strategies, including interest rate trends and volumes positions, the current balance sheet and earnings position, cash flow estimates, liquidity positions and funding alternatives, interest rate risk position (quarterly), capital position, review of the investment portfolio of the Bank and the Company, and the approval of investment transactions. The current Investment Policy limits the Bank to investments of high quality, U.S. Treasury securities, U.S. Government agency securities and high grade municipal securities. High risk investments, derivatives and non traditional investments are prohibited, although the Bank does have investments in structured notes, which are permitted under the investment policy. Investment maturities are generally limited to ten to fifteen years, except as specifically approved by the ALCO, and mortgage backed pass through securities with average lives generally not to exceed eight years.

The Bank's customer base has benefited from the extensive business and personal contacts of its Directors and Executive Officers. To introduce new customers to the Bank, enhanced reliance is expected on proactively designed officer calling programs, newly created advisory board structures and enhanced referral programs.

RISK FACTORS

An investment in our common stock involves various risks. The following is a summary of certain risks identified by us as affecting our business. You should carefully consider the risk factors listed below, as well as other cautionary statements made in this Annual Report on Form 10-K, and risks and uncertainties which we may identify in our other reports and documents filed with the Securities and Exchange Commission or other public announcements. These risk factors may cause our future earnings to be lower or our financial condition to be less favorable than we expect. In addition, other risks of which we are not aware, which relate to the banking and financial services industries in general, or which we do not believe are material, may cause earnings to be lower, or hurt our future financial condition. You should read this section together with the other information in this Annual Report on Form 10-K.

Our results of operations, financial condition and the value of our shares may be adversely affected if we are not able to maintain our historical growth rate.

Since opening for business in 1998, our asset level has increased rapidly, including a 9% increase in 2007. Over the past five years (2003-2007), our net income has increased at an average annual rate of 24%, with a decline in net income of 4% in 2007. We cannot assure you that we will continue to achieve comparable results in future years. As our asset size and earnings increase, it may become more difficult to achieve high rates of increase in assets and earnings. Additionally, it may become more difficult to achieve continued improvements in our expense levels and efficiency ratio. We may not be able to maintain the relatively low levels of nonperforming assets that we have experienced. Declines in the rate of growth of income or assets or deposits, and increases in operating expenses or nonperforming assets may have an adverse impact on the value of the common stock.

We may not be able to successfully manage continued growth.

We intend to seek further growth in the level of our assets and deposits and the number of our branches, both within our existing footprint and possibly to expand our footprint in the Maryland suburbs of Washington D.C., and in the District of Columbia. We cannot be certain as to our ability to manage increased levels of assets and liabilities, and an expanded branch system, without increased expenses and higher levels of nonperforming assets. We may be required to make additional investments in equipment and personnel to manage higher asset levels and loan balances and a larger branch network, which may adversely impact earnings, shareholder returns and our efficiency ratio. Increases in operating expenses or nonperforming assets may have an adverse impact on the value of our common stock.

We may fail to realize the cost savings we estimate for the proposed acquisition of Fidelity merger, and may not be successful in integrating the operations of Fidelity.

The success of the proposed acquisition of Fidelity & Trust, if consummated as expected, will depend, in part, on our ability to realize the estimated cost savings and revenue enhancements from combining the businesses of the Company and Fidelity. While we believe that these cost savings and revenue enhancement estimates are achievable, it is possible that the potential cost savings and revenue enhancements could turn out to be more difficult to achieve than we anticipated. Our estimates also depend on our ability to combine the businesses of the Company and Fidelity in a manner that permits those cost savings and revenue enhancements to be realized. Our ability to realize increases in revenue will depend, in part, on our ability to retain customers and employees, and to capitalize on existing relationships for the provision of additional products and services. If our estimates turn out to be incorrect or we are not able to successfully combine our two companies, the anticipated cost savings and increased revenues may not be realized fully or at all, or may take longer to realize than expected. It is possible that the integration process could result in the loss of key employees, the disruption of each company's ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with clients and employees or to achieve the anticipated benefits of the merger. As with any combination of banking institutions, there also may be disruptions that cause us to lose customers or cause customers to withdraw their deposits from our banks. There can be no assurance that customers will readily accept changes to their banking arrangements after the merger.

The costs and effects related to the legacy mortgage operations of F&T Mortgage may be greater or more expensive than we anticipated, which could have an adverse impact on the results of operations, shareholder returns and financial condition of Eagle following the merger, and on the market price for Eagle common stock.

Until September 2007, F&T Mortgage, a wholly owned subsidiary of F&T Bank, originated mortgages for sale into the secondary market. While many of these mortgages were conforming mortgages sold to the quasi-governmental mortgage agencies, or guaranteed under Federal programs, others were

nonconforming or "exotic" loans, including no documentation and low documentation loans, negative amortization and subprime loans. Under the terms of the agreements under which substantially all of these loans were sold, F&T Mortgage, and in certain cases, F&T Bank is required to repurchase loans which are paid off early, default early, or which breached the representations and warranties in the loan sale agreements. While we expect that any request to repurchase loans for early payment default or early payoff will have been presented prior to the effective time of the merger, or will be time-barred, there is no express limit on the time frame in which a representations and warranties claim can be made. Although F&T Mortgage has had extremely limited requests to repurchase loans for representations and warranties breaches, it is not possible to predict with accuracy the extent to which it may receive such requests in the future. Although Fidelity and the Company believe that there are significant arguments that F&T Bank, and the Bank, would not be legally obligated to effect most such repurchases on behalf of F&T Mortgage, there can be no assurance that such arguments will be successful, or that the expense and effort of defending against, or settling litigation relating to, such requests will not be much greater than anticipated.

Our concentrations of loans may create a greater risk of loan defaults and losses.

A substantial portion of our loans are secured by real estate in the Washington, D.C. metropolitan area, and substantially all of our loans are to borrowers in that area. We also have a significant amount of real estate construction loans and land related loans for residential and commercial developments. At December 31, 2007, 80% of our loans were secured by real estate, primarily commercial real estate. Management believes that the commercial real estate concentration risk is mitigated by diversification among the types and characteristics of real estate collateral properties, sound underwriting practices, and ongoing portfolio monitoring and market analysis. Of these loans, \$100 million, or 17% were construction and land development loans. An additional 18% of portfolio loans were commercial and industrial loans which are not secured by real estate. These categories of loans generally have a higher risk of default than other types of loans, such as single family residential mortgage loans. The repayments of these loans often depends on the successful operation of a business or the sale or development of the underlying property and as a result, are more likely to be adversely affected by adverse conditions in the real estate market or the economy in general. While we believe that our loan portfolio is well diversified in terms of borrowers and industries, these concentrations expose us to the risk that adverse developments in the real estate market, or in the general economic conditions in the Washington, D.C. metropolitan area, could increase the levels of nonperforming loans and charge-offs, and reduce loan demand. In that event, we would likely experience lower earnings or losses. Additionally, if, for any reason, economic conditions in our market area deteriorate, or there is significant volatility or weakness in the economy or any significant sector of the area's economy, our ability to develop our business relationships may be diminished, the quality and collectibility of our loans may be adversely affected, the value of collateral may decline and loan demand may be reduced. Under guidance from the banking agencies, we may be required to maintain higher levels of capital than we would otherwise be expected to maintain, and to employ greater risk management efforts, as a result of our real estate concentrations.

Commercial, commercial real estate and construction loans tend to have larger balances than single family mortgages loans and other consumer loans. Because the loan portfolio contains a significant number of commercial and commercial real estate and construction loans with relatively large balances, the deterioration of one or a few of these loans may cause a significant increase in nonperforming assets. An increase in nonperforming loans could result in: a loss of earnings from these loans, an increase in the provision for loan losses, or an increase in loan charge-offs, which could have an adverse impact on our results of operations and financial condition.

Further, under guidance adopted by the federal banking regulators, banks which have concentrations in construction, land development or commercial real estate loans (other than loans for majority owner occupied properties) would be expected to maintain higher levels of risk management and, potentially, higher levels of capital. It is possible that we may be required to maintain higher levels of capital than we would otherwise be expected to maintain as a result of our levels of construction, development and commercial real estate loans, which may require us to obtain additional capital sooner than we would otherwise seek it, which may reduce shareholder returns.

Additionally, through ECV, we provide subordinated financing for the acquisition, development and construction of real estate or other projects, the primary financing for which would be provided by EagleBank. These subordinated financings and the business of ECV will generally entail a higher risk profile (including lower priority and higher loan to value ratios) than loans made by the Bank. A portion of the amount which the Company expects to receive for such loans will be payments based on the success, sale or completion of the underlying project, and as such the income of the Company may be more volatile from period to period, based on the status of such projects. There can be no assurance that the Company will be able to successfully operate or manage the business of providing higher loan to value financing.

Our financial condition and results of operations would be adversely affected if our allowance for loan losses is not sufficient to absorb actual losses or if we are required to increase our allowance for loan losses.

Historically, we have enjoyed a relatively low level of nonperforming assets and net charge-offs, both in absolute dollars, as a percentage of loans and as compared to many of our peer institutions. As a result of this historical experience, we have incurred a relatively lower loan loss provision expense, which has positively impacted our earnings. However, experience in the banking industry indicates that a portion of our loans will become delinquent, that some of our loans may only be partially repaid or may never be repaid and we may experience other losses for reasons beyond our control. Despite our underwriting criteria and historical experience, we may be particularly susceptible to losses due to: (1) the geographic concentration of our loans, (2) the concentration of higher risk loans, such as commercial real estate, construction and commercial and industrial loans, and (3) the relative lack of seasoning of certain of our loans. As a result, there can be no assurance that we will be able to maintain our relatively low levels of nonperforming assets and charge-offs. Although we believe that our allowance for loan losses is maintained at a level adequate to absorb any inherent losses in our loan portfolio, these estimates of loan losses are necessarily subjective and their accuracy depends on the outcome of future events. If we need to make significant and unanticipated increases in our loss allowance in the future, our results of operations and financial condition would be materially adversely affected at that time.

While we strive to carefully monitor credit quality and to identify loans that may become nonperforming, at any time there are loans included in the portfolio that will result in losses, but that have not been identified as nonperforming or potential problem loans. We cannot be sure that we will be able to identify deteriorating loans before they become nonperforming assets, or that we will be able to limit losses on those loans that are identified. As a result, future additions to the allowance may be necessary.

Lack of seasoning of our loan portfolio may increase the risk of credit defaults in the future.

Due to our rapid growth, a substantial amount of the loans in our portfolio and of our lending relationships are of relatively recent origin. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process referred to as "seasoning." A portfolio of older loans will usually behave more predictably than a newer portfolio. As a result, because a large portion of our loan portfolio is relatively new, the current level of delinquencies and defaults may not be representative of the level that will prevail when the portfolio becomes more seasoned, which may be higher than current levels. If delinquencies and defaults increase, we may be required to increase our provision for loan losses, which would adversely affect our results of operations and financial condition.

Our continued growth depends on our ability to meet minimum regulatory capital levels. Growth and shareholder returns may be adversely affected if sources of capital are not available to help us meet them.

As we grow, we will have to maintain our regulatory capital levels at or above the required minimum levels. If earnings do not meet our current estimates, if we incur unanticipated losses or expenses, or if we grow faster than expected, we may need to obtain additional capital sooner than expected, through borrowing, additional issuances of debt or equity securities, or otherwise. If we do not have continued

access to sufficient capital, we may be required to reduce or eliminate the dividend paid on our common stock, reduce our level of assets or reduce our rate of growth in order to maintain regulatory compliance. Under those circumstances net income and the rate of growth of net income may be adversely affected. Additional issuances of equity securities could have a dilutive effect on existing shareholders.

There is no assurance that we will be able to successfully compete with others for business.

The Washington, D.C. metropolitan statistical area in which we operate is considered highly attractive from an economic and demographic viewpoint, and is a highly competitive banking market. We compete for loans, deposits, and investment dollars with numerous regional and national banks, online divisions of out-of-market banks, and other community banking institutions, as well as other kinds of financial institutions and enterprises, such as securities firms, insurance companies, savings associations, credit unions, mortgage brokers, and private lenders. Many competitors have substantially greater resources than us, and operate under less stringent regulatory environments. The differences in resources and regulations may make it harder for us to compete profitably, reduce the rates that we can earn on loans and investments, increase the rates we must offer on deposits and other funds, and adversely affect our overall financial condition and earnings.

Trading in the common stock has been light. As a result, shareholders may not be able to quickly and easily sell their common stock.

Although our common stock is listed for trading on the NASDAQ Capital Market and a number of brokers offer to make a market in the common stock on a regular basis, trading volume to date has been limited, averaging approximately 5,000 shares per day over the year ended December 31, 2007, and there can be no assurance that a more active and liquid market for the common stock will develop or can be maintained. As a result, shareholders may find it difficult to sell a significant number of shares at the prevailing market price.

Directors and officers of Eagle Bancorp own approximately 17% of the outstanding common stock. As a result of their combined ownership, they could make it more difficult to obtain approval for some matters submitted to shareholder vote, including acquisitions of the Company. The results of the vote may be contrary to the desires or interests of the public shareholders.

Directors and executive officers and their affiliates own approximately 17% of the outstanding shares of common stock, and combined with directors of EagleBank, are believed to own approximately 26% of the currently outstanding common stock, excluding in each case shares which may be acquired upon the exercise of options. By voting against a proposal submitted to shareholders, the directors and officers, as a group, may be able to make approval more difficult for proposals requiring the vote of shareholders, such as some mergers, share exchanges, asset sales, and amendments to the Articles of Incorporation.

Changes in interest rates and other factors beyond our control could have an adverse impact on our financial performance and results.

Our operating income and net income depend to a great extent on our net interest margin, i.e., the difference between the interest yields we receive on loans, securities and other interest bearing assets and the interest rates we pay on interest bearing deposits and other liabilities. Net interest margin is affected by changes in market interest rates, because different types of assets and liabilities may react differently, and at different times, to market interest rate changes. When interest bearing liabilities mature or reprice more quickly than interest earning assets in a period, an increase in market rates of interest could reduce net interest income. Similarly, when interest earning assets mature or reprice more quickly than interest bearing liabilities, falling interest rates could reduce net interest income. These rates are highly sensitive to many factors beyond our control, including competition, general economic conditions and monetary and

fiscal policies of various governmental and regulatory authorities, including the Board of Governors of the Federal Reserve System.

We attempt to manage our risk from changes in market interest rates by adjusting the rates, maturity, repricing, and balances of the different types of interest earning assets and interest bearing liabilities, but interest rate risk management techniques are not exact. As a result, a rapid increase or decrease in interest rates could have an adverse effect on our net interest margin and results of operations. At December 31, 2007, our cumulative net liability sensitive twelve month gap position was 6% of total assets and as such we expect that the decline in projected net interest income over a twelve month period resulting from a 100 basis point increase in rates would be approximately 2%. The results of our interest rate sensitivity simulation model depend upon a number of assumptions which may not prove to be accurate. There can be no assurance that we will be able to successfully manage our interest rate risk. Increases in market rates and adverse changes in the local residential real estate market, the general economy or consumer confidence would likely have a significant adverse impact on our noninterest income, as a result of reduced demand for residential mortgage loans, which we make on a pre-sold basis.

Adverse changes in the real estate market in our market area could also have an adverse affect on our cost of funds and net interest margin, as we have a large amount of noninterest bearing deposits related to real estate sales and development. While we expect that we would be able to replace the liquidity provided by these deposits, the replacement funds would likely be more costly, negatively impacting earnings.

Additionally, changes in applicable law, if enacted, including those that would permit banks to pay interest on checking and demand deposit accounts established by businesses, could have a significant negative effect on net interest income, net income, net interest margin, return on assets and return on equity. At December 31, 2007, 23% of our deposits were noninterest bearing demand deposits.

The requirement that the Bank commence paying deposit insurance premiums in 2007 also adversely affected our results of operations. Prior to 2007, we have never been required to pay any deposit insurance premiums. Future payments of deposit insurance premiums may have an adverse effect on our earnings. This change or other legislative or regulatory developments could have a significant negative effect on our net interest income, net income, net interest margin, return on assets and return on equity.

Substantial regulatory limitations on changes of control and anti-takeover provisions of Maryland law may make it more difficult for you to receive a change in control premium.

With certain limited exceptions, federal regulations prohibit a person or company or a group of persons deemed to be "acting in concert" from, directly or indirectly, acquiring more than 10% (5% if the acquiror is a bank holding company) of any class of our voting stock or obtaining the ability to control in any manner the election of a majority of our directors or otherwise direct the management or policies of our company without prior notice or application to and the approval of the Federal Reserve. There are comparable prior approval requirements for changes in control under Maryland law. Also, Maryland corporate law contains several provisions that may make it more difficult for a third party to acquire control of the Company without the approval of our Board of Directors, and may make it more difficult or expensive for a third party to acquire a majority of our outstanding common stock.

EMPLOYEES

At December 31, 2007 the Bank employed 173 persons on a full time basis, six of which are executive officers of the Bank. None of the Bank's employees are represented by any collective bargaining group, and the Bank believes that its employee relations are good. The Bank provides a benefit program which includes health and dental insurance, a 401k plan, life and long term disability insurance. Additionally, the Company maintains a stock-based compensation plan for employees of the Bank who meet certain eligibility requirements.

MARKET AREA AND COMPETITION

The Bank's main office and the headquarters of the Company and the Bank is located at 7815 Woodmont Avenue, Bethesda, Maryland 20814. The Bank has five additional Maryland offices, located at 110 North Washington Street, Rockville; 8665 Georgia Avenue, Silver Spring; 11921 Rockville Pike, Rockville; 9600 Blackwood Road, Gaithersburg; and 15 Wisconsin Circle, Chevy Chase. There are three offices in Washington DC, located at 20th and K Streets, NW; 1228 Connecticut Ave, NW; and 1425 K Street, NW.

The primary service area of the Bank is the Washington D.C. metropolitan statistical area. The Washington, D.C. metropolitan statistical area attracts a substantial federal workforce, as well as supporting a variety of support industries such as attorneys, lobbyists, government contractors, real estate developers and investors, non-profit organizations, tourism and consultants.

Montgomery County, Maryland with a total population of approximately 962,000 and occupying an area of about 500 square miles is located roughly 30 miles southwest of Baltimore and is a diverse and healthy segment of Maryland's economy. Montgomery County is a thriving business center and is Maryland's most populous jurisdiction. While the State of Maryland boasts a demographic profile superior to the U.S. economy at large, the economy in and around Montgomery County is among the very best in Maryland. According to data from the Maryland National Capital Parks and Planning Commission, the number of jobs in the County have increased about 1-2% per year in the recent past to approximately 509,000, (2006) with the public sector contributing about 25% of this total (2005 census update). According to the 2007 Economic Forces Report for Montgomery County, job growth slowed due mainly to declines in consumer related industries such as hotels and merchandise stores. The unemployment rate in Montgomery County is among the lowest in the state at 2.5% (December 2007). A very educated population has contributed to favorable median household income of \$91,641 (2006) and average single family new and used home sales prices of \$485,000 (2006). According to the 2005 census update, approximately 64% of the County's residents hold college or advanced degrees, placing Montgomery County among the most educated in the nation. The area boasts a diverse business climate with a strong federal government presence, a substantial technology sector, a housing construction and renovation sector, and a legal, financial services and professional services sector. According to the 2007 Economic Forces Report for Montgomery County. The market for commercial office space improved from March 2006 to March 2007, increasing to 26.9 million square feet from 26.6 million, and an overall Class A office vacancy rates was about 6.62%. There was about 1.6 million square feet of office space under construction in mid 2006 for delivery in 2007. Developers and leasing agents have proposed 890,000 square feet of space for completion in 2008. Class A office rents in Montgomery County have been much less volatile than in some other markets in the region. The county is also an incubator for firms engaged in bio-technology and the area is attracting significant venture capital. Transportation congestion remains the biggest threat to future economic development and the quality of life in the area.

Washington D.C. in addition to being the seat of the Federal government is a vibrant city with a well educated, diverse population. Over the last eight years the total population has grown to approximately 580,000. Median household income, at \$49,549, is above the national median level. The growth of residents in the city is due partially to improvements in the city's services and also to the many housing options available, ranging from grand old apartment buildings to Federal era town homes to the most modern condominiums. Over the last few years the housing market has grown to over 275,000 units. While the Federal government and its employees are a major factor in the economy, over 100 million square feet of commercial office space support a dynamic business community of more than 20,000 companies. These include law and accounting firms, trade and professional associations, information technology companies, international financial institutions, health and education organizations and research and management companies. Employment in the city has been growing at an annual rate of 5.4% and currently stands at 775,000. This is a well educated and highly paid work force. Over 51% of the jobs in the city are in managerial or professional positions. The Federal Government provides just about 25% of the

employment and there is another 18% in professional services firms. Other large employers include the many local universities and hospitals. Another significant factor in the economy is the leisure and hospitality industry.

Montgomery County is home to many major federal and private sector research and development and regulatory agencies, including the National Institute of Standards and Technology, the National Institutes of Health, National Oceanic and Atmospheric Administration, Naval Research and Development Center, Naval Surface Warfare Center, Nuclear Regulatory Commission, the Food and Drug Administration and the National Naval Medical Center in Bethesda.

Deregulation of financial institutions and holding company acquisitions of banks across state lines has resulted in widespread, fundamental changes in the financial services industry. This transformation, although occurring nationwide, is particularly intense in the greater Washington, D.C. metropolitan area because of the changes in the area's economic base in recent years and changing state laws authorizing interstate mergers and acquisitions of banks, and the interstate establishment or acquisition of branches.

Throughout the Washington D.C. metropolitan area, competition is exceptionally keen from large banking institutions headquartered outside of Maryland. In addition, the Bank competes with other community banks, savings and loan associations, credit unions, mortgage companies, finance companies and others providing financial services. Among the advantages that many of these large institutions have over the Bank are their abilities to finance extensive advertising campaigns, maintain extensive branch networks and technology investments, and to directly offer certain services, such as international banking and trust services, which are not offered directly by the Bank. Further, the greater capitalization of the larger institutions allows for substantially higher lending limits than the Bank. Certain of these competitors have other advantages, such as tax exemption in the case of credit unions, and lesser regulation in the case of mortgage companies and finance companies.

REGULATION

The following summaries of statutes and regulations affecting bank holding companies do not purport to be complete discussions of all aspects of such statutes and regulations and are qualified in their entirety by reference to the full text thereof.

The Company. The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, (the "Act") and is subject to supervision by the Federal Reserve Board. As a bank holding company, the Company is required to file with the Federal Reserve Board an annual report and such other additional information as the Federal Reserve Board may require pursuant to the Act. The Federal Reserve Board may also make examinations of the Company and each of its subsidiaries.

The Act requires approval of the Federal Reserve Board for, among other things, the acquisition by a proposed bank holding company of control of more than five percent (5%) of the voting shares, or substantially all the assets, of any bank or the merger or consolidation by a bank holding company with another bank holding company. The Act also generally permits the acquisition by a bank holding company of control or substantially all the assets of any bank located in a state other than the home state of the bank holding company, except where the bank has not been in existence for the minimum period of time required by state law; but if the bank is at least 5 years old, the Federal Reserve Board may approve the acquisition.

With certain limited exceptions, a bank holding company is prohibited from acquiring control of any voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in any activity other than banking or managing or controlling banks or furnishing services to or performing service for its authorized subsidiaries. A bank holding company may, however, engage in or acquire an interest in, a company that engages in activities which the Federal Reserve Board has determined by order or regulation to be so closely related to banking or managing or controlling banks as

to be properly incident thereto. In making such a determination, the Federal Reserve Board is required to consider whether the performance of such activities can reasonably be expected to produce benefits to the public, such as convenience, increased competition or gains in efficiency, which outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The Federal Reserve Board is also empowered to differentiate between activities commenced *de novo* and activities commenced by the acquisition, in whole or in part, of a going concern. Some of the activities that the Federal Reserve Board has determined by regulation to be closely related to banking include making or servicing loans, performing certain data processing services, acting as a fiduciary or investment or financial advisor, and making investments in corporations or projects designed primarily to promote community welfare.

Subsidiary banks of a bank holding company are subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to the bank holding company or any of its subsidiaries, or investments in the stock or other securities thereof, and on the taking of such stock or securities as collateral for loans to any borrower. Further, a holding company and any subsidiary bank are prohibited from engaging in certain tie-in arrangements in connection with the extension of credit. A subsidiary bank may not extend credit, lease or sell property, or furnish any services, or fix or vary the consideration for any of the foregoing on the condition that: (i) the customer obtain or provide some additional credit, property or services from or to such bank other than a loan, discount, deposit or trust service; (ii) the customer obtain or provide some additional credit, property or service from or to the Company or any other subsidiary of the Company; or (iii) the customer not obtain some other credit, property or service from competitors, except for reasonable requirements to assure the soundness of credit extended.

Effective on March 11, 2000, the Gramm Leach-Bliley Act of 1999 (the "GLB Act") allows a bank holding company or other company to certify status as a financial holding company, which allows such company to engage in activities that are financial in nature, that are incidental to such activities, or are complementary to such activities. The GLB Act enumerates certain activities that are deemed financial in nature, such as underwriting insurance or acting as an insurance principal, agent or broker, underwriting, dealing in or making markets in securities, and engaging in merchant banking under certain restrictions. It also authorizes the Federal Reserve Board to determine by regulation what other activities are financial in nature, or incidental or complementary thereto. The GLB Act allows a wider array of companies to own banks, which could result in companies with resources substantially in excess of the Company's entering into competition with the Company and the Bank.

The Bank. The Bank, as a Maryland chartered commercial bank which is a member of the Federal Reserve System (a "state member bank") and whose accounts will be insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (the "FDIC") up to the maximum legal limits of the FDIC, is subject to regulation, supervision and regular examination by the Maryland Department of Financial Institutions and the Federal Reserve Board. The regulations of these various agencies govern most aspects of the Bank's business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowing, dividends and location and number of branch offices.

The laws and regulations governing the Bank generally have been promulgated to protect depositors and the deposit insurance funds, and not for the purpose of protecting stockholders.

Competition among commercial banks, savings and loan associations, and credit unions has increased following enactment of legislation which greatly expanded the ability of banks and bank holding companies to engage in interstate banking or acquisition activities. As a result of federal and state legislation, banks in the Washington D.C./Maryland/Virginia area can, subject to limited restrictions, acquire or merge with a bank in another of the jurisdictions, and can branch *de novo* in any of the jurisdictions. Additionally, legislation has been proposed which may result in non-banking companies being authorized to own banks, which could result in companies with resources substantially in excess of the Company's entering into competition with the Company and the Bank.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Banking is a business which depends on interest rate differentials. In general, the differences between the interest paid by a bank on its deposits and its other borrowings and the interest received by a bank on loans extended to its customers and securities held in its investment portfolio constitute the major portion of the bank's earnings. Thus, the earnings and growth of the Bank will be subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve Board, which regulates the supply of money through various means including open market dealings in United States government securities. The nature and timing of changes in such policies and their impact on the Bank cannot be predicted.

Branching and Interstate Banking. The federal banking agencies are authorized to approve interstate bank merger transactions without regard to whether such transaction is prohibited by the law of any state, unless the home state of one of the banks has opted out of the interstate bank merger provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Riegle-Neal Act") by adopting a law after the date of enactment of the Riegle-Neal Act and prior to June 1, 1997 which applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate acquisitions of branches are permitted only if the law of the state in which the branch is located permits such acquisitions. Such interstate bank mergers and branch acquisitions are also subject to the nationwide and statewide insured deposit concentration limitations described in the Riegle-Neal Act.

The Riegle-Neal Act authorizes the federal banking agencies to approve interstate branching *de novo* by national and state banks in states which specifically allow for such branching. The District of Columbia, Maryland and Virginia have all enacted laws which permit interstate acquisitions of banks and bank branches and permit out-of-state banks to establish *de novo* branches.

The GLB Act made substantial changes in the historic restrictions on non-bank activities of bank holding companies, and allows affiliations between types of companies that were previously prohibited. The GLB Act also allows banks to engage in a wider array of non banking activities through "financial subsidiaries."

USA Patriot Act. Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act, commonly referred to as the "USA Patriot Act" or the "Patriot Act", financial institutions are subject to prohibitions against specified financial transactions and account relationships, as well as enhanced due diligence standards intended to detect, and prevent, the use of the United States financial system for money laundering and terrorist financing activities. The Patriot Act requires financial institutions, including banks, to establish anti-money laundering programs, including employee training and independent audit requirements, meet minimum standards specified by the act, follow minimum standards for customer identification and maintenance of customer identification records, and regularly compare customer lists against lists of suspected terrorists, terrorist organizations and money launderers. The costs or other effects of the compliance burdens imposed by the Patriot Act or future anti-terrorist, homeland security or anti-money laundering legislation or regulation cannot be predicted with certainty.

Capital Adequacy Guidelines. The Federal Reserve Board and the FDIC have adopted risk based capital adequacy guidelines pursuant to which they assess the adequacy of capital in examining and supervising banks and bank holding companies and in analyzing bank regulatory applications. Risk-based capital requirements determine the adequacy of capital based on the risk inherent in various classes of assets and off-balance sheet items.

State member banks are expected to meet a minimum ratio of total qualifying capital (the sum of core capital (Tier 1) and supplementary capital (Tier 2) to risk weighted assets of 8%. At least half of this amount (4%) should be in the form of core capital.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

Tier 1 Capital generally consists of the sum of common stockholders' equity and perpetual preferred stock (subject in the case of the latter to limitations on the kind and amount of such stock which may be included as Tier 1 Capital), less goodwill, without adjustment for changes in the market value of securities classified as "available-for-sale" in accordance with FAS 115, together with a limited amount of other qualifying interests, including trust preferred securities. Tier 2 Capital consists of the following: hybrid capital instruments; perpetual preferred stock which is not otherwise eligible to be included as Tier 1 Capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan losses and excess restricted core capital elements. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics, with the categories ranging from 0% (requiring no risk-based capital) for assets such as cash, to 100% for the bulk of assets which are typically held by a bank holding company, including certain multi-family residential and commercial real estate loans, commercial business loans and consumer loans. Residential first mortgage loans on one to four family residential real estate and certain seasoned multi-family residential real estate loans, which are not 90 days or more past-due or nonperforming and which have been made in accordance with prudent underwriting standards are assigned a 50% level in the risk-weighting system, as are certain privately-issued mortgage-backed securities representing indirect ownership of such loans. Off-balance sheet items also are adjusted to take into account certain risk characteristics. Under guidance adopted by the federal banking regulators, banks which have concentrations in construction, land development or commercial real estate loans (other than loans for majority owner occupied properties) would be expected to maintain higher levels of risk management and, potentially, higher levels of capital.

In addition to the risk-based capital requirements, the Federal Reserve Board has established a minimum 3.0% Leverage Capital Ratio (Tier 1 Capital to total adjusted assets) requirement for the most highly-rated banks, with an additional cushion of at least 100 to 200 basis points for all other banks, which effectively increases the minimum Leverage Capital Ratio for such other banks to 4.0% 5.0% or more. The highest-rated banks are those that are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, those which are considered a strong banking organization. A bank having less than the minimum Leverage Capital Ratio requirement shall, within 60 days of the date as of which it fails to comply with such requirement, submit a reasonable plan describing the means and timing by which the bank shall achieve its minimum Leverage Capital Ratio requirement. A bank which fails to file such plan is deemed to be operating in an unsafe and unsound manner, and could subject the bank to a cease-and-desist order. Any insured depository institution with a Leverage Capital Ratio that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the Federal Deposit Insurance Act (the "FDIA") and is subject to potential termination of deposit insurance. However, such an institution will not be subject to an enforcement proceeding solely on account of its capital ratios, if it has entered into and is in compliance with a written agreement to increase its Leverage Capital Ratio and to take such other action as may be necessary for the institution to be operated in a safe and sound manner. The capital regulations also provide, among other things, for the issuance of a capital directive, which is a final order issued to a bank that fails to maintain minimum capital or to restore its capital to the minimum capital requirement within a specified time period. Such directive is enforceable in the same manner as a final cease-and-desist order.

Prompt Corrective Action. Under Section 38 of the FDIA, each federal banking agency is required to implement a system of prompt corrective action for institutions which it regulates. The federal banking agencies have promulgated substantially similar regulations to implement the system of prompt corrective action established by Section 38 of the FDIA. Under the regulations, a bank shall be deemed to be: (i) "well capitalized" if it has a Total Risk Based Capital Ratio of 10.0% or more, a Tier 1 Risk Based Capital Ratio of 6.0% or more, a Leverage Capital Ratio of 5.0% or more and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has a Total Risk Based Capital Ratio of 8.0% or more, a Tier 1 Risk Based Capital Ratio of 4.0% or more and a Tier 1 Leverage Capital Ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of "well capitalized;"

(iii) "undercapitalized" if it has a Total Risk Based Capital Ratio that is less than 8.0%, a Tier 1 Risk based Capital Ratio that is less than 4.0% or a Leverage Capital Ratio that is less than 4.0% (3.0% under certain circumstances); (iv) "significantly undercapitalized" if it has a Total Risk Based Capital Ratio that is less than 6.0%, a Tier 1 Risk Based Capital Ratio that is less than 3.0% or a Leverage Capital Ratio that is less than 3.0%; and (v) "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

An institution generally must file a written capital restoration plan which meets specified requirements with an appropriate federal banking agency within 45 days of the date the institution receives notice or is deemed to have notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. A federal banking agency must provide the institution with written notice of approval or disapproval within 60 days after receiving a capital restoration plan, subject to extensions by the applicable agency.

An institution which is required to submit a capital restoration plan must concurrently submit a performance guaranty by each company that controls the institution. Such guaranty shall be limited to the lesser of (i) an amount equal to 5.0% of the institution's total assets at the time the institution was notified or deemed to have notice that it was undercapitalized or (ii) the amount necessary at such time to restore the relevant capital measures of the institution to the levels required for the institution to be classified as adequately capitalized. Such a guaranty shall expire after the federal banking agency notifies the institution that it has remained adequately capitalized for each of four consecutive calendar quarters. An institution which fails to submit a written capital restoration plan within the requisite period, including any required performance guaranty, or fails in any material respect to implement a capital restoration plan, shall be subject to the restrictions in Section 38 of the FDIA which are applicable to significantly undercapitalized institutions.

A "critically undercapitalized institution" is to be placed in conservatorship or receivership within 90 days unless the FDIC formally determines that forbearance from such action would better protect the deposit insurance fund. Unless the FDIC or other appropriate federal banking regulatory agency makes specific further findings and certifies that the institution is viable and is not expected to fail, an institution that remains critically undercapitalized on average during the fourth calendar quarter after the date it becomes critically undercapitalized must be placed in receivership. The general rule is that the FDIC will be appointed as receiver within 90 days after a bank becomes critically undercapitalized unless extremely good cause is shown and an extension is agreed to by the federal regulators. In general, good cause is defined as capital which has been raised and is imminently available for infusion into the Bank except for certain technical requirements which may delay the infusion for a period of time beyond the 90 day time period.

Immediately upon becoming undercapitalized, an institution shall become subject to the provisions of Section 38 of the FDIA, which (i) restrict payment of capital distributions and management fees; (ii) require that the appropriate federal banking agency monitor the condition of the institution and its efforts to restore its capital; (iii) require submission of a capital restoration plan; (iv) restrict the growth of the institution's assets; and (v) require prior approval of certain expansion proposals. The appropriate federal banking agency for an undercapitalized institution also may take any number of discretionary supervisory actions if the agency determines that any of these actions is necessary to resolve the problems of the institution at the least possible long-term cost to the deposit insurance fund, subject in certain cases to specified procedures. These discretionary supervisory actions include: requiring the institution to raise additional capital; restricting transactions with affiliates; requiring divestiture of the institution or the sale of the institution to a willing purchaser; and any other supervisory action that the agency deems appropriate. These and additional mandatory and permissive supervisory actions may be taken with respect to significantly undercapitalized and critically undercapitalized institutions.

Additionally, under Section 11(c)(5) of the FDIA, a conservator or receiver may be appointed for an institution where: (i) an institution's obligations exceed its assets; (ii) there is substantial dissipation of the

institution's assets or earnings as a result of any violation of law or any unsafe or unsound practice; (iii) the institution is in an unsafe or unsound condition; (iv) there is a willful violation of a cease-and-desist order; (v) the institution is unable to pay its obligations in the ordinary course of business; (vi) losses or threatened losses deplete all or substantially all of an institution's capital, and there is no reasonable prospect of becoming "adequately capitalized" without assistance; (vii) there is any violation of law or unsafe or unsound practice or condition that is likely to cause insolvency or substantial dissipation of assets or earnings, weaken the institution's condition, or otherwise seriously prejudice the interests of depositors or the insurance fund; (viii) an institution ceases to be insured; (ix) the institution is undercapitalized and has no reasonable prospect that it will become adequately capitalized, fails to become adequately capitalized when required to do so, or fails to submit or materially implement a capital restoration plan; or (x) the institution is critically undercapitalized or otherwise has substantially insufficient capital.

Regulatory Enforcement Authority. Federal banking law grants substantial enforcement powers to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

Deposit Insurance Premiums. Pursuant to deposit insurance reform legislation, in December 2006, the FDIC adopted a new risk based assessment system for determining deposit insurance premiums. Under the new requirements, four risk categories (I-IV), each subject to different premium rates, are established, based upon an institution's status as well capitalized, adequately capitalized or undercapitalized, and the institution's supervisory rating. Under the new rules, all insured depository institutions will pay deposit insurance premiums, currently ranging between 5 and 7 basis points on an institution's assessment base for institutions in risk category I (well capitalized institutions perceived as posing the least risk to the insurance fund), and 10, 28 and 43 basis points for institutions in risk categories II, III, and IV. The level of rates is subject to periodic adjustment by the FDIC. The Bank's current assessment level is risk category I.

PROPERTIES

The main banking office and the executive offices for the Bank and the Company are located at 7815 Woodmont Avenue, Bethesda, Maryland, in a 12,000 square foot, two story masonry structure (plus lower level), with parking. The Company leases the building under a five year lease option which expires in March 2013. The Silver Spring office of the Bank is located at 8665 Georgia Avenue, Silver Spring, Maryland and consists of 3,635 square feet. The property is currently occupied under a lease, which expires in June 2016. The Rockville office is located at 110 North Washington Street, Rockville, Maryland, and consists of 2,000 square feet. The property is currently occupied under a five year lease option which expires in June 2013. The Shady Grove office is located at 9600 Blackwell Road, Suite 200, Rockville, Maryland, and consists of 2,326 square feet. The property is currently occupied under a ten year lease, which expires in January 2012. The Rockville Pike office is located at 11921 Rockville Pike, Rockville, Maryland and consists of 2,183 square feet. The property is currently occupied under a five year lease, which expires in December 2008. The K Street office of the Bank is located at 2001 K Street N.W., Washington, D.C. and consists of 4,154 square feet. The property is currently occupied under a ten year lease, which expires in January 2011. The Dupont Circle office is located at 1228 Connecticut Avenue, N.W., Washington, D.C. and consists of 2,784 square feet. The property is currently occupied under a ten year lease, which expires in May 2014. The McPherson Square office is located at 1425 K Street, N.W., Washington, D.C. and consists of 5,199 square feet. The property is currently occupied under a ten year lease, which expires in January 2015. The Chevy Chase office is located at 15 Wisconsin Circle, Chevy Chase, Maryland and consists of 4,276 square feet. The property is currently occupied under a ten year lease, which expires in May 2016.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

In January 2002, the Company occupied an office facility in Bethesda at 7768 Woodmont Avenue under a ten year lease which expires in December 2011. Additional contiguous space at this location has been leased and was incorporated into the existing lease. The current space consists of 7,906 square feet. This facility is currently under three sub-lease arrangements which run concurrent to the lease expiration in December 2011.

In June 2003, the Company occupied an additional office facility in Bethesda at 7819 Norfolk Avenue, consisting of 2,820 square feet under a ten year lease with options which expires in May 2013. This facility is currently under a sub-lease arrangement which runs concurrent to the lease expiration in May 2013.

In April 2004, the Company occupied an operations center at 11961 Tech Road, Silver Spring, Maryland, consisting of 9,172 square feet. The property is currently occupied under a seven year lease with options which expires in December 2020. In February 2008, the Company leased additional space amounting to approximately 2,000 square feet at this facility with terms that are co-terminus with the existing lease.

In November 2006, the Company entered into a lease for additional office space at 7830 Old Georgetown Road, Bethesda, Maryland 20814 consisting of 14,778 square feet under a ten year lease which expires in December 2016. The Company completed a fit-up of the space for lending and administrative personnel and commenced occupancy in February 2007.

DISCLOSURE CONTROLS AND PROCEDURES

The Company's management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated, as of the last day of the period covered by this report, the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Eagle Bancorp, Inc. (the "Company") is responsible for the preparation, integrity and fair presentation of the financial statements included in this Annual Report. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reflect management's judgments and estimates concerning the effects of events and transactions that are accounted for or disclosed.

Management is also responsible for establishing and maintaining effective internal control over financial reporting. The Company's internal control over financial reporting includes those policies and procedures that pertain to the Company's ability to record, process, summarize and report reliable financial data. The internal control system contains monitoring mechanisms, and appropriate actions taken to correct identified deficiencies. Management believes that internal controls over financial reporting, which are subject to scrutiny by management and the Company's internal auditors, support the integrity and reliability of the financial statements. Management recognizes that there are inherent limitations in the effectiveness of any internal control system, including the possibility of human error and the circumvention or overriding of internal controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. In addition, because of changes in conditions and circumstances, the effectiveness of internal control over financial reporting may vary over time. The Audit Committee of the Board of Directors (the "Committee"), is comprised entirely of outside directors who are independent of management. The Committee is responsible for the appointment and compensation of the independent auditors and makes decisions regarding the appointment or removal of members of the internal audit function. The Committee meets periodically with management, the independent auditors, and the internal auditors to ensure that they are carrying out their responsibilities. The Committee is also responsible for performing an oversight role by reviewing and monitoring the financial, accounting, and auditing procedures of the Company in addition to reviewing the Company's financial reports. The independent auditors and the internal auditors have full and unlimited access to the Audit Committee, with or without the presence of management, to discuss the adequacy of internal control over financial reporting, and any other matters which they believe should be brought to the attention of the Audit Committee.

Management assessed the Company's system of internal control over financial reporting as of December 31, 2007. This assessment was conducted based on the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission "Internal Control Integrated Framework." Based on this assessment, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2006. Management's assessment concluded that there were no material weaknesses within the Company's internal control structure.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15 under the Securities Act of 1934) during the quarter ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The 2007 financial statements have been audited by the independent registered public accounting firm of Stegman & Company ("Stegman"). Personnel from Stegman were given unrestricted access to all financial records and related data, including minutes of all meetings of the Board of Directors and committees thereof. Management believes that all representations made to the independent auditors were valid and appropriate. The resulting report from Stegman accompanies the financial statements. Stegman has also issued a report on the effectiveness of internal control over financial reporting. That report has also been made a part of this Annual Report.

/s/ Ronald D. Paul
President and Chief
Executive Officer of
the Company

/s/ Michael T. Flynn
Executive Vice President
and Chief Operating
Officer of the Company
and President of the Bank
(Washington D.C.
Division)

/s/ Susan G. Riel
Executive Vice President
and Chief Operating
Officer of the Bank

/s/ James H. Langmead
Senior Vice President and
Chief Financial Officer of
the Company

**REPORT OF STEGMAN & COMPANY
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders
of Eagle Bancorp, Inc.

We have audited Eagle Bancorp Inc.'s (the "Company") internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* (issued by the Committee of Sponsoring Organizations of the Treadway Commission as the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Management Report on Internal Control over Financial Reporting". Our responsibility is to express an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Eagle Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2007, and 2006 and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007 of Eagle Bancorp, Inc. and our report dated March 10, 2008 expressed an unqualified opinion on those consolidated financial statements.

/s/ STEGMAN & COMPANY

Baltimore, Maryland
March 10, 2008

Exhibits and Financial Statement Schedules

The following financial statements are included in this report

Report of Independent Registered Public Accounting Firm
 Consolidated Balance Sheets at December 31, 2007 and 2006
 Consolidated Statements of Operations for the years ended December 31, 2007,
 2006 and 2005
 Consolidated Statements of Cash Flows for the years ended December 31, 2007,
 2006 and 2005
 Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2007, 2006 and 2005
 Notes to the Consolidated Financial Statements

All financial statement schedules have been omitted as the required information is either inapplicable or included in the consolidated financial statements or related notes.

Exhibit No.	Description of Exhibit
2.1	Agreement and Plan of Merger, dated as of December 2, 2007 by and among Eagle Bancorp, Inc., Woodmont Holdings, Inc., Fidelity & Trust Financial Corporation and Fidelity & Trust Bank(1)
3.1	Certificate of Incorporation of the Company, as amended(2)
3.2	Bylaws of the Company(3)
10.1	1998 Stock Option Plan(4)
10.2	Employment Agreement between Michael Flynn and the Company(5)
10.3	Employment Agreement between Thomas D. Murphy and the Bank(5)
10.4	Employment Agreement between Ronald D. Paul and the Company(6)
10.5	Director's Fee Agreement between Leonard L. Abel and the Company(6)
10.6	Employment Agreement between Susan G. Riel and the Bank(5)
10.7	Employment Agreement between Martha Foulon-Tonat and the Bank(5)
10.9	Employment Agreement between James H. Langmead and the Bank(5)
10.10	Employee Stock Purchase Plan(7)
10.11	2006 Stock Plan(8)
11	Statement Regarding Computation of Per Share Income Please refer to Note 9 to the consolidated financial statements for the year ended December 31, 2006.
21	Subsidiaries of the Registrant
23	Consent of Stegman & Company
31.1	Certification of Ronald D. Paul
31.2	Certification of Susan G. Riel
31.3	Certification of Michael T. Flynn
31.4	Certification of James H. Langmead
32.1	Certification of Ronald D. Paul
32.2	Certification of Susan G. Riel
32.3	Certification of Michael T. Flynn
32.4	Certification of James H. Langmead

- (1) Incorporated by reference to the exhibit of the same number to the Company's Current Report on Form 8-K filed on December 3, 2007.
- (2) Incorporated by reference to the exhibit of the same number to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2002.
- (3) Incorporated by reference to the exhibit of the same number to the Company's Current Report on Form 8-K filed on October 30, 2007.
- (4) Incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended December 31, 1998.
- (5) Incorporated by reference to exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Edgar Filing: EAGLE BANCORP INC - Form 10-K

- (6) Incorporated by reference to exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2003.
- (7) Incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8 (No. 333-116352)
- (8) Incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8 (No. 333-135072)

QuickLinks

DOCUMENTS INCORPORATED BY REFERENCE

Form 10-K Cross Reference Sheet

Six Year Summary of Selected Financial Data

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

PENDING ACQUISITION

CRITICAL ACCOUNTING POLICIES

RESULTS OF OPERATIONS

BALANCE SHEET ANALYSIS

COMPARISON OF 2006 VERSUS 2005

CONTRACTUAL OBLIGATIONS

OFF-BALANCE SHEET ARRANGEMENTS

LIQUIDITY MANAGEMENT

INTEREST RATE RISK MANAGEMENT

GAP Table

CAPITAL RESOURCES AND ADEQUACY

IMPACT OF INFLATION AND CHANGING PRICES

NEW ACCOUNTING STANDARDS

MARKET FOR COMMON STOCK AND DIVIDENDS

Equity Compensation Plan Information

REPORT OF STEGMAN & COMPANY INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

EAGLE BANCORP, INC. Consolidated Balance Sheets

EAGLE BANCORP, INC. Consolidated Statements of Operations Years Ended December 31,

EAGLE BANCORP, INC. Consolidated Statements of Changes in Stockholders' Equity For The Years Ended December 31, 2007, 2006 and 2005

EAGLE BANCORP, INC. Consolidated Statements of Cash Flows Years Ended December 31,

Eagle Bancorp, Inc. Notes to Consolidated Financial Statements for the Years Ended December 31, 2007, 2006 and 2005

CONDENSED BALANCE SHEETS December 31, 2007 and 2006

CONDENSED STATEMENTS OF INCOME For the Years Ended December 31, 2007, 2006 and 2005

CONDENSED STATEMENTS OF CASH FLOWS For the Years Ended December 31, 2007, 2006 and 2005

BUSINESS

RISK FACTORS

EMPLOYEES

MARKET AREA AND COMPETITION

REGULATION

PROPERTIES

DISCLOSURE CONTROLS AND PROCEDURES

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

REPORT OF STEGMAN & COMPANY INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Exhibits and Financial Statement Schedules

SIGNATURES