

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

EAGLE BANCORP INC
Form 10-Q
May 08, 2006

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

FORM 10-Q

(MARK ONE)

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2006

OR

() 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 No.)

7815 Woodmont Avenue, Bethesda, Maryland
(Address of principal executive offices)

20814
(Zip Code)

(301) 986-1800
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year,
if changed since last report)

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 (x) No ()

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

Large accelerated filer [] Accelerated filer [X] Non-accelerated filer []

Indicate by check mark whether the registrant is a shell company (as defined in

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

Rule 12b-2 of the Exchange Act Yes_____ No (x)

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of April 25, 2006, the registrant had 7,248,392 shares of
Common Stock outstanding.

Item 1 - Financial Statements

EAGLE BANCORP, INC.
Consolidated Balance Sheets
March 31, 2006 and December 31, 2005
(dollars in thousands)

| | March 31, 2006 (unaudited) | Decem 2 |
|---|----------------------------------|------------|
| ASSETS | ----- | ----- |
| Cash and due from banks | \$ 16,689 | \$ 1 |
| Interest bearing deposits with banks and other short term investments | 1,718 | 1 |
| Federal funds sold | 31,630 | |
| Investment securities available for sale, at fair value | 69,954 | 6 |
| Loans held for sale | 3,010 | |
| Loans | 552,375 | 54 |
| Less allowance for credit losses | (6,085) | (|
| | ----- | ----- |
| Loans, net | 546,290 | 54 |
| Premises and equipment, net | 5,852 | |
| Accrued interest, deferred taxes and other assets | 19,423 | 1 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 694,566 | \$ 67 |
| | ===== | ===== |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Deposits: | | |
| Noninterest bearing demand | \$ 149,778 | \$ 16 |
| Interest bearing transaction | 66,309 | 7 |
| Savings and money market | 140,697 | 14 |
| Time, \$100,000 or more | 140,482 | 12 |
| Other time | 73,979 | 6 |
| | ----- | ----- |
| Total deposits | 571,245 | 56 |
| Customer repurchase agreements and federal funds purchased | 31,549 | 3 |
| Other short-term borrowings | 20,000 | |
| Other liabilities | 4,531 | |
| | ----- | ----- |
| Total liabilities | 627,325 | 60 |
| | ----- | ----- |
| | | |
| STOCKHOLDERS' EQUITY | | |
| Common stock, \$.01 par value; shares authorized 20,000,000, shares | | |

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

| | | |
|--|------------|-------|
| issued and outstanding 7,233,864 (2006) and 7,184,891 (2005) | 72 | |
| Additional paid in capital | 49,419 | 4 |
| Retained earnings | 18,394 | 1 |
| Accumulated other comprehensive (loss) | (644) | |
| | ----- | ----- |
| Total stockholders' equity | 67,241 | 6 |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 694,566 | \$ 67 |
| | ===== | ===== |

2

EAGLE BANCORP, INC.
Consolidated Statements of Operations
For the Three Month Periods Ended March 31, 2006 and 2005 (unaudited)
(dollars in thousands, except per share data)

| | 2006 | 2005 |
|--|----------|----------|
| | ----- | ----- |
| INTEREST INCOME | | |
| Interest and fees on loans | \$10,328 | \$ 6,997 |
| Interest and dividends on investment securities | 701 | 487 |
| Interest on balances with other banks | - | 42 |
| Interest on federal funds sold | 195 | 184 |
| | ----- | ----- |
| Total interest income | 11,224 | 7,710 |
| | ----- | ----- |
| INTEREST EXPENSE | | |
| Interest on deposits | 2,959 | 1,141 |
| Interest on customer repurchase agreements and federal funds purchased | 189 | 33 |
| Interest on other short-term borrowings | 232 | 61 |
| | ----- | ----- |
| Total interest expense | 3,380 | 1,235 |
| | ----- | ----- |
| NET INTEREST INCOME | 7,844 | 6,475 |
| PROVISION FOR CREDIT LOSSES | 115 | 417 |
| | ----- | ----- |
| NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES | 7,729 | 6,058 |
| | ----- | ----- |
| NONINTEREST INCOME | | |
| Service charges on deposits | 324 | 269 |
| Gain on sale of loans | 176 | 495 |
| Other income | 340 | 275 |
| | ----- | ----- |
| Total noninterest income | 840 | 1,039 |
| | ----- | ----- |
| NONINTEREST EXPENSE | | |
| Salaries and employee benefits | 2,974 | 2,560 |
| Premises and equipment expenses | 869 | 801 |
| Advertising | 119 | 96 |
| Outside data processing | 228 | 181 |

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

| | | |
|----------------------------------|----------|----------|
| Other expenses | 1,033 | 837 |
| | ----- | ----- |
| Total noninterest expense | 5,223 | 4,475 |
| | ----- | ----- |
| INCOME BEFORE INCOME TAX EXPENSE | 3,346 | 2,622 |
| INCOME TAX EXPENSE | 1,363 | 969 |
| | ----- | ----- |
| NET INCOME | \$ 1,983 | \$ 1,653 |
| | ===== | ===== |
| EARNINGS PER SHARE | | |
| Basic | \$ 0.27 | \$ 0.23 |
| Diluted | \$ 0.26 | \$ 0.22 |
| DIVIDENDS DECLARED PER SHARE | \$ 0.07 | \$ 0.07 |

See notes to consolidated financial statements.

3

EAGLE BANCORP, INC.
Consolidated Statements of Cash Flows
For the Three Month Periods Ended March 31, 2006 and 2005 (unaudited)
(dollars in thousands)

| | |
|---|----------|
| | 2006 |
| | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | |
| Net income | \$ 1,983 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | |
| Provision for credit losses | 115 |
| Depreciation and amortization | 261 |
| Gains on sale of loans | (176) |
| Origination of loans held for sale | (10,838) |
| Proceeds from sale of loans held for sale | 10,928 |
| Stock based compensation expense | 170 |
| Tax benefit from exercise of non-qualified stock options | 191 |
| Increase in other assets | (921) |
| (Decrease) / increase in other liabilities | (1,916) |
| | ----- |
| Net cash provided (used) by operating activities | (203) |
| | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Increase / (decrease) in interest bearing deposits with banks and other short term investments | 9,513 |
| Purchases of available for sale investment securities | (5,104) |
| Proceeds from maturities of available for sale securities | 3,146 |
| Net increase in loans | (3,178) |
| Bank premises and equipment acquired | (339) |
| | ----- |
| Net cash provided (used) in investing activities | 4,038 |
| | ----- |

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

CASH FLOWS FROM FINANCING ACTIVITIES:

| | |
|---|-----------|
| Increase in deposits | 2,352 |
| (Decrease) / increase in customer repurchase agreements and federal funds purchased | (590) |
| Increase / (decrease) in other short-term borrowings | 20,000 |
| Issuance of common stock | 464 |
| Payment of dividends | (507) |
| | ----- |
| Net cash provided by financing activities | 21,719 |
| | ----- |
| NET INCREASE IN CASH | 25,554 |
| CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD | 22,765 |
| | ----- |
| CASH AND DUE FROM BANKS AT END OF PERIOD | \$ 48,319 |
| | ===== |
| SUPPLEMENTAL CASH FLOWS INFORMATION: | |
| Interest paid | \$ 3,136 |
| | ===== |
| Income taxes paid | \$ 100 |
| | ===== |

See notes to consolidated financial statements.

4

EAGLE BANCORP, INC.
Consolidated Statements of Changes in Stockholders' Equity
(dollars in thousands)

| | Common Stock | Additional Paid in Capital | Retained Earnings | Accum Ot Compre Income |
|--|-----------------|----------------------------------|----------------------|---------------------------------|
| | ----- | ----- | ----- | ----- |
| Balance, January 1, 2006 | \$ 72 | \$ 48,594 | \$ 16,918 | |
| Comprehensive Income | | | | |
| Net Income | | | 1,983 | |
| Other comprehensive income: | | | | |
| Unrealized loss on securities available for sale (net of taxes) | | | | |
| Total Comprehensive Income | | | | ----- |
| Cash Dividend (\$.07 per share) | | | (507) | |
| Stock based compensation | | 170 | | |
| Exercise of options for 54,531 shares of common stock | | 464 | | |
| Tax benefit on non-qualified options exercise | | 191 | | |
| | ----- | ----- | ----- | ----- |
| Balance, March 31, 2006 | \$ 72 | \$ 49,419 | \$ 18,394 | ===== |
| | ===== | ===== | ===== | ===== |
| Balance, January 1, 2005 | \$ 54 | \$ 47,014 | \$ 11,368 | |
| Comprehensive Income | | | | |

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

| | | | |
|--|-------|-----------|-----------|
| Net Income | | | 1,653 |
| Other comprehensive income: | | | |
| Unrealized loss on securities available for sale (net of taxes) | | | |
| Total Comprehensive Income | | | |
| Cash Dividend (\$.07 per share) | | (4) | (496) |
| 1.3 to one stock split in the form of a 30% stock dividend | 17 | (17) | |
| Exercise of options for 41,468 shares of common stock | | 382 | |
| Tax benefit on non-qualified options exercise | | 58 | |
| Balance, March 31, 2005 | \$ 71 | \$ 47,433 | \$ 12,525 |

See notes to consolidated financial statements.

5

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the three months ended March 31, 2006 and 2005
(unaudited)

1. BASIS OF PRESENTATION

General - The financial statements of Eagle Bancorp, Inc. (the "Company") included herein are unaudited; however, they reflect all adjustments consisting only of normal recurring accruals that, in the opinion of Management, are necessary to present fairly the results for the periods presented. The amounts as of December 31, 2005 were derived from audited consolidated financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. There have been no significant changes to the Company's Accounting Policies as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. The Company believes that the disclosures are adequate to make the information presented not misleading. The results of operations for the three months ended March 31, 2006 are not necessarily indicative of the results of operations to be expected for the remainder of the year, or for any other period. Certain reclassifications have been made to amounts previously reported to conform to the classification made in 2006.

2. NATURE OF OPERATIONS

The Company, through its bank subsidiary, provides domestic financial services primarily in Montgomery County, Maryland and Washington, DC. 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 mortgages and small business loans. A noninterest income business was

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

organized in the first quarter of 2005, which provides title and attendant services.

3. 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).

4. INVESTMENT SECURITIES

Amortized cost and estimated fair value of securities available for sale are summarized as follows: (in thousands)

6

| MARCH 31, 2006 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Es |
|--|----------------|------------------------|-------------------------|----|
| U. S. Government agency securities | \$ 45,445 | \$ - | \$ 702 | |
| Mortgage backed securities | 20,814 | - | 624 | |
| Federal Reserve and Federal Home Loan Bank stock | 3,379 | - | - | |
| Other equity investments | 1,380 | 262 | - | |
| | \$ 71,018 | \$ 262 | \$ 1,326 | |

| DECEMBER 31, 2005 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | E |
|--|----------------|------------------------|-------------------------|---|
| U. S. Government agency securities | \$ 47,652 | \$ - | \$ 654 | |
| Mortgage backed securities | 17,798 | - | 558 | |
| Federal Reserve and Federal Home Loan Bank stock | 2,230 | - | - | |
| Other equity investments | 1,380 | 214 | 12 | |
| | \$ 69,060 | \$ 214 | \$ 1,224 | |

Gross unrealized losses and fair value by length of time that the individual available securities have been in a continuous unrealized loss position as of March 31, 2006 are as follows:

| Estimated Fair | Less than 12 months | More than 12 months | Un |
|----------------|---------------------|---------------------|----|
|----------------|---------------------|---------------------|----|

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

MARCH 31, 2006

| | Value | | |
|--|------------------|---------------|---------------|
| U. S. Government agency securities | \$ 44,743 | \$ 301 | \$ 401 |
| Mortgage backed securities | 20,190 | 69 | 555 |
| Federal Reserve and Federal Home Loan Bank stock | 3,379 | - | - |
| Other equity investments | 1,642 | - | - |
| | <u>\$ 69,954</u> | <u>\$ 370</u> | <u>\$ 956</u> |

DECEMBER 31, 2005

| | Estimated Fair Value | Less than 12 months | More than 12 months | Un |
|--|----------------------------|------------------------|------------------------|----|
| U. S. Treasury securities | | | | |
| U. S. Government agency securities | \$ 46,998 | \$ 218 | \$ 436 | |
| Mortgage backed securities | 17,240 | - | 558 | |
| Federal Reserve and Federal Home Loan Bank stock | 2,230 | - | - | |
| Other equity investments | 1,582 | 12 | - | |
| | <u>\$ 68,050</u> | <u>\$ 230</u> | <u>\$ 994</u> | |

The unrealized losses that exist are the result of changes in market interest rates since original purchases. All of the bonds are rated AAA. The weighted average life of debt securities, which comprise 93% of total investment securities is relatively short at 2.3 years. These factors, coupled with the Company's ability and intent to hold these investments for a period of time sufficient to allow for any anticipated recovery in fair value substantiates that the unrealized losses are temporary in nature.

7

5. INCOME TAXES

The Company employs the liability method of accounting for income taxes as required by Statement of Financial Accounting Standards No. 109 (SFAS109), "Accounting for Income Taxes." Under the liability method, deferred-tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary differences) and are measured at the enacted rates that will be in effect when these differences reverse.

6. EARNINGS PER SHARE

Earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period, including any potential dilutive common shares outstanding, such as stock options. As of March 31, 2006 there were 59,250 shares excluded from the diluted net income per share computation because their inclusion would be anti-dilutive.

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

7. SHARE-BASED COMPENSATION

The Company maintains the 1998 Stock Option Plan (the "1998 Plan"). The 1998 Plan provides for the periodic granting of incentive and non-qualifying options to selected key employees and members of the Board. Options for not more than 1,142,732 shares of common stock may be granted under the Plan and the term of such options shall not exceed ten years. Option awards are made with an exercise price equal to the market price of the Company's shares at the date of grant. The option grants generally vest over a period of one to two years.

The Company also maintains the 2004 Employee Stock Purchase Plan (the "ESPP"). Under the ESPP, a total of 195,000 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 year expire no later than the last business day of January in the calendar year following the year in which the grant is made.

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

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants during the quarter ended March 31, 2006 and the year ended December 31, 2005. For periods prior to 2006, the Company used the average of the option term and the vesting period to estimate the life of the option. The options granted in the first quarter of 2006 were for 34,099 shares under the ESPP which have a one-year term and vest immediately upon grant, and for 1,500 shares granted under the 1998 Plan.

| | Quarter ended March 31, 2006 | Year ended December 31, 2005 |
|--|------------------------------------|------------------------------------|
| Dividend yield | 1.42% | 1.63% |
| Expected volatility | 21.83% | 22.94% |
| Weighted average risk free interest rate | 4.45% | 4.27% |
| Expected lives (in years) | 1.0 | 6.5 |

8

Following is a summary of changes in shares under option (split adjusted) for the quarter and year indicated:

| | Quarter ended March 31, 2006 | | Year ended December 31, 2005 | |
|-----------------------|---------------------------------|--|---------------------------------|--|
| (shares in thousands) | Number of Shares | Weighted Average Exercise Price | Number of Shares | Weighted Average Exercise Price |
| | | | | |

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

| | | | | |
|--|-------|-----------|-------|-----------|
| Outstanding at beginning of period | 753 | \$10.13 | 690 | \$7.63 |
| Granted | 36 | 19.66 | 208 | 17.42 |
| Exercised | (55) | (8.51) | (137) | (8.41) |
| Cancelled / Expired | (11) | (13.77) | (8) | (12.98) |
| | ----- | | ----- | |
| Outstanding at end of period | 723 | \$10.66 | 753 | \$10.13 |
| | ===== | | ===== | |
| Shares exercisable at period end | 686 | \$10.07 | 661 | \$9.06 |
| | ----- | | ----- | |
| Non-vested shares | 37 | | 92 | |
| | ----- | | ----- | |
| Weighted average fair value of options granted during the period | | \$4.34 | | \$4.94 |
| | | ----- | | ----- |
| Weighted average remaining contract life | | 5.2 years | | 5.5 years |
| | | ----- | | ----- |

| Range of Exercise Price | Number | Weighted Average Remaining Contract Life (in years) | Weighted Average Exercise Price |
|-------------------------|---------|---|---------------------------------|
| ----- | ----- | ----- | ----- |
| \$ 4.26-\$8.75 | 365,032 | 3.7 | \$5.23 |
| \$8.76-\$13.26 | 37,683 | 6.8 | 10.48 |
| \$13.27-\$17.77 | 226,572 | 8.2 | 14.76 |
| \$17.78-\$23.28 | 94,152 | 3.4 | 21.94 |
| | ----- | | |
| | 723,439 | | \$10.66 |
| | ===== | | ===== |

As of December 31, 2005, there was \$128 thousand of total unrecognized compensation cost related to non-vested shares under the 1988 Plan. There was no unrecognized compensation cost under the ESPP. The \$128 thousand cost is being amortized ratably over calendar year 2006 based on the remaining vesting period. Through March 31, 2006, \$32 thousand has been recognized in compensation cost related to those grants. In February 2006, the Company granted options for 34,099 shares under the ESPP. These awards were vested 100% at grant and the fair value of the awards was expensed in the quarter ended March 31, 2006. This amount was \$138 thousand. In February, the Company granted 1,500 shares under the 1998 Plan.

In total, the Company recognized \$170 thousand in share based compensation expense for the first quarter of 2006 (\$0.02 per share) as compared to \$0 compensation expense recognized for the first quarter of 2005, as a new accounting rule under FAS123R was adopted as of January 1, 2006.

Prior to January 1, 2006, share 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 Statement of Operations. For the first quarter of 2005, the pro-forma share based compensation amount was \$432 thousand (\$0.06 per share).

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operation.

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

The following discussion provides information about the results of operations, and financial condition, liquidity, and capital resources of the Company and its subsidiaries. This discussion and analysis should be read in conjunction with the unaudited Consolidated Financial Statements and Notes thereto, appearing elsewhere in this report and the Management Discussion and Analysis in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

9

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

Eagle Bancorp, Inc. 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, 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 Bank currently has five offices serving Montgomery County and three offices in the District of Columbia. The Company expects to open its ninth community banking office in the second quarter 2006 in Chevy Chase, Montgomery County, Maryland. In February 2005, Eagle Land Title, LLC, a Bank subsidiary which performs title and attendant services commenced operations.

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 in the 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

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

lender, have been designated a Preferred Lender by the Small Business Administration (SBA), and are the leading community bank SBA lenders in the Washington D.C. district.

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 certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available.

10

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 or environmental factors allowance. Each component is determined based on estimates that can and do change when actual events occur.

The specific allowance allocates an allowance to identified loans. A loan for which reserves are individually allocated may show deficiencies in the borrower's overall financial condition, payment record, support available from financial guarantors and or the fair market value of collateral. When a loan is identified as impaired, a specific reserve is established based on the Company's assessment of the loss that may be associated with the individual loan.

The formula allowance is used to estimate the loss on internally risk rated loans, exclusive of those identified as requiring specific reserves. Loans identified in the risk rating evaluation as substandard, doubtful and loss, are segregated from non-classified loans. Classified loans are assigned allowance factors based on an impairment analysis. Allowance factors relate to the level

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

of the internal risk rating.

The nonspecific or environmental factors allowance is an estimate of potential loss of the remaining loans (those not identified as either requiring specific reserves or having classified risk ratings). The loss estimates are based on more global factors, such as delinquency trends, loss history, trends in the volume and size of individual credits, effects of changes in lending policy, the experience and depth of management, national and local economic trends, any concentrations of credit, the quality of the loan review system and the effect of external factors such as competition and regulatory requirements. The environmental factors allowance captures losses whose impact on the portfolio may have occurred but have yet to be recognized in the formula.

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 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 will 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 provisioning in the future. For additional information regarding the allowance for credit losses, refer to the discussion under the caption "Allowance for Credit Losses" below.

RESULTS OF OPERATIONS

The Company reported net income of \$2.0 million for the three months ended March 31, 2006, as compared to net income of \$1.7 million for the three months ended March 31, 2005, an increase of 20%. Income per basic share was \$0.27 for the three months ended March 31, 2006, as compared to \$0.23 same period in 2005. Income per diluted share was \$0.26 for the three months ended March 31, 2006, as compared to \$0.22 for the same period in 2005.

11

The Company had an annualized return on average assets of 1.20% for both the first three months of 2006 and 2005 and an annualized return on average equity of 12.08% for the first three months of 2006, as compared to a return on average equity of 11.32% for the same three months of 2005. The return on equity increase resulted from additional leveraging of the equity position. The ratio of average equity to average assets declined from 10.57% for the first quarter of 2005 to 9.93% for the first quarter of 2006. As discussed below, the capital ratios of the Bank and Company remain above well capitalized levels.

The increase in net income for the three months ended March 31, 2006 as compared to the same period in 2005, can be attributed substantially to an increase of 21% in net interest income, resulting from an increase of 20% in average earning assets and a modest increase in the net interest margin of three basis points between the comparable periods to 5.01%. The net interest margin

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

increase was due to the increased value of non-interest funding sources during a period of substantial increases in market interest rates. Since March 2005, the Federal Reserve Bank has increased the federal funds target rate by 2.00% to 4.75% in eight interest rate increases of 25 basis points. Since the Company's non-interest funding sources comprise approximately 30% of average earning assets, this effect has been substantial. The value of non-interest sources (defined as the difference between the net interest margin and the net interest spread) increased to 89 basis points for the first quarter of 2006 from 40 basis points for the first quarter of 2005, while the average growth of noninterest sources funding earning assets amounted to \$26 million or 17% between the first quarter of 2006 and 2005. While the net interest margin has increased due to the favorable position of noninterest funding sources, the net interest spread (defined as the difference between the yield on earning assets and the cost of interest bearing liabilities) declined for the first quarter of 2006 as compared to the same period in 2005 from 4.58% to 4.12%. While the interest rate on earning assets has risen by 125 basis points for the first quarter of 2006 as compared to 2005, the cost of interest bearing liabilities has increased by 171 basis points, due to the proportion of average time deposits funding average earning assets increasing to 31% for the first quarter of 2006 from 27% for the first quarter of 2005. The Company has acquired these higher levels of average time deposits to fund a portion of its average loan growth in the first quarter of 2006 over 2005. As a result of competitive pressures and growth objectives, the rates paid on interest bearing deposits and interest bearing liabilities may result in a higher cost of funding in future periods, which may not be offset by further increases in interest rates on earning assets. As a result of such potential margin compression, the Company's earnings could be adversely affected.

Loans, which generally have higher yields than securities and other earning assets, increased from 81% of average earning assets in the first three months of 2005 to 86% of average earning assets for the same period of 2006. Investment securities in the first quarter of 2006 amounted to 11% of average earning assets as compared to 12% for the first three months in 2005. This decline was directly related to average loan growth over the past twelve month period exceeding the growth of average deposit and other funding sources.

The provision for credit losses was \$115 thousand for the first quarter in 2006 as compared to \$417 thousand for the same period in 2005. This decrease was attributable to the lower rate of growth in the loan portfolio in the first quarter of 2006 which was 1%, as compared to the first quarter of 2005, which growth was 5%. As discussed in the section on Allowance for Credit Losses, the Company had just \$15 thousand of net charge-offs in the first quarter of 2006. This compared to net recoveries on previously charged-off loans of \$6 thousand for the first three months of 2005. At March 31, 2006, the allowance for credit losses was \$6.1 million or 1.10% of total loans, as compared to \$4.7 million or 1.07% of total loans at March 31, 2005 and \$6.0 million or 1.09% of total loans at December 31, 2005.

Noninterest income decreased 19%, to \$840 thousand for the first three months of 2006, from \$1.0 million in the same period of 2005. The decline was attributed primarily to lower amounts of gains on the sale of SBA loans which amounted to \$138 thousand in the first quarter of 2006 as compared to \$385 thousand for the same period in 2005. Activity in SBA loan sales to secondary markets can vary widely from quarter to quarter. EagleBank has been recognized as the leading community bank SBA lender in its marketplace and continued emphasis in this business is anticipated. The decline in gains on the sale of SBA loans was partially offset by an increase in deposit service charges, which amounted to \$324 thousand in the initial quarter of 2006, as compared to \$269 thousand for the same period in 2005, a 20% increase. These service charge increases are associated primarily with new relationships acquired in the first quarter of 2006. Gains on the sale of residential mortgage loans were \$38 thousand for the first quarter of 2006, as compared to \$110 thousand for the

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

same period in 2005. The Company is in the process of renewing its efforts to expand residential mortgage lending and associated sale of these assets on a servicing

12

released basis. Other noninterest income increased to \$340 thousand in the first quarter of 2006 as compared to \$275 thousand for the same quarter in 2005, a 24% increase, due primarily to higher loan prepayment and commitment fees.

Non-interest expenses were \$5.2 million for the first quarter of 2006, as compared to \$4.5 million for 2005, a 17% increase. The primary reasons for this increase were increases in staff levels and related personnel cost, director fees, \$170 thousand of costs associated with share based compensation under new accounting expensing rules, occupancy cost increases, and higher data processing, licensing, and other professional fees associated with a larger organization. The efficiency ratio, which is a measure of the level of noninterest expenses to revenue, was only slightly higher in the first quarter of 2006 at 60.14%, as compared to 59.56% for the same period in 2005. The company emphasizes the efficiency ratio as a measure of noninterest expense control.

The combination of increases in net interest income, primarily from increased amounts of average loans in the first quarter of 2006 as compared to 2005, a reduced provision for credit losses due to a lower rate of growth in loans in the first three months of 2006, lower amounts of noninterest income and increases in noninterest expenses, resulted in an improvement in reported income for the first quarter of 2006 versus 2005.

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. Noninterest bearing deposits and capital are other components representing funding sources, which factors have been significant in the first quarter of 2006 versus 2005 (refer to discussion above under Results of Operations). 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 for the first three months of 2006 was \$7.8 million compared to \$6.5 million for the first three months of 2005, a 21% increase.

The table below 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 expense on interest bearing liabilities. While net interest spread provides a quick comparison of earnings rates versus cost of funds, management believes that margin provides a better measurement of performance. Margin includes the effect of noninterest bearing sources in its calculation and is net interest income expressed as a percentage of average earning assets.

13

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

AVERAGE BALANCES, INTEREST YIELDS AND RATES, AND NET INTEREST MARGIN
(dollars in thousands)

| | Three Months End | | |
|--|--------------------|----------|-----------------------|
| | 2006 | | |
| | Average Balance | Interest | Average Yield/Rate |
| ASSETS: | | | |
| Interest earning assets: | | | |
| Interest bearing deposits with other banks and other short-term investments | \$ 3,146 | \$ 30 | 3.87% |
| Loans (1) | 545,594 | 10,328 | 7.68% |
| Investment securities available for sale | 67,771 | 671 | 4.02% |
| Federal funds sold | 17,960 | 195 | 4.40% |
| Total interest earning assets | 634,471 | 11,224 | 7.18% |
| Total noninterest earning assets | 42,222 | | |
| Less: allowance for credit losses | 6,029 | | |
| Total noninterest earning assets | 36,193 | | |
| TOTAL ASSETS | \$ 670,664 | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Interest bearing liabilities: | | | |
| Interest bearing transaction | \$ 87,419 | \$ 36 | 0.17% |
| Savings and money market | 119,248 | 1,142 | 3.88% |
| Time deposits | 194,458 | 1,781 | 3.71% |
| Customer repurchase agreements and federal funds purchased | 32,567 | 189 | 2.35% |
| Other short-term borrowings | 14,611 | 232 | 6.44% |
| Total interest bearing liabilities | 448,303 | 3,380 | 3.06% |
| Noninterest bearing liabilities: | | | |
| Noninterest bearing demand | 152,344 | | |
| Other liabilities | 3,390 | | |
| Total noninterest bearing liabilities | 155,734 | | |
| Stockholders' equity | 66,627 | | |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 670,664 | | |
| Net interest income | | \$ 7,844 | |
| Net interest spread | | | 4.12% |

Net interest margin

5.01%

(1) Includes Loans held for Sale

14

Allowance for Credit Losses

The provision for credit losses represents the amount of expense charged to current 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.

Management has developed a comprehensive analytical process to monitor the adequacy of the allowance for credit losses. This process and guidelines were developed utilizing among other factors, the guidance from federal banking regulatory agencies. The results of this process, in combination with conclusions of the Bank's outside loan review consultant, support management's assessment as to the adequacy of the allowance at the balance sheet date. Please refer to the discussion under the caption "Critical Accounting Policies" for an overview of the methodology management employs on a quarterly basis to assess the adequacy of the allowance and the provisions charged to expense. Also, refer to the following table which reflects the comparative charge-offs and recoveries of prior loan charge-offs information.

During the first three months of 2006, a provision for credit losses was made in the amount of \$115 thousand and the allowance for credit losses increased \$100 thousand, including the impact of \$15 thousand in net charge-offs during the period. The provision for credit losses of \$115 thousand in the first three months of 2006 compared to a provision for credit losses of \$417 thousand in the first three months of 2005. The lower level of the provision in 2006 is primarily attributable to a slower rate of loan growth in the loan portfolio in the first quarter of 2006.

At March 31, 2006, the Company had \$6.2 million of loans classified as nonaccrual as compared to \$491 thousand at December 31, 2005 and \$151 thousand at March 31, 2005. The Company had no restructured loans at either, March 31, 2006, December 31, 2005 or March 31, 2005. Significant variation in these amounts 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) properties at March 31, 2006, December 31, 2005 or March 31, 2005. The balance of impaired loans was \$409 thousand at March 31, 2006, with specific reserves against those loans of \$260 thousand, compared to \$151 thousand at March 31, 2005 with specific reserves of \$57 thousand. The significant increase in non-accrual loans in the first quarter of 2006 was due principally to two real estate loans placed on non-accrual status in first quarter, which management has been monitoring closely, believes are well secured and for which no principal loss is anticipated. The allowance for loan losses represented 1.10% of total loans at March 31, 2006 as compared to 1.09% at December 31, 2005. This increase in the ratio of the allowance in the first quarter was due 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.

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

As part of its comprehensive loan review process, the Company's Board of Directors and the Bank Director's Loan Committee and or Board of Director's Credit Review Committees carefully evaluates loans which are past due 30 days or more. The Committee(s) make a thorough assessment of the conditions and circumstances surrounding each delinquent loan. The Bank's loan policy requires that loans be placed on nonaccrual if they are ninety days past due, unless they are well secured and in the process of collection.

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

15

The following table sets forth activity in the allowance for credit losses for the periods indicated.

| (dollars in thousands) | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2006 | 2005 |
| Balance at beginning of year | \$ 5,985 | \$ 4,240 |
| Charge-offs: | | |
| Commercial | - | - |
| Real estate - commercial | - | - |
| Construction | - | - |
| Home equity | - | - |
| Other consumer | 15 | - |
| | ----- | ----- |
| Total | 15 | 0 |
| | ----- | ----- |
| Recoveries: | | |
| Commercial | - | 6 |
| Real estate - commercial | - | - |
| Construction | - | - |
| Home equity | - | - |
| Other consumer | - | - |
| | ----- | ----- |
| Total | - | 6 |
| | ----- | ----- |
| Net (charge-offs) recoveries | (15) | 6 |
| | ----- | ----- |
| Additions charged to operations | 115 | 417 |
| | ----- | ----- |
| Balance at end of period | \$ 6,085 | \$ 4,663 |
| | ===== | ===== |
| Annualized ratio of net charge-offs during the period to average loans outstanding during the period | .01% | (.01)% |
| | ----- | ----- |

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

The following table reflects the allocation of the allowance for credit losses at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future losses or charge-offs and does not restrict the use of the allowance to absorb losses in any category.

ALLOCATIONS

| (dollars in thousands) | As of March 31, 2006 | | As of D 2 |
|---|-------------------------|-------|--------------|
| | Amount | % (1) | Amount |
| Commercial | \$ 2,484 | 22% | \$ 2,594 |
| Real estate - commercial | 2,578 | 53% | 2,395 |
| Real estate - residential | 34 | 0% | 48 |
| Construction - commercial and residential | 664 | 15% | 602 |
| Home equity | 182 | 9% | 176 |
| Other consumer | 83 | 1% | 84 |
| Unallocated | 60 | | 86 |
| | | | |
| Total loans | \$ 6,085 | 100% | \$ 5,985 |
| | | | |

(1) Represents the percent of loans in each category to total loans

16

Nonperforming Assets

The Company's nonperforming assets, which are comprised of loans delinquent 90 days or more, non-accrual loans, restructured loans and other real estate owned, totaled \$6.2 million at March 31, 2006 compared to \$151 thousand at March 31, 2005. The percentage of nonperforming loans to total loans was 1.12% at March 31, 2006, compared to 0.03% at March 31, 2005.

The following table shows the amounts of nonperforming assets at the dates indicated.

| (dollars in thousands) | March 31, | | December 31 |
|--------------------------------|-----------|--------|-------------|
| | 2006 | 2005 | 2005 |
| Nonaccrual Loans | | | |
| Commercial | \$ 416 | \$ 151 | \$ 362 |
| Consumer | 129 | - | 129 |
| Real estate | 5,610 | - | - |
| Accrual loans-past due 90 days | | | |
| Commercial | - | - | - |
| Consumer | - | - | - |
| Real estate | - | - | - |
| Restructured loans | - | - | - |
| Real estate owned | - | - | - |
| | | | |
| Total non-performing assets | \$ 6,155 | \$ 151 | \$ 491 |
| | | | |

As noted above, the Company experienced an increase in the level of

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

nonaccrual loans in the first quarter of 2006 resulting primarily from the addition of two commercial loans, both of which are secured by real estate. The loans were placed on nonaccrual due to past due status, construction cost overruns, and/or delays in completion of the associated projects. The Company continues to monitor these credits. Based upon the Company's review of third party appraisals of the underlying collateral, the addition of supplementary collateral, guarantors, and additional equity contributions, the Company believes it will not incur a principal loss in connection with the resolution of these loans.

At March 31, 2006, there were an additional \$1.1 million of performing loans considered potential problem loans, defined as loans which are not included in the 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.

Noninterest Income

Noninterest income consists primarily of deposit account service charges, gains on the sale of SBA and residential mortgage loans, other noninterest loan fees, income from bank owned life insurance ("BOLI") and other service fees. For the three months ended March 31, 2006, noninterest income was \$840 thousand. This compared to \$1.0 million of noninterest income for the three months ended March 31, 2005, a decline of 19% due primarily to a lower amount of gains on the sale of SBA loans. There were no investment gains or losses in either the first quarter of 2006 or 2005.

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 \$138 thousand for the three months ended March 31, 2006 compared to \$385 thousand for the three months ended March 31, 2005. Activity in SBA loan sales to secondary markets can vary widely from quarter to quarter. EagleBank has been recognized as the leading community bank SBA lender in its marketplace and continued emphasis is anticipated. The Company also originates residential mortgage loans on a pre-sold basis, servicing released. Sales of these mortgage loans yielded gains of \$38 thousand in the first three months of 2006 compared to \$110 thousand in the same period in 2005. The Company is in the

17

process of renewing its efforts to expand residential mortgage lending and associated sale of these assets on a servicing released basis. Income for the three months ended March 31, 2006 was \$324 thousand from deposit account service charges, \$62 thousand from SBA loan service fees and \$97 thousand from BOLI, versus \$269 thousand from deposit account service charges, \$46 thousand from SBA service fees and \$101 thousand from BOLI for the three months ended March 31, 2005. Other noninterest income amounted to \$181 thousand for the first three months of 2006, as compared to \$127 thousand in the first quarter of 2005. The increase in deposit services was primarily related to new relationships. The increase in other non-interest income was due primarily to loan prepayment and commitment fees.

Noninterest Expense

Noninterest expense was \$5.2 million for the three months ended March 31, 2006 compared to \$4.5 million for the three months ended March 31, 2005, an increase of 17%.

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

Salaries and benefits were \$3.0 million for the first quarter of 2006, as compared to \$2.6 million for 2005, a 16% increase. This increase was due to staff additions and related personnel costs, as well as to share based compensation under new accounting expensing rules which commenced January 1, 2006, and which amounted to \$170 thousand for the first three months of 2006 as compared to no expense in 2005. Refer to Note 6 above under "Share Based Compensation" for further details on this expense. At March 31, 2006, the Company staff numbered approximately 149, as compared to 130 at March 31, 2005.

Premises and equipment expenses amounted to \$869 thousand for the quarter ended March 31, 2006 versus \$801 thousand for the same period in 2005. This increase of 8% was due to a full quarter's operation of a new banking office opened in late January 2005 and to ongoing operating expense increases associated with the Company's facilities, all of which are leased, and to increased equipment costs.

Advertising costs increased from \$96 thousand in the quarter ended March 31, 2005 to \$119 thousand in the same period in 2006, the increases associated primarily with increased ongoing product promotions.

Outside data processing costs were \$228 thousand for the initial quarter in 2006, as compared to \$181 thousand in 2005, or an increase of 25%. The increase was due to increases in numbers of accounts and services.

Other expenses, increased from \$837 thousand in the first quarter of 2005 to \$1.0 million for the three months ended March 31, 2006, or an increase of 22%. The major components of costs in this category include professional fees, including audit and accounting, ATM expenses, telephone, courier, printing, business development, office supplies, charitable contributions, director fees and dues. For the first quarter of 2006, as compared to 2005, the significant increases in this category were primarily director fees and special audit engagement services.

Income Tax Expense

The Company's ratio of income tax expense to pre-tax income (termed effective tax rate) increased to 40.7% in the first quarter of 2006 as compared to 37.0% for the same period in 2005. This increase was due to the expensing of stock based compensation in the first quarter of 2006, which is non-deductible, and to the use of a 35% marginal federal income tax rate in 2006 as compared to a 34% marginal federal income tax rate in 2005.

FINANCIAL CONDITION

Summary

At March 31, 2006, assets were \$694.6 million, loans were \$552.4 million, deposits were \$571.2 million and stockholders' equity was \$67.2 million. As compared to December 31, 2005, assets grew by \$22.3 million (3.3%), loans by \$3.1 million (1.0%), deposits by \$2.4 million (1.0%) and stockholders' equity by \$2.3 million (3.5%).

18

The Company paid a cash dividend of \$.07 per share in both the first quarter of 2006 and 2005

Loans

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

Loans, net of amortized deferred fees and costs, at March 31, 2006, December 31, 2005 and March 31, 2005 by major category are summarized below:

| (dollars in thousands) | As of March 31, 2006 | | As of December 2005 |
|---|-------------------------|------|------------------------|
| | Amount | % | Amount |
| Commercial | \$ 120,435 | 22% | \$ 118,928 |
| Real estate mortgage - commercial (1) | 289,377 | 53% | 284,667 |
| Real estate mortgage - residential | 1,135 | 0% | 1,130 |
| Construction - commercial and residential | 85,167 | 15% | 90,035 |
| Home equity | 52,471 | 9% | 50,776 |
| Other consumer | 3,790 | 1% | 3,676 |
| | | | |
| Total loans | 552,375 | 100% | \$ 549,212 |
| Less: Allowance for Credit Losses | (6,085) | | (5,985) |
| | | | |
| Net Loans and Leases | \$ 546,290 | | \$ 543,227 |
| | | | |

(1) includes loans for land acquisition and development

Deposits and Other Borrowings

The principal sources of funds for the Bank are core deposits, consisting of demand deposits, NOW accounts, money market accounts, savings accounts and certificates of 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 three months ending March 31, 2006, noninterest bearing deposits declined \$15.3 million due to seasonal factors, while interest bearing deposits increased by \$17.7 million, primarily due to growth in time deposits.

Approximately 37% of the Bank's deposits at March 31, 2006 are made up of time deposits, which are generally the most expensive form of deposit because of their fixed rate and term. Certificates of deposit in denominations of \$100 thousand or more can be more volatile and more expensive than certificates of less than \$100 thousand. However, because the Bank focuses on relationship banking, its historical experience has been that large certificates of deposit have not been more volatile or significantly more expensive than smaller denomination certificates. It has been the practice of the Bank to pay posted rates on its certificates of deposit whether under or over \$100 thousand, although some exceptions have been made for large deposit transactions. From time to time, when appropriate in order to fund strong loan demand, the Bank accepts certificates of deposits, generally in denominations of less than \$100 thousand from bank and credit union subscribers to a wholesale deposit rate line. These deposits amounted to approximately \$9 million or 2% of total deposits at March 31, 2006, as compared to approximately \$16 million of deposits at March 31, 2005 and approximately \$11 million at December 31, 2005. The Bank has found rates on these deposits to be generally competitive with rates in our market given the speed and minimal noninterest cost at which deposits can be

acquired.

At March 31, 2006, the Company had approximately \$150 million in noninterest bearing demand deposits, representing 26% of total deposits. This compared to approximately \$165 million of these deposits at December 31, 2005, the lower balances due to seasonal declines in commercial deposits. These deposits are primarily business checking accounts on which the payment of interest is prohibited by regulations of the Federal Reserve. Proposed

19

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 CD investment or a money market account. The balances in these accounts were \$31.5 million at March 31, 2006 compared to \$32.1 million at December 31, 2005. 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 March 31, 2006, the Company had no outstanding balances under its lines of credit provided by a correspondent bank. The Bank had \$20.0 million of FHLB borrowings, as compared to no balances outstanding at December 31, 2005. These advances are secured primarily by a blanket lien on qualifying loans in the Bank's commercial mortgage loan portfolio. The Bank obtained advances during the first quarter of 2006 to compensate for weaker seasonal flows in core deposits.

Liquidity Management

Liquidity is a measure of the 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 entire investment securities portfolio is in an available-for-sale status which allows it flexibility to generate cash from sales as needed to meet ongoing loan demand. These sources of liquidity are 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 \$10 million line of credit with a correspondent bank, against which there were no amounts outstanding at March 31, 2006. Additionally, the Bank can purchase up to \$37 million in federal funds on an unsecured basis and \$5.5 million on a secured basis from its correspondents,

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

against which there were no borrowings outstanding at March 31, 2006. At March 31, 2006, the Bank was also eligible to take advances from the FHLB up to \$79 million based on collateral at the FHLB, of which it had \$20 million of advances outstanding at March 31, 2006. 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, customer 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 Committee has adopted policy guidelines which emphasize the importance of core deposits and their continued growth.

20

At March 31, 2006, under the Bank's liquidity formula, it had \$208 million of primary and secondary liquidity sources, which was deemed adequate to meet current and projected funding needs.

The following is a schedule of significant funding commitments at March 31, 2006:

| | (in thousands) |
|------------------------------------|----------------|
| Unused lines of credit (consumer) | \$ 62,507 |
| Other commitments to extend credit | 157,917 |
| Standby letters of credit | 4,041 |
| | ----- |
| Total | \$ 224,465 |
| | ===== |

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

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

objectives subject to established risk limits. In the current interest rate environment, the Company is managing its assets to be either variably priced or with relatively short maturities, so as to mitigate the risk to earnings and capital should interest rates increase from current levels. At the same time, the Bank seeks to acquire longer-term core deposits to lock in relatively lower cost funds. In the current market, due to competitive factors and customer preferences, the effort to attract longer-term fixed priced liabilities has not been as successful as the Company's best case asset liability mix would prefer. 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. The Company analysis at March 31, 2006 shows a positive effect on income when interest rates are shocked up 100 and 200 basis points, due to the significant level of variable rate loans. A negative impact occurs if rates were to decline based on the Company's asset sensitive position. Interest rate declines would reduce income on earning assets more than the benefit of reductions in the cost of funds, potentially resulting in net interest margin contraction. The Company concluded in the second quarter of 2005, based on market factors and its recent experience, that larger increases in its retail deposit rate assumptions would likely occur in a rising interest rate environment and modified its model assumptions to reflect more rate sensitivity within the core deposit base. While the impact of higher interest rates continues to be viewed as positive to future net interest income and market values of equity, this assumption change moderated the benefits of such higher interest rates assumptions, as compared to earlier analysis.

21

The following table reflects the result of a shock simulation on the March 31, 2006 balances.

| Change in interest rates (basis points) | Percentage change in net interest income | Percentage change in net income |
|--|---|------------------------------------|
| ----- | ----- | ----- |
| +200 | + 3.0% | +8.1% |
| +100 | +1.5% | +4.2% |
| 0 | - | - |
| -100 | -2.7% | -7.5% |
| -200 | -6.5% | -17.6% |

Certain shortcomings are inherent in the method of analysis presented

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

in the foregoing table. For example, although certain assets and liabilities may have similar maturities or repricing 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. Additionally, certain assets, such as adjustable-rate mortgage loans, have features that limit 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

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.

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.

The current interest rate environment is signaling higher interest rates. Management has been emphasizing the acquisition of variable rate and shorter term assets and has been attempting to secure longer-term core deposits. While management believes that this overall position creates a good 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 rate sensitivity of the Company. A negative GAP indicates the degree to which the volume of repricable liabilities exceeds repricable assets in given time periods. At March 31, 2006, the Company had a positive cumulative GAP position of approximately 14% out to three months and a negative cumulative GAP position of -1% out to twelve months, as compared to a three month positive GAP of 9% and a cumulative twelve month positive GAP of 3% at December 31, 2005. The change in the GAP position at March 31, 2006 as compared to December 31, 2005 relates primarily to a change in the mix of deposits toward more time deposits with maturities within 12 months. The current position is within guideline limits established by ALCO.

If interest rates continue to rise, as many forecasters are predicting, the Bank's interest income and margin are expected to be stable because of the present positive mismatch position 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 rise in the cost of liabilities may be greater than anticipated by the GAP model. If this were to occur, the benefits of a rising interest rate environment may not be in accordance with management's expectations. 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.

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

22

GAP ANALYSIS
MARCH 31, 2006
(dollars in thousand)

| Repriceable in: | 0-3 mos | 4-12 mos | 13-36 mos | 37-60 mos | over 60 mos |
|---|-------------------|-------------------|------------------|------------------|------------------|
| RATE SENSITIVE ASSETS: | | | | | |
| Investments and bank deposits | \$ 7,541 | \$ 14,445 | \$ 27,511 | \$ 14,118 | \$ 6,339 |
| Loans (1) | 298,474 | 60,932 | 106,097 | 72,561 | 17,321 |
| Fed funds and other short-term investments | 33,348 | - | - | - | - |
| Other earning assets | - | 11,219 | - | - | - |
| Total | \$ 339,363 | \$ 86,596 | \$133,608 | \$ 86,679 | \$ 23,660 |
| RATE SENSITIVE LIABILITIES: | | | | | |
| Noninterest bearing demand | \$ 6,447 | \$ 20,262 | \$ 36,521 | \$ 31,017 | \$ 55,531 |
| Interest bearing transaction | 19,892 | - | 13,262 | 13,262 | 19,893 |
| Savings and money market | 137,795 | - | 622 | 415 | 1,865 |
| Time deposits | 34,850 | 161,576 | 17,212 | 823 | - |
| Customer repurchase agreements | 31,549 | - | - | - | - |
| Other short-term borrowings | 10,000 | 10,000 | - | - | - |
| Total | \$ 240,533 | \$ 191,838 | \$ 67,617 | \$ 45,517 | \$ 77,289 |
| GAP | \$ 98,830 | \$ (105,242) | \$ 65,991 | \$ 41,162 | \$ (53,629) |
| Cumulative GAP | \$ 98,830 | \$ (6,412) | \$ 59,579 | \$100,741 | \$ 47,112 |
| Cumulative gap as percent of total assets | 14.23% | (0.92)% | 8.58% | 14.50% | 6.78% |

(1) Includes loans held for sale

Although NOW and MMA accounts are subject to immediate repricing, the Bank's GAP model has incorporated a repricing schedule to account for a lag in rate changes based on our experience, as measured by the amount of those deposit rate changes relative to the amount of rate change in assets.

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, and 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 both the Company and the Bank continues to exceed regulatory requirements to be considered well-capitalized. The primary

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

indicators used by bank regulators in measuring the capital position are the tier 1 risk-based capital ratio, the total risk-based capital ratio, and the tier 1 leverage ratio. Tier 1 capital consists of common and qualifying preferred stockholders' equity less intangibles. Total risk-based capital consists of tier 1 capital, qualifying subordinated debt, and a portion of the allowance for credit losses. Risk-based capital ratios are calculated with reference to risk-weighted assets. The tier 1 leverage ratio measures the ratio of tier 1 capital to total average assets for the most recent three month period.

The ability of the Company to continue to grow is dependent on its earnings and the ability to obtain additional funds for contribution to the Bank's capital, through additional borrowing, the sale of additional common stock, the sale of preferred stock, or through the issuance of additional qualifying equity equivalents, such as subordinated debt or trust preferred securities.

23

Capital

The actual capital amounts and ratios for the Company and Bank as of March 31, 2006 and March 31, 2005 are presented in the table below:

| Dollars in thousands | Company Actual Amount ----- | Company Actual Ratio ----- | Bank Actual Amount ----- | Bank Actual Ratio ----- |
|---|--------------------------------------|-------------------------------------|-----------------------------------|----------------------------------|
| As of March 31, 2006 | | | | |
| Total capital to risk-weighted assets | \$73,970 | 12.4% | \$64,853 | 11.0% |
| Tier 1 capital to risk-weighted assets | \$67,885 | 11.4% | \$58,833 | 10.0% |
| Tier 1 capital to average assets (leverage) | \$67,885 | 10.1% | \$58,833 | 8.9% |
| As of March 31, 2005 | | | | |
| Total capital to risk-weighted assets | \$64,692 | 13.0% | \$51,660 | 10.7% |
| Tier 1 to risk-weighted assets | \$60,029 | 12.1% | \$47,012 | 9.7% |
| Tier 1 capital to average assets (leverage) | \$60,029 | 10.7% | \$47,012 | 8.7% |

** 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 restricting extension of credit and transfers of assets between the Bank and the Company. At March 31, 2006, the Bank could pay dividends to the parent to the extent of its earnings so long as it maintained required capital ratios.

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Please refer to Item 2 of this report, "Management's Discussion and Analysis of Financial Condition and Results of Operations", under the caption "Asset/Liability Management and Quantitative and Qualitative Disclosure About Market Risk".

Item 4. Controls and Procedures

The Company's management, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated as of the last day of the period covered by this report the effectiveness of the operation of the Company's disclosure controls and procedures, as defined in Rule 13a-14 under the Securities and 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.

24

Part II Other Information

Item 1. Legal Proceedings

From time to time the Company may become involved in legal proceedings. At the present time there are no proceedings which the Company believes will have an adverse impact on the financial condition or earnings of the Company.

Item 1A. Risk Factors

There have been no material changes as of March 31, 2006 in the risk factors from those disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

- | | |
|---------------------------------------|-----------------|
| (a) Sales of Unregistered Securities. | None |
| (b) Use of Proceeds. | Not Applicable. |
| (c) Issuer Purchases of Securities. | None |

Item 3 Defaults Upon Senior Securities None

Item 4 Submission of Matters to a Vote of Security Holders None

Item 5 Other Information None.

- | | |
|--|------|
| (a) Required 8-K Disclosures | None |
| (b) Changes in Procedures for Director Nominations | None |

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

Item 6 Exhibits

| Exhibit No. | Description of Exhibit |
|-------------|--|
| 3(a) | Certificate of Incorporation of the Company, as amended (1) |
| 3(b) | Bylaws of the Company (2) |
| 10.1 | 1998 Stock Option Plan (3) |
| 10.2 | Employment Agreement between Michael T. Flynn and the Company (4) |
| 10.3 | Employment Agreement between Thomas D. Murphy and the Bank (4) |
| 10.4 | Employment Agreement between Ronald D. Paul and the Company (4) |
| 10.5 | Director Fee Agreement between Leonard L. Abel and the Company (4) |
| 10.6 | Employment Agreement between Susan G. Riel and the Bank (4) |
| 10.7 | Employment Agreement between Martha F. Tonat and the Bank (4) |
| 10.8 | Employment Agreement between Wilmer L. Tinley and the Bank (4) |
| 10.9 | Employee Agreement for James H. Langmead (5) |
| 10.10 | Employee Stock Purchase Plan (6) |
| 11 | Statement Regarding Computation of Per Share Income |
| 21 | Subsidiaries of the Registrant |
| 31.1 | Rule 13a-14(a) Certification of Ronald D. Paul |
| 31.2 | Rule 13a-14(a) Certification of Wilmer L. Tinley |
| 31.3 | Rule 13a-14(a) Certification of Michael T. Flynn |
| 32.1 | Section 1350 Certification of Ronald D. Paul |

25

| | |
|------|---|
| 32.2 | Section 1350 Certification of Wilmer L. Tinley |
| 32.3 | Section 1350 Certification of Michael T. Flynn |
| 32.4 | Section 1350 Certification of James H. Langmead |

-
- (1) Incorporated by reference to the exhibit of the same number to the Company's Quarterly Report on Form 10-QSB for the period ended September 30, 2002.
 - (2) Incorporated by reference to Exhibit 3(b) to the Company's Registration Statement on Form SB-2, dated December 12, 1997.
 - (3) Incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended December 31, 1998. (4) Incorporated by reference to exhibits of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2003.
 - (5) Incorporated by reference to exhibits of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2004
 - (6) Incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8 (No. 333-116352)

26

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Edgar Filing: EAGLE BANCORP INC - Form 10-Q

EAGLE BANCORP, INC.

Date: May 5, 2006

By: /s/ Ronald D. Paul

Ronald D. Paul, President and CEO

Date: May 5, 2006

By: /s/ Wilmer L. Tinley

Wilmer L. Tinley, Senior Vice President and
Chief Financial Officer