

BROOKLINE BANCORP INC  
Form 10-Q  
August 07, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended **June 30, 2007**

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 **0-23695**

**Brookline Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**160 Washington Street, Brookline, MA**  
(Address of principal executive offices)

**04-3402944**

(I.R.S. Employer  
Identification No.)

**02447-0469**  
(Zip Code)

**(617) 730-3500**

(Registrant's telephone number, including area code)

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

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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

Non-accelerated filer

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

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**BROOKLINE BANCORP, INC. AND SUBSIDIARIES  
FORM 10-Q**

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**Part I - Financial Information****Item 1. Financial Statements**

**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**  
(In thousands except share data)

|   | June 30,<br>2007<br>(unaudited) | December 31,<br>2006 |
|---|---------------------------------|----------------------|
| <b>ASSETS</b>   |                                 |                      |
| Cash and due from banks   | \$ 16,679                       | \$ 18,237            |
| Short-term investments  | 134,853                         | 134,417              |
| Securities available for sale   | 275,884                         | 335,246              |
| Securities held to maturity (market value of \$223 and \$242, respectively)   | 216                             | 233                  |
| Restricted equity securities  | 26,563                          | 28,567               |
| Loans   | 1,853,089                       | 1,792,062            |
| Allowance for loan losses   | (23,312 )                       | (23,024 )            |
| Net loans   | 1,829,777                       | 1,769,038            |
| Accrued interest receivable   | 9,443                           | 10,310               |
| Bank premises and equipment, net  | 9,258                           | 9,335                |
| Deferred tax asset  | 11,098                          | 11,036               |
| Prepaid income taxes  | 3,815                           | 1,801                |
| Goodwill  | 42,545                          | 42,545               |
| Identified intangible assets, net of accumulated amortization of \$5,611 and \$4,604, respectively                          | 7,341                           | 8,348                |
| Other assets  | 4,137                           | 3,927                |
| Total assets  | \$ 2,371,609                    | \$ 2,373,040         |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                                 |                      |
| Retail deposits   | \$ 1,231,252                    | \$ 1,210,206         |
| Brokered deposits   | 77,871                          | 78,060               |
| Borrowed funds  | 480,211                         | 463,806              |
| Subordinated debt   | 7,039                           | 12,092               |
| Mortgagors escrow accounts  | 5,275                           | 5,114                |
| Accrued expenses and other liabilities  | 21,683                          | 19,494               |
| Total liabilities   | 1,823,331                       | 1,788,772            |
| Minority interest in subsidiary   | 1,255                           | 1,375                |
| Stockholders equity:  |                                 |                      |
| Preferred stock, \$0.01 par value; 50,000,000 shares authorized; none issued  |                                 |                      |
| Common stock, \$0.01 par value; 200,000,000 shares authorized; 63,050,455 shares and 62,989,384 shares issued, respectively | 631                             | 630                  |
| Additional paid-in capital  | 510,511                         | 508,248              |
| Retained earnings, partially restricted   | 83,133                          | 96,229               |
| Accumulated other comprehensive loss  | (985 )                          | (640 )               |
| Treasury stock, at cost 3,465,611 shares and 1,405,611 shares, respectively   | (42,984 )                       | (18,144 )            |
| Unallocated common stock held by ESOP 602,027 shares and 629,081 shares, respectively                                       | (3,283 )                        | (3,430 )             |
| Total stockholders equity   | 547,023                         | 582,893              |
| Total liabilities and stockholders equity   | \$ 2,371,609                    | \$ 2,373,040         |

See accompanying notes to the unaudited consolidated financial statements.



**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Income**  
(In thousands except share data)

|  | Three months ended<br>June 30,<br>2007<br>(unaudited) |            | Six months ended<br>June 30,<br>2007 |            |
|--|---|------------|--------------------------------------|------------|
|  | 2006  | 2006       | 2006                                 | 2006       |
| <b>Interest income:</b>  |   |            |                                      |            |
| Loans  | \$ 30,329   | \$ 28,151  | \$ 59,922                            | \$ 52,202  |
| Debt securities  | 3,560   | 3,640      | 7,340                                | 7,259      |
| Marketable equity securities   | 7   | 30         | 35                                   | 63         |
| Restricted equity securities   | 403   | 2          | 884                                  | 311        |
| Short-term investments   | 1,798   | 1,326      | 3,483                                | 2,438      |
| Total interest income  | 36,097  | 33,149     | 71,664                               | 62,273     |
| <b>Interest expense:</b>   |   |            |                                      |            |
| Retail deposits  | 11,138  | 8,385      | 21,856                               | 15,831     |
| Brokered deposits  | 1,046   | 637        | 2,073                                | 637        |
| Borrowed funds   | 5,704   | 6,213      | 11,160                               | 11,057     |
| Subordinated debt  | 158   | 225        | 391                                  | 431        |
| Total interest expense   | 18,046  | 15,460     | 35,480                               | 27,956     |
| Net interest income  | 18,051  | 17,689     | 36,184                               | 34,317     |
| Provision for loan losses  | 1,107   | 859        | 2,357                                | 1,607      |
| Net interest income after provision for loan losses                  | 16,944  | 16,830     | 33,827                               | 32,710     |
| <b>Non-interest income:</b>  |   |            |                                      |            |
| Fees and charges   | 1,272   | 961        | 2,291                                | 1,535      |
| Gains on securities, net   |   |            |                                      | 558        |
| Other income (loss)  | 9   | (51)       | 40                                   | 17         |
| Total non-interest income  | 1,281   | 910        | 2,331                                | 2,110      |
| <b>Non-interest expense:</b>   |   |            |                                      |            |
| Compensation and employee benefits                                   | 5,246   | 5,089      | 10,485                               | 9,435      |
| Occupancy  | 836   | 766        | 1,691                                | 1,559      |
| Equipment and data processing  | 1,653   | 1,522      | 3,172                                | 2,940      |
| Professional services  | 536   | 331        | 1,015                                | 642        |
| Advertising and marketing  | 279   | 269        | 406                                  | 455        |
| Amortization of identified intangibles                               | 504   | 569        | 1,007                                | 1,096      |
| Other  | 1,172   | 900        | 2,280                                | 1,574      |
| Total non-interest expense   | 10,226  | 9,446      | 20,056                               | 17,701     |
| Income before income taxes and minority interest                     | 7,999   | 8,294      | 16,102                               | 17,119     |
| Provision for income taxes   | 3,103   | 3,298      | 6,221                                | 6,726      |
| Net income before minority interest                                  | 4,896   | 4,996      | 9,881                                | 10,393     |
| Minority interest in earnings of subsidiary                          | 44  | 67         | 88                                   | 67         |
| Net income   | \$ 4,852  | \$ 4,929   | \$ 9,793                             | \$ 10,326  |
| <b>Earnings per common share:</b>                                    |   |            |                                      |            |
| Basic  | \$ 0.08   | \$ 0.08    | \$ 0.16                              | \$ 0.17    |
| Diluted  | 0.08  | 0.08       | 0.16                                 | 0.17       |
| <b>Weighted average common shares outstanding during the period:</b> |   |            |                                      |            |
| Basic  | 59,749,897  | 60,363,461 | 60,139,899                           | 60,336,646 |
| Diluted  | 60,346,901  | 61,082,113 | 60,762,771                           | 61,066,784 |

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See accompanying notes to the unaudited consolidated financial statements.

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**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Comprehensive Income**  
(In thousands)

|  | Three months ended              |          | Six months ended |           |
|--|---------------------------------|----------|------------------|-----------|
|  | June 30,<br>2007<br>(unaudited) | 2006     | June 30,<br>2007 | 2006      |
| Net income   | \$ 4,852                        | \$ 4,929 | \$ 9,793         | \$ 10,326 |
| Other comprehensive losses, net of taxes:                            |                                 |          |                  |           |
| Unrealized securities holding losses                                 | (1,229 )                        | (250 )   | (534 )           | (995 )    |
| Income tax benefit   | 449                             | 100      | 193              | 381       |
| Net unrealized securities holding losses                             | (780 )                          | (150 )   | (341 )           | (614 )    |
| Adjustment of accumulated obligation for postretirement benefits     |                                 |          |                  |           |
| Income tax benefit   | (7 )                            |          | (7 )             |           |
| Net adjustment of accumulated obligation for postretirement benefits | 3                               |          | 3                |           |
| Net unrealized holding losses  | (4 )                            |          | (4 )             |           |
| Net unrealized holding losses  | (784 )                          | (150 )   | (345 )           | (614 )    |
| Less reclassification adjustment for gains included in net income:   |                                 |          |                  |           |
| Realized gains   |                                 |          |                  | 558       |
| Income tax expense   |                                 |          |                  | 200       |
| Net reclassification adjustment                                      |                                 |          |                  | 358       |
| Net other comprehensive losses                                       | (784 )                          | (150 )   | (345 )           | (972 )    |
| Comprehensive income   | \$ 4,068                        | \$ 4,779 | \$ 9,448         | \$ 9,354  |

See accompanying notes to the unaudited consolidated financial statements.



**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Changes in Stockholders Equity**  
**Six Months Ended June 30, 2007 and 2006 (Unaudited)**  
(Dollars in thousands)

|   | Common<br>stock | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>loss | Treasury<br>stock | Unearned<br>compensation-<br>recognition<br>and retention<br>plans | Unallocated<br>common<br>stock<br>held by<br>ESOP | Total<br>stockholders<br>equity |
|---|-----------------|----------------------------------|----------------------|---|-------------------|--|---|---------------------------------|
| Balance at December 31, 2005  | \$ 630          | \$ 512,338                       | \$ 121,042           | \$ (1,577 )                                   | \$ (18,144 )      | \$ (8,103 )  | \$ (3,736 )                                       | \$ 602,450                      |
| Net income  |                 |                                  | 10,326               |   |                   |  |   | 10,326                          |
| Other comprehensive losses  |                 |                                  |                      | (972 )  |                   |  |   | (972 )                          |
| Common stock dividends of \$0.37 per share  |                 |                                  | (22,335 )            |   |                   |  |   | (22,335 )                       |
| Payment of dividend equivalent rights   |                 |                                  | (388 )               |   |                   |  |   | (388 )                          |
| Income tax benefit from dividend payments on unexercised stock options and allocated ESOP shares          |                 | 222                              |                      |   |                   |  |   | 222                             |
| Transfer of unearned compensation under the recognition and retention plans to additional paid-in capital |                 | (8,103 )                         |                      |   |                   | 8,103  |   |                                 |
| Compensation under recognition and retention plans  |                 | 1,574                            |                      |   |                   |  |   | 1,574                           |
| Common stock held by ESOP committed to be released (28,038 shares)  |                 | 262                              |                      |   |                   |  | 153   | 415                             |
| Balance at June 30, 2006  | \$ 630          | \$ 506,293                       | \$ 108,645           | \$ (2,549 )                                   | \$ (18,144 )      | \$   | \$ (3,583 )                                       | \$ 591,292                      |

(Continued)

**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Changes in Stockholders' Equity (Continued)**  
**Six Months Ended June 30, 2007 and 2006 (Unaudited)**  
(Dollars in thousands)

|  | Common<br>stock | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>loss | Treasury<br>stock | Unallocated<br>common<br>stock<br>held by<br>ESOP | Total<br>stockholders<br>equity |
|--|-----------------|----------------------------------|----------------------|---|-------------------|---|---------------------------------|
| Balance at December 31, 2006   | \$ 630          | \$ 508,248                       | \$ 96,229            | \$ (640)                                      | )\$ (18,144)      | )\$ (3,430)                                       | )\$ 582,893                     |
| Net income   |                 |                                  | 9,793                |   |                   |   | 9,793                           |
| Other comprehensive losses   |                 |                                  |                      | (345)   |                   |   | (345)                           |
| Common stock dividends of \$0.37 per share   |                 |                                  | (22,404)             |   |                   |   | (22,404)                        |
| Payment of dividend equivalent rights  |                 |                                  | (485)                |   |                   |   | (485)                           |
| Exercise of stock options (92,460 shares)  | 1               | 357                              |                      |   |                   |   | 358                             |
| Treasury stock purchases (2,060,000 shares)  |                 |                                  |                      |   | (24,840)          |   | (24,840)                        |
| Income tax benefit from dividend payments on unexercised stock options and allocated ESOP shares |                 | 310                              |                      |   |                   |   | 310                             |
| Compensation under recognition and retention plans   |                 | 1,404                            |                      |   |                   |   | 1,404                           |
| Common stock held by ESOP committed to be released (27,054 shares)                               |                 | 192                              |                      |   |                   | 147   | 339                             |
| Balance at June 30, 2007   | \$ 631          | \$ 510,511                       | \$ 83,133            | \$ (985)                                      | )\$ (42,984)      | )\$ (3,283)                                       | )\$ 547,023                     |

See accompanying notes to the unaudited consolidated financial statements.

**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**  
(In thousands)

|   | <b>Six months ended</b> |                    |
|---|-------------------------|--------------------|
|   | <b>June 30,</b>         | <b>2006</b>        |
|   | <b>2007</b>             | <b>(unaudited)</b> |
| <b>Cash flows from operating activities:</b>                                      |                         |                    |
| Net income  | \$ 9,793                | \$ 10,326          |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |                    |
| Provision for loan losses   | 2,357                   | 1,607              |
| Compensation under recognition and retention plans                                | 1,404                   | 1,574              |
| Release of ESOP shares  | 339                     | 415                |
| Depreciation and amortization   | 725                     | 718                |
| Net amortization (accretion) of securities premiums and discounts                 | (539 )                  | 134                |
| Amortization of deferred loan origination costs                                   | 4,870                   | 4,002              |
| Amortization of identified intangible assets                                      | 1,007                   | 1,096              |
| Accretion of acquisition fair value adjustments                                   | (437 )                  | (642 )             |
| Amortization of mortgage servicing rights   | 10                      | 10                 |
| Net gains from sales of securities  |                         | (558 )             |
| Equity interest in earnings of other investment                                   |                         | (1 )               |
| Minority interest in earnings of subsidiary                                       | 88                      | 67                 |
| Deferred income taxes   | 134                     | 249                |
| (Increase) decrease in:   |                         |                    |
| Accrued interest receivable   | 867                     | (67 )              |
| Prepaid income taxes  | (2,014 )                | (2,610 )           |
| Other assets  | (220 )                  | 466                |
| Increase (decrease) in:   |                         |                    |
| Income taxes payable  |                         | (630 )             |
| Accrued expenses and other liabilities  | 2,083                   | 1                  |
| Net cash provided from operating activities                                       | 20,467                  | 16,157             |
| <b>Cash flows from investing activities:</b>                                      |                         |                    |
| Proceeds from sales of securities available for sale                              |                         | 903                |
| Proceeds from redemptions and maturities of securities available for sale         | 110,003                 | 54,804             |
| Proceeds from redemptions and maturities of securities held to maturity           | 17                      | 56                 |
| Purchase of securities available for sale   | (50,552 )               | (39,853 )          |
| Purchase of Federal Home Loan Bank of Boston stock                                |                         | (5,486 )           |
| Proceeds from redemptions of Federal Home Loan Bank of Boston stock               | 2,004                   |                    |
| Net increase in loans   | (67,581 )               | (63,732 )          |
| Purchase of bank premises and equipment   | (680 )                  | (399 )             |
| Acquisition, net of cash and cash equivalents acquired                            |                         | (10,374 )          |
| Net cash used for investing activities  | (6,789 )                | (64,081 )          |

(Continued)

**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows (Continued)**  
(In thousands)

|  | Six months ended<br>June 30,<br>2007<br>(unaudited) | 2006         |
|--|---|--------------|
| Cash flows from financing activities:  |   |              |
| Increase (decrease) in demand deposits and NOW, savings and money market savings accounts        | \$ 265  | \$ (27,761 ) |
| Increase in retail certificates of deposit   | 20,807  | 31,607       |
| Increase (decrease) in brokered certificates of deposit  | (189 )  | 68,096       |
| Proceeds from Federal Home Loan Bank of Boston advances  | 558,500   | 1,548,000    |
| Repayment of Federal Home Loan Bank of Boston advances   | (542,075 )  | (1,447,340 ) |
| Repayment of subordinated debt   | (5,000 )  |              |
| Repayment of other borrowed funds of subsidiary  |   | (95,410 )    |
| Increase in mortgagors' escrow accounts  | 161   | 316          |
| Income tax benefit from dividend payments on unexercised stock options and allocated ESOP shares | 310   | 222          |
| Proceeds from exercise of stock options  | 358   |              |
| Purchase of treasury stock   | (24,840 )   |              |
| Payment of dividends on common stock   | (22,404 )   | (22,335 )    |
| Payment of dividend equivalent rights  | (485 )  | (388 )       |
| Payment of dividend to minority interest members of subsidiary                                   | (208 )  |              |
| Net cash (used for) provided from financing activities   | (14,800 )   | 55,007       |
| Net increase (decrease) in cash and cash equivalents   |   |              |
|  | (1,122 )  | 7,083        |
| Cash and cash equivalents at beginning of period   | 152,654   | 118,395      |
| Cash and cash equivalents at end of period   | \$ 151,532  | \$ 125,478   |
| Supplemental disclosures of cash flow information:   |   |              |
| Cash paid during the period for:   |   |              |
| Interest on deposits and borrowed funds  | \$ 35,775   | \$ 27,316    |
| Income taxes   | 7,793   | 8,707        |
| Acquisition of Eastern Funding LLC:  |   |              |
| Assets acquired (excluding cash and cash equivalents)  | \$  | 111,536      |
| Liabilities assumed  |   | 99,772       |
| Minority interest in subsidiary  |   | 1,190        |

See accompanying notes to the unaudited consolidated financial statements.

**BROOKLINE BANCORP, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**  
**Six Months Ended June 30, 2007 and 2006**  
**(Unaudited)**

**(1) Summary of Significant Accounting Policies and Related Matters (Dollars in thousands except per share amounts)**

*Basis of Presentation*

The consolidated financial statements include the accounts of Brookline Bancorp, Inc. (the Company) and its wholly owned subsidiaries, Brookline Bank ( Brookline ) and Brookline Securities Corp. Brookline includes the accounts of its wholly owned subsidiary, BBS Investment Corporation, and its 86.3% owned subsidiary, Eastern Funding LLC (see note 2).

The Company operates as one reportable segment for financial reporting purposes. All significant intercompany transactions and balances are eliminated in consolidation. Certain amounts previously reported have been reclassified to conform to the current year's presentation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles ( GAAP ) for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation have been included. Results for the six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

In preparing these consolidated financial statements, management has made estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses.

*Critical Accounting Policies*

*Allowance for Loan Losses*

The allowance for loan losses is established through provisions for loan losses charged to earnings. Loans are charged off against the allowance when the collectibility of principal is unlikely. Indirect automobile loans delinquent 120 days are charged off, net of recoverable value, unless it can be clearly demonstrated that repayment will occur regardless of the delinquency status. Recoveries of loans previously charged off are credited to the allowance. In determining the level of the allowance for loan losses, management evaluates specific credits and the loan portfolio in general using several criteria that include historical performance, collateral values, cash flows and current economic conditions. The evaluation culminates with a judgment on the probability of collection of loans outstanding.

Management's methodology provides for three allowance components. The first component represents allowances established for specific identified loans. The second component represents allowances for groups of homogenous loans that currently exhibit no identified weaknesses and are evaluated on a collective basis. Allowances for groups of similar loans are established based on factors such as historical loss experience, the level and trends of loan delinquencies, and the level and trends of classified assets. Regarding the indirect automobile loan portfolio, allowances are established over the average life of the loans due to the absence of sufficient historical loss experience. The last component is an unallocated allowance which is based on evaluation of factors such as trends in the economy and real estate values in the areas where the Company lends money, concentrations in the amount of loans the Company has outstanding to large borrowers and concentrations in the type and geographic location of loan collateral. Determination of the unallocated allowance is a very subjective process. Management believes the unallocated allowance is an important component of the total allowance because it (a) addresses the probable inherent risk of loss that exists in the Company's loan portfolio (which is substantially comprised of loans with repayment terms extended over many years) and (b) helps to minimize the risk related to the imprecision inherent in the estimation of the other two components of the allowance.

*Goodwill and Identified Intangible Assets*

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Goodwill is not subject to amortization. Identified intangible assets are assets resulting from acquisitions that are being amortized over their estimated useful lives. The recoverability of goodwill and identified intangible assets is evaluated for impairment at least annually. If impairment is deemed to have occurred, the amount of impairment is charged to expense when identified.



### *Earnings Per Common Share*

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding for the applicable period, exclusive of unearned ESOP shares and unvested recognition and retention plan shares. Diluted earnings per share is calculated after adjusting the denominator of the basic earnings per share calculation for the effect of all potential dilutive common shares outstanding during the period. The dilutive effects of options and unvested restricted stock awards are computed using the treasury stock method.

### *Stock-Based Compensation*

Deferred compensation for shares awarded under recognition and retention plans is recorded as a reduction of stockholders' equity. Compensation expense is recognized over the vesting period of shares awarded based upon the fair value of the shares at the award date.

Compensation expense for the Employee Stock Ownership Plan ( ESOP ) is recorded at an amount equal to the shares allocated by the ESOP multiplied by the average fair market value of the shares during the year. The Company recognizes compensation expense ratably over the year based upon the Company's estimate of the number of shares expected to be allocated by the ESOP. The difference between the average fair market value and the cost of the shares allocated by the ESOP is recorded as an adjustment to additional paid-in-capital.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123-R, Share-Based Payment ( SFAS 123-R ), which requires that the grant-date fair value of awarded stock options be expensed over the requisite service period. Based on options outstanding at June 30, 2007, adoption of SFAS 123-R had no material effect on the Company's financial position at June 30, 2007 or results of operations as of and for the six months ended June 30, 2007 and 2006, and is not expected to have a material effect on the Company's financial position or results of operations thereafter.

### *Income Taxes*

Effective January 1, 2007, the Company adopted *Financial Accounting Standards Board ( FASB ) Interpretation No. 48 ( FIN 48 )*, *Accounting for Uncertainty in Income Taxes* . The interpretation requires that only tax positions that are more likely than not to be sustained upon a tax examination are to be recognized in a company's financial statements to the extent that the benefit is greater than 50% likely of being recognized. Adoption of FIN 48 did not have a material effect on the Company's financial position or results of operations.

### *Cash Equivalents*

For purposes of reporting cash flows, cash equivalents include highly liquid assets with an original maturity of three months or less. Highly liquid assets include cash and due from banks, short-term investments and money market loan participations.

## **(2) Acquisition (Dollars in thousands)**

### *Eastern Funding LLC ( Eastern )*

On April 13, 2006, the Company through its wholly-owned subsidiary, Brookline Bank, completed a merger agreement increasing its ownership interest in Eastern from 28.3% to 86.7%. Eastern, which was founded by Michael J. Fanger in 1997, specializes primarily in the financing of coin-operated laundromats, dry cleaning stores and convenient stores in the greater metropolitan New York area and selected other locations throughout the United States. The acquisition of a controlling interest in Eastern has enabled the Company to originate high yielding loans to small business entities. Mr. Fanger continues to serve as chief executive officer of Eastern and he, along with a family member and two executive officers of Eastern, own the minority interest position.

The purchase was completed through payment of \$16,575 in cash, including transaction costs. The transaction was accounted for using the purchase method of accounting, which required that the assets and liabilities of Eastern be recorded at fair value as of the acquisition date to the extent of the ownership interest acquired. The results of operations of Eastern are included in the Company's consolidated statements of income from the date of acquisition. The allocation of the purchase price to the net assets of Eastern and the resulting goodwill are presented below.





A summary of the transaction follows:

|  |            |
|--|------------|
| Total purchase price paid in cash, including transaction costs | \$ 16,575  |
| Fair value of assets acquired:                                 |            |
| Loans, net of allowance for loan losses                        | \$ 106,045 |
| Identified intangible assets                                   | 1,110      |
| Other assets   | 8,315      |
| Total assets acquired  | 115,470    |
| Fair value of liabilities assumed:                             |            |
| Borrowed funds   | 95,410     |
| Other liabilities  | 4,562      |
| Total liabilities assumed                                      | 99,972     |
| Fair value of assets acquired less liabilities assumed         | 15,498     |
| Less: Brookline Bancorp, Inc. investment in Eastern            | (4,663 )   |
| Minority interest ownership                                    | (1,190 )   |
| Fair value of net assets acquired                              | 9,645      |
| Goodwill resulting from the acquisition                        | \$ 6,930   |

As part of the merger, a member agreement was entered into which specifies the conditions under which the Company or the minority interest owners can buy or sell their ownership interests in Eastern, and how the price of such purchases and sales is to be determined. The minority interest owners may not sell or transfer their interests to anyone other than the Company except for family-related transfers permitted under the merger agreement. During a five year period subsequent to the date of the member agreement, Mr. Fanger is required to purchase additional units of interest in Eastern depending on the magnitude of annual cash distributions of Eastern's earnings. Mr. Fanger may also make discretionary purchases of additional units of ownership during the five year period subsequent to the date of the member agreement. The per unit price of all required and discretionary purchases by Mr. Fanger is book value as defined in the member agreement. The aggregate purchases made by Mr. Fanger may not increase by more than 5% his percentage of ownership of Eastern as of the merger date. Effective April 1, 2007, Mr. Fanger purchased required and discretionary units of interests which resulted in an increase in total minority interest ownership at that date from 13.3% to 13.7%.

**(3) Investment Securities (Dollars in thousands)**

Securities available for sale and held to maturity are summarized below:

|  | <b>June 30, 2007</b>      |                                       |  |                                 |
|--|---------------------------|---------------------------------------|--|---------------------------------|
|  | <b>Amortized<br/>cost</b> | <b>Gross<br/>unrealized<br/>gains</b> | <b>Gross<br/>unrealized<br/>losses</b> | <b>Estimated<br/>fair value</b> |
| <b>Securities available for sale:</b>  |                           |                                       |  |                                 |
| <b>Debt securities:</b>  |                           |                                       |  |                                 |
| U.S. Government-sponsored enterprises  | \$ 125,908                | \$ 5                                  | \$ 216                                 | \$ 125,697                      |
| Municipal obligations  | 7,115                     |                                       | 109                                    | 7,006                           |
| Auction rate municipal obligations   | 13,050                    |                                       |  | 13,050                          |
| Corporate obligations  | 5,894                     | 28                                    | 3                                      | 5,919                           |
| Other obligations  | 500                       |                                       |  | 500                             |
| Collateralized mortgage obligations issued by U.S.<br>Government-sponsored enterprises | 88,885                    | 17                                    | 636                                    | 88,266                          |
| Mortgage-backed securities issued by U.S. Government-sponsored<br>enterprises          | 35,961                    | 5                                     | 1,193                                  | 34,773                          |
| Total debt securities  | 277,313                   | 55                                    | 2,157                                  | 275,211                         |
| Marketable equity securities   | 535                       | 166                                   | 28                                     | 673                             |
| Total securities available for sale  | \$ 277,848                | \$ 221                                | \$ 2,185                               | \$ 275,884                      |

Securities held to maturity:

|   |        |      |    |        |
|---|--------|------|----|--------|
| Mortgage-backed securities issued by U.S. Government-sponsored<br>enterprises | \$ 216 | \$ 7 | \$ | \$ 223 |
|---|--------|------|----|--------|

|  | <b>December 31, 2006</b>  |                                       |  |                                 |
|--|---------------------------|---------------------------------------|--|---------------------------------|
|  | <b>Amortized<br/>cost</b> | <b>Gross<br/>unrealized<br/>gains</b> | <b>Gross<br/>unrealized<br/>losses</b> | <b>Estimated<br/>fair value</b> |
| <b>Securities available for sale:</b>  |                           |                                       |  |                                 |
| <b>Debt securities:</b>  |                           |                                       |  |                                 |
| U.S. Government-sponsored enterprises  | \$ 213,528                | \$ 90                                 | \$ 247                                 | \$ 213,371                      |
| Municipal obligations  | 8,660                     |                                       | 153                                    | 8,507                           |
| Auction rate municipal obligations   | 12,650                    |                                       |  | 12,650                          |
| Corporate obligations  | 6,467                     | 49                                    | 6                                      | 6,510                           |
| Other obligations  | 500                       |                                       |  | 500                             |
| Collateralized mortgage obligations issued by U.S.<br>Government-sponsored enterprises | 52,126                    | 21                                    | 176                                    | 51,971                          |
| Mortgage-backed securities issued by U.S.<br>Government-sponsored enterprises.         | 40,209                    | 7                                     | 1,154                                  | 39,062                          |
| Total debt securities  | 334,140                   | 167                                   | 1,736                                  | 332,571                         |
| Marketable equity securities   | 2,535                     | 178                                   | 38                                     | 2,675                           |
| Total securities available for sale  | \$ 336,675                | \$ 345                                | \$ 1,774                               | \$ 335,246                      |

Securities held to maturity:

|   |        |      |    |        |
|---|--------|------|----|--------|
| Mortgage-backed securities issued by U.S. Government-sponsored<br>enterprises | \$ 233 | \$ 9 | \$ | \$ 242 |
|---|--------|------|----|--------|

Debt securities of U.S. Government-sponsored enterprises include obligations issued by Fannie Mae, Freddie Mac, Ginnie Mae, Federal Home Loan Banks and the Federal Farm Credit Bank. None of those obligations is backed by the full faith and credit of the U.S. Government except for mortgage-backed securities issued by Ginnie Mae amounting to \$25 at June 30, 2007 and \$38 at December 31, 2006.

(4) **Loans (Dollars in thousands)**

A summary of loans follows:

|                                  | June 30,<br>2007 | December 31,<br>2006 |
|----------------------------------|------------------|----------------------|
| Mortgage loans:                  |                  |                      |
| One-to-four family               | \$ 297,103       | \$ 286,623           |
| Multi-family                     | 326,507          | 331,106              |
| Commercial real estate           | 381,580          | 373,744              |
| Construction and development     | 35,960           | 37,589               |
| Home equity                      | 35,027           | 36,432               |
| Second                           | 19,045           | 16,646               |
| Total mortgage loans             | 1,095,222        | 1,082,140            |
| Indirect automobile loans        | 591,048          | 540,094              |
| Commercial loans Eastern         | 138,605          | 127,275              |
| Other commercial loans           | 112,710          | 110,780              |
| Other consumer loans             | 3,640            | 3,322                |
| Total gross loans                | 1,941,225        | 1,863,611            |
| Unadvanced funds on loans        | (104,710)        | (85,879)             |
| Deferred loan origination costs: |                  |                      |
| Indirect automobile loans        | 15,367           | 13,175               |
| Commercial loans Eastern         | 891              | 991                  |
| Other                            | 316              | 164                  |
| Total loans                      | \$ 1,853,089     | \$ 1,792,062         |

(5) **Allowance for Loan Losses (Dollars in thousands)**

An analysis of the allowance for loan losses for the periods indicated follows:

|  | Six month ended<br>June 30, |           |
|--|-----------------------------|-----------|
|  | 2007                        | 2006      |
| Balance at beginning of period         | \$ 23,024                   | \$ 22,248 |
| Allowance obtained through acquisition |                             | 1,958     |
| Provision for loan losses              | 2,258                       | 1,607     |
| Charge-offs                            | (2,312)                     | (1,350)   |
| Recoveries                             | 342                         | 375       |
| Balance at end of period               | \$ 23,312                   | \$ 24,838 |

During the six months ended June 30, 2007, the liability for unfunded credit commitments was increased to \$1,385 at June 30, 2007 by a \$99 charge to the provision for loan losses. Such liability, which is included in other liabilities, was \$1,286 at December 31, 2006.

**(6) Deposits (Dollars in thousands)**

A summary of deposits follows:

|  | <b>June 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|--------------------------|------------------------------|
| Demand checking accounts               | \$ 65,898                | \$ 65,926                    |
| NOW accounts                           | 85,864                   | 94,538                       |
| Savings accounts                       | 70,798                   | 66,339                       |
| Guaranteed savings accounts            | 23,691                   | 32,725                       |
| Money market savings accounts          | 222,649                  | 209,107                      |
| Retail certificate of deposit accounts | 762,352                  | 741,571                      |
| Total retail deposits                  | 1,231,252                | 1,210,206                    |
| Brokered certificates of deposit       | 77,871                   | 78,060                       |
| Total deposits                         | \$ 1,309,123             | \$ 1,288,266                 |

**(7) Accumulated Other Comprehensive Loss (Dollars in thousands)**

Accumulated other comprehensive loss at June 30, 2007 and December 31, 2006 was comprised of unrealized losses on securities available for sale, net of income taxes, of \$1,231 and \$890, respectively, and an unrealized gain related to postretirement benefits, net of income taxes, of \$246 and \$250, respectively. At June 30, 2007 and December 31, 2006, the resulting net income tax benefit amounted to \$555 and \$359, respectively.

**(8) Commitments and Contingencies (Dollars in thousands)***Loan Commitments*

At June 30, 2007, the Company had outstanding commitments to originate loans of \$63,200, \$10,651 of which were one-to-four family mortgage loans, \$15,019 were commercial real estate mortgage loans, \$9,523 were multi-family mortgage loans, \$3,710 were commercial loans to condominium associations and \$24,297 were commercial loans. Unused lines of credit available to customers were \$52,068, of which \$48,493 were equity lines of credit.

*Legal Proceedings*

On February 28, 2007, Brookline Bank received a complaint filed against it in the Superior Court for the Commonwealth of Massachusetts (the Action ) by Carrie E. Mosca. Ms. Mosca defaulted on a loan obligation on an automobile that she co-owned. She alleges that the form of notice of sale of collateral that the Bank sent to her after she and the co-owner became delinquent on the loan obligation did not contain information required to be provided to a consumer under the Massachusetts Uniform Commercial Code. The Action purports to be brought on behalf of a class of individuals to whom the Bank sent the same form of notice in connection with transactions documented as consumer transactions during the four year period prior to the filing of the Action. The Action seeks statutory damages, an order restraining the Bank from future use of the form of notice sent to Ms. Mosca, an order barring the Bank from recovering any deficiency from other individuals to whom it sent the same form of notice and attorneys' fees and costs. The Action is in the discovery phase. The Bank intends to vigorously defend the Action. The Company is unable at this time to form an estimate of the loss, if any, that may arise from this matter.

In addition to the above matter, the Company and its subsidiaries are involved in litigation that is considered incidental to the business of the Company. Management believes the results of such litigation will be immaterial to the consolidated financial condition or results of operations of the Company.

**(9) Dividend Declaration**

On July 19, 2007, the Board of Directors of the Company approved a regular quarterly dividend of \$0.085 per share and an extra dividend of \$0.20 per share payable August 15, 2007 to stockholders of record on July 31, 2007.



(10) **Share-Based Payment Arrangements (Dollars in thousands, except per share amounts)**

*Recognition and Retention Plans*

The Company has two recognition and retention plans, the 1999 RRP and the 2003 RRP. Under both of the plans, shares of the Company's common stock were reserved for issuance as restricted stock awards to officers, employees and non-employee directors of the Company. Shares issued upon vesting may be either authorized but unissued shares or reacquired shares held by the Company as treasury shares. Any shares not issued because vesting requirements are not met will again be available for issuance under the plans. Shares awarded vest over varying time periods ranging from six months up to eight years for the 1999 RRP and from less than three months to over five years for the 2003 RRP. In the event a recipient ceases to maintain continuous service with the Company by reason of normal retirement (applicable to the 1999 RRP and in part to the 2003 RRP), death or disability, or following a change in control, RRP shares still subject to restriction will vest and be free of such restrictions.

Total expense for the RRP plans amounted to \$776, \$899, \$1,404 and \$1,574 for the three months and six months ended June 30, 2007 and 2006, respectively. The compensation cost of non-vested RRP shares at June 30, 2007 is expected to be charged to expense as follows: \$1,116 during the six month period ended December 31, 2007 and \$2,231 and \$143 during the years ended December 31, 2008 and 2009, respectively. As of June 30, 2007, the number of shares available for award under the 1999 RRP and the 2003 RRP were 29,774 shares and 131,060 shares, respectively.

*Stock Option Plans*

The Company has two stock option plans, the 1999 Option Plan and the 2003 Option Plan. Under both of the plans, shares of the Company's common stock were reserved for issuance to directors, employees and non-employee directors of the Company. Shares issued upon the exercise of a stock option may be either authorized but unissued shares or reacquired shares held by the Company as treasury shares. Any shares subject to an award which expire or are terminated unexercised will again be available for issuance under the plans. The exercise price of options awarded is the fair market value of the common stock of the Company on the date the award is made. Options vest over periods ranging from less than one month through over five years. Part of the options granted under the 1999 Option Plan and all of the options granted under the 2003 Option Plan include a reload feature whereby an optionee exercising an option by delivery of shares of common stock would automatically be granted an additional option at the fair market value of stock when such additional option is granted equal to the number of shares so delivered. If an individual to whom a stock option was granted ceases to maintain continuous service by reason of normal retirement, death or disability, or following a change in control, all options and rights granted and not fully exercisable become exercisable in full upon the happening of such an event and shall remain exercisable for a period ranging from three months to five years.

Total expense for the stock option plans amounted to \$1 and none for the six months ended June 30, 2007 and 2006, respectively.

Activity under the Company's stock option plans for the six months ended June 30, 2007 was as follows:

|   |           |
|---|-----------|
| Options outstanding at January 1, 2007                                | 3,182,988 |
| Reload options granted at \$12.46 per option                          | 7,929     |
| Cancelled reloaded options (\$11.00 to \$15.42 per option)            | (16,849 ) |
| Forfeited options (\$15.02 per option)                                | (60,000 ) |
| Options exercised at \$4.944 per option                               | (92,460 ) |
| Options outstanding at June 30, 2007                                  | 3,021,608 |
| Exercisable at June 30, 2007 at:                                      |           |
| \$ 4.944 per share  | 1,679,108 |
| \$ 12.91 per share  | 41,000    |
| \$ 15.02 per share  | 1,297,500 |
|   | 3,017,608 |
| Aggregate intrinsic value of options outstanding                      | \$ 11,025 |
| Weighted average exercise price per option                            | \$ 9.39   |
| Weighted average remaining contractual life in years at end of period | 3.81      |

As of June 30, 2007, the number of options available for award under the Company's 1999 Stock Option Plan and 2003 Stock Option Plan were 245,980 options and 1,197,500 options, respectively.

#### *Employee Stock Ownership Plan*

The Company maintains an ESOP to provide eligible employees the opportunity to own Company stock. Employees are eligible to participate in the Plan after reaching age twenty-one, completion of one year of service and working at least one thousand hours of consecutive service during the year. Contributions are allocated to eligible participants on the basis of compensation, subject to federal tax law limits.

A loan obtained by the ESOP from the Company to purchase Company common stock is payable in quarterly installments over 30 years and bears interest at 8.50% per annum. The loan can be prepaid without penalty. Loan payments are principally funded by cash contributions from the Bank, subject to federal tax law limits. The outstanding balance of the loan at June 30, 2007 and December 31, 2006, which was \$3,877 and \$4,002, respectively, is eliminated in consolidation.

Shares used as collateral to secure the loan are released and available for allocation to eligible employees as the principal and interest on the loan is paid. Employees vest in their ESOP account at a rate of 20% annually commencing in the year of completion of three years of credited service or immediately if service is terminated due to death, retirement, disability or change in control. Dividends on released shares are credited to the participants' ESOP accounts. Dividends on unallocated shares are generally applied towards payment of the loan. ESOP shares committed to be released are considered outstanding in determining earnings per share.

At June 30, 2007, the ESOP held 602,027 unallocated shares at an aggregate cost of \$3,283; the market value of such shares at that date was \$6,929. For the six months ended June 30, 2007 and 2006, \$339 and \$415, respectively, was charged to compensation expense based on the commitment to release to eligible employees 27,054 shares and 28,038 shares in those respective periods.

#### **(11) Postretirement Benefits (Dollars in thousands)**

Postretirement benefits are provided for part of the annual expense of health insurance premiums for retired employees and their dependents. No contributions are made by the Company to invest in assets allocated for the purpose of funding this benefit obligation.





The following table provides the components of net periodic postretirement benefit costs for the three months and six months ended June 30, 2007 and 2006:

|                            | Three months ended |       | Six months ended |       |
|----------------------------|--------------------|-------|------------------|-------|
|                            | June 30,<br>2007   | 2006  | June 30,<br>2007 | 2006  |
| Service cost               | \$ 14              | \$ 14 | \$ 28            | \$ 28 |
| Interest cost              | 11                 | 12    | 22               | 23    |
| Prior service cost         | (7 )               | (6 )  | (14 )            | (11 ) |
| Actuarial (gain) loss      | (3 )               | (1 )  | 2                | (2 )  |
| Net periodic benefit costs | \$ 15              | \$ 19 | \$ 38            | \$ 38 |

Benefits paid amounted to \$7 and \$5 for the six months ended June 30, 2007 and 2006, respectively.

## (12) Stockholders Equity (Dollars in thousands)

### *Capital Distributions and Restrictions Thereon*

OTS regulations impose limitations on all capital distributions by savings institutions. Capital distributions include cash dividends, payments to repurchase or otherwise acquire the institution's shares, payments to shareholders of another institution in a cash-out merger and other distributions charged against capital. The regulations establish three tiers of institutions. An institution, such as the Bank, that exceeds all capital requirements before and after a proposed capital distribution ( Tier 1 institution ) may, after prior notice but without the approval of the OTS, make capital distributions during a year up to 100% of its current year net income plus its retained net income for the preceding two years not previously distributed. Any additional capital distributions require OTS approval.

### *Common Stock Repurchases*

During the 2007 first and second quarters, 335,000 shares and 1,725,000 shares, respectively, of the Company's common stock were repurchased at an average cost of \$12.35 and \$11.94, respectively, exclusive of transaction costs.

As of June 30, 2007, the Company was authorized to repurchase up to 2,212,532 shares of its common stock. On July 19, 2007, the Board of Directors of the Company approved a program to repurchase an additional 2,000,000 shares of the Company's common stock. The new program will become effective upon completion of the buy back of 2,212,532 shares remaining under the previously approved existing repurchase program. Under both the existing and new repurchase programs, the Board of Directors has delegated to the discretion of the Company's senior management the authority to determine the timing of the repurchases and the prices at which the repurchases will be made.

### *Restricted Retained Earnings*

As part of the stock offering in 2002 and as required by regulation, Brookline Bank established a liquidation account for the benefit of eligible account holders and supplemental eligible account holders who maintain their deposit accounts at Brookline Bank after the stock offering. In the unlikely event of a complete liquidation of Brookline Bank (and only in that event), eligible depositors who continue to maintain deposit accounts at Brookline Bank would be entitled to receive a distribution from the liquidation account. Accordingly, retained earnings of the Company are deemed to be restricted up to the balance of the liquidation account. The liquidation account balance is reduced annually to the extent that eligible depositors have reduced their qualifying deposits as of each anniversary date. Subsequent increases in deposit account balances do not restore an account holder's interest in the liquidation account. The liquidation account totaled \$36,512 at December 31, 2006.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Forward Looking Statements**

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements made by or on behalf of the Company.

The following discussion contains forward-looking statements based on management's current expectations regarding economic, legislative and regulatory issues that may impact the Company's earnings and financial condition in the future. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Any statements included herein preceded by, followed by or which include the words "may", "could", "should", "will", "would", "believe", "expect", "anticipate", "estimate", "intend", "plan", "assume" or similar words constitute forward-looking statements.

Forward-looking statements, implicitly and explicitly, include assumptions underlying the statements. While the Company believes the expectations reflected in its forward-looking statements are reasonable, the statements involve risks and uncertainties that are subject to change based on various factors, some of which are outside the control of the Company. The following factors, among others, could cause the Company's actual performance to differ materially from the expectations, forecasts and projections expressed in the forward-looking statements: general and local economic conditions, changes in interest rates, demand for loans, real estate values, deposit flows, regulatory considerations, competition, technological developments, retention and recruitment of qualified personnel, and market acceptance of the Company's pricing, products and services.

**Executive Level Overview**

The following is a summary of operating and financial condition highlights as of and for the three months and six months ended June 30, 2007 and 2006.

**Operating Highlights**

|  | Three months ended<br>June 30,          |           | Six months ended<br>June 30, |           |   |
|--|---|-----------|------------------------------|-----------|---|
|  | 2007                                    | 2006      | 2007                         | 2006      |   |
|  | (In thousands except per share amounts) |           |                              |           |   |
| Net interest income                              | \$ 18,051                               | \$ 17,689 | \$ 36,184                    | \$ 34,317 |   |
| Provision for loan losses                        | 1,107                                   | 859       | 2,357                        | 1,607     |   |
| Non-interest income                              | 1,281                                   | 910       | 2,331                        | 2,110     |   |
| Amortization of identified intangible assets     | 504                                     | 569       | 1,007                        | 1,096     |   |
| Other non-interest expenses                      | 9,722                                   | 8,877     | 19,049                       | 16,605    |   |
| Income before income taxes and minority interest | 7,999                                   | 8,294     | 16,102                       | 17,119    |   |
| Provision for income taxes                       | 3,103                                   | 3,298     | 6,221                        | 6,726     |   |
| Minority interest in earnings of subsidiary      | 44                                      | 67        | 88                           | 67        |   |
| Net income                                       | 4,852                                   | 4,929     | 9,793                        | 10,326    |   |
| Basic earnings per common share                  | \$ 0.08                                 | \$ 0.08   | \$ 0.16                      | \$ 0.17   |   |
| Diluted earnings per common share                | 0.08                                    | 0.08      | 0.16                         | 0.17      |   |
| Interest rate spread                             | 2.13                                    | % 2.14    | % 2.11                       | % 2.15    | % |
| Net interest margin                              | 3.18                                    | % 3.11    | % 3.18                       | % 3.11    | % |

**Financial Condition Highlights**

|                                      | At<br>June 30,<br>2007<br>(In thousands) |     | At<br>December 31,<br>2006 |     | At<br>June 30,<br>2006 |   |
|--------------------------------------|--|-----|----------------------------|-----|------------------------|---|
| Total assets                         | \$ 2,371,609                             |     | \$ 2,373,040               |     | \$ 2,381,365           |   |
| Net loans                            | 1,829,777                                |     | 1,769,038                  |     | 1,778,953              |   |
| Retail deposits                      | 1,231,252                                |     | 1,210,206                  |     | 1,171,967              |   |
| Brokered deposits                    | 77,871                                   |     | 78,060                     |     | 68,096                 |   |
| Borrowed funds and subordinated debt | 487,250                                  |     | 475,898                    |     | 524,282                |   |
| Stockholders' equity                 | 547,023                                  |     | 582,893                    |     | 591,292                |   |
| Stockholders' equity to total assets | 23.07                                    | %   | 24.56                      | %   | 24.83                  | % |
| Allowance for loan losses            | \$ 23,312                                | (A) | \$ 23,024                  | (A) | \$ 24,838              |   |
| Non-performing assets                | 4,224                                    |     | 1,959                      |     | 1,156                  |   |

(A) Net of an allowance for unfunded loan commitments of \$1,385 and \$1,286, respectively, which is included in other liabilities at those dates.

The major factors affecting recent and projected operating and financial condition highlights are as follows:

- The continued pressure on interest rate spread and net interest margin
- The acquisition of a controlling interest in Eastern Funding LLC ( Eastern )
- Growth of the indirect automobile loan portfolio
- Higher provisions for loan losses relating to the Eastern and indirect automobile loan portfolios
- Higher non-interest expenses due primarily to inclusion of Eastern since the 2006 second quarter, growth of indirect automobile lending, the opening of a new branch in April 2006 and higher personnel-related expenses
- Repurchases of the Company's common stock (335,000 shares in the 2007 first quarter and 1,725,000 shares in the 2007 second quarter)

Commentary on each of the factors listed is presented on the following pages.

**Average Balances, Net Interest Income, Interest Rate Spread and Net Interest Margin**

The following tables set forth information about the Company's average balances, interest income and rates earned on average interest-earning assets, interest expense and rates paid on interest-bearing liabilities, interest rate spread and net interest margin for the three months and six months ended June 30, 2007 and 2006. Average balances are derived from daily average balances and yields include fees and costs which are considered adjustments to yields.

|  | Three months ended June 30,<br>2007          |             |       | Average<br>yield/<br>cost | 2006               |             |                           |
|--|--|-------------|-------|---------------------------|--------------------|-------------|---------------------------|
|  | Average<br>balance<br>(Dollars in thousands) | Interest(1) |       |                           | Average<br>balance | Interest(1) | Average<br>yield/<br>cost |
| <b>Assets</b>  |  |             |       |                           |                    |             |                           |
| Interest-earning assets:   |  |             |       |                           |                    |             |                           |
| Short-term investments   | \$ 138,758                                   | \$ 1,798    | 5.20  | %                         | \$ 109,539         | \$ 1,326    | 4.86 %                    |
| Debt securities(2)   | 288,231                                      | 3,646       | 5.06  |                           | 355,854            | 3,728       | 4.19                      |
| Equity securities(2) (3)   | 27,254                                       | 413         | 6.08  |                           | 30,604             | 44          | 0.57                      |
| Mortgage loans(4)  | 1,032,270                                    | 16,488      | 6.39  |                           | 1,088,971          | 17,426      | 6.40                      |
| Commercial loans   |  |             |       |                           |                    |             |                           |
| Eastern Funding (4)  | 129,088                                      | 3,444       | 10.70 |                           | 111,875            | 3,022       | 10.80                     |
| Other commercial loans(4)  | 69,274                                       | 1,234       | 7.13  |                           | 67,465             | 1,140       | 6.76                      |
| Indirect automobile loans(4)                                       | 594,485                                      | 9,098       | 6.14  |                           | 517,906            | 6,509       | 5.04                      |
| Other consumer loans(4)  | 3,328  | 65          | 7.81  |                           | 2,981              | 54          | 7.25                      |
| Total interest-earning assets                                      | 2,282,688                                    | 36,186      | 6.35  | %                         | 2,285,195          | 33,249      | 5.82 %                    |
| Allowance for loan losses  | (23,162 )                                    |             |       |                           | (24,624 )          |             |                           |
| Non-interest earning assets  | 97,926                                       |             |       |                           | 106,097            |             |                           |
| Total assets   | \$ 2,357,452                                 |             |       |                           | \$ 2,366,668       |             |                           |
| <b>Liabilities and Stockholders</b>                                |  |             |       |                           |                    |             |                           |
| <b>Equity</b>  |  |             |       |                           |                    |             |                           |
| Interest-bearing liabilities:                                      |  |             |       |                           |                    |             |                           |
| Deposits:  |  |             |       |                           |                    |             |                           |
| NOW accounts   | \$ 86,446                                    | 69          | 0.32  | %                         | \$ 91,160          | 56          | 0.25 %                    |
| Savings accounts   | 97,496                                       | 407         | 1.67  |                           | 118,965            | 486         | 1.64                      |
| Money market savings accounts                                      | 221,129                                      | 1,566       | 2.84  |                           | 218,833            | 1,301       | 2.38                      |
| Retail certificates of deposit                                     | 753,724                                      | 9,096       | 4.84  |                           | 668,202            | 6,542       | 3.93                      |
| Total retail deposits  | 1,158,795                                    | 11,138      | 3.86  |                           | 1,097,160          | 8,385       | 3.07                      |
| Brokered certificates of deposit                                   | 77,958                                       | 1,046       | 5.38  |                           | 47,639             | 637         | 5.36                      |
| Total deposits   | 1,236,753                                    | 12,184      | 3.95  |                           | 1,144,799          | 9,022       | 3.16                      |
| Borrowed funds   | 468,236                                      | 5,704       | 4.82  |                           | 529,105            | 6,213       | 4.65                      |
| Subordinated debt  | 8,260  | 158         | 7.57  |                           | 12,176             | 225         | 7.28                      |
| Total interest bearing liabilities                                 | 1,713,249                                    | 18,046      | 4.22  | %                         | 1,686,080          | 15,460      | 3.68 %                    |
| Non-interest-bearing demand  |  |             |       |                           |                    |             |                           |
| checking accounts  | 61,803                                       |             |       |                           | 62,735             |             |                           |
| Other liabilities  | 24,376                                       |             |       |                           | 23,817             |             |                           |
| Total liabilities  | 1,799,428                                    |             |       |                           | 1,772,632          |             |                           |
| Stockholders' equity   | 558,024                                      |             |       |                           | 594,036            |             |                           |
| Total liabilities and stockholders' equity                         | \$ 2,357,452                                 |             |       |                           | \$ 2,366,668       |             |                           |
| Net interest income (tax equivalent basis)/interest rate spread(5) |  |             |       |                           |                    |             |                           |
|  |  | 18,140      | 2.13  | %                         |                    | 17,789      | 2.14 %                    |
| Less adjustment of tax exempt income                               |  |             |       |                           |                    |             |                           |
|  |  | 89          |       |                           |                    | 100         |                           |
| Net interest income  |  | \$ 18,051   |       |                           |                    | \$ 17,689   |                           |
| Net interest margin (6)  |  |             | 3.18  | %                         |                    |             | 3.11 %                    |

- (1) Tax exempt income on equity securities and municipal bonds is included on a tax equivalent basis.
- (2) Average balances include unrealized gains (losses) on securities available for sale. Equity securities include marketable equity securities (preferred and common stocks) and restricted equity securities.
- (3) The Federal Home Loan Bank ( FHLB ) changed the timing of its declaration of dividends on its common stock. As a result, no dividend was declared by the FHLB in the second quarter of 2006 and, accordingly, no income was recognized by the Company in that period. The FHLB declared dividends in the third quarter that were equivalent to two quarterly periods. The amount of FHLB dividend income recognized by the Company in the first quarter of 2007 and 2006 was \$480,000 and \$307,000, respectively, and \$401,000 in the second quarter of 2007.
- (4) Loans on non-accrual status are included in average balances.
- (5) Interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.
- (6) Net interest margin represents net interest income (tax equivalent basis) divided by average interest-earning assets.

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|   | Six months ended June 30,<br>2007            |             |                           | 2006               |             |                           |  |
|---|--|-------------|---------------------------|--------------------|-------------|---------------------------|--|
|   | Average<br>balance<br>(Dollars in thousands) | Interest(1) | Average<br>yield/<br>cost | Average<br>balance | Interest(1) | Average<br>yield/<br>cost |  |
| <b>Assets</b>   |  |             |                           |                    |             |                           |  |
| Interest-earning assets:  |  |             |                           |                    |             |                           |  |
| Short-term investments  | \$ 134,641                                   | \$ 3,483    | 5.22 %                    | \$ 106,523         | \$ 2,438    | 4.62 %                    |  |
| Debt securities(2)  | 301,427                                      | 7,510       | 4.98                      | 360,811            | 7,412       | 4.11                      |  |
| Equity securities(2) (3)  | 28,135                                       | 933         | 6.68                      | 29,108             | 398         | 2.75                      |  |
| Mortgage loans(4)   | 1,035,081                                    | 33,222      | 6.42                      | 1,096,629          | 34,805      | 6.35                      |  |
| Commercial loans  |  |             |                           |                    |             |                           |  |
| Eastern Funding(4)  | 128,597                                      | 6,926       | 10.77                     | 56,247             | 3,022       | 10.80                     |  |
| Other commercial loans(4)   | 69,112                                       | 2,458       | 7.11                      | 65,138             | 2,231       | 6.85                      |  |
| Indirect automobile loans(4)  | 578,691                                      | 17,186      | 5.99                      | 500,318            | 12,038      | 4.85                      |  |
| Other consumer loans(4)   | 3,278  | 130         | 7.93                      | 2,952              | 106         | 7.18                      |  |
| Total interest-earning assets   | 2,278,962                                    | 71,848      | 6.32 %                    | 2,217,726          | 62,450      | 5.64 %                    |  |
| Allowance for loan losses   | (23,069 )                                    |             |                           | (23,472 )          |             |                           |  |
| Non-interest earning assets   | 98,636                                       |             |                           | 102,002            |             |                           |  |
| Total assets  | \$ 2,354,529                                 |             |                           | \$ 2,296,256       |             |                           |  |
| <b>Liabilities and Stockholders</b>                                       |  |             |                           |                    |             |                           |  |
| <b>Equity</b>   |  |             |                           |                    |             |                           |  |
| Interest-bearing liabilities:   |  |             |                           |                    |             |                           |  |
| Deposits:   |  |             |                           |                    |             |                           |  |
| NOW accounts  | \$ 86,814                                    | 141         | 0.33 %                    | \$ 91,365          | 109         | 0.24 %                    |  |
| Savings accounts  | 97,699                                       | 804         | 1.66                      | 118,416            | 890         | 1.52                      |  |
| Money market savings accounts   | 215,640                                      | 2,968       | 2.78                      | 224,616            | 2,497       | 2.24                      |  |
| Retail certificates of deposit  | 750,982                                      | 17,943      | 4.82                      | 656,823            | 12,335      | 3.79                      |  |
| Total retail deposits   | 1,151,135                                    | 21,856      | 3.83                      | 1,091,220          | 15,831      | 2.93                      |  |
| Brokered certificates of deposit  | 77,713                                       | 2,073       | 5.38                      | 23,951             | 637         | 5.36                      |  |
| Total deposits  | 1,228,848                                    | 23,929      | 3.93                      | 1,115,171          | 16,468      | 2.98                      |  |
| Borrowed funds  | 461,507                                      | 11,160      | 4.81                      | 489,235            | 11,057      | 4.50                      |  |
| Subordinated debt   | 10,160                                       | 391         | 7.65                      | 12,191             | 431         | 7.03                      |  |
| Total interest bearing liabilities  | 1,700,515                                    | 35,480      | 4.21 %                    | 1,616,597          | 27,956      | 3.49 %                    |  |
| Non-interest-bearing demand   |  |             |                           |                    |             |                           |  |
| checking accounts   | 62,072                                       |             |                           | 62,672             |             |                           |  |
| Other liabilities   | 25,026                                       |             |                           | 21,695             |             |                           |  |
| Total liabilities   | 1,787,613                                    |             |                           | 1,700,964          |             |                           |  |
| Stockholders equity.  | 566,916                                      |             |                           | 595,292            |             |                           |  |
| Total liabilities and<br>stockholders equity                              | \$ 2,354,529                                 |             |                           | \$ 2,296,256       |             |                           |  |
| Net interest income (tax<br>equivalent basis)/interest rate<br>spread (5) |  |             |                           |                    |             |                           |  |
|   |  | 36,368      | 2.11 %                    |                    | 34,494      | 2.15 %                    |  |
| Less adjustment of tax exempt<br>income                                   |  |             |                           |                    |             |                           |  |
|   |  | 184         |                           |                    | 177         |                           |  |
| Net interest income   |  | \$ 36,184   |                           |                    | \$ 34,317   |                           |  |
| Net interest margin (6)   |  |             | 3.18 %                    |                    |             | 3.11 %                    |  |

(1) Tax exempt income on equity securities and municipal bonds is included on a tax equivalent basis.

(2) Average balances include unrealized gains (losses) on securities available for sale. Equity securities include marketable equity securities (preferred and common stocks) and restricted equity securities.

(3) The Federal Home Loan Bank ( FHLB ) changed the timing of its declaration of dividends on its common stock. As a result, no dividend was declared by the FHLB in the second quarter of 2006 and, accordingly, no income was recognized by the Company in that period. The FHLB declared dividends in the third quarter that were equivalent to two quarterly periods. The amount of FHLB dividend income recognized by the Company in the six months ended June 30, 2007 and 2006 was \$881,000 and \$307,000, respectively.

(4) Loans on non-accrual status are included in average balances.

(5) Interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.

(6) Net interest margin represents net interest income (tax equivalent basis) divided by average interest-earning assets.

Highlights from the preceding tables follow.

- Interest rate spread declined from 2.15% in the first half of 2006 to 2.11% in the first half of 2007 as the average rate paid on interest-bearing liabilities rose more rapidly than the average rate realized on interest-earning assets. In the 2007 second quarter, however, interest rate spread improved to 2.13% from the 2.11% interest rate spread realized in the 2007 first quarter.

- Net interest margin increased from 3.11% in the first half of 2006 to 3.18% in the first half of 2007 and in the 2007 second quarter. The improvement in net interest margin resulted primarily from higher asset yields. Net interest margin declined, however, from 3.20% in the 2007 first quarter to 3.18% in the 2007 second quarter due to a reduction in stockholders' equity resulting primarily from repurchases of the Company's common stock and payment of an extra dividend of \$0.20 per share in February 2007.
- As mentioned in note 3 on the preceding tables, in the 2006 second quarter, the FHLB changed the timing of its declaration of dividends on its common stock. That change had the adverse impact on the 2006 second quarter income disclosed in note 3 on the preceding tables.
- The average balance of total loans outstanding as a percent of the average balance of total interest-earning assets increased from 78% in the first half of 2006 to 80% in the first half of 2007. Generally, the yield on loans is higher than the yield on investment securities.
- Average interest-earning assets in the 2007 second quarter were \$2.5 million, or 0.1%, lower than in the 2006 second quarter. Declines in the average balances of mortgage loans (\$57 million) and debt securities (\$68 million) were substantially offset by increases in the average balances of indirect automobile loans (\$77 million), Eastern loans (\$17 million) and short-term investments (\$29 million).
- Average interest-earning assets increased \$61 million, or 3%, in the first half of 2007 compared to the first half of 2006. The growth resulted primarily from increases in indirect automobile loans (\$78 million), Eastern loans (\$72 million – see the next subsection for additional information regarding Eastern) and short-term investments (\$28 million). Offsetting some of these increases were reductions in the average balances of mortgage loans (\$62 million) and debt securities (\$59 million).
- Asset growth in the first half of 2007 compared to the first half of 2006 was funded primarily from growth of retail deposits (\$60 million, or 5%) and brokered certificates of deposit (\$54 million). The average balance of borrowings from the FHLB declined \$28 million.
- The average rate earned on mortgage loans, the Company's largest asset category, increased modestly from 6.35% in the first half of 2006 to 6.42% in the first half of 2007, but declined from 6.45% in the 2007 first quarter to 6.39% in the 2007 second quarter. Competition for mortgage loans has made it increasingly difficult to raise the pricing of loan originations. Due in part to such competition, the Company has refrained from aggressive origination of mortgage loans with unattractive yields.
- The average yield on the indirect automobile loan portfolio improved from 5.04% in the 2006 second quarter to 5.83% in the 2007 first quarter and 6.14% in the 2007 second quarter as rates on loan originations are higher than the rates on loans that are being paid down.
- Interest income was 15% higher in the first half of 2007 than in the first half of 2006. Net interest income, however, increased only 5% as interest expense rose 27% between the two periods. The more significant rise in funding costs resulted primarily from higher rates paid for borrowed funds and higher rates being offered in the market place for deposits with shorter maturities. The mix of deposits shifted from lower rate transaction deposit accounts to higher rate certificates of deposit. Certificates of deposit comprised 62% of total retail deposits at June 30, 2007 compared to 61% at December 31, 2006 and 58% at June 30, 2006.



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The inverted yield curve environment, which has existed for some time, has started to change modestly. Meaningful improvement in interest rate spread and net interest margin will continue to be difficult until the yield curve becomes more upward in slope.

### **Acquisition of Controlling Interest in Eastern**

As described more fully in note 2 to the consolidated financial statements appearing on pages 9 and 10 herein, on April 13, 2006, the Company acquired a controlling interest in Eastern. Included in the Company's earnings are the operating results of Eastern commencing in the 2006 second quarter. In the first quarter of 2006, the Company accounted for its investment in Eastern under the equity method.

Eastern specializes primarily in the financing of coin-operated laundromats, dry cleaning stores and convenience stores in the greater metropolitan New York area and selected other locations in the United States. The Eastern loan portfolio amounted to \$106 million at the time of acquisition and \$139 million at June 30, 2007. Included in the total at June 30,

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2007 are \$9.5 million of seasoned loans purchased from a third-party manufacturer of laundry equipment. The average rate earned on the Eastern loan portfolio in the 2007 second quarter was 10.70%.

Eastern's loans earn higher rates of interest because the borrowers are typically small businesses that lack the capital to borrow funds at lower rates. Because of higher risk characteristics, the rate of losses on Eastern's loans will normally exceed that experienced in other segments of the Company's loan portfolio.

#### **Indirect Automobile Loan Portfolio**

The Company's indirect automobile (auto) loan portfolio has grown from \$459 million at the end of 2005 to \$540 million at the end of 2006 and \$591 million at June 30, 2007. It is expected that the rate of growth will decline going forward because of market conditions and the higher level of loan originations required to offset the reductions in loan balances from normal monthly principal payments.

In originating auto loans, there is a strong correlation between the interest rate offered and the credit risk of the borrower. In general, the lower the credit score of the borrower, the higher the interest rate earned. Correspondingly, loan losses are normally higher when credit scores are lower.

Since entering the business in February 2003, it has been the policy of the Company to limit loans to borrowers with credit scores below 660 to no more than 15% of the total portfolio. In 2006, based on its historically favorable loan loss experience and a desire to improve the profitability of auto lending, the Company expanded its lending to borrowers with lower credit scores. The Company expects the resulting increase in income to more than offset the increase in loan losses that likely will result from this initiative. The 15% policy limit was not changed. The percent of auto loans outstanding with credit scores below 660 was 11.7% at June 30, 2007 compared to 11.0% at December 31, 2006 and 8.5% at December 31, 2005. The average credit score of all auto loans outstanding was 730 at June 30, 2007, 732 at December 31, 2006 and 731 at December 31, 2005.

#### **Provision for Loan Losses**

The provision for loan losses was \$1,107,000 in the 2007 second quarter compared to \$859,000 in the 2006 second quarter and \$2,357,000 in the first half of 2007 compared to \$1,607,000 in the first half of 2006. The provision for loan losses is comprised of amounts relating to the auto loan portfolio, the Eastern loan portfolio and the remainder of the Company's loan portfolio.

The provision for loan losses related to the auto loan portfolio was \$779,000 in the 2007 second quarter and \$757,000 in the 2006 second quarter. These amounts exceeded net charge-offs of \$528,000 and \$420,000 in those respective periods, resulting in annualized rates of net charge-offs of 0.36% and 0.32%, respectively. The provision for loan losses related to the auto loan portfolio was \$1,623,000 in the first half of 2007 and \$1,505,000 in the first half of 2006. Net charge-offs were \$1,295,000 and \$899,000 in those respective periods resulting in annualized rates of net charge-offs of 0.45% and 0.36%, respectively. Loans delinquent 30 days and over were \$5,851,000, or 0.99% of auto loans outstanding at June 30, 2007, compared to \$5,594,000 (1.00%) at March 31, 2007 and \$7,092,000 (1.31%) at December 31, 2006.

The provision for loan losses related to the Eastern portfolio was \$328,000 in the 2007 second quarter, \$380,000 in the 2007 first quarter and \$177,000 in the 2006 second quarter. Net charge-offs in the 2007 second and first quarters were \$288,000 and \$391,000, respectively, resulting in a six month annualized rate of net charge-offs of 1.06% of average loans outstanding. Loans delinquent 30 days or more increased from \$1,436,000 (1.13% of total loans) at December 31, 2006 to \$2,221,000 (1.75%) at March 31, 2007, but declined to \$2,034,000 (1.47%) at June 30, 2007. Loans on non-accrual at those respective dates increased from \$657,000 (0.52% of total loans) to \$2,199,000 (1.74%) and \$2,254,000 (1.75% of total loans excluding \$9.5 million of seasoned loans purchased at the end of the quarter). The total allowance for loan losses for Eastern's loans at June 30, 2007 was \$2,326,000, or 1.80% of loans outstanding (excluding the quarter end purchase). Despite a much lower rate of charge-off experience, the allowance is maintained at 1.80% in recognition of the higher risk exposure associated with Eastern's loans. The higher risk exposure is the reason why the rates charged on the loans are significantly higher than on other segments of the Company's loan portfolio.

Regarding the remainder of the Company's loan portfolio, which is comprised primarily of mortgage loans, \$25,000 was provided in the first half of 2007 and \$75,000 was credited to income in the first half of 2006. The credit was due primarily to the reduction of mortgage loans outstanding and payments made on loans acquired in connection with the acquisition of Mystic Financial, Inc. in January 2005. No mortgage loans were charged off in the first half of 2007 and 2006. Mortgage loans delinquent 30 days or more at June 30, 2007 were insignificant at \$516,000.



### **Non-Interest Expense**

Non-interest expenses were \$780,000, or 8.3%, higher in the 2007 second quarter than in the 2006 second quarter due primarily to higher expenses related to auto lending resulting from portfolio growth, higher occupancy costs and higher legal fees. The \$2,355,000, or 13.3%, increase in non-interest expenses in the first half of 2007 compared to the first half of 2006 was due primarily to the inclusion of Eastern for only the second quarter in 2006 compared to two quarters in 2007, the opening of a new branch in April 2006 and the other reasons mentioned regarding the second quarter comparison.

### **Repurchases of the Company's Common Stock**

During the 2007 second quarter, the Company repurchased 1,725,000 shares of its common stock at a total cost of \$20.7 million, or \$11.99 per share including transaction costs. An additional 335,000 shares had been purchased in the 2007 first quarter at a total cost of \$4.2 million, or \$12.40 per share including transaction costs. Based on a prior approval and after consideration of the shares repurchased in the 2007 second quarter, management was authorized to repurchase 2,212,532 shares of the Company's common stock as of June 30, 2007. On July 19, 2007, the Board of Directors increased that authorization by an additional 2,000,000 shares.

### **Other Operating Highlights**

*Non-Interest Income.* Sales of marketable equity securities resulted in a net gain of \$558,000 in the 2006 first quarter. There were no other sales of securities in the second quarter of 2006 or in the first half of 2007.

Excluding securities gains, the increases in non-interest income in the 2007 quarterly and six month periods compared to the same periods for 2006 were due primarily to higher deposit service fees and loan fees. Loan fees included fees from prepayment of mortgage loans in the 2007 and 2006 second quarters of \$333,000 and \$92,000, respectively, and in the first half of 2007 and 2006 of \$459,000 and \$124,000, respectively.

*Provision for Income Taxes.* The effective rate of federal and state income taxes applied to the Company's pre-tax income declined from 39.3% in the first half of 2006 to 38.6% in the first half of 2007 due primarily to a higher portion of taxable income being earned by the Company's investment securities subsidiaries. Income in those subsidiaries is subject to a lower rate of state taxation than income earned by the Company and its other subsidiaries.

### **Other Financial Condition Highlights**

*Deposits.* Retail deposits at June 30, 2007 were \$21.0 million, or 1.7%, higher than at December 31, 2006. The mix of deposits continued to shift to higher paying categories as \$20.8 million of the increase occurred in certificate of deposit accounts. Continuation of the current interest rate environment could result in further shifting to higher rate deposits.

*Borrowed Funds.* Funds borrowed from the FHLB increased \$16.4 million from December 31, 2006 to \$480.2 million at June 30, 2007. On April 22, 2007, the Company called and paid off \$5.0 million of floating rate debentures that were scheduled to mature in 2032. The annual interest rate paid on the debentures at the date of payment was 9.09%.

*Stockholders' Equity.* Stockholders' equity declined \$35.9 million in the first half of 2007 to \$547.0 million at June 30, 2007. The decline resulted primarily from repurchases of the Company's common stock at a total cost of \$24.8 million and payment of an extra dividend of \$0.20 per share (\$12.2 million in total) to stockholders in February 2007.

The Board of Directors approved payment of a regular quarterly dividend of \$0.085 per share and another extra dividend of \$0.20 per share to stockholders of record on July 31, 2007 and payable August 15, 2007. The extra dividend is the ninth time since August 2003 that the Board of Directors has approved such a payment. The aggregate amount paid, over \$107 million, or \$1.80 per share, represents a taxable return of capital to stockholders rather than a taxable distribution of earnings. The payout of semi-annual extra dividends has been an effective means to reduce the Company's excess capital in a measured way and to treat all stockholders equally. Future payments of extra dividends and the magnitude of any such payments will be considered in light of changing opportunities to deploy capital effectively, including the repurchase of Company common stock and expansion of the Company's business through acquisitions.



**Non-Performing Assets, Restructured Loans and Allowance for Loan Losses**

The following table sets forth information regarding non-performing assets, restructured loans and the allowance for loan losses:

|   | June 30,<br>2007       |   | December 31,<br>2006 |   |
|---|------------------------|---|----------------------|---|
|   | (Dollars in thousands) |   |                      |   |
| Non-accrual loans:                                    |                        |   |                      |   |
| Mortgage loans:                                       |                        |   |                      |   |
| One-to-four family                                    | \$ 516                 |   | \$                   |   |
| Commercial real estate                                |                        |   | 90                   |   |
| Commercial loans Eastern                              | 2,254                  |   | 657                  |   |
| Indirect automobile loans                             | 216                    |   | 153                  |   |
| Total non-accrual loans                               | 2,986                  |   | 900                  |   |
| Repossessed vehicles                                  | 864                    |   | 784                  |   |
| Repossessed equipment                                 | 374                    |   | 178                  |   |
| Other receivable                                      |                        |   | 97                   |   |
| Total non-performing assets                           | \$ 4,224               |   | \$ 1,959             |   |
| Restructured loans                                    | \$ 617                 |   | \$                   |   |
| Allowance for loan losses                             | \$ 23,312              |   | \$ 23,024            |   |
| Allowance for loan losses as a percent of total loans | 1.26                   | % | 1.28                 | % |
| Non-accrual loans as a percent of total loans         | 0.16                   | % | 0.05                 | % |
| Non-performing assets as a percent of total assets    | 0.18                   | % | 0.08                 | % |

Loans are placed on non-accrual status either when reasonable doubt exists as to the full timely collection of interest and principal or automatically when loans become past due 90 days.

Restructured loans represent performing loans for which concessions (such as reductions of interest rates to below market rates and/or extension of repayment terms) are granted due to a borrower's financial condition.

In addition to identifying non-performing loans, the Company identifies loans that are characterized as impaired pursuant to generally accepted accounting principles. The definition of impaired loans is not the same as the definition of non-accrual loans, although the two categories tend to overlap. All of the Eastern loans on non-accrual at June 30, 2007 and December 31, 2006 were considered to be impaired loans. Specific reserves on those loans amounted to \$801,000 and \$122,000 at those respective dates.

The unallocated portion of the allowance for loan losses was \$4.2 million, or 18.0% of the total allowance for loan losses, at June 30, 2007 compared to \$4.3 million, or 18.7% of the total allowance for loan losses, at December 31, 2006.

See the section Provision for Loan Losses on a preceding page for additional information about the Company's loans, including delinquencies and charge-offs.

**Asset/Liability Management**

The Company's Asset/Liability Committee is responsible for managing interest rate risk and reviewing with the Board of Directors on a quarterly basis its activities and strategies, the effect of those strategies on the Company's operating results, the Company's interest rate risk position and the effect changes in interest rates would have on the Company's net interest income.

Generally, it is the Company's policy to reasonably match the rate sensitivity of its assets and liabilities. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within the same time period.

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At June 30, 2007, interest-earning assets maturing or repricing within one year amounted to \$1.013 billion and interest-bearing liabilities maturing or repricing within one year amounted to \$1.225 billion, resulting in a cumulative one year negative gap position of \$212 million, or 8.9% of total assets. At December 31, 2006, the Company had a negative one year cumulative gap position of \$117 million, or 4.9% of total assets. The change in the cumulative one year gap position from the end of 2006 resulted primarily from reduction in the total of debt securities maturing within one year and an increase in borrowings maturing within one year.

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## Liquidity and Capital Resources

The Company's primary sources of funds are deposits, principal and interest payments on loans and debt securities and borrowings from the FHLB. While maturities and scheduled amortization of loans and investments are predictable sources of funds, deposit flows and mortgage loan prepayments are greatly influenced by interest rate trends, economic conditions and competition.

Based on its monitoring of deposit trends and its current pricing strategy for deposits, management believes the Company will retain a large portion of its existing deposit base. Growth during the remainder of 2007 will depend on several factors, including the interest rate environment and competitor pricing.

The Company utilizes advances from the FHLB to fund growth and to manage part of the interest rate sensitivity of its assets and liabilities. Total advances outstanding at June 30, 2007 amounted to \$480.2 million and the Company had the capacity to increase that amount to \$681.7 million.

The Company's most liquid assets are cash and due from banks, short-term investments and debt securities that generally mature within 90 days. At June 30, 2007, such assets amounted to \$161.7 million, or 6.8% of total assets.

At June 30, 2007, Brookline Bank exceeded all regulatory capital requirements. The Bank's Tier I capital was \$438.8 million, or 19.4% of adjusted assets. The minimum required Tier I capital ratio is 4.00%.

## Recent Accounting Pronouncements

*Financial Accounting Standards Board ( FASB ) Interpretation No. 48 ( FIN 48 ), Accounting for Uncertainty in Income Taxes* . In June 2006, the FASB issued FIN 48, an interpretation of FASB Statement No. 109, *Accounting for Income Taxes* , in order to add clarity to the accounting for uncertainty in income taxes recognized in a company's financial statements. The interpretation requires that only tax positions that are more likely than not to be sustained upon a tax examination are to be recognized in a company's financial statements to the extent that the benefit is greater than 50% likely of being recognized. The differences that arise between the amounts recognized in the financial statements and the amounts recognized in the tax return will lead to an increase or decrease in current taxes, an increase or decrease to the deferred tax asset or deferred tax liability, respectively, or both. FIN 48 is effective for fiscal years beginning after December 15, 2006. Adoption of FIN 48 did not have a material effect on the Company's financial position or results of operations.

*Statement of Financial Accounting Standards No. 157 ( SFAS 157 ), Fair Value Measurements* . In September 2006, the FASB issued SFAS 157 to provide consistency and comparability in determining fair value measurements and to provide for expanded disclosures about fair value measurements. The definition of fair value maintains the exchange price notion in earlier definitions of fair value but focuses on the exit price of the asset or liability. The exit price is the price that would be received to sell the asset or paid to transfer the liability adjusted for certain inherent risks and restrictions. Expanded disclosures are also required about the use of fair value to measure assets and liabilities. The effective date is for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not believe that adoption of SFAS 157 will have a material impact on the Company's financial position or results of operations.

*Statement of Financial Accounting Standards No. 159 ( SFAS 159 ), Fair Value Option for Financial Assets and Financial Liabilities* . In February 2007, the FASB issued SFAS 159 which generally permits the measurement of selected eligible financial instruments, including investment securities, at fair value as of specified election dates and to report unrealized gains or losses on those instruments in earnings at each subsequent reporting date. Generally, the fair value option may be applied on an instrument by instrument basis but, once applied, the election is irrevocable and is applied to the entire instrument. This accounting standard is to be adopted no later than January 1, 2008, although earlier adoption is permitted, subject to certain conditions. The Company does not contemplate early adoption of SFAS 159 and is unable



to determine at this time whether adoption will have a material effect on its financial statements.

**Item 3. Quantitative and Qualitative Disclosures about Market Risks**

For a discussion of the Company's management of market risk exposure and quantitative information about market risk, see pages 13 through 15 of the Company's Annual Report incorporated by reference in Part II item 7A of Form 10-K for the fiscal year ending December 31, 2006.

**Item 4. Controls and Procedures**

Under the supervision and with the participation of the Company's management, including its chief executive officer and chief financial officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls

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and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, the chief executive officer and the chief financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective to insure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms.

There has been no change in the Company's internal control over financial reporting identified in connection with the quarterly evaluation that occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Part II - Other Information**

**Item 1. Legal Proceedings**

On February 28, 2007, Brookline Bank received a complaint filed against it in the Superior Court for the Commonwealth of Massachusetts (the Action) by Carrie E. Mosca. Ms. Mosca defaulted on a loan obligation on an automobile that she co-owned. She alleges that the form of notice of sale of collateral that the Bank sent to her after she and the co-owner became delinquent on the loan obligation did not contain information required to be provided to a consumer under the Massachusetts Uniform Commercial Code. The Action purports to be brought on behalf of a class of individuals to whom the Bank sent the same form of notice in connection with transactions documented as consumer transactions during the four year period prior to the filing of the Action. The Action seeks statutory damages, an order restraining the Bank from future use of the form of notice sent to Ms. Mosca, an order barring the Bank from recovering any deficiency from other individuals to whom it sent the same form of notice and attorneys' fees and costs. The Action is in the discovery phase. The Bank intends to vigorously defend the Action. The Company is unable at this time to form an estimate of the loss, if any, that may arise from this matter.

In addition to the above matter, the Company and its subsidiaries are involved in litigation that is considered incidental to the business of the Company. Management believes the results of such litigation will be immaterial to the consolidated financial condition or results of operations of the Company.

**Item 1A. Risk Factors**

There have been no material changes from the risk factors presented in the Company's Form 10-K for the year ended December 31, 2006 filed on February 28, 2007.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

a) Not applicable.

b) Not applicable.

c) The following table presents a summary of the Company's share repurchases during the quarter ended June 30, 2007.

| Period                         | Total Number of Shares Purchased | Average Price Paid Per Share(1) | Total Number of Shares Purchased as Part of Publicly Announced Programs(2)(3) | Maximum Number of Shares that May Yet be Purchased Under the Programs |
|--------------------------------|----------------------------------|---------------------------------|---|---|
| April 1 through April 30, 2007 | 363,200                          | \$ 12.23                        | 1,863,200   | (2) 1,074,332 (2)   |
| May 1 through May 31, 2007     | 473,700                          | \$ 11.97                        | 2,336,900   | (2) 600,632 (2)   |
| June 1 through June 30, 2007   | 888,100                          | \$ 11.81                        | 600,632<br>287,468  | (2)<br>(3) 2,212,532 (3)  |

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|       |           |    |       |
|-------|-----------|----|-------|
| Total | 1,725,000 | \$ | 11.94 |
|-------|-----------|----|-------|

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(1) Excludes transaction costs.

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(2) On March 6, 2003, the Company announced that the Office of Thrift Supervision (the OTS ) did not object to its request to repurchase up to 5% of its outstanding common stock, or 2,937,532 shares. Prior to April 1, 2007, 1,500,000 of the shares authorized under this program had been repurchased. Repurchase of the remaining 1,437,532 shares authorized under this program was completed in June 2007.

(3) On April 19, 2007, the Board of Directors approved another program to repurchase an additional 2,500,000 shares of the Company s common stock. Such program did not require the approval of the OTS.

(4) On July 19, 2007, the Board of Directors approved another program to repurchase an additional 2,000,000 shares of the Company s common stock. Such program did not require the approval of the OTS.

The Board of Directors has delegated to the discretion of the Company s senior management the authority to determine the timing of the repurchases and the prices at which the repurchases will be made.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

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

On April 19, 2007, the Company held its annual meeting of stockholders for the purpose of the election of five Directors to three year terms and ratification of the appointment of KPMG LLP as the independent registered public accounting firm for the Company for the year ending December 31, 2007.

The number of votes cast at the meeting was as follow:

|                               | Number of<br>Votes For | Number of<br>Votes Withheld |
|-------------------------------|------------------------|-----------------------------|
| <b>Election of Directors:</b> |                        |                             |
| Davis C. Chapin               | 55,014,262             | 1,347,946                   |
| John A. Hackett               | 55,182,596             | 1,179,613                   |
| John L. Hall, II              | 55,036,419             | 1,325,789                   |
| Hollis W. Plimpton, Jr.       | 55,027,958             | 1,334,251                   |
| Rosamond B. Vaule             | 55,034,092             | 1,328,117                   |

  

|  | Number of<br>Votes For | Number of<br>Votes Against | Number of Votes<br>Abstained |
|--|------------------------|----------------------------|------------------------------|
| Ratification of appointment of the independent registered public accounting firm | 55,685,733             | 442,207                    | 60,197                       |

**Item 5. Other Information**

Not applicable.

**Item 6. Exhibits**

*Exhibits*

Exhibit 11 Statement Regarding Computation of Per Share Earnings

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- Exhibit 31.1 Certification of Chief Executive Officer
- Exhibit 31.2 Certification of Chief Financial Officer
- Exhibit 32.1 Section 1350 Certification of Chief Executive Officer
- Exhibit 32.2 Section 1350 Certification of Chief Financial Officer

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**SIGNATURES**

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

**BROOKLINE BANCORP, INC.**

Date: August 7, 2007

By:

/s/ Richard P. Chapman, Jr.  
Richard P. Chapman, Jr.  
President and Chief Executive Officer

Date: August 7, 2007

By:

/s/ Paul R. Bechet  
Paul R. Bechet  
Senior Vice President, Treasurer and Chief  
Financial Officer