

BROOKLINE BANCORP INC  
Form 10-Q  
November 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 September 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)

**04-3402944**

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

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

**02447-0469**  
(Zip Code)

**(617) 730-3500**

(Registrant's telephone number, including area code)

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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

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)**

|                                                                                                                             | September 30,<br>2007 | December 31,<br>2006 |
|-----------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
|                                                                                                                             | (unaudited)           |                      |
| <b><u>ASSETS</u></b>                                                                                                        |                       |                      |
| Cash and due from banks                                                                                                     | \$ 15,665             | \$ 18,237            |
| Short-term investments                                                                                                      | 130,254               | 134,417              |
| Securities available for sale                                                                                               | 265,424               | 335,246              |
| Securities held to maturity (market value of \$203 and \$242, respectively)                                                 | 195                   | 233                  |
| Restricted equity securities                                                                                                | 26,563                | 28,567               |
| Loans                                                                                                                       | 1,892,087             | 1,792,062            |
| Allowance for loan losses                                                                                                   | (23,461)              | (23,024)             |
| Net loans                                                                                                                   | 1,868,626             | 1,769,038            |
| Accrued interest receivable                                                                                                 | 9,897                 | 10,310               |
| Bank premises and equipment, net                                                                                            | 9,267                 | 9,335                |
| Deferred tax asset                                                                                                          | 10,936                | 11,036               |
| Prepaid income taxes                                                                                                        | 1,089                 | 1,801                |
| Goodwill                                                                                                                    | 42,545                | 42,545               |
| Identified intangible assets, net of accumulated amortization of \$6,115 and \$4,604, respectively                          | 6,837                 | 8,348                |
| Other assets                                                                                                                | 4,608                 | 3,927                |
| Total assets                                                                                                                | \$ 2,391,906          | \$ 2,373,040         |
| <b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>                                                                          |                       |                      |
| Retail deposits                                                                                                             | \$ 1,244,642          | \$ 1,210,206         |
| Brokered deposits                                                                                                           | 67,991                | 78,060               |
| Borrowed funds                                                                                                              | 512,019               | 463,806              |
| Subordinated debt                                                                                                           | 7,024                 | 12,092               |
| Mortgagors' escrow accounts                                                                                                 | 5,429                 | 5,114                |
| Accrued expenses and other liabilities                                                                                      | 21,997                | 19,494               |
| Total liabilities                                                                                                           | 1,859,102             | 1,788,772            |
| Minority interest in subsidiary                                                                                             | 1,321                 | 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; 63,256,281 shares and 62,989,384 shares issued, respectively | 633                   | 630                  |
| Additional paid-in capital                                                                                                  | 511,758               | 508,248              |
| Retained earnings, partially restricted                                                                                     | 70,109                | 96,229               |
| Accumulated other comprehensive income (loss)                                                                               | 7                     | (640)                |
| Treasury stock, at cost 3,922,911 shares and 1,405,611 shares, respectively                                                 | (47,815)              | (18,144)             |
| Unallocated common stock held by ESOP 588,500 shares and 629,081 shares, respectively                                       | (3,209)               | (3,430)              |

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|                                            |    |           |    |           |
|--------------------------------------------|----|-----------|----|-----------|
| Total stockholders' equity                 |    | 531,483   |    | 582,893   |
| Total liabilities and stockholders' equity | \$ | 2,391,906 | \$ | 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>September 30, |           | Nine months ended<br>September 30, |           |
|-----------------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                                     | 2007                                | 2006      | 2007                               | 2006      |
|                                                     | (unaudited)                         |           |                                    |           |
| Interest income:                                    |                                     |           |                                    |           |
| Loans                                               | \$ 31,258                           | \$ 29,154 | \$ 91,181                          | \$ 81,356 |
| Debt securities                                     | 3,342                               | 3,774     | 10,682                             | 11,033    |
| Marketable equity securities                        | 15                                  | 30        | 50                                 | 93        |
| Restricted equity securities                        | 469                                 | 763       | 1,353                              | 1,074     |
| Short-term investments                              | 1,759                               | 1,436     | 5,242                              | 3,874     |
| Total interest income                               | 36,843                              | 35,157    | 108,508                            | 97,430    |
| Interest expense:                                   |                                     |           |                                    |           |
| Retail deposits                                     | 11,476                              | 9,523     | 33,332                             | 25,354    |
| Brokered deposits                                   | 1,019                               | 968       | 3,092                              | 1,605     |
| Borrowed funds                                      | 6,211                               | 6,256     | 17,371                             | 17,313    |
| Subordinated debt                                   | 140                                 | 236       | 531                                | 667       |
| Total interest expense                              | 18,846                              | 16,983    | 54,326                             | 44,939    |
| Net interest income                                 | 17,997                              | 18,174    | 54,182                             | 52,491    |
| Provision for loan losses                           | 1,503                               | 813       | 3,860                              | 2,420     |
| Net interest income after provision for loan losses | 16,494                              | 17,361    | 50,322                             | 50,071    |
| Non-interest income:                                |                                     |           |                                    |           |
| Fees and charges                                    | 926                                 | 829       | 3,217                              | 2,362     |
| Gains on securities, net                            |                                     |           |                                    | 558       |
| Other income                                        | 1                                   | 8         | 40                                 | 28        |
| Total non-interest income                           | 927                                 | 837       | 3,257                              | 2,948     |
| Non-interest expense:                               |                                     |           |                                    |           |
| Compensation and employee benefits                  | 5,227                               | 5,027     | 15,712                             | 14,462    |
| Occupancy                                           | 854                                 | 837       | 2,545                              | 2,396     |
| Equipment and data processing                       | 1,700                               | 1,538     | 4,872                              | 4,478     |
| Professional services                               | 462                                 | 365       | 1,477                              | 1,007     |
| Advertising and marketing                           | 406                                 | 294       | 813                                | 749       |
| Amortization of identified intangibles              | 503                                 | 569       | 1,510                              | 1,665     |
| Other                                               | 1,243                               | 1,002     | 3,521                              | 2,577     |
| Total non-interest expense                          | 10,395                              | 9,632     | 30,450                             | 27,334    |
| Income before income taxes and minority interest    | 7,026                               | 8,566     | 23,129                             | 25,685    |
| Provision for income taxes                          | 2,711                               | 3,383     | 8,932                              | 10,109    |
| Net income before minority interest                 | 4,315                               | 5,183     | 14,197                             | 15,576    |
| Minority interest in earnings of subsidiary         | 66                                  | 74        | 154                                | 141       |
| Net income                                          | \$ 4,249                            | \$ 5,109  | \$ 14,043                          | \$ 15,435 |
| Earnings per common share:                          |                                     |           |                                    |           |
| Basic                                               | \$ 0.07                             | \$ 0.08   | \$ 0.24                            | \$ 0.25   |
| Diluted                                             | 0.07                                | 0.08      | 0.23                               | 0.25      |

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Weighted average common shares outstanding during the period:

|         |            |            |            |            |
|---------|------------|------------|------------|------------|
| Basic   | 58,541,627 | 60,387,098 | 59,597,169 | 60,353,648 |
| Diluted | 59,020,681 | 61,060,561 | 60,171,865 | 61,064,942 |

See accompanying notes to the unaudited consolidated financial statements.

## BROOKLINE BANCORP, INC. AND SUBSIDIARIES

## Consolidated Statements of Comprehensive Income

(In thousands)

|                                                                      | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |           |
|----------------------------------------------------------------------|-------------------------------------|----------|------------------------------------|-----------|
|                                                                      | 2007                                | 2006     | 2007                               | 2006      |
|                                                                      | (unaudited)                         |          |                                    |           |
| Net income                                                           | \$ 4,249                            | \$ 5,109 | \$ 14,043                          | \$ 15,435 |
| Other comprehensive income, net of taxes:                            |                                     |          |                                    |           |
| Unrealized securities holding gains                                  | 1,559                               | 2,306    | 1,025                              | 1,311     |
| Income tax expense                                                   | (563)                               | (847)    | (370)                              | (467)     |
| Net unrealized securities holding gains                              | 996                                 | 1,459    | 655                                | 844       |
| Adjustment of accumulated obligation for postretirement benefits     | (6)                                 |          | (13)                               |           |
| Income tax benefit                                                   | 2                                   |          | 5                                  |           |
| Net adjustment of accumulated obligation for postretirement benefits | (4)                                 |          | (8)                                |           |
| Net unrealized holding gains                                         | 992                                 | 1,459    | 647                                | 844       |
| Less reclassification adjustment for gains included in net income:   |                                     |          |                                    |           |
| Realized gains                                                       |                                     |          |                                    | 558       |
| Income tax expense                                                   |                                     |          |                                    | 200       |
| Net reclassification adjustment                                      |                                     |          |                                    | 358       |
| Net other comprehensive income                                       | 992                                 | 1,459    | 647                                | 486       |
| Comprehensive income                                                 | \$ 5,241                            | \$ 6,568 | \$ 14,690                          | \$ 15,921 |

See accompanying notes to the unaudited consolidated financial statements.



## BROOKLINE BANCORP, INC. AND SUBSIDIARIES

## Consolidated Statements of Changes in Stockholders' Equity

Nine Months Ended September 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 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                                                                                                                                                    |                 |                                  | 15,435               |                                               |                   |                                                                    |                                                | 15,435                          |
| Other comprehensive income                                                                                                                                    |                 |                                  |                      | 486                                           |                   |                                                                    |                                                | 486                             |
| Common stock dividends of<br>\$0.655 per share                                                                                                                |                 |                                  | (39,579)             |                                               |                   |                                                                    |                                                | (39,579)                        |
| Payment of dividend equivalent<br>rights                                                                                                                      |                 |                                  | (960)                |                                               |                   |                                                                    |                                                | (960)                           |
| Income tax benefit from vested<br>recognition and retention plan<br>shares and dividend payments on<br>unexercised stock options and<br>allocated ESOP shares |                 | 224                              |                      |                                               |                   |                                                                    |                                                | 224                             |
| Transfer of unearned<br>compensation under the<br>recognition and retention plans to<br>additional paid-in capital                                            |                 | (8,103)                          |                      |                                               |                   | 8,103                                                              |                                                |                                 |
| Compensation under recognition<br>and retention plans                                                                                                         |                 | 2,226                            |                      |                                               |                   |                                                                    |                                                | 2,226                           |
| Common stock held by ESOP<br>committed to be released (42,057<br>shares)                                                                                      |                 | 371                              |                      |                                               |                   |                                                                    | 229                                            | 600                             |
| Balance at September 30, 2006                                                                                                                                 | \$ 630          | \$ 507,056                       | \$ 95,938            | \$ (1,091)                                    | \$ (18,144)       | \$                                                                 | \$ (3,507)                                     | \$ 580,882                      |

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|                                                                                                                                                   | Common<br>stock | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income (loss) | Treasury<br>stock | Unallocated<br>common 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                                                                                                                                        |                 |                                  | 14,043               |                                                        |                   |                                                | 14,043                          |
| Other comprehensive income                                                                                                                        |                 |                                  |                      | 647                                                    |                   |                                                | 647                             |
| Common stock dividends of \$0.655 per share                                                                                                       |                 |                                  | (39,181)             |                                                        |                   |                                                | (39,181)                        |
| Payment of dividend equivalent rights                                                                                                             |                 |                                  | (982)                |                                                        |                   |                                                | (982)                           |
| Exercise of stock options (299,186 shares)                                                                                                        | 3               | 774                              |                      |                                                        |                   |                                                | 777                             |
| Treasury stock purchases (2,517,300 shares)                                                                                                       |                 |                                  |                      |                                                        | (29,671)          |                                                | (29,671)                        |
| Reload options granted                                                                                                                            |                 | 81                               |                      |                                                        |                   |                                                | 81                              |
| Income tax benefit from vested recognition and retention plan shares and dividend payments on unexercised stock options and allocated ESOP shares |                 | 310                              |                      |                                                        |                   |                                                | 310                             |
| Compensation under recognition and retention plans                                                                                                |                 | 2,070                            |                      |                                                        |                   |                                                | 2,070                           |
| Forfeiture of unvested recognition and retention plan shares (23,460 shares)                                                                      |                 |                                  |                      |                                                        |                   |                                                |                                 |
| Common stock held by ESOP committed to be released (40,581 shares)                                                                                |                 | 275                              |                      |                                                        |                   | 221                                            | 496                             |
| Balance at September 30, 2007                                                                                                                     | \$ 633          | \$ 511,758                       | \$ 70,109            | \$ 7                                                   | \$ (47,815)       | \$ (3,209)                                     | \$ 531,483                      |

See accompanying notes to the unaudited consolidated financial statements.

## BROOKLINE BANCORP, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(In thousands)

|                                                                                   | 2007 | Nine months ended<br>September 30,<br>(unaudited) | 2006      |
|-----------------------------------------------------------------------------------|------|---------------------------------------------------|-----------|
| Cash flows from operating activities:                                             |      |                                                   |           |
| Net income                                                                        | \$   | 14,043                                            | \$ 15,435 |
| Adjustments to reconcile net income to net cash provided by operating activities: |      |                                                   |           |
| Provision for loan losses                                                         |      | 3,860                                             | 2,420     |
| Compensation under recognition and retention plans                                |      | 2,070                                             | 2,226     |
| Release of ESOP shares                                                            |      | 496                                               | 600       |
| Depreciation and amortization                                                     |      | 1,092                                             | 1,058     |
| Net amortization (accretion) of securities premiums and discounts                 |      | (810)                                             | 77        |
| Amortization of deferred loan origination costs                                   |      | 7,553                                             | 6,214     |
| Amortization of identified intangible assets                                      |      | 1,511                                             | 1,665     |
| Accretion of acquisition fair value adjustments                                   |      | (612)                                             | (954)     |
| Amortization of mortgage servicing rights                                         |      | 16                                                | 15        |
| Net gains from sales of securities                                                |      |                                                   | (558)     |
| Equity interest in earnings of other investment                                   |      |                                                   | (1)       |
| Minority interest in earnings of subsidiary                                       |      | 154                                               | 141       |
| Deferred income taxes                                                             |      | (265)                                             | (501)     |
| (Increase) decrease in:                                                           |      |                                                   |           |
| Accrued interest receivable                                                       |      | 413                                               | (833)     |
| Prepaid income taxes                                                              |      | 712                                               | (1,690)   |
| Other assets                                                                      |      | (697)                                             | 50        |
| Increase (decrease) in:                                                           |      |                                                   |           |
| Income taxes payable                                                              |      |                                                   | (630)     |
| Accrued expenses and other liabilities                                            |      | 2,330                                             | 1,446     |
| Net cash provided from operating activities                                       |      | 31,866                                            | 26,180    |
| Cash flows from investing activities:                                             |      |                                                   |           |
| Proceeds from sales of securities available for sale                              |      |                                                   | 903       |
| Proceeds from redemptions and maturities of securities available for sale         |      | 123,744                                           | 105,882   |
| Proceeds from redemptions and maturities of securities held to maturity           |      | 38                                                | 165       |
| Purchase of securities available for sale                                         |      | (51,960)                                          | (98,359)  |
| 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                                                             |      | (110,445)                                         | (62,980)  |
| Purchase of bank premises and equipment                                           |      | (1,072)                                           | (516)     |
| Acquisition, net of cash and cash equivalents acquired                            |      |                                                   | (10,547)  |
| Net cash used for investing activities                                            |      | (37,691)                                          | (70,938)  |

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|                                                                                                                                                   | 2007        | Nine months ended<br>September 30,<br>(unaudited) | 2006        |
|---------------------------------------------------------------------------------------------------------------------------------------------------|-------------|---------------------------------------------------|-------------|
| <b>Cash flows from financing activities:</b>                                                                                                      |             |                                                   |             |
| Decrease in demand deposits and NOW, savings and money market savings accounts                                                                    | \$ (16,499) |                                                   | \$ (52,498) |
| Increase in retail certificates of deposit                                                                                                        | 50,974      |                                                   | 72,138      |
| Increase (decrease) in brokered certificates of deposit                                                                                           | (10,069)    |                                                   | 78,096      |
| Proceeds from Federal Home Loan Bank of Boston advances                                                                                           | 739,500     |                                                   | 2,697,500   |
| Repayment of Federal Home Loan Bank of Boston advances                                                                                            | (691,257)   |                                                   | (2,619,414) |
| Repayment of subordinated debt                                                                                                                    | (5,000)     |                                                   |             |
| Repayment of other borrowed funds of subsidiary                                                                                                   |             |                                                   | (95,410)    |
| Increase in mortgagors' escrow accounts                                                                                                           | 315         |                                                   | 203         |
| Income tax benefit from vested recognition and retention plan shares and dividend payments on unexercised stock options and allocated ESOP shares | 310         |                                                   | 224         |
| Proceeds from exercise of stock options                                                                                                           | 777         |                                                   |             |
| Reload stock options granted                                                                                                                      | 81          |                                                   |             |
| Purchase of treasury stock                                                                                                                        | (29,671)    |                                                   |             |
| Payment of dividends on common stock                                                                                                              | (39,181)    |                                                   | (39,579)    |
| Payment of dividend equivalent rights                                                                                                             | (982)       |                                                   | (960)       |
| Payment of dividend to minority interest members of subsidiary                                                                                    | (208)       |                                                   |             |
| Net cash (used for) provided from financing activities                                                                                            | (910)       |                                                   | 40,300      |
| Net decrease in cash and cash equivalents                                                                                                         | (6,735)     |                                                   | (4,458)     |
| Cash and cash equivalents at beginning of period                                                                                                  | 152,654     |                                                   | 118,395     |
| Cash and cash equivalents at end of period                                                                                                        | \$ 145,919  |                                                   | \$ 113,937  |
| <b>Supplemental disclosures of cash flow information:</b>                                                                                         |             |                                                   |             |
| Cash paid during the period for:                                                                                                                  |             |                                                   |             |
| Interest on deposits and borrowed funds                                                                                                           | \$ 53,726   |                                                   | \$ 43,332   |
| Income taxes                                                                                                                                      | 8,175       |                                                   | 11,978      |
| <b>Acquisition of Eastern Funding LLC:</b>                                                                                                        |             |                                                   |             |
| Assets acquired (excluding cash and cash equivalents)                                                                                             | \$          |                                                   | 111,709     |
| Liabilities assumed                                                                                                                               |             |                                                   | 99,972      |
| 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**

**Nine Months Ended September 30, 2007 and 2006**

**(Unaudited)**

**(1) Basis of Presentation and New Accounting Pronouncement Adopted in 2007**

*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 ( Eastern ). A controlling interest in Eastern was acquired on April 13, 2006. 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.

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 in the United States of America ( 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 nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

*New Accounting Pronouncement Adopted in 2007*

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.

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

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

|                                                           | September 30, 2007 |                              |                               |                         |
|-----------------------------------------------------------|--------------------|------------------------------|-------------------------------|-------------------------|
|                                                           | Amortized<br>cost  | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Estimated<br>fair value |
| <b>Securities available for sale:</b>                     |                    |                              |                               |                         |
| <b>Debt securities:</b>                                   |                    |                              |                               |                         |
| U.S. Government-sponsored enterprises                     | \$ 117,408         | \$ 268                       | \$ 12                         | \$ 117,664              |
| Municipal obligations                                     | 5,606              |                              | 58                            | 5,548                   |
| Auction rate municipal obligations                        | 13,050             |                              |                               | 13,050                  |
| Corporate obligations                                     | 4,846              | 2                            | 93                            | 4,755                   |
| Other obligations                                         | 500                |                              |                               | 500                     |
| <b>Collateralized mortgage obligations issued by U.S.</b> |                    |                              |                               |                         |
| Government-sponsored enterprises                          | 88,372             | 275                          | 104                           | 88,543                  |
| <b>Mortgage-backed securities issued by U.S.</b>          |                    |                              |                               |                         |
| Government-sponsored enterprises                          | 34,102             | 5                            | 818                           | 33,289                  |
| <b>Total debt securities</b>                              | <b>263,884</b>     | <b>550</b>                   | <b>1,085</b>                  | <b>263,349</b>          |
| Marketable equity securities                              | 1,943              | 167                          | 35                            | 2,075                   |
| <b>Total securities available for sale</b>                | <b>\$ 265,827</b>  | <b>\$ 717</b>                | <b>\$ 1,120</b>               | <b>\$ 265,424</b>       |
| <b>Securities held to maturity:</b>                       |                    |                              |                               |                         |
| <b>Mortgage-backed securities issued by U.S.</b>          |                    |                              |                               |                         |
| Government-sponsored enterprises                          | \$ 195             | \$ 8                         | \$                            | \$ 203                  |

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|                                                    | December 31, 2006 |                              |                               |                         |
|----------------------------------------------------|-------------------|------------------------------|-------------------------------|-------------------------|
|                                                    | Amortized<br>cost | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Estimated<br>fair value |
| Securities available for sale:                     |                   |                              |                               |                         |
| Debt securities:                                   |                   |                              |                               |                         |
| 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. |                   |                              |                               |                         |
| Government-sponsored enterprises                   | 52,126            | 21                           | 176                           | 51,971                  |
| Mortgage-backed securities issued by U.S.          |                   |                              |                               |                         |
| 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 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 \$21 at September 30, 2007 and \$38 at December 31, 2006.

(3) **Loans (Dollars in thousands)**

A summary of loans follows:

|                                  | September 30,<br>2007 | December 31,<br>2006 |
|----------------------------------|-----------------------|----------------------|
| Mortgage loans:                  |                       |                      |
| One-to-four family               | \$ 298,759            | \$ 286,623           |
| Multi-family                     | 323,202               | 331,106              |
| Commercial real estate           | 375,125               | 373,744              |
| Construction and development     | 22,640                | 37,589               |
| Home equity                      | 34,227                | 36,432               |
| Second                           | 23,222                | 16,646               |
| Total mortgage loans             | 1,077,175             | 1,082,140            |
| Indirect automobile loans        | 605,912               | 540,094              |
| Commercial loans Eastern         | 140,213               | 127,275              |
| Other commercial loans           | 157,431               | 110,780              |
| Other consumer loans             | 3,654                 | 3,322                |
| Total gross loans                | 1,984,385             | 1,863,611            |
| Unadvanced funds on loans        | (109,433)             | (85,879)             |
| Deferred loan origination costs: |                       |                      |
| Indirect automobile loans        | 15,879                | 13,175               |
| Commercial loans Eastern         | 873                   | 991                  |

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|             |    |           |    |           |
|-------------|----|-----------|----|-----------|
| Other       |    | 383       |    | 164       |
| Total loans | \$ | 1,892,087 | \$ | 1,792,062 |



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

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

|                                        | 2007     | Nine month ended<br>September 30, | 2006     |
|----------------------------------------|----------|-----------------------------------|----------|
| Balance at beginning of period         | \$23,024 |                                   | \$22,248 |
| Allowance obtained through acquisition |          |                                   | 1,958    |
| Provision for loan losses              | 3,701    |                                   | 2,420    |
| Charge-offs                            | (3,954)  |                                   | (2,063)  |
| Recoveries                             | 690      |                                   | 503      |
| Balance at end of period               | \$23,461 |                                   | \$25,066 |

During the nine months ended September 30, 2007, the liability for unfunded credit commitments was increased to \$1,445 at September 30, 2007 by a \$159 charge to the provision for loan losses. Such liability, which is included in other liabilities, was \$1,286 at December 31, 2006.

**(5) Deposits (Dollars in thousands)**

A summary of deposits follows:

|                                        | September 30,<br>2007 | December 31,<br>2006 |
|----------------------------------------|-----------------------|----------------------|
| Demand checking accounts               | \$ 64,946             | \$ 65,926            |
| NOW accounts                           | 81,301                | 94,538               |
| Savings accounts                       | 65,524                | 66,339               |
| Guaranteed savings accounts            | 21,132                | 32,725               |
| Money market savings accounts          | 219,233               | 209,107              |
| Retail certificate of deposit accounts | 792,506               | 741,571              |
| Total retail deposits                  | 1,244,642             | 1,210,206            |
| Brokered certificates of deposit       | 67,991                | 78,060               |
| Total deposits                         | \$ 1,312,633          | \$ 1,288,266         |

**(6) Accumulated Other Comprehensive Income (Loss) (Dollars in thousands)**

Accumulated other comprehensive income of \$7 at September 30, 2007 was comprised of an unrealized loss on securities available for sale, net of income taxes, of \$235 and an unrealized gain related to postretirement benefits, net of income taxes, of \$242. Accumulated other comprehensive loss of \$640 at December 31, 2006 was comprised of an unrealized loss on securities available for sale, net of income taxes, of \$890 and an unrealized gain related to postretirement benefits, net of income taxes, of \$250. At September 30, 2007 and December 31, 2006, the

resulting net income tax (expense) benefit amounted to \$(6) and \$359, respectively.

(7) **Commitments and Contingencies (Dollars in thousands)**

*Loan Commitments*

At September 30, 2007, the Company had outstanding commitments to originate loans of \$70,654, \$9,640 of which were one-to-four family mortgage loans, \$16,155 were commercial real estate mortgage loans, \$20,768 were multi-family mortgage loans, \$3,465 were commercial loans to condominium associations and \$20,626 were commercial loans. Unused lines of credit available to customers were \$54,927, of which \$51,354 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.

**(8) Dividend Declaration**

On October 18, 2007, the Board of Directors of the Company approved a regular quarterly dividend of \$0.085 per share payable November 15, 2007 to stockholders of record on October 31, 2007.

**(9) 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 \$666, \$652, \$2,070 and \$2,226 for the three months and nine months ended September 30, 2007 and 2006, respectively. The compensation cost of non-vested RRP shares at September 30, 2007 is expected to be charged to expense as follows: \$534 during the three month period ended December 31, 2007 and \$2,135 and \$143 during the years ended December 31, 2008 and 2009, respectively. As of September 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 \$81 and none for the nine months ended September 30, 2007 and 2006, respectively.

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

|                                                                       |           |
|-----------------------------------------------------------------------|-----------|
| Options outstanding at January 1, 2007                                | 3,182,988 |
| Reload options granted at:                                            |           |
| \$ 12.46 per option                                                   | 7,929     |
| \$ 10.69 per option                                                   | 46,249    |
| \$ 10.87 per option                                                   | 56,836    |
| Cancelled reloaded options (\$11.00 to \$15.42 per option)            | (16,849)  |
| Forfeited options (\$15.02 per option)                                | (80,500)  |
| Options exercised at \$4.944 per option                               | (402,271) |
| Options outstanding at September 30, 2007                             | 2,794,382 |
| Exercisable at September 30, 2007 at:                                 |           |
| \$ 4.944 per share                                                    | 1,369,297 |
| \$ 10.69 per share                                                    | 46,249    |
| \$ 10.87 per share                                                    | 56,836    |
| \$ 12.91 per share                                                    | 41,000    |
| \$ 15.02 per share                                                    | 1,277,000 |
|                                                                       | 2,790,382 |
| Aggregate intrinsic value of options outstanding                      | \$ 9,183  |
| Weighted average exercise price per option                            | \$ 9.89   |
| Weighted average remaining contractual life in years at end of period | 3.68      |

As of September 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 1,218,000 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

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the Bank, subject to federal tax law limits. The outstanding balance of the loan at September 30, 2007 and December 31, 2006, which was \$3,814 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 September 30, 2007, the ESOP held 588,500 unallocated shares at an aggregate cost of \$3,209; the market value of such shares at that date was \$6,821. For the nine months ended September 30, 2007 and 2006, \$496 and \$600, respectively, was charged to compensation expense based on the commitment to release to eligible employees 40,581 shares and 42,057 shares in those respective periods.

(10) **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 nine months ended September 30, 2007 and 2006:

|                            | Three months ended<br>September 30, |       | Nine months ended<br>September 30, |       |
|----------------------------|-------------------------------------|-------|------------------------------------|-------|
|                            | 2007                                | 2006  | 2007                               | 2006  |
| Service cost               | \$ 14                               | \$ 14 | \$ 43                              | \$ 42 |
| Interest cost              | 11                                  | 12    | 33                                 | 35    |
| Prior service cost         | (7)                                 | (6)   | (21)                               | (17)  |
| Actuarial gain             | (3)                                 | (1)   | (1)                                | (2)   |
| Net periodic benefit costs | \$ 15                               | \$ 19 | \$ 54                              | \$ 58 |

Benefits paid amounted to \$11 and \$8 for the nine months ended September 30, 2007 and 2006, respectively.

(11) **Stockholders' Equity (Dollars in thousands, except per share amounts)**

*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 three months and nine months ended September 30, 2007, 457,300 shares and 2,157,300 shares, respectively, of the Company's common stock were repurchased at an average cost of \$10.56 and \$11.79, respectively, inclusive 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 1,755,232 shares remaining as of September 30, 2007 under the previously approved existing repurchase program. Under both the previous 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 nine months ended September 30, 2007 and 2006.

**Operating Highlights**

|                                                  | Three months ended<br>September 30,     |           | Nine months ended<br>September 30, |           |
|--------------------------------------------------|-----------------------------------------|-----------|------------------------------------|-----------|
|                                                  | 2007                                    | 2006      | 2007                               | 2006      |
|                                                  | (In thousands except per share amounts) |           |                                    |           |
| Net interest income                              | \$ 17,997                               | \$ 18,174 | \$ 54,182                          | \$ 52,491 |
| Provision for loan losses                        | 1,503                                   | 813       | 3,860                              | 2,420     |
| Non-interest income                              | 927                                     | 837       | 3,257                              | 2,948     |
| Amortization of identified intangible assets     | 503                                     | 569       | 1,510                              | 1,665     |
| Other non-interest expenses                      | 9,892                                   | 9,063     | 28,940                             | 25,669    |
| Income before income taxes and minority interest | 7,026                                   | 8,566     | 23,129                             | 25,685    |

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|                                             |         |         |         |         |
|---------------------------------------------|---------|---------|---------|---------|
| Provision for income taxes                  | 2,711   | 3,383   | 8,932   | 10,109  |
| Minority interest in earnings of subsidiary | 66      | 74      | 154     | 141     |
| Net income                                  | 4,249   | 5,109   | 14,043  | 15,435  |
| Basic earnings per common share             | \$ 0.07 | \$ 0.08 | \$ 0.24 | \$ 0.25 |
| Diluted earnings per common share           | 0.07    | 0.08    | 0.23    | 0.25    |
| Interest rate spread                        | 2.14%   | 2.17%   | 2.13%   | 2.16%   |
| Net interest margin                         | 3.16%   | 3.15%   | 3.18%   | 3.13%   |

**Financial Condition Highlights**

|                                      | At<br>Sept. 30,<br>2007 | At<br>December 31,<br>2006<br>(In thousands) | At<br>Sept. 30,<br>2006 |
|--------------------------------------|-------------------------|----------------------------------------------|-------------------------|
| Total assets                         | \$ 2,391,906            | \$ 2,373,040                                 | \$ 2,375,472            |
| Net loans                            | 1,868,626               | 1,769,038                                    | 1,775,342               |
| Retail deposits                      | 1,244,642               | 1,210,206                                    | 1,187,700               |
| Brokered deposits                    | 67,991                  | 78,060                                       | 78,096                  |
| Borrowed funds and subordinated debt | 519,043                 | 475,898                                      | 501,660                 |
| Stockholders' equity                 | 531,483                 | 582,893                                      | 580,882                 |
| Stockholders' equity to total assets | 22.22%                  | 24.56%                                       | 24.45%                  |
| Allowance for loan losses            | \$ 23,461(A)            | \$ 23,024(A)                                 | \$ 25,066               |
| Non-performing assets                | 4,820                   | 1,959                                        | 2,299                   |

(A) Net of an allowance for unfunded loan commitments of \$1,445 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

Growth of the indirect automobile ( auto ) loan portfolio

Higher provisions for loan losses relating to the auto and Eastern loan portfolios

Higher non-interest expense of \$763,000 (7.9%) in the 2007 third quarter compared to the 2006 third quarter and \$3,116,000 (11.4%) in the 2007 nine month period compared to the 2006 nine month period

Repurchases of the Company's common stock (457,300 shares in the 2007 third quarter and 2,517,300 shares in the 2007 nine month period)

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 nine months ended September 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 September 30, |              |                                           |                 |              |                    |
|---------------------------------------------------------------------|----------------------------------|--------------|-------------------------------------------|-----------------|--------------|--------------------|
|                                                                     | 2007                             |              |                                           | 2006            |              |                    |
|                                                                     | Average balance                  | Interest (1) | Average yield/cost (Dollars in thousands) | Average balance | Interest (1) | Average yield/cost |
| <b>Assets</b>                                                       |                                  |              |                                           |                 |              |                    |
| Interest-earning assets:                                            |                                  |              |                                           |                 |              |                    |
| Short-term investments                                              | \$ 134,882                       | 1,759        | 5.17%                                     | \$ 108,992      | \$ 1,436     | 5.23%              |
| Debt securities (2)                                                 | 269,968                          | 3,428        | 5.08                                      | 349,759         | 3,865        | 4.42               |
| Equity securities (2) (4)                                           | 27,704                           | 490          | 7.02                                      | 31,215          | 805          | 10.23              |
| Mortgage loans (3)                                                  | 1,029,843                        | 16,316       | 6.34                                      | 1,075,151       | 17,305       | 6.44               |
| Commercial loans - Eastern Funding (3)                              | 140,105                          | 3,703        | 10.57                                     | 122,349         | 3,338        | 10.82              |
| Other commercial loans (3)                                          | 76,076                           | 1,358        | 7.14                                      | 67,866          | 1,190        | 7.01               |
| Indirect automobile loans (3)                                       | 616,968                          | 9,815        | 6.31                                      | 541,343         | 7,263        | 5.32               |
| Other consumer loans (3)                                            | 3,450                            | 66           | 7.65                                      | 3,058           | 58           | 7.59               |
| Total interest-earning assets                                       | 2,298,996                        | 36,935       | 6.41%                                     | 2,299,733       | 35,260       | 6.11%              |
| Allowance for loan losses                                           | (23,310)                         |              |                                           | (25,000)        |              |                    |
| Non-interest earning assets                                         | 99,626                           |              |                                           | 104,092         |              |                    |
| Total assets                                                        | \$ 2,375,312                     |              |                                           | \$ 2,378,825    |              |                    |
| <b>Liabilities and Stockholders' Equity</b>                         |                                  |              |                                           |                 |              |                    |
| Interest-bearing liabilities:                                       |                                  |              |                                           |                 |              |                    |
| Deposits:                                                           |                                  |              |                                           |                 |              |                    |
| NOW accounts                                                        | \$ 81,869                        | 63           | 0.31%                                     | \$ 86,869       | 54           | 0.25%              |
| Savings accounts                                                    | 90,684                           | 360          | 1.57                                      | 111,492         | 478          | 1.70               |
| Money market savings accounts                                       | 224,967                          | 1,628        | 2.87                                      | 221,066         | 1,458        | 2.62               |
| Retail certificates of deposit                                      | 767,063                          | 9,425        | 4.87                                      | 694,076         | 7,533        | 4.31               |
| Total retail deposits                                               | 1,164,583                        | 11,476       | 3.91                                      | 1,113,503       | 9,523        | 3.39               |
| Brokered certificates of deposit                                    | 74,996                           | 1,019        | 5.39                                      | 71,574          | 968          | 5.37               |
| Total deposits                                                      | 1,239,579                        | 12,495       | 4.00                                      | 1,185,077       | 10,491       | 3.51               |
| Borrowed funds                                                      | 502,870                          | 6,211        | 4.83                                      | 512,691         | 6,256        | 4.77               |
| Subordinated debt                                                   | 7,034                            | 140          | 7.79                                      | 12,144          | 236          | 7.60               |
| Total interest bearing liabilities                                  | 1,749,483                        | 18,846       | 4.27%                                     | 1,709,912       | 16,983       | 3.94%              |
| Non-interest-bearing demand checking accounts                       | 63,405                           |              |                                           | 59,864          |              |                    |
| Other liabilities                                                   | 25,470                           |              |                                           | 24,088          |              |                    |
| Total liabilities                                                   | 1,838,358                        |              |                                           | 1,793,864       |              |                    |
| Stockholders' equity                                                | 536,954                          |              |                                           | 584,961         |              |                    |
| Total liabilities and stockholders' equity                          | \$ 2,375,312                     |              |                                           | \$ 2,378,825    |              |                    |
| Net interest income (tax equivalent basis)/interest rate spread (5) |                                  | 18,089       | 2.14%                                     |                 | 18,277       | 2.17%              |
| Less adjustment of tax exempt income                                |                                  | 92           |                                           |                 | 103          |                    |
| Net interest income                                                 |                                  | \$ 17,997    |                                           |                 | \$ 18,174    |                    |
| Net interest margin (6)                                             |                                  |              | 3.16%                                     |                 |              | 3.15%              |

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- (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) Loans on non-accrual status are included in average balances.
- (4) 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 dividend income was recognized by the Company in that period. In the third quarter of 2006, the FHLB declared dividends that were equivalent to two quarterly periods. The amount of dividend income recognized by the Company in the third quarter of 2006 was \$761. The yield on average interest-earning assets in the three months ended September 30, 2006 was 0.06% higher than it otherwise would have been if the equivalent of an extra quarterly dividend had not been received during that three month period.
- (5) Interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.

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

|                                                                     | Nine months ended September 30, |              |                                              |                 |              |                    |
|---------------------------------------------------------------------|---------------------------------|--------------|----------------------------------------------|-----------------|--------------|--------------------|
|                                                                     | 2007                            |              |                                              | 2006            |              |                    |
|                                                                     | Average balance                 | Interest (1) | Average yield/cost<br>(Dollars in thousands) | Average balance | Interest (1) | Average yield/cost |
| <b>Assets</b>                                                       |                                 |              |                                              |                 |              |                    |
| Interest-earning assets:                                            |                                 |              |                                              |                 |              |                    |
| Short-term investments                                              | \$ 134,722                      | \$ 5,242     | 5.19%                                        | \$ 107,355      | \$ 3,874     | 4.81%              |
| Debt securities (2)                                                 | 290,825                         | 11,023       | 5.01                                         | 357,086         | 11,291       | 4.22               |
| Equity securities (2)                                               | 27,990                          | 1,430        | 6.78                                         | 29,818          | 1,203        | 5.38               |
| Mortgage loans (3)                                                  | 1,033,393                       | 49,538       | 6.39                                         | 1,089,391       | 52,110       | 6.38               |
| Commercial loans - Eastern Funding (3)                              | 132,475                         | 10,629       | 10.70                                        | 78,523          | 6,360        | 10.80              |
| Other commercial loans (3)                                          | 71,459                          | 3,816        | 7.12                                         | 66,058          | 3,421        | 6.91               |
| Indirect automobile loans (3)                                       | 591,590                         | 27,001       | 6.09                                         | 514,143         | 19,301       | 5.01               |
| Other consumer loans (3)                                            | 3,336                           | 197          | 7.87                                         | 2,988           | 164          | 7.32               |
| Total interest-earning assets                                       | 2,285,790                       | 108,876      | 6.35%                                        | 2,245,362       | 97,724       | 5.80%              |
| Allowance for loan losses                                           | (23,150)                        |              |                                              | (23,987)        |              |                    |
| Non-interest earning assets                                         | 98,893                          |              |                                              | 102,697         |              |                    |
| Total assets                                                        | \$ 2,361,533                    |              |                                              | \$ 2,324,072    |              |                    |
| <b>Liabilities and Stockholders Equity</b>                          |                                 |              |                                              |                 |              |                    |
| Interest-bearing liabilities:                                       |                                 |              |                                              |                 |              |                    |
| Deposits:                                                           |                                 |              |                                              |                 |              |                    |
| NOW accounts                                                        | \$ 85,148                       | 203          | 0.32%                                        | \$ 89,850       | 163          | 0.24%              |
| Savings accounts                                                    | 95,335                          | 1,164        | 1.63                                         | 116,083         | 1,368        | 1.57               |
| Money market savings accounts                                       | 218,783                         | 4,596        | 2.80                                         | 223,419         | 3,955        | 2.36               |
| Retail certificates of deposit                                      | 756,401                         | 27,369       | 4.82                                         | 669,377         | 19,868       | 3.96               |
| Total retail deposits                                               | 1,155,667                       | 33,332       | 3.85                                         | 1,098,729       | 25,354       | 3.08               |
| Brokered certificates of deposit                                    | 76,797                          | 3,092        | 5.37                                         | 40,000          | 1,605        | 5.35               |
| Total deposits                                                      | 1,232,464                       | 36,424       | 3.94                                         | 1,138,729       | 26,959       | 3.16               |
| Borrowed funds                                                      | 475,446                         | 17,371       | 4.87                                         | 497,139         | 17,313       | 4.64               |
| Subordinated debt                                                   | 9,106                           | 531          | 7.78                                         | 12,176          | 667          | 7.30               |
| Total interest bearing liabilities                                  | 1,717,016                       | 54,326       | 4.22%                                        | 1,648,044       | 44,939       | 3.64%              |
| Non-interest-bearing demand checking accounts                       | 62,521                          |              |                                              | 61,725          |              |                    |
| Other liabilities                                                   | 25,176                          |              |                                              | 22,492          |              |                    |
| Total liabilities                                                   | 1,804,713                       |              |                                              | 1,732,261       |              |                    |
| Stockholders equity                                                 | 556,820                         |              |                                              | 591,811         |              |                    |
| Total liabilities and stockholders equity                           | \$ 2,361,533                    |              |                                              | \$ 2,324,072    |              |                    |
| Net interest income (tax equivalent basis)/interest rate spread (4) |                                 | 54,550       | 2.13%                                        |                 | 52,785       | 2.16%              |
| Less adjustment of tax exempt income                                |                                 | 368          |                                              |                 | 294          |                    |
| Net interest income                                                 |                                 | \$ 54,182    |                                              |                 | \$ 52,491    |                    |
| Net interest margin (5)                                             |                                 |              | 3.18%                                        |                 |              | 3.13%              |

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

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

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

Highlights from the above tables follow.



Interest rate spread declined from 2.16% in the 2006 nine month period to 2.13% in the 2007 nine month period as the average rate paid on interest-bearing liabilities rose more rapidly than the average rate realized on interest-earning assets. In the 2007 third quarter, however, interest rate spread improved modestly to 2.14% from 2.13% in the 2007 second quarter and 2.11% in the 2007 first quarter.

Net interest margin increased from 3.13% in the 2006 nine month period to 3.18% in the 2007 nine month period. The improvement resulted primarily from an increase in higher yielding loans. Net interest margin, however, declined from 3.20% in the 2007 first quarter to 3.18% in the 2007 second quarter and 3.16% in the 2007 third quarter. The decline was due primarily to a reduction in stockholders' equity resulting from repurchases of the Company's common stock and the payments of extra dividends of \$0.20 per share both in February and August 2007. Stockholders' equity at September 30, 2007 (\$531.5 million) was \$51.4 million less than at December 31, 2006 (\$582.9 million).

As previously mentioned, a change in the timing of the declaration of dividends by the FHLB caused the yield on average interest-earning assets in the 2006 third quarter to be 0.06% higher than it otherwise would have been if the equivalent of an extra quarterly dividend had not been received in that quarter.

Foregone interest income from the use of \$29.7 million to repurchase shares of the Company's common stock was approximately \$357,000 in the 2007 third quarter and \$527,000 in the 2007 nine month period.

Interest income was 11% higher in the 2007 nine month period than in the 2006 nine month period. Net interest income, however, increased only 3% as interest expense rose 21%. The Company's mix of deposits continued to shift from lower rate transaction accounts to higher rate certificates of deposit. Certificates of deposit comprised 65.5% of the average balance of total retail deposits in the 2007 nine month period compared to 60.9% in the 2006 nine month period.

The average balance of total loans outstanding as a percent of the average of total interest-earning assets increased from 80.1% in the 2007 second quarter to 81.2% in the 2007 third quarter and from 78.0% in the 2006 nine month period to 80.2% in the 2007 nine month period. Generally, the yield on loans is higher than on investment securities.

Average interest-earning assets in the 2007 third quarter were \$16.3 million, or 0.7%, higher than in the 2007 second quarter. Declines in the average balances of mortgage loans (\$2.4 million), debt securities (\$18.3 million) and short-term investments (\$3.9 million) were more than offset by increases in the average balances of auto loans (\$22.5 million), Eastern loans (\$11.0 million), most of which resulted from the purchase of \$9.5 million of seasoned loans from a third party manufacturer of laundry equipment at the end of the 2007 second quarter, and \$6.8 million in commercial loans.

Average interest-earning assets in the 2007 nine month period increased \$40.4 million, or 1.8%, compared to the 2006 nine month period. The growth resulted primarily from increases in auto loans (\$77.4 million), Eastern loans (\$54.0 million), most of which occurred upon the acquisition in April 2006, commercial loans (\$5.4 million) and short-term investments (\$27.4 million). Offsetting some of these increases were reductions in the average balances of

mortgage loans (\$56.0 million) and debt securities (\$66.3 million).

The average rate earned on mortgage loans, the Company's largest asset category, declined from 6.44% in the 2006 third quarter to 6.34% in the 2007 third quarter. Over the past year, it was increasingly difficult to incorporate rising funding costs into the pricing of mortgage loan originations. Some financial institutions and other entities active in mortgage lending sought to enhance yields by originating higher risk mortgage loans. The Company refrained from such originations and, at September 30, 2007, its mortgage loan portfolio did not include any subprime or option adjustable rate loans. The decision to maintain high underwriting standards and aggressive loan pricing by competitors resulted in less loan originations and the decline in mortgage loans outstanding mentioned above.

Growth in auto loans and Eastern loans, coupled with higher yields earned on those loans, more than offset the adverse consequences resulting from the decline in average balances and yields on mortgage loans. The yield on auto loans improved from 5.32% in the 2006 third quarter to 6.31% in the 2007 third quarter. The yield on Eastern loans remained high in relation to other asset categories at 10.57% in the 2007 third quarter compared to 10.82% in the 2006 third quarter. The decline resulted primarily from the purchase of seasoned loans at the end of the 2007 second quarter previously mentioned and an increase in loans on non-accrual status.

The average balance of borrowings from the FHLB declined from \$497.1 million in the 2006 nine month period to \$475.4 million in the 2007 nine month period, but the rates paid on such borrowings increased from 4.64% to 4.87% in those respective periods. The average balance of borrowings from the FHLB was \$502.9 million in the 2007 third quarter and the rate paid on such funds was 4.83%.

The inverted yield curve, which existed for some time, started to modestly slope upward in the 2007 second quarter. The Board of Governors of the Federal Reserve System in September 2007 reduced by 0.50% the federal funds rate for overnight borrowings between banks. These developments should have a favorable impact prospectively on the Company's interest rate spread and net interest margin. Meaningful improvement, however, will continue to be difficult until the yield curve becomes more upward in slope.

## Auto Loans

The Company's auto loan portfolio, which grew \$74.4 million, or 14.0%, from September 30, 2006 (\$531.5 million) to September 30, 2007 (\$605.9 million), grew \$14.9 million, or 2.5%, in the 2007 third quarter. The recent slower rate of growth was attributable to the following factors: the need for higher loan originations to offset the reduction in loan balances from normal monthly principal payments, contraction in auto sales and aggressive interest rate promotions by manufacturer finance subsidiaries. In light of a rise in auto loan delinquencies and charge-offs in the 2007 third quarter and signs of a possible weakening of the economy that could make it more difficult for consumers to service their debt, the Company has tightened its underwriting guidelines and expects moderate, if any, growth in its auto loan portfolio during the next few quarters.

Since entering the business in February 2003, it has been the Company's policy 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 and the financing of used autos versus new autos. The percent of auto loans outstanding with credit scores below 660 was 11.7% at September 30, 2007 and June 30, 2007, 11.0% at December 31, 2006 and 10.6% at September 30, 2006. The average credit score of all auto loans weighted by principal balances outstanding at September 30, 2007 was 727.

Prior to 2007, the annualized rate of net charge-offs as a percent of auto loans outstanding remained relatively constant. The rate was 0.40% in 2004, 0.32% in 2005 and 0.35% in 2006. In the 2007 first quarter, the annualized rate rose to 0.55%, then declined to 0.36% in the 2007 second quarter and increased to 0.80% in the 2007 third quarter. Loans delinquent 30 days or more were \$7.4 million, or 1.23% of loans outstanding at September 30, 2007 compared to \$5.9 million (0.99%) at June 30, 2007 and \$7.1 million (1.31%) at December 31, 2006. The rise in net charge-offs in 2007 appears to be due primarily to economic pressures affecting the ability of consumers to service their debt and larger per unit losses upon auto repossession due to weaker demand and slowing retail auto business activity. Continuation of these factors would likely result in higher auto loan losses during the next few quarters.

## Provision for Loan Losses

The provision for loan losses, which is comprised of amounts relating to the auto loan portfolio, the Eastern loan portfolio and the remainder of the Company's loan portfolio, was \$1,503,000 in the 2007 third quarter compared to \$813,000 in the 2006 third quarter and \$3,860,000 in the 2007 nine month period compared to \$2,420,000 in the 2006 nine month period.

The amounts provided for auto loans in the 2007 and 2006 third quarters were \$1,389,000 and \$850,000, respectively, and \$3,012,000 and \$2,355,000, respectively, in the 2007 and 2006 nine month periods. The increases resulted in part from higher loan balances but more from a rise in net charge-offs. Net charge-offs were \$1,232,000 in the 2007 third quarter (an annualized rate of net charge-offs of 0.80%) and \$2,527,000 in the 2007 nine month period (0.57%). Net charge-offs in the 2006 nine month period were \$1,381,000 (0.36%). See the prior section, "Auto Loans", for a discussion about the reasons for the higher charge-offs and trends in this segment of the Company's lending activities.

The provisions for loan losses related to the Eastern portfolio in the 2007 and 2006 third quarters were \$114,000 and \$238,000, respectively, \$823,000 in the 2007 nine month period and \$415,000 in the six month period ended September 30, 2006. Net charge-offs declined from \$391,000 in the 2007 first quarter to \$288,000 in the 2007 second quarter and \$63,000 in the 2007 third quarter, which was aided by recoveries of \$179,000 in that quarter. The resulting annualized rate of net charge-offs for the 2007 nine month period was 0.75% 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 \$2,002,000 (1.45%) at

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June 30, 2007 and \$3,414,000 (2.44%) at September 30, 2007. Loans on non-accrual at those respective dates were \$657,000 (0.52% of total loans), \$2,254,000 (1.63%) and \$2,169,000 (1.55%). The total allowance for loan losses related to Eastern's loans was \$2,377,000, or 1.80% of loans outstanding at September 30, 2007 (excluding seasoned loans purchased at the end of the 2007 second quarter). Despite a much lower rate of net 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 above those 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 and commercial loans, the provision for loan losses in the 2007 third quarter and nine month period were none and \$25,000, respectively. In the 2006 third quarter and nine month period, credits to the provision for loan losses of \$275,000 and \$350,000, respectively, were taken to income as a result of reductions in loans outstanding caused by payoffs. No mortgage loans or commercial loans were charged off in 2007 or 2006. Loans delinquent 90 days or more at September 30, 2007 were \$1,026,000.

### **Non-Interest Expense**

Non-interest expenses were \$763,000, or 7.9%, higher in the 2007 third quarter than in the 2006 third quarter due primarily to higher expenses related to auto loan growth, higher marketing expenses for promotion of deposit programs, higher legal fees and higher costs for loan collections and auto repossessions. The \$3,116,000, or 11.4%, increase in non-interest expenses in the 2007 nine month period compared to the 2006 nine month period was due primarily to the inclusion of Eastern's operations for only six months in 2006 (due to the acquisition of a controlling interest in April of that year), the opening of a new branch in April 2006, higher professional fees for legal and audit services, and higher costs for loan collections and auto repossessions.

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

During the 2007 third quarter, the Company repurchased 457,300 shares of its common stock at a total cost of \$4,831,000, or \$10.56 per share including transaction costs. In the 2007 nine month period, the Company repurchased 2,517,300 shares of its common stock at a total cost of \$29,671,000, or \$11.79 per share including transaction costs. As of September 30, 2007, the Company remained authorized to repurchase an additional 3,755,332 shares of common stock.

### **Other Operating Highlights**

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

Excluding securities gains, the increases in non-interest income in the 2007 third quarter and nine month periods compared to the same periods for 2006 were due primarily to higher deposit service fees, mortgage loan prepayment fees and auto loan fees. There were no fees from prepayment of mortgage loans in the 2007 third quarter compared to \$99,000 in the 2006 third quarter; prepayment fees in the 2007 and 2006 nine month periods were \$460,000 and \$223,000, respectively. Fees from auto loan activities were \$169,000 in the 2007 third quarter compared to \$82,000 in the 2006 third quarter and \$482,000 in the 2007 nine month period compared to \$247,000 in the 2006 nine month period.

*Provision for Income Taxes.* The effective rate of federal and state income taxes applied to the Company's pre tax income declined from 39.5% in the 2006 third quarter and 39.4% in the 2006 nine month period to 38.6% in the 2007 third quarter and nine month periods 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 September 30, 2007 were \$13.4 million, or 1.1%, higher than at June 30, 2007 and \$34.4 million, or 2.8%, higher than at December 31, 2006. The mix of deposits continued to shift to higher paying categories; certificates of deposit increased \$30.2 million in the 2007 third quarter and \$50.9 million since December 31, 2006. Competition for deposits, which remains keen, could result in further shifting to higher rate deposits.

Brokered deposits declined from \$78.1 million at December 31, 2006 to \$77.9 million at June 30, 2007 and \$68.0 million at September 30, 2007. Brokered deposits maturing in the 2007 third quarter were replaced with funds from FHLB borrowings due to more attractive rate offerings.

*Borrowed Funds.* Funds borrowed from the FHLB increased from \$463.8 million at December 31, 2006 to \$480.2 million at June 30, 2007 and \$512.0 million at September 30, 2007. Proceeds from the borrowings were used primarily to fund part of the loan growth and repurchases of the Company's common stock, replace maturing brokered deposits and pay off \$5.0 million of floating rate debentures scheduled to mature in 2032 that were callable in April 2007. The annual interest rate paid on the debentures at the date of payment was 9.09%.

*Stockholders' Equity.* Stockholders' equity declined \$15.5 million in the 2007 third quarter and \$51.4 million in the 2007 nine month period. The declines resulted primarily from repurchases of the Company's common stock at a total cost of \$29.7 million and payment to stockholders of extra dividends of \$0.20 per share each in February and August 2007 (\$24.1 million in total).

**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:

|                                                       | September 30,<br>2007  | December 31,<br>2006 |
|-------------------------------------------------------|------------------------|----------------------|
|                                                       | (Dollars in thousands) |                      |
| Non-accrual loans:                                    |                        |                      |
| Mortgage loans:                                       |                        |                      |
| One-to-four family                                    | \$ 719                 | \$                   |
| Construction                                          | 307                    |                      |
| Commercial real estate                                |                        | 90                   |
| Commercial loans - Eastern                            | 2,169                  | 657                  |
| Indirect automobile loans                             | 178                    | \$ 153               |
| Total non-accrual loans                               | 3,373                  | 900                  |
| Repossessed vehicles                                  | 1,159                  | 784                  |
| Repossessed equipment - Eastern                       | 288                    | 178                  |
| Other receivable                                      |                        | 97                   |
| Total non-performing assets                           | \$ 4,820               | \$ 1,959             |
| Restructured loans                                    | \$ 553                 | \$                   |
| Allowance for loan losses                             | \$ 23,461              | \$ 23,024            |
| Allowance for loan losses as a percent of total loans | 1.24%                  | 1.28%                |
| Non-accrual loans as a percent of total loans         | 0.18%                  | 0.05%                |
| Non-performing assets as a percent of total assets    | 0.20%                  | 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. The rise in total non-accrual loans since December 31, 2006 occurred primarily in the Eastern loan portfolio and in the mortgage loan portfolio.

Eastern loans on non-accrual increased from \$657,000 (0.52% of Eastern loans outstanding) at December 31, 2006 to \$2,154,000 (1.70%) at March 31, 2007 and \$2,254,000 (1.63%) at June 30, 2007, but declined modestly to \$2,169,000 (1.55%) at September 30, 2007. All of the Eastern loans on non-accrual are considered impaired pursuant to generally accepted accounting principles in the United States. Specific reserves on those loans amounted to \$122,000 at December 31, 2006, \$801,000 at June 30, 2007 and \$682,000 at September 30, 2007.

While the total of Eastern loans on non-accrual has remained about the same during the last two quarters of 2007, loans delinquent 30 days and over increased from \$1,436,000 (1.13% of total loans) at December 31, 2006 to \$2,219,000 (1.75%) at March 31, 2007, declined slightly to \$2,002,000 (1.45%) at June 30, 2007 and rose significantly to \$3,414,000 (2.44%) at September 30, 2007. Eastern's typical customer is a small business owner with limited capital resources available to absorb deteriorating economic conditions when they arise. The increase in delinquencies is a sign that some of Eastern's customers are experiencing economic difficulties and that loan charge-offs could be higher in the future. See the section Provision for Loan Losses on a previous page for information regarding Eastern loan losses incurred in 2006 and 2007 and the allowance for loan losses established for the Eastern loan portfolio.



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Mortgage loans on non-accrual increased from \$90,000 at December 31, 2006 to \$516,000 at June 30, 2007 and \$1,026,000 at September 30, 2007. While the rate of increase is high, mortgage loan delinquencies remained modest in relation to a portfolio with over \$1.0 billion of loans outstanding. Foreclosure proceedings have commenced on the non-accrual mortgage loans. A specific reserve of \$40,000 was established for the estimated loss exposure related to those loans. At September 30, 2007, the mortgage loan portfolio did not include any subprime loans or option adjustable rate loans.

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.

The total of repossessed vehicles has increased in 2007 due to a higher volume of auto lending and a rise in auto loan delinquencies. The Company is experiencing larger per unit losses upon repossession due to weaker demand and slowing retail auto business activity. Continuation of these trends could result in higher losses from repossessions in the future. See the section "Provision for Loan Losses" on a previous page for information regarding auto loan losses.

The allowance for loan losses was \$23,461,000, or 1.24% of loans outstanding at September 30, 2007 compared to \$23,024,000, or 1.28% of loans outstanding at December 31, 2006. While the allowance expressed as a percent of loans declined modestly, the total of the allowance is considered adequate based on the continued low amount of loans on non-accrual status, the absence of problem loans in the mortgage loan portfolio, generally favorable loan loss experience in the auto loan and Eastern loan portfolios, despite higher charge-offs in 2007, and the unallocated portion of the total allowance. Such unallocated portion amounted to \$4,240,000 (18.1% of the total allowance) at September 30, 2007 compared to \$4,315,000 (18.7%) at December 31, 2006.

### **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.

At September 30, 2007, interest-earning assets maturing or repricing within one year amounted to \$1.046 billion and interest-bearing liabilities maturing or repricing within one year amounted to \$1.216 billion, resulting in a cumulative one year negative gap position of \$170 million, or 7.1% of total assets. The Company had a negative one year cumulative gap position of \$212 million or 8.9% of total assets at June 30, 2007, and \$117 million, or 4.9% of total assets at December 31, 2006. The change in the cumulative one year gap position from the end of 2006 resulted primarily from an increase in interest-bearing liabilities and a shortening of the average maturity of certificates of deposit and borrowings from the FHLB.

A liability-sensitive gap position would generally imply a negative impact on net interest income in periods of rising rates and a positive impact in periods of falling rates. GAP analysis has limitations because it cannot measure the effect of interest rate movements and competitive pressures on the repricing and maturity characteristics of interest-earning assets and interest-bearing liabilities.

### **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 September 30, 2007 amounted to \$512.0 million and the Company had the capacity to increase that amount to \$666.1 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 September 30, 2007, such assets amounted to \$157.9 million, or 6.6% of total assets.

At September 30, 2007, Brookline Bank exceeded all regulatory capital requirements. The Bank's Tier I capital was \$443.4 million, or 19.3% 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 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 September 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 |
|----------------------------------------|----------------------------------|----------------------------------|---------------------------------------------------------------------------------|-----------------------------------------------------------------------|
| July 1 through July 31, 2007           | 260,000                          | \$ 10.60                         | 547,468                                                                         | 3,952,532                                                             |
| August 1 through August 31, 2007       | 197,300                          | \$ 10.52                         | 744,768                                                                         | 3,755,232                                                             |
| September 1 through September 30, 2007 |                                  |                                  | 744,768                                                                         | 3,755,232                                                             |
| <b>Total</b>                           | <b>457,300</b>                   | <b>\$ 10.56</b>                  |                                                                                 |                                                                       |

(1) Includes transaction costs.

(2) On April 19, 2007, the Board of Directors approved a program to repurchase 2,500,000 shares of the Company's common stock. Prior to July 1, 2007, 287,468 shares authorized under this program had been repurchased.

(3) 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.

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**

None

**Item 5. Other Information**

Not applicable.

**Item 6. Exhibits**

*Exhibits*





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- Exhibit 11 Statement Regarding Computation of Per Share Earnings
- 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

**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: November 7, 2007

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

Date: November 7, 2007

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