

BROOKLINE BANCORP INC
Form 10-Q
November 02, 2006

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, 2006

OR

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

For the transition period from _____ to _____

Commission file number 0-23695

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)

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

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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

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, 2006 (unaudited) | December 31, 2005 |
|--|--------------------------------------|----------------------|
| <u>ASSETS</u> | | |
| Cash and due from banks | \$ 16,483 | \$ 15,507 |
| Short-term investments | 97,454 | 102,888 |
| Securities available for sale | 367,373 | 374,906 |
| Securities held to maturity (market value of \$754 and \$423, respectively) | 745 | 410 |
| Restricted equity securities | 28,567 | 23,081 |
| Loans | 1,800,408 | 1,636,755 |
| Allowance for loan losses | (25,066) | (22,248) |
| Net loans | 1,775,342 | 1,614,507 |
| Other investment | | 4,662 |
| Accrued interest receivable | 10,697 | 9,189 |
| Bank premises and equipment, net | 9,681 | 10,010 |
| Deferred income tax asset | 11,581 | 11,347 |
| Prepaid income taxes | 1,690 | |
| Goodwill | 42,489 | 35,615 |
| Identified intangible assets, net of accumulated amortization of \$4,035 and \$2,370, respectively | 8,917 | 9,471 |
| Other assets | 4,453 | 3,111 |
| Total assets | \$ 2,375,472 | \$ 2,214,704 |
| <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u> | | |
| Retail deposits | \$ 1,187,700 | \$ 1,168,307 |
| Brokered deposits | 78,096 | |
| Borrowed funds | 489,537 | 411,507 |
| Subordinated debt | 12,123 | 12,218 |
| Mortgagors' escrow accounts | 5,580 | 5,377 |
| Income taxes payable | | 630 |
| Accrued expenses and other liabilities | 20,223 | 14,215 |
| Total liabilities | 1,793,259 | 1,612,254 |
| Minority interest in subsidiary | 1,331 | |
| 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; 62,989,384 shares issued | 630 | 630 |
| Additional paid-in capital | 507,056 | 512,338 |
| Retained earnings, partially restricted | 95,938 | 121,042 |
| Accumulated other comprehensive loss | (1,091) | (1,577) |
| Treasury stock, at cost - 1,405,611 shares | (18,144) | (18,144) |
| Unearned compensation - recognition and retention plans | | (8,103) |
| Unallocated common stock held by ESOP - 643,104 shares and 685,161 shares, respectively | (3,507) | (3,736) |
| Total stockholders' equity | 580,882 | 602,450 |
| Total liabilities and stockholders' equity | \$ 2,375,472 | \$ 2,214,704 |

See accompanying notes to the unaudited consolidated financial statements.

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

| | Three months ended September 30, 2006 (unaudited) | | Nine months ended September 30, 2006 | |
|---|--|-----------|--|-----------|
| | 2005 | 2006 | 2005 | 2006 |
| Interest income: | | | | |
| Loans | \$ 29,154 | \$ 22,830 | \$ 81,356 | \$ 66,908 |
| Debt securities | 3,774 | 2,876 | 11,033 | 7,787 |
| Marketable equity securities | 30 | 78 | 93 | 228 |
| Restricted equity securities | 763 | 241 | 1,074 | 699 |
| Short-term investments | 1,436 | 1,259 | 3,874 | 3,115 |
| Total interest income | 35,157 | 27,284 | 97,430 | 78,737 |
| Interest expense: | | | | |
| Retail deposits | 9,523 | 6,159 | 25,354 | 16,071 |
| Brokered deposits | 968 | | 1,605 | |
| Borrowed funds | 6,256 | 3,994 | 17,313 | 11,048 |
| Subordinated debt | 236 | 182 | 667 | 485 |
| Total interest expense | 16,983 | 10,335 | 44,939 | 27,604 |
| Net interest income | 18,174 | 16,949 | 52,491 | 51,133 |
| Provision for loan losses | 813 | 32 | 2,420 | 1,643 |
| Net interest income after provision for loan losses | 17,361 | 16,917 | 50,071 | 49,490 |
| Non-interest income: | | | | |
| Fees and charges | 829 | 798 | 2,362 | 2,851 |
| Gains on securities, net | | | 558 | 853 |
| Equity interest in earnings from other investment | | 110 | 1 | 328 |
| Other income | 8 | 20 | 27 | 92 |
| Total non-interest income | 837 | 928 | 2,948 | 4,124 |
| Non-interest expense: | | | | |
| Compensation and employee benefits | 5,027 | 4,000 | 14,462 | 11,929 |
| Occupancy | 837 | 721 | 2,396 | 2,111 |
| Equipment and data processing | 1,538 | 1,361 | 4,478 | 4,547 |
| Advertising and marketing | 294 | 352 | 749 | 807 |
| Merger/conversion | | 1 | | 894 |
| Amortization of identified intangibles | 569 | 593 | 1,665 | 1,778 |
| Other | 1,367 | 1,602 | 3,584 | 3,858 |
| Total non-interest expense | 9,632 | 8,630 | 27,334 | 25,924 |
| Income before income taxes and minority interest | 8,566 | 9,215 | 25,685 | 27,690 |
| Provision for income taxes | 3,383 | 3,694 | 10,109 | 11,196 |
| Net income before minority interest | 5,183 | 5,521 | 15,576 | 16,494 |
| Minority interest in earnings of subsidiary | 74 | | 141 | |
| Net income | \$ 5,109 | \$ 5,521 | \$ 15,435 | \$ 16,494 |
| Earnings per common share: | | | | |
| Basic | \$ 0.08 | \$ 0.09 | \$ 0.25 | \$ 0.27 |
| Diluted | 0.08 | 0.09 | 0.25 | 0.27 |

Weighted average common shares outstanding during the period:

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| | | | | |
|---------|------------|------------|------------|------------|
| Basic | 60,387,098 | 60,108,206 | 60,353,648 | 60,026,232 |
| Diluted | 61,060,561 | 60,948,961 | 61,064,942 | 60,830,950 |

See accompanying notes to the unaudited consolidated financial statements.

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

| | Three months ended September 30, 2006 | | Nine months ended September 30, 2006 | |
|--|---|----------|--|-----------|
| | 2006 (unaudited) | 2005 | 2006 | 2005 |
| Net income | \$ 5,109 | \$ 5,521 | \$ 15,435 | \$ 16,494 |
| Other comprehensive income, net of taxes: | | | | |
| Unrealized holding gains (losses) | 2,306 | (1,377) | 1,311 | (1,855) |
| Income tax charge (benefit) | (847) | 506 | 467 | 684 |
| Net unrealized holding gains (losses) | 1,459 | (871) | 844 | (1,171) |
| Less reclassification adjustment for gains included in net income: | | | | |
| Realized gains | | | 558 | 853 |
| Income tax expense | | | 200 | 306 |
| Net reclassification adjustment | | | 358 | 547 |
| Net other comprehensive gain (loss) | 1,459 | (871) | 486 | (1,718) |
| Comprehensive income | \$ 6,568 | \$ 4,650 | \$ 15,921 | \$ 14,776 |

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, 2006 and 2005 (Unaudited)
(Dollars in thousands)

| | Common stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive income (loss) | Treasury stock | Unearned compensation- recognition and retention plans | Unallocated common stock held by ESOP | Total stockholders equity |
|---|-----------------|----------------------------------|----------------------|--|-------------------|--|--|---------------------------------|
| Balance at December 31, 2004 | \$ 605 | \$ 471,799 | \$ 144,081 | \$ 560 | \$ (17,017) | \$ (10,963) | \$ (4,052) | \$ 585,013 |
| Net income | | | 16,494 | | | | | 16,494 |
| Unrealized loss on securities available for sale, net of reclassification adjustment | | | | (1,718) | | | | (1,718) |
| Common stock dividends of \$0.655 per share | | | (39,955) | | | | | (39,955) |
| Exercise of stock options (4,520 shares) | | 23 | | | | | | 23 |
| 2,516,525 shares issued for the acquisition of Mystic Financial, Inc. | 25 | 39,157 | | | | | | 39,182 |
| Shares obtained through the acquisition of Mystic Financial, Inc. (70,312 shares) | | | | | (1,127) | | | (1,127) |
| Income tax benefit from dividend payments on unvested recognition and retention plan shares and allocated ESOP shares and the exercise of non-incentive stock options | | 907 | | | | | | 907 |
| Recognition and retention plan shares forfeited | | (144) | | | | 144 | | |
| Compensation under recognition and retention plans | | | | | | 2,040 | | 2,040 |
| Common stock held by ESOP committed to be released (41,598 shares) | | 421 | | | | | 226 | 647 |
| Balance at September 30, 2005 | \$ 630 | \$ 512,163 | \$ 120,620 | \$ (1,158) | \$ (18,144) | \$ (8,779) | \$ (3,826) | \$ 601,506 |

BROOKLINE BANCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
Nine Months Ended September 30, 2006 and 2005 (Unaudited)
(Dollars in thousands)

| | Common stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive loss | Treasury stock | Unearned compensation- recognition and retention plans | Unallocated common stock held by ESOP | Total stockholders 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 |
| Unrealized gain on securities available for sale, net of reclassification adjustment | | | | 486 | | | | 486 |
| Common stock dividends of \$0.655 per share | | | (39,579) | | | | | (39,579) |
| Payment of dividend equivalent rights | | | (960) | | | | | (960) |
| Income tax benefit from dividend payments on unexercised stock options and allocated ESOP shares | | 224 | | | | | | 224 |
| Transfer of unearned compensation under the recognition and retention plans to additional paid-in capital | | (8,103) | | | | 8,103 | | |
| Compensation under recognition and retention plans | | 2,226 | | | | | | 2,226 |
| Common stock held by ESOP committed to be released (42,057 shares) | | 371 | | | | | 229 | 600 |
| Balance at September 30, 2006 | \$ 630 | \$ 507,056 | \$ 95,938 | \$ (1,091) | \$ (18,144) | \$ | \$ (3,507) | \$ 580,882 |

See accompanying notes to the unaudited consolidated financial statements.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(In thousands)

| | Nine months ended September 30, 2006 (unaudited) | |
|---|---|------------|
| | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Net income | \$ 15,435 | \$ 16,494 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 2,420 | 1,643 |
| Compensation under recognition and retention plans | 2,226 | 2,040 |
| Release of ESOP shares | 600 | 647 |
| Depreciation and amortization | 1,058 | 1,159 |
| Amortization, net of accretion, of securities premiums and discounts | 77 | 1,671 |
| Amortization of deferred loan origination costs | 6,214 | 4,536 |
| Amortization of identified intangible assets | 1,665 | 1,778 |
| Accretion of acquisition fair value adjustments | (954) | (1,377) |
| Amortization of mortgage servicing rights | 15 | 51 |
| Net gains from sales of securities | (558) | (853) |
| Equity interest in earnings of other investment | (1) | (328) |
| Swap agreement market valuation credit | | (49) |
| Write-down of other real estate owned | | 250 |
| Income tax benefit from dividend payments on unvested recognition and retention plan shares and allocated ESOP shares and the exercise of non-incentive stock options | | 907 |
| Deferred income taxes | (501) | (839) |
| (Increase) decrease in: | | |
| Accrued interest receivable | (833) | (1,413) |
| Prepaid income taxes | (1,690) | 1,552 |
| Other assets | 50 | 2,361 |
| Increase (decrease) in: | | |
| Income taxes payable | (630) | |
| Accrued expenses and other liabilities | 1,446 | 519 |
| Minority interest in earnings of subsidiary | 141 | |
| Net cash provided from operating activities | 26,180 | 30,749 |
| Cash flows from investing activities: | | |
| Proceeds from sales of securities available for sale | 903 | 9,769 |
| Proceeds from redemptions and maturities of securities available for sale | 105,882 | 164,896 |
| Proceeds from redemptions and maturities of securities held to maturity | 165 | 48 |
| Purchase of securities available for sale | (97,859) | (201,790) |
| Purchase of securities held to maturity | (500) | |
| Purchase of Federal Home Loan Bank of Boston stock | (5,486) | (1,415) |
| Net increase in loans | (62,980) | (41,375) |
| Proceeds from sales of participations in loans | | 29,438 |
| Purchase of bank premises and equipment | (516) | (861) |
| Acquisition, net of cash and cash equivalents acquired | (10,547) | (13,006) |
| Distribution from other investment | | 239 |
| Net cash used for investing activities | (70,938) | (54,057) |

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| | Nine months ended September 30, 2006 | | 2005 |
|--|---|--------------|--------------|
| | (unaudited) | | |
| Cash flows from financing activities: | | | |
| Decrease in demand deposits and NOW, savings and money market savings accounts | \$ | (52,498) | \$ (96,310) |
| Increase in retail certificates of deposit | | 72,138 | 144,520 |
| Increase in brokered certificates of deposit | | 78,096 | |
| Proceeds from Federal Home Loan Bank of Boston advances | | 2,697,500 | 581,600 |
| Repayment of Federal Home Loan Bank of Boston advances | | (2,619,414) | (553,543) |
| Repayment of other borrowed funds of subsidiary | | (95,410) | |
| Increase (decrease) in mortgagors escrow accounts | | 203 | (181) |
| Income tax benefit from dividend payments on unexercised stock options and allocated ESOP shares | | 224 | |
| Proceeds from exercise of stock options | | | 23 |
| Payment of dividends on common stock | | (39,579) | (39,955) |
| Payment of dividend equivalent rights | | (960) | |
| Net cash provided from financing activities activities | | 40,300 | 36,154 |
| Net increase (decrease) in cash and cash equivalents | | (4,458) | 12,846 |
| Cash and cash equivalents at beginning of period | | 118,395 | 136,865 |
| Cash and cash equivalents at end of period | \$ | 113,937 | \$ 149,711 |
| Supplemental disclosures of cash flow information: | | | |
| Cash paid during the period for: | | | |
| Interest on deposits, borrowed funds and subordinated debt | \$ | 43,332 | \$ 27,548 |
| Income taxes | | 11,978 | 9,392 |
| Acquisition of Mystic Financial, Inc.: | | | |
| Assets acquired (excluding cash and cash equivalents) | \$ | | \$ 471,412 |
| Liabilities assumed | | | 420,351 |
| Acquisition of Eastern Funding LLC: | | | |
| 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, 2006 and 2005
(Unaudited)

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

Basis of Presentation

The consolidated financial statements include the accounts of Brookline Bancorp, Inc. (the Company) and its wholly owned subsidiaries, Brookline Bank (Brookline) and Brookline Securities Corp. Brookline includes its wholly owned subsidiary, BBS Investment Corporation, and its 86.7% owned subsidiary, Eastern Funding LLC (see note 2).

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

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation have been included. Results for the nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

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

Critical Accounting Policies

Allowance for Loan Losses

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

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

Goodwill and Identified Intangible Assets

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

BROOKLINE BANCORP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
Nine Months Ended September 30, 2006 and 2005
(Unaudited)

Earnings Per Common Share

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

Stock-Based Compensation

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

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

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

Prior to January 1, 2006, the Company measured compensation cost for stock options in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees as the excess, if any, of the fair market value of the Company's stock at the grant date above the exercise price of options granted. This generally did not result in compensation charges to earnings. Disclosed in the following table are net income and earnings per share, as reported, and pro forma net income and earnings per share as if compensation was measured at the date of grant based on the fair value of the award and recognized over the service period.

| | Three months ended September 30, 2005 | | Nine months ended September 30, 2005 | |
|---|--|----------------|---|----------------|
| | Basic | Diluted | Basic | Diluted |
| Net income as reported | \$ 5,521 | \$ 5,521 | \$ 16,494 | \$ 16,494 |
| Total stock-based compensation expense determined using fair value accounting for stock option awards, net of taxes | (65) | (65) | (194) | (194) |
| Dividends on unvested restricted stock awards | (227) | (216) | (531) | (508) |
| Pro forma net income | \$ 5,229 | \$ 5,240 | \$ 15,769 | \$ 15,792 |
| Earnings per share: | | | | |
| As reported | \$ 0.09 | \$ 0.09 | \$ 0.27 | \$ 0.27 |
| Pro forma | 0.09 | 0.09 | 0.26 | 0.26 |

Cash Equivalents

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

BROOKLINE BANCORP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
Nine Months Ended September 30, 2006 and 2005
(Unaudited)

(2) Acquisitions (Dollars in thousands)*Eastern Funding LLC (Eastern)*

On April 13, 2006, the Company through its wholly-owned subsidiary, Brookline Bank, completed a merger agreement increasing its ownership interest in Eastern from 28.3% to 86.7%. Eastern, which was founded by Michael J. Fanger in 1997, specializes primarily in the financing of coin-operated laundry, dry cleaning and grocery store equipment in the greater metropolitan New York area and selected other locations in the Northeast. The acquisition of a controlling interest in Eastern will enable the Company to originate high yielding loans to small business entities. Mr. Fanger continues to serve as chief executive officer of Eastern and he, along with a family member and two executive officers of Eastern, own the 13.3% minority interest position.

The purchase was completed through payment of \$16,519 in cash, including transaction costs. The transaction was accounted for using the purchase method of accounting, which required that the assets and liabilities of Eastern be recorded at fair value as of the acquisition date to the extent of the ownership interest acquired. The results of operations of Eastern are included in the Company's 2006 consolidated statement of income from the date of acquisition. The allocation of the purchase price to the net assets of Eastern and the resulting goodwill are presented below.

Purchase price

| | |
|--|-----------|
| Cash paid to holders of Eastern units of ownership | \$ 14,942 |
| Direct acquisition costs, net of related income tax benefits | 1,577 |
| Total purchase price | 16,519 |

Allocation of the purchase price

| | |
|---|-----------|
| Assets acquired at historic cost: | |
| Cash and cash equivalents | \$ 5,972 |
| Loans, net | 106,472 |
| Premises and equipment | 261 |
| Other assets | 2,082 |
| Total assets acquired at historic cost | 114,787 |
| Liabilities assumed: | |
| Borrowed funds | 95,410 |
| Other liabilities | 4,562 |
| Total liabilities assumed | 99,972 |
| Net assets at historic cost | 14,815 |
| Fair value adjustments: | |
| Loans | \$ (427) |
| Identified intangible assets | 1,110 |
| Net effect of fair value adjustments | 683 |
| Net assets at fair value | 15,498 |
| Less: | |
| Brookline Bancorp, Inc. investment in Eastern | (4,663) |
| Minority interest ownership | (1,190) |
| Fair value of net assets acquired | 9,645 |
| Goodwill resulting from the acquisition | \$ 6,874 |

BROOKLINE BANCORP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
Nine Months Ended September 30, 2006 and 2005
(Unaudited)

Identified intangible assets included \$668 for the estimated value of Eastern's customer list and \$442 for the estimated value of the employment agreements with three executive officers. The values assigned to the customer list and the employment agreements are being amortized over eight years and five years, respectively, on a straight-line basis.

As part of the merger, employment agreements were entered into with Mr. Fanger and the two executive officers who have an ownership interest in Eastern (the Executives). The employment agreements are for three years commencing as of the merger date. On each of the first anniversary date and second anniversary date of the merger, the employment agreements can be extended for an additional year such that the remaining term of the employment agreements shall be three years unless the Company provides written notice to the Executive at least sixty days prior to either such anniversary date that his employment agreement will not be extended. The employment agreements provide a base salary that will be subject to annual review by the Compensation Committee of the Company; such base salary can be increased, but not decreased. The Executives are also entitled to an annual incentive bonus, the amounts of which are to be determined based on defined profitability and asset quality benchmarks. The Executives are also entitled to the same benefits offered to full-time employees of the Company. Upon an Event of Termination, as defined in the employment agreements, the Executive would be entitled to a severance payment, the amount of which would depend on the facts and circumstances associated with the termination. The maximum amount of such payments equals two times annual base salary and incentive bonus for Mr. Fanger and one times annual base salary and incentive bonus for the two other executives. Non-compete clauses become effective upon termination of an Executive's employment.

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

Mystic Financial, Inc. (Mystic)

On January 7, 2005, the Company acquired all of the outstanding common shares of Mystic, the holding company of Medford Co-operative Bank (Medford), which had seven retail banking offices serving customers primarily in Middlesex County in Massachusetts. The acquisition of Mystic provided expanded commercial and retail banking opportunities in that market and enabled the Company to deploy some of its excess capital. As part of the acquisition, Mystic was merged into the Company and Medford was merged into Brookline. On April 11, 2005, the operating systems of Medford were converted to the operating systems of Brookline.

Under the terms of the transaction agreement, (a) 60% of the shares of Mystic common stock were exchanged for Company common stock based on an exchange ratio of 2.6786 shares of Company common stock for each share of Mystic common stock and (b) 40% of the shares of Mystic common stock were exchanged for cash of \$39.00 per share. Cash was paid for fractional shares. The acquisition was accounted for using the purchase method of accounting and, accordingly, the assets and liabilities of Mystic were recorded at fair value as of the acquisition date. The results of operations of Mystic are included in the consolidated statements of income from the date of acquisition. The purchase price to complete the acquisition was \$69,075. Goodwill resulting from the acquisition was \$35,615. A core deposit intangible asset of \$11,841 recognized at the time of the acquisition is being amortized over nine years on an accelerated basis using the sum-of-the-digits method.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
Nine Months Ended September 30, 2006 and 2005
(Unaudited)

(3) Investment Securities (Dollars in thousands)

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

| | September 30, 2006 | | | |
|---|---------------------------|---------------------------------------|--|---------------------------------|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| Securities available for sale: | | | | |
| Debt securities: | | | | |
| U.S. Government-sponsored enterprises | \$ 287,700 | \$ 207 | \$ 635 | 287,272 |
| Municipal obligations | 8,663 | | 179 | 8,484 |
| Auction rate municipal obligations | 12,650 | | | 12,650 |
| Corporate obligations | 6,469 | 51 | 7 | 6,513 |
| Other obligations | 500 | | | 500 |
| Collateralized mortgage obligations issued by U.S. Government-sponsored enterprises | 7,992 | 22 | | 8,014 |
| Mortgage-backed securities issued by U.S. Government-sponsored enterprises | 42,608 | 13 | 1,314 | 41,307 |
| Total debt securities | 366,582 | 293 | 2,135 | 364,740 |
| Marketable equity securities | 2,535 | 149 | 51 | 2,633 |
| Total securities available for sale | \$ 369,117 | \$ 442 | 2,186 | 367,373 |
| Securities held to maturity: | | | | |
| Other obligations | \$ 500 | \$ | \$ | \$ 500 |
| Mortgage-backed securities issued by U.S. Government-sponsored enterprises | 245 | 9 | | 254 |
| Total securities held to maturity | \$ 745 | \$ 9 | \$ | \$ 754 |
| | | | | |
| | December 31, 2005 | | | |
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| Securities available for sale: | | | | |
| Debt securities: | | | | |
| U.S. Government-sponsored enterprises | \$ 295,232 | \$ | \$ 1,716 | \$ 293,516 |
| Municipal obligations | 8,671 | | 167 | 8,504 |
| Auction rate municipal obligations | 12,750 | | | 12,750 |
| Corporate obligations | 7,478 | 57 | 15 | 7,520 |
| Other obligations | 500 | | | 500 |
| Collateralized mortgage obligations issued by U.S. Government-sponsored enterprises | 211 | | 1 | 210 |
| Mortgage-backed securities issued by U.S. Government-sponsored enterprises | 49,681 | 6 | 1,324 | 48,363 |
| Total debt securities | 374,523 | 63 | 3,223 | 371,363 |
| Marketable equity securities | 2,881 | 713 | 51 | 3,543 |
| Total securities available for sale | \$ 377,404 | \$ 776 | \$ 3,274 | \$ 374,906 |
| Securities held to maturity: | | | | |
| Other obligations | \$ 100 | \$ | \$ | \$ 100 |
| Mortgage-backed securities issued by U.S. Government-sponsored enterprises | 310 | 13 | | 323 |
| Total securities held to maturity | \$ 410 | \$ 13 | \$ | \$ 423 |

BROOKLINE BANCORP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
Nine Months Ended September 30, 2006 and 2005
(Unaudited)

Debt securities of U.S. Government-sponsored enterprises include obligations issued by Fannie Mae, Freddie Mac, 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.

(4) Loans (Dollars in thousands)

A summary of loans follows:

| | September 30, 2006 | December 31, 2005 |
|---------------------------------------|-----------------------|----------------------|
| Mortgage loans: | | |
| One-to-four family | \$ 286,381 | \$ 287,450 |
| Multi-family | 334,922 | 358,955 |
| Commercial real estate | 383,041 | 377,462 |
| Construction and development | 42,925 | 56,847 |
| Home equity | 39,129 | 42,924 |
| Second | 16,506 | 22,978 |
| Total mortgage loans | 1,102,904 | 1,146,616 |
| Commercial loans Eastern Funding | 125,449 | |
| Other commercial loans | 111,257 | 105,384 |
| Indirect automobile loans | 531,487 | 459,234 |
| Other consumer loans | 3,224 | 3,119 |
| Total gross loans | 1,874,321 | 1,714,353 |
| Unadvanced funds on loans | (87,976) | (88,659) |
| Deferred loan origination costs loans | 14,063 | 11,061 |
| Total loans | \$ 1,800,408 | \$ 1,636,755 |

The above table reflects a reclassification of \$20,812 as of December 31, 2005 from multi-family mortgage loans to construction and development mortgage loans. The reclassification was made to conform to the current year's presentation.

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

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

| | Nine months ended September 30, | |
|---|------------------------------------|-----------|
| | 2006 | 2005 |
| Balance at beginning of period | \$ 22,248 | \$ 17,540 |
| Allowance obtained through acquisitions | 1,958 | 3,501 |
| Provision for loan losses | 2,420 | 1,643 |
| Charge-offs | (2,063) | (1,259) |
| Recoveries | 503 | 475 |
| Balance at end of period | \$ 25,066 | \$ 21,900 |

BROOKLINE BANCORP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
Nine Months Ended September 30, 2006 and 2005
(Unaudited)

(6) Deposits (Dollars in thousands)

A summary of deposits follows:

| | September 30, 2006 | December 31, 2005 |
|--|-----------------------|----------------------|
| Demand checking accounts | \$ 63,004 | \$ 64,705 |
| NOW accounts | 87,853 | 98,901 |
| Savings accounts | 70,229 | 90,424 |
| Guaranteed savings accounts | 36,057 | 27,475 |
| Money market savings accounts | 211,910 | 240,293 |
| Retail certificate of deposit accounts | 718,647 | 646,509 |
| Total retail deposits | 1,187,700 | 1,168,307 |
| Brokered certificates of deposit | 78,096 | |
| Total deposits | \$ 1,265,796 | \$ 1,168,307 |

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

Accumulated other comprehensive loss is comprised entirely of unrealized losses on securities available for sale, net of income taxes. At September 30, 2006 and December 31, 2005, such taxes amounted to \$654 and \$920, respectively.

(8) Commitments (Dollars in thousands)

At September 30, 2006, the Company had outstanding commitments to originate loans of \$64,743, \$7,662 of which were one-to-four family mortgage loans, \$30,633 were commercial real estate mortgage loans, \$3,240 were multi-family mortgage loans, \$4,680 were commercial loans to condominium associations and \$18,528 were commercial loans. Unused lines of credit available to customers were \$51,130, of which \$47,199 were equity lines of credit.

(9) Dividend Declaration

On October 19, 2006, the Board of Directors of the Company approved and declared a regular quarterly cash dividend of \$0.085 per share payable on November 15, 2006 to stockholders of record on October 31, 2006.

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

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

The compensation cost of non-vested RRP shares at September 30, 2006 is expected to be charged to expense as follows: \$633 during the three month period ended December 31, 2006 and \$2,422, \$2,378 and \$157 during the years ended December 31, 2007, 2008 and 2009, respectively. Total expense for the RRP plans amounted to \$652, \$668, \$2,226 and \$2,040 for the three months and nine months ended September 30, 2006 and 2005, respectively. As of September 30, 2006, the number of shares available for award under the 1999 RRP and the 2003 RRP were 29,774

shares and 92,000 shares, respectively.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES**Notes to Consolidated Financial Statements (continued)****Nine Months Ended September 30, 2006 and 2005****(Unaudited)**

In accordance with SFAS 123-R, effective January 1, 2006, dividends paid on unvested RRP shares are recognized as compensation expense; prior to that date, such dividend payments were charged to retained earnings. Dividends paid on unvested RRP shares during the nine months ended September 30, 2006 and 2005 amounted to \$370 and \$515, respectively.

Stock Option Plans

The Company has a stock option plan that has been in place since 1999 (the 1999 Option Plan) and another plan that was approved by stockholders on August 27, 2003 (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 and 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.

Stock options granted under both of the Plans included limited rights and other features (Limited Rights) that could have required cash settlement of the options on the occurrence of certain circumstances outside the control of the Company. On December 28, 2005, the Compensation Committee of the Board of Directors of the Company voted to amend the Plans to eliminate Limited Rights that grant the holder of options awarded under such Plans the right to receive a cash settlement of any options outstanding in circumstances that are not within the absolute discretion of the Company and to accelerate the vesting of all unvested stock options outstanding on that date granted under the Plans to December 28, 2005. Such options included the following: 20,000 options granted under the 1999 Plan at an exercise price of \$12.91 per option, 10,000 of which were to vest on January 16, 2006 and 10,000 on January 16, 2007, and 249,600 options granted under the 2003 Plan at an exercise price of \$15.02 per option, 71,900 of which were to vest each on January 2, 2006, January 2, 2007 and January 2, 2008, and 33,900 on January 2, 2009. If the vesting dates of such options had not been accelerated, to comply with the requirements of SFAS 123-R, non-cash compensation expense of approximately \$290,000 in 2006, \$202,000 in 2007, \$97,000 in 2008 and less than \$1,000 in 2009 would have had to be recognized in the Company's financial statements for those years.

Activity under the Company's stock option plans for the nine months ended September 30, 2006 was as follows:

| | |
|---|-----------|
| Options outstanding at January 1, 2006 | 3,177,988 |
| Options granted | 5,000 |
| Options exercised | |
| Options outstanding at September 30, 2006 | 3,182,988 |
| Exercisable at September 30, 2006 at: | |
| \$ 4.944 per share | 1,771,568 |
| \$ 11.00 per share | 5,393 |
| \$ 12.91 per share | 45,000 |
| \$ 15.02 per share | 1,357,500 |
| \$ 15.42 per share | 3,527 |
| | 3,182,988 |
| Aggregate intrinsic value of options outstanding and exercisable | \$ 15,653 |
| Weighted average exercise price per option | \$ 9.38 |
| Weighted average remaining contractual life in years at end of period | 4.60 |

BROOKLINE BANCORP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
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(Unaudited)

As of September 30, 2006, 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 1,137,500 options, respectively.

In accordance with the terms of the 1999 and 2003 Option Plans, dividend equivalent rights amounting to \$960 and \$702 were paid or payable during the nine months ended September 30, 2006 and 2005, respectively, to holders of unexercised vested options as a result of the \$0.20 per share extra dividends paid to stockholders in February and August of 2006 and 2005. In accordance with SFAS 123-R, effective January 1, 2006, dividend equivalent rights are charged to retained earnings; prior to that date, such payments were recognized as compensation expense.

Employee Stock Ownership Plan

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

A loan obtained by the ESOP from the Company to purchase Company common stock is payable in quarterly installments over 30 years and bears interest at 8.50% per annum. The loan can be prepaid without penalty. Loan payments are principally funded by cash contributions from the Bank, subject to federal tax law limits. The outstanding balance of the loan at September 30, 2006 and December 31, 2005, which was \$4,064 and \$4,252, 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, 2006, the ESOP held 643,104 unallocated shares at an aggregate cost of \$3,507; the market value of such shares at that date was \$8,843. For the nine months ended September 30, 2006 and 2005, \$600 and \$647, respectively, was charged to compensation expense based on the commitment to release to eligible employees 42,057 shares and 41,598 shares in those respective periods.

(11) Postretirement Benefits (Dollars in thousands)

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

The following table provides the actual components of net periodic postretirement benefit costs for the three months and nine months ended September 30, 2006 and 2005.

| | Three months ended | | Nine months ended | |
|----------------------------|-----------------------|-------|-----------------------|--------|
| | September 30, 2006 | 2005 | September 30, 2006 | 2005 |
| Service cost | \$ 14 | \$ 39 | \$ 42 | \$ 116 |
| Interest cost | 12 | 19 | 35 | 58 |
| Prior service cost | (6) | (5) | (17) | (16) |
| Actuarial (gain) loss | (1) | 6 | (2) | 19 |
| Net periodic benefit costs | \$ 19 | \$ 59 | \$ 58 | \$ 177 |

Benefits paid for the nine months ended September 30, 2006 and 2005 amounted to \$8 and \$13, respectively.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
Nine Months Ended September 30, 2006 and 2005
(Unaudited)

(12) Stockholders Equity (Dollars in thousands)

Capital Distributions and Restrictions Thereon

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

Common Stock Repurchases

As of September 30, 2006, the Company was authorized to repurchase up to 1,772,532 shares of its common stock. The repurchase of additional shares would require prior authorization of the Board of Directors of the Company.

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 \$40,905 at December 31, 2005.

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, 2005 filed on March 10, 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

Over the past year, short and long-term interest rates have moved gradually toward similar levels, thus creating a flattening yield curve environment. More recently, short-term rates have exceeded rates for assets with maturities beyond one year, thus creating an inverted yield curve environment. Shrinkage between rates earned on loans and investment securities and rates paid on deposits and liabilities has had a negative effect on profitability.

The table on the following page is a summary of operating and financial condition highlights as of and for the three months and nine months ended September 30, 2006 and 2005.

Operating Highlights

| | Three months ended September 30, | | Nine months ended September 30, | | |
|--|---|-----------|------------------------------------|-----------|---|
| | 2006 | 2005 | 2006 | 2005 | |
| | (In thousands except per share amounts) | | | | |
| Net interest income | \$ 18,174 | \$ 16,949 | \$ 52,491 | \$ 51,133 | |
| Provision for loan losses | 813 | 32 | 2,420 | 1,643 | |
| Non-interest income | 837 | 928 | 2,948 | 4,124 | |
| Merger/conversion expense | | 1 | | 894 | |
| Amortization of identified intangible assets | 569 | 593 | 1,665 | 1,778 | |
| Other non-interest expenses | 9,063 | 8,036 | 25,669 | 23,252 | |
| Income before income taxes and minority interest | 8,566 | 9,215 | 25,685 | 27,690 | |
| Provision for income taxes | 3,383 | 3,694 | 10,109 | 11,196 | |
| Minority interest in earnings of subsidiary | 74 | | 141 | | |
| Net income | 5,109 | 5,521 | 15,435 | 16,494 | |
| Basic earnings per common share | \$ 0.08 | \$ 0.09 | \$ 0.25 | \$ 0.27 | |
| Diluted earnings per common share | 0.08 | 0.09 | 0.25 | 0.27 | |
| Interest rate spread | 2.17 | % 2.42 | % 2.16 | % 2.51 | % |
| Net interest margin | 3.15 | % 3.20 | % 3.13 | % 3.25 | % |

Financial Condition Highlights

| | At September 30, 2006 (In thousands) | At June 30, 2006 | At December 31, 2005 | |
|-------------------------------------|---|------------------------|----------------------------|---|
| Total assets | \$ 2,375,472 | \$ 2,381,365 | \$ 2,214,704 | |
| Net loans | 1,775,342 | 1,778,953 | 1,614,507 | |
| Retail deposits | 1,187,700 | 1,171,967 | 1,168,307 | |
| Brokered deposits | 78,096 | 68,096 | | |
| Borrowed funds | 489,537 | 512,127 | 411,507 | |
| Stockholders equity | 580,882 | 591,292 | 602,450 | |
| Allowance for loan losses | \$ 25,066 | \$ 24,838 | \$ 22,248 | |
| Non-performing assets | 2,299 | 1,156 | 973 | |
| Stockholders equity to total assets | 24.45 | % 24.83 | % 27.20 | % |

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

- The continued pressure on interest rate spread and net interest margin
- The acquisition of a controlling interest in Eastern Funding LLC (Eastern)
- Growth of the indirect automobile loan portfolio
- Higher provisions for loan losses due primarily to growth in certain loan segments
- Lower non-interest income due primarily to reduced mortgage loan prepayment fees
- Higher non-interest expenses due to inclusion of Eastern since the 2006 second quarter, the opening of a new branch in April 2006 and higher personnel-related expenses

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 table sets 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, 2006 and 2005. 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, 2006 | | | Average yield/ cost | 2005 | | |
|---|--|--------------|-------|---------------------------|--------------------|--------------|---------------------------|
| | Average balance (Dollars in thousands) | Interest (1) | | | Average balance | Interest (1) | Average yield/ cost |
| Assets | | | | | | | |
| Interest-earning assets: | | | | | | | |
| Short-term investments | \$ 108,992 | \$ 1,436 | 5.23 | % | \$ 148,957 | \$ 1,259 | 3.35 % |
| Debt securities (2) | 349,759 | 3,865 | 4.42 | | 341,734 | 2,943 | 3.45 |
| Equity securities (2) (4) | 31,215 | 805 | 10.23 | | 31,572 | 348 | 4.38 |
| Mortgage loans (3) | 1,075,151 | 17,305 | 6.44 | | 1,089,451 | 16,762 | 6.15 |
| Commercial loans - Eastern Funding (3) | 122,349 | 3,338 | 10.82 | | | | |
| Other commercial loans (3) | 67,866 | 1,190 | 7.01 | | 73,321 | 1,124 | 6.11 |
| Indirect automobile loans (3) | 541,343 | 7,263 | 5.32 | | 444,258 | 4,892 | 4.37 |
| Other consumer loans (3) | 3,058 | 58 | 7.59 | | 3,117 | 52 | 7.19 |
| Total interest-earning assets | 2,299,733 | 35,260 | 6.11 | % | 2,132,410 | 27,380 | 5.12 % |
| Allowance for loan losses | (25,000) | | | | (22,253) | | |
| Non-interest earning assets | 104,092 | | | | 99,631 | | |
| Total assets | \$ 2,378,825 | | | | \$ 2,209,788 | | |
| Liabilities and Stockholders | | | | | | | |
| Equity | | | | | | | |
| Interest-bearing liabilities: | | | | | | | |
| Deposits: | | | | | | | |
| NOW accounts | \$ 86,869 | 54 | 0.25 | % | \$ 96,616 | 45 | 0.18 % |
| Savings accounts | 111,492 | 478 | 1.70 | | 143,306 | 507 | 1.40 |
| Money market savings accounts | 221,066 | 1,458 | 2.62 | | 260,271 | 1,161 | 1.77 |
| Retail certificates of deposit | 694,076 | 7,533 | 4.31 | | 583,760 | 4,446 | 3.02 |
| Total retail deposits | 1,113,503 | 9,523 | 3.39 | | 1,083,953 | 6,159 | 2.25 |
| Brokered certificates of deposit | 71,574 | 968 | 5.37 | | | | |
| Total deposits | 1,185,077 | 10,491 | 3.51 | | 1,083,953 | 6,159 | 2.25 |
| Borrowed funds | 512,691 | 6,256 | 4.77 | | 424,401 | 3,994 | 3.68 |
| Subordinated debt | 12,144 | 236 | 7.60 | | 12,269 | 182 | 5.77 |
| Total interest bearing liabilities | 1,709,912 | 16,983 | 3.94 | % | 1,520,623 | 10,335 | 2.70 % |
| Non-interest-bearing demand checking accounts | 59,864 | | | | 67,711 | | |
| Other liabilities | 24,088 | | | | 14,694 | | |
| Total liabilities | 1,793,864 | | | | 1,603,028 | | |
| Stockholders' equity | 584,961 | | | | 606,760 | | |
| Total liabilities and stockholders equity | \$ 2,378,825 | | | | \$ 2,209,788 | | |
| Net interest income (tax equivalent basis)/interest rate spread (5) | | 18,277 | 2.17 | % | | 17,045 | 2.42 % |
| Less adjustment of tax exempt income | | 103 | | | | 96 | |
| Net interest income | | \$ 18,174 | | | | \$ 16,949 | |
| Net interest margin (6) | | | 3.15 | % | | | 3.20 % |

(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) 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 and 2005 was \$761 and \$239, respectively. 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.
- (6) Net interest margin represents net interest income (tax equivalent basis) divided by average interest-earning assets.

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| | Nine months ended September 30, 2006 | | | 2005 | | |
|---|--|--------------|---------------------------|--------------------|--------------|---------------------------|
| | Average balance (Dollars in thousands) | Interest (1) | Average yield/ cost | Average balance | Interest (1) | Average yield/ cost |
| Assets | | | | | | |
| Interest-earning assets: | | | | | | |
| Short-term investments | \$ 107,355 | \$ 3,874 | 4.81 % | \$ 143,762 | \$ 3,115 | 2.89 % |
| Debt securities (2) | 357,086 | 11,291 | 4.22 | 332,851 | 7,910 | 3.17 |
| Equity securities (2) | 29,818 | 1,203 | 5.38 | 31,607 | 1,011 | 4.27 |
| Mortgage loans (3) | 1,089,391 | 52,110 | 6.38 | 1,101,257 | 50,290 | 6.09 |
| Commercial loans - Eastern Funding | | | | | | |
| (3) | 78,523 | 6,360 | 10.80 | | | |
| Other commercial loans (3) | 66,058 | 3,421 | 6.91 | 75,272 | 3,334 | 5.89 |
| Indirect automobile loans (3) | 514,143 | 19,301 | 5.01 | 416,446 | 13,129 | 4.20 |
| Other consumer loans (3) | 2,988 | 164 | 7.32 | 3,040 | 156 | 7.19 |
| Total interest-earning assets | 2,245,362 | 97,724 | 5.80 % | 2,104,235 | 78,945 | 4.99 % |
| Allowance for loan losses | (23,987) | | | (21,319) | | |
| Non-interest earning assets | 102,697 | | | 97,117 | | |
| Total assets | \$ 2,324,072 | | | \$ 2,180,033 | | |
| Liabilities and Stockholders Equity | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Deposits: | | | | | | |
| NOW accounts | \$ 89,850 | 163 | 0.24 % | \$ 98,273 | 121 | 0.16 % |
| Savings accounts | 116,083 | 1,368 | 1.57 | 154,158 | 1,609 | 1.39 |
| Money market savings accounts | 223,419 | 3,955 | 2.36 | 276,233 | 3,150 | 1.52 |
| Retail certificates of deposit | 669,377 | 19,868 | 3.96 | 529,401 | 11,191 | 2.82 |
| Total retail deposits | 1,098,729 | 25,354 | 3.08 | 1,058,065 | 16,071 | 2.03 |
| Brokered certificates of deposit | 40,000 | 1,605 | 5.35 | | | |
| Total deposits | 1,138,729 | 26,959 | 3.16 | 1,058,065 | 16,071 | 2.03 |
| Borrowed funds | 497,139 | 17,313 | 4.64 | 413,941 | 11,048 | 3.56 |
| Subordinated debt | 12,176 | 667 | 7.30 | 11,871 | 485 | 5.45 |
| Total interest bearing liabilities | 1,648,044 | 44,939 | 3.64 % | 1,483,877 | 27,604 | 2.48 % |
| Non-interest-bearing demand | | | | | | |
| checking accounts | 61,725 | | | 67,685 | | |
| Other liabilities | 22,492 | | | 15,498 | | |
| Total liabilities | 1,732,261 | | | 1,567,060 | | |
| Stockholders equity. | 591,811 | | | 612,973 | | |
| Total liabilities and stockholders equity | \$ 2,324,072 | | | \$ 2,180,033 | | |
| Net interest income (tax equivalent basis)/interest rate spread (4) | | 52,785 | 2.16 % | | 51,341 | 2.51 % |
| Less adjustment of tax exempt income | | 294 | | | 208 | |
| Net interest income | | \$ 52,491 | | | \$ 51,133 | |
| Net interest margin (5) | | | 3.13 % | | | 3.25 % |

(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 table and the table on the preceding page follow.

- The Company is a member of and an owner of common stock issued by the Federal Home Loan Bank of Boston (FHLB). As a result of a change in the timing of FHLB dividend declarations, no dividend was declared by the FHLB in the 2006 second quarter 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 and 2005 was \$761,000 and \$239,000, respectively.

- Interest rate spread has been declining steadily from 2.59% in the 2005 first quarter to 2.42% in the 2005 third quarter and to 2.17% in the 2006 third quarter (2.11% after exclusion of the extra FHLB dividend received in that quarter). These declines resulted primarily from a more rapid increase in the average rates paid on deposits and borrowed funds than the pace of increase in the average rates earned on assets.
- The trend in net interest margin has been similar to that in interest rate spread, although less pronounced in degree of decline. Net interest margin was 3.20% in the 2005 third quarter compared to 3.15% in the 2006 third quarter (3.11% after exclusion of the extra FHLB dividend). Net interest margin has been aided in the 2006 second and third quarters by inclusion of the higher yielding Eastern loan portfolio. It was affected adversely by the reduction in the percent of total average assets funded by stockholders' equity from 27.5% in the 2005 third quarter to 24.6% in the 2006 third quarter.
- Average interest-earning assets increased \$167 million, or 8%, in the 2006 third quarter compared to the 2005 third quarter and \$15 million, or less than 1%, in the 2006 third quarter compared to the 2006 second quarter. Substantially all of the growth occurred in the indirect automobile loan portfolio (up \$97 million and \$23 million in the respective comparable periods) and as a result of the Eastern acquisition (\$122 million in average loans outstanding in the 2006 third quarter). Lower yields are earned on the indirect automobile loan portfolio than on the other segments of the Company's loan portfolio. Higher yields are earned on Eastern's portfolio.
- The average balance of mortgage loans outstanding was \$14 million less in the 2006 third quarter than in the 2006 second quarter and in the 2005 third quarter. The declines are due in part to increased competitive pressure that has driven down the pricing of new mortgage loan originations. Without improvement in mortgage loan pricing, the Company will be inclined to continue to approach mortgage loan originations with caution.
- Loan growth was funded primarily by a combination of higher costing borrowings from the FHLB and brokered certificates of deposit and a \$40 million reduction in the average balance of short-term investments in the 2006 third quarter compared to the 2005 third quarter.
- Customarily, higher rates are paid on certificates of deposit than on transaction related deposit accounts. Retail certificates of deposit comprised 61% of total retail deposits at September 30, 2006 compared to 55% at December 31, 2005 and 52% at September 30, 2005. This shift in the mix of deposits resulted primarily from a rising interest rate environment triggered by the rate setting actions of the Federal Reserve and increased competition for deposits.

As we have mentioned frequently in prior reports, interest rate spread and net interest margin are greatly influenced by interest rates established by the Federal Reserve. Commencing in June 2004 and extending through June 2006, the Board of Governors of the Federal Reserve System approved 17 rate increases of 0.25% each in the federal funds rate for overnight borrowings between banks. Since June 2006, the Federal Reserve has left the federal funds borrowing rate unchanged at 5.25%. The combination of the rate setting actions of the Federal Reserve and trends in economic indicators such as the rate of inflation, the rate of economic growth, unemployment and the housing market has caused the yield curve to flatten and, more recently, to become inverted. Improvement in interest rate spread and net interest margin will continue to be difficult to achieve until the slope of the yield curve starts to move upward.

Acquisition of Controlling Interest in Eastern

As described more fully in note 2 to the consolidated financial statements appearing on pages 10 and 11 herein, on April 13, 2006, the Company increased its ownership interest in Eastern from 28.3% to 86.7%.

The Eastern loan portfolio has increased from \$106 million since the acquisition to \$125 million at September 30, 2006. The rate of losses on Eastern loans will normally exceed that experienced in other segments of the Company's loan portfolio because of the higher risk characteristics associated with those loans. Likewise, the yields earned on those loans are substantially higher than those earned on other segments of the Company's loan portfolio.

Indirect Automobile Loan Business

The Company's indirect automobile loan portfolio grew from \$369 million at the end of 2004 to \$459 million at the end of 2005 and \$531 million at September 30, 2006. It is expected that the rate of growth will decline because of market conditions and the higher level of loan originations required to compensate for the reduction in loans outstanding that occurs from normal monthly principal payments.

The primary challenge related to the Company's indirect automobile loan business is to improve profitability. Since the commencement of this lending segment in February 2003, the Company has focused on making loans to individuals with excellent credit histories. While this emphasis has resulted in favorable loan loss experience, it has held back profitability since high quality loans typically generate lower yields. Since inception, less than 10% of loan originations have been to individuals with credit scores below 660, despite a Company policy limit allowing up to 15% of loan originations to be to borrowers with credit scores below 660. Based on analysis of loan originations, the Company is planning to increase the percent of loan originations to individuals with credit scores below 660 to a level closer to the 15% Company policy limit that has been in effect since inauguration of indirect automobile lending. The Company expects the resulting increase in income to more than offset any increase in loan loss experience that might arise from this policy change. While the average credit scores of all borrowers comprising the portfolio may decline from the current average of over 730, the Company intends to continue to focus primarily on making loans to individuals with good to excellent credit histories.

Provision for Loan Losses

The provision for loan losses was \$813,000 in the 2006 third quarter compared to \$32,000 in the 2005 third quarter. The provision for loan losses for the nine months ended September 30, 2006 and 2005 was \$2,420,000 and \$1,643,000, respectively.

The provision for loan losses is comprised of amounts related to indirect automobile lending, the Eastern portfolio and the remainder of the Company's loan portfolio. The provisions related to the indirect automobile loan portfolio in the 2006 and 2005 quarters were \$850,000 and \$692,000, respectively, and in the 2006 and 2005 nine month periods \$2,355,000 and \$2,019,000, respectively. The higher amounts resulted primarily from the increases in loans outstanding. Net charge-offs in the 2006 and 2005 nine month periods were \$1,380,000 and \$863,000, respectively, or annualized rates of 0.36% and 0.28%, respectively, based on average indirect automobile loans outstanding during those periods. Indirect automobile loans delinquent more than 30 days were \$4.8 million, or 0.91% of the portfolio, at September 30, 2006 compared to \$5.3 million, or 1.01% of the portfolio, at June 30, 2006 and \$5.5 million, or 1.21% of the portfolio, at December 31, 2005.

The provision for loan losses related to the Eastern portfolio was \$238,000 in the 2006 third quarter and \$415,000 since the acquisition of a controlling interest by the Company in April 2006. Net charge-offs were \$104,000 in the 2006 quarter and \$87,000 since the acquisition. Loans delinquent over 30 days amounted to \$2.1 million, or 1.66%, of total loans at September 30, 2006. Of that amount, \$796,000 is on non-accrual; additionally, \$400,000 is included in non-performing assets as equipment in possession.

Regarding the remainder of the loan portfolio, credits to the provision for loan losses of \$275,000 and \$660,000 were taken to income in the 2006 and 2005 third quarters, respectively, and \$350,000 and \$376,000 were taken to income in the 2006 and 2005 nine month periods, respectively. Such credits resulted from reductions in loans outstanding caused by payoffs. Of the credit taken to income in the 2005 third quarter, \$650,000 related to payoff of some of the loans, including certain higher risk loans, acquired in the January 2005 Mystic transaction (see note 2 to the consolidated financial statements on page 11 herein).

Non-Interest Income

Non-interest income declined from \$928,000 in the 2005 third quarter to \$837,000 in the 2006 third quarter and from \$4.1 million in the 2005 nine month period to \$2.9 million in the 2006 nine month period. The reductions resulted primarily from lower mortgage loan prepayment fees, lower securities gains and the effect of the change in the reporting of the Company's share of Eastern's earnings from the equity method before the date of acquisition to inclusion in the consolidated financial statements subsequent to the date of acquisition.

Mortgage loan prepayment fees declined from \$274,000 in the 2005 quarter to \$99,000 in the 2006 quarter and from \$1,419,000 in the 2005 nine month period to \$223,000 in the 2006 nine month period. No gains were recognized from the sale of securities in the 2006 and 2005 quarters. Gains recognized in the 2006 and 2005 nine month periods were \$558,000 and \$853,000, respectively. The Company's equity interest in the earnings of Eastern in 2006 up to the time of the acquisition and in the 2005 nine month period amounted to \$1,000 and \$328,000, respectively.

Non-Interest Expense

Merger/conversion expenses related to the Mystic acquisition were \$894,000 in the 2005 nine month period. No expenses of this nature were incurred in the 2006 nine month period.

As a result of adoption of a new accounting pronouncement (SFAS 123-R), effective January 1, 2006, dividends paid on unvested shares awarded to directors, officers and employees of the Company are recognized as compensation expense whereas, prior to that date, such payments were charged to retained earnings. Dividends paid on unvested shares

amounted to \$155,000 in the 2006 third quarter and \$370,000 in the 2006 nine month period. The new accounting pronouncement also required that, effective January 1, 2006, dividend equivalent rights payable to holders of outstanding vested stock options be charged to retained earnings; prior to that date, such payments were recognized as compensation expense. Dividend equivalent rights paid or payable to holders of unexercised vested options were \$960,000 in the 2006 nine month period compared to \$702,000 in the 2005 nine month period, \$339,000 of which was recognized in the 2005 third quarter.

The 2006 nine month period includes compensation expense of \$243,000 resulting from the vesting of restricted stock upon the retirement of a member of the Board of Directors. Excluding this expense and the expenses mentioned in the two preceding paragraphs, total non-interest expenses were \$1,187,000, or 14.3%, higher in the 2006 third quarter than in the 2005 third quarter and \$2,393,000, or 9.8%, higher in the 2006 nine month period than in the 2005 nine month period. Those increases were attributable primarily to the inclusion of Eastern's expenses which were \$870,000 in the 2006 third quarter and \$1,713,000 since the date of the acquisition. Also contributing to the increases were the added expenses of a new branch that opened in April 2006, the hiring of new loan officers, and higher processing and servicing costs resulting from growth of the indirect automobile loan portfolio.

Other Operating Highlights

Provision for Income Taxes. The effective income tax rate declined from 40.4% in the 2005 nine month period to 39.4% in the 2006 nine month period due primarily to a higher portion of taxable income being earned by the Company's investment security 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, 2006 were \$15.7 million, or 1.3%, higher than at June 30, 2006 and \$19.3 million, or 1.7%, higher than at December 31, 2005. While the aggregate increase in deposits was modest, the mix of deposits continued to shift to higher paying categories due to intense competition for funds in a rising rate environment. As discussed earlier herein, certificates of deposit represented 61% of total retail deposits at September 30, 2006 compared to 55% at December 31, 2005 and 52% at September 30, 2005. Continuation of the current interest rate environment could result in further shifting to higher rate deposits.

The Company obtained \$68.1 million in brokered deposits in the 2006 second quarter and an additional \$10 million in the 2006 third quarter. The weighted average maturity of the brokered deposits at origination was 2.2 years and the weighted average annual rate to be paid on the deposits was 5.38%. Obtaining of the brokered deposits did not require the pledging of assets as collateral as is normally the case in borrowings from the FHLB. The funds were used primarily to pay off some of the higher rate borrowed funds of Eastern.

Borrowed Funds. Funds borrowed from the FHLB increased from \$411.5 million at December 31, 2005 to \$512.1 million at June 30, 2006 and decreased thereafter to \$489.5 million at September 30, 2006. Proceeds from the additional borrowings in the first half of 2006 were used primarily to fund indirect automobile loan growth and to pay off some of the higher rate borrowed funds of Eastern.

During the first half of 2006, \$78.6 million of FHLB borrowings matured. Those borrowings had a weighted average life to maturity of 3.2 years and a weighted average annual rate of interest of 3.62%. During that same period, \$97 million of new borrowings were obtained from the FHLB with a weighted average life to maturity of 3.3 years and a weighted average annual rate of interest of 5.24%. The remainder of the net increase in FHLB borrowings, \$81.6 million, were advances with maturities of less than 90 days.

In the 2006 third quarter, \$33.4 million of FHLB advances that had an average life to maturity of 3.7 years and a weighted average annual rate of interest of 4.15% matured and were paid off and \$16.0 million of new borrowings were obtained, \$15.0 million of which was for three years at an annual rate of interest of 5.54%. The remainder of the net decrease in FHLB borrowings in the 2006 third quarter resulted from the net payoff of advances with maturities of less than 90 days.

Stockholders' Equity. Stockholders' equity declined from \$602 million at December 31, 2005 to \$591 million at June 30, 2006 and \$581 million at September 30, 2006 due primarily to payment of extra dividends of \$0.20 per share to stockholders in February and August 2006. The extra dividend paid in August 2006 was the seventh time since August

2003 that such an extra dividend was paid. The aggregate amount of extra dividends paid, over \$83 million or \$1.40 per share, represents a return of capital to stockholders rather than a distribution of earnings. (For income tax purposes, such payments had to be reported as taxable income.)

The payout of the semi-annual extra dividends has been an effective means to reduce the Company's excess capital in a measured way and to treat all stockholders equally. While it is the intent of the Board of Directors to continue to return capital to stockholders through payment of an extra dividend semi-annually, the magnitude of any future payment will be considered in light of changing opportunities to deploy capital effectively, including the repurchase of Company common stock and expansion of the Company's business through acquisitions.

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

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

| | September 30, 2006 (Dollars in thousands) | December 31, 2005 | | |
|---|---|----------------------|------|---|
| Non-accrual loans: | | | | |
| Indirect automobile loans | \$ 177 | \$ 313 | | |
| Mortgage loans | 90 | 167 | | |
| Commercial loans | 796 | | | |
| Total non-accrual loans | 1,063 | 480 | | |
| Repossessed vehicles | 733 | 493 | | |
| Equipment in possession | 400 | | | |
| Other | 103 | | | |
| Total non-performing assets | \$ 2,299 | \$ 973 | | |
| Allowance for loan losses | \$ 25,066 | \$ 22,248 | | |
| Allowance for loan losses as a percent of total loans | 1.39 | % | 1.36 | % |
| Non-accrual loans as a percent of total loans | 0.06 | % | 0.03 | % |
| Non-performing assets as a percent of total assets | 0.10 | % | 0.04 | % |

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.

In addition to identifying non-performing loans, the Company identifies loans that are characterized as impaired pursuant to generally accepted accounting principles. The definition of impaired loans is not the same as the definition of non-accrual loans, although the two categories tend to overlap. There were no impaired loans as of September 30, 2006, other than the commercial loans on non-accrual.

The unallocated portion of the allowance for loan losses was \$4.1 million, or 16.3% of the total allowance for loan losses, at September 30, 2006 compared to \$4.1 million, or 18.6% of the total allowance for loan losses, at December 31, 2005.

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, 2006, interest-earning assets maturing or repricing within one year amounted to \$1.033 billion and interest-bearing liabilities maturing or repricing within one year amounted to \$1.070 billion, resulting in a cumulative one year negative gap position of \$37 million, or 1.5% of total assets. At December 31, 2005, the Company had a negative one year cumulative gap position of \$13 million, or 0.6% of total assets. Based on the interest rate environment of the past several months, the Company has sought to maintain a modest cumulative one year negative gap position.

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.

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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 2006 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, 2006 amounted to \$489.5 million and the Company had the capacity to increase that amount to \$705 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, 2006, such assets amounted to \$236 million, or 9.9% of total assets.

At September 30, 2006, Brookline Bank exceeded all regulatory capital requirements. The Bank's Tier I capital was \$430 million, or 19.4% of adjusted assets. The minimum required Tier I capital ratio is 4.00%.

Recent Accounting Pronouncements

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

SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - An Amendment of FASB Statements No. 87, 88, 106 and 132(R) . In September 2006, the FASB issued SFAS 158. SFAS 158 will require companies to recognize the funded status of defined benefit plans (other than a multiemployer plan) and to recognize any changes in funded status through comprehensive income in the year in which the changes occur. Additionally, SFAS 158 will require companies to measure the funded status of a plan as of the date of their fiscal year end financial statements with limited exceptions. The effective date for recognition of the funded status of a defined benefit postretirement plan and presentation of the required disclosures is as of the end of the fiscal year ending after December 15, 2006 for publicly traded companies. The effective date for measuring plan assets and benefit obligations as of the fiscal year end is effective for fiscal years ending December 15, 2008. The Company has not yet measured the impact of the adoption of SFAS 158 on the Company's financial position for its postretirement medical benefit plan.

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 12 through 14 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, 2005.

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

The Company and its subsidiaries are not involved in any litigation, nor is the Company aware of any pending litigation, other than legal proceedings incident to the business of the Company. Management believes the results of any current pending litigation would be immaterial to the consolidated financial condition or results of operations of the Company.

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

Not applicable.

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

- 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

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SIGNATURES

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

BROOKLINE BANCORP, INC.

Date: November 2, 2006

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

Date: November 2, 2006

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