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November 9th, 2017

Brookline Bancorp, Inc.: BRKL

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Sector: Financial
Industry: Savings & Loans
Current Price: $16.05
Target Price: $17.87

BUY

Current Price:	$16.05
Target Price:	$17.87
Market Cap:	1.11B
Average Volume:	.360M
ROE:	7.59%
Ke:	11.34%
ROE:	8.28%
KE:	7.91%

Company Description: Brookline Bancorp, Inc. is a localized banking company, which services mostly house loans, commercial loans, and vehicle loans. Brookline is headquartered in Boston, Ma. The company has subsidies throughout Massachusetts, with some scattered businesses in Rhode Island.

Thesis: Brookline Bancorp, Inc. is a banking and lending institution, as such its everyday activities are contingent on federal funds rate. With the loss of the LIBOR rate, the spotlight has increasingly grown on the federal funds rate. The rate has been so low for so long I believe that rate hikes will not adversely affect banks as they have done in the past.

Catalysts:

- **Short Term (within the year):** Expectation of a federal funds rate is expected in December. This has been built into the price and if there is no hike then the company will be undervalued.
- **Mid Term (1-2 years):** Corporate tax cuts will mean companies will have a higher ability to run projects. Increased borrowings to initially service these projects is expected.
- **Long Term (3+):** The average car age has increased. Massachusetts also has an average house construction date dating back to the 1980's. This ago of house is among the oldest in the united states. These items will need to get serviced and updated at some point.

Business Description:

Aging Demographic:

Brookline Bancorp (BRKL), which is headquartered in Boston, MA, is an area seemingly due for expansion and revamp. Brookline services about 50% commercial and 50% personal loans. Many of the personal loans are mortgages. Boston, and Massachusetts as a whole, is seemingly the perfect place to be in order to service these types of loans due to aging homes. The average home within the Massachusetts has a construction date in the 1980's according to Zillow. With only 20 states with older construction dates, one could assume that many of these houses are in need of renovation. With the looming increase in rates, many homeowners may see it fit to refinance/ receive loans now in order to service their homes. Another indication of need of housing in Massachusetts is the fact that

Massachusetts population has grown by nearly 500,000 people since 2000. This growth is nearly 8%. If this is true, Massachusetts may be in need of more and new housing should push the average original home construction date up; because this has not happened, one can infer there is a need to build new housing.

Cars on average have a life of 8 years according to NBC. Average cars on the road are at an unprecedented age of 11.4 years. This means that the current age of car on the road exceeds the historical average life of the car. This indicates that people have been denying themselves from new cars. Consumers are either denying themselves because they currently do not have the money to buy a new car. Consumers may also be denying themselves a new car in order to save up for a luxury vehicle for the first time. Either way, this data indicates that within the next year there should be an influx of vehicle loans. These loans will need service and they happen to all be within Brookline's geographic region.

Tax Implications:

The company recorded an effective tax rate of 34% for the last three months. The fact that this tax rate is so high is very encouraging. The company has consistently managed to be in line or beat earnings for both EPS and revenue with an effective tax rate of well over the proposed tax rate. Although it is questionable if the proposed tax rate will be passed, it seems likely that there will be reform to lower the tax rate. Companies such as Brookline Bancorp will benefit immensely as the effective tax will have nowhere to go but down, as they will not even be operational in any countries with a tax rate above their current effective tax rate. This means that earnings and margins will be improved by default without any work being done on management's behalf. Another notable trend is that the company has never operated below a 34% effective tax rate and have continually operated within the 34-37% range. The reason for the lowest effective tax rate was due to a change in accounting methods which required the stock compensation be realized instead of expensed when they happen. Brookline pays the majority of their stock compensation in the third quarter. These accounting method changes are not expected to have a material impact like this again. With an expected effective tax rate of 35.4% in the fourth quarter taxes are returning to a more traditional level. With a company never operating below the current specific tax rate and always operating within such a tight window, many investors most likely have this range of tax rate built into their pricing models. With a deduction in taxes many investors may be surprised during earnings; even seasoned investors who have long followed this company.

Efficiency ratio:

Efficiency ratios are essential in determining a bank's ability to make money. Efficiency ratios describe how well a bank is able to use its resources in able to create cash inflows. Recently the bank was able to take its efficiency from 57.9% in the second quarter, all the way down to 56.05% in the most recent quarter. This efficiency ratio is great as it shows the company is getting better art managing the assets it does have. An important note to make is that all competitors with lower or comparable efficiency ratios have a much higher price to book. This could indicate that although the competitors are more efficient all of their upside has been priced in. Although margins are often a useful tool to compare companies I thought it unfair to use in this instance as the company mentioned in their earnings call that they were expecting margin expansion. Instead of issuing a blind guess as to the severity of it, mainly because its acquisition with First Line Bank presents unknowns in the form of synergies, I have decided to exclude it from this ratio analysis.

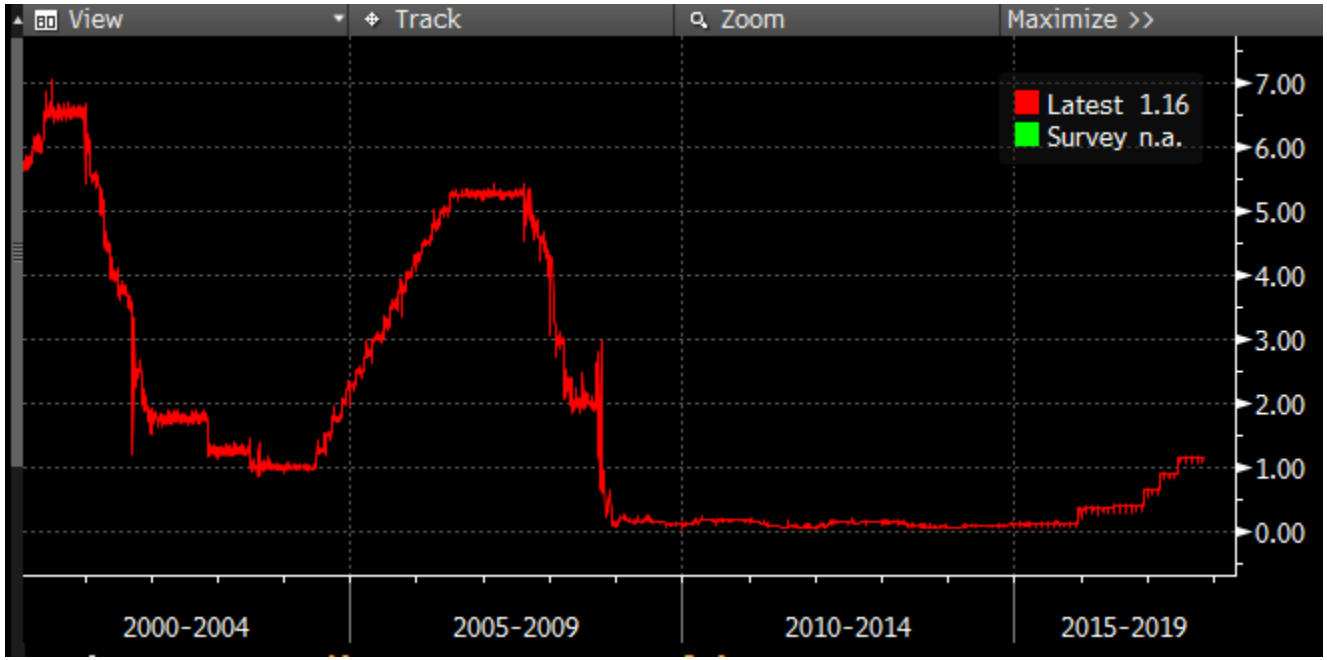
Name (BICS Best Fit)	Mkt Cap (USD)	Effic Ratio LF	P/B
Median	1.09B	59.93%	1.70
100) BROOKLINE BANCORP INC	1.15B	56.05%	1.44
101) KEARNY FINANCIAL CORP...	1.17B	71.18%	1.16
102) BENEFICIAL BANCORP INC	1.20B	68.36%	1.15
103) LAKELAND FINANCIAL CORP	1.20B	45.11%	2.58
104) STATE BANK FINANCIAL ...	1.09B	58.26%	1.70
105) SEACOAST BANKING COR...	1.08B	59.93%	1.77
106) FIRST BANCORP/NC	1.08B	62.86%	1.73
107) CITY HOLDING CO	1.06B	51.73%	2.11
108) MERIDIAN BANCORP INC	1.04B	46.60%	1.62
109) 1ST SOURCE CORP	1.28B	60.69%	1.79

Acquisition:
This quarter brought about the acquisition of First Commons Bank.

The acquisition of First Commons Bank is expected to create exceptional cost synergies within the firm. The company released a statement within the announcement of the acquisition that they believe this acquisition could lead to "Projected cost saves: 50%". First

Commons Bank is based out of eastern Massachusetts so they are familiar with the area in which the bank operates. The acquisition was completed using $52.5 million in Brookline shares, this is expected to create a share dilution of $.05. The company is expected to create an additional 2% to EPS on annual basis. This 2% translates to about $.016 per share in additional earnings per year. Assuming the P/E ratio holds constant at 19.23x, this additional EPS translates to an additional $.30768 per share. The addition of First Commons thus creates more value than it dilutes and also creates long term cost synergies. When looking at a value for the acquisition on a multiples basis an investor must first discern what the EBITDA of the private company was. In 2016 First Commons bank had an EBITDA of $13.4 million. The transaction value of the purchase of First Commons Banks was $55.958 million dollars. This imputes that the TV/EBITDA was 4.145x, this is much lower than 6x which is looked at as the threshold for a cheap acquisition.

Risk Free Rate:



Risk Free Rates are very important in the valuation of the financial companies as their income is nearly solely dependent on lending. Lending is often based around a risk free rate plus a premium for the chance an investor will not be able to repay. The federal funds rate pushes where risk free rates are. Also, federal funds rate rises have the ability to choke off supply to banks. Many investors use federal funds

dot plot in order to create a target of where the federal funds rate will be, and thus, where risk free rates should be placed at. Brookline has essentially safeguarded itself from getting choked off on money supply by becoming deposit rich and tier 1 capital rich.

In recent news relating to the Fed is the fact that Trump has named a successor to Janet Yellen. Janet Yellen has been more passive than Trump has seemingly preferred, because of this many assumed that Trump would replace Yellen with John Taylor. Surprisingly Trump opted to pick Jerome Powell, a much less hawkish and passive choice as perceived by the investors. Currently the federal funds rate is 1.16%; through looking at the dot plot, the consensus is that this rate will be up to 2.125% by 2018. The dot plot consensus was most likely reached with John Taylor winning in mind. Since this is the case, I believe many investors are using models that are far too bearish for the amount of revenues the company will receive. Although I believe markets are bullish on how high rates will get in such a small amount of time, it is hard to contest that rates are inevitably on the rise. Although raising rates usually means less demand for loans, I do not think this company will be affected by this plague. Since the company is located in, an area with a need to update houses and get new cars I believe that demand will not be an issue. The company also services many commercial loans for heavy-duty equipment and again this demand is much more fixed than other types of financial demand. The company has therefore made a decision to focus on increasing efficiencies in existing loan and build up the ability to act on rates when there is the inevitable increase.

Tier 1 Capital:

Brookline has recently been putting themselves in a position to have the ability to service the expected influx of loans. Total deposits have increased $96.3 million this year; a 2.12% raise in total deposits. The company has done this while reducing investment securities and total borrowings. By reducing investment securities and total borrowings, Brookline has essentially prepared itself for the rate hikes. The company has decided that demand will remain through rate hikes. Since demand will remain constant through rate hikes instead of lending at a lower rate, the company can simply wait for rates to raise and lend at higher rates. Another attempt at raising liquidity was the fact that deposits grew faster than loan balances. In the third quarter loan balances grew $102 million dollars, a 1.885% increase and deposits grew $96millon, a 2.044% increase. Even through creating liquidity for the future Brookline was able to remain profitable. Brookline was able to realize record EPS of $.2 per share while accumulating liquidity to loan later. Deposits grew 8.723% faster than loans as a percentage. These added deposits indicate that the company most likely has an outlook of rates raising. Saving account balances has also grown 14%, this can be accounted for from the fourth quarter due to real estate tax deferrals.

Adding to the fact that deposits have grown faster than lending rates, the company is also flush with tier 1 capital. This capital can be viewed as an over-saturation of high end capital. Currently, the tier 1 capital ratio is at 12.38%. A capital ratio like this is far above the minimum ratio required by the FDIC. This leaves room for growth within ROE. The company currently has a GAAP ROE figure of 7.58%, which is low when compared to comparable companies, such as State Bank Financial Corp (STBZ) who boosts a GAAP ROE of 8.40%. ROE may be low because of the inability to ask higher rates from such credit worthy clients. By systemically getting ROE down to 6% over the next 4 years the company could increase its net income and , assuming a similar payout ratio, pay larger dividends.

Conclusion:

The company is also located in an industry that seemingly will require financing at any given moment. The larger question is: Is the company priced to buy now? Using financial services model one can extrapolate prices in different circumstances. In addition, an assumption has been made that the companies risk free rate is directly linked to the federal funds rate and its movement. If the company continues to grow at the current rate, with the tax premium being held constant as well as the Federal funds rate being held constant a valuation of $33.34 could be expected. This may be optimistic, as the federal funds rate most likely will increase. If the same analysis is made but the federal funds rate is pushed to the dot plot estimate of 2.125% then the company valuation would be $13.87. If the federal funds rate is instead made to be 1.8%, a very realistic number, the value of the company is $17.87. Although are very realistic, in order to take away bias a second model which is not contingent on risk free rates can be used while reaching similar prices. Brookline Bancorp has a tier 1-capital ratio of 12.38%. this is double what is mandated by the FDIC. By having such high quality debt, the company has essentially assured itself it will recoup on these loans. The company has also missed higher interest rates at the lower tiered capital. Brookline can begin to take advantage of these lower Tier opportunities in the future. In my model, I have the company systematically reducing this tier 1 capital ratio to 6% within 4 years. By doing so, my model shows that, there is currently a -.5% discount within the market on its current value. By forecasting this forward one Year, a target of $15.60 is reached. As stated above, I believe taxes will effect this valuation immensely. Due to recent discussions, I have decided to move taxing implications back to 2019 and have taken a 24% time weighted average of tax rates from this point on. Using this assumption the model returns a price of $17.36 in one year.

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Federal Funds Rate	1.16%	
	Current	Next Year
Equity Invested =	$702,740.00	$702,740.00
PV of Equity Excess Retu	$941,356.20	$1,849,437.01
Value of Equity =	$1,644,096.20	$2,552,177.01
Number of shares =	76500	76545
Value Per Share =	$21.49	$33.34

Federal Funds Rate	1.80%	
	Current	Next Year
Equity Invested =	$702,740.00	$702,740.00
PV of Equity Excess Retu	$340,686.07	$665,150.76
Value of Equity =	$1,043,426.07	$1,367,890.76
Number of shares =	76500	76545
Value Per Share =	$13.64	$17.87

Federal Funds Rate	2.13%	
	Current	Next Year
Equity Invested =	$702,740.00	$702,740.00
PV of Equity Excess Retu	$180,746.38	$358,869.85
Value of Equity =	$883,486.38	$1,061,609.85
Number of shares =	76500	76545
Value Per Share =	$11.55	$13.87

	No Changes
Diluted Shares Outstanding:	76.65
Implied Share Price:	$14.82
Current Share Price	$16.05
Premium/(Discount) to implied price:	7.64%

	Tier 1 Capital Movement
Diluted Shares Outstanding:	76.65
Implied Share Price:	$15.60
Current Share Price	$16.05
Return	-2.80%

	Tier One and Taxes
Diluted Shares Outstanding:	76.65
Implied Share Price:	$17.36
Current Share Price	$16.05
Return	8.17%

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