

FLUSHING FINANCIAL CORP
Form 10-Q
August 09, 2006

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

FORM 10-Q

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

For the quarterly period ended **June 30, 2006**

Commission file number **000-24272**

FLUSHING FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

11-3209278

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

1979 Marcus Avenue, Suite E140, Lake Success, New York 11042

(Address of principal executive offices)

(718) 961-5400

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
o Yes x No

The number of shares of the registrant's Common Stock outstanding as of July 31, 2006 was 21,110,660.

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PART I FINANCIAL INFORMATION
FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Consolidated Statements of Financial Condition
(Unaudited)

<i>(Dollars in thousands, except per share data)</i>	June 30, 2006	December 31, 2005
ASSETS		
Cash and due from banks	\$ 18,925	\$ 26,754
Securities available for sale:		
Mortgage-backed securities	304,454	301,194
Other securities	39,736	36,567
Loans:		
Multi-family residential	815,318	788,071
Commercial real estate	476,351	399,081
One-to-four family mixed-use property	527,706	477,775
One-to-four family residential	171,554	134,641
Co-operative apartments	9,778	2,161
Construction	79,523	49,522
Small Business Administration	12,757	9,239
Commercial business and other	30,494	19,362
Net unamortized premiums and unearned loan fees	8,877	8,409
Allowance for loan losses	(7,148)	(6,385)
Net loans	2,125,210	1,881,876
Interest and dividends receivable	11,915	10,554
Bank premises and equipment, net	17,644	7,238
Federal Home Loan Bank of New York stock	31,663	29,622
Bank owned life insurance	39,634	26,526
Goodwill	12,857	3,905
Core deposit intangible	3,513	
Other assets	34,691	28,972
Total assets	\$ 2,640,242	\$ 2,353,208
LIABILITIES		
Due to depositors:		
Non-interest bearing	\$ 70,806	\$ 58,678
Interest-bearing:		
Certificate of deposit accounts	1,017,509	898,157
Savings accounts	274,601	273,753
Money market accounts	254,761	175,247
NOW accounts	47,100	42,029
Total interest-bearing deposits	1,593,971	1,389,186
Mortgagors escrow deposits	24,295	19,423
Borrowed funds	538,344	510,810
Securities sold under agreements to repurchase	178,900	178,900
Other liabilities	25,937	19,744
Total liabilities	2,432,253	2,176,741
STOCKHOLDERS EQUITY		
Preferred stock (\$0.01 par value; 5,000,000 shares authorized; none issued)		

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<i>(Dollars in thousands, except per share data)</i>	June 30, 2006	December 31, 2005
Common stock (\$0.01 par value; 40,000,000 shares authorized; 21,165,011 shares and 19,466,894 shares issued at June 30, 2006 and December 31, 2005, respectively; 21,102,652 shares and 19,465,844 shares outstanding at June 30, 2006 and December 31, 2005, respectively)	211	195
Additional paid-in capital	69,221	39,635
Treasury stock (62,359 shares and 1,050 shares at June 30, 2006 and December 31, 2005, respectively)	(1,046)	(12)
Unearned compensation	(3,270)	(4,159)
Retained earnings	151,676	146,068
Accumulated other comprehensive loss, net of taxes	(8,803)	(5,260)
	<u>207,989</u>	<u>176,467</u>
Total liabilities and stockholders' equity	<u>\$ 2,640,242</u>	<u>\$ 2,353,208</u>

The accompanying notes are an integral part of these consolidated financial statements.

PART I FINANCIAL INFORMATION
FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Consolidated Statements of Income and Comprehensive Income
(Unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2006	2005	2006	2005
<i>(Dollars in thousands, except per share data)</i>				
Interest and dividend income				
Interest and fees on loans	\$ 33,584	\$ 28,236	\$ 65,849	\$ 54,501
Interest and dividends on securities:				
Interest	3,628	4,160	7,328	8,522
Dividends	76	81	153	162
Other interest income	258	9	428	17
	<u>37,546</u>	<u>32,486</u>	<u>73,758</u>	<u>63,202</u>
Interest expense				
Deposits	13,224	8,088	24,734	15,771
Other interest expense	7,661	7,236	15,448	13,396
	<u>20,885</u>	<u>15,324</u>	<u>40,182</u>	<u>29,167</u>
Net interest income	16,661	17,162	33,576	34,035
Provision for loan losses				
	<u>16,661</u>	<u>17,162</u>	<u>33,576</u>	<u>34,035</u>
Net interest income after provision for loan losses	16,661	17,162	33,576	34,035
Non-interest income				
Loan fee income	879	607	1,509	1,137
Banking services fee income	339	353	710	736
Net gain on sale of loans held for sale	237	142	360	142
Net gain on sale of loans	73		100	19
Net gain on sale of securities			81	
Federal Home Loan Bank of New York stock dividends	380	268	759	432
Bank owned life insurance	401	285	671	564
Other income	277	206	603	346
	<u>2,586</u>	<u>1,861</u>	<u>4,793</u>	<u>3,376</u>
Total non-interest income	2,586	1,861	4,793	3,376
Non-interest expense				
Salaries and employee benefits	4,813	4,413	9,567	8,691
Occupancy and equipment	1,261	1,011	2,370	1,974
Professional services	967	839	1,934	1,779
Data processing	656	534	1,294	1,069
Depreciation and amortization of premises and equipment	364	398	731	801
Other operating expenses	2,324	2,165	3,921	3,649
	<u>10,385</u>	<u>9,360</u>	<u>19,817</u>	<u>17,963</u>
Total non-interest expense	10,385	9,360	19,817	17,963
Income before income taxes	8,862	9,663	18,552	19,448
Provision for income taxes				

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	For the three months ended June 30,		For the six months ended June 30,	
Federal	2,863	2,991	5,804	5,985
State and local	593	778	1,431	1,600
Total taxes	3,456	3,769	7,235	7,585
Net income	\$ 5,406	\$ 5,894	\$ 11,317	\$ 11,863
<u>Other comprehensive (loss) income, net of tax</u>				
Unrealized holding losses arising during the period	\$ (1,571)	\$ 2,574	\$ (3,494)	\$ (786)
Less: reclassification adjustments for gains included in income			(49)	
Net unrealized holding losses	(1,571)	2,574	(3,543)	(786)
Comprehensive net income	\$ 3,835	\$ 8,468	\$ 7,774	\$ 11,077
Basic earnings per share	\$ 0.30	\$ 0.34	\$ 0.64	\$ 0.68
Diluted earnings per share	\$ 0.30	\$ 0.33	\$ 0.63	\$ 0.66
Dividends per share	\$ 0.11	\$ 0.10	\$ 0.22	\$ 0.20

The accompanying notes are an integral part of these consolidated financial statements.

PART I FINANCIAL INFORMATION
FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Consolidated Statements of Cash Flows
(Unaudited)

<i>(In thousands)</i>	For the six months June 30,	
	2006	2005
<u>OPERATING ACTIVITIES</u>		
Net income	\$ 11,317	\$ 11,863
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of bank premises and equipment	731	801
Origination of loans held for sale	(4,820)	(1,837)
Proceeds from sale of loans held for sale	5,228	1,979
Net gain on sale of loans held for sale	(360)	(142)
Net gain on sales of loans	(100)	(19)
Net gain on sale of securities	(81)	
Amortization of unearned premium, net of accretion of unearned discount	480	840
Stock-based compensation expense	1,414	66
Deferred compensation	(166)	(148)
Excess tax benefits from stock-based payment arrangements	(33)	
Deferred income tax (expense)benefit	(54)	40
Net increase (decrease) in other assets and liabilities	2,465	(7)
	16,021	13,436
<u>INVESTING ACTIVITIES</u>		
Purchases of bank premises and equipment	(2,040)	(626)
Net purchases of Federal Home Loan Bank of New York shares	(349)	(6,899)
Purchases of securities available for sale	(15,023)	(326)
Proceeds from sales and calls of securities available for sale	11,499	30
Proceeds from maturities and prepayments of securities available for sale	25,561	43,625
Net originations and repayment of loans	(140,757)	(219,230)
Purchases of loans	(1,980)	
Proceeds from sale of loans	8,695	1,030
Proceeds from sale of delinquent loans	6,853	1,658
Purchase of bank owned life insurance	(10,000)	
Cash used to acquire Atlantic Liberty Financial Corporation	(14,663)	
Cash acquired in acquisition of Atlantic Liberty Financial Corporation	3,401	
	(128,803)	(180,738)
<u>FINANCING ACTIVITIES</u>		
Net increase in non-interest bearing deposits	8,418	8,478
Net increase in interest-bearing deposits	103,179	20,016
Net increase in mortgagors escrow deposits	3,422	5,425
Net proceeds of short-term borrowed funds	22,000	23,000
Proceeds from long-term borrowings	30,000	135,000
Repayment of long-term borrowings	(55,014)	(20,013)
Purchases of treasury stock	(4,522)	(2,829)
Excess tax benefits from stock-based payment arrangements	33	
Proceeds from issuance of common stock upon exercise of stock options	1,341	1,083
Cash dividends paid	(3,904)	(3,494)
	104,953	166,666

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	For the six months June 30,	
	_____	_____
Net decrease in cash and cash equivalents	(7,829)	(636)
Cash and cash equivalents, beginning of period	26,754	14,661
	_____	_____
Cash and cash equivalents, end of period	\$ 18,925	\$ 14,025
	_____	_____

SUPPLEMENTAL CASH FLOW DISCLOSURE

Interest paid	\$ 39,048	\$ 28,456
Income taxes paid	3,644	7,004
Taxes paid if excess tax benefits were not tax deductible	4,770	
Fair value of assets acquired	170,811	
Fair value of liabilities assumed	144,254	
Common shares issued in exchange for Atlantic Liberty common shares	26,557	

The accompanying notes are an integral part of these consolidated financial statements.

PART I FINANCIAL INFORMATION
FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Consolidated Statements of Changes in Stockholders Equity
(Unaudited)

<i>(Dollars in thousands)</i>	For the six months ended June 30, 2006
<u>Common Stock</u>	
Balance, beginning of period	\$ 195
Issuance upon the exercise of stock options (71,278 common shares)	
Shares issued upon vesting of restricted stock unit awards (4,500 common shares)	
Shares issued in connection with acquisition of Atlantic Liberty (1,622,339 common shares)	16
	<hr/>
Balance, end of period	\$ 211
<u>Additional Paid-In Capital</u>	
Balance, beginning of period	\$ 39,635
Award of common shares released from Employee Benefit Trust (2,890 common shares)	39
Cumulative adjustment related to adoption of SFAS No. 123R	847
Shares issued upon vesting of restricted stock unit awards (38,896 common shares)	60
Vesting of restricted stock unit awards (58,486 common shares)	(933)
Forfeiture of restricted stock awards (1,560 common shares)	15
Options exercised (71,878 common shares)	516
Stock-based compensation expense	1,375
Stock-based income tax benefit	1,126
Shares issued in connection with acquisition of Atlantic Liberty (1,622,339 common shares)	26,541
	<hr/>
Balance, end of period	\$ 69,221
<u>Treasury Stock</u>	
Balance, beginning of period	\$ (12)
Purchases of common shares outstanding (257,000 common shares)	(4,237)
Issuance upon exercise of stock options (182,550 common shares)	2,963
Purchase of common shares to fund options exercised (22,002 common shares)	(371)
Repurchase of restricted stock awards to satisfy tax obligations (17,283 common shares)	(285)
Forfeiture of restricted stock awards (1,560 common shares)	(15)
Shares issued upon vesting of restricted stock unit awards (53,986 common shares)	911
	<hr/>
Balance, end of period	\$ (1,046)
<u>Unearned Compensation</u>	
Balance, beginning of period	\$ (4,159)
Cumulative adjustment related to adoption of SFAS No. 123R	516
Release of shares from Employee Benefit Trust (109,567 common shares)	373
	<hr/>
Balance, end of period	\$ (3,270)
<u>Retained Earnings</u>	
Balance, beginning of period	\$ 146,068
Net income	11,317
Cash dividends declared and paid	(3,904)
Stock options exercised (181,950 common shares)	(1,767)
Shares issued upon vesting of restricted stock unit awards (19,590 common shares)	(38)
	<hr/>
Balance, end of period	\$ 151,676

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<i>(Dollars in thousands)</i>	For the six months ended June 30, 2006
<u>Accumulated Other Comprehensive Loss, net</u>	
Balance, beginning of period	\$ (5,260)
Change in net unrealized loss on securities available for sale, net of taxes, of approximately \$2,598	(3,494)
Less: Reclassification adjustment for gains included in net income, net of taxes, of approximately \$32	(49)
	<hr/>
Balance, end of period	\$ (8,803)
	<hr/>
Total Stockholders Equity	\$ 207,989
	<hr/>

The accompanying notes are an integral part of these consolidated financial statements.

PART I FINANCIAL INFORMATION
FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Notes to Consolidated Financial Statements

1. Basis of Presentation

The primary business of Flushing Financial Corporation (the Holding Company) is the operation of its wholly-owned subsidiary, Flushing Savings Bank, FSB (the Bank). The consolidated financial statements presented in this Form 10-Q include the collective results of the Holding Company, the Bank, and the Bank's subsidiaries, but reflect principally the Bank's activities.

The information furnished in these interim statements reflects all adjustments which are, in the opinion of management, necessary for a fair statement of the results for such periods of Flushing Financial Corporation and Subsidiaries (the Company). Such adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for the full year.

Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The interim financial information should be read in conjunction with the Company's 2005 Annual Report on Form 10-K.

Certain reclassifications have been made to prior year amounts to conform with the current year presentation.

2. Acquisition of Atlantic Liberty Financial Corporation

On June 30, 2006, the Company acquired 100 percent of the outstanding common stock of Atlantic Liberty Financial Corporation (Atlantic Liberty), the parent holding company for Atlantic Liberty Savings, F.A., based in Brooklyn, New York. The aggregate purchase price was \$41.2 million, which included \$14.7 million of cash and common stock valued at \$26.6 million. Under the terms of the Agreement and Plan of Merger, dated December 20, 2005, Atlantic Liberty's shareholders received \$24.00 in cash, 1.43 Holding Company shares per Atlantic Liberty share owned, or a combination thereof, subject to aggregate allocation to all Atlantic Liberty's shareholders of 65% stock / 35% cash. In connection with the merger, the Company issued 1.6 million shares of common stock, the value of which was determined based on the closing price of the Company's common stock on the announcement date of December 21, 2005, and two days prior to and after the announcement date.

The acquisition was accounted for as a purchase. The Company recorded goodwill (the excess of cost over the fair value of net assets acquired) of \$9.0 million in the transaction. This amount is subject to adjustment as estimates made for the fair value of assets acquired and liabilities assumed may be recorded in future periods. In accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, goodwill is not being amortized in connection with this transaction. The Company estimates that none of the goodwill will be deductible for income tax purposes. The Company also recorded a core deposit intangible asset of \$3.5 million, which will be amortized using the straight-line method over 7.5 years, resulting in an annual expense of \$0.5 million. The results of Atlantic Liberty's operations have not been included in the consolidated statements of income.

The purchase price has been allocated to the assets acquired and liabilities assumed using fair values as of the acquisition date. The Company acquired \$170.8 million in assets, which includes \$3.4 million of cash, \$116.2 million in net loans, \$34.9 million in securities, \$9.1 million in fixed assets and \$7.2 million in other assets, and assumed \$144.3 million in liabilities, which includes \$106.8 million in deposits, \$30.5 million in borrowed funds and \$6.9 in other liabilities.

As a result of the acquisition, the Bank now has branches on Montague Street and Avenue J in Brooklyn, two highly attractive markets. The Holding Company expects the transaction to be accretive to earnings per share.

Had the acquisition of Atlantic Liberty taken place on January 1, 2006, the Company's pro forma net income for the six month period ended June 30, 2006 would have been \$7.8 million, or \$0.40 per diluted share. Included in Atlantic Liberty's financial results were merger related expenses of \$3.4 million, on an after-tax basis. Excluding these merger related expenses, the Company's pro forma net income would have been \$11.1 million, or \$0.57 per diluted share. These results, which do not reflect cost savings that may be achieved, are not necessarily indicative of the actual results that would have occurred had the acquisition taken place on January 1, 2006.

PART I FINANCIAL INFORMATION
FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Notes to Consolidated Financial Statements

3. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

4. Earnings Per Share

Basic earnings per share for the six-month periods ended June 30, 2006 and 2005 was computed by dividing net income by the total weighted average number of common shares outstanding, including only the vested portion of restricted stock and restricted stock unit awards. Diluted earnings per share includes the additional dilutive effect of stock options outstanding and the unvested portion of restricted stock and restricted stock unit awards during the period. Earnings per share have been computed based on the following:

<i>(In thousands, except per share data)</i>	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Net income	\$ 5,406	\$ 5,894	\$ 11,317	\$ 11,863
Divided by:				
Weighted average common shares outstanding	17,811	17,487	17,789	17,483
Weighted average common stock equivalents	269	450	290	487
Total weighted average common shares and common stock equivalents	18,080	17,937	18,079	17,970
Basic earnings per share	\$ 0.30	\$ 0.34	\$ 0.64	\$ 0.68
Diluted earnings per share	\$ 0.30	\$ 0.33	\$ 0.63	\$ 0.66
Dividends per share	\$ 0.11	\$ 0.10	\$ 0.22	\$ 0.20
Dividend payout ratio	36.67%	29.41%	34.38%	29.41%

Common stock equivalents that are antidilutive are not included in the computation of diluted earnings per share. Options to purchase 290,525 shares at an average exercise price of \$18.03 and 169,400 shares at an average exercise price of \$18.14, were not included in the computation of diluted earnings per share for the three months ended June 30, 2006 and 2005, respectively. Unvested restricted stock and restricted stock unit awards totaling 82,368 shares at an average market price on date of grant of \$18.17, and 18,999 unvested restricted stock unit awards at an average market price on date of grant of \$19.81 were not included in the computation of diluted earnings per share for the three months ended June 30, 2006 and 2005, respectively. Options to purchase 354,575 shares at an average exercise price of \$17.80 and 35,750 shares at an average exercise price of \$19.94 were not included in the computation of diluted earnings per share for the six months ended June 30, 2006 and 2005, respectively. Unvested restricted stock and restricted stock unit awards totaling 109,398 shares at an average market price on date of grant of \$17.82 and 17,874 shares at an average market price on date of grant of \$19.94 were not included in the computation of diluted earnings per share for the six months ended June 30, 2006 and 2005, respectively.

PART I FINANCIAL INFORMATION
FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Notes to Consolidated Financial Statements

4. Stock-Based Compensation

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment. This statement revised SFAS No. 123, Accounting for Stock Based Compensation, and superseded APB Opinion No. 25 Accounting for Stock Issued to Employees and its related implementation guidance. SFAS No. 123R establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires a fair-value-based measurement method in accounting for share-based payment transactions with employees. It also requires measurement of the cost of employee services received in exchange for an award of an equity instrument based on the grant date fair value of the award. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. The requisite service period is usually the vesting period. Prior to January 1, 2006, the Company accounted for stock-based compensation in accordance with APB No. 25, which did not require compensation cost to be recognized, with the exception of certain circumstances. The Company also followed the disclosure requirements of SFAS No. 123 and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. The Company elected to adopt SFAS No. 123R using the modified prospective method, and, accordingly, financial statement amounts for the prior period presented in this Form 10-Q have not been restated to reflect the fair value method of expensing share-based compensation.

Assuming the Company had recognized compensation cost for stock-based compensation in accordance with SFAS No. 123R prior to January 1, 2006, net income and earnings per share would have been as indicated in the table below:

	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
<i>(Dollars in thousands, except share data)</i>				
Net income, as reported	\$ 5,406	\$ 5,894	\$ 11,317	\$ 11,863
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	651	466	892	535
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(651)	(584)	(892)	(735)
Pro forma net income	<u>\$ 5,406</u>	<u>\$ 5,776</u>	<u>\$ 11,317</u>	<u>\$ 11,663</u>
Basic earnings per share:				
As reported	\$ 0.30	\$ 0.34	\$ 0.64	\$ 0.68
Pro forma	\$ 0.30	\$ 0.33	\$ 0.64	\$ 0.67
Diluted earnings per share:				
As reported	\$ 0.30	\$ 0.33	\$ 0.63	\$ 0.66
Pro forma	\$ 0.30	\$ 0.32	\$ 0.63	\$ 0.65

For the three months ended June 30, 2006 and 2005, the Company's net income, as reported, includes \$1.1 million and \$0.8 million, respectively, of stock-based compensation costs and \$0.4 million and \$0.3 million of income tax benefits related to the stock-based compensations plans. The adoption of SFAS No. 123R reduced income before income taxes by less than \$0.1 million, net income by less than \$0.1 million, and basic and diluted earnings per share each by less than \$0.01. There were no realized tax benefits. Cash used by operating activities and cash provided by financing activities for the three months ended June 30, 2006 were each increased by \$18,000 as a result of the adoption of the SFAS No. 123R.

For the six months ended June 30, 2006 and 2005, the Company's net income, as reported, includes \$1.5 million and \$0.9 million, respectively, of stock-based compensation costs and \$0.6 million and \$0.3 million of income tax benefits related to the stock-based compensations plans. The adoption of SFAS No. 123R reduced income before income taxes by \$0.2 million, net income by \$0.1 million, and basic and diluted earnings per share each by \$0.01. There were no realized tax benefits. Cash used by operating activities and cash provided by financing activities for the six months ended June 30, 2006 were each increased by \$33,000 as a result of the adoption of the SFAS No. 123R.

PART I FINANCIAL INFORMATION
FLUSHING FINANCIAL CORPORATION and SUBSIDIARIES
Notes to Consolidated Financial Statements

The Company estimates the fair value of stock options using the Black-Scholes valuation model that uses the assumptions noted in the table below. Key assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of the Company's stock price, the risk-free interest rate over the options expected term and the annual dividend yield. The Company uses the fair value of the common stock on the date of award to measure compensation cost for restricted stock and restricted stock unit awards. Compensation cost is recognized over the vesting period of the award, using the straight line method. For the three and six month periods ended June 30, 2006, there were 131,475 stock options granted and awards of 120,425 shares of restricted stock units. For the three and six month periods ended June 30, 2005, there were 123,725 stock options granted and awards of 121,675 restricted stock units.

The following are the significant weighted assumptions relating to the valuation of the Company's stock options granted for the periods indicated. All grants were made in the three months ended June 30 for each period presented.

	2006	2005
Dividend yield	3.38%	2.24%
Expected volatility	29.31%	21.48%
Risk-free interest rate	5.10%	3.87%
Expected option life (years)	7	7

Holders of Atlantic Liberty stock options had the election to convert their options to Holding Company options or receive cash for the difference between their option price and \$24.00. Holders of 148,734 Atlantic Liberty options, with an exercise price of \$18.50, elected to receive 212,687 Holding Company options with an exercise price of \$12.94. This is considered a modification under SFAS 123R. No additional expense was recognized as the fair value of these options after this modification is less than the fair value before the modification, as the time period in which they can be exercised, and therefore their expected life, was reduced. The following are the significant assumptions relating to the valuation of the Atlantic Liberty stock options upon modification.

Dividend yield	3.71%
Expected volatility	29.31%
Risk-free interest rate	5.13%