BROOKLINE BANCORP INC
Form 10-Q
May 05, 2008

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2008

OR

**o 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	**04-3402944**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
160 Washington Street, Brookline, MA	**02447-0469**
(Address of principal executive offices)	(Zip Code)

(617) 730-3500
(Registrant s telephone number, including area code)

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

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 x	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO x

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)

		March 31, 2008 (unaudited)		December 31, 2007
ASSETS				
Cash and due from banks	$	16,976	$	17,699
Short-term investments		78,925		135,925
Securities available for sale		340,273		284,051
Securities held to maturity (market value of $191 and $199, respectively)		180		189
Restricted equity securities		28,365		28,143
Loans		1,931,323		1,890,896
Allowance for loan losses		(24,941)		(24,445)
Net loans		1,906,382		1,866,451
Accrued interest receivable		9,218		9,623
Bank premises and equipment, net		9,154		9,045
Deferred tax asset		10,133		10,849
Prepaid income taxes		552		2,105
Goodwill		43,241		42,545
Identified intangible assets, net of accumulated amortization of $7,056 and $6,618, respectively		5,896		6,334
Other assets		5,045		5,551
Total assets	$	2,454,340	$	2,418,510
LIABILITIES AND STOCKHOLDERS EQUITY				
Retail deposits	$	1,311,245	$	1,250,337
Brokered deposits		67,904		67,904
Borrowed funds		540,134		548,015
Subordinated debt				7,008
Mortgagors escrow accounts		5,437		5,051
Accrued expenses and other liabilities		20,237		20,116
Total liabilities		1,944,957		1,898,431
Minority interest in subsidiary		1,417		1,371
Stockholders equity:				
Preferred stock, $0.01 par value; 50,000,000 shares authorized; none issued				
Common stock, $0.01 par value; 200,000,000 shares authorized; 63,584,403 shares and 63,323,703 shares issued, respectively		636		633
Additional paid-in capital		515,826		513,949
Retained earnings, partially restricted		54,701		68,875
Accumulated other comprehensive income		1,974		121
Treasury stock, at cost 5,373,733 shares and 5,333,633 shares, respectively		(62,107)		(61,735)
Unallocated common stock held by ESOP 561,921 shares and 574,974 shares, respectively		(3,064)		(3,135)

Total stockholders equity		507,966		518,708
Total liabilities and stockholders equity	$	2,454,340	$	2,418,510

See accompanying notes to the unaudited consolidated financial statements.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Income

(In thousands except share data)

	Three months ended March 31, (unaudited) 2008	2007
Interest income:		
Loans	$ 30,990	$ 29,594
Debt securities	3,416	3,780
Short-term investments	1,007	1,684
Restricted equity securities	407	481
Marketable equity securities	67	28
Total interest income	35,887	35,567
Interest expense:		
Retail deposits	11,512	10,718
Brokered deposits	911	1,027
Borrowed funds	6,203	5,456
Subordinated debt	65	233
Total interest expense	18,691	17,434
Net interest income	17,196	18,133
Provision for credit losses	2,114	1,249
Net interest income after provision for credit losses	15,082	16,884
Non-interest income (loss):		
Fees and charges	943	1,019
Loss on write-down of securities	(1,249)	
Other income	15	30
Total non-interest income (loss)	(291)	1,049
Non-interest expense:		
Compensation and employee benefits	5,348	5,239
Occupancy	934	855
Equipment and data processing	1,698	1,478
Professional services	486	479
Advertising and marketing	135	141
Amortization of identified intangible assets	438	503
Other	1,264	1,135
Total non-interest expense	10,303	9,830
Income before income taxes and minority interest	4,488	8,103
Provision for income taxes	1,748	3,118
Net income before minority interest	2,740	4,985
Minority interest in earnings of subsidiary	46	44
Net income	$ 2,694	$ 4,941
Earnings per common share:		
Basic	$ 0.05	$ 0.08
Diluted	0.05	0.08

Weighted average common shares outstanding during the period:		
Basic	57,488,499	60,534,234
Diluted	57,763,871	61,182,972

See accompanying notes to the unaudited consolidated financial statements.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(In thousands)

	Three months ended March 31, 2008	Three months ended March 31, 2007
	(unaudited)	(unaudited)
Net income	$ 2,694	$ 4,941
Other comprehensive income, net of taxes:		
Unrealized securities holding gains	1,624	695
Income tax expense	572	255
Net unrealized securities holding gains	1,052	440
Adjustment of accumulated obligation for postretirement benefits		
Income tax benefit		
Net adjustment of accumulated obligation for postretirement benefits		
Net unrealized holding gains	1,052	440
Less reclassification adjustment for securities loss included in net income:		
Loss on write-down of securities	(1,249)	
Income tax benefit	448	
Net reclassification adjustment	(801)	
Net other comprehensive income	1,853	440
Comprehensive income	$ 4,547	$ 5,381

See accompanying notes to the unaudited consolidated financial statements.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders Equity

Three Months Ended March 31, 2008 and 2007 (Unaudited)

(Dollars in thousands)

	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Unallocated common stock held by ESOP	Total stockholders equity
Balance at December 31, 2006	$ 630	$ 508,248	$ 96,229	$ (640)	$ (18,144)	$ (3,430)	$ 582,893
Net income			4,941				4,941
Other comprehensive income				440			440
Common stock dividends of $0.285 per share			(17,297)				(17,297)
Payment of dividend equivalent rights			(485)				(485)
Exercise of stock options (84,531 shares)	1	357					358
Treasury stock purchases (335,000 shares)					(4,153)		(4,153)
Income tax benefit from vested recognition and retention plans shares and dividend payments on unexercised stock options and allocated ESOP shares		94					94
Compensation under recognition and retention plans		628					628
Common stock held by ESOP committed to be released (13,527 shares)		101				74	175
Balance at March 31, 2007	$ 631	$ 509,428	$ 83,388	$ (200)	$ (22,297)	$ (3,356)	$ 567,594

	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock	Unallocated common stock held by ESOP	Total stockholders equity
Balance at December 31, 2007	$ 633	$ 513,949	$ 68,875	$ 121	$ (61,735)	$ (3,135)	$ 518,708
Net income			2,694				2,694
Other comprehensive income				1,853			1,853
Common stock dividends of $0.285 per share			(16,411)				(16,411)
Payment of dividend equivalent rights			(457)				(457)
Exercise of stock options (391,218 shares)	3	696					699
Reload stock options granted (130,518 options)		59					59
Treasury stock purchases (40,100 shares)					(372)		(372)
Income tax benefit from vested recognition and retention plans shares and dividend payments on unexercised stock options and allocated ESOP shares		528					528
Compensation under recognition and retention plans		534					534
Common stock held by ESOP committed to be released (13,053 shares)		60				71	131
Balance at March 31, 2008	$ 636	$ 515,826	$ 54,701	$ 1,974	$ (62,107)	$ (3,064)	$ 507,966

See accompanying notes to the unaudited consolidated financial statements.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(In thousands)

	Three months ended March 31, 2008 (unaudited)	2007
Cash flows from operating activities:		
Net income	$ 2,694	$ 4,941
Adjustments to reconcile net income to net cash provided from operating activities:		
Provision for credit losses	2,114	1,249
Depreciation and amortization	338	360
Net accretion of securities premiums and discounts	(221)	(265)
Amortization of deferred loan origination costs	2,664	2,355
Amortization of identified intangible assets	438	503
Accretion of acquisition fair value adjustments	(119)	(235)
Amortization of mortgage servicing rights	6	3
Loss on write-down of securities	1,249	
Write-down of other real estate owned	40	
Minority interest in earnings of subsidiary	46	44
Compensation under recognition and retention plans	534	628
Release of ESOP shares	131	175
Deferred income taxes	(1,000)	419
Decrease (increase) in:		
Accrued interest receivable	405	726
Prepaid income taxes	1,553	487
Other assets	460	(575)
Increase in accrued expenses and other liabilities	95	1,624
Net cash provided from operating activities	11,427	12,439
Cash flows from investing activities:		
Proceeds from sales or calls of securities available for sale	3,275	
Proceeds from redemptions and maturities of securities available for sale	9,786	79,609
Proceeds from redemptions and maturities of securities held to maturity	9	9
Purchase of securities available for sale	(67,409)	(42,137)
Purchase (redemption) of Federal Home Loan Bank of Boston stock	(222)	2,004
Net increase in loans	(44,594)	(18,347)
Purchase of bank premises and equipment	(463)	(233)
Net cash provided from (used for) investing activities	(99,618)	20,905

	Three months ended March 31, 2008		Three months ended March 31, 2007
	(unaudited)		
Cash flows from financing activities:			
Increase in demand deposits and NOW, savings and money market savings accounts	$ 17,558		$ 3,263
Increase in retail certificates of deposit	43,351		21,818
Decrease in brokered certificates of deposit			(70)
Proceeds from Federal Home Loan Bank of Boston advances	108,540		213,000
Repayment of Federal Home Loan Bank of Boston advances	(116,413)		(246,205)
Repayment of subordinated debt	(7,000)		
Increase in mortgagors escrow accounts	386		313
Income tax benefit from vested recognition and redemption plan shares and dividend payments on unexercised stock options and allocated ESOP shares	528		94
Exercise of stock options	699		358
Reload stock options granted	59		
Purchase of treasury stock	(372)		(4,153)
Payment of dividends on common stock	(16,411)		(17,297)
Payment of dividend equivalent rights	(457)		(485)
Net cash provided from (used for) financing activities	30,468		(29,364)
Net increase (decrease) in cash and cash equivalents	(57,723)		3,980
Cash and cash equivalents at beginning of period	153,624		152,654
Cash and cash equivalents at end of period	$ 95,901		$ 156,634
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest on deposits and borrowed funds	$ 18,005		$ 16,835
Income taxes	665		2,120

See accompanying notes to the unaudited consolidated financial statements.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Three Months Ended March 31, 2008 and 2007

(Unaudited)

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

Basis of Presentation

The consolidated financial statements include the accounts of Brookline Bancorp, Inc. (the Company) and its wholly owned subsidiaries, Brookline Bank (Brookline) and Brookline Securities Corp. Brookline includes the accounts of its wholly owned subsidiary, BBS Investment Corporation, and its 86.0% (86.3% at December 31, 2007) owned subsidiary, Eastern Funding LLC.

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 three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

(2) Investment Securities (Dollars in thousands)

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

	March 31, 2008			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Securities available for sale:				
Debt securities:				
U.S. Government-sponsored enterprises	$ 81,253	$ 618	$	81,871
Municipal obligations	4,530	30	1	4,559

Auction rate municipal obligations	9,775			9,775
Corporate obligations	4,618		287	4,331
Other obligations	500			500
Collateralized mortgage obligations issued by U.S. Government-sponsored enterprises	125,339	1,913		127,252
Mortgage-backed securities issued by U.S. Government-sponsored enterprises	108,383	526	260	108,649
Total debt securities	334,398	3,087	548	336,937
Marketable equity securities	3,215	153	32	3,336
Total securities available for sale	$ 337,613	$ 3,240	580	340,273
Securities held to maturity:				
Mortgage-backed securities issued by U.S. Government-sponsored enterprises	$ 180	$ 11	$	$ 191

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Three Months Ended March 31, 2008 and 2007

(Unaudited)

	December 31, 2007			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Securities available for sale:				
Debt securities:				
U.S. Government-sponsored enterprises	$ 80,621	$ 288	$ 5	$ 80,904
Municipal obligations	4,531	7	25	4,513
Auction rate municipal obligations	13,050			13,050
Corporate obligations	4,779		201	4,578
Other obligations	500			500
Collateralized mortgage obligations issued by U.S. Government-sponsored enterprises	129,137	532	118	129,551
Mortgage-backed securities issued by U.S. Government-sponsored enterprises.	47,182	79	357	46,904
Total debt securities	279,800	906	706	280,000
Marketable equity securities	4,464	176	589	4,051
Total securities available for sale	$ 284,264	$ 1,082	$ 1,295	$ 284,051
Securities held to maturity:				
Mortgage-backed securities issued by U.S. Government-sponsored enterprises	$ 189	$ 10	$	$ 199

Debt securities of U.S. Government-sponsored enterprises include obligations issued by Fannie Mae, Freddie Mac, Ginnie Mae, Federal Home Loan Banks and the Federal Farm Credit Bank. None of those obligations is backed by the full faith and credit of the U.S. Government except for mortgage-backed securities issued by Ginnie Mae amounting to $10 at March 31, 2008 and $16 at December 31, 2007.

(3) Loans (Dollars in thousands)

A summary of loans follows:

	March 31, 2008	December 31, 2007
Mortgage loans:		
One-to-four family	$ 298,659	$ 296,329
Multi-family	336,564	330,925
Commercial real estate	403,550	381,300
Construction and development	26,137	26,807
Home equity	34,524	35,110

Second		25,864		23,878
Total mortgage loans		1,125,298		1,094,349
Indirect automobile loans		591,065		594,332
Commercial loans Eastern		144,557		141,675
Other commercial loans		163,664		154,442
Other consumer loans		3,870		3,909
Total gross loans		2,028,454		1,988,707
Unadvanced funds on loans		(114,160)		(114,651)
Deferred loan origination costs:				
Indirect automobile loans		15,560		15,445
Commercial loans Eastern		802		824
Other		667		571
Total loans	$	1,931,323	$	1,890,896

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Three Months Ended March 31, 2008 and 2007

(Unaudited)

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

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

	Three month ended March 31, 2008	2007
Balance at beginning of period	$ 24,445	$ 23,024
Provision for loan losses	2,088	1,228
Charge-offs	(1,788)	(1,304)
Recoveries	196	149
Balance at end of period	$ 24,941	$ 23,097

During the three months ended March 31, 2008 and 2007, the liability for unfunded credit commitments was increased by charges to the provision for credit losses of $26 and $21, respectively. The liability, which is included in other liabilities, was $1,513 at March 31, 2008 and $1,487 at December 31, 2007.

(5) Deposits (Dollars in thousands)

A summary of deposits follows:

	March 31, 2008	December 31, 2007
Demand checking accounts	$ 66,595	$ 66,538
NOW accounts	86,359	84,875
Savings accounts	68,930	67,351
Guaranteed savings accounts	18,919	19,799
Money market savings accounts	230,705	215,387
Retail certificate of deposit accounts	839,737	796,387
Total retail deposits	1,311,245	1,250,337
Brokered certificates of deposit	67,904	67,904
Total deposits	$ 1,379,149	$ 1,318,241

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

Accumulated other comprehensive income at March 31, 2008 was comprised of unrealized gains on securities available for sale, net of income taxes, of $1,732 and an unrealized gain related to postretirement benefits, net of income taxes, of $242. Accumulated other comprehensive income at December 31, 2007 was comprised of an unrealized loss on securities available for sale, net of income taxes, of $121 and an unrealized gain related to postretirement benefits, net of income taxes, of $242. At March 31, 2008 and December 31, 2007, the resulting net income tax liability, amounted to $1,103 and $83, respectively.

(7) Commitments and Contingencies (Dollars in thousands)

Loan Commitments

At March 31, 2008, the Company had outstanding commitments to originate loans of $56,993, $12,017 of which were one-to-four family mortgage loans, $22,690 were commercial real estate mortgage loans, $11,930 were multi-family mortgage loans, $2,950 were commercial loans to condominium associations and $7,406 were commercial loans. Unused lines of credit available to customers were $54,628, of which $48,825 were equity lines of credit.

Legal Proceedings

On February 21, 2007, Carrie E. Mosca filed a putative class action complaint against Brookline Bank in the Superior

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Three Months Ended March 31, 2008 and 2007

(Unaudited)

Court for the Commonwealth of Massachusetts (the Action). Ms. Mosca defaulted on a loan obligation on an automobile that she co-owned. She alleges that the form of notice of sale of collateral that the Bank sent to her after she and the co-owner became delinquent on the loan obligation did not contain information required to be provided to a consumer under the Massachusetts Uniform Commercial Code. The Action purports to be brought on behalf of a class of individuals to whom the Bank sent the same form of notice in connection with transactions documented as consumer transactions during the four year period prior to the filing of the Action. The Action seeks statutory damages, an order restraining the Bank from future use of the form of notice sent to Ms. Mosca, an order barring the Bank from recovering any deficiency from other individuals to whom it sent the same form of notice, attorneys fees, litigation expenses and costs. The amount of potential damages, if any, will depend upon whether a class action is certified, the size of the class and the measure of damages decided upon by the court. The Bank is defending the Action vigorously. The parties have engaged in discovery related to the issue of class certification. The Company is unable at this time to form an estimate of the loss, if any, that may arise from this matter.

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

(8) Dividend Declaration

On April 17, 2008, the Board of Directors of the Company approved and declared a regular quarterly cash dividend of $0.085 per share payable on May 15, 2008 to stockholders of record on April 30, 2008.

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

Recognition and Retention Plans

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

Total expense for the RRP plans amounted to $534 and $628 for the three months ended March 31, 2008 and 2007, respectively. The compensation cost of non-vested RRP shares at March 31, 2008 is expected to be charged to expense as follows: $1,601 during the nine month period ended December 31, 2008 and $143 during the year ended December 31, 2009. As of March 31, 2008, the number of shares available for award under the 1999 RRP and the 2003 RRP were 29,774 shares and 131,960 shares, respectively.

Stock Option Plans

The Company has two stock option plans, the 1999 Option Plan and the 2003 Option Plan . Under both of the plans, shares of the Company s common stock were reserved for issuance to directors, employees and non-employee directors of the Company. Shares issued upon the exercise of a stock option may be either authorized but unissued shares or reacquired shares held by the Company as treasury shares. Any shares subject to an award which expire or are terminated unexercised will again be available for issuance under the plans. The exercise price of options awarded is the fair market value of the common stock of the Company on the date the award is made. Options vest over periods ranging from less than one month through over five years and certain of the options 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.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Three Months Ended March 31, 2008 and 2007

(Unaudited)

Total expense for the stock option plans amounted to $59 and $1 for the three months ended March 31, 2008 and 2007, respectively.

Activity under the Company s stock option plans for the three months ended March 31, 2008 was as follows:

Options outstanding at January 1, 2008	2,722,960
Options exercised at $4.944 per option	(391,218)
Reload options granted at $9.19 per option	130,518
Options forfeited at $12.91 per share	(40,000)
Options outstanding at March 31, 2008	2,422,260

Exercisable at March 31, 2008 at:		
$ 4.944 per share		858,079
$ 9.19 per share		130,518
$ 10.36 per share		28,717
$ 10.59 per share		23,861
$ 10.69 per share		46,249
$ 10.87 per share		56,836
$ 12.91 per share		1,000
$ 15.02 per share		1,273,000
		2,418,260
Aggregate intrinsic value of options outstanding and exercisable	$	6,032
Weighted average exercise price per option	$	10.85
Weighted average remaining contractual life in years at end of period		3.52

As of March 31, 2008, the number of options available for award under the Company s 1999 Stock Option Plan and 2003 Stock Option Plan were 285,980 options and 1,222,000 options, respectively.

Employee Stock Ownership Plan

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

A loan obtained by the ESOP from the Company to purchase Company common stock is payable in quarterly installments over 30 years and bears interest at 8.50% per annum. The loan can be prepaid without penalty. Loan payments are principally funded by cash contributions from the Bank, subject to federal tax law limits. The outstanding balance of the loan at March 31, 2008 and December 31, 2007, which was $3,689 and $3,752, 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 March 31, 2008, the ESOP held 561,921 unallocated shares at an aggregate cost of $3,064; the market value of such shares at that date was $6,451. For the three months ended March 31, 2008 and 2007, $131 and $175, respectively, was charged to compensation expense based on the commitment to release to eligible employees 13,053 shares and 13,527 shares in those respective periods.

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Three Months Ended March 31, 2008 and 2007

(Unaudited)

(10) Postretirement Benefits (Dollars in thousands)

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

The following table provides the components of net periodic postretirement benefit costs for the three months ended March 31, 2008 and 2007:

	2008	2007
Service cost	$ 18	$ 14
Interest cost	13	11
Prior service cost	(6)	(7)
Actuarial (gain) loss	(1)	5
Net periodic benefit costs	$ 24	$ 23

Benefits paid amounted to $3 and $4 for the three months ended March 31, 2008 and 2007, respectively.

(11) Stockholders Equity (Dollars in thousands)

Capital Distributions and Restrictions Thereon

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

Common Stock Repurchases

During the 2008 first quarter, 40,100 shares of the Company s common stock were repurchased at an average cost of $9.29, including transaction costs.

As of March 31, 2008, the Company was authorized to repurchase up to 4,804,410 shares of its common stock. The Board of Directors has delegated to the discretion of the Company s senior management the authority to determine the timing of the repurchases and the prices at which the repurchases will be made.

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 $33,151 at December 31, 2007.

(12) Fair Value Disclosures (Dollars in thousands)

Effective January 1, 2008, the Company adopted *Statement of Financial Accounting Standards No. 157 (SFAS 157), Fair Value Measurements* , which provides a framework for measuring fair value under U.S. generally accepted

BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Three Months Ended March 31, 2008 and 2007

(Unaudited)

accounting principles. SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In addition, SFAS 157 specifies a hierarchy of valuation techniques based on whether the inputs to those techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have the following fair value hierarchy:

Level 1	- Quoted prices for identical instruments in active markets
Level 2	- Quoted prices for similar instruments in active or non-active markets and model-derived valuations in which all significant inputs and value drivers are observable in active markets
Level 3	- Valuation derived from significant unobservable inputs

The Company uses fair value measurements to record certain assets at fair value on a recurring basis. Additionally, the Company may be required to record at fair value other assets on a nonrecurring basis. These nonrecurring fair value adjustments typically involve the application of lower-of-cost-or market value accounting or write-downs of individual assets. In accordance with *Financial Accounting Standards Board (FASB) Staff Position No. 157-2, Effective Date of FASB Statement No. 157* , we have delayed the application of SFAS 157 for nonfinancial assets, such as goodwill and real property held for sale, and nonfinancial liabilities until January 1, 2009.

The only assets of the Company recorded at fair value on a recurring basis at March 31, 2008 were securities available for sale. The following table presents the level of valuation assumptions used to determine the fair value of such securities:

	Carrying Value			
	Level 1	**Level 2**	**Level 3**	**Total**
Securities available for sale	$ 657	$ 328,841	$ 10,775	$ 340,273

The securities comprising the balance at March 31, 2008 in the level 3 column included $9,775 of auction rate municipal obligations, a $500 obligation of a foreign country maturing September 30, 2008 and a $500 trust preferred obligation issued by a financial institution, all of which lacked quoted prices in active markets. In the judgment of management, the fair value of these securities was considered to approximate their carrying value because they were deemed to be fully collectible and the rates paid on the securities were at least equal to rates paid on securities with similar maturities. While it is possible that unrealized depreciation may have existed at March 31, 2008 with respect to the auction rate municipal obligations, such unrealized depreciation, if any, would be immaterial to the Company s consolidated financial statements as of and for the three months ended March 31, 2008 and would not be considered as other-than-temporary in nature.

The following table presents the level of valuation assumptions used by the Company to determine assets recorded at fair value on a nonrecurring basis at March 31, 2008:

	Carrying Value			
	Level 1	Level 2	Level 3	Total
Repossessed vehicles	$	$	$ 1,175	$ 1,175
Repossessed equipment			589	589
Other real estate owned			477	477
Total assets at fair value on a nonrecurring basis	$	$	$ 2,241	$ 2,241

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 s constitute forward-looking statements.

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

Executive Level Overview

The following is a summary of operating and financial condition highlights as of and for the three months ended March 31, 2008 and 2007.

Operating Highlights

	Three months ended March 31, 2008	Three months ended March 31, 2007
	(In thousands except per share amounts)	
Net interest income	$ 17,196	$ 18,133
Provision for credit losses	2,114	1,249
Loss on write-down of securities	(1,249)	
Non-interest income	958	1,049
Amortization of identified intangible assets	438	503
Other non-interest expenses	9,865	9,327

Income before income taxes		4,488		8,103
Provision for income taxes		1,748		3,118
Minority interest in earnings of subsidiary		46		44
Net income		2,694		4,941
Basic earnings per common share	$	0.05	$	0.08
Diluted earnings per common share		0.05		0.08
Interest rate spread		2.02%		2.11%
Net interest margin		2.96%		3.20%

Financial Condition Highlights

Net cash used in operating activities from continuing operations	(4,595)	(1,953)	(2,257)
Net cash used in operating activities from discontinued operations	-	(446)	

(1,647

)

Net cash used in operating activities

(4,595

)

(2,399

)

(3,904

)

Cash flows from investing activities:

Purchase of property and equipment	(214)	(24)	(245)
Proceeds from sale of property and equipment	31	-	13
Proceeds from sale of product line	-		

-

257

Investment in long-term marketable securities

-

-

(607

)

Proceeds from redemption of marketable securities

-

1,331

2,316

Investment in other companies

-

(676

)

-

Acquisitions, net of cash acquired (a,b,c,d)

(4,548

)

-

(1,124

)

Net cash provided by (used in) investing activities from continuing operations	(4,731)
	631
	610
Net cash used in investing activities from discontinued operations	-
	(221)

(1,087

)

Net cash provided by (used in) investing activities

(4,731

)

410

(477

)

Cash flows from financing activities:

Proceeds from shares issuance, net

6,625

-

-

Repayment of short-term and long-term bank loans

(293

)

(26

)

(55

)

Proceeds from short-term bank loans

1,454

686

933

Proceeds from long-term bank loans

4,203

-

-

Proceeds (payments) from long-term convertible note and warrants, net of issuance expenses

(120

)

1,319

1,246

Payment of long-term convertible note

	(351
)	
	(438
)	
	(55
)	
Proceeds from exercise of options	
	46
	135
	2,090

Net cash provided by financing activities	
	11,564
	1,676
	4,159

Increase (decrease) in cash and cash equivalents	2,238
	(313)
	(222)
Increase in cash and cash equivalents from discontinued operations	-
	114
	163

Effect of exchange rate changes on cash and cash equivalents	-
	-
	(13)
Cash and cash equivalents at the beginning of the year	2,033
	2,232
	2,304

Cash and cash equivalents at the end of the year	$ 4,271	$ 2,033	$ 2,232

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

		Year ended December 31,	
	2007	**2006**	**2005**
Supplemental disclosure of cash flow activities:			
(i) Net cash paid during the year for:			
Interest	$ 336	$ 532	$ 126
Income tax	$ 38	$ 180	$ 309
(ii) Non-cash activities:			
Conversion of convertible note into shares	$ 2,017	$ -	$ 1,614
Sale of the communication segment in consideration for shares in Qualmax	$ -	$ 958	$ 4,690
Conversion of Qualmax s debt into New World Brand s shares	$ -	$ 1,480	$ -
Sale of PrintBOS:			
Consideration, net	$ -	$ -	$ 275
Disposal of fixed assets	-	-	(28)
Disposal of liability	-	-	100
Related expenses	-	-	(74)
Capital gain	$ -	$ -	$ 273
Sale of the communication segment:			
Consideration, net	$ -	$ 2,437	$ 3,690
Disposal of tangible and intangible assets	-	(752)	(2,425)
Related expenses	-	-	(486)
Capital gain	$ -	$ 1,685	$ 779
(a) Acquisition of Odem:			
Fair value of net tangible assets acquired (excluding cash and cash equivalents) and liabilities assumed at acquisition date	$ -	$ -	$ 1,020
Fair value of net intangible assets acquired at acquisition date	-	-	718
Less -	-	-	
Amount acquired by issuance of shares	-	-	532

Payables	-	-	219
Add-	-	-	
Cancellation of Put and Call options	-	-	137
	$ -	$ -	$ 1,124

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

B.O.S. BETTER ONLINE SOLUTIONS LTD.
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CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31, 2007	2006	2005
(b) Acquisition of Summit			
Fair value of net tangible assets acquired (excluding cash and cash equivalents) and liabilities assumed at acquisition date	$ 3,192	$ -	$ -
Fair value of net intangible assets acquired at acquisition date	2,058	-	-
Less - Amount acquired by issuance of shares	(903)	-	-
	$ 4,347	$ -	$ -
(c) Acquisition of CYMS Ltd assets and liabilities			
Fair value of net tangible assets acquired (excluding cash and cash equivalents) and liabilities assumed at acquisition date	$ 11	$ -	$ -
Fair value of net intangible assets acquired at acquisition date	55	-	-
Less amount acquired by issuance of shares	(15)	-	-
	$ 51	$ -	$ -
(d) Acquisition of OptimizeIT assets and liabilities			
Fair value of net intangible assets acquired at acquisition date	$ 170	-	-
Less amount acquired by issuance of shares	(20)	-	-
	$ 150	$ -	$ -

B.O.S. BETTER ONLINE SOLUTIONS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL

a. B.O.S. Better Online Solutions Ltd. (BOS) is an Israeli corporation (together with its subsidiaries the Company).

The Company has two operating segments, the Mobile and RFID Solutions segment and the Supply Chain Solutions segment.

The Company s wholly owned subsidiaries include:

In Israel:

(1) BOScom Ltd, part of the Mobile and RFID segment. In January 2008 BOScom changed it s name to Dimex Solutions Ltd. and its subsidiary Dimex Hagalil Projects (2008) Ltd., which was incorporated in January 2008. (see note 19);

(2) Odem Electronic Technologies 1992 Ltd., which was purchased on November 18, 2004 from Odem s previous shareholders, and in which, by November 2005, the Company s holdings increased to 100%. Odem, an Israeli company, is a major solution provider and distributor of RFID and electronics components and advance technologies in the Israeli market. Odem is a part of both the Mobile and RFID and the Supply Chain segments; and

(3) Quasar Telecom Ltd., which obtained the assets BOS acquired in September 2004 from Quasar Communication Systems Ltd. The assets of Quasar Telecom were sold to IP Gear Ltd., a subsidiary of Qualmax Inc. as part of the sale of the Communications Segment in the fourth quarter of 2005.

In the U.S.:

(1) Ruby-Tech Inc., a New York corporation, a wholly owned subsidiary of Odem and a part of both the Mobile and RFID and the Supply Chain segments;

(2) Lynk USA Inc., a Delaware Corporation, and its subsidiaries:

a. Summit Radio Corp., part of the Supply chain solutions segment, was purchased on November 21, 2007 from Summit s previous shareholders. Summit is a supply chain provider, mainly of electronic components to the aircraft and defense industry.

b. Pacific Information Systems, Inc. (PacInfo), a, Delaware corporation and PacInfo s subsidiary, Dean Tech Technologies Associates, LLC., a Texan corporation, are no longer active.

(3) BOS Delaware Inc., a Delaware corporation, which operations were ceased in 2002.

NOTE 1:- GENERAL (Cont.)

In Europe:

BOScom had a UK subsidiary, Better On-Line Solutions Ltd., and its subsidiary, Better On-Line Solutions S.A.S in France. Since 2002, the subsidiaries are no longer active.

BOS communication segment (the communication segment) included: BOScom s business of communication solutions which provides multi-path, intelligent routing voice over IP gateways and the Company s wholly-owned subsidiary Quasar Telecom (2004) Ltd. (Quasar), which provides communication solutions based on cellular technology. The assets and liabilities of this segment have been sold as part of the disposal of the communication segment in December 2005 (see d).

In addition, the Company holds shares in two other companies:

1. Surf Communication Systems Ltd. (Surf), a developer and supplier of access and network convergence software solutions to the wire line and wireless telecommunications and data communications industries. In June 2006, the Company invested $300, following which, the Company holds 6.94% of Surf s issued and outstanding shares (see Note 5).

2. Qualmax Inc. (Qualmax), a U.S. public corporation listed on the Pink Sheets (QMXI.PK), and its subsidiary New World Brands Inc. (OTC: NWBD.OB) (NWB). The Company holds 17.87% of the issued and outstanding shares of Qualmax Inc. and 3.96% of the issued and outstanding shares of NWB. The Company s holdings in Qualmax and NWB were received as the consideration for the sale of the communication segment (see d).

b. Business combination:

Acquisition of Odem:

On November 18, 2004, the Company purchased 63.8% of the outstanding shares of Odem, from Odem s existing shareholders. In consideration for Odem s shares the Company (i) issued 290,532 of the Company s Ordinary shares subject to lock-up periods of 2 to 4 years and (ii) paid an amount of $1,971 in cash.

On September 29, 2005 and November 1, 2005, the Company purchased an additional 23.9% and 12.3% of the outstanding shares of Odem, respectively, from Odem s minority shareholders. Following these purchases, the Company owns 100% of Odem. In consideration for the 12.3% of Odem s shares purchased in November 2005 the Company paid $554, in cash and for the 23.9% of Odem s shares purchase in September 2005 the Company (i) issued 232,603 of the Company s Ordinary shares and (ii) paid an amount of $716 in cash.

U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL (Cont.)

The acquisitions have been treated using the purchase method of accounting in accordance with SFAS 141 Business Combinations . The purchase price has been allocated to the assets acquired and liabilities assumed based on their estimated fair value at the date of acquisition. The excess of the purchase price over the estimated fair value of the tangible and intangible assets acquired has been recorded as goodwill.

The Company has allocated the total cost of Odem acquisition in 2005 as follows:

Allocation of purchase price	November 1, 2005	September 29, 2005	Total	Estimated useful life
Tangible assets	$ 340	$ 681	$ 1,021	
Customer list (1)	85	509	594	9 years
Deferred tax liability	(23)	(136)	(159)	
Goodwill	138	144	282	
Total purchase price	$ 540	$ 1,198	$ 1,738	

(1) The Company s allocation of purchase price valued the acquired customer list by calculating cash flow benefit as a direct result of the customer relationship.

Acquisition of Summit:

On November 21, 2007 the Company purchased 100% of the outstanding shares of Summit, from Summit s existing shareholders. In consideration for Summit s shares the Company (i) issued 360,000 of the Company s Ordinary shares subject to lock-up periods of 1-2 years and (ii) paid an amount of $4,472 in cash (including $373 against undistributed net income for the first nine months of 2007 in Summit). In addition, Summit s selling shareholders will receive contingent consideration up to $500, based on performance in the years 2008 and 2009.

The Company s consolidated financial statements reflect the purchase price determined as follows:

	November 21, 2007
Issuance of shares (1)	$ 874
Cash consideration	4,472
Transaction costs (includes issuance costs in the amount of $29)	355
Total purchase price	$ 5,701

(1) The value of the Ordinary shares issued was determined based on the average market price of the Company s Ordinary shares over the period of two days before and after the terms of the transaction were agreed to and announced.

**B.O.S. BETTER ONLINE SOLUTIONS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL (Cont.)

The Company has allocated the total purchase price as follows:

Allocation of purchase price	Summit	Estimated useful life
Cash	$ 451	
Tangible assets (1)	3,192	
Backlog (2)	55	
Customer list (3)	167	12 years
Non-competing rights (4)	40	6 years
Deferred tax liability	(113)	
Goodwill	1,909	
Total purchase price	$ 5,701	

(1) Includes fair value of inventory Reflects the expected profit from realization of the inventory.

(2) Backlog The economic value of the backlog is calculated by deducting the relative expenses which will be accrued to sales equal to the Backlog.

(3) Customer list - The Company s allocation of purchase price is valued the acquired customer list by calculating cash flow benefit as a direct result of the customer relationship.

(4) Non-competing rights - The value of the non-competing right is calculated by assessing the economic damage which might occur due to possible competing by the Sellers, and which is mitigated by having a non-competing agreement. The value of the non-competing right is the discounted cash flow which relates to portion of the Company s income that could have been lost if the Sellers would compete.

The acquisitions have been treated using the purchase method of accounting in accordance with SFAS 141 Business Combinations . The purchase price has been allocated to the assets acquired and liabilities assumed based on their estimated fair value at the date of acquisition. The results of operations of Summit are included in the consolidated financial statements of operations as of the acquisition date.

The excess of the purchase price over the estimated fair value of the tangible and intangible assets acquired has been recorded as goodwill.

The results of operations of Summit have been included in the Company s consolidated statements of income since the completion of the acquisition in November 21, 2007. The following unaudited pro forma information presents a summary of the results of operations of the Company assuming the acquisition of Summit occurred at the beginning of each of the following periods:

**B.O.S. BETTER ONLINE SOLUTIONS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL (Cont.)

	Year Ended December 31, 2007 (unaudited)	2006
Revenues	$ 39,110	$ 36,436
Net income (loss)	$ (8,669)	$ 309
Net income per share basic	$ (1.00)	$ 0.05
Net income per share diluted	$ (1.00)	$ 0.05

Acquisition of Cyms Ltd. assets and Liabilities:

On July 1, 2007, the Company entered into an agreement with Cyms Ltd., to purchase its assets and liabilities, for an aggregate consideration of $ 66 which was paid by issuance of 5,594 shares of the Company and cash payment of $51. The assets of Cyms Ltd. were transferred into the Company on July 1, 2007 (the closing date).

The Company s consolidated financial statements reflect the purchase price determined as follows:

	November 21, 2007
Issuance of shares (1)	$ 15
Cash consideration	51
Total purchase price	$ 66

(1) The value of the Ordinary shares issued was determined based on the average market price of the Company s Ordinary shares over the period of two days before and after the terms of the transaction were agreed to and announced.

The Company has allocated the total purchase price as follows:

Allocation of purchase price	Cyms	Estimated useful life
Tangible assets	$ 11	
Technology (1)	55	6 years
Total purchase price	$ 66	

(1) The Company s allocation of purchase price valued the acquired technology by calculating cash flow benefit as a direct result of the technology.

U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL (Cont.)

The Summit acquisition has been treated using the purchase method of accounting in accordance with SFAS 141 Business Combinations . The purchase price has been allocated to the assets acquired and liabilities assumed based on their estimated fair value at the date of acquisition.

Acquisition of OptimizeIT, a partnership organized under the laws of the State of Israel, assets and liabilities:

On October 1, 2007, the Company entered into an agreement with OptimizeIT to purchase its assets, for an aggregate consideration of $170 which was paid by issuance of 8,000 shares of the Company and a cash payment of $150. The assets of Optimize IT were transferred into the Company on October 1, 2007

The Company s consolidated financial statements reflect the purchase price determined as follows:

	November 21, 2007
Issuance of shares (1)	$ 20
Cash consideration	150
Total purchase price	$ 170

The Company has allocated the total purchase price as follows:

Allocation of purchase price	OptimizeIT	Estimated useful life
Research and development in process	$ 170	NA
Total purchase price	$ 170	

The Company recorded a charge of $170 with respect to the OptimizeIT transaction related to in process research and development for projects which have not yet reached technological feasibility and which have no alternative future use.

The Cyms and OptimizeIT transactions have been treated as asset acquisitions on the basis of the fair values exchanged.

NOTE 1:- GENERAL (Cont.)

c. Sale of product line:

On July 18, 2005, BOScom signed an asset purchase agreement with Consist Technologies Ltd. and Consist International Inc. (collectively, Consist), for the sale of its PrintBOS product line in consideration of $500 and a contingent payment in each of the next three years equal to 6%-10% of future revenues exceeding $1,000 per year, Consist will generate from the PrintBOS product line. The Company has recognized a gain of $273 in 2005 with respect of this sale. As of December 31, 2005, the Company has received $375 and the remaining $125 has been placed in an escrow for a period of three years, pending repayment of royalties to the Office of the Chief Scientist (OCS) on sales of PrintBOS products. For the years ended December 31, 2006 and 2007, total revenues generated by Consist from the PrintBOS products in each year were less than $1,000 and, therefore, the Company did not receive any royalties in 2006 and 2007.

d. Discontinued operations:

1. Sale of communication segment:

On December 31, 2005, the Company sold its communication segment, including its property and equipment, goodwill, technology, trade name, existing distribution channels and related contingent liability to the Office of the Chief Scientist to IP Gear Ltd. (IP Gear), a wholly owned Israeli subsidiary of Qualmax. The consideration paid to the Company in the transaction was approximately 3.2 million Qualmax shares of Common stock constituting approximately 16% of Qualmax s total issued and outstanding Common stock and $800 in royalties to be paid at a rate of 4% from future revenues IP Gear will generate from the disposed segment (Royalties) with the entire $800 due no later than 90 days from the third anniversary of the closing of the transaction. Additional shares may be issued to the Company at the end of four consecutive fiscal quarters following the closing of the transaction, contingent upon IP Gear generating by then a certain level of revenues from the disposed segment (Earn Out Shares). The maximum number of Earn Out Shares that may further be issued to the Company is approximately 1 million, constituting an additional 5% of Qualmax outstanding shares. In June 2006, the Company received 250,000 of Qualmax shares, valued at $1.43 per share, as part of the Earn Out Shares consideration.

The Company received certain piggy-back registration rights with respect to the Qualmax shares. The Company does not have a representative on the Board of Qualmax.

In addition, the Company and IP Gear entered into an Outsourcing Agreement, pursuant to which the Company provided IP Gear with certain operating services relating to the sold communication segment through December 31, 2006. In accordance with the Outsourcing Agreement, the first three months of services were provided for no charge. For services rendered from April 2006 through December 2006, the Company charged IP Gear $240, which was paid by issuing the Company Qualmax subsidiary s shares in December 2006, as part of an agreement signed by the parties (see below).

B.O.S. BETTER ONLINE SOLUTIONS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL (Cont.)

The Company also granted a bridge loan to IP Gear in the amount of $1,000. The term of the loan is three years and it bears interest equal to the Prime rate plus 2.5%, up to a maximum of 12%. In the first 18 months, IP Gear shall pay only the interest accrued on the loan and monthly principal and interest payments shall commence thereafter. The loan granted to IP Gear is secured by a first priority floating charge, which may be subordinated to a charge in favor of a major financial institution in the event such charge is recorded. In addition, repayment is guaranteed by Qualmax Inc.

The loan agreement provides that if the disposed segment would incur losses that exceed $250 in the first quarter of 2006, the principal amount to be repaid under the loan shall be reduced by the excess losses. In such event, Qualmax shall issue to the Company additional shares of Common stock against such reduction, valued at a predetermined price of $1.43 per share. Pursuant to this provision, in May 2006, Qualmax issued to the Company 244,755 shares, at a price of $1.43 per share, resulting in an amount of $350. In June 2006, Qualmax issued BOS an additional 174,825 shares, reducing the principal amount of the loan to $400. As of December 31, 2007 the company holds 17.87% of the issued and outstanding Common stock of QMX.

Qualmax also issued to the Company a five-year warrant for the purchase of up to 107,143 shares, constituting less than 1%, of its outstanding shares in Qualmax, at the exercise price of $2.80 per share (Warrants). The Company received certain piggy-back registration rights with respect to the shares underlying the Warrants.

The Company signed in December 2006 an agreement with Qualmax and its subsidiaries, NWB and IP Gear, pursuant to which, the outstanding debt of Qualmax to the Company, in the amount of $1,480 (which included long-term debt, outsourcing fees, royalties and other debts), was repaid to the Company through the issuance of 5.506652 shares of series A Convertible Preferred stock of NWB which are convertible into approximately 16,446,544 shares of NWB

Common stock, reflecting a conversion rate of $0.09 per one share of Common stock. During 2007 NWB converted its series A Preferred stock into Common stock and as a result the company holds as of December 31, 2007, 3.96% of the issued and outstanding Common stock of NWB.

The Company s registration rights with respect to the Qualmax shares shall also apply to NWB shares. In addition, the Company agreed to enter into a lock up agreement, restricting the transfer of its share holdings in Qualmax and in NWB, for up to two years.

In connection with the transaction, the Company agreed to grant NWB, contingent upon the satisfaction of certain conditions, a three-year option that will expire on December 31, 2009, to purchase up to 30% of the NWB s shares held by the Company, at prices ranging from $0.12 to $0.24 per share of Common stock. As of December 31, 2007 the conditions have not been met, hence the option has not been granted and the fair value of the option is $0.

U.S. dollars in thousands, except share and per share data

NOTE 1:- GENERAL (Cont.)

As of December 31, 2007, the restriction on the shares held in Qualmax and NWB terminates within one year and as a result the shares should be recorded at fair value. Therefore, the Company accounts for its holdings in Qualmax and NWB shares as available for sale in accordance with Statement of Financial Accounting Standard 115 Accounting for Certain Investments in Debt and Equity Securities . Unrealized gains and losses, net of the related tax effect as of December 31, 2007, are included in other comprehensive income. As a result of the decrease in the share prices of these companies as of December 31, 2007, the Company recorded loss of $5,588. On February 18, 2008, New World Brands and Qualmax, entered into an agreement and plan of merger (see note 19), pursuant to which Qualmax will be merged with and into NWB. Upon completion of the merger, which is subject to completion of certain conditions, BOS holding in Qualmax will be converted into holding in New World Brands. These holdings were the consideration for selling the communication division in years 2005 and 2006.

For the years ended December 31, 2006 and 2005, the Company s consolidated financial statements reflected a capital gain from the sale of the communication segment, which was determined as follows:

	Year ended December 31,	
	2006	2005
Consideration:		
Ordinary shares of Qualmax (1)	$ 957	$ 4,586
107,143 warrants (2)	-	104
5.50652 series A Preferred stock of NWB (3)	1,480	-
Debt conversion (loan granted to IP Gear)	-	(1,000)
Total consideration	2,437	3,690
Cost:		
Disposal of assets (liabilities) related to the communication segment	752	2,425
Transactions related costs	-	486
Total cost	752	2,911
Capital gain	$ 1,685	$ 779

There was no capital gain in 2007.

(1) Valued at $1.43 per share.

(2) Valued at $0.97 per warrant.

(3) 5.50652 series A Preferred stock convertible into 16.5 million shares of Common stock of NWB. Each share of Common stock is valued at $0.09 per share.

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NOTE 1:- GENERAL (Cont.)

Following the agreement, signed in December 2006, the Company has accounted for the communication segment as a discontinued operations , in accordance with EITF 03-13 Applying the Conditions in Paragraph 42 of FASB Statement 144 in Determining Whether to Report Discontinued Operations . As such, the results of operations, including revenues, cost of revenues, operating expenses, and other income and expenses of the communication segment for 2005, have been reclassified in the accompanying statements of operations as discontinued operations.

As of December 31, 2007, Qualmax share price is $0.21 and NWB share price is $0.04. The Company recorded a loss in the amount of $5,588 as the decrease was other than temporary.

2. Discontinued product line:

During the fourth quarter of 2002, PacInfo ceased its operations.

The results of operations, including revenues, cost of revenues, operating expenses and other income and expenses of the communication segment and PacInfo s operations for 2007, 2006 and 2005, have been reclassified in the statements of operations. Taxes were not attributed to the discontinued operations due to utilization of losses from previous years, for which a valuation allowance was provided.

Summarized selected financial information and cash flows of the discontinued operations are as follows:

	Year ended December 31,		
	2007	2006	2005
Revenues	$ -	$ -	$ 2,954
Cost of revenues	-	-	2,171
Operating expenses	-	752	3,157
Operating loss	-	(752)	(2,374)
Gain derived from sale of the discontinued operations	237	2,437	779
Net income (loss)	$ 237	$ 1,685	$ (1,595)

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NOTE 1:- GENERAL (Cont.)

	Year ended December 31,		
	2007	**2006**	**2005**
Cash flows from operating activities			
Gain (loss) from discontinued operations	$ 237	$ 1,685	$ (1,595)
Depreciation and amortization of equipment and intangibles	-	-	107
Capital gain	-	(2,052)	(779)
Adjustments due to changes in working capital	(237)	(79)	620
Net cash flows used in operating activities	$ -	$ (446)	$ (1,647)
Cash flows from investing activities			
Communication sales costs	$ -	$ (221)	$ -
Purchase of property and equipment	-	-	(27)
Payment on account of sale of Communication Segment	-	-	(1,060)
Investment in Company	-	-	-
Net cash flows used in investing activities	$ -	$ (221)	$ (1,087)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements are prepared according to United States generally accepted accounting principles (U.S. GAAP).

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

A substantial portion of the Company s revenues is generated in U.S. dollar (dollars). In addition, most of the Company s costs are incurred in dollars. Company s management believes that the dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional and reporting currency of the Company is the dollar.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with Statement 52 of the Financial Accounting Standards Board (FASB) Foreign Currency Translation . All transactions gains and losses from the remeasurement of monetary balance sheet items are reflected in the statement of operations as financial income or expenses as appropriate.

The financial statements of Odem, a subsidiary, whose functional currency as of December 31, 2004, was other than dollar have been translated into dollars, but on April 1, 2005, due to significant changes in circumstances initiated by management, like transition of Odem s majority of sales, expenses and budget from New Israeli Shekels (NIS) to dollars, indicate a functional currency change. Since the functional currency changed from a foreign currency to the reporting currency, dollars, as of March 31, 2005, the translation adjustments for non-monetary assets prior to the change, became the accounting basis for the periods starting April 1, 2005.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances including profits from intercompany sales not yet realized outside the Company have been eliminated upon consolidation.

d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash originally purchased with maturities of less than three months.

e. Inventories:

Inventory write-offs are provided to cover risks arising from slow-moving items or technological obsolescence. As of December 31, 2007 and 2006, inventory is presented net of $358 and $100, respectively, for technological obsolescence and slow moving items (see also Note 4).

Inventories are valued at the lower of cost or market value. Cost is determined as follows:

Raw and packaging materials - moving average cost method.

Products in progress and finished products - moving average cost method.

f. Grants and royalty-bearing grants:

Grants and royalty-bearing grants from the Chief Scientist of the Ministry of Industry and Trade in Israel for funding certain approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the related costs incurred, and are presented as a deduction of research and development costs.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

During 2005, the Company received a royalty-bearing grant from the Chief Scientist of the Ministry of Industry and Trade in Israel, in the amount of $296, for its participation in the discontinued operations. There were no grants in 2007 and 2006.

g. Investment in an affiliate:

An affiliate is a company in which the Company is able to exercise significant influence, but that is not a subsidiary and is accounted for by the equity method, net of write-down for decrease in fair value which is not of a temporary nature. The Company s investment in Surf has been included as an affiliate until September 30, 2005. In June 2006, following an investment round, the Company holding in Surf decreased to 7.8% of Surf s issued and outstanding shares. As a result, the Company ceased to have the ability to exercise significant influence over Surf and, accordingly, the adjusted carrying amount of the investment is accounted for based on the cost accounting method (see Note 5).

The Company s investment in this company is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment may not be recoverable, in accordance with Accounting Principle Board Opinion 18 The Equity Method of Accounting for Investments in Common Stock (APB 18). During 2005, an impairment of $1,385 has been recorded in equity in losses of an affiliate in the statement of operations.

h. Investment in other companies:

Investments in public companies with restrictions of less than one year are classified as available-for-sale under FAS 115 (Readily Determined Sales Price Currently Available on a Security Exchange), and are adjusted to their fair market value with unrealized gains and losses recorded as a component of accumulated other comprehensive income (loss).

Investment in QMX and NWB presented, commencing December 31, 2007 at the sales price on the applicable Security Exchange, respectively to FAS 115 (See note 1d).

Management evaluates investments in other companies for evidence of other than temporary declines in value. Accordingly, during 2007 and 2006, an impairment loss, due to other than temporary decline, of $5,588 and $39 has been recorded, accordingly and presented in other income (loss), net in the consolidated statements of operations. During 2005, no impairment losses have been identified.

i. Property, plant and equipment:

Property, plant and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated by using the straight line method over the estimated useful lives of the assets, at the following annual rates:

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

	%	
Computers and software	20 - 33	(mainly 33%)
Office furniture and equipment	6 - 15	(mainly 10%)
Leasehold improvements	10	(over the shorter of the period of the lease or the life of the assets)
Vehicles	15	
Plant	4	

j. Impairment of long-lived assets:

The Company s long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standard 144 Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144) whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. During 2007, 2006 and 2005, no impairment losses have been identified.

k. Goodwill:

Goodwill represents excess of the costs over the net assets of businesses acquired. Under SFAS 142 goodwill is not amortized but instead is tested for impairment at least annually or between annual tests in certain circumstances, and written-down when impaired. Goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. The reporting units of the Company for purposes of the impairment test are: the Company s Mobile and RFID operating segments, Summit and Odem which comprise the Supply Chain segment, as these are the components of the business for which discrete financial information is available and segment management regularly reviews the operating results of those components. Fair value is determined using income and market approaches. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates, weighted average cost of capital and estimates of market multiples for each of the reportable units. During 2007, 2006 and 2005, no impairment losses have been identified.

l. Research and development costs:

Statement of Financial Accounting Standards 86 Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed, (SFAS 86) requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company s product development process, technological feasibility is established upon completion of a working model. Research and development costs incurred in the process of developing product improvements or new products, are generally charged to expenses as incurred, net of participation of the Office of the Chief Scientist of the Israeli Ministry of Industry and Trade. Costs incurred by the Company between completion of the working model and the point at which the product is ready for general releases are insignificant.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

m. Severance pay:

The Company s liability for severance pay for Israeli resident employees is calculated pursuant to the Israeli severance pay law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. Employees are entitled to one month s salary for each year of employment or a portion thereof. The Company s liability for its Israeli resident employees is covered by insurance policies designed solely for distributing severance pay. The value of these policies is recorded as an asset in the Company s balance sheet.

The insurance policies include profits accumulated up to the balance sheet date. The insurance policies may be withdrawn only upon complying with the Israeli severance pay law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies and includes profits.

Severance expenses for 2007, 2006 and 2005 amounted to $275, $298 and $256, respectively.

n. Revenue recognition:

The Company sells its products through direct sales, distributors and resellers channels.

The Company derives its revenues from the sale of products, license fees for its products, commissions, support and services.

Revenues from product sales are recognized in accordance with Staff Accounting Bulletin 104 Revenue Recognition in Financial Statements (SAB 104) when delivery has occurred, persuasive evidence of an arrangement exists, the vendor s fee is fixed or determinable, no further obligation exists, and collectibility is reasonably assured.

Most of the Company s revenues are generates from sale of its products directly to end-users and indirectly, mostly through independent distributors. Other than pricing terms which may differ due to the volume of purchases between distributors and end-users, there are no material differences in the terms and arrangements involving direct and indirect customers. The majority of the Company s products sold through agreements with independent distributors are non-exchangeable, non refundable, non-returnable without any rights of price protection or stock rotation. Accordingly, the Company considers the distributors as end-users.

Revenue from license fees is recognized in accordance with Statement of Position (SOP) 97-2 Software Revenue Recognition , when persuasive evidence of an agreement exists, delivery has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable, and collectibility is probable. The Company generally does not grant a right of return to its customers. When a right of return exists, the Company defers revenue until the right of return expires, at which time revenue is recognized provided that all other revenue recognition criteria have been met.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from maintenance and support are recognized ratably over the period of the support contract. The fair value of the support is determined based on the price charged when it is sold separately or renewed.

With regard to software arrangements involving multiple elements such as software product and maintenance and support, the Company has adopted Statement of Position No. 98-9, Modification of SOP No. 97-2, Software Revenue Recognition with Respect to Certain Transactions (SOP No. 98-9). According to SOP No. 98-9, revenues should be allocated to the different elements in the arrangement under the residual method when Vendor Specific Objective Evidence (VSOE) of fair value exists for all undelivered elements and no VSOE exists for the delivered elements. Under the residual method, at the outset of the arrangement with the customer, the Company defers revenue for the fair value of its undelivered elements (maintenance and support) and recognizes revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (software product) when the basic criteria in SOP No. 97-2 have been met. Any discount in the arrangement is allocated to the delivered element. Maintenance and support revenue is deferred and recognized on a straight-line basis over the term of the maintenance and support agreement. The VSOE of fair value of the undelivered elements (maintenance and support) is determined based on the price charged for the undelivered element when sold separately or for new arrangements, based upon the price that management will determine to charge.

o. Warranty:

BOScom provides a warranty of between 3 to 36 months at no extra charge, whereby defective hardware covered by the warranty should be sent back to the company. The Company estimates the costs that may be incurred under its warranty and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect the Company s warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

During 2007 and 2006, the Company s Provision for warranty was $20 and $73, respectively.

p. Income taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No 109, Accounting for Income Taxes . This Statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company has provided valuation allowances, in respect of deferred tax assets resulting from tax loss carryforward and other reserves and allowances due to its history of operating losses and current uncertainty concerning its ability to realize these deferred tax assets in the future.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes An interpretation of FASB Statement No. 109.

The Interpretation clarifies the accounting for uncertainties in income taxes recognized in an enterprise s financial statements and prescribes a recognition threshold and measurement attributes of income tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain tax position taken or expected to be taken on an income tax return must be recognized in the financial statements at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized in the financial statements unless it is more likely than not of being sustained. The Company adopted the provisions of FIN 48 as of January 1, 2007. The impact of adopting FIN 48 was insignificant to the Company s consolidated financial statements.

q. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, trade receivables, other accounts receivable and marketable securities.

The trade receivables of the Company are derived from sales to customers located primarily in Israel, South America, North America and Europe. The Company generally does not require collateral; however, in certain circumstances, the Company may require letters of credit, other collateral, additional guarantees or advanced payments. An allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection.

The Company has no off-balance-sheet concentrations of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

r. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share are calculated based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings (loss) per share is calculated based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year, in accordance with SFAS 128, Earnings Per Share .

The total number of shares related to the outstanding options and warrants excluded from the calculations of diluted net earnings (loss) per share, since they would have an anti-dilutive effect, were 3,305,333, 1,386,424 and 1,506,803 for the years ended December 31, 2007, 2006 and 2005, respectively.

s. Accounting for share-based compensation:

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards 123 (revised 2004), Share-Based Payment (SFAS 123(R)) which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors. SFAS 123(R) supersedes Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees (APB 25), for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin 107 (SAB 107) relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

SFAS 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company s consolidated statement of operations. Prior to the adoption of SFAS 123(R), the Company accounted for equity-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards 123, Accounting for Share-based Compensation (SFAS 123).

The Company adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the Accounting Standard starting from January 1, 2006, the first day of the Company s fiscal year 2006. Under that transition method, compensation cost recognized in the year ended December 31, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

As a result of adopting SFAS 123(R) on January 1, 2006, the Company s income before income taxes for the year ended December 31, 2006 was $370, lower than if it had continued to account for stock-based compensation under APB 25. Basic and diluted net earnings per share for the year ended December 31, 2006, are $0.06 and $0.05, respectively, lower than if the Company had continued to account for share-based compensation under APB 25.

Prior to January 1, 2006, the Company applied the intrinsic value method of accounting for stock options as prescribed by APB 25, whereby compensation expense is equal to the excess, if any, of the quoted market price of the stock over the exercise price on the date of grant of the award.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The pro-forma table below reflects the Company s stock based compensation expense, net loss and basic and diluted net loss per share for the year ended December 31, 2005 had the Company applied the fair value recognition provisions of SFAS 123, as follows:

	December 31, 2005
Net loss from continuing operations, as reported	$ (2,010)
Add: share-based compensation expenses related to employee stock options determined under intrinsic value method included in the reported net loss	62
Deduct: share-based compensation expense related to employee stock options determined under fair value method for all awards	(246)
Pro forma net loss from continuing operations	(2,194)
Pro forma net loss from discontinued operations	(1,595)
Pro forma net loss	$ (3,789)
Basic and diluted net loss per share from continuing operations, as reported	$ (0.36)
Basic and diluted net loss per share from discontinued operations, as reported	$ (0.28)
Basic and diluted net loss per share, as reported	$ (0.64)
Basic and diluted net loss per share, including the effect of share-based compensation expense	$ (0.67)

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The fair value for options granted in 2005 is amortized over their vesting period and estimated at the date of grant using the Black-Scholes-Merton options pricing model with the following weighted average assumptions:

	Year ended December 31, 2005
Risk free interest	4.00%
Dividend yields	0%
Volatility	120%
Average Expected life	3 years

Pro-forma compensation expense under SFAS 123, among other computational differences, does not consider potential pre-vesting forfeitures. Because of these differences, the pro-forma stock based compensation expense presented above for the prior year ended December 31, 2005 under SFAS 123 and the stock based compensation expense recognized during the years ended December 31, 2007 and 2006 under SFAS 123(R) are not directly comparable.

The Company recognizes compensation expenses for the value of its awards granted subsequent to January 1, 2006 based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The Company estimates the fair value of stock options granted using the Black-Scholes options pricing model. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements over the most recent periods ending on the date of grant, equal to the expected option term. The expected option term represents the average of the options contractual life and the vesting period in accordance with SAB 107 guidance. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value for options granted in 2007 and 2006 is estimated on the date of grant using a Black-Scholes options pricing model with the following weighted average assumptions:

	2007	2006
Risk free interest	4.62%	4.91%
Dividend yields	0%	0%
Volatility	58%	78%
Expected option term	5.68 years	3.44 years
Forfeiture rate	15%	0%

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

During 2007 and 2006, the Company recognized stock-based compensation expense related to employee stock options in the amount of $516 and $727 respectively as follows:

	Year ended December 31,	
	2007	**2006**
Selling and marketing	$ 296	$ 152
General and administrative	220	575
Total Stock-based compensation expense	$ 516	$ 727

During the year ended December 31 2005, the Company recognized general and administrative, stock-based compensation expense in the amount of $112.

The Company applies SFAS 123 Accounting for stock Based Compensation (SFAS 123) and EITF 96-18, Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction With, Selling, Goods or Services , with respect to warrants issued to non-employees. SFAS 123 requires the use of option valuation models to measure the fair value of the warrants at the date of grant.

t. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables, other accounts receivable and trade payables approximate their fair value due to the short-term maturities of such instruments. The fair value for marketable securities is based on quoted market prices. The fair value of investments in other companies is based on independent third-party evaluations.

u. Impact of recently issued accounting pronouncements:

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157) which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements and, accordingly, does not require any new fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis, and should be applied prospectively. The adoption of the provisions of SFAS 157 related to financial assets and liabilities and other assets and liabilities that are carried at fair value on a recurring basis is not anticipated to materially impact the Company s consolidated financial position and results of operations. Subsequently, the FASB provided for a one-year deferral of the provisions of SFAS 157 for non-financial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements on a non-recurring basis.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company is currently evaluating the impact of adopting the provisions of SFAS 157 for non-financial assets and liabilities that are recognized or disclosed on a non-recurring basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). Under this Standard, the Company may elect to report financial instruments and certain other items at fair value on a contract-by-contract basis with changes in value reported in earnings. This election is irrevocable. SFAS 159 provides an opportunity to mitigate volatility in reported earnings that is caused by measuring hedged assets and liabilities that were previously required to use a different accounting method than the related hedging contracts when the complex provisions of SFAS 133 hedge accounting are not met. SFAS 159 is effective for years beginning after November 15, 2007. There is no impact of adopting SFAS 159 on its financial position, cash flows, and results of operations of the Company.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (Revised 2007) (SFAS 141R), Business Combinations. SFAS 141R will change the accounting for business combinations. Under SFAS 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS 141R will change the accounting treatment and disclosure for certain specific items in a business combination. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R will have an impact on accounting for future business combinations once adopted and not on prior acquisitions. The Company is currently evaluating the impact of adopting the provisions of SFAS 141R.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This standard is effective for fiscal years beginning after December 15, 2008 and should be applied prospectively. However, the presentation and disclosure requirements of the statement shall be applied retrospectively for all periods presented. The adoption of the provisions of Statement No. 160 is not anticipated to materially impact the Company s consolidated financial position and results of operations. The Company is currently evaluating the impact of adopting the provisions of SFAS 160.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In December 2007, the U.S. Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 110 (SAB No. 110) to amend the SEC s views discussed in Staff Accounting Bulletin 107 (SAB No. 107) regarding the use of the simplified method in developing an estimate of expected life of share options in accordance with SFAS No. 123(R). SAB No. 110 is effective for the company beginning in the first quarter of fiscal year 2008. The Company expects to continue using the simplified method. As a result, the Company does not expect the adoption of SAB No. 110 will have a significant impact on its consolidated financial statements.

NOTE 3:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2007	2006
Government authorities Income tax advances and V.A.T	$ 363	$ 279
Advances to suppliers	405	296
Prepaid expenses	129	201
Other	48	82
	$ 945	$ 858

NOTE 4:- INVENTORIES

Raw materials (including packaging materials and Products in progress)	$ 260	$ 120
Finished products	8,061	3,897
	$ 8,321	$ 4,017

The inventories are presented net of write-off for technological obsolescence and slow moving items of $358 and $100 as of December 31, 2007 and 2006, respectively.

NOTE 5:- INVESTMENT IN OTHER COMPANIES

a. Investment in Surf Communication Systems Ltd.:

U.S. dollars in thousands, except share and per share data

NOTE 5:- INVESTMENT IN OTHER COMPANIES (Cont.)

In September 2005, Surf entered into a private placement that is considered an event of change in circumstances having a significant adverse effect on the fair value of the investment. Therefore, the Company has evaluated its investment in Surf and determined that it amounts to $722 as of December 31, 2005 based on management s analysis (supported by an independent third-party valuation). As a result, the Company has recorded an impairment of $1,385, which has been included in the equity in losses of an affiliate in the statement of operations for the year December 31, 2005.

In June 2006, as part of the investment round, the Company invested $300 in Surf, following which, the Company holds 7.8% of Surf s issued and outstanding shares. As a result, the Company ceased to have the ability to exercise significant influence over Surf and, accordingly, the adjusted carrying amount of the investment of $722 is accounted for based on the cost accounting method, which resulted in impairment of $39. As of December 31, 2007 the Company holds 6.94% of Surf s issued and outstanding shares.

Summarized combined financial information of Surf for the years in which the investment was accounted using the equity method was as follows:

	Year ended December 31, 2005
Revenues	$ 2,055
Cost of sales	$ 660
Operating expenses from continuing operations	$ 3,694
Net loss	$ 2,334

U.S. dollars in thousands, except share and per share data

NOTE 5:- INVESTMENT IN OTHER COMPANIES (Cont.)

b. The Company s investments in companies comprise of:

	December 31,	
	2007	2006
Surf Communication Systems Ltd.	$ 983	$ 983
Qualmax Inc. (1)	819	5,619
New World Brands Inc. (1)	692	1,480
	$ 2,494	$ 8,082

(1) As of December 31, 2007 the investment in the companies was changed from cost method under APB18 to available for sale under FAS115 and presented in fair value (See Note 1d and Note 2h).

NOTE 6:- PROPERTY, PLANT AND EQUIPMENT

	December 31,	
	2007	2006
Cost:		
Computers and software	$ 1,942	$ 1,697
Office furniture and equipment	562	458
Leasehold improvements and plant	1,313	1,116
Vehicles	60	89
	3,877	3,360
Accumulated depreciation:		
Computers and software	1,794	1,569
Office furniture and equipment	431	301
Leasehold improvements and plant	928	906
Vehicles	5	64
	3,158	2,840

Depreciated cost	$ 719	$ 520

Depreciation expenses amounted to $123, $171 and $317 for the years ended December 31, 2007, 2006 and 2005, respectively.

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NOTE 7:- OTHER INTANGIBLE ASSETS

	December 31, 2007	December 31, 2006
Cost:		
Backlog	$ 55	$ -
Non-competing rights	40	-
Technology	226	-
Customer list	2,177	2,010
	2,498	2,010
Accumulated amortization:		
Backlog	55	-
Non-competing rights	1	-
Technology	178	-
Customer list	586	381
	820	381
Amortized cost	$ 1,678	$ 1,629

Amortization expenses amounted to $439, $207 and $143 for the years ended December 31, 2007, 2006 and 2005, respectively.

Estimated amortization expenses for the years ended:

	December 31,
2008	246
2009	246
2010	238
2011	227
2012 and thereafter	721
	$ 1,678

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NOTE 8:- GOODWILL

Goodwill attributed to operating segments for the years ended December 31, 2007, 2006 and 2005 is as follows:

	Mobile and RFID	Supply chain solutions	Total
Balance as of January 1, 2006	$ -	$ 952	$ 952
Acquisition of Summit	-	1,909	1,909
Balance as of December 31, 2007	$ -	$ 2,861	$ 2,861

NOTE 9:- SHORT-TERM BANK LOANS

Loan currency	Weighted Interest Rate as of December 31, 2007	December 31,	
	%	2007	2006
NIS	6.61	$ 1,380	$ 2,931
Euro	6.55	590	-
$	6.55	2,415	-
		4,385	2,931
Add current maturities	7.75	643	18
		$ 5,028	$ 2,949

Odem has registered floating charges on its assets and certain fix charges on its assets in connection with the loans.

U.S. dollars in thousands, except share and per share data

NOTE 10:- ACCRUED EXPENSES AND OTHER LIABILITIES

	December 31,	
	2007	2006
Government of Israel royalties and V.A.T	$ 416	$ 319
Provision for warranty	20	73
Professional services	342	315
Short term deferred tax	75	60
Other	437	232
	$ 1,290	$ 999

NOTE 11:- LONG-TERM BANK LOANS

a. Classified by linkage terms and interest rates, the total amount of the loans is as follows:

Loan currency	Weighted Interest Rate as of December 31, 2007	December 31,	
	%	2007	2006
NIS	6.43	$ 1,479	$ 18
$	7.75	2,450	-
		3,929	18
Less current maturities	7.75	643	18
		$ 3,286	$ -

During 2007, the Company complied with the covenants set forth under the long-term loan agreement.

b. The loans mature in the following years subsequent to the balance sheet dates:

First year (current maturities)	643
2009	3,091
2010	174
2011	13
2012	8

c. Odem and Summit have registered floating charges on their assets and certain fix charges in connection with the loans.

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NOTE 12:- LONG-TERM CONVERTIBLE NOTE

On June 10, 2004, the Company entered into a Securities Purchase Agreement (the Purchase Agreement), with Laurus Master Fund Ltd. (the Investor), under which the Company issued to the Investor in a private placement (i) a Secured Convertible Term Note of a $2,000 principal amount, due June 10, 2007 (the Note); and (ii) a warrant to purchase 130,000 Ordinary shares at an exercise price of $4.04 per share (the Warrant). Under the terms of the agreement, several fees in the amount of $115 were paid to the Investor. These fees are presented as discount of the principal convertible loan. The Note is convertible into Ordinary shares at a price of $3.08 per share. The principal amount of the Note is repayable in monthly installments, commencing September 2004, in the initial amount of $20 eventually increasing to $74. The Note bears prime interest rate plus 3% which is subject to reduction in certain conditions. The Warrant is exercisable, in whole or in part, until June 10, 2011. Pursuant to its undertaking in the Registration Rights Agreement with the Investor the Company filed with the Securities and Exchange Commission a registration statement on Form F-3 covering the resale of Ordinary shares that are issuable upon conversion of the Note and/or exercise of the Warrants, and/or issuable in payment of principal and interest on the Note. The Registration Rights Agreement provided that any delay in registration and/or effectiveness of the underlying shares of the transaction, or failure to maintain their effectiveness, will result in penalties to be paid in cash, as liquidated damages. The registration statement became effective on March 11, 2005. Due to the delay in the effectiveness of the registration of the shares, the Company paid the Investor liquidated damages of $92.

The Note conversion price is subject to proportional adjustment in the event of stock splits, combinations, subdivisions of the Ordinary shares or if dividend is paid in Ordinary shares. In addition, if the Company issues stock in certain types of transactions at a price lower than the initial conversion price, then the conversion price will be adjusted to a lower price based on a weighted average formula.

The fair value of the Warrants was calculated using the Black-Scholes options pricing model with the following assumptions: a risk-free interest rate of 3.34%, a dividend yield of 0%, a volatility of the expected market price of the Company s Ordinary shares of 100% and a weighted-average contractual life of 7 year. The fair value of the Warrants in the amount of $99 is presented as a component in shareholders equity. Since the effective conversion price was greater than the share price at the commitment date, no beneficial conversion feature exists.

In March 2005, the Investor elected to convert $308 of the Note principal into 100,000 Ordinary shares of the Company. Due to the private placement agreement secured by the Company in June 2005, the conversion price was adjusted to $2.94 per share, and in July 2005, the Investor completed the conversion of the balance of the Note principal, which had not been previously converted or repaid, and the accrued interest into an additional 540,293 Ordinary shares for approximately $1,580.

NOTE 12:- LONG-TERM CONVERTIBLE NOTE (Cont.)

In September 2005, the Company entered into a Second Securities Purchase Agreement (the Second Purchase Agreement) with the Investor, under which the Company issued to the Investor in a private placement (i) a Secured Convertible Term Note of a $1,500 principal amount, due September 2008 (the Note), and (ii) a warrant to purchase 73,052 ordinary shares at an exercise price of $4.04 per share (the Warrant). According to the Second Agreement, several fees in the total amount of $116 were paid to the Investor. These fees are presented as a discount of the principal convertible loan. The Note is convertible into Ordinary shares at a price of $3.08 per share. The principal amount of the Note is repayable in monthly installments, commencing as of January 2006, in the initial amount of $15 eventually increasing to $55. The Note bears prime interest rate plus 1.5% which is subject to reduction under certain conditions. The Warrant is exercisable, in whole or in part, until September 29, 2012. Pursuant to its undertaking in the Registration Rights agreement with the Investor, the Company filed with the Securities and Exchange Commission a registration statement on Form F-3 covering the resale of Ordinary shares that is issuable upon conversion of the Note and/or exercise of the Warrants, and/or issuable in payment of principal and interest on the Note. The Registration Rights agreement provided that any delay in registration and/or effectiveness of the underlying shares of the transaction, or failure to maintain their effectiveness, will result in penalties to be paid in cash, as liquidated damages. The registration statement became effective on February 8, 2006.

The Note conversion price is subject to proportional adjustment in the event of stock splits, combinations, subdivisions of the Ordinary shares or if dividend is paid on the Ordinary shares in Ordinary shares. In addition, if BOS issues stock in certain types of transactions at a price lower than the initial conversion price, then the conversion price will be adjusted to a lower price based on a weighted average formula.

The fair value of the Warrants was calculated using the Black-Scholes options pricing model with the following assumptions: a risk-free interest rate of 4.08%, a dividend yield of 0%, a volatility of the expected market price of the Company s Ordinary shares of 100% and a weighted-average contractual life of seven years. The fair value of the Warrants in the amount of $144 is offset against the note, amortized over the period of the note and presented as a component in shareholders equity.

On August 17, 2006 the Company entered into a Third Securities Purchase Agreement (the Third Agreement) with the Investor under which the Company issued to the Investor in a private placement (i) a third Convertible Term Note of a $1,500 principal amount, due August 2009 (the Note), and (ii) a warrant to purchase 73,052 Ordinary shares at an exercise price of $4.04 per share (the Warrant). The Note is convertible into Ordinary shares at a price of $3.08 per share for the first 500,000 and $4.08 for any additional amount payable thereunder. The principal amount of the Note is repayable in monthly installments, commencing as of December 2006, in the initial amount of $15 eventually increasing to $55. The Note bears prime interest rate plus 1.5% which is subject to reduction under certain conditions. The Warrant is exercisable, in whole or in part, until August 16, 2013 at an exercise price of $4.04 for the first 24,351 Ordinary shares acquirable thereunder, and of $5.30 per share for the additional 48,701 acquirable thereunder. Pursuant to its undertaking in the Registration Rights agreement with the Investor, the Company filed with the Securities and Exchange Commission a registration statement on Form F-3 covering the resale of Ordinary shares that is issuable upon conversion of the Note and/or exercise of the Warrants, and/or issuable in payment of principal and interest on the Note.

NOTE 12:- LONG-TERM CONVERTIBLE NOTE (Cont.)

The Registration Rights agreement provided that any delay in registration and/or effectiveness of the underlying shares of the transaction, or failure to maintain their effectiveness, will result in penalties to be paid in cash, as liquidated damages. The registration statement became effective on December 5, 2006.

The fair value of the Warrants was calculated using the Black-Scholes options pricing model with the following assumptions: a risk-free interest rate of 4.83%, a dividend yield of 0%, a volatility of the expected market price of the Company s Ordinary shares of 80% and a weighted-average contractual life of seven years. The fair value of the Warrants in the amount of $131 is offset against the note, amortized over the period of the note and presented as a component in shareholders equity.

On June 21, 2007, the Company entered into an agreement with the Investor, pursuant to which the Investor converted the entire outstanding principal amount for approximately $2,223 into 878,670 Ordinary Shares of the Company at a conversion price of $2.53. As a result of reducing the conversion price which resulted in the Company recorded expenses upon conversion of $611 in year 2007.

NOTE 13:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Commitments:

1. Royalty commitments:

a) Under the Company s research and development agreements with the Office of the Chief Scientist (OCS) and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3.5% of sales of products developed with funds provided by the OCS, up to an amount equal to 100% of the research and development grants (dollar-linked) received from the OCS. The obligation to pay these royalties is contingent upon actual sales of the products. Royalties payable with respect to grants received under programs approved by the OCS after January 1, 1999, are subject to interest on the U.S. dollar-linked value of the total grants received at the annual rate of LIBOR applicable to U.S. dollar deposits at the time the grants are received.

As of December 31, 2007, the Company has an outstanding contingent obligation to pay royalties, including interest, in the amount of approximately $3,462, in respect of these grants.

b) The Israeli Government, through the Overseas Marketing Fund, awarded the Company grants for participation in expenses for overseas marketing. The Company is committed to pay royalties to the Fund for Encouragement of Marketing Activities at the rate of 3% of the increase in export sales, up to the amount of the grants received by the Company linked to the dollar and bearing interest.

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NOTE 13:- COMMITMENTS AND CONTINGENT LIABILITIES

As of December 31, 2007, the Company has an outstanding contingent obligation to pay royalties including interest of $83 with respect to these grants.

2. Other commitments:

The facilities of the Company are rented under operating lease agreements that expire on various dates ending in 2009. Minimum future rental payments for 2008, 2009, 2010, 2011, 2012, are $163, $140, $55, $48 and $4 respectively.

The Company s motor vehicles are rented under various cancelable operating lease agreements. The lease agreements for the motor vehicles expire on various dates ending in 2009. The maximum breach of contract fees can amount to $74.

Lease payments for the facilities occupied by the Company and the Company s motor vehicles in 2007, 2006 and 2005 amounted to $407, $343 and $408, respectively.

b. In April 2006, BOSâNOVA EURL, a French company and former distributor of the Company, served the Company with a claim filed with the French Trade Tribunal alleging breach of exclusive distributor rights in France and asserting ownership to certain intellectual property rights in the Company s products. The plaintiff seeks an amount of approximately 3.3 million Euros and additional remedies. This claim follows a previous motion for temporary injunctive relief that was filed against the Company s new French distributor, said motion ultimately denied by French Trade Tribunal. On September 18, 2007, the French Trade Tribunal rejected the Company s assertion that jurisdiction is with the Israeli courts, and the Company has appealed this decision. The Company assesses the prospect of the claimant to prevail and recover a significant amount is remote. The Company s financial statements include a provision in this respect.

In January 2008, a former employee of the Company, filed a claim against the Company in the Labor Court in Tel Aviv, for severance payments in the amount of NIS 306 (approximately $80). The plaintiff also demands compensation for delay in payment of the said severance pay of NIS 207 (approximately $54). The Company is yet to file its statement of defense. The Company s financial statements include a provision in this respect.

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NOTE 14:- SHAREHOLDERS EQUITY

a. Private placement:

In April 2007, the Company completed a right offering in which it issued 1,739,398 ordinary shares at a share price of $2.5. The gross proceeds amounted to $4.4 million and the issuance costs amounted to $400.

On June 21, 2007 Laurus Master Fund Ltd. converted the entire outstanding principal amount under its Convertible Notes of approximately $2,223 into 878,670 Ordinary Shares of BOS. (See also Note 12).

On June 26, 2007 the Company entered into a definitive private placement agreement with a European private investor for the issuance of 226,415 Ordinary Shares at a price per share of $2.65. Issuance costs amounted to $36.

On July 1, 2007 the Company issued 5,594 shares of the Company as part of the consideration paid for the purchasing the assets of Cyms Ltd. (See Note 1b).

On October 1, 2007 the Company issued 8,000 shares of the Company as part of the consideration paid for the purchasing of OptimizeIT assets (See Note 1b).

On November 21, 2007 the Company issued 360,000 shares of the Company as part of the consideration paid for the purchasing of Summit shares (See Note 1b).

On December 11, 2007 the Company entered into a Share Purchase Agreement with Catalyst Fund L.P. (Catalyst) and three subsidiaries of D.S. Apex Holdings Ltd. (Apex), under which the Company issued on December 31, 2007 833,560 Ordinary Shares at a price of $2.40 per share (reflecting an aggregate investment of approximately $2 million), and 541,814 warrants at exercise price of $2.76, exercisable for four years from their date of issuance. The Company has paid 3% placement fees in cash to APEX and 6% in 25,007 Ordinary Shares to Catalyst. The Company also entered into a Registration Rights Agreement pursuant to which the Company shall prepare and file with the Securities and Exchange Commission a registration statement covering the resale of the Ordinary Shares issued to the investors.

The Company s outstanding warrants to shareholders as of December 31, 2007 are as follows:

Range of exercise price	Outstanding and exercisable warrants as of December 31, 2007	Weighted average exercise Price of outstanding warrants	Weighted average remaining contractual life (years)	Weighted average exercise price of warrants exercisable
$ 2.76	541,814	$ 2.76	4.00	$ 2.76
$ 3.03	572,219	$ 3.03	0.50	$ 3.03
	1,114,033	$ 2.90	2.20	$ 2.90

U.S. dollars in thousands, except share and per share data

NOTE 14:- SHAREHOLDERS EQUITY (Cont.)

b. Stock option plans:

In May 2003, the Company s shareholders approved the adoption of the 2003 Stock Option Plan (the Plan), pursuant to which 625,000 Ordinary Shares are reserved for purchase by employees, directors, consultants and service providers of the Company. In June 2005, the Company s shareholders approved an increase of the number of Ordinary shares reserved for issuance under the Plan, to 1,000,000. In May 2006, the Company s shareholders approved an increase of the number of Ordinary Shares reserved for issuance under Plan, to 1,500,000. In August 2007, the Company s shareholders approved an increase of the number of Ordinary shares reserved for issuance under the Plan, to 2,600,000. Any option which is canceled or forfeited before expiration will become available for future grants.

As of December 31, 2007 an aggregate of 869,171 of these options are still available for future grants. Each option granted under the Plans expires between 3-10 years from the date of the grant. The options vest gradually over a period of up to four years.

During 1994, 1995, 1999, 2000, 2001, the Company s Board adopted stock option plans (the Plans) pursuant to which 656,250 options for the purchase of the Company s Ordinary Shares may be granted to officers, directors, consultants and employees of the Company. The Board has resolved that no further grants shall be made from these Plans.

A summary of the Company s employees and director s stock option activity and related information for the year ended December 31, 2007, is as follows:

	Number of options	Weighted-average exercise price	Weighted-average remaining contractual term (in years)	Aggregate intrinsic value
Options outstanding at January 1, 2007	822,660	$ 3.36	5.01	$ 0.69
Changes during the year:				
Granted	1,153,100	$ 2.47		
Exercised	(19,999)	$ 2.39		
Forfeited or cancelled	(135,565)	$ 7.98		
Options outstanding at December 31, 2007	1,820,196	$ 2.47	6.62	$ 0.15
Vested and expected to vest	1,619,554	$ 2.47	6.62	$ 0.15
Exercisable at December 31, 2007	334,665	$ 2.24	3.87	

The weighted-average grant-date fair value of options granted during the year ended December 31, 2007 and 2006 was $1.43 and $1.45, respectively. The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the fair market value of the Company Ordinary Shares on December 31, 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2007.

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NOTE 14:- SHAREHOLDERS EQUITY (Cont.)

Total aggregate intrinsic value of options exercised for the year ended December 31, 2007 and 2006 was $0.70 and $0.00 respectively. The aggregated intrinsic value of options outstanding for the year ended December 31, 2007 and 2006 was $0.15 and $0.69, respectively. As of December 31, 2007 there was $1,560 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company s stock option plans. That cost is expected to be recognized over a weighted-average period of 23 months.

As of December 31, 2007 there was $1,560 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted to employees and directors under the Company s Plans. That cost is expected to be recognized over a weighted-average period of 23 months.

Cash received from exercise of options for the years ended December 31, 2007, 2006 and 2005 were approximately $46, $135 and $50 respectively.

As part of the disposition of the communication segment and the PrintBOS product line, the Company extended the options contractual life of employees who became the buyers employees. As a result, the Company recorded an expense of $104 in 2005 which was offset from the capital gain derived from the sale of this segment and product line in 2005.

The options granted to employees outstanding as of December 31, 2007 have been separated into ranges of exercise prices, as follows:

exercise price	Options outstanding as of December 31, 2007	remaining contractual life (years)	Options exercisable as of December 31, 2007	Weighted average remaining contractual life (years)
$ 0	73,000	6.88	73,000	6.88
$ 1.84	30,000	0.67	30,000	0.67
$ 2.00	10,462	1.62	10,462	1.62
$ 2.28	7,500	2.50	5,000	2.50
$ 2.39	400,000	6.75	-	-
$ 2.48	7,500	2.87	5,000	2.87
$ 2.52	700,600	9.16	-	-
$ 2.57	22,500	4.61	-	-
$ 2.58	67,261	5.84	16,816	5.84
$ 2.63	7,500	3.14	2,500	3.14
$ 2.68	420,976	3.38	140,324	2.38
$ 2.70	15,000	3.39	5,000	3.39
$ 3.00	48,000	7.15	36,666	7.08
$ 6.80	8,197	0.87	8,197	0.87
$ 18.00	450	1.86	450	1.86
$ 28.00	1,250	2.4	1,250	2.4
	1,820,196	6.62	334,665	3.87

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NOTE 14:- SHAREHOLDERS EQUITY (Cont.)

c. Warrants issued to service providers:

The Company accounts for these options in accordance with the provisions of SFAS 123 and EITF 96-18. The fair value for these options was estimated at the date of grant using Black-Scholes options pricing model with the following assumptions for the years ended December 31, 2006 and 2005: risk-free interest rate of 4.9% and 1.5%, respectively, dividend yields of 0% and 0%, respectively, volatility of 77% and 70%, respectively, and an expected life of 4.2 years and 2.5 years, respectively. No warrants were granted to service provider during year 2007.

The compensation expenses that have been recorded in the consolidated financial statements regarding these warrants for the years ended December 31, 2007, 2006 and 2005 were $43, $116 and $348, respectively.

The Company s outstanding warrants to service providers as of December 31, 2007 are as follows:

Range of exercise price	Outstanding and exercisable warrants as of December 31, 2007	Warrants outstanding Weighted average exercise price	Weighted average exercise price of warrants exercisable	Weighted average remaining contractual life (years)
$ 2.3	10,000	$ 2.3	$ 2.3	3.00
$ 3.08	10,000	$ 3.08	$ 3.08	1.00
$ 4.00	75,000	$ 4.00	$ 4.00	1.00
$ 4.04	227,403	$ 4.04	$ 4.04	4.10
$ 5.30	48,701	$ 5.30	$ 5.3	5.63
	371,104	$ 4.12	$ 4.12	3.56

NOTE 15:- TAXES ON INCOME

a. Reduction in corporate tax rate:

In June 2004, an amendment to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004 was passed by the Knesset (Israeli parliament) and on July 25, 2005, another law was passed, the amendment to the Income Tax Ordinance (No. 147) 2005, according to which the corporate tax rate is to be progressively reduced to the following tax rates: 2004 - 35%, 2005 - 34%, 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26%, 2010 and thereafter - 25%.

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NOTE 15:- TAXES ON INCOME (Cont.)

c. Loss carryforward:

Domestic (Israel):

The Company and its Israeli subsidiary have accumulated losses for Israel income tax purposes as of December 31, 2007, in the amount of approximately $36,132. These losses may be carryforward (linked to the Israeli Consumer Price Index (CPI)) and offset against taxable income in the future for an indefinite period.

Foreign:

As of December 31, 2007, the U.S. subsidiaries had U.S. Federal and State net operating loss carryforward of approximately $8,100, which can be carried forward and offset against taxable income. Utilization of U.S. net operating losses may be subject to substantial annual limitations due to the change in ownership provisions of the Internal Revenue Code of 1986 and similar state law provisions. The annual limitations may result in the expiration of net operating losses before utilization.

d. Deferred income taxes:

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company s deferred tax liabilities and assets are as follows:

	December 31,	
	2007	2006
Assets in respect of:		
Property, plant and equipment	$ 21	$ 3
Allowances and provisions	517	296
Net operating loss carryforward	11,445	10,674
	11,983	10,973
Liabilities in respect of intangible assets	(441)	(422)
Net deferred tax assets before valuation allowance	11,542	10,551
Valuation allowance (1)	(11,922)	(10,936)
Net deferred tax liability	$ (380)	$ (385)

(1) The Company has provided valuation allowances for BOS and all its subsidiaries except for Odem, in respect of deferred tax assets resulting from tax loss carryforward and other reserves and allowances due to their history of operating losses and current uncertainty concerning their ability to realize these deferred tax assets in the future.

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NOTE 15:- TAXES ON INCOME (Cont.)

	December 31,	
	2007	2006
Presented in balance sheet:		
Current assets	$ 19	$ 14
Long-term assets	42	23
Current liabilities	(75)	(60)
Long-term liabilities	(366)	(362)
Net deferred tax liability	$ (380)	$ (385)

e. Taxes on income (tax benefit) are comprised as follows:

	Year ended December 31,		
	2007	2006	2005
Current	$ 80	$ 17	$ 259
Prior years	47	-	-
Deferred	(118)	(106)	(55)
	$ 9	$ (89)	$ 204
Domestic	$ 16	$ (106)	$ 74
Foreign	(7)	17	130
	$ 9	$ (89)	$ 204

f. Effective tax

Income (loss) before taxes on income from operating activities related to continuing operations	$ (8,624)	$ (1,682)	$ 167

Statutory tax rate	29%	31%	34%
Provision at statutory tax rate	(2,501)	(521)	57
Non-deductible expenses	290	21	219
Deferred taxes on losses reserves and allowances for which a valuation allowance was provided	2,220	411	(72)
Taxes on income (tax benefit)	$ 9	$ (89)	$ 204

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NOTE 15:- TAXES ON INCOME (Cont.)

g. Tax assessments:

BOS and BOScom have final assessments through 2002. Odem has final assessment through 2004.

k. The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. The impact of adopting FIN 48 was insignificant impact on the Company s consolidated financial statements.

In accordance with the Company s accounting policy, both before and after adoption of FIN 48, interest expense and potential penalties related to income taxes are included in the tax expense line of the Company s condensed consolidated statements of operations.

The Company and its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states in the U.S. and Israel jurisdiction. BOS, BOScom and Quasar may be subject to examination by the Israel tax authorities for fiscal years 2002 through 2007. Odem may be subjected to examination by the Israel tax authorities for fiscal years 2004 through 2007. Link USA (the U.S. subsidiary) may be subject to examination by the U.S. Internal Revenue Service (IRS) for fiscal years 1998 through 2007 can be carried forward and offset against taxable income for 15 to 20 years.

The Company believes that it has adequately provided for any reasonably foreseeable outcomes related to tax audits and settlement. The final tax outcome of the Company s tax audits could be different from that which is reflected in the Company s income tax provisions and accruals. Such differences could have a material effect on the Company s income tax provision and net loss in the period in which such determination is made.

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U.S. dollars in thousands, except share and per share data

NOTE 16:- SUPPLEMENTARY INFORMATION TO STATEMENTS OF OPERATIONS

a. Financial income (expenses), net:

	Year ended December 31,		
	2007	**2006**	**2005**
Financial income:			
Interest on bank deposits and marketable securities	$ 122	$ 73	$ 57
Other (mainly foreign currency translation income)	-	65	-
	122	138	57
Financial expenses:			
In respect of long-term bank loans and convertible note	(585)	(694)	(427)
Other (mainly foreign currency translation losses)	(6)	(70)	(78)
	(611)	(764)	(505)
	$ (469)	$ (626)	$ (448)

b. Earnings (loss) per share:

1. Numerator:

Numerator for basic and diluted net earnings (loss) per share:			
Loss from continuing operations	$ (8,633)	$ (1,593)	$ (2,010)
Income (loss) from discontinued operations	237	1,685	(1,595)
Net earnings (loss) available to Ordinary shareholders	$ (8,396)	$ 92	$ (3,605)

2. Denominator (in thousands):

Basic weighted average Ordinary shares outstanding (in thousands)	8,651	6,675	5,616

Diluted weighted average Ordinary Shares outstanding (in thousands)	11,783	6,793	5,616
Basic and diluted net loss per share from continuing operations	$ (1.00)	$ (0.24)	$ (0.36)
Basic and diluted net earnings (loss) per share from discontinued operations	$ 0.02	$ 0.25	$ (0.28)
Basic and diluted net earnings (loss) per share	$ (0.97)	$ 0.01	$ (0.64)

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NOTE 17:- SEGMENTS AND GEOGRAPHICAL INFORMATION

Commencing 2006 and subsequent to the disposal of the communication segment in 2006, the Company managed its business with two reportable segments, consisting of the Software Solutions segment and the Supply Chain Solutions segment. Commencing 2007 and subsequent to the acquisition of Summit, the Company manages its business with two reportable segments, consisting of the Mobile and RFID Solutions segment and Supply Chain Solutions segment. Amounts for fiscal years 2006 and 2005 have been recast to conform to the current management view.

The Company s management makes financial decisions and allocates resources, based on the information it receives from its internal management system. The Company allocates resources and assesses performance for each operating segment using information about revenues, gross profit and operating income (loss) before interest and taxes.

a. Revenues, gross profit and operating income (loss) for the operating segments for the years 2007, 2006 and 2005 were as follow:

	Mobile and RFID	Supply Chain Solutions	Not allocated	Consolidated
2007				
Revenues	$ 2,673	$ 21,101	$ -	$ 23,774
Gross profit	$ 1,436	$ 3,239	$ -	$ 4,675
Operating profit (loss)	$ (108)	$ (108)	$ (1,706)	$ (1,922)
Assets related to segment	$ 1,205	$ 27,002	$ 2,925	$ 31,132
2006				
Revenues	$ 2,344	$ 18,573	$ -	$ 20,917
Gross profit	$ 1,401	$ 3,316	$ -	$ 4,717
Operating loss	$ 126	$ 641	$ (1,823)	$ (1,056)
Assets related to segment	$ 243	$ 13,700	$ 10,586	$ 24,529
2005				
Revenues	$ 3,993	$ 20,186	$ (80)	$ 24,099
Gross profit	$ 2,442	$ 3,803	$ -	$ 6,245
Operating income (loss)	$ 607	$ 1,167	$ (1,514)	$ 260
Assets related to segment	$ 391	$ 11,535	$ 10,720	$ 22,646

U.S. dollars in thousands, except share and per share data

NOTE 17:- SEGMENTS AND GEOGRAPHICAL INFORMATION (Cont.)

b. The following presents total revenues and long-lived assets for the years 2007, 2006 and 2005 based on the location of customers:

	Year ended December 31,					
	2007		2006		2005	
	Total revenues	Long-lived assets *)	Total revenues	Long-lived assets *)	Total revenues	Long-lived assets *)
America	$ 5,420	$ 2,225	$ 2,848	$ -	$ 3,439	$ -
Far East	964	-	2,019	-	6,083	-
Europe	1,511	-	1,173	-	1,171	-
Israel and others	15,879	3,033	14,877	3,101	13,406	3,455
	$ 23,774	$ 5,258	$ 20,917	$ 3,101	$ 24,099	$ 3,455

Total revenues are attributed to geographical areas based on the location of customers in accordance with Statement of Financial Accounting 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131).

*) Long-lived assets comprise goodwill, intangible assets, property, plant and equipment.

c. Major customer s data as a percentage of total revenues:

	Year ended December 31,		
	2007	2006	2005
Customer A	4%	7%	11%
Customer B	21%	24%	16%

Major customer s trade receivable balances as of December 31, 2007 and 2006 are $1,417 and $2,388, respectively.

NOTE 18:- RELATED PARTIES

Service Agreement of Cukierman & Co.:

The Company s audit committee and Board approved the engagement of Cukierman & Co. Investment House Ltd., to provide non-exclusive investment-banking services and business development services to the Company, effective April 15, 2003. Cukierman & Co. is a company indirectly controlled by Mr. Edouard Cukierman. Since June 26, 2003, Mr. Cukierman serves as Chairman of the Company s Board, and he is also a co-manager of the Catalyst Fund, the Company s largest shareholder. For its services, Cukierman & Co. is paid a monthly sum of $10 plus VAT, in addition to a success fee of 4%-6% for a consummated private placement. According to its terms, the Company may terminate the agreement at any time, by giving one month prior written notice. The agreement provided that the success fees for securing M&A transactions will be 3.5% of the proceeds exchanged in such a transaction.

U.S. dollars in thousands, except share and per share data

NOTE 18:- RELATED PARTIES (Cont.)

The payments the Company paid and accrued according to the Service Agreement with Cukierman & Co are:

	Payments in Year ended December 31, 2007	Accrued liability as of December 31, 2007
Business development	$ 70	$ 50
Success fee in respect of issuance of convertible loan	120	-
Success fee in respect of issuance of investment in Summit	28*	143
Total	$ 218	$ 193

* Payment by 12,600 shares of the Company at a price of $2.28 per share (reflecting the Company share price at the grant date).

	Payments in Year ended December 31, 2006	Accrued liability as of December 31, 2006
Business development	$ 120	$ 11
Success fee in respect of issuance of convertible loan	75	2
	$ 195	$ 13

On May 18, 2006 the shareholders approved a grant to Mr. Edouard Cukierman of 21,666 Ordinary Shares (for no consideration), and 233,876 options to purchase Ordinary Shares of the Company, pursuant to the Company s 2003 Israeli Share Option Plan, at an exercise price of $2.68. The options exercise price was equal to the average closing price of the Company s shares on the Nasdaq Global Market on the 20 trading days preceding the shareholders meeting date at which the grant was approved (the Grant Date). The options vest in three equal parts on the first, second and third anniversary of the Grant Date, and expire from May 2010 through May 2012.

On November 7, 2007 the shareholders approved the Agreement with Edouard Cukierman, the Chairman of the Board, pursuant to which, Mr. Edouard Cukierman shall be granted options (the Options) to purchase up to 100,000 Ordinary Shares of the Company per each calendar year of service as the Company s Chairman of the Board of Directors (the Service) in the years 2007-2010 (pro-rated for any part of the Calendar year). The Options shall be in lieu of any compensation, fees or options otherwise payable by the Company to Cukierman as a director.

The Options shall vest on a quarterly basis. The exercise price of the Options is $2.385 which was equal to the weighted average of the closing prices of the Company s Ordinary Shares on the Nasdaq Global Market during the thirty-day period preceding the shareholders approval. Unexercised Options shall expire after five years from their respective grant date.

U.S. dollars in thousands, except share and per share data

NOTE 18:- RELATED PARTIES (Cont.)

Pursuant to the Agreement, if the Service is terminated by the Company for no Cause (as defined in the Agreement) then: (i) any unvested Options shall be immediately vested in full as of the date of the termination; (ii) the Company shall grant Cukierman such number of Options amounting, together with Options previously granted, to 400,000 Options, and such additional options shall be vested upon grant; and (iii) the Options shall be exercisable for a period of twenty four (24) months from termination.

If the Service is terminated by Cukierman in circumstances not involving Cause, his vested options shall be exercisable for six (6) months from the date of said termination.

On December 11, 2007 the Company entered into a Share Purchase Agreement under which the Company issued on December 31, 2007 833,560 Ordinary Shares at a price of $2.40 per share (reflecting an aggregate investment of approximately $2 million), and 541,814 warrants at exercise price of $2.76, exercisable for four years from their date of issuance.

The investors are Catalyst Fund L.P. (Catalyst) and three subsidiaries of D.S. Apex Holdings Ltd. (Apex). The Company paid 3% placement fees in cash to Apex and 6% in ordinary shares to Catalyst.

The payments the Company paid and accrued according to the Share Purchase Agreement are:

	Payments in Year ended December 31, 2007	Accrued liability as of December 31, 2007
Catalyst	$ 50	$ -
APEX	-	48

* Payment by 26,000 shares of the Company at a price of $1.90 per share (reflecting the Company share price at the grant date).

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NOTE 19:- SUBSEQUENT EVENT (UNAUDITED)

In January 2008, BOScom changed its name to Dimex Solutions Ltd. On January 14, 2008, Dimex Solutions incorporated a fully owned subsidiary named Dimex Hagalil Projects (2008) Ltd.

In March 2008, Dimex Solutions Ltd. purchased the assets and activities of Dimex Systems Ltd., an Israeli private company and Dimex Hagalil Projects (2008) Ltd. purchased assets and activities of Dimex Hagalil Ltd., subsidiary of Dimex Systems Ltd. (together called Dimex). Dimex is an integrator of AIDC (Automatic Identification and Data Collection) solutions based on RFID and Barcode technology. The consideration for acquiring the business operation of Dimex was NIS 17.6 million (approximately $4,800) and for the inventory, accounts receivable and fixed assets, the consideration was NIS 27 million (approximately $7,400).

The consideration is comprised of cash, payable over a 24-month period and 500,224 BOS Ordinary Shares (equal to approximately 4.4% of then outstanding shares of BOS). Part of the acquisition will be financed by bank debt.

The acquisition is treated using the purchase method of accounting in accordance with SFAS 141, Business Combinations .

On February 18, 2008 NWB and Qualmax, entered into an agreement and plan of merger, pursuant to which Qualmax will be merged with and into the NWB. Upon completion of the merger, which is subject to certain conditions, BOS holdings in Qualmax will be converted into holdings in NWB.