

GENERAL MILLS INC
Form 10-Q
December 19, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED November 25, 2007**
- 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: 001-01185

GENERAL MILLS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

41-0274440
(I.R.S. Employer
Identification No.)

Number One General Mills Boulevard
Minneapolis, MN

(Mail: P.O. Box 1113)
(Address of principal executive offices)

55426
(Mail: 55440)
(Zip Code)

(763) 764-7600

(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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer Accelerated filer Non-accelerated filer

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

Number of shares of Common Stock outstanding as of December 13, 2007: 336,763,642 (excluding 40,543,022 shares held in the treasury).

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General Mills, Inc.

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements.

GENERAL MILLS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited) (In Millions, Except per Share Data)

	Quarter Ended		Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006
Net sales	\$ 3,703.4	\$ 3,466.6	\$ 6,775.4	\$ 6,327.0
Cost of sales	2,372.2	2,187.0	4,288.0	3,983.7
Selling, general, and administrative expenses	641.3	605.5	1,272.9	1,180.3

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Restructuring, impairment, and other exit costs (income)	2.8	(1.1)	17.3	(3.0)
Operating profit	687.1	675.2	1,197.2	1,166.0
Interest expense, net	115.9	110.5	229.2	215.5
Earnings before income taxes and after-tax earnings from joint ventures	571.2	564.7	968.0	950.5
Income taxes	208.3	202.7	338.6	340.7
After-tax earnings from joint ventures	27.6	23.4	50.0	42.5
Net earnings	\$ 390.5	\$ 385.4	\$ 679.4	\$ 652.3
Earnings per share - basic	\$ 1.19	\$ 1.12	\$ 2.04	\$ 1.87
Earnings per share - diluted	\$ 1.14	\$ 1.08	\$ 1.95	\$ 1.81
Dividends per share	\$ 0.39	\$ 0.35	\$ 0.78	\$ 0.70

See accompanying notes to consolidated financial statements.

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GENERAL MILLS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In Millions)

	Nov. 25, 2007	May 27, 2007
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 530.1	\$ 417.1
Receivables	1,221.8	952.9
Inventories	1,567.2	1,173.4
Prepaid expenses and other current assets	449.5	443.1
Deferred income taxes	75.3	67.2
Total current assets	3,843.9	3,053.7
Land, buildings, and equipment	2,974.5	3,013.9

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Goodwill	6,752.4	6,835.4
Other intangible assets	3,764.3	3,694.0
Other assets	1,746.4	1,586.7
Total assets	\$ 19,081.5	\$ 18,183.7
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$ 786.1	\$ 777.9
Current portion of long-term debt	2,049.2	1,734.0
Notes payable	2,046.0	1,254.4
Other current liabilities	1,341.8	2,078.8
Total current liabilities	6,223.1	5,845.1
Long-term debt	3,599.1	3,217.7
Deferred income taxes	1,413.6	1,433.1
Other liabilities	1,923.9	1,229.9
Total liabilities	13,159.7	11,725.8
Minority interests	242.3	1,138.8
Stockholders' equity:		
Common stock, 502.3 shares issued, \$0.10 par value	50.2	50.2
Additional paid-in capital	6,173.0	5,841.3
Retained earnings	6,165.7	5,745.3
Common stock in treasury, at cost, shares of 166.3 and 161.7	(6,760.4)	(6,198.0)
Accumulated other comprehensive income (loss)	51.0	(119.7)
Total stockholders' equity	5,679.5	5,319.1
Total liabilities and equity	\$ 19,081.5	\$ 18,183.7

See accompanying notes to consolidated financial statements.

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GENERAL MILLS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

(Unaudited)
\$.10 Par Value Common Stock

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(One Billion Shares Authorized)
 Issued Treasury

In Millions, Except per Share Data	Shares	Par Amount	Additional Paid-in Capital	Treasury		Retained Earnings	Unearned Compensation	Accumulated Other Comprehensive Income (Loss)	Total
				Shares	Amount				
Balance as of May 28, 2006	502.3	\$ 50.2	\$ 5,736.6	(145.9)	\$ (5,163.0)	\$ 5,106.6	\$ (83.5)	\$ 125.4	\$ 5,772.3
Comprehensive income:									
Net earnings						1,143.9			1,143.9
Other comprehensive income, net of tax:									
Net change on hedge derivatives								22.3	22.3
Foreign currency translation								193.8	193.8
Minimum pension liability adjustment								(20.8)	(20.8)
Other comprehensive income								195.3	195.3
Total comprehensive income									1,339.2
Adoption of SFAS No. 123R			(83.5)				83.5		
Adoption of SFAS No. 158								(440.4)	(440.4)
Cash dividends declared (\$1.44 per share)						(505.2)			(505.2)
Stock compensation plans (includes income tax benefits of \$73.1)			164.6	9.5	339.4				504.0
Shares purchased				(25.3)	(1,385.1)				(1,385.1)
Unearned compensation related to restricted stock awards			(95.0)						(95.0)
Issuance of shares to settle conversion on zero coupon debentures, net of tax			(10.7)		10.7				
Earned compensation			129.3						129.3
Balance as of May 27, 2007	502.3	\$ 50.2	\$ 5,841.3	(161.7)	\$ (6,198.0)	\$ 5,745.3		\$ (119.7)	\$ 5,319.1
Comprehensive income:									
Net earnings						679.4			679.4
Other comprehensive income, net of tax:									
Net change on hedge derivatives								5.7	5.7
Foreign currency translation								150.3	150.3
Amortization of losses and prior service costs								14.7	14.7
Other comprehensive income								170.7	170.7
Total comprehensive income									850.1
Cash dividends declared (\$.78 per share)						(259.4)			(259.4)
Stock compensation plans (includes income tax benefits of \$13.0)			122.5	2.1	82.3				204.8
Shares purchased				(21.0)	(1,226.5)				(1,226.5)
Shares issued under forward purchase contract			168.2	14.3	581.8				750.0
Unearned compensation related to restricted stock awards			(103.4)						(103.4)
Adoption of FIN No.48			57.8			8.4			66.2
Capital appreciation paid to holders of Series B-1 limited membership interests in General Mills Cereals, LLC (GMC)						(8.0)			(8.0)
Earned compensation			86.6						86.6

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Balance as of November 25, 2007 502.3 \$ 50.2 \$ 6,173.0 (166.3) \$ (6,760.4) \$ 6,165.7 \$ 51.0 \$ 5,679.5

See accompanying notes to consolidated financial statements.

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GENERAL MILLS, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited) (In Millions)

	Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006
Cash Flows - Operating Activities		
Net earnings	\$ 679.4	\$ 652.3
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	235.6	209.3
After-tax earnings from joint ventures	(50.0)	(42.5)
Stock-based compensation	86.6	80.2
Deferred income taxes	(38.0)	11.9
Distributions of earnings from joint ventures	16.2	10.0
Pension, other postretirement, and postemployment benefit costs	(23.2)	(28.2)
Restructuring, impairment, and other exit costs (income)	13.4	(3.4)
Changes in current assets and liabilities	(472.6)	(359.9)
Other, net	(3.7)	35.5
Net cash provided by operating activities	443.7	565.2
Cash Flows - Investing Activities		
Purchases of land, buildings, and equipment	(186.4)	(149.5)
Acquisitions	0.9	(58.0)
Investments in affiliates, net	4.8	(111.8)
Proceeds from sale of marketable securities, net of purchases		0.3
Proceeds from disposal of land, buildings, and equipment	11.3	11.5
Proceeds from disposal of businesses		11.7
Other, net		(11.7)
Net cash used by investing activities	(169.4)	(307.5)
Cash Flows - Financing Activities		
Change in notes payable	744.0	1,159.2
Issuance of long-term debt	700.0	
Payment of long-term debt	(5.7)	(581.9)
Settlement of Lehman Brothers forward purchase contract	750.0	
Repurchase of Series B-1 limited membership interests in General Mills Cereals, LLC (GMC)	(843.0)	
Repurchase of General Mills Capital, Inc. preferred stock	(150.0)	

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Proceeds from sale of Class A limited membership interests in GMC	92.3	
Common stock issued	52.4	147.4
Tax benefit on exercised options	13.0	33.2
Purchases of common stock for treasury	(1,284.5)	(890.2)
Dividends paid	(259.4)	(247.4)
Other, net		(32.3)
Net cash used by financing activities	(190.9)	(412.0)
Effect of exchange rates change on cash and cash equivalents	29.6	(1.2)
Increase (decrease) in cash and cash equivalents	113.0	(155.5)
Cash and cash equivalents - beginning of year	417.1	647.4
Cash and cash equivalents - end of period	\$ 530.1	\$ 491.9
Cash Flow from Changes in Current Assets and Liabilities:		
Receivables	\$ (247.5)	\$ (205.2)
Inventories	(374.6)	(308.8)
Prepaid expenses and other current assets	25.3	(0.1)
Accounts payable	4.3	7.7
Other current liabilities	119.9	146.5
Changes in current assets and liabilities	\$ (472.6)	\$ (359.9)

See accompanying notes to consolidated financial statements.

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GENERAL MILLS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(1) Background

The accompanying Consolidated Financial Statements of General Mills, Inc. (we, us, our, or the Company) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the rules and regulations for reporting on Form 10-Q. Accordingly, they do not include certain information and disclosures required for comprehensive financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature. Operating results for the quarterly and six-month periods ended November 25, 2007, are not necessarily indicative of the results that may be expected for the fiscal year ending May 25, 2008.

These statements should be read in conjunction with the Consolidated Financial Statements and footnotes included in our Annual Report on Form 10-K for the fiscal year ended May 27, 2007. The accounting policies used in preparing these Consolidated Financial Statements are the same as those described in Note 2 to the Consolidated Financial Statements in that Form 10-K, except as discussed in Notes 6, 16, and 18 to these Consolidated Financial Statements. In addition, certain reclassifications to our previously reported financial information have been made to conform to the current period presentation.

(2) Acquisitions and Divestitures

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During the first quarter of fiscal 2008, we acquired a controlling interest in HD Distributors (Thailand) Company Limited. Prior to acquiring the controlling interest, we accounted for our investment as a joint venture. The purchase price, net of cash acquired, resulted in a \$1.3 million cash inflow classified in acquisitions on the Consolidated Statements of Cash Flows. The pro forma effect of this acquisition was not material.

During the first quarter of fiscal 2007, our Cereal Partners Worldwide (CPW) joint venture completed the acquisition of the Uncle Tobys cereal business in Australia for \$385.6 million. We funded our 50 percent share of the purchase price by making additional advances to and equity contributions in CPW totaling \$135.1 million (classified as investments in affiliates, net, on the Consolidated Statements of Cash Flows) and by acquiring a 50 percent beneficial interest in certain intellectual property for \$57.7 million (classified as acquisitions on the Consolidated Statements of Cash Flows). During the six-month period ended November 25, 2007, we completed the allocation of our purchase price and reclassified \$16.3 million from goodwill to other intangible assets on our Consolidated Balance Sheets. We also sold our par-baked bread product line, including plants in Chelsea, Massachusetts and Tempe, Arizona, and recorded a \$5.9 million loss on the sale, including the write-off of \$6.2 million of goodwill, in restructuring, impairment, and other exit costs.

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(3) Restructuring, Impairment, and Other Exit Costs

Restructuring, impairment, and other exit costs (income) were as follows:

Expense (income), in millions	Quarter Ended		Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006
Closure of Poplar, Wisconsin plant	\$ 2.7	\$	\$ 2.7	\$
Closure of Allentown, Pennsylvania plant			10.1	
Closure of Trenton, Ontario plant			8.5	
Restructuring at Chanhassen, Minnesota plant			3.0	
Gain on sale of previously closed Vallejo, California plant			(7.1)	
Gain on sale of previously closed San Adrian, Spain plant				(8.6)
Loss from divestiture of par-baked bread product line		(0.3)		5.9
Charges associated with restructuring actions previously announced	0.1	(0.8)	0.1	(0.3)
Total	\$ 2.8	\$ (1.1)	\$ 17.3	\$ (3.0)

During the second quarter of fiscal 2008, we approved a plan to transfer *Old El Paso* production from our Poplar, Wisconsin facility to other plants and close the Poplar facility. This action to improve capacity utilization and reduce costs affects 113 employees at the Poplar facility, and resulted in a charge of \$2.7 million consisting entirely of employee severance. We anticipate this project will be completed by January 31, 2009.

During the six-month period ended November 25, 2007, we took additional restructuring actions beyond the item described above. Due to declining financial results, we decided to exit our frozen waffle product line (retail and foodservice) and to close our frozen waffle plant in Allentown, Pennsylvania, affecting 111 employees. We recorded a charge of \$10.1 million related to this closure, consisting of \$3.9 million of employee severance and a \$6.2 million non-cash impairment charge against long-lived assets at the plant. We also completed an analysis of the viability of our Bakeries and Foodservice frozen dough facility in Trenton, Ontario, and will close the facility, affecting 470 employees. We recorded an \$8.5 million charge for employee severance expenses and curtailment charges associated with a defined benefit pension plan. These actions, including the anticipated timing of the disposition of the plants we will close, are expected to be completed by February 28, 2009. We also restructured our production scheduling and discontinued our cake product line at our Chanhassen, Minnesota Bakeries and Foodservice plant. These actions affected 125 employees, and we recorded a charge for employee severance of \$3.0 million. These actions are expected to be completed by the end of fiscal 2008.

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Collectively, the total charges we expect to incur with respect to these fiscal 2008 restructuring actions are approximately \$70.0 million, of which \$48.1 million is expected to be recognized in fiscal 2008. This includes a \$17.3 million non-cash second quarter charge related to accelerated depreciation on long-lived assets at our Trenton, Ontario plant, and an additional amount will be recorded in the third quarter prior to the plant's closure. The accelerated depreciation charges are recorded in cost of sales in our Consolidated Statements of Earnings, and in unallocated corporate expenses in our segment results.

During the six-month period ended November 25, 2007, we sold our previously closed Vallejo, California plant and received \$10.6 million in proceeds.

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In the six-month period ended November 26, 2006, we sold our previously closed plant in San Adrian, Spain, for proceeds of \$9.5 million. We also received net proceeds of \$11.7 million from the divestiture of our par-baked bread product line.

(4) Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill during fiscal 2008 were as follows:

In millions	U.S. Retail	International	Bakeries and Foodservice	Joint Ventures	Total
Balance as of May 27, 2007	\$ 5,202.9	\$ 142.2	\$ 981.8	\$ 508.5	\$ 6,835.4
Finalization of purchase accounting				(16.3)	(16.3)
Adoption of FIN No. 48	(110.9)	(10.6)	(30.4)		(151.9)
Other activity, primarily foreign currency translation	16.8	12.7	4.7	51.0	85.2
Balance as of Nov. 25, 2007	\$ 5,108.8	\$ 144.3	\$ 956.1	\$ 543.2	\$ 6,752.4

The changes in the carrying amount of other intangible assets during fiscal 2008 were as follows:

In millions	U.S. Retail	International	Joint Ventures	Total
Balance as of May 27, 2007	\$ 3,175.2	\$ 460.9	\$ 57.9	\$ 3,694.0
Finalization of purchase accounting			14.5	30.8
Other activity, primarily foreign currency translation			34.0	39.5
Balance as of Nov. 25, 2007	\$ 3,175.2	\$ 509.4	\$ 79.7	\$ 3,764.3

(5) Inventories

The components of inventories were as follows:

In millions	Nov. 25, 2007	May 27, 2007
Raw materials and packaging	\$ 273.4	\$ 242.1

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Finished goods	1,129.0	898.0
Grain	288.1	111.4
Excess of FIFO or weighted-average cost over LIFO cost	(123.3)	(78.1)
 Total	 \$ 1,567.2	 \$ 1,173.4

(6) Derivatives and Hedging Activities

Application of hedge accounting under Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS 133), requires significant resources, recordkeeping, and analytical systems. As a result of the rising compliance costs and the complexity associated with the application of hedge accounting, we have elected to discontinue the use of hedge accounting for all commodity derivative positions entered into after the beginning of fiscal 2008. Accordingly, the changes in the values of these derivatives are recorded currently in cost of sales in our Consolidated Statements of Earnings.

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Regardless of designation for accounting purposes, we believe all of our commodity hedges are economic hedges of our risk exposures, and as a result we consider these derivatives to be hedges for purposes of measuring segment operating performance. Thus, these gains and losses are reported in unallocated corporate expenses outside of segment operating results until such time that the exposure we are hedging affects earnings. At that time we reclassify the hedge gain or loss from unallocated corporate expenses to segment operating profit, allowing our operating segments to realize the economic effects of the hedge without experiencing any resulting mark-to-market volatility, which remains in unallocated corporate expenses. Commodity derivatives previously accounted for as cash flow hedges are not affected by this change, and any gains or losses deferred to accumulated other comprehensive income (loss) in stockholders' equity will remain there until the hedged item affects earnings.

Pursuant to this policy, unallocated corporate expenses for the quarter and six-month period ended November 25, 2007 included:

	Quarter Ended	Six-Month Period Ended
In millions	Nov. 25, 2007	Nov. 25, 2007
Mark-to-market net gain on commodity derivative positions, primarily from agricultural derivatives	\$ 32.8	\$ 42.1
Net realized gains on hedge positions reclassified to segment operating profit, primarily agricultural derivatives	(17.7)	(30.0)
Net gain recognized in unallocated corporate expenses	\$ 15.1	\$ 12.1

(7) Debt

The components of notes payable were as follows:

In millions	Nov. 25, 2007	May 27, 2007
U.S. commercial paper	\$ 1,152.4	\$ 476.9

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Euro commercial paper	757.5	639.0
Financial institutions	136.1	138.5
 Total	 \$ 2,046.0	 \$ 1,254.4

Our commercial paper borrowings are supported by fee-paid committed credit lines consisting of a \$1.9 billion facility expiring in October 2012 and a \$1.1 billion facility expiring in October 2010. As of November 25, 2007, we did not have any outstanding borrowings under these agreements.

As of October 25, 2007, we terminated our credit agreement dated August 3, 2007, which provided an aggregate revolving commitment of \$750.0 million and was scheduled to expire on December 6, 2007.

On October 15, 2007, we and an affiliate of Lehman Brothers Holdings, Inc. (Lehman Brothers) settled the forward purchase contract established in October 2004 in conjunction with the issuance by Lehman Brothers of \$750.0 million of notes that were mandatorily exchangeable for shares of our common stock. In settlement of that forward purchase contract, we issued 14.3 million shares of our common stock and received \$750.0 million in cash from Lehman Brothers. We used the cash to reduce outstanding commercial paper balances.

On October 9, 2007, we entered into a new five-year credit agreement with an initial aggregate revolving commitment of \$1.9 billion which is scheduled to expire in October 2012. Concurrent with the execution of the new credit agreement, we terminated our five-year credit agreement dated January 20, 2004, which provided \$750.0 million of revolving credit and was scheduled to expire in January 2009, and our amended and restated credit agreement, dated October 17, 2006, which provided \$1.1 billion of revolving credit and was scheduled to expire in October 2007.

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On August 29, 2007, we completed the sale of \$700.0 million of 5.65 percent fixed-rate notes due September 10, 2012. The proceeds of the notes were used to repay outstanding commercial paper. Interest on the notes is payable semi-annually in arrears. The notes may be redeemed at our option at any time for a specified make-whole amount. The notes are senior unsecured, unsubordinated obligations and contain a change of control provision, as defined in the instruments governing the notes.

Our credit facilities and certain of our long-term debt agreements contain restrictive covenants. As of November 25, 2007, we were in compliance with all of these covenants.

(8) Minority Interests

On August 7, 2007, we repurchased for a net amount of \$843.0 million all of the outstanding Series B-1 limited membership interests (Series B-1 Interests) previously issued by our subsidiary General Mills Cereals, LLC (GMC) as part of a required remarketing of those interests. The purchase price reflected the Series B-1 Interests' original capital account balance of \$835.0 million and \$8.0 million of capital account appreciation attributable and paid to the third party holder of the Series B-1 Interests. The capital appreciation paid to the third party holder of the Series B-1 Interests was recorded as a reduction to retained earnings, a component of stockholders' equity, on the Consolidated Balance Sheets, and reduced net earnings available to common stockholders in our basic and diluted earnings per share (EPS) calculations. We used commercial paper to fund the repurchase.

We and the third party holder of all of GMC's outstanding Class A limited membership interests (Class A Interests) agreed to reset, effective on June 28, 2007, the preferred rate of return applicable to the Class A Interests to the sum of 3 month LIBOR plus 65 basis points. On June 28, 2007, we also sold \$92.3 million of additional Class A Interests to the same third party. There was no gain or loss associated with these transactions. As of November 25, 2007, the carrying value of all outstanding Class A Interests on our Consolidated Balance Sheets was \$242.3 million, and the capital account balance of the Class A Interests, upon which preferred distributions are calculated, was \$248.1 million.

On June 28, 2007, we repurchased for \$150.0 million all of the outstanding Series A preferred stock of our subsidiary General Mills Capital, Inc. (GM Capital) using proceeds from the sale of the Class A Interests and commercial paper. There was no gain or loss associated with this repurchase.

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Our minority interests contain restrictive covenants. As of November 25, 2007, we were in compliance with all of these covenants.

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(9) Stockholders' Equity

The following table provides detail of total comprehensive income:

In millions	Quarter Ended			Quarter Ended		
	Nov. 25, 2007			Nov. 26, 2006		
	Pretax	Tax	Net	Pretax	Tax	Net
Net earnings			\$ 390.5			\$ 385.4
Other comprehensive income (loss):						
Foreign currency translation adjustments	\$ 132.6	\$	\$ 132.6	\$ (24.8)	\$	\$ (24.8)
Other fair value changes:						
Securities				1.1	(0.4)	0.7
Hedge derivatives	19.1	(6.7)	12.4	2.1	(1.7)	0.4
Reclassification to earnings:						
Hedge derivatives	(5.8)	2.0	(3.8)	6.4	(2.4)	4.0
Amortization of losses and prior service costs	11.7	(4.4)	7.3			
Other comprehensive income (loss)	\$ 157.6	\$ (9.1)	\$ 148.5	\$ (15.2)	\$ (4.5)	\$ (19.7)
Total comprehensive income			\$ 539.0			\$ 365.7

In millions	Six-Month Period Ended			Six-Month Period Ended		
	Nov. 25, 2007			Nov. 26, 2006		
	Pretax	Tax	Net	Pretax	Tax	Net
Net earnings			\$ 679.4			\$ 652.3
Other comprehensive income (loss):						
Foreign currency translation adjustments	\$ 150.3	\$	\$ 150.3	\$ (27.2)	\$	\$ (27.2)
Minimum pension liability				(4.7)	1.6	(3.1)
Other fair value changes:						
Securities	(1.0)	0.3	(0.7)	1.1	(0.4)	0.7
Hedge derivatives	38.5	(13.9)	24.6	(16.2)	5.3	(10.9)
Reclassification to earnings:						
Hedge derivatives	(28.3)	10.1	(18.2)	18.2	(6.7)	11.5
Amortization of losses and prior service costs	23.1	(8.4)	14.7			
Other comprehensive income (loss)	\$ 182.6	\$ (11.9)	\$ 170.7	\$ (28.8)	\$ (0.2)	\$ (29.0)

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Total comprehensive income \$ 850.1 \$ 623.3

Except for reclassifications to earnings, changes in other comprehensive income (loss) are primarily non-cash items.

Accumulated other comprehensive income (loss) balances, net of tax effects, were as follows:

In millions	Nov. 25, 2007	May 27, 2007
Foreign currency translation adjustments	\$ 552.4	\$ 402.1
Unrealized gain (loss) from:		
Securities	3.2	3.9
Hedge derivatives	(30.1)	(36.5)
Pension, other postretirement, and postemployment benefits:		
Net actuarial loss	(436.4)	(448.5)
Prior service costs	(38.1)	(40.7)
Accumulated other comprehensive income (loss)	\$ 51.0	\$ (119.7)

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On December 10, 2007, the Board of Directors approved the retirement of 125.0 million shares of common stock in treasury effective December 10, 2007. This action will reduce common stock by \$12.5 million, reduce additional paid-in capital by \$5,068.3 million, and reduce common stock in treasury by \$5,080.8 million on our Consolidated Balance Sheets as of that date.

(10) Stock Plans

We have various stock-based compensation programs under which awards, including stock options, restricted stock, and restricted stock units, may be granted to employees and non-employee directors. These programs and related accounting are described on pages 58 to 60 of our Annual Report on Form 10-K for the fiscal year ended May 27, 2007.

On September 24, 2007, our stockholders approved the General Mills, Inc. 2007 Stock Compensation Plan, replacing the General Mills, Inc. 2005 Stock Compensation Plan. No additional shares may be issued under the 2005 Plan after the approval of the 2007 Plan. A description of the 2007 Plan can be found in our Proxy Statement for the 2007 Annual Meeting filed with the SEC on August 14, 2007.

Compensation expense related to stock-based payments recognized in selling, general, and administrative expenses in the Consolidated Statements of Earnings was as follows:

	Quarter Ended		Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006
Compensation expense related to stock-based payments	\$ 31.5	\$ 27.6	\$ 86.6	\$ 80.8

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As of November 25, 2007, unrecognized compensation expense related to non-vested stock options and restricted stock units was \$223.2 million. This expense will be recognized over 24 months, on average.

Net cash proceeds from the exercise of stock options less shares used for withholding taxes and the intrinsic value of options exercised were as follows:

In millions	Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006
Net cash proceeds	\$ 52.5	\$ 151.1
Intrinsic value of options exercised	\$ 31.0	\$ 85.2

We estimate the fair value of each option on the grant date using the Black-Scholes option-pricing model, which requires us to make predictive assumptions regarding future stock price volatility, employee exercise behavior, and dividend yield. We estimate our future stock price volatility using the historical volatility over the expected term of the option, excluding time periods of volatility we believe a marketplace participant would exclude in estimating our stock price volatility. For the fiscal 2008 grants, we have excluded historical volatility for fiscal 2002 and prior, primarily because volatility driven by the acquisition of Pillsbury does not reflect what we believe to be expected future volatility. We also have considered, but did not use, implied volatility in our estimate, because trading activity in options on our stock, especially those with tenors of greater than 6 months, is insufficient to provide a reliable measure of expected volatility. Our method of selecting the other valuation assumptions is explained on pages 58 and 59 in our Annual Report on Form 10-K for the fiscal year ended May 27, 2007.

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The estimated fair values of stock options granted and the assumptions used for the Black-Scholes option-pricing model were as follows:

	Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006
Estimated fair values of stock options granted	\$ 10.57	\$ 10.74
Assumptions:		
Risk-free interest rate	5.1%	5.3%
Expected term	8.5 years	8 years
Expected volatility	15.6%	19.7%
Dividend yield	2.7%	2.8%

Information on stock option activity follows:

Shares (thousands)	Weighted- average exercise price	Weighted- average remaining contractual term (years)	Aggregate intrinsic value (millions)
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Outstanding as of May 27, 2007	53,773.2	\$	43.09		
Granted	5,473.0		58.77		
Exercised	(1,525.8)		37.85		
Forfeited or expired	(53.8)		49.41		
Outstanding as of Nov. 25, 2007	57,666.6	\$	44.71	4.78	\$ 723.4
Exercisable as of Nov. 25, 2007	38,124.8	\$	41.40	3.13	\$ 598.6

Information on restricted stock unit activity follows:

	Units (thousands)	Weighted- average grant-date fair value
Non-vested as of May 27, 2007	4,785.9	\$ 48.74
Granted	1,855.0	58.72
Vested	(436.9)	47.44
Forfeited	(100.0)	51.32
Non-vested as of Nov. 25, 2007	6,104.0	\$ 51.82

The total grant-date fair value of restricted stock unit awards that vested in the six-month period ended November 25, 2007, was \$20.7 million. The total grant-date fair value of restricted stock unit awards that vested in the six-month period ended November 26, 2006, was \$15.5 million.

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(11) Earnings Per Share

Basic and diluted EPS were calculated using the following:

In millions, except per share data	Quarter Ended		Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006
Net earnings - as reported	\$ 390.5	\$ 385.4	\$ 679.4	\$ 652.3
Capital appreciation paid on Series B-1 interests in GMC (a)			(8.0)	
Net earnings for basic and diluted EPS calculations	\$ 390.5	\$ 385.4	\$ 671.4	\$ 652.3
Average number of common shares - basic EPS	328.0	343.9	329.0	347.9
Incremental share effect from:				
Stock options (b)	10.7	10.6	10.8	10.0

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Restricted stock, restricted stock units, and other (b)	3.0	2.1	2.8	1.7
Forward purchase contract (c)	0.7	0.8	1.0	0.6
Average number of common shares - diluted EPS	342.4	357.4	343.6	360.2
Earnings per share - basic	\$ 1.19	\$ 1.12	\$ 2.04	\$ 1.87
Earnings per share - diluted	\$ 1.14	\$ 1.08	\$ 1.95	\$ 1.81

(a) See Note 8.

(b) Incremental shares from stock options, restricted stock, and restricted stock units are computed by the treasury stock method. Stock options and restricted stock units excluded from our computation of diluted EPS because they were not dilutive were as follows:

In millions	Quarter Ended		Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006
Anti-dilutive stock options and restricted stock units	5.6	5.3	4.8	6.7

(c) On October 15, 2007, we settled the forward purchase contract with Lehman Brothers by issuing 14.3 million shares of common stock.
(12) Share Repurchases

During the second quarter of fiscal 2008, we repurchased 0.1 million shares of common stock for \$6.1 million. In the six-month period ended November 25, 2007, we repurchased 21.0 million shares of common stock for \$1,226.5 million, of which \$0.4 million was included in current liabilities as of November 25, 2007, and settled after the end of the quarter.

During the second quarter of fiscal 2007, we repurchased 2.9 million shares of common stock for \$153.8 million. In the six-month period ended November 26, 2006, we repurchased 17.1 million shares of common stock for \$890.2 million.

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(13) Interest Expense, Net

The components of interest, including distributions to minority interest holders, net were as follows:

Expense (income), in millions	Quarter Ended	Six-Month Period Ended
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	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006
Interest expense	\$ 120.4	\$ 100.2	\$ 227.4	\$ 196.7
Distributions paid on preferred stock and interests of subsidiaries	3.0	15.9	16.2	31.7
Capitalized interest	(1.2)	(0.5)	(2.4)	(1.1)
Interest income	(6.3)	(5.1)	(12.0)	(11.8)
Total	\$ 115.9	\$ 110.5	\$ 229.2	\$ 215.5

(14) Statements of Cash Flows

During the six-month period ended November, 25, 2007, we made cash interest payments of \$227.3 million, compared to \$211.0 million in the same period last year. In the six-month period ended November 25, 2007, we made tax payments of \$200.1million, compared to \$230.0 million in the same period last year.

(15) Retirement and Postemployment Benefits

Components of net pension, other postretirement, and postemployment (income) expense for each fiscal period were as follows:

In millions	Defined Benefit Pension Plans		Other Postretirement Benefit Plans		Postemployment Benefit Plans	
	Quarter Ended		Quarter Ended		Quarter Ended	
	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006
Service cost	\$ 20.0	\$ 18.3	\$ 4.1	\$ 4.1	\$ 1.2	\$ 1.2
Interest cost	49.1	46.4	14.7	14.5	0.9	1.0
Expected return on plan assets	(90.1)	(83.8)	(7.6)	(6.8)		
Amortization of losses	5.9	3.1	3.9	3.9	(0.1)	(0.1)
Amortization of prior service costs (credits)	1.9	2.0	(0.4)	(0.4)	0.5	0.5
Other adjustments		0.1			3.3	5.0
Net (income) expense	\$ (13.2)	\$ (13.9)	\$ 14.7	\$ 15.3	\$ 5.8	\$ 7.6

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In millions	Defined Benefit Pension Plans		Other Postretirement Benefit Plans		Postemployment Benefit Plans	
	Six-Month Period Ended		Six-Month Period Ended		Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006

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Service cost	\$ 40.0	\$ 36.6	\$ 8.2	\$ 8.2	\$ 2.4	\$ 2.4
Interest cost	98.2	92.8	29.4	29.1	1.8	2.0
Expected return on plan assets	(180.2)	(167.6)	(15.2)	(13.6)		
Amortization of losses	11.5	6.2	7.7	7.8	(0.1)	(0.1)
Amortization of prior service costs (credits)	3.8	4.0	(0.8)	(0.8)	1.0	1.0
Other adjustments		0.1			6.7	10.0
Net (income) expense	\$ (26.7)	\$ (27.9)	\$ 29.3	\$ 30.7	\$ 11.8	\$ 15.3

(16) Income Taxes

Effective Tax Rate

Our consolidated effective income tax rate is influenced by tax planning opportunities available to us in the various jurisdictions in which we operate. The effective tax rate for the second quarter of fiscal 2008 was 36.5 percent compared to 35.9 percent for the second quarter of fiscal 2007. The 0.6 percentage point increase in the effective tax rate is primarily due to a 1.8 percent reduction in the estimated value of tax credits and a 0.5 percent increase in the state tax rate which were partially offset by a 0.7 percent reduction of deferred taxes caused by a law change in Michigan, a 0.4 percent decrease related to additional domestic deductions, a 0.3 percent reduction related to additional foreign tax credits and 0.3 percent of miscellaneous other items.

The effective tax rate for the six-month period ended November 25, 2007 was 35.0 percent compared to 35.8 percent for the same period of fiscal 2007. The 0.8 percentage point decrease is primarily due to a 0.7 percent discrete tax decrease from international deferred foreign income taxes resulting from tax rate changes, a 1.0 percent benefit related to discrete and general foreign tax credits, a 0.4 percent decrease related to additional domestic deductions and 0.3 percent of miscellaneous other items. These were partially offset by a 1.1 percent reduction in the estimated value of other tax credits and a 0.5 percent increase in the state tax rate. The impact of the Michigan law change which impacted first and second quarters in offsetting amounts had no impact on the year to date effective tax rate.

Uncertain Tax Positions

We adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109, as of the beginning of fiscal 2008. Prior to adoption, our policy was to establish reserves that reflected the probable outcome of known tax contingencies. The effects of final resolution, if any, were recognized as changes to the effective income tax rate in the period of resolution. FIN 48 requires application of a more likely than not threshold to the recognition and derecognition of uncertain tax positions. FIN 48 permits us to recognize the amount of tax benefit that has a greater than 50 percent likelihood of being ultimately realized upon settlement. It further requires that a change in judgment related to the expected ultimate resolution of uncertain tax positions be recognized in earnings in the quarter of such change.

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As a result of adoption, we recorded a \$218.1 million reduction to accrued tax liabilities, a \$151.9 reduction to goodwill, a \$57.8 million increase to additional paid in capital and a \$8.4 million increase to retained earnings at the beginning of fiscal 2008.

The following table sets forth changes in our total gross unrecognized tax benefit liabilities, excluding accrued interest, for the year to date period ended November 25, 2007. Approximately \$168.5 million of this total represents the amount that, if recognized, would affect our effective income tax rate in future periods. This amount differs from the gross unrecognized tax benefits presented in the table due to the decrease in U.S. federal income taxes that would occur upon recognition of the state tax benefits included therein.

In Millions

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Balance as of May 28, 2007	\$ 464.9
Tax positions related to current year:	
Additions	29.2
Reductions	
Tax positions related to prior years:	
Additions	35.5
Reductions	(1.0)
Settlements	
Lapses in statutes of limitations	(7.6)
Balance as of November 25, 2007	\$ 521.0

As of November 25, 2007, we have classified approximately \$7.3 million of the unrecognized tax benefits as a current liability as these amounts are expected to be paid within the next 12 months. The remaining amount of our unrecognized tax liability was classified in other noncurrent liabilities.

We report accrued interest and penalties related to unrecognized tax benefits in income tax expense. For the six-month period ended November 25, 2007, we recognized \$20.9 million of tax-related interest expense and penalties, and had \$113.6 million of accrued interest and penalties at November 25, 2007.

We do not expect any significant changes to the estimated amount of liability associated with our uncertain tax positions that arose prior to fiscal 2008, other than the payment of the amount noted above which is identified as a current liability.

Annually we file more than 350 income tax returns in approximately 100 global taxing jurisdictions. The number of years with open tax audits varies depending on the tax jurisdiction. Our major taxing jurisdictions include the United States (federal and state) and Canada. With limited exceptions, we are no longer subject to U.S. federal examinations by the Internal Revenue Service (IRS) for fiscal years before 2002. The IRS recently concluded field examinations for our 2002 and 2003 fiscal years. A payment of \$24.8 million was made during the first quarter of fiscal 2008 to cover the additional tax liability plus interest related to all agreed adjustments for this audit cycle. The IRS also proposed additional adjustments for the 2002-2003 audit cycle including several adjustments to the tax benefits associated with the sale of minority interests in our GMC subsidiary. We believe we have meritorious defenses and intend to vigorously defend our position. Our potential liability for this matter is significant and, notwithstanding our reserves against this potential liability, an unfavorable resolution could have a material adverse impact on our results of operations or cash flows from operations. We do not expect that the amount of our tax reserves for these issues will change in the next 12 months. The IRS initiated its audit of our fiscal 2004 through 2006 tax years during the first quarter of fiscal 2008.

Various examinations by United States state taxing authorities could be conducted for any open tax year, which vary by jurisdiction, but are generally from 3 to 5 years. Currently, several state examinations are in progress. The Canada Revenue Agency is conducting an audit of our income tax returns in Canada for fiscal years 2003 (which corresponds to our earliest tax year still open for examination) through 2005. We do not anticipate that any United States state tax or Canadian tax adjustments will have a significant impact on our financial position, cash flows or results of operations.

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(17) Business Segment Information

We operate in the consumer foods industry. We have three operating segments by type of customer and geographic region as follows: U.S. Retail, International, and Bakeries and Foodservice.

Our U.S. Retail segment reflects business with a wide variety of grocery stores, mass merchandisers, membership stores, natural food chains, and drug, dollar, and discount chains operating throughout the United States. Our major product categories in the United States are ready-to-eat cereals, refrigerated yogurt, ready-to-serve soup, dry dinners, shelf stable and frozen vegetables, refrigerated and frozen dough products, dessert and baking mixes, frozen pizza and pizza snacks, grain, fruit and savory snacks, microwave popcorn, and a wide variety of organic products

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including soup, granola bars, and cereal.

Our International segment is largely made up of retail businesses outside of the United States. In Canada, our major product categories are ready-to-eat cereals, shelf stable and frozen vegetables, dry dinners, refrigerated and frozen dough products, dessert and baking mixes, frozen pizza snacks, and grain, fruit and savory snacks. In markets outside the United States and Canada, our product categories include super-premium ice cream, granola and grain snacks, shelf stable and frozen vegetables, dough products, and dry dinners. Our International segment also includes products manufactured in the United States for export internationally, primarily in Caribbean and Latin American markets, as well as products we manufacture for sale to our joint ventures internationally. Revenues from export activities are reported in the region or country where the end customer is located.

In our Bakeries and Foodservice segment, we sell branded cereals, snacks, dinner and side dish products, refrigerated and soft-serve frozen yogurt, frozen dough products, branded baking mixes, and custom food items. Our customers include foodservice distributors and operators, convenience stores, vending machine operators, quick service chains and other restaurants, and business and school cafeterias in the United States and Canada. In addition, mixes and unbaked and fully baked frozen dough products are marketed throughout the United States and Canada to retail, supermarket, and wholesale bakeries.

Operating profit for these segments excludes unallocated corporate expenses (variances to planned corporate overhead expenses, variances to planned domestic employee benefits and incentives, all stock compensation costs, annual contributions to the General Mills Foundation, and other items that are not part of our measurement of segment operating performance, including gains and losses from commodity derivatives entered into after May 27, 2007, until passed back to our operating segments in accordance with our internal hedge documentation as discussed in Note 6), and restructuring, impairment, and other exit costs. These items affecting operating profit are centrally managed at the corporate level and are excluded from the measure of segment profitability reviewed by executive management. Under our supply chain organization, our manufacturing, warehouse, and distribution activities are substantially integrated across our operations in order to maximize efficiency and productivity. As a result, fixed assets and depreciation and amortization expenses are neither maintained nor available by operating segment. Our operating segment results were as follows:

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In millions	Quarter Ended		Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006	Nov. 25, 2007	Nov. 26, 2006
Net sales:				
U.S. Retail	\$ 2,521.0	\$ 2,441.7	\$ 4,552.7	\$ 4,351.7
International	665.7	544.6	1,265.1	1,050.2
Bakeries and Foodservice	516.7	480.3	957.6	925.1
Total	\$ 3,703.4	\$ 3,466.6	\$ 6,775.4	\$ 6,327.0
Operating profit:				
U.S. Retail	\$ 583.8	\$ 595.6	\$ 1,057.1	\$ 1,042.9
International	84.3	61.9	155.3	117.8
Bakeries and Foodservice	48.0	56.1	82.0	85.1
Total segment operating profit	716.1	713.6	1,294.4	1,245.8
Corporate unallocated expenses	26.2	39.5	79.9	82.8
Restructuring, impairment, and other exit costs (income)	2.8	(1.1)	17.3	(3.0)

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Operating profit	\$ 687.1	\$ 675.2	\$ 1,197.2	\$ 1,166.0
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(18) New Accounting Pronouncements

In the first quarter of fiscal 2008, we adopted Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides interpretive guidance on the process and diversity in practice of quantifying financial statement misstatements resulting in the potential carryover of improper amounts on the balance sheet. The SEC believes that registrants should quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The adoption of SAB 108 did not have a material impact on our results of operations or financial condition.

Also in the first quarter of fiscal 2008, we adopted SFAS No. 155, *Hybrid Instruments* (SFAS 155). SFAS 155 amends SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities* and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS 155 is effective for all financial instruments acquired or issued after May 27, 2007. The adoption of SFAS 155 did not have any impact on our results of operations or financial condition.

In September 2006, the FASB ratified the consensus of Emerging Issues Task Force Issue No. 06-5, *Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4* (EITF 06-5). EITF 06-5 requires that a policyholder consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract on a policy by policy basis. We adopted EITF 06-5 in the first quarter of fiscal 2008, and it did not have any impact on our results of operations or financial condition.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

INTRODUCTION

This Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with the MD&A included in our Annual Report on Form 10-K for the fiscal year ended May 27, 2007, for important background regarding, among other things, our key business drivers. Significant trademarks and service marks used in our business are set forth in *italics* herein. Certain terms used throughout this report are defined in a glossary on page 32 of this report.

CONSOLIDATED RESULTS OF OPERATIONS

Second Quarter Results

For the second quarter of fiscal 2008, we reported diluted earnings per share of \$1.14, up 5.6 percent from \$1.08 per share earned in the same period last year. Net earnings were \$390.5 million in the quarter, up 1.3 percent from \$385.4 million last year. Net sales grew 6.8 percent to \$3.7 billion and total segment operating profit of \$716.1 million was consistent with the second quarter of fiscal 2007. (See page 32 for a discussion of this measure not defined by generally accepted accounting principles (GAAP)).

Net sales growth during the second quarter of fiscal 2008 was the result of 5.6 points of growth from net price realization and product mix and 1.4 points of favorable foreign currency exchange, offset by 0.2 points of decreased combined segment volume. During the second quarter of fiscal 2008, volume was essentially flat as growth in the International operating segment was offset by declines in Bakeries and Foodservice including the effects of product lines divested in fiscal 2007, and U.S. Retail. On November 1, 2007, we voluntarily recalled all pepperoni varieties of *Totino's* and *Jeno's* frozen pizzas (sold primarily in our U.S. Retail operating segment) manufactured on or before October 30, 2007 due to potential contamination. The pizza recall did not significantly impact our net sales in the second quarter.

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Components of net sales growth Second quarter of fiscal 2008 vs. second quarter of fiscal 2007	U.S. Retail	International	Bakeries and Foodservice	Combined Segments
Volume (a)	-1.9 pts	8.1 pts	-1.0 pts	-0.2 pts
Price/product mix	5.1 pts	5.1 pts	8.6 pts	5.6 pts
Foreign currency exchange	NA	9.0 pts	NA	1.4 pts
Net sales growth	3.2 pts	22.2 pts	7.6 pts	6.8 pts

(a) Measured in tons based on the stated weight of our product shipments.

Cost of sales increased \$185.2 million from the second quarter of fiscal 2007 to \$2,372.2 million. Higher input costs and changes in mix increased cost of sales by \$178.8 million. We recorded \$32.8 million of mark-to-market net gains on our commodity derivatives in the second quarter of fiscal 2008, pursuant to our policy described in Note 6 on page 9, \$15.1 million of which will mitigate future input cost inflation. We also recorded \$17.3 million of accelerated depreciation on long-lived assets associated with our previously announced restructuring action at our plant in Trenton, Ontario. In addition, we incurred \$19.0 million of costs, including product write offs, logistics, and other costs, related to the voluntary frozen pizza recall.

Selling, general, and administrative (SG&A) expenses were up \$35.8 million in the second quarter of fiscal 2008 versus the same period in fiscal 2007. The increase in SG&A was primarily driven by a 10.5 percent increase in consumer marketing expense. SG&A expenses as a percent of net sales in fiscal 2008 decreased 20 basis points from fiscal 2007 to 17.3 percent.

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Restructuring, impairment, and other exit costs (income) were \$2.8 million of expense for the second quarter of fiscal 2008 and \$1.1 million of income for the same period of fiscal 2007, comprised of the following:

Expense (income), in millions	Quarter Ended	
	Nov. 25, 2007	Nov. 26, 2006
Closure of Poplar, Wisconsin plant	\$ 2.7	\$
Loss from divestiture of par-baked bread product line		(0.3)
Charges associated with restructuring actions previously announced	0.1	(0.8)
Total	\$ 2.8	\$ (1.1)

During the second quarter of fiscal 2008, we approved a plan to transfer *Old El Paso* production from our Poplar, Wisconsin facility to other plants and close the Poplar facility. This action to improve capacity utilization and reduce costs affects 113 employees at the Poplar facility, and resulted in a charge of \$2.7 million consisting entirely of employee severance. We anticipate this project will be completed by January 31, 2009.

Net interest expense for the second quarter of fiscal 2008 totaled \$115.9 million, a \$5.4 million increase from the same period of fiscal 2007. Average interest bearing instruments increased \$539.6 million leading to an \$8.2 million increase in net interest expense, while average interest rates decreased 20 basis points generating a \$2.8 million decrease in net interest expense. Average debt balances increased to fund higher share repurchases in anticipation of our issuance of shares to settle the forward contract with Lehman Brothers.

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The **effective tax rate** for the second quarter of fiscal 2008 was 36.5 percent compared to 35.9 percent for the second quarter of fiscal 2007. The 0.6 percentage point increase in the effective tax rate is primarily due to a 1.8 percent reduction in the estimated value of tax credits and a 0.5 percent increase in the state tax rate which were partially offset by a 0.7 percent reduction of deferred taxes caused by a law change in Michigan, a 0.4 percent decrease related to additional domestic deductions, a 0.3 percent reduction related to additional foreign tax credits and 0.3 percent of miscellaneous other items.

After-tax earnings from joint ventures increased \$4.2 million from the second quarter of fiscal 2007, to \$27.6 million. Net sales for Cereal Partners Worldwide (CPW) increased 21.4 percent driven by higher volume, including 5 points of favorable foreign exchange. Net sales for our Häagen-Dazs ice cream joint ventures in Asia grew 3.6 percent as an increase in sales volume was partially offset by unfavorable foreign exchange. 8th Continent, our soy products joint venture, recorded a 15.4 percent net sales decrease in the second quarter of fiscal 2008.

Average diluted shares outstanding decreased by 15.0 million in the second quarter of fiscal 2008, from the same period a year ago due primarily to the repurchase of 29.3 million shares of our common stock since the end of the second quarter of fiscal 2007. This was partially offset by the issuance of 14.3 million shares to settle the forward contract with Lehman Brothers, the issuance of shares upon stock option exercises, the issuance of annual stock awards, and the vesting of restricted stock units.

Six-month Results

For the six-month period ended November 25, 2007, we reported diluted earnings per share of \$1.95, up 7.7 percent from \$1.81 per share earned in the same period last year. Net earnings were \$679.4 million, up 4.2 percent from \$652.3 million last year. Net sales for the six-month period grew 7.1 percent to \$6.8 billion and total segment operating profit increased 3.9 percent to \$1,294.4 million (See page 32 for a discussion of this measure not defined by GAAP).

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Net sales growth during the six-month period ended November 25, 2007, was the result of 1.1 points of combined segment volume growth, 4.6 points of growth from net price realization and product mix, and 1.3 points of favorable foreign currency exchange. Volume growth was recorded in our U.S. Retail and International operating segments, while Bakeries and Foodservice volumes declined, including the effects of divested product lines in fiscal 2007. As discussed previously, on November 1, 2007, we voluntarily recalled certain varieties of frozen pizza. The pizza recall did not significantly impact our net sales for the six-month period ended November 25, 2007.

**Components of net sales growth
Six-month period ended Nov. 25,
2007 vs. six-month period ended
Nov. 26, 2006**

	U.S. Retail	International	Bakeries and Foodservice	Combined Segments
Volume (a)	0.2 pts	8.4 pts	-2.9 pts	1.1 pts
Price/product mix	4.4 pts	4.0 pts	6.4 pts	4.7 pts
Foreign currency exchange	NA	8.1 pts	NA	1.3 pts
Net sales growth	4.6 pts	20.5 pts	3.5 pts	7.1 pts

(a) Measured in tons based on the stated weight of our product shipments.

Cost of sales increased \$304.3 million from the six-month period ended November 26, 2006, to \$4,288.0 million. Higher volume drove \$51.6 million of this increase. Higher input costs and changes in mix increased cost of sales by \$258.6 million. We recorded \$42.1 million of mark-to-market net gains on our commodity derivatives in the six-month period ended November 25, 2007, pursuant to our policy described in Note 6 on page 9, \$12.1 million of which will mitigate future input cost inflation. We also recorded \$17.3 million of accelerated depreciation on long-lived assets associated with our previously announced restructuring action at our plant in Trenton, Ontario. In addition, we incurred \$19.0 million of costs, including product write offs, logistics, and other costs, related to the voluntary frozen pizza recall.

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SG&A expenses were up \$92.6 million in the six-month period ended November 25, 2007, versus the same period in fiscal 2007. SG&A expenses as a percent of net sales in fiscal 2008 increased 10 basis points from fiscal 2007 to 18.8 percent. This increase was primarily driven by a 10.5 percent increase in consumer marketing expense and \$10.9 million of costs associated with the remarketing of the Class A and Series B-1 Interests of our subsidiary General Mills Cereals, LLC (GMC).

Restructuring, impairment, and other exit costs (income) were \$17.3 million of expense for the six-month period ended November 25, 2007, and \$3.0 million of income for the same period last year, comprised of the following:

Expense (income), in millions	Six-Month Period Ended	
	Nov. 25, 2007	Nov. 26, 2006
Closure of Poplar, Wisconsin plant	\$ 2.7	\$
Closure of Allentown, Pennsylvania plant	10.1	
Closure of Trenton, Ontario plant	8.5	
Restructuring at Chanhassen, Minnesota plant	3.0	
Gain on sale of previously closed Vallejo, California plant	(7.1)	
Gain on sale of previously closed San Adrian, Spain plant		(8.6)
Loss from divestiture of par-baked bread product line		5.9
Charges associated with restructuring actions previously announced	0.1	(0.3)
Total	\$ 17.3	\$ (3.0)

During the six-month period ended November 25, 2007, we took additional restructuring actions beyond the item described in our Second Quarter Results section on page 22.

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Due to declining financial results, we decided to exit our frozen waffle product line (retail and foodservice) and to close our frozen waffle plant in Allentown, Pennsylvania, affecting 111 employees. We recorded a charge of \$10.1 million related to this closure, consisting of \$3.9 million of employee severance and a \$6.2 million non-cash impairment charge against long-lived assets at the plant. We also completed an analysis of the viability of our Bakeries and Foodservice frozen dough facility in Trenton, Ontario, and will close the facility, affecting 470 employees. We recorded an \$8.5 million charge for employee severance and curtailment charges associated with a defined benefit pension plan. These actions, including the anticipated timing of the disposition of the plants we will close, are expected to be completed by February 28, 2009. We also restructured our production scheduling and discontinued our cake product line at our Chanhassen, Minnesota Bakeries and Foodservice plant. These actions affected 125 employees, and we recorded a charge for employee severance of \$3.0 million. These actions are expected to be completed by the end of fiscal 2008.

Collectively, the total charges we expect to incur with respect to these fiscal 2008 restructuring actions are approximately \$70.0 million, of which \$48.1 million is expected to be recognized in fiscal 2008. This includes a \$17.3 million non-cash second quarter charge related to accelerated depreciation on long-lived assets at our Trenton, Ontario plant, and an additional amount will be recorded in the third quarter prior to the plant's closure. The accelerated depreciation charges are recorded in cost of sales in our Consolidated Statements of Earnings, and in unallocated corporate expenses in our segment results.

During the six-month period ended November 25, 2007, we sold our previously closed Vallejo, California plant and received \$10.6 million in proceeds.

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In the six-month period ended November 26, 2006, we sold our previously closed plant in San Adrian, Spain for proceeds of \$9.5 million. We also received net proceeds of \$11.7 million from the divestiture of our par-baked bread product line.

Net interest expense for the six-month period ended November 25, 2007, totaled \$229.2 million, a \$13.7 million increase from the same six-month period last year. Average interest bearing instruments increased \$731.0 million leading to a \$22.7 million increase in net interest expense, while average interest rates decreased 20 basis points generating a \$9.0 million decrease in net interest expense. Average debt balances have increased to fund higher share repurchases in anticipation of our issuance of shares to settle the forward contract with Lehman Brothers.

The **effective tax rate** for the six-month period ended November 25, 2007 was 35.0 percent compared to 35.8 percent for the same period of fiscal 2007. The 0.8 percentage point decrease is primarily due to a 0.7 percent discrete tax decrease from international deferred foreign income taxes resulting from tax rate changes, a 1.0 percent benefit related to discrete and general foreign tax credits, a 0.4 percent decrease related to additional domestic deductions and 0.3 percent of miscellaneous other items. These were partially offset by a 1.1 percent reduction in the estimated value of other tax credits and a 0.5 percent increase in the state tax rate. The impact of the Michigan law change which impacted first and second quarters in offsetting amounts had no impact on the year to date effective tax rate.

After-tax earnings from joint ventures increased \$7.5 million from the six-month period ended November 26, 2006, to \$50.0 million. Net sales for CPW increased 23.5 percent driven by higher volume, including 3.9 points of growth from the acquisition of Uncle Tobys, and 5 points of favorable foreign exchange. Net sales for our Häagen-Dazs ice cream joint ventures in Asia matched prior-year levels as an increase in sales volume was offset by unfavorable foreign exchange. 8th Continent recorded a 15.5 percent net sales decrease in the six-month period ended November 25, 2007.

Average diluted shares outstanding decreased by 16.6 million in the six-month period ended November 25, 2007, from the same period a year ago due primarily to the repurchase of 29.3 million shares of our common stock since the end of the second quarter of fiscal 2007, 21.0 million shares of which were purchased in the first six-month period of fiscal 2008, partially offset by the issuance of 14.3 million shares to settle the forward contract with Lehman Brothers, the issuance of shares upon stock option exercises, the issuance of annual stock awards, and the vesting of restricted stock units.

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SEGMENT OPERATING RESULTS

U.S. Retail Segment Results

Net sales for our U.S. Retail operations grew 3.2 percent in the second quarter of fiscal 2008, to \$2,521.0 million. Net price realization and product mix drove 5.1 points of growth. Volume on a tonnage basis fell 1.9 percentage points. The voluntary frozen pizza recall did not significantly impact our U.S. Retail net sales in the second quarter of fiscal 2008.

Net sales for our U.S. Retail operations were up 4.6 percent in the six-month period ended November 25, 2007, to \$4,552.7 million. Net price realization and product mix drove 4.4 points of growth. Volume on a tonnage basis increased 0.2 percentage points. The voluntary frozen pizza recall did not significantly impact our U.S. Retail net sales in the six-month period ended November 25, 2007.

U.S. Retail Net Sales Percentage Change by Division

	Quarter Ended	Six-Month Period Ended
	Nov. 25, 2007	Nov. 25, 2007
Snacks	12.0%	14.0%

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Yoplait	11.3	7.3
Big G	2.7	4.0
Baking Products	2.5	4.1
Meals	0.9	2.9
Pillsbury	-1.8	1.3
Small Planet Foods	13.6	5.8
 Total	 3.2%	 4.6%

During the second quarter of fiscal 2008, Snacks net sales grew 12.0 percent driven by continued strong sales for *Nature Valley* grain snacks, *Fiber One* bars, and fruit snacks. Yoplait recorded net sales growth of 11.3 percent, reflecting net price realization, continued strong performance from *Yoplait Light* yogurt, and new products, including *Yo-Plus* yogurt. Net sales for Big G cereals grew 2.7 percent, driven mainly by pricing and package size changes on established cereal brands. The Meals division recorded a 0.9 percent net sales increase, led by *Progresso* ready-to-serve soups that offset slight declines in our dry dinners category. Pillsbury net sales declined 1.8 percent, as the impact of the voluntary frozen pizza recall more than offset growth in other categories within this division.

Operating profits for the second quarter of fiscal 2008, declined 2.0 percent to \$583.8 million from \$595.6 million in the same period a year ago. Volume declines decreased operating profit by \$21.9 million. Increased supply chain costs of \$65.1 million, excluding the effect of the frozen pizza recall, and a 7.1 percent increase in consumer marketing expenses were offset by favorable price and product mix. In addition, the voluntary frozen pizza recall reduced operating profits by \$19.9 million.

Operating profits for the six-month period ended November 25, 2007, improved 1.4 percent to \$1,057.1 million from \$1,042.9 million in the same period a year ago. Volume growth increased operating profit by \$5.7 million. Increased supply chain costs of \$96.6 million, excluding the effect of the frozen pizza recall, and an 8.1 percent increase in consumer marketing expenses were more than offset by favorable price and product mix. In addition, the voluntary frozen pizza recall reduced operating profits by \$19.9 million.

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International Segment Results

Net sales for our International segment were up 22.2 percent in the second quarter of fiscal 2008 to \$665.7 million. This growth was driven by an 8.1 point increase in sales volume, 9.0 points of favorable foreign exchange, and 5.1 points of net price realization and product mix. Net sales were up 20.5 percent in the six-month period ended November 25, 2007 to \$1,265.1 million. This growth was driven by an 8.4 point increase in sales volume, 8.1 points of favorable foreign exchange, and 4.0 points of net price realization and product mix. Sales volumes increased across all of our geographic regions, especially in Europe and Latin America.

International Net Sales Percentage Change by Geographic Region

	Quarter Ended	Six-Month Period Ended
	Nov. 25, 2007	Nov. 25, 2007
Europe	19.9%	18.0%
Canada	15.5	13.4
Asia/Pacific	24.4	21.2
Latin America and South Africa	42.6	43.1

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Total	22.2%	20.5%
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For the second quarter of fiscal 2008, net sales in Europe grew 19.9 percent reflecting strong performance from *Old El Paso* and *Nature Valley* across the region, and especially in the United Kingdom. Net sales in Canada increased 15.5 percent, led by *Nature Valley* grain snacks, ready-to-eat cereals, and *Old El Paso* products. In the Asia/Pacific region, net sales grew by 24.4 percent led by strong growth for *Häagen-Dazs* in China and new *Wanchai Ferry* products. Latin America and South Africa net sales increased 42.6 percent led by market share gains and pricing actions taken in key countries.

Operating profits for the second quarter of fiscal 2008 improved 36.2 percent to \$84.3 million from \$61.9 million in the same period a year ago, with foreign currency exchange contributing 24.6 points of that growth. The growth was also driven by a \$13.6 million increase from higher volumes resulting from increases in consumer marketing spending. Net price realization offset supply chain and administrative cost increases.

Operating profits for the six-month period ended November 25, 2007 improved 31.8 percent to \$155.3 million from \$117.8 million in the same period a year ago, with foreign currency exchange contributing 20.3 points of that growth. The growth was also driven by a \$28.0 million increase from higher volumes resulting from increases in consumer marketing spending. Net price realization offset supply chain and administrative cost increases.

Bakeries and Foodservice Segment Results

Net sales for our Bakeries and Foodservice segment increased 7.6 percent to \$516.7 million in the second quarter of fiscal 2008. The increase in net sales was driven by an 8.6 point benefit from price increases taken to counter rising input costs, and changes in product mix. This was offset somewhat by a 1.0 point decline in volume, mainly in the distributors and restaurants customer channel, and included the effects of frozen pie and par-baked bread product lines divested in fiscal 2007.

Net sales for our Bakeries and Foodservice segment increased 3.5 percent to \$957.6 million in the six-month period ended November 25, 2007. The increase in net sales was driven mainly by 6.4 points of benefit from net price realization and product mix. This was partially offset by a 2.9 point decline in volume, mainly in the distributors and restaurants customer channel, and included the effects of frozen pie and par-baked bread product lines divested in fiscal 2007.

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Bakeries and Foodservice Net Sales Percentage Change by Customer Channel

	Quarter Ended	Six-Month Period Ended
	Nov. 25, 2007	Nov. 25, 2007
Distributors and restaurants	3.2%	(0.4)%
Bakery channels	13.1	7.3
Convenience stores and vending	6.2	5.1
Total	7.6%	3.5%

Operating profits for the segment for the second quarter of fiscal 2008 were \$48.0 million, down from \$56.1 million in the second quarter of fiscal 2007. For the six-month period ended November 25, 2007, operating profits for the segment were \$82.0 million, down from \$85.1 million in the same period a year ago. The decreases for the quarter and six-month period were largely driven by higher input costs and \$3.0 million of expenses for conversion from brokers to a direct sales force for the organization. This was partially offset by manufacturing efficiencies and benefits from prior restructuring activities.

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Unallocated Corporate Expenses

For the second quarter, unallocated corporate expenses were \$26.2 million in fiscal 2008 compared to \$39.5 million in fiscal 2007. The decrease is primarily due to a net gain on commodity derivatives of \$15.1 million, the recognition of a previously deferred gain on the sale of a corporate investment of \$10.8 million and lower compensation costs. These benefits were partially offset by \$17.3 million of accelerated depreciation on long-lived assets associated with our previously announced restructuring action at our plant in Trenton, Ontario.

For the six-month period ended November 25, 2007, unallocated corporate expenses were \$79.9 million, compared to \$82.8 million for the same period last year. The decrease is primarily due to a net gain on commodity derivatives of \$12.1 million and the recognition of a previously deferred gain on the sale of a corporate investment of \$10.8 million. These were offset by \$17.3 million of accelerated depreciation on long-lived assets associated with our previously announced restructuring action at our plant in Trenton, Ontario and \$10.9 million of costs related to the remarketing of the Class A and Series B-1 interests in GMC.

LIQUIDITY

During the six-month period ended November 25, 2007, our operations generated \$443.7 million of cash compared to \$565.2 million of cash in the same period last year. The \$121.5 million decrease in cash from operations was primarily due to increased working capital (accounts receivable and inventory).

During the six-month period ended November 25, 2007, \$374.6 million of cash was used to increase inventories, mainly due to inflation in commodity prices and higher levels of raw material inventories.

Cash used by investing activities decreased \$138.1 million from the six-month period ended November 26, 2006. Last year's period included the acquisition of the Uncle Tobys business by our CPW joint venture.

Financing activities used \$190.9 million of cash in the six-month period ended November 25, 2007. Net cash provided by notes payable was \$744.0 million. We used a significant amount of cash flows from notes payable to finance share repurchases and our repurchases of the Series B-1 interests in GMC and the Series A preferred stock of General Mills Capital, Inc. We used the \$700.0 million proceeds from the issuance of long-term debt to reduce outstanding commercial paper balances. Also, during fiscal 2008, we received \$750.0 million as part of the settlement of a forward contract with Lehman Brothers and used the cash to reduce outstanding commercial paper balances.

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On August 7, 2007, we repurchased for a net amount of \$843.0 million all of the outstanding Series B-1 Interests in GMC as part of a required remarketing of those interests. The purchase price reflected the Series B-1 Interests' original capital account balance of \$835.0 million and \$8.0 million of capital account appreciation attributable and paid to the third party holder of the Series B-1 Interests. The capital appreciation paid to the third party holder of the Series B-1 Interests was recorded as a reduction to retained earnings, a component of stockholders' equity, on the Consolidated Balance Sheets, and reduced net earnings available to common stockholders in our basic and diluted earnings per share (EPS) calculations.

We and the third party holder of all of GMC's outstanding Class A limited membership interests (Class A Interests) agreed to reset, effective on June 28, 2007, the preferred rate of return applicable to the Class A Interests to the sum of 3 month LIBOR plus 65 basis points. On June 28, 2007, we sold \$92.3 million of additional Class A Interests to the same third party. There was no gain or loss associated with these transactions. As of November 25, 2007, the carrying value of all outstanding Class A Interests on our Consolidated Balance Sheets was \$242.3 million, and the capital account balance of the Class A Interests, upon which preferred distributions are calculated, was \$248.1 million.

On June 28, 2007, we repurchased for \$150.0 million all of the outstanding Series A preferred stock of our subsidiary General Mills Capital, Inc. using proceeds from the sale of the Class A Interests and commercial paper. There was no gain or loss associated with this repurchase.

During the six-month period ended November 25, 2007, we repurchased 21.0 million shares of common stock for \$1,226.5 million. As of November 25, 2007, we had unpaid obligations associated with our share repurchases totaling \$0.4 million included in other current liabilities.

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We settled these obligations shortly after the end of our fiscal quarter.

On December 10, 2007, our Board of Directors approved a quarterly dividend of 39 cents per share, payable on February 1, 2008, to shareholders of record on January 10, 2008. During the six-month period ended November 25, 2007, we paid \$259.4 million in dividends compared to \$247.4 million in the same period last year. In addition, the Board of Directors approved the retirement of 125.0 million shares of common stock in treasury effective December 10, 2007. This action will reduce common stock by \$12.5 million, reduce additional paid-in capital by \$5,068.3 million, and reduce common stock in treasury by \$5,080.8 million on our Consolidated Balance Sheets as of that date.

CAPITAL RESOURCES

Our capital structure was as follows:

In millions	Nov. 25, 2007	May 27, 2007
Notes payable	\$ 2,046.0	\$ 1,254.4
Current portion of long-term debt	2,049.2	1,734.0
Long-term debt	3,599.1	3,217.7
 Total debt	 7,694.3	 6,206.1
Minority interests	242.3	1,138.8
Stockholders' equity	5,679.5	5,319.1
 Total capital	 \$ 13,616.1	 \$ 12,664.0

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Commercial paper is a continuing source of short-term financing. We issue commercial paper in the United States, Canada, and Europe. Our commercial paper borrowings are supported by fee-paid committed credit lines consisting of a \$1.9 billion facility expiring in October 2012 and a \$1.1 billion facility expiring in October 2010. As of November 25, 2007, we did not have any outstanding borrowings under these agreements.

As of October 25, 2007, we terminated our credit agreement dated August 3, 2007, which provided an aggregate revolving commitment of \$750.0 million and was scheduled to expire on December 6, 2007.

On October 15, 2007, we and Lehman Brothers settled the forward contract established between the parties in October 2004 in conjunction with the issuance by Lehman Brothers of \$750.0 million of notes that were mandatorily exchangeable for shares of our common stock. In settlement of that forward contract, we issued 14.3 million shares of our common stock and received \$750.0 million in cash from Lehman Brothers. We used the cash received to reduce outstanding commercial paper balances.

On October 9, 2007, we entered into a new five-year credit agreement with an initial aggregate revolving commitment of \$1.9 billion which is scheduled to expire in October 2012. As of November 25, 2007, we do not have any outstanding borrowings under this agreement or any other credit facility. Concurrent with the execution of the new credit agreement, we terminated our five-year credit agreement dated January 20, 2004, which provided \$750.0 million of revolving credit and was scheduled to expire in January 2009, and our amended and restated credit agreement, dated October 17, 2006, which provided \$1.1 billion of revolving credit and was scheduled to expire in October 2007.

Our credit facilities, certain of our long-term debt agreements, and our minority interests contain restrictive covenants. As of November 25, 2007, we were in compliance with all of these covenants.

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We have \$2.0 billion of long-term debt maturing in the next 12 months and classified as current, including \$1.4 billion that may mature in fiscal 2008 based on the put rights of the note holders. We also have classified \$142.4 million of long-term debt as current based on our intention to redeem the debt within the next 12 months. We believe that cash flows from operations, together with available short- and long-term debt financing, will be adequate to meet our liquidity and capital needs for at least the next 12 months.

On August 29, 2007, we completed the sale of \$700.0 million of 5.65 percent fixed-rate notes due September 10, 2012. The proceeds of the notes were used to repay outstanding commercial paper. Interest on the notes is payable semi-annually in arrears. The notes may be redeemed at our option at any time for a specified make-whole amount. The notes are senior unsecured, unsubordinated obligations and contain a change of control provision, as defined in the instruments governing the notes.

We have an effective shelf registration statement on file with the Securities and Exchange Commission covering the sale of debt securities, common stock, preference stock, depository shares, securities warrants, purchase contracts, purchase units, and units. As of November 25, 2007, \$3.0 billion remained available under the shelf registration for future use.

OFF BALANCE-SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

There were no material changes outside the ordinary course of our business in our contractual obligations or off-balance-sheet arrangements during the first six months of fiscal 2008, except for a new data contract that we entered into in June. We have contractual obligations of \$155.2 million over the eight year life of this contract.

SIGNIFICANT ACCOUNTING ESTIMATES

Our significant accounting policies are described in Note 2 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended May 27, 2007. The accounting policies used in preparing our interim fiscal 2008 Consolidated Financial Statements are the same as those described in our Form 10-K, except as discussed in Notes 6, 16, and 18 to these Consolidated Financial Statements for the quarterly and six-month periods ended November 25, 2007.

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Our significant accounting estimates are those that have meaningful impact on the reporting of our financial condition and results of operations. These estimates include our accounting for promotional expenditures, intangible assets, stock compensation, income taxes, and defined benefit pension, other postretirement, and postemployment benefits. Except for changes in these estimates as disclosed below, the assumptions and methodologies used in the determination of those estimates as of November 25, 2007, are the same as those described in our Annual Report on Form 10-K for the fiscal year ended May 27, 2007.

Stock Compensation

We have various stock-based compensation programs under which awards, including stock options, restricted stock, and restricted stock units, may be granted to employees and non-employee directors. Stock option grants are made at 100 percent of the fair market value of our stock at the date of grant. These awards generally vest over four years and have a ten-year and one-month term. The expense recorded in our Consolidated Financial Statements is based on the fair value of the awards.

We estimate the fair value of each option on the grant date using the Black-Scholes option-pricing model, which requires us to make predictive assumptions regarding future stock price volatility, employee exercise behavior, and dividend yield. We estimate our future stock price volatility using the historical volatility over the expected term of the option, excluding time periods of volatility we believe a marketplace participant would exclude in estimating our stock price volatility. For the fiscal 2008 grants, we have excluded historical volatility for fiscal 2002 and prior, primarily because volatility driven by the acquisition of Pillsbury does not reflect what we believe to be expected future volatility. We also have considered, but did not use, implied volatility in our estimate, because trading activity in options on our stock, especially those with tenors of greater than 6 months, is insufficient to provide a reliable measure of expected volatility. Our method of selecting the other valuation assumptions is explained on pages 58 and 59 in our Annual Report on Form 10-K for the fiscal year ended May 27, 2007.

Income Taxes

We adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation (FIN) No 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48), as of the beginning of fiscal 2008. Prior to adoption, our policy was to establish reserves that reflected the probable outcome of known tax contingencies. The effects of final resolution, if any, were recognized as changes to the effective income tax rate in the period of resolution. FIN 48 requires application of a more likely than not threshold to the recognition and derecognition of uncertain tax positions. FIN 48 permits us to recognize the amount of tax benefit that has a greater than 50 percent likelihood of being ultimately realized upon settlement. It further requires that a change in judgment related to the expected ultimate resolution of uncertain tax positions be recognized in earnings in the quarter of such change.

Annually we file more than 350 income tax returns in approximately 100 global taxing jurisdictions. A number of years may elapse before an uncertain tax position is audited and finally resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, we believe that our reserves for income taxes reflect the most likely outcome. We adjust these reserves, as well as the related interest, in light of changing facts and circumstances. Settlement of any particular position would usually require the use of cash.

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The number of years with open tax audits varies depending on the tax jurisdiction. Our major taxing jurisdictions include the United States (federal and state) and Canada. With limited exceptions, the Company is no longer subject to United States federal examinations by the Internal Revenue Service (IRS) for fiscal years before 2002. The IRS recently concluded field examinations for our 2002 and 2003 fiscal years. A payment of \$24.8 million was made during the first quarter of fiscal 2008 to cover the additional tax liability plus interest related to all agreed adjustments for this audit cycle. The IRS also proposed additional adjustments for the 2002-2003 audit cycle including several adjustments to the tax benefits associated with the sale of minority interests in our GMC subsidiary. We believe we have meritorious defenses and intend to vigorously defend our position. Our potential liability for this matter is significant and, notwithstanding our reserves against this potential liability, an unfavorable resolution could have a material adverse impact on our results of operations and cash flows from operations. We do not expect the amount of our tax reserves for these issues to change in the next 12 months. The IRS initiated its audit of our fiscal 2004 through 2006 tax years during the first quarter of fiscal 2008.

Various tax examinations by United States state taxing authorities could be conducted for any open tax year, which vary by jurisdiction, but are generally from 3 to 5 years. Currently, several state examinations are in progress. The Canada Revenue Agency is conducting an audit of our income tax returns in Canada for fiscal years 2003 (which is our earliest tax year still open for examination) through 2005. We do not anticipate that any United States state tax or Canadian tax adjustments will have a significant impact on our financial position or results of operations.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB approved the issuance of Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007) Business Combinations (SFAS 141R). SFAS 141R establishes principles and requirements for how the acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R applies to business combinations for which the acquisition date is on or after December 15, 2008. We are evaluating the impact of SFAS 141R on our results of operations and financial condition.

In December 2007, the FASB approved the issuance of SFAS No. 160 Noncontrolling Interests in Consolidated Financial Statements an amendment to ARB No. 51 (SFAS 160). SFAS 160 establishes accounting and reporting standards that require the ownership interest in subsidiaries held by parties other than the parent be clearly identified and presented in the Consolidated Balance Sheets within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and the noncontrolling interest be clearly identified and presented on the face of the Consolidated Statement of Earnings; and changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. This statement is effective for fiscal years beginning on or after December 15, 2008, which for us is the first quarter of fiscal 2010. We are evaluating the impact of SFAS 160 on our results of operations and financial condition.

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In June 2007, the FASB approved the issuance of Emerging Issues Task Force Issue (EITF) No. 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities (EITF 07-3). EITF 07-3 requires that nonrefundable advance payments for future research and development activities for materials, equipment, facilities, and purchased intangible assets that have an alternative future use be recognized in accordance with SFAS No. 2, Accounting for Research and Development Costs. EITF 07-3 is effective for fiscal years beginning after December 15, 2007, which for us is the first quarter of fiscal 2009. We are evaluating the impact of EITF 07-3 on our results of operations and financial condition.

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In June 2007, the FASB approved the issuance of EITF No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards (EITF 06-11). EITF 06-11 requires that tax benefits from dividends paid on unvested restricted shares be charged directly to stockholders' equity instead of benefiting income tax expense. EITF 06-11, which will be effective for us in the first quarter of fiscal 2009, is expected to increase our effective income tax rate by approximately 20 basis points.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS No. 115 (SFAS 159). This statement provides companies with an option to measure, at specified election dates, many financial instruments and certain other items at fair value that are not currently measured at fair value. A company that adopts SFAS 159 will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. This statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This statement is effective for fiscal years beginning after November 15, 2007, which for us is the first quarter of fiscal 2009. We are evaluating the impact of SFAS 159 on our results of operations and financial condition.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). This statement provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS 123R and related interpretations and pronouncements that require or permit measurement similar to fair value but are not intended to measure fair value. For financial assets and liabilities, this pronouncement is effective for fiscal years beginning after November 15, 2007, which for us is the first quarter of fiscal 2009. For non-financial assets and liabilities, it is effective for fiscal years beginning after November 15, 2008, which for us is the first quarter of fiscal 2010. We are evaluating the impact of SFAS 157 on our results of operations and financial condition.

NON-GAAP MEASURES

We have included in this MD&A a measure of financial performance that is not defined by GAAP. This non-GAAP measure should be viewed in addition to, and not in lieu of, the comparable GAAP measure.

Total Segment Operating Profit

This non-GAAP measure is used in internal management reporting and as a component of the Board of Directors' rating of our performance for management and employee incentive compensation. Management and the Board of Directors believe that this measure provides useful information to investors because it is the profitability measure we use to evaluate segment performance. A reconciliation of this measure to the relevant GAAP measure, operating profit, is included in Note 17 to the Consolidated Financial Statements included in this Form 10-Q.

GLOSSARY

Derivatives. Financial instruments that we use to manage our risk arising from changes in commodity prices, interest rates, foreign exchange rates, and stock prices.

Generally Accepted Accounting Principles (GAAP). Guidelines, procedures, and practices that we are required to use in recording and reporting accounting information in our published financial statements.

Goodwill. The difference between the purchase price of acquired companies and the related fair values of net assets acquired.

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Hedge accounting. Special accounting for qualifying hedges that allows changes in a hedging instrument's fair value to offset corresponding changes in the hedged item in the same reporting period. Hedge accounting is permitted for certain hedging instruments and hedged items, only if the hedging relationship is highly effective, and only prospectively from the date a hedging relationship is formally documented.

Interest bearing instruments. Notes payable, long term debt, including current portion, minority interests, cash and cash equivalents and certain interest bearing investments classified within prepaid expenses and other current assets and other assets.

LIBOR. London Interbank Offered Rate.

Minority interests. Preferred stock and interests of subsidiaries held by third parties.

Net price realization. The impact of list and promoted price increases, net of trade and other promotion costs.

Total debt. Notes payable and long-term debt, including current portion.

CAUTIONARY STATEMENT RELEVANT TO FORWARD-LOOKING INFORMATION FOR THE PURPOSE OF SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This report contains or incorporates by reference forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are based on our management's current expectations and assumptions. We also may make written or oral forward-looking statements, including statements contained in our filings with the SEC and in our reports to stockholders.

The words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "plan," "project" or similar expressions identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results and those currently anticipated or projected. We wish to caution you not to place undue reliance on any such forward-looking statements.

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we are identifying important factors that could affect our financial performance and could cause our actual results in future periods to differ materially from any current opinions or statements.

Our future results could be affected by a variety of factors, such as: competitive dynamics in the consumer foods industry and the markets for our products, including new product introductions, advertising activities, pricing actions, and promotional activities of our competitors; economic conditions, including changes in inflation rates, interest rates, or tax rates; product development and innovation; consumer acceptance of new products and product improvements; consumer reaction to pricing actions and changes in promotion levels; acquisitions or dispositions of businesses or assets; changes in capital structure; changes in laws and regulations, including labeling and advertising regulations; impairments in the carrying value of goodwill, other intangible assets, or other long-lived assets, or changes in the useful lives of other intangible assets; changes in accounting standards and the impact of significant accounting estimates; product quality and safety issues, including recalls and product liability; changes in customer demand for our products; effectiveness of advertising, marketing, and promotional programs; changes in consumer behavior, trends, and preferences, including weight loss trends; consumer perception of health-related issues, including obesity; consolidation in the retail environment; changes in purchasing and inventory levels of significant customers; fluctuations in the cost and availability of supply chain resources, including raw materials, packaging, and energy; disruptions or inefficiencies in the supply chain; volatility in the market value of derivatives used to hedge price risk for certain commodities; benefit plan expenses due to changes in plan asset values and discount rates used to determine plan liabilities; failure of our information technology systems; resolution of uncertain income tax matters; foreign economic conditions, including currency rate fluctuations; and political unrest in foreign markets and economic uncertainty due to terrorism or war.

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You should also consider the risk factors that we identify on pages 5 through 10 of our Annual Report on Form 10-K for the fiscal year ended May 27, 2007, which could also affect our future results.

We undertake no obligation to publicly revise any forward-looking statements to reflect events or circumstances after the date of those statements or to reflect the occurrence of anticipated or unanticipated events.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no material changes in our market risk during the six-month period ended November 25, 2007. For additional information, see Item 7A of our Annual Report on Form 10-K for the fiscal year ended May 27, 2007.

Item 4. Controls and Procedures.

We, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of November 25, 2007, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is (1) recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, in a manner that allows timely decisions regarding required disclosure.

During our fiscal quarter ended November 25, 2007, we made a change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. During the second quarter of fiscal 2008, we finalized the design of, tested, and implemented a new consolidation and financial reporting system.

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Part II. OTHER INFORMATION

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

The following table sets forth information with respect to shares of our common stock that we purchased during the fiscal quarter ended November 25, 2007.

Period	Total Number of Shares	Average Price Paid Per	Total Number of Shares Purchased as Part of a Publicly	Maximum Number of Shares that may yet be Purchased Under
--------	------------------------------	------------------------------	--	--

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	Purchased (a)	Share	Announced Program (b)	the Program (b)
Aug. 27, 2007- Sep. 30, 2007	45,304	\$ 57.56	45,304	45,723,021
Oct. 1, 2007- Oct. 28, 2007	28,959	\$ 57.47	28,959	45,694,062
Oct. 29, 2007- Nov. 25, 2007	31,500	\$ 57.05	31,500	45,662,562
Total	105,763	\$ 57.39	105,763	45,662,562

- (a) The total number of shares purchased includes: (i) 89,100 shares purchased from the ESOP fund of our 401(k) savings plan, and (ii) 16,663 shares of restricted stock withheld for the payment of withholding taxes upon vesting of restricted stock. These amounts include 7,000 shares acquired at an average price of \$57.10 for which settlement occurred after November 25, 2007.
- (b) On December 11, 2006, our Board of Directors approved and we announced an authorization for the repurchase of up to 75,000,000 shares of our common stock. Purchases can be made in the open market or in privately negotiated transactions, including the use of call options and other derivative instruments, Rule 10b5-1 trading plans, and accelerated repurchase programs. The Board did not specify an expiration date for the authorization.

Item 4. Submission of Matters to a Vote of Security Holders.

- (a) The Annual Meeting of Stockholders was held on September 24, 2007.
- (b) All 13 directors nominated were elected at the Annual Meeting.
- (c) For the election of directors, the results were as follows:

Paul Danos	For	280,570,251
	Against	3,991,796
	Abstain	2,736,672
William T. Esrey	For	276,457,998
	Against	7,881,373
	Abstain	2,959,348
Raymond V. Gilmartin	For	278,737,860
	Against	5,875,543
	Abstain	2,685,316
Judith Richards Hope	For	277,218,605
	Against	7,293,715
	Abstain	2,786,399
Heidi G. Miller	For	157,632,908
	Against	126,093,387
	Abstain	3,572,424

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Hilda Ochoa-Brillembourg	For	278,868,332
	Against	5,571,543
	Abstain	2,858,844
Steve Odland	For	280,570,590
	Against	4,005,254
	Abstain	2,722,875
Kendall J. Powell	For	279,073,001
	Against	5,530,391
	Abstain	2,695,327
Michael D. Rose	For	269,341,178
	Against	15,168,847
	Abstain	2,788,694
Robert L. Ryan	For	279,846,138
	Against	4,736,403
	Abstain	2,716,178
Stephen W. Sanger	For	277,238,988
	Against	7,254,588
	Abstain	2,805,143
A. Michael Spence	For	241,217,918
	Against	42,880,192
	Abstain	3,200,609
Dorothy A. Terrell	For	277,743,720
	Against	6,813,841
	Abstain	2,741,158

The appointment of KPMG LLP as our independent registered public accounting firm for fiscal 2008 was ratified:

For: 280,467,174
 Against: 4,804,721
 Abstain: 2,026,824

The 2007 Stock Compensation Plan was adopted:

For: 193,892,164
 Against: 52,280,014
 Abstain: 3,106,120
 Broker 38,020,421
 Non-Vote:

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Item 6.	Exhibits.
Exhibit 3.1	By-laws of General Mills, Inc.
Exhibit 10.1	General Mills, Inc. 2007 Stock Compensation Plan (incorporated herein by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K filed September 28, 2007)
Exhibit 10.2	Amendment No. 1, dated as of October 9, 2007, to Five-Year Credit Agreement, dated as of October 21, 2005, among General Mills, Inc., the several financial institutions from time to time party to the agreement and JPMorgan Chase Bank, N.A., as Administrative Agent (incorporated herein by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed October 15, 2007)
Exhibit 10.3	Five-Year Credit Agreement, dated as of October 9, 2007, among General Mills, Inc., the several financial institutions from time to time party to the agreement and JPMorgan Chase Bank, N.A., as Administrative Agent (incorporated herein by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed October 15, 2007)
Exhibit 10.4	Amendment to Credit Agreements, dated as of October 31, 2007, among General Mills, Inc., various financial institutions, and JPMorgan Chase Bank, N.A., as Administrative Agent
Exhibit 12.1	Computation of Ratio of Earnings to Fixed Charges
Exhibit 31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

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

GENERAL MILLS, INC.

(Registrant)

Date December 19, 2007

/s/ Siri S. Marshall

Siri S. Marshall
Senior Vice President,
General Counsel and Secretary

Date December 19, 2007

/s/ Richard O. Lund

Richard O. Lund
Vice President, Controller
(Principal Accounting Officer)

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Exhibit Index

Exhibit No.	Description
3.1	By-laws of General Mills, Inc.
10.4	Amendment to Credit Agreements, dated as of October 31, 2007, among General Mills, Inc., various financial institutions, and JPMorgan Chase Bank, N.A., as Administrative Agent
12.1	Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

ight;">

Commercial

	244,854
	3.76
%	131,653
	4.61
%	376,507
	4.06
	38

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%

Equipment financing

435,629

7.35

%

41,095

6.74

%

476,724

7.30

%

Condominium association

41,859

4.80

%

0.00

%

41,859

4.80

39

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%

Total commercial loans and leases

722,342

5.99

%

172,748

5.11

%

895,090

5.82

%

Indirect automobile loans

479,782

5.14

%

0.00

%

479,782

5.14

40

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%

Consumer loans:

Residential mortgage

375,028

3.71

%

132,071

4.06

%

507,099

3.81

41

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%

Home equity

112,486

3.41

%

145,353

3.96

%

257,839

3.72

%

Other consumer

7,401

4.48

%

1,130

13.83

%

8,531

5.72

42

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%

Total consumer loans

494,915

3.66

%

278,554

4.05

%

773,469

3.80

%

Total loans and leases

\$

3,266,200

4.74

%

\$

938,815

4.51

%

\$

4,205,015

4.68

%

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012**

	Originated		At December 31, 2012 Acquired		Total	
	Balance	Weighted Average Coupon	Balance	Weighted Average Coupon	Balance	Weighted Average Coupon
(Dollars in Thousands)						
Commercial real estate loans:						
Commercial real estate mortgage	\$ 871,552	4.62%	\$ 429,681	4.69%	\$ 1,301,233	4.64%
Multi-family mortgage	506,017	4.50%	100,516	4.99%	606,533	4.58%
Construction	80,913	4.20%	17,284	4.73%	98,197	4.29%
Total commercial real estate loans	1,458,482	4.56%	547,481	4.75%	2,005,963	4.61%
Commercial loans and leases:						
Commercial	230,892	3.89%	151,385	4.72%	382,277	4.22%
Equipment financing	366,297	7.69%	54,694	6.91%	420,991	7.59%
Condominium association	44,187	5.02%			44,187	5.02%
Total commercial loans and leases	641,376	6.14%	206,079	5.30%	847,455	5.93%
Indirect automobile loans	542,344	5.31%			542,344	5.31%
Consumer loans:						
Residential mortgage	368,095	3.87%	143,014	4.18%	511,109	3.93%
Home equity	99,683	3.45%	161,879	4.07%	261,562	3.83%
Other consumer	6,122	5.35%	1,157	12.97%	7,279	6.56%
Total consumer loans	473,900	3.78%	306,050	4.15%	779,950	3.92%
Total loans and leases	\$ 3,116,102	4.89%	\$ 1,059,610	4.67%	\$ 4,175,712	4.83%

The Company's lending is primarily in the eastern half of Massachusetts, southern New Hampshire and Rhode Island, with the exception of equipment financing, 41.7% of which is in the greater New York/New Jersey metropolitan area and 58.3% of which is in other areas in the United States of America.

Residential mortgage loans held-for-sale were \$4.2 million and \$3.2 million at June 30, 2013 and December 31, 2012, respectively.

Accretable Yield for the Acquired Loan Portfolio

The following tables summarize activity in the accretable yield for the acquired loan portfolio for the periods indicated:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In Thousands)			
Balance at beginning of period	\$ 53,815	\$ 73,921	\$ 57,812	\$ (1,369)
Acquisitions				81,503
Reclassification from nonaccretable difference for loans with improved cash flows	3,180		5,376	
Accretion	(4,813)	(5,265)	(11,006)	(11,478)
Balance at end of period	\$ 52,182	\$ 68,656	\$ 52,182	\$ 68,656

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012**

Subsequent to acquisition, management periodically reforecasts the expected cash flows for acquired ASC 310-30 loans, taking into account prepayment speeds, probability of default and loss given defaults. Management then compares this reforecast to the original estimates to evaluate the need for a loan loss provision and/or prospective yield adjustments. During the six months ended June 30, 2013, accretable yield adjustments totaling \$5.4 million were made for certain loan pools. These accretable yield adjustments, which are subject to continued re-assessment, will be recognized over the remaining lives of those pools. No accretable yield adjustments were made in the acquired loan portfolio during the six months ended June 30, 2012.

The aggregate remaining nonaccretable difference (representing both principal and interest) applicable to acquired loans totaled \$9.2 and \$14.6 million at June 30, 2013 and December 31, 2012, respectively.

Related Party Loans

The Banks' authority to extend credit to their respective directors and executive officers, as well as to entities controlled by such persons, is currently governed by the requirements of the Sarbanes-Oxley Act of 2002 and Regulation O of the FRB. Among other things, these provisions require that extensions of credit to insiders (1) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features; and (2) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Banks' capital. In addition, the extensions of credit to insiders must be approved by each Bank's Board of Directors.

The following table summarizes the change in the total amounts of loans and advances, to directors, executive officers and their affiliates for the periods indicated. All loans were performing at June 30, 2013.

	Six Months Ended June 30,	
	2013	2012
	(In Thousands)	
Balance at beginning of period	\$ 4,083	\$ 16,428
Acquired loans		2,848
New loans granted during the period	100	131
Advances on lines of credit	91	4
Repayments	(349)	(13,917)
Loans no longer classified as insider loans	545	
Balance at end of period	\$ 4,470	\$ 5,494

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Unfunded commitments on extensions of credit to insiders totaled \$7.1 million and \$6.9 million at June 30, 2013 and December 31, 2012, respectively.

Recourse Obligations

As a result of the acquisition of BankRI, the Company has a recourse obligation under a lease sale agreement for up to 8.0% of the original sold balance of approximately \$9.8 million relating to the lease portfolio of BankRI's subsidiary Macrolease. Historically, delinquency rates for this lease portfolio have been significantly less than 8.0%; the rate at June 30, 2013 was 0.26%. At June 30, 2013, a liability for the recourse obligation was included in the Company's unaudited consolidated financial statements.

Loans and Leases Pledged as Collateral

At June 30, 2013 and December 31, 2012, respectively, \$1.3 billion and \$1.5 billion of loans and leases were pledged as collateral for repurchase agreements; municipal deposits; treasury, tax and loan deposits; swap agreements; FRB borrowings; and FHLBB borrowings.

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012***Loans Serviced for Others*

Loans serviced for others are not included in the accompanying unaudited consolidated balance sheets. The portion of unpaid principal balance of mortgage and other loans serviced for others were \$110.9 million and \$164.5 million at June 30, 2013 and December 31, 2012, respectively.

(5) Allowance for Loan and Lease Losses

The following tables present the changes in the allowance for loan and lease losses and the recorded investment in loans and leases by portfolio segment for the periods indicated:

	Three Months Ended June 30, 2013					
	Commercial Real Estate	Commercial	Indirect Automobile	Consumer	Unallocated	Total
	(In Thousands)					
Balance at March 31, 2013	\$ 20,588	\$ 11,652	\$ 5,000	\$ 2,596	\$ 2,696	\$ 42,532
Charge-offs	(81)	(477)	(318)	(154)		(1,030)
Recoveries		182	149	60		391
Provision (credit) for loan and lease losses	1,512	434	(136)	497	81	2,388
Balance at June 30, 2013	\$ 22,019	\$ 11,791	\$ 4,695	\$ 2,999	\$ 2,777	\$ 44,281

	Three Months Ended June 30, 2012					
	Commercial Real Estate	Commercial	Indirect Automobile	Consumer	Unallocated	Total
	(In Thousands)					
Balance at March 31, 2012	\$ 16,836	\$ 7,078	\$ 5,656	\$ 1,825	\$ 3,033	\$ 34,428
Charge-offs		(3,416)	(344)	(210)		(3,970)
Recoveries	40	124	119	12		295
Provision (credit) for loan and lease losses	1,062	5,176	249	486	(295)	6,678
Balance at June 30, 2012	\$ 17,938	\$ 8,962	\$ 5,680	\$ 2,113	\$ 2,738	\$ 37,431

	Six Months Ended June 30, 2013					
	Commercial Real Estate	Commercial	Indirect Automobile	Consumer	Unallocated	Total

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(In Thousands)

Balance at December 31, 2012	\$	20,018	\$	10,655	\$	5,304	\$	2,545	\$	2,630	\$	41,152
Charge-offs		(81)		(724)		(680)		(206)				(1,691)
Recoveries		4		264		279		86				633
Provision (credit) for loan and lease losses		2,078		1,596		(208)		574		147		4,187
Balance at June 30, 2013	\$	22,019	\$	11,791	\$	4,695	\$	2,999	\$	2,777	\$	44,281

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012**

	Commercial Real Estate	Commercial	Six Months Ended June 30, 2012			Unallocated	Total
			Indirect Automobile	Consumer	(In Thousands)		
Balance at December 31, 2011	\$ 15,477	\$ 5,997	\$ 5,604	\$ 1,577	\$ 3,048	\$ 31,703	
Charge-offs		(3,757)	(783)	(218)		(4,758)	
Recoveries	80	202	266	13		561	
Provision (credit) for loan and lease losses	2,381	6,520	593	741	(310)	9,925	
Balance at June 30, 2012	\$ 17,938	\$ 8,962	\$ 5,680	\$ 2,113	\$ 2,738	\$ 37,431	

The liability for unfunded credit commitments, which is included in other liabilities, was \$0.9 million and \$0.7 million at June 30, 2013 and December 31, 2012, respectively. During the six-month period ended June 30, 2013, the liability for unfunded credit commitments increased by \$0.2 million to reflect changes in the estimate of loss exposure associated with credit commitments. No credit commitments were charged off against the liability account in the six-month periods ended June 30, 2013 or 2012.

Provision for Credit Losses

The provisions for credit losses are set forth below for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In Thousands)			
Provisions for loan and lease losses:				
Commercial real estate	\$ 1,512	\$ 1,062	\$ 2,078	\$ 2,381
Commercial	434	5,176	1,596	6,520
Indirect automobile	(136)	249	(208)	593
Consumer	497	486	574	741
Unallocated	81	(295)	147	(310)
Total provision for loan and lease losses	2,388	6,678	4,187	9,925
Unfunded credit commitments	51		107	
Total provision for credit losses	\$ 2,439	\$ 6,678	\$ 4,294	\$ 9,925

Procedure for Placing Loans and Leases on Nonaccrual

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Accrual of interest on loans generally is discontinued when contractual payment of principal or interest becomes past due 90 days or, if in management's judgment, reasonable doubt exists as to the full timely collection of interest. Exceptions may be made if the loan has matured and is in the process of renewal or is well-secured and in the process of collection. When a loan is placed on nonaccrual status, interest accruals cease and uncollected accrued interest is reversed and charged against current interest income. Interest payments on nonaccrual loans are generally applied to principal. If collection of the principal is reasonably assured, interest payments are recognized as income on the cash basis. Loans are generally returned to accrual status when principal and interest payments are current, full collectability of principal and interest is reasonably assured and a consistent record of performance has been achieved.

Allowance for Loan and Lease Losses Methodology

Management has established a methodology to determine the adequacy of the allowance for loan and lease losses that assesses the risks and losses inherent in the loan and lease portfolio. For purposes of determining the allowance for loan and lease losses, the Company has segmented certain loans and leases in the portfolio by product type into the following pools: (1) commercial real estate loans, (2) commercial loans and leases, (3) indirect

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BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

At and for the Six Months Ended June 30, 2013 and 2012

automobile loans and (4) consumer loans. Portfolio segments are further disaggregated into classes based on the associated risks within the segments. Commercial real estate loans are divided into three classes: commercial real estate mortgage loans, multi-family mortgage loans and construction loans. Commercial loans and leases are divided into three classes: commercial loans, equipment financing, and loans to condominium associations. The indirect automobile loan segment is not divided into classes. Consumer loans are divided into three classes: residential mortgage loans, home equity loans and other consumer loans. For each class of loan, management makes significant judgments in selecting the estimation method that fits the credit characteristics of its class and portfolio segment as set forth below.

General Allowance

The general allowance for loan and lease losses was \$39.8 million at June 30, 2013, compared to \$36.8 million at December 31, 2012. The general portion of the allowance for loan and lease losses increased by \$3.0 million during the six months ended June 30, 2013, in part as a result of growth in commercial real estate and equipment financing portfolios.

Specific Allowance

The specific allowance for loan and lease losses was \$1.1 million at June 30, 2013, compared to \$1.7 million at December 31, 2012. The specific allowance decreased by \$0.6 million during the six months ended June 30, 2013, largely as a result of a large commercial real estate loan payoff, offset by specific reserves on the equipment financing portfolio.

Unallocated Allowance

The unallocated allowance for loan and lease losses was \$3.4 million at June 30, 2013, compared to \$2.6 million at December 31, 2012. The unallocated portion of the allowance for loan and lease losses increased by \$0.8 million during the six months ended June 30, 2013, largely as a result of a change in the mix of the loan portfolio and organic loan growth.

Credit Quality Assessment

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At the time of loan origination, a rating is assigned based on the financial strength of the borrower and the value of assets pledged as collateral. The Company continually monitors the asset quality of the loan portfolio using all available information. The officer responsible for handling each loan is required to initiate changes to risk ratings when changes in facts and circumstances occur that warrant an upgrade or downgrade in a loan rating. Based on this information, loans demonstrating certain payment issues or other weaknesses may be categorized as delinquent, impaired, nonperforming and/or put on nonaccrual status. Additionally, in the course of resolving such loans, the Company may choose to restructure the contractual terms of certain loans to match the borrower's ability to repay the loan based on their current financial condition. If a restructured loan meets certain criteria, it may be categorized as a troubled debt restructuring.

The Company reviews numerous credit quality indicators when assessing the risk in its loan portfolio. For the commercial real estate mortgage, multi-family mortgage, construction, commercial, equipment financing, condominium association and other consumer loan and lease classes, the Company utilizes an eight-grade loan rating system, which assigns a risk rating to each borrower based on a number of quantitative and qualitative factors associated with a loan transaction. Factors considered include industry and market conditions; position within the industry; earnings trends; operating cash flow; asset/liability values; debt capacity; guarantor strength; management and controls; financial reporting; collateral; and other considerations. In addition, the Company's independent loan review group evaluates the credit quality and related risk ratings of the commercial real estate and commercial loan portfolios. The results of these reviews are reported to the Board of Directors. For the indirect automobile portfolio, the Company primarily uses borrower FICO scores for monitoring credit risk while for residential mortgage and home equity portfolios loan-to-value ratios are used as the primary credit quality indicator.

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BROOKLINE BANCORP, INC. AND SUBSIDIARIES

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The ratings categories used for assessing credit risk in the commercial real estate mortgage, multi-family mortgage, construction, commercial, equipment financing, condominium association and other consumer loan and lease classes are defined as follows:

1-4 Rating Pass

Loan rating grades 1 through 4 are classified as Pass, which indicates borrowers are performing in accordance with the terms of the loan and are less likely to result in loss due to the capacity of the borrower to pay and the adequacy of the value of assets pledged as collateral.

5 Rating Other Asset Especially Mentioned (OAEM)

Borrowers exhibit potential credit weaknesses or downward trends deserving management's attention. If not checked or corrected, these trends will weaken the Company's asset and position. While potentially weak, currently these borrowers are marginally acceptable; no loss of principal or interest is envisioned.

6 Rating Substandard

Borrowers exhibit well-defined weaknesses that jeopardize the orderly liquidation of debt. Substandard loans may be inadequately protected by the current net worth and paying capacity of the obligors or by the collateral pledged, if any. Normal repayment from the borrower is in jeopardy. Although no loss of principal is envisioned, there is a distinct possibility that a partial loss of interest and/or principal will occur if the deficiencies are not corrected. Collateral coverage may be inadequate to cover the principal obligation.

7 Rating Doubtful

Borrowers exhibit well-defined weaknesses that jeopardize the orderly liquidation of debt with the added provision that the weaknesses make collection of the debt in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Serious problems exist to the point where partial loss of principal is likely.

8 Rating Definite Loss

Borrowers deemed incapable of repayment. Loans to such borrowers are considered uncollectible and of such little value that continuation as active assets of the Company is not warranted.

Assets rated as OAEM, substandard or doubtful based on criteria established under banking regulations are collectively referred to as criticized assets.

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The following tables present the recorded investment in total loans in each class (unpaid balance of loans and leases outstanding excluding deferred loan origination costs) at June 30, 2013 by credit quality indicator.

	At June 30, 2013						
	Commercial Real Estate Mortgage	Multi- Family Mortgage	Construction	Commercial (In Thousands)	Equipment Financing	Condominium Association	Other Consumer
Originated:							
Loan rating:							
Pass	\$ 955,570	\$ 503,226	\$ 101,240	\$ 241,947	\$ 429,584	\$ 41,855	\$ 7,401
OAEM	7,652			1,058	1,741		
Substandard	929	544		135	4,076	4	
Doubtful				1,714	228		
	\$ 964,151	\$ 503,770	\$ 101,240	\$ 244,854	\$ 435,629	\$ 41,859	\$ 7,401
Acquired:							
Loan rating:							
Pass	\$ 365,597	\$ 87,541	\$ 10,695	\$ 120,827	\$ 40,209		\$ 1,110
OAEM	5,138	2,048	655	3,241	224		
Substandard	13,423	1,580	94	7,395	662		20
Doubtful	742			190			
	\$ 384,900	\$ 91,169	\$ 11,444	\$ 131,653	\$ 41,095		\$ 1,130

	Indirect Automobile (In Thousands)
Originated:	
Credit score:	
Over 700	\$ 398,562
661-700	63,713
660 and below	15,591
Data not available	1,916
	\$ 479,782

	Residential Mortgage (In Thousands)	Home Equity
Originated:		

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Loan-to-value ratio:

Less than 50%	\$	95,326	\$	67,567
50% - 69%		142,177		24,946
70% - 79%		117,090		15,015
80% and over		19,949		3,977
Data not available		486		981
Total	\$	375,028	\$	112,486

Acquired:

Loan-to-value ratio:

Less than 50%	\$	24,128	\$	94,572
50% - 69%		43,662		26,173
70% - 79%		36,682		15,948
80% and over		21,790		2,648
Data not available		5,809		6,012
Total	\$	132,071	\$	145,353

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The following tables present the recorded investment in loans in each class (unpaid balance of loans and leases outstanding excluding deferred loan origination costs) at December 31, 2012 by credit quality indicator.

	At December 31, 2012						
	Commercial Real Estate Mortgage	Multi- Family Mortgage	Construction	Commercial (In Thousands)	Equipment Financing	Condominium Association	Other Consumer
Originated:							
Loan rating:							
Pass	\$ 863,901	\$ 504,883	\$ 80,913	\$ 227,201	\$ 359,064	\$ 44,179	\$ 6,093
OAEM	5,686	146		1,196	2,979		
Substandard	1,965	988		502	4,213	8	29
Doubtful				1,993	41		
Total	\$ 871,552	\$ 506,017	\$ 80,913	\$ 230,892	\$ 366,297	\$ 44,187	\$ 6,122
Acquired:							
Loan rating:							
Pass	\$ 409,725	\$ 93,058	\$ 17,186	\$ 140,589	\$ 54,175		\$ 1,157
OAEM	2,740	2,439		1,344	286		
Substandard	17,216	5,019	98	8,635	233		
Doubtful				817			
Total	\$ 429,681	\$ 100,516	\$ 17,284	\$ 151,385	\$ 54,694		\$ 1,157

	Indirect Automobile (In Thousands)
Originated:	
Credit score:	
Over 700	\$ 454,056
661-700	69,319
660 and below	16,934
Data not available	2,035
	\$ 542,344

	Residential Mortgage (In Thousands)	Home Equity
Originated:		
Loan-to-value ratio:		
Less than 50%	\$ 86,659	\$ 50,398
50% - 69%	142,172	25,284

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70% - 79%		111,234		16,523
80% and over		27,858		6,042
Data not available		172		1,436
Total	\$	368,095	\$	99,683

Acquired:

Loan-to-value ratio:

Less than 50%	\$	23,398	\$	28,401
50% - 69%		42,214		39,385
70% - 79%		42,748		33,044
80% and over		31,614		34,267
Data not available		3,040		26,782
Total	\$	143,014	\$	161,879

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The following tables present an age analysis of the recorded investment in total loans and leases (unpaid balance of loans and leases outstanding excluding deferred loan origination costs) at June 30, 2013 and December 31, 2012.

	At June 30, 2013						Loans and Leases Past	
	31-60 Days	Past Due 61-90 Days	Greater Than 90 Days	Total	Current	Total Loans and Leases	Due Greater Than 90 Days and Accruing	Nonaccrual Loans and Leases
	(In Thousands)							
Originated:								
Commercial real estate mortgage	\$ 886	\$ 929	\$	\$ 1,815	\$ 962,336	\$ 964,151	\$	\$ 496
Multi-family mortgage	1,270			1,270	502,500	503,770		1,459
Construction					101,240	101,240		
Commercial	1,047	22	865	1,934	242,920	244,854		1,749
Equipment financing	3,018	659	1,807	5,484	430,145	435,629	15	3,942
Condominium association					41,859	41,859		4
Indirect automobile	5,427	719	165	6,311	473,471	479,782	9	156
Residential mortgage	424	564	510	1,498	373,530	375,028		1,693
Home equity	200			200	112,286	112,486		75
Other consumer	5			5	7,396	7,401		1
	\$ 12,277	\$ 2,893	\$ 3,347	\$ 18,517	\$ 3,247,683	\$ 3,266,200	\$ 24	\$ 9,575

	At June 30, 2013						Loans and Leases Past	
	31-60 Days	Past Due 61-90 Days	Greater Than 90 Days	Total	Current	Total Loans and Leases	Due Greater Than 90 Days and Accruing	Nonaccrual Loans and Leases
	(In Thousands)							
Acquired:								
Commercial real estate mortgage	\$ 1,288	\$ 914	\$ 4,647	\$ 6,849	\$ 378,051	\$ 384,900	\$ 3,860	\$ 2,186
Multi-family mortgage	295		398	693	90,476	91,169	398	134
Construction					11,444	11,444		
Commercial	496	423	2,397	3,316	128,337	131,653	1,728	2,931
Equipment financing	58	72	106	236	40,859	41,095	90	72

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Residential mortgage	760	192	4,044	4,996	127,075	132,071	3,267	1,093
Home equity	1,244	545	884	2,673	142,680	145,353	273	1,482
Other consumer	7	20		27	1,103	1,130		20
	\$ 4,148	\$ 2,166	\$ 12,476	\$ 18,790	\$ 920,025	\$ 938,815	\$ 9,616	\$ 7,918

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	31-60 Days	Past Due 61-90 Days	Greater Than 90 Days	Total	Current	Total Loans and Leases	Loans and Leases Past Due Greater Than 90 Days and Accruing	Nonaccrual Loans and Leases
					(In Thousands)			
Originated:								
Commercial real estate mortgage	\$ 1,530	\$	\$ 435	\$ 1,965	\$ 869,587	\$ 871,552	\$ 434	\$ 1,539
Multi-family mortgage	2,410	60	988	3,458	502,559	506,017		1,932
Construction	2,354	816		3,170	77,743	80,913		
Commercial	26	75	26	127	230,765	230,892	26	1,993
Equipment financing	2,595	1,439	1,618	5,652	360,645	366,297		3,817
Condominium association					44,187	44,187		8
Indirect automobile	5,592	923	99	6,614	535,730	542,344	1	99
Residential mortgage			1,059	1,059	367,036	368,095	27	2,008
Home equity			33	33	99,650	99,683		58
Other consumer		2	5	7	6,115	6,122	5	29
	\$ 14,507	\$ 3,315	\$ 4,263	\$ 22,085	\$ 3,094,017	\$ 3,116,102	\$ 493	\$ 11,483

At December 31, 2012

	31-60 Days	Past Due 61-90 Days	Greater Than 90 Days	Total	Current	Total Loans and Leases	Loans and Leases Past Due Greater Than 90 Days and Accruing	Nonaccrual Loans and Leases
					(In Thousands)			
Acquired:								
Commercial real estate mortgage	\$ 2,911	\$	\$ 7,289	\$ 10,200	\$ 419,481	\$ 429,681	\$ 6,616	\$ 2,475
Multi-family mortgage	2,738	395	2,178	5,311	95,205	100,516	1,857	2,301
Construction					17,284	17,284		
Commercial	866	177	4,353	5,396	145,989	151,385	3,503	3,461
Equipment financing	133	21	194	348	54,346	54,694	197	56
Residential mortgage	247	121	5,266	5,634	137,380	143,014	3,650	1,796
Home equity	1,582	507	607	2,696	159,183	161,879	321	658
Other consumer	7			7	1,150	1,157		16
	\$ 8,484	\$ 1,221	\$ 19,887	\$ 29,592	\$ 1,030,018	\$ 1,059,610	\$ 16,144	\$ 10,763

Commercial Real Estate Loans At June 30, 2013, loans outstanding in the three classes within this category expressed as a percentage of total loans and leases outstanding (including deferred loan origination costs) were as follows: commercial real estate mortgage loans 32.1%; multi-family mortgage loans 14.1%; and construction loans 2.7%.

Loans in this portfolio that are on nonaccrual status and/or risk-rated substandard or worse are evaluated on an individual loan basis for impairment. For non-impaired commercial real estate loans, loss factors are applied to outstanding loans by risk rating for each of the three classes in the portfolio. The factors applied are based primarily on historic loan loss experience and an assessment of internal and external factors and other relevant information from the past five years. Management has accumulated information on actual loan charge-offs and recoveries by class covering, depending on loan/lease category, up to 28 years of loss history. The Company has a long history of low frequency of loss in this loan class. As a result, determination of loss factors is based on considerable judgment by management, including evaluation of the risk characteristics related to current internal and external factors. Notable risk characteristics related to the commercial real estate mortgage and multi-family mortgage portfolios are

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the concentration in those classes of outstanding loans within the greater Boston and Providence metropolitan areas and the effect the local economies could have on the collectability of those loans. While unemployment in the greater Boston metropolitan area is not as high as in other parts of the United States, it is nonetheless elevated in relation to historic trends. Unemployment in Rhode Island remains high relative to other parts of the United States. Should unemployment in the greater Boston and/or Providence metropolitan areas remain elevated, the resulting negative consequences could affect occupancy rates in the properties financed by the Company and cause certain borrowers to be unable to service their debt obligations.

Other factors taken into consideration in establishing the allowance for loan and lease losses for this class were the rate of growth of originated loans, the decrease in originated loans delinquent over 30 days from \$8.6 million at December 31, 2012 to \$3.1 million at June 30, 2013 and the increase in originated criticized loans from \$8.8 million at December 31, 2012 to \$9.1 million at June 30, 2013. The Company also takes into consideration the impact that the economy, and in particular the housing market, has on the rents and values associated with its apartment and multi-family mortgage loans. The increase in renters versus homeowners has increased multi-family rents. This trend, coupled with historically low capitalization rates, has increased apartment and multi-family property valuations, which, in turn, has increased the number of multi-family properties under development. These increases in multi-family rents and valuations could drop if the demand for rentable housing declines or interest rates rise. For further discussion of criticized loans, see *Credit Quality Assessment* section above.

While the Company's construction loan portfolio is small, there are higher risks associated with such loans. The source of repayment for the majority of the construction loans is derived from the sale of constructed housing units. These risk factors are considered when estimating allowances for loan losses for this asset class. A project that is viable at the outset can experience losses when there is a drop in the demand for housing units. Typically, the level of loss in relation to the amount loaned is high when construction projects run into difficulty.

Commercial Loans and Leases At June 30, 2013, loans and leases outstanding in the three classes within this portfolio expressed as a percent of total loans and leases outstanding (including deferred loan origination costs), were as follows: commercial loans and leases 9.0%; equipment financing loans 11.3%; and loans to condominium associations 1.0%.

Loans and leases in this portfolio that are on nonaccrual status and/or risk-rated substandard or worse are evaluated on an individual basis for impairment. For non-impaired commercial loans and leases, loss factors are applied to outstanding loans by risk rating for each of the three classes in the portfolio. The factors applied are based on historic loan and lease loss experience and on an assessment of internal and external factors. Management has accumulated information on actual loan and lease charge-offs and recoveries by class covering 19 years for commercial loans and leases, six years for equipment financing loans and leases, and twelve years for loans to condominium associations. Commercial loan and lease losses generally have been infrequent and modest while no losses have been experienced from loans to condominium associations since the Company started originating such loans. The risk characteristics described in *Commercial Real Estate Loans* above regarding concentration of outstanding loans within the greater Boston and Providence metropolitan areas and the status of the local economies are also applicable to the commercial and condominium association loan classes. Until the economy improves sufficiently, some commercial loan borrowers may have difficulty generating sufficient profitability and liquidity to service their debt obligations.

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The Company's equipment financing loans and leases are concentrated in the financing of coin-operated laundry, dry cleaning, fitness and convenience store equipment, and, most recently, tow trucks. A significant share (40.5%) of the Company's equipment financing business is conducted in the states of New York and New Jersey, with the balance in other locations throughout the United States. The loans and leases are considered to be of higher risk because the borrowers are typically small-business owners who operate with limited financial resources and are more likely to experience difficulties in meeting their debt obligations when the economy is weak or unforeseen adverse events arise.

The factors taken into consideration in establishing the allowance for loan and lease losses for all commercial loan and lease categories included the rate of growth of originated loans and leases outstanding, the entrée into tow-truck lending, the increase in originated loans and leases delinquent over 30 days from \$5.8 million

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at December 31, 2012 to \$7.4 million at June 30, 2013, and the decrease in total criticized originated loans and leases from \$10.9 million at December 31, 2012 to \$9.0 million at June 30, 2013.

Regarding loans to condominium associations, loan proceeds are generally used for capital improvements and loan payments are generally derived from ongoing association dues or special assessments. While the loans are unsecured, associations are permitted statutory liens on condominium units when owners do not pay their dues or special assessments. Proceeds from the subsequent sale of an owner unit can sometimes be a source for payment of delinquent dues and assessments. These factors have been considered in determining the amount of allowance for loan and lease losses established for this loan class.

Indirect Automobile Loans At June 30, 2013, indirect automobile loans represented 11.4% of the Company's total loan and lease portfolio (including deferred loan origination costs). Determination of the allowance for loan and lease losses for this portfolio is based primarily on borrowers' credit scores (generally considered to be a good indicator of capacity to pay a loan, with the risk of loan loss increasing as credit scores decrease), and on an assessment of trends in loan underwriting, loan loss experience, and the economy and industry conditions. Data are gathered on loan originations by year broken down into the following ranges of borrower credit scores: over 700, between 661 and 700, and 660 and below. The Company's loan policy specifies underwriting guidelines based in part on the score of the borrower and includes ceilings on the percent of loans originated that can be to borrowers with credit scores of 660 and below. The breakdown of the amounts shown in *Credit Quality Information* above is based on borrower credit scores at the time of loan origination. Due to the weakened economy, it is possible that the credit scores of certain borrowers may have deteriorated since the time the loan was originated. Additionally, migrations of loan charge-offs and recoveries are analyzed by year of origination. Based on that data and taking into consideration other factors such as loan delinquencies and economic conditions, projections are made as to the amount of expected losses inherent in the portfolio. The percentage of loans made to borrowers with credit scores of 660 and below was 3.3% and 3.1% at June 30, 2013 and December 31, 2012, respectively.

Consumer Loans At June 30, 2013, loans outstanding within the three classes within this portfolio expressed as a percent of total loans and leases outstanding (including deferred loan origination costs) were as follows: residential mortgage loans 12.1%; home equity loans 6.1%; and other consumer loans 0.2%.

Significant risk characteristics related to the residential mortgage and home equity loan portfolios are the geographic concentration of the properties financed within selected communities in the greater Boston and Providence metropolitan areas and the economic conditions in those areas as previously commented upon in the *Commercial Real Estate Loans* subsection above. The loan-to-value ratio is the primary credit quality indicator used for residential mortgage loans and home equity loans. Generally, loans are not made when the loan-to-value ratio exceeds 80% unless private mortgage insurance is obtained and/or there is a financially strong guarantor. The loan-to-value ratios for residential mortgage loans are based on loan balances outstanding at June 30, 2013 and December 31, 2012 expressed as a percent of appraised real estate values at the time of loan origination. The loan-to-value ratios for home equity loans outstanding at June 30, 2013 and December 31, 2012 are based on the maximum amount of credit available to a borrower plus the balance of other loans secured by the same real estate serving as collateral for the home equity loan at the time the line of credit was established expressed as a percent of the appraised value of the real estate at the time the line of credit was established. Consumer loans that become 90 days or more past due or are placed on nonaccrual regardless of past due status are reviewed on an individual basis for impairment by assessing the net realizable value of underlying collateral and the economic condition of the borrower. For non-impaired loans, loss factors are applied to loans outstanding for each class. The factors applied are based

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primarily on historic loan loss experience, the value of underlying collateral, underwriting standards, and trends in loan-to-value ratios, credit scores of borrowers, sales activity, selling prices, geographic concentrations and employment conditions.

The risk of loss on a home equity loan is higher since the property securing the loan has often been previously pledged as collateral for a first mortgage loan. The Company gathers and analyzes delinquency data, to the extent that data are available on these first liens, for purposes of assessing the collectability of the second liens held for the Company even if these home equity loans are not delinquent. These data are further analyzed for performance differences between amortizing and non-amortizing home equity loans, the percentage borrowed to total loan

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commitment, and by the amount of payments made by the borrowers. The exposure to loss is not considered to be high due to the combination of current property values, the low level of losses experienced in the past few years and the low level of loan delinquencies at June 30, 2013. If the local economy weakens, however, a rise in losses in those loan classes could occur. Historically, losses in these classes have been low.

Impaired Loans and Leases

When the ultimate collectability of the total principal of an impaired loan or lease is in doubt and the loan is on nonaccrual status, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan or lease is not in doubt and the loan or lease is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

The following tables include the recorded investment and unpaid principal balances of impaired loans and leases with the related allowance amount, if applicable, for the originated and acquired loan and lease portfolios at the dates and for the periods indicated. Also presented are the average recorded investments in the impaired loans and leases and the related amount of interest recognized during the period that the impaired loans were impaired.

	At June 30, 2013			Three Months Ended June 30, 2013		Six Months Ended June 30, 2013	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment (In Thousands)	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Originated:							
With no related allowance recorded:							
Commercial real estate	\$ 1,970	\$ 1,969	\$	\$ 1,939	\$ 30	\$ 2,695	\$ 30
Commercial	3,868	3,846		3,139	29	4,030	60
Consumer	1,315	1,311		1,323	18	1,328	18
	7,153	7,126		6,401	77	8,053	108
With an allowance recorded:							
Commercial real estate	1,448	1,447	175	1,256	10	1,469	17
Commercial	1,755	1,749	561	1,682	6	1,686	7
Consumer	3,274	3,263	418	2,681	35	3,475	39
	6,477	6,459	1,154	5,619	51	6,630	63
Total	\$ 13,630	\$ 13,585	\$ 1,154	\$ 12,020	\$ 128	\$ 14,683	\$ 171

At June 30, 2013

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	Recorded Investment	Unpaid Principal Balance	Related Allowance	Three Months Ended June 30, 2013		Six Months Ended June 30, 2013	
				Average Recorded Investment (In Thousands)	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Acquired:							
With no related allowance recorded:							
Commercial real estate	\$ 7,698	\$ 7,786	\$	\$ 3,217	\$ 88	\$ 11,291	\$ 99
Commercial	3,858	4,079		1,548	26	4,369	66
Consumer	537	587		317	8	1,489	8
	12,093	12,452		5,082	122	17,149	173
With an allowance recorded:							
Commercial real estate	3,642	4,171	123	3,679		3,700	
Commercial	584	618	144			631	
Consumer							
	4,226	4,789	267	3,679		4,331	
Total	\$ 16,319	\$ 17,241	\$ 267	\$ 8,761	\$ 122	\$ 21,480	\$ 173

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	At December 31, 2012			Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment (In Thousands)	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Originated:							
With no related allowance recorded:							
Commercial real estate	\$ 2,051	\$ 2,051	\$	\$ 2,954	\$ 71	\$ 3,613	\$ 148
Commercial	3,032	3,059		4,130	47	4,638	90
Consumer	1,191	1,187		2,702	24	2,957	52
	6,274	6,297		9,786	142	11,208	290
With an allowance recorded:							
Commercial real estate	2,517	2,516	241	213	28	353	39
Commercial	3,422	3,559	703	1,916	66	1,852	108
Consumer	3,648	3,636	596	2,288	32	2,303	61
	9,587	9,711	1,540	4,417	126	4,508	208
Total	\$ 15,861	\$ 16,008	\$ 1,540	\$ 14,203	\$ 268	\$ 15,716	\$ 498

	At December 31, 2012			Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment (In Thousands)	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Acquired:							
With no related allowance recorded:							
Commercial real estate	\$ 17,918	\$ 19,129	\$	\$ 5,738	\$	\$ 3,647	\$
Commercial	7,329	7,782		1,481		658	2
Consumer	3,266	3,379		1,430		788	1
	28,513	30,290		8,649		5,093	3
With an allowance recorded:							
Commercial real estate	673	684	75	1,384		692	
Commercial	113	121	75				
Consumer							
	786	805	150	1,384		692	
Total	\$ 29,299	\$ 31,095	\$ 150	\$ 10,033	\$	\$ 5,785	\$ 3

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012**

The following tables present information regarding impaired and non-impaired loans and leases at the dates indicated:

	At June 30, 2013							
	Loans and Leases Individually Evaluated for Impairment		Loans and Leases Collectively Evaluated for Impairment		Acquired Loans (ASC 310-20 and ASC 310-30)		Total	
	Portfolio	Allowance	Portfolio	Allowance	Portfolio	Allowance	Portfolio	Allowance
	(In Thousands)							
Commercial real estate	\$ 3,418	\$ 175	\$ 1,565,743	\$ 21,769	\$ 487,513	\$ 75	\$ 2,056,674	\$ 22,019
Commercial	5,623	561	716,719	11,121	172,748	109	895,090	11,791
Indirect automobile			479,782	4,695			479,782	4,695
Consumer	4,589	418	490,326	2,156	278,554	425	773,469	2,999
Unallocated				2,766		11		2,777
Total	\$ 13,630	\$ 1,154	\$ 3,252,570	\$ 42,507	\$ 938,815	\$ 620	\$ 4,205,015	\$ 44,281

	At December 31, 2012							
	Loans and Leases Individually Evaluated for Impairment		Loans and Leases Collectively Evaluated for Impairment		Acquired Loans (ASC 310-20 and ASC 310-30)		Total	
	Portfolio	Allowance	Portfolio	Allowance	Portfolio	Allowance	Portfolio	Allowance
	(In Thousands)							
Commercial real estate	\$ 4,568	\$ 241	\$ 1,453,913	\$ 19,702	\$ 547,482	\$ 75	\$ 2,005,963	\$ 20,018
Commercial	6,454	703	634,922	9,877	206,079	75	847,455	10,655
Indirect automobile			542,344	5,304			542,344	5,304
Consumer	4,839	596	469,061	1,949	306,050		779,950	2,545
Unallocated				2,630				2,630
Total	\$ 15,861	\$ 1,540	\$ 3,100,240	\$ 39,462	\$ 1,059,611	\$ 150	\$ 4,175,712	\$ 41,152

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012*****Troubled Debt Restructured Loans and Leases***

The recorded investment in troubled debt restructurings and the associated specific allowances for loan and lease losses, in the originated and acquired loan and lease portfolios, are as follows for the periods indicated.

	Number of Loans/Leases	Recorded Investment		Three Months Ended June 30, 2013			Defaulted Number of Loans/Leases	Recorded Investment
		At Modification	At End of Period	Specific Allowance for Loan and Lease Losses (Dollars in Thousands)	Nonaccrual Loans and Leases	Additional Commitment		
Originated:								
Commercial real estate mortgage		\$	\$	\$	\$	\$		\$
Commercial Equipment financing	2	488	498	12	372		2	1,714
Residential mortgage							1	373
Total	2	\$ 488	\$ 498	\$ 12	\$ 372	\$	4	\$ 2,390

	Number of Loans/Leases	Recorded Investment		Three Months Ended June 30, 2013			Defaulted Number of Loans/Leases	Recorded Investment
		At Modification	At End of Period	Specific Allowance for Loan and Lease Losses (Dollars in Thousands)	Nonaccrual Loans and Leases	Additional Commitment		
Acquired:								
Commercial real estate mortgage		\$	\$	\$	\$	\$		\$
Commercial Equipment financing	1	424	421		421			
Residential mortgage								
Total	1	\$ 424	\$ 421	\$	\$ 421	\$		\$

	Number of Loans/Leases	Recorded Investment		Three Months Ended June 30, 2012			Defaulted Number of Loans/Leases	Recorded Investment
		At Modification	At End of Period	Specific Allowance for Loan and Lease Losses (Dollars in Thousands)	Nonaccrual Loans and Leases	Additional Commitment		
Originated:								
		\$	\$	\$	\$	\$		\$

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Commercial real
estate mortgage

Commercial

Equipment
financing

Residential
mortgage

Total

1	280	280	7	280					
2	770	770	152	770					
3	\$ 1,050	\$ 1,050	\$ 159	\$ 1,050	\$				\$

For the three months ended June 30, 2012, there were no troubled debt restructurings in the Company's acquired portfolio.

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012**

	Number of Loans/ Leases	Recorded Investment		Six Months Ended June 30, 2013			Additional Commitment	Defaulted Number of Loans/ Leases	Recorded Investment
		At Modification	At End of Period	Specific Allowance for Loan and Lease Losses (Dollars in Thousands)	Nonaccrual Loans and Leases				
Originated:									
Commercial real estate mortgage	1	\$ 1,039	\$	\$	\$	\$			\$
Commercial									
Equipment financing	8	1,125	1,129	42	372				
Residential mortgage	1	415	372						
Total	10	\$ 2,579	\$ 1,501	\$ 42	\$ 372	\$			\$

	Number of Loans/ Leases	Recorded Investment		Six Months Ended June 30, 2013			Additional Commitment	Defaulted Number of Loans/ Leases	Recorded Investment
		At Modification	At End of Period	Specific Allowance for Loan and Lease Losses (Dollars in Thousands)	Nonaccrual Loans and Leases				
Acquired:									
Commercial real estate mortgage		\$	\$	\$	\$	\$			\$
Commercial	1	424	421		421				
Equipment financing									
Residential mortgage									
Total	1	\$ 424	\$ 421	\$	\$ 421	\$			\$

	Number of Loans/ Leases	Recorded Investment		Six Months Ended June 30, 2012			Additional Commitment	Defaulted Number of Loans/ Leases	Recorded Investment
		At Modification	At End of Period	Specific Allowance for Loan and Lease Losses (Dollars in Thousands)	Nonaccrual Loans and Leases				
Originated:									
Commercial real estate mortgage	1	\$ 355	\$ 348	\$ 33	\$ 33	\$			\$
Commercial	1	97	94	2	2				
Equipment financing	5	1,181	1,113	57	57				
Residential mortgage	4	1,302	1,302	174	174				
Total	11	\$ 2,935	\$ 2,857	\$ 266	\$ 266	\$			\$

Six Months Ended June 30, 2012

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	Number of Loans/ Leases	Recorded Investment		Specific Allowance for Loan and Lease Losses (Dollars in Thousands)	Nonaccrual Loans and Leases	Additional Commitment	Defaulted Number of Loans/ Leases	Recorded Investment
		At Modification	At End of Period					
Acquired:								
Commercial real estate mortgage	1	\$ 3,262	\$ 3,262	\$ 16	\$ 3,262	\$		\$
Commercial Equipment financing								
Residential mortgage								
Total	1	\$ 3,262	\$ 3,262	\$ 16	\$ 3,262	\$		\$

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012**

The following table sets forth the Company's balances of troubled debt restructurings that were modified at the dates indicated, by type of modification.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In Thousands)			
Loans with one modification:				
Extended maturity	\$	\$	\$	\$ 343
Adjusted principal		770	372	4,564
Adjusted interest rate	793		793	348
Combination maturity, principal, interest rate	126	280	757	864
Total loans with one modification	\$ 919	\$ 1,050	\$ 1,922	\$ 6,119
Loans with more than one modification:				
Extended maturity	\$	\$	\$	\$ 25
Adjusted principal		295		3,897
Total loans with more than one modification	\$	\$ 295	\$	\$ 3,922

The financial impact of the modification of performing or nonperforming loans and leases for the three months ended June 30, 2013 and 2012 was \$0.3 million and zero, respectively. The financial impact of the modification of performing or nonperforming loans and leases for the six months ended June 30, 2013 and 2012 was also \$0.3 million and zero, respectively.

As of June 30, 2013 and 2012, there were no commitments to lend funds to debtors owing receivables whose terms had been modified in troubled debt restructurings.

(6) Goodwill and Other Intangible Assets

The following table sets forth the composition of goodwill and other intangible assets at the dates indicated:

	At June 30, 2013	At December 31, 2012
	(In Thousands)	
Goodwill	\$ 137,890	\$ 137,890
Other intangible assets:		

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Core deposits	17,770	19,773
Trade name	1,210	1,333
Trust relationship	188	404
Total other intangible assets	19,168	21,510
Total goodwill and other intangible assets	\$ 157,058	\$ 159,400

The estimated aggregate future amortization expense for intangible assets remaining at June 30, 2013 is as follows:

Remainder of 2013	\$ 2,653
2014	3,339
2015	3,062
2016	2,626
2017	2,004
Thereafter	5,484
	\$ 19,168

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012****(7) Comprehensive Income**

Comprehensive income represents the sum of net income (loss) and other comprehensive income (loss). For the three months and six months ended June 30, 2013 and June 30, 2012, the Company's other comprehensive income include the following two components: (i) unrealized holding gains (losses) on investment securities available-for-sale; and (ii) adjustment of accumulated obligation for postretirement benefits.

Changes in accumulated other comprehensive (loss) income by component, net of tax, were as follows for the periods indicated:

	Three Months Ended June 30, 2013		
	Investment Securities Available-for-Sale	Postretirement Benefits (In Thousands)	Accumulated Other Comprehensive Income
Balance at March 31, 2013	\$ 2,108	\$ 125	\$ 2,233
Other comprehensive (loss) income	(6,680)	6	(6,674)
Balance at June 30, 2013	\$ (4,572)	\$ 131	\$ (4,441)

	Three Months Ended June 30, 2012		
	Investment Securities Available-for-Sale	Postretirement Benefits (In Thousands)	Accumulated Other Comprehensive Income
Balance at March 31, 2012	\$ 2,329	\$ 128	\$ 2,457
Other comprehensive loss	(485)	(3)	(488)
Balance at June 30, 2012	\$ 1,844	\$ 125	\$ 1,969

	Six Months Ended June 30, 2013		
	Investment Securities Available-for-Sale	Postretirement Benefits (In Thousands)	Accumulated Other Comprehensive Income
Balance at December 31, 2012	\$ 3,358	\$ 125	\$ 3,483
Other comprehensive (loss) income	(7,930)	6	(7,924)
Balance at June 30, 2013	\$ (4,572)	\$ 131	\$ (4,441)

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Six Months Ended June 30, 2012

	Investment Securities Available-for-Sale	Postretirement Benefits (In Thousands)	Accumulated Other Comprehensive Income
Balance at December 31, 2011	\$ 1,834	\$ 129	\$ 1,963
Other comprehensive income (loss)	10	(4)	6
Balance at June 30, 2012	\$ 1,844	\$ 125	\$ 1,969

The Company did not reclassify any amounts out of accumulated other comprehensive (loss) income for the three months or six months ended June 30, 2013 or for the three months or six months ended June 30, 2012.

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BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

At and for the Six Months Ended June 30, 2013 and 2012

(8) Derivatives and Hedging Activities

The Company may use interest-rate contracts (swaps, caps and floors) as part of interest-rate risk management strategy. Interest-rate swap, cap and floor agreements are entered into as hedges against future interest-rate fluctuations on specifically identified assets or liabilities. The Company did not have derivative fair value hedges or derivative cash flow hedges at June 30, 2013 or December 31, 2012.

Derivatives not designated as hedges are not speculative but rather, result from a service the Company provides to certain customers for a fee. The Company executes interest-rate swaps with commercial banking customers to aid them in managing their interest-rate risk. The interest-rate swap contracts allow the commercial banking customers to convert floating-rate loan payments to fixed-rate loan payments. The Company concurrently enters into offsetting swaps with a third-party financial institution, effectively minimizing its net risk exposure resulting from such transactions. The third-party financial institution exchanges the customer's fixed-rate loan payments for floating-rate loan payments. As the interest-rate swaps associated with this program do not meet hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. At June 30, 2013, the Company had eight interest-rate swaps with an aggregate notional amount of \$23.0 million related to this program, compared to ten interest-rate swaps with an aggregate notional amount of \$33.2 million at December 31, 2012.

The table below presents the fair value and classification of the Company's derivative financial instruments on the unaudited consolidated balance sheets at June 30, 2013, and the effect of the Company's derivative financial instruments on the unaudited consolidated income statements for the three months and six months ended June 30, 2013. Asset derivatives and liability derivatives are included in other assets and accrued expenses and other liabilities on the unaudited consolidated balance sheets, respectively. Gains recognized on derivatives are included in fees, charges and other income on the unaudited consolidated income statements.

Total derivatives (interest-rate products) not designated as hedging instruments	\$	948	\$	987	\$	(22)	\$ (25)

(1) The amount of gain (loss) recognized in income on derivatives represents changes related to the fair value of the interest rate products.

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By using derivative financial instruments, the Company exposes itself to credit risk. Credit risk is the risk of failure by the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Company, which creates credit risk for the Company. When the fair value of a derivative is negative, the Company owes the counterparty and, therefore, it does not possess credit risk. The credit risk in derivative instruments is mitigated by entering into transactions with highly-rated counterparties that management believes to be creditworthy and by limiting the amount of exposure to each counterparty. The estimated net credit risk exposure for derivative financial instruments was \$39,000 and \$64,000 at June 30, 2013 and December 31, 2012, respectively.

Certain of the derivative agreements contain provisions that require the Company to post collateral if the derivative exposure exceeds a threshold amount. The Company has posted collateral of \$0.4 million and \$0.5 million in the normal course of business at June 30, 2013 and December 31, 2012, respectively.

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The tables below presents the offsetting of derivatives and amounts subject to master netting agreements not offset in the unaudited consolidated balance sheet at the dates indicated.

At June 30, 2013						
	Gross Amounts of Recognized Assets / Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position (In Thousands)	Gross Amounts Not Offset in the Statement of Financial Position Financial Instruments	Cash Collateral Received / Posted	Net Amount
Asset Derivatives	\$ 948	\$	\$ 948	\$	\$	\$ 948
Liability Derivatives	\$ 987	\$	\$ 987	\$	\$ 428	\$ 1,415

At December 31, 2012						
	Gross Amounts of Recognized Assets / Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position (In Thousands)	Gross Amounts Not Offset in the Statement of Financial Position Financial Instruments	Cash Collateral Received / Posted	Net Amount
Asset Derivatives	\$ 1,317	\$	\$ 1,317	\$	\$	\$ 1,317
Liability Derivatives	\$ 1,380	\$	\$ 1,380	\$	\$ 548	\$ 1,928

(9) Earnings per Share

The following table sets forth a reconciliation of basic and diluted earnings per share (EPS) for the periods indicated:

	June 30, 2013		Three Months Ended June 30, 2012	
	Basic	Fully Diluted (In Thousands Except Share Data)	Basic	Fully Diluted
Numerator:				

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Net income	\$	9,490	\$	9,490	\$	7,529	\$	7,529
Denominator:								
Weighted average shares outstanding		69,774,703		69,774,703		69,677,656		69,677,656
Effect of dilutive securities				58,838				38,234
Adjusted weighted average shares outstanding		69,774,703		69,833,541		69,677,656		69,715,890
EPS	\$	0.14	\$	0.14	\$	0.11	\$	0.11

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012**

	June 30, 2013		Six Months Ended		June 30, 2012	
	Basic	Fully Diluted (In Thousands Except Share Data)	Basic	Fully Diluted	Basic	Fully Diluted
Numerator:						
Net income	\$ 18,304	\$ 18,304	\$ 13,878	\$ 13,878	\$ 13,878	\$ 13,878
Denominator:						
Weighted average shares outstanding	69,768,777	69,768,777	69,671,130	69,671,130	69,671,130	69,671,130
Effect of dilutive securities		54,838				35,564
Adjusted weighted average shares outstanding	69,768,777	69,823,615	69,671,130	69,671,130	69,671,130	69,706,694
EPS	\$ 0.26	\$ 0.26	\$ 0.20	\$ 0.20	\$ 0.20	\$ 0.20

(10) Fair Value of Financial Instruments

A description of the valuation methodologies used for assets and liabilities measured at fair value on a recurring and non-recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. There were no changes in the valuation techniques used during 2013.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The following tables set forth the carrying value of assets and liabilities measured at fair value on a recurring basis at the dates indicated:

	Carrying Value at June 30, 2013			Total
	Level 1	Level 2	Level 3	
Assets:				
Securities available-for-sale:				
GSEs	\$	\$ 39,336	\$	\$ 39,336
GSE CMOs		253,712		253,712
GSE MBSs		163,544		163,544
Private-label CMOs		4,844		4,844
SBA commercial loan asset-backed securities		269		269
Auction-rate municipal obligations			1,796	1,796
Municipal obligations		1,093		1,093

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Corporate debt obligations			10,634			10,634
Trust preferred securities and pools			1,590		1,039	2,629
Marketable equity securities		1,320				1,320
Total securities available-for-sale	\$	1,320	\$	475,022	\$	2,835
					\$	479,177
Interest-rate swaps	\$		\$	948	\$	948
					\$	948
Liabilities:						
Interest-rate swaps	\$		\$	987	\$	987
					\$	987

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	Level 1	Carrying Value at December 31, 2012		Total
		Level 2	Level 3	
(In Thousands)				
Assets:				
Securities available-for-sale:				
GSEs	\$	\$ 69,809	\$	\$ 69,809
GSE CMOs		217,001		217,001
GSE MBSs		169,648		169,648
Private-label CMOs		6,866		6,866
SBA commercial loan asset-backed securities		381		381
Auction-rate municipal obligations			1,976	1,976
Municipal obligations		1,101		1,101
Corporate debt obligations		10,685		10,685
Trust preferred securities and pools		1,578	941	2,519
Marketable equity securities	1,337			1,337
Total securities available-for-sale	\$ 1,337	\$ 477,069	\$ 2,917	\$ 481,323
Interest-rate swaps	\$	\$ 1,317	\$	\$ 1,317
Liabilities:				
Interest-rate swaps	\$	\$ 1,380	\$	\$ 1,380

Investment Securities Available-for-Sale

The fair value of investment securities is based principally on market prices and dealer quotes received from third-party, nationally-recognized pricing services for identical investment securities such as U.S. Treasury and agency securities that are included in Level 1. These prices are validated by comparing the primary pricing source with an alternative pricing source when available. When quoted market prices for identical securities are unavailable, the Company uses market prices provided by independent pricing services based on recent trading activity and other observable information, including but not limited to market interest-rate curves, referenced credit spreads and estimated prepayment speeds where applicable. These investments include certain U.S. and government agency debt securities, municipal and corporate debt securities, and GSE residential MBSs and CMOs, all of which are included in Level 2. Certain fair values are estimated using pricing models (such as trust preferred securities and auction-rate municipal securities) and are included in Level 3.

Interest-Rate Swaps

The fair values for the interest-rate swap assets and liabilities represent a Level 2 valuation and are based on settlement values adjusted for credit risks associated with the counterparties and the Company and observable market interest rate curves. Credit risk adjustments consider factors such as the likelihood of default by the Company and its counterparties, its net exposures and remaining contractual life. To date, the Company has not realized any losses due to a counterparty's inability to pay any net uncollateralized position. The change in value of interest-rate swap

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assets and liabilities attributable to credit risk was not significant during the reported periods. See also Note 8, Derivatives and Hedging Activities.

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The table below presents quantitative information about significant unobservable inputs (Level 3) for assets measured at fair value on a recurring basis at June 30, 2013.

	Fair Value	Valuation Technique	Unobservable Input (Dollars in Thousands)	Range	Weighted Average Yields
Auction-rate municipals	\$ 1,796	Discounted cash flow	Discount rate	0-5%	4.5%
Trust preferred pools	\$ 1,039	Discounted cash flow	Cumulative default Cure given deferral/ default	0-100% 0-15%	11.3%
			Discount rate	5-30%	

The reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) is as follows:

	Three Months Ended June 30, 2013		2012		Six Months Ended June 30, 2013		2012	
	(In Thousands)		(In Thousands)		(In Thousands)		(In Thousands)	
Investment securities available-for-sale, beginning of period	\$	2,852	\$	3,436	\$	2,917	\$	3,208
Acquired, BankRI								184
Principal paydowns and other		(207)		(380)		(330)		(384)
Total unrealized gains included in other comprehensive income		190		262		248		310
Investment securities available-for-sale, end of period	\$	2,835	\$	3,318	\$	2,835	\$	3,318

There were no transfers between levels for assets and liabilities recorded at fair value on a recurring basis during the three months and six months ended June 30, 2013 or June 30, 2012.

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012***Assets and Liabilities Recorded at Fair Value on a Non-Recurring Basis*

The table below summarizes assets and liabilities measured at fair value on a non-recurring basis at the dates indicated:

	Level 1	Carrying Value at June 30, 2013		Total
		Level 2	Level 3	
(In Thousands)				
Assets measured at fair value on a non-recurring basis:				
Collateral-dependent impaired loans and leases	\$	\$	\$ 882	\$ 882
Other real estate owned			791	791
Repossessed vehicles and equipment		491		491
	\$	\$ 491	\$ 1,673	\$ 2,164

	Level 1	Carrying Value at December 31, 2012		Total
		Level 2	Level 3	
(In Thousands)				
Assets measured at fair value on a non-recurring basis:				
Collateral-dependent impaired loans and leases	\$	\$ 36,749	\$	\$ 36,749
Other real estate owned		903		903
Repossessed vehicles and equipment		588		588
	\$	\$ 38,240	\$	\$ 38,240

Collateral-Dependent Impaired Loans and Leases

For nonperforming loans and leases where the credit quality of the borrower has deteriorated significantly, fair values of the underlying collateral were estimated using purchase and sales agreements (Level 2), or comparable sales or recent appraisals (Level 3), adjusted for selling costs and other expenses.

Other Real Estate Owned

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The Company records other real estate owned at the lower of cost or fair value. In estimating fair value, the Company utilizes purchase and sales agreements (Level 2) or comparable sales, recent appraisals or cash flows discounted at an interest rate commensurate with the risk associated with these cash flows (Level 3), adjusted for selling costs and other expenses.

Repossessed Assets

Repossessed vehicles and repossessed equipment are carried at estimated fair value less costs to sell based on auction pricing (Level 2).

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012***Summary of Estimated Fair Values of Financial Instruments*

The following table presents the carrying amount, estimated fair value, and placement in the fair value hierarchy of the Company's financial instruments at the dates indicated. This table excludes financial instruments for which the carrying amount approximates fair value. Financial assets for which the fair value approximates carrying value include cash and cash equivalents, FHLBB and FRB stock and accrued interest receivable. Financial liabilities for which the fair value approximates carrying value include non-maturity deposits, short-term borrowings and accrued interest payable.

	Carrying Value	Estimated Fair Value	Level 1 Inputs (In Thousands)	Fair Value Measurements Level 2 Inputs	Level 3 Inputs
At June 30, 2013					
Financial assets:					
Securities held-to-maturity	\$ 500	\$ 500	\$	\$	\$ 500
Loans and leases, net	4,160,734	4,127,795			4,127,795
Loans held-for-sale	4,221	4,221		4,221	
Financial liabilities:					
Certificates of deposit	972,502	977,643		977,643	
Borrowed funds	830,066	838,721		838,721	
At December 31, 2012					
Financial assets:					
Securities held-to-maturity	\$ 500	\$ 502	\$	\$	\$ 502
Loans and leases, net	4,134,560	4,193,678			4,193,678
Loans held-for-sale	3,233	3,233			3,233
Financial liabilities:					
Certificates of deposit	1,010,941	1,019,916		1,019,916	
Borrowed funds	853,969	872,046		872,046	

Investment Securities Held-to-Maturity

The fair values of investment securities held-to-maturity are estimated using pricing models or are based on comparisons to market prices of similar securities and are considered to be Level 3.

Loans and Leases

The fair values of performing loans and leases were estimated by segregating the portfolio into its primary loan and lease categories commercial real estate mortgage, multi-family mortgage, construction, commercial, equipment financing, condominium association, indirect automobile, residential mortgage, home equity and other consumer. These categories were further disaggregated based on significant financial characteristics such as type of interest rate (fixed / variable) and payment status (current / past-due). The Company discounts the contractual cash flows for each loan category using interest rates currently being offered for loans with similar terms to borrowers of similar quality and incorporates estimates of future loan prepayments. This method of estimating fair value does not incorporate the exit price concept of fair value.

Loans Held for Sale

Residential mortgage loans held for sale are recorded at the lower of cost or fair value and are therefore measured at fair value on a non-recurring basis. When available, observable inputs, including pricing on recent closed market transactions for loans with similar characteristics, are used as secondary market data, and such loans are classified as Level 2 measurements. When not available, loans are classified as Level 3 measurements.

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BROOKLINE BANCORP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

At and for the Six Months Ended June 30, 2013 and 2012

Deposits

The fair values of deposit liabilities with no stated maturity (demand, NOW, savings and money market savings accounts) are equal to the carrying amounts payable on demand. The fair value of certificates of deposit represents contractual cash flows discounted using interest rates currently offered on deposits with similar characteristics and remaining maturities. The fair value estimates for deposits do not include the benefit that results from the low-cost funding provided by the Company's core deposit relationships (deposit-based intangibles).

Borrowed Funds

The fair value of federal funds purchased is equal to the amount borrowed. The fair value of FHLBB advances and repurchase agreements represents contractual repayments discounted using interest rates currently available for borrowings with similar characteristics and remaining maturities. The fair values reported for retail repurchase agreements are based on the discounted value of contractual cash flows. The discount rates used are representative of approximate rates currently offered on borrowings with similar characteristics and maturities. The fair values reported for subordinated deferrable interest debentures are based on the discounted value of contractual cash flows. The discount rates used are representative of approximate rates currently offered on instruments with similar terms and maturities.

(11) Income Taxes

The Company recorded income tax expense of \$5.4 million for the three months ended June 30, 2013, compared to \$4.4 million for the three months ended June 30, 2012, representing total effective tax rates of 35.3% and 36.1%, respectively. On a year-to-date basis, the Company recorded income tax expense of \$10.5 million for the first six months of 2013, compared to \$9.3 million for the first six months of 2012, representing total effective tax rates of 35.5% and 39.2%, respectively.

The decrease in the effective state and federal tax rate for the three months and six months ended June 30, 2013 is primarily due to the non-deductibility of \$1.4 million of the \$5.4 million in professional fees incurred related to the BankRI acquisition in 2012.

(12) Commitments and Contingencies

Off-Balance-Sheet Financial Instruments

The Company is party to off-balance-sheet financial instruments in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include loan commitments, standby and commercial letters of credits, and interest-rate swaps. According to GAAP, these financial instruments are not recorded in the financial statements until they are funded or related fees are incurred or received.

The contract amounts reflect the extent of the involvement the Company has in particular classes of these instruments. Such commitments involve, to varying degrees, elements of credit risk and interest-rate risk in excess of the amount recognized in the consolidated balance sheet. The Company's exposure to credit loss in the event of non-performance by the counterparty is represented by the contractual amount of the instruments. The Company uses the same policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012**

Financial instruments with off-balance-sheet risk at the dates indicated follow:

	At June 30, 2013	At December 31, 2012
	(In Thousands)	
Financial instruments whose contract amounts represent credit risk:		
Commitments to originate loans and leases:		
Commercial real estate	\$ 58,665	\$ 85,726
Commercial	76,949	67,857
Residential mortgage	6,174	8,726
Unadvanced portion of loans and leases	519,808	421,143
Unused lines of credit:		
Home equity	187,754	165,936
Other consumer	5,804	4,017
Other commercial	972	965
Unused letters of credit:		
Financial standby letters of credit	19,730	19,887
Performance standby letters of credit	2,916	2,916
Commercial and similar letters of credit	158	112
Back-to-back interest-rate swaps	23,021	33,221

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee by the customer. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if any, is based on management's credit evaluation of the borrower.

Standby and commercial letters of credits are conditional commitments issued by the Company to guarantee performance of a customer to a third party. These standby and commercial letters of credit are primarily issued to support the financing needs of the Company's commercial customers. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

The liability for unfunded credit commitments, included in other liabilities, was \$0.9 million at June 30, 2013 and \$0.7 million at December 31, 2012.

From time to time the Company enters into back-to-back interest-rate swaps with commercial customers and third-party financial institutions. These swaps allow the Company to offer long-term fixed-rate commercial loans while mitigating the interest-rate risk of holding those loans. In a back-to-back interest-rate swap transaction, the Company lends to a commercial customer on a floating-rate basis and then enters into an

interest-rate swap with that customer. Concurrently, the Company enters into offsetting swaps with a third-party financial institution, effectively minimizing its net interest-rate risk exposure resulting from such transactions.

Table of Contents**BROOKLINE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements****At and for the Six Months Ended June 30, 2013 and 2012***Lease Commitments*

The Company leases certain office space under various noncancellable operating leases. A summary of future minimum rental payments under such leases at the dates indicated follows:

Year Ending December 31,	Minimum Rental Payments (In Thousands)	
Remainder of 2013	\$	2,276
2014		3,977
2015		3,614
2016		3,391
2017		2,973
Thereafter		8,153
Total	\$	24,384

The leases contain escalator clauses for real estate taxes and other expenditures. Total rental expense was \$2.6 million during the six months ended June 30, 2013, compared to \$2.1 million during the six months ended June 30, 2012.

Legal Proceedings

In the normal course of business, there are various outstanding legal proceedings. In the opinion of management, after consulting with legal counsel, the consolidated financial position and results of operations of the Company are not expected to be affected materially by the outcome of such proceedings.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q that are not historical facts may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve risks and uncertainties. These statements, which are based on certain assumptions and describe Brookline Bancorp, Inc.'s (the Company's) future plans, strategies and expectations, can generally be identified by the use of the words may, will, should, could, would, potential, estimate, project, believe, intend, anticipate, expect, target and similar expressions. These statements include, among other things, regarding the Company's intent, belief or expectations with respect to economic conditions, trends affecting the Company's financial condition or results of operations, and the Company's exposure to market, liquidity, interest-rate and credit risk.

Forward-looking statements are based on the current assumptions underlying the statements and other information with respect to the beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions of management and the financial condition, results of operations, future performance and business are only expectations of future results. Although the Company believes that the expectations reflected in the Company's forward-looking statements are reasonable, the Company's actual results could differ materially from those projected in the forward-looking statements as a result of, among other factors, adverse conditions in the capital and debt markets; changes in interest rates; competitive pressures from other financial institutions; the effects of continuing weakness in general economic conditions on a national basis or in the local markets in which the Company operates, including changes which adversely affect borrowers' ability to service and repay their loans and leases; changes in the value of securities and other assets in the Company's investment portfolio; changes in loan and lease default and charge-off rates; the adequacy of allowances for loan and lease losses; deposit levels necessitating increased borrowing to fund loans and investments; changes in government regulation; the risk that goodwill and intangibles recorded in the Company's financial statements will become impaired; and changes in assumptions used in making such forward-looking statements, as well as the other risks and uncertainties detailed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012 and other filings submitted to the Securities and Exchange Commission. Forward-looking statements speak only as of the date on which they are made. The Company does not undertake any obligation to update any forward-looking statement to reflect circumstances or events that occur after the date the forward-looking statements are made.

Introduction

Brookline Bancorp, Inc. (the Company), a Delaware corporation, operates as a multi-bank holding company for Brookline Bank and its subsidiaries; Bank Rhode Island (BankRI) and its subsidiaries; First Ipswich Bank (First Ipswich) and formerly known as The First National Bank of Ipswich) and its subsidiaries; and Brookline Securities Corp.

As a commercially-focused financial institution with 47 full-service banking offices throughout Greater Boston, the North Shore of Massachusetts and Rhode Island, the Company, through Brookline Bank, BankRI and First Ipswich (the Banks), offers a wide range of commercial, business and retail banking services, including a full complement of cash management products, on-line banking services, consumer and residential loans and investment services, designed to meet the financial needs of small- to mid-sized businesses and individuals throughout Central New England. Specialty lending activities include indirect automobile loans as well as equipment financing in the New York/New Jersey metropolitan area and elsewhere.

The Company focuses its business efforts on profitably growing its commercial lending businesses, both organically and through acquisitions. The Company's customer focus, multi-bank structure, and risk management are integral to its organic growth strategy and serve to differentiate the Company from its competitors. As full-service financial institutions, the Banks and their subsidiaries focus on the continued acquisition of well-qualified customers, the deepening of long-term banking relationships through a full complement of products and excellent customer service, and strong risk management. The Company's multi-bank structure retains the local-bank orientation while relieving local bank management of the responsibility for most back-office functions which are consolidated at the holding-company level. Branding and decision-making, including credit decisioning and pricing, remain largely local in order to better meet the needs of bank customers and further motivate the Banks' commercial, business and retail bankers.

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The Company is subject to competition from other financial and non-financial institutions and is supervised, examined and regulated by the Board of Governors of the Federal Reserve System (FRB). As Massachusetts-chartered member banks, Brookline Bank and First Ipswich are also subject to regulation under the laws of the Commonwealth of Massachusetts and the jurisdiction of the Massachusetts Division of Banks. As Rhode Island-chartered member bank, BankRI is also subject to regulation under the laws of the State of Rhode Island and the jurisdiction of the Banking Division of the Rhode Island Department of Business Regulation. The FDIC continues to insure all of the Banks' deposits. Additionally, all Massachusetts-chartered savings banks are required to be members of the Depositors Insurance Fund (DIF), a corporation that insures savings bank deposits in excess of the FDIC insurance limits of \$250,000 per person. As such, Brookline Bank offers 100% insurance on all deposits as a result of a combination of insurance from the FDIC and the DIF.

The Company's common stock is traded on the Nasdaq Global Select MarketSM under the symbol BRKL.

Critical Accounting Policies

The SEC defines critical accounting policies as those involving significant judgments and difficult or complex assumptions by management, often as a result of the need to make estimates about matters that are inherently uncertain or variable, which have, or could have, a material impact on the carrying value of certain assets or net income. The preparation of financial statements in accordance with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates. As discussed in the Company's 2012 Annual Report on Form 10-K, management has identified the valuation of available-for-sale securities, accounting for assets and liabilities acquired, the determination of the allowance for loan and lease losses, the review of goodwill and intangibles for impairment, and income tax accounting as the Company's most critical accounting policies.

Non-GAAP Financial Measures and Reconciliations to GAAP

In addition to evaluating the Company's results of operations in accordance with GAAP, management periodically supplements this evaluation with an analysis of certain non-GAAP financial measures, such as the ratio of the allowance for loan and lease losses related to originated loans and leases as a percentage of originated loans and leases, the efficiency and tangible equity ratios, tangible book value per share and operating earnings metrics. Management believes that these non-GAAP financial measures provide information useful to investors in understanding the Company's underlying operating performance and trends, and facilitates comparisons with the performance assessment of financial performance, including non-interest expense control, while the tangible equity ratio and tangible book value per share are used to analyze the relative strength of the Company's capital position.

Operating earnings exclude acquisition-related and other non-recurring expenses from net income, which allows the Company to measure and assess financial results on a more consistent basis from period to period. These expenses are also excluded when calculating the operating efficiency ratio. In light of diversity in presentation among financial institutions, the methodologies used by the Company for determining the non-GAAP financial measures discussed above may differ from those used by other financial institutions.

Table of Contents**Selected Financial Data**

	At and for the Three Months Ended				At and for the Six Months Ended			
	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012	June 30, 2012	June 30, 2013	June 30, 2012	
	(Dollars in Thousands, Except Per Share Data)							
FINANCIAL CONDITION DATA								
Total assets	\$ 5,150,480	\$ 5,110,378	\$ 5,147,534	\$ 5,061,444	\$ 4,972,381	\$ 5,150,480	\$ 4,972,381	
Total loans and leases	4,205,015	4,173,985	4,175,712	4,144,012	4,012,544	4,205,015	4,012,544	
Allowance for loan and lease losses	44,281	42,532	41,152	38,913	37,431	44,281	37,431	
Net loans and leases	4,160,734	4,131,453	4,134,560	4,105,099	3,975,113	4,160,734	3,975,113	
Investment securities available-for-sale	479,177	486,625	481,323	466,822	384,533	479,177	384,533	
Investment securities held-to-maturity	500	500	500	500	500	500	500	
Goodwill and identified intangible assets	157,058	158,235	159,400	161,197	162,468	157,058	162,468	
Total deposits	3,656,981	3,626,033	3,616,259	3,568,016	3,521,206	3,656,981	3,521,206	
Core deposits (1)	2,684,479	2,630,826	2,605,318	2,525,487	2,471,744	2,684,479	2,471,744	
Certificates of deposit	972,502	995,207	1,010,941	1,042,529	1,049,462	972,502	1,049,462	
Total borrowed funds	830,066	820,447	853,969	828,256	794,101	830,066	794,101	
Stockholders equity	611,284	614,039	612,097	605,962	598,865	611,284	598,865	
Tangible stockholders equity (non-GAAP) (2)	454,226	455,804	452,697	444,765	436,397	454,226	436,397	
Nonperforming loans and leases (3)	17,493	21,693	22,246	21,289	21,066	17,493	21,066	
Nonperforming assets (4)	18,986	22,941	23,737	23,675	23,831	18,986	23,831	
EARNINGS DATA								
Interest and dividend income	\$ 52,900	\$ 51,612	\$ 52,976	\$ 55,394	\$ 51,839	\$ 104,511	\$ 104,830	
Interest expense	7,537	7,943	8,412	8,983	9,080	15,481	18,438	
Net interest income	45,363	43,669	44,564	46,411	42,759	89,030	86,392	
Provision for credit losses	2,439	1,855	3,101	2,862	6,678	4,294	9,925	
Provision for income taxes	5,382	5,129	6,868	5,176	4,398	10,511	9,296	
Non-interest income	3,138	3,327	6,504	3,785	4,721	6,466	8,315	
Non-interest expense	30,815	30,772	28,869	30,436	28,621	61,585	61,069	
Net income	9,490	8,813	11,863	11,401	7,529	18,304	13,878	
Operating earnings	9,490	8,813	11,863	11,401	7,529	18,304	17,850	
PER COMMON SHARE DATA								
Net income Basic	\$ 0.14	\$ 0.13	\$ 0.17	\$ 0.16	\$ 0.11	\$ 0.26	\$ 0.20	
Net income Diluted	0.14	0.13	0.17	0.16	0.11	0.26	0.20	
Dividends paid per common share	0.085	0.085	0.085	0.085	0.085	0.17	0.17	
Book value per share (end of period)	8.73	8.77	8.74	8.65	8.59	8.73	8.59	
Tangible book value per share (end of period) (non-GAAP) (5)	6.48	6.51	6.46	6.35	6.26	6.48	6.26	
Stock price (end of period)	8.68	9.14	8.50	8.82	8.85	8.68	8.85	
PERFORMANCE RATIOS								

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Net interest margin	3.78%	3.70%	3.79%	4.00%	3.81%	3.74%	3.85%
Return on average assets (annualized)	0.74%	0.70%	0.93%	0.90%	0.61%	0.72%	0.57%
Operating return on average assets (non-GAAP) (annualized) (6)	0.74%	0.70%	0.93%	0.90%	0.61%	0.72%	0.73%
Efficiency ratio (non-GAAP) (7)	63.53%	65.48%	56.53%	60.63%	60.28%	64.49%	64.48%
Operating efficiency ratio (non-GAAP) (8)	63.53%	65.48%	56.53%	60.63%	60.28%	64.49%	58.78%
Return on average tangible assets (non-GAAP)	0.76%	0.72%	0.96%	0.93%	0.64%	0.74%	0.59%
Return on average stockholders' equity (annualized)	6.16%	5.72%	7.76%	7.53%	5.04%	5.93%	4.64%
Operating return on average stockholders' equity (non-GAAP) (annualized)	6.16%	5.72%	7.76%	7.53%	5.04%	5.93%	5.97%
Return on average tangible stockholders' equity (annualized)	8.28%	7.70%	10.53%	10.27%	6.95%	7.98%	6.41%
Operating return on average tangible stockholders' equity (non-GAAP) (9)	8.28%	7.70%	10.53%	10.27%	6.95%	7.98%	8.25%
Dividend payout ratio (10)	62.78%	67.60%	50.22%	52.24%	79.08%	65.10%	85.50%

(Continued)

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	June 30, 2013	March 31, 2013	At and for the Three Months Ended			At and for the Six Months Ended	
			December 31, 2012	September 30, 2012	June 30, 2012	June 30, 2013	June 30, 2012
	(Dollars in Thousands, Except Per Share Data)						
GROWTH RATIOS							
Total loan and lease growth (annualized) (11)	2.97%	-0.17%	3.06%	13.11%	8.06%	1.40%	94.95%
Organic loan and lease growth (annualized) (12)	2.97%	-0.17%	3.06%	13.11%	8.06%	1.40%	11.46%
Total deposit growth (annualized) (11)	3.41%	1.08%	5.41%	5.32%	7.15%	2.25%	152.98%
Organic deposit growth (annualized) (12)	3.41%	1.08%	5.41%	5.32%	7.15%	2.25%	12.03%
ASSET QUALITY RATIOS							
Net loan and lease charge-offs as a percentage of average loans and leases (annualized)	0.06%	0.04%	0.08%	0.15%	0.37%	-1.99%	-1.55%
Nonperforming loans and leases as a percentage of total loans and leases (13)	0.42%	0.52%	0.53%	0.51%	0.52%	0.42%	0.52%
Nonperforming assets as a percentage of total assets (13)	0.37%	0.45%	0.46%	0.47%	0.48%	0.37%	0.48%
Total allowance for loan and lease losses as a percentage of total loans and leases (13)	1.05%	1.02%	0.98%	0.94%	0.93%	1.05%	0.93%
Allowance for loan and lease losses related to originated loans and leases as a percentage of originated loans and leases (non-GAAP) (14)	1.34%	1.34%	1.33%	1.31%	1.33%	1.34%	1.33%
CAPITAL RATIOS							
Stockholders' equity to total assets	11.87%	12.02%	11.89%	11.97%	12.04%	11.87%	12.04%
Tangible equity ratio (non-GAAP) (15)	9.10%	9.20%	9.08%	9.08%	9.07%	9.10%	9.07%
Tier 1 leverage capital ratio	9.47%	9.49%	9.44%	9.03%	9.16%	9.47%	9.16%
Tier 1 risk-based capital ratio	11.23%	11.21%	10.85%	10.42%	10.60%	11.23%	10.60%
Total risk-based capital ratio	12.31%	12.26%	11.83%	11.64%	11.82%	12.31%	11.82%

(1) Core deposits consist of demand checking, NOW, money market and savings accounts.

(2) Tangible stockholders' equity is calculated by subtracting goodwill and identified intangible assets, net, from total stockholders' equity.

(3) Nonperforming loans and leases consist of nonaccrual loans and leases. Amount includes deferred origination costs.

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- (4) Nonperforming assets consist of nonperforming loans and leases, other real estate owned and other repossessed assets. Amount includes deferred origination costs.
- (5) Tangible book value per share is calculated by dividing tangible stockholders' equity by common shares (total common shares issued, less common shares classified as treasury shares and unallocated ESOP common shares).
- (6) Operating return on average assets is calculated by dividing annualized operating earnings by average assets during the period.
- (7) The efficiency ratio is calculated by dividing non-interest expense by the sum of net interest income and non-interest income for the period.
- (8) The operating efficiency ratio is calculated by dividing non-interest expense less acquisition-related expenses for the period by the sum of net interest income and non-interest income for the period.
- (9) Operating return on average tangible stockholders' equity is calculated by dividing annualized operating earnings by average tangible stockholders' equity during the period.
- (10) The dividend payout ratio is calculated by dividing dividends paid during the period by net income during the period.
- (11) Total growth is calculated by dividing the annualized change in the balance during the period by the balance at the beginning of the period.
- (12) Organic growth is calculated by dividing the annualized change in the balance during the period less the fair value of acquired loan and deposit balances at the date of acquisition by the balance at the beginning of the period.
- (13) Amount includes acquired and originated loans and leases and deferred loan origination costs.
- (14) Amount excludes acquired loans and leases and includes deferred loan origination costs associated with originated loans.
- (15) The tangible equity ratio is calculated by dividing tangible stockholders' equity (total stockholders' equity less goodwill and identified intangible assets, net (the numerator)) by tangible assets (total assets less goodwill and identified intangible assets, net (the denominator)).

Executive Overview

Growth

Total assets increased slightly from \$5.1 billion at December 31, 2012 to \$5.2 billion at June 30, 2013. The loan and lease portfolio increased \$29.3 million, or 0.7%, from December 31, 2012 to \$4.2 billion at June 30, 2013. The Company's commercial loan portfolios, which are comprised of commercial real estate loans and commercial loans and leases, continued to exhibit growth. The Company's commercial loan portfolios, which total \$3.0 billion, or 70.2% of total loans and leases at June 30, 2013, increased 6.9% on an annualized basis during the first half of 2013. Loan growth in the Company's commercial loan portfolios was offset by a \$62.6 million decrease in the indirect automobile portfolio during the first half of the year, due to fewer loan originations in the auto lending market.

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The ratio of the allowance for loan and lease losses to total loans and leases was 1.05% at June 30, 2013, compared to 0.98% at December 31, 2012. The allowance for loan and lease losses related to originated loans and leases as a percentage of the total originated loans and leases, including deferred loan origination costs, was 1.34% at June 30, 2013 as compared with 1.33% at December 31, 2012. The Company continued to employ its historical underwriting methodology throughout the six-month period ended June 30, 2013 and continued to calculate its allowance for loan and lease losses on a historically consistent basis.

Nonperforming assets at June 30, 2013 totaled \$19.0 million or 0.37% of total assets, as compared with \$23.7 million, or 0.46% of total assets, at December 31, 2012. Net charge-offs for the three months ended June 30, 2013 were \$0.6 million, or 0.06% of average loans and leases, compared to 0.08% for the three months ended December 31, 2012 and 0.37% for the three months ended June 30, 2012.

Deposits were up slightly from December 31, 2012. The Company's core deposits increased as a percentage of total deposits from 72.0% at December 31, 2012 to 73.4% at June 30, 2013.

The Company remains well-capitalized as defined by its regulatory requirements with capital ratios in excess of all minimum regulatory requirements. The Company's Tier 1 leverage ratio was 9.47% at June 30, 2013, compared to 9.44% at December 31, 2012. The Company's tangible equity ratio was 9.10% at June 30, 2013, compared to 9.08% at December 31, 2012.

Net Income

For the three months ended June 30, 2013, the Company reported net income of \$9.5 million, or \$0.14 per diluted share, up 26.0% from the three months ended June 30, 2012. For the six months ended June 30, 2013, the Company reported net income of \$18.3 million, or \$0.26 per diluted share, up 31.9% from the six months ended June 30, 2012. The annualized return on average assets was 0.74% and 0.72% for the three months and six months ended June 30, 2013, respectively, compared to 0.61% and 0.57% for the three months and six months ended June 30, 2012, respectively. The annualized return on average stockholders' equity was 6.16% and 5.93% for the three months and six months ended June 30, 2013, compared to 5.04% and 4.64% for the three months and six months ended June 30, 2012, respectively.

Net earnings from operations, which exclude acquisition-related expenses, were \$9.5 million, or \$0.14 per diluted share for the three months ended June 30, 2013. This compared to \$7.5 million, or \$0.11 per diluted share for the three months ended June 30, 2012. Net earnings from operations were \$18.3 million, or \$0.26 per diluted share for the six months ended June 30, 2013. This compared to \$17.9 million, or \$0.26 per diluted share for the six months ended June 30, 2012. Annualized operating returns on average assets were 0.74% and 0.72%, respectively, for the three months and six months ended June 30, 2013, compared to 0.61% and 0.73%, respectively, for the three months and six months ended June 30, 2012. Annualized operating returns on average stockholders' equity were 6.16% and 5.93%, respectively, for the three months and six months ended June 30, 2013, compared to 5.04% and 5.97%, respectively, for the three months and six months ended June 30, 2012.

Net interest margin was 3.78% and 3.74%, respectively, for the three months and six months ended June 30, 2013, compared to 3.81% and 3.85%, respectively, for the three months and six months ended June 30, 2012. The yield on interest-earning assets decreased 21 basis points from 4.62% during the second quarter of 2012 to 4.41% during the second quarter in 2013, due to continued rate pressures in the lending market. The decrease in yields on interest-earning assets is offset by a decrease of 19 basis points in the Company's overall cost of funds, from 0.98% for the three months ended June 30, 2012 to 0.79% for the three months ended June 30, 2013. The Company's net interest margin will likely

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continue to be under pressure due to competitive pricing pressure in all loan categories and the continuation of a low interest-rate environment, along with the Company's diminishing ability to reduce its cost of funds.

Results for the second quarter of 2013 included a \$2.4 million provision for credit losses. The provision has decreased from \$6.7 million for the second quarter of 2012. Of the \$6.7 million provision recorded in the second quarter of 2012, \$4.2 million was related to two short-term commercial loans made by BankRI shortly after the Company's acquisition of BankRI.

Non-interest income totaled \$3.1 million and \$6.5 million, respectively, for the three months and six months ended June 30, 2013. This compared to \$4.7 million and \$8.3 million, respectively, for the three months and six months ended June 30, 2012. The decrease is primarily attributable to an increased loss from investments in affordable housing projects of \$0.4 million quarter-over-quarter and \$0.6 million period-over-period, as well as a net gain on sales of securities of \$0.8 million in the second quarter of 2012.

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Non-interest expense increased \$2.2 million, or 7.7%, from \$28.6 million during the three months ended June 30, 2012 to \$30.8 million for the three months ended June 30, 2013. While compensation and employee benefit expense increased due to addition of loan officers and other individuals in key support areas of the Company, professional service expenses decreased substantially in the amount of \$1.0 million, or 40.8%, in the second quarter of 2013. Professional service expenses in the second quarter of 2012 were elevated largely due to the acquisition of BankRI.

The following table summarizes the Company's operating earnings, operating earnings per share (EPS) and operating return on average assets for the periods indicated:

	June 30, 2013	Three Months Ended March 31, 2013	June 30, 2012	Six Months Ended June 30, 2013	June 30, 2012
	(Dollars in Thousands, Except Per Share Data)				
Net income, as reported	\$ 9,490	\$ 8,813	\$ 7,529	\$ 18,304	\$ 13,878
Adjustments to arrive at operating earnings:					
Acquisition-related expenses					5,396
Total pre-tax adjustments					5,396
Tax effect					(1,424)
Total adjustments, net of tax					3,972
Operating earnings	\$ 9,490	\$ 8,813	\$ 7,529	\$ 18,304	\$ 17,850
Earnings per share, as reported	\$ 0.14	\$ 0.13	\$ 0.11	\$ 0.26	\$ 0.20
Adjustments to arrive at operating earnings per share:					
Acquisition-related expenses					0.06
Total adjustments per share					0.06
Operating earnings per fully dilutive share	\$ 0.14	\$ 0.13	\$ 0.11	\$ 0.26	\$ 0.26
Average total assets	\$ 5,138,144	\$ 5,071,163	\$ 4,904,933	\$ 5,103,316	\$ 4,883,160
Operating return on average assets (annualized)	0.74%	0.70%	0.61%	0.72%	0.73%
Average total stockholders' equity	\$ 616,327	\$ 616,627	\$ 597,908	\$ 616,868	\$ 598,277
Operating return on average stockholders' equity (annualized)	6.16%	5.72%	5.04%	5.93%	5.97%

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The following table summarizes the Company's operating return on average tangible stockholders' equity:

	June 30, 2013	Three Months Ended March 31, 2013	June 30, 2012	Six Months Ended June 30, 2013	June 30, 2012
	(Dollars in Thousands)				
Operating earnings	\$ 9,490	\$ 8,813	\$ 7,529	\$ 18,304	\$ 17,850
Average stockholders' equity	616,327	616,627	597,908	616,868	598,277
Less: Average goodwill and average identified intangible assets, net	157,799	158,949	164,288	158,371	165,315
Average tangible stockholders' equity	\$ 458,528	\$ 457,678	\$ 433,620	\$ 458,497	\$ 432,962
Operating return on average tangible stockholders' equity (annualized)	8.28%	7.70%	6.95%	7.98%	8.25%

The following tables summarize the Company's tangible equity ratio and tangible book value per share derived from amounts reported in the unaudited consolidated balance sheet at the dates indicated.

	At June 30, 2013	At March 31, 2013	At June 30, 2012
	(Dollars in Thousands)		
Total stockholders' equity	\$ 611,284	\$ 614,039	\$ 598,865
Less: Goodwill and identified intangible assets, net	157,058	158,235	162,468
Tangible stockholders' equity	\$ 454,226	\$ 455,804	\$ 436,397
Total assets	\$ 5,150,480	\$ 5,110,378	\$ 4,972,381
Less: Goodwill and identified intangible assets, net	157,058	158,235	162,468
Tangible assets	\$ 4,993,422	\$ 4,952,143	\$ 4,809,913
Tangible equity ratio	9.10%	9.20%	9.07%

	At June 30, 2013	At March 31, 2013	At June 30, 2012
	(Dollars in Thousands, Except Share Data)		
Tangible stockholders' equity	\$ 454,226	\$ 455,804	\$ 436,397
Common shares issued	75,744,445	75,744,445	75,414,713
Less: Common shares classified as treasury shares	5,373,733	5,373,733	5,373,733
Less: Unallocated ESOP shares	312,792	323,355	356,064
Common shares outstanding	70,057,920	70,047,357	69,684,916
Tangible book value per share	\$ 6.48	\$ 6.51	\$ 6.26

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The following table summarizes the Company's dividend payout ratio:

	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
	(Dollars in Thousands)			
Dividends paid (1)	\$ 5,958	\$ 5,954	\$ 11,915	\$ 11,865
Net income, as reported	\$ 9,490	\$ 7,529	\$ 18,304	\$ 13,878
Dividend payout ratio	62.78%	79.08%	65.10%	85.50%

(1) Dividends Paid excludes cash payment on the Company's unallocated ESOP shares.

The following table summarizes the Company's allowance for loan and lease losses related to originated loans and leases as a percentage of total originated loans and lease:

	At June 30, 2013	At December 31, 2012	At June 30, 2012
		(Dollars in Thousands)	
Allowance for loan and lease losses	\$ 44,281	\$ 41,152	\$ 37,431
Less:			
Allowance for acquired loans and leases losses	620		
Allowance for originated loan and lease losses	\$ 43,661	\$ 41,152	\$ 37,431
Total loans and leases	\$ 4,205,015	\$ 4,175,712	\$ 4,012,544
Less:			
Total acquired loans and leases	938,815	1,059,610	1,187,844
Total originated loans and leases	\$ 3,266,200	\$ 3,116,102	\$ 2,824,700
Allowance for loan and lease losses related to originated loans and leases as a percentage of originated loans and leases	1.34%	1.33%	1.33%

Financial Condition

General

Total assets of \$5.2 billion increased slightly from \$5.1 billion at December 31, 2012, and increased \$178.1 million, or 3.6%, from \$5.0 billion at June 30, 2012.

The loan and lease portfolio increased \$29.3 million, or 0.7%, from December 31, 2012 to \$4.2 billion at June 30, 2013. The Company's commercial loan portfolios, which are comprised of commercial real estate loans and commercial loans and leases, grew \$98.3 million, or 6.9% on an annualized basis, to \$3.0 billion at June 30, 2013 as compared to \$2.9 billion at December 31, 2012. At June 30, 2013, the commercial loan and lease and commercial real estate portfolios totaled \$3.0 billion, or 70.2% of total loans and leases. Offsetting the growth in the commercial portfolios was a \$62.6 million decrease in the indirect automobile portfolio from December 31, 2012 to June 30, 2013, due to management's unwillingness to originate loans at what it considers to be the very low interest rates.

Cash, cash equivalents, and investments securities available-for-sale were \$579.0 million at June 30, 2013 as compared to \$598.4 million at December 31, 2012. The decrease during the first half of 2013 reflects tighter management of cash with excess used to pay down debts. Total cash, cash equivalents, and investment securities were 11.3% and 11.6% of total assets at June 30, 2013 and December 31, 2012, respectively, and in line with management's liquidity targets.

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Deposits of \$3.7 billion at June 30, 2013 increased slightly from December 31, 2012, and increased \$135.8 million, or 3.9%, as compared to \$3.5 billion at June 30, 2012. Core deposits increased at a 6.1% annualized rate in the first half of 2013, from \$2.6 billion at December 31, 2012 to \$2.7 billion at June 30, 2013, raising the core deposit ratio from 72.0% at December 31, 2012 to 73.4% at June 30, 2013. Total borrowings decreased approximately \$23.9 million from \$854.0 million at December 31, 2012 to \$830.1 million at June 30, 2013.

The ratio of stockholders' equity to total assets was 11.87% and 11.89% at June 30, 2013 and December 31, 2012, respectively. The ratio of tangible stockholders' equity to tangible assets was 9.10% and 9.08% at June 30, 2013 and December 31, 2012, respectively.

Loans and Leases

The following table summarizes the Company's portfolio of loans and leases receivable at the dates indicated:

	June 30, 2013		December 31, 2012	
	Balance	Percent of Total (Dollars in Thousands)	Balance	Percent of Total
Commercial real estate loans:				
Commercial real estate mortgage	\$ 1,349,051	32.1%	\$ 1,301,233	31.1%
Multi-family mortgage	594,939	14.1%	606,533	14.5%
Construction	112,684	2.7%	98,197	2.3%
Total commercial real estate loans	2,056,674	48.9%	2,005,963	47.9%
Commercial loans and leases:				
Commercial	376,507	9.0%	382,277	9.1%
Equipment financing	476,724	11.3%	420,991	10.1%
Condominium association	41,859	1.0%	44,187	1.1%
Total commercial loans and leases	895,090	21.3%	847,455	20.3%
Indirect automobile	479,782	11.4%	542,344	13.0%
Consumer loans:				
Residential mortgage	507,099	12.1%	511,109	12.3%
Home equity	257,839	6.1%	261,562	6.3%
Other consumer	8,531	0.2%	7,279	0.2%
Total consumer loans	773,469	18.4%	779,950	18.8%
Total loans and leases	4,205,015	100.0%	4,175,712	100.0%
Allowance for loan and lease losses	(44,281)		(41,152)	
Net loans and leases	\$ 4,160,734		\$ 4,134,560	

The following table sets forth the growth in the Company's loan and lease portfolios during the six months ended June 30, 2013:

	At June 30, 2013	At December 31, 2012	Dollar Change	Percent Change (Annualized)
	(Dollars in Thousands)			
Commercial real estate	\$ 2,056,674	\$ 2,005,963	\$ 50,711	5.1%

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Commercial	895,090	847,455	47,635	11.2%
Indirect automobile	479,782	542,344	(62,562)	-23.1%
Consumer	773,469	779,950	(6,481)	-1.7%
Total loans and leases	\$ 4,205,015	\$ 4,175,712	\$ 29,303	1.4%

The Company's loan portfolio consists primarily of first mortgage loans secured by commercial, multi-family and residential real estate properties located in the Company's primary lending area, indirect automobile loans, loans to business entities, including commercial lines of credit, loans to condominium associations and loans and leases used to finance equipment used by small businesses. The Company also provides financing for construction and development projects, home equity and other consumer loans.

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The Company employs seasoned commercial lenders and retail bankers who rely on community and business contacts as well as referrals from customers, attorneys and other professionals to generate loans and deposits. Existing borrowers are also an important source of business since many of them have more than one loan outstanding with the Company. The Company's ability to originate loans depends on the strength of the economy, trends in interest rates, and levels of customer demand and market competition.

Commercial Real Estate Loans

The commercial real estate portfolio of \$2.1 billion at June 30, 2013 is composed of commercial real estate mortgage loans, multi-family mortgage loans, and construction loans and is the largest component of the Company's overall loan portfolio, representing 48.9% of total loans and leases outstanding at June 30, 2013. For the commercial real estate portfolio, the Company focuses on making loans in the \$3 million to \$10 million range.

Typically, commercial real estate loans are larger in size and involve a greater degree of risk than owner-occupied residential mortgage loans. Loan repayment is usually dependent on the successful operation and management of the properties and the value of the properties securing the loans. Economic conditions can greatly affect cash flows and property values.

A number of factors are considered in originating commercial real estate and multi-family mortgage loans. The qualifications and financial condition of the borrower (including credit history), as well as the potential income generation and the value and condition of the underlying property, are evaluated. When evaluating the qualifications of the borrower, the Company considers the financial resources of the borrower, the borrower's experience in owning or managing similar property and the borrower's payment history with the Company and other financial institutions. Factors considered in evaluating the underlying property include the net operating income of the mortgaged premises before debt service and depreciation, the debt service coverage ratio (the ratio of cash flow before debt service to debt service), the use of conservative capitalization rates, and the ratio of the loan amount to the appraised value. Generally, personal guarantees are obtained from commercial real estate loan borrowers.

Commercial real estate and multi-family mortgage loans are typically originated for terms of five years with amortization periods of 20 to 30 years. Many of the loans are priced at inception on a fixed-rate basis generally for periods ranging from two to five years with repricing periods for longer-term loans. When possible, prepayment penalties are included in loan covenants on these loans.

Brookline Bank's urban and suburban market area is characterized by a large number of apartment buildings, condominiums and office buildings. As a result, multi-family and commercial real estate mortgage lending has been a significant part of Brookline Bank's activities for many years. These types of loans typically generate higher yields, but also involve greater credit risk. Many of Brookline Bank's borrowers have more than one multi-family or commercial real estate loan outstanding with Brookline Bank.

Over 99% of the commercial real estate loans outstanding at June 30, 2013 were secured by properties located in New England. The commercial real estate portfolio at that date was composed primarily of loans secured by office buildings (\$418.4 million), retail stores (\$389.8 million), industrial properties (\$70.2 million), apartment buildings (\$407.5 million), and mixed-use properties (\$157.9 million).

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Construction and development financing is generally considered to involve a higher degree of risk than long-term financing on improved, occupied real estate and thus has higher concentration limits than do other commercial credit classes. Risk of loss on a construction loan is largely dependent upon the accuracy of the initial estimate of construction costs, the estimated time to sell or rent the completed property at an adequate price or rate of occupancy, and market conditions. If the estimates and projections prove to be inaccurate, the Company may be confronted with a project which, upon completion, has a value that is insufficient to assure full loan repayment.

Criteria applied in underwriting construction loans for which the primary source of repayment is the sale of the property are different from the criteria applied in underwriting construction loans for which the primary source of repayment is the stabilized cash flow from the completed project. For those loans where the primary source of repayment is from resale of the property, in addition to the normal credit analysis performed for other loans, the Company also analyzes project costs, the attractiveness of the property in relation to the market in which it is located and demand within the market area. For those construction loans where the source of repayment is the stabilized cash flow from the completed project, the Company analyzes not only project costs but also how long it might take to achieve satisfactory occupancy and the reasonableness of projected rental rates in relation to market rental rates.

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Historically, construction and development lending has comprised a modest part of the Company's loan originations. At June 30, 2013, originated construction loans equaled \$101.2 million, or 3.1% of total originated loans outstanding at that date.

Commercial Loans and Leases

The commercial loan and lease portfolio of \$895.1 million at June 30, 2013 is composed of commercial loans, equipment financing loans and leases and condominium association loans and represented 21.3% of total loans outstanding at June 30, 2013. The Company focuses on making commercial loans in the \$1 million to \$10 million range.

The Company provides commercial banking services to companies in its market area. Over 95% of the commercial loans outstanding at June 30, 2013 were made to borrowers located in New England. Product offerings include lines of credit, term loans, letters of credit, deposit services and cash management. These types of credit facilities have as their primary source of repayment cash flows from the operations of a business. Interest rates offered are available on a floating basis tied to the prime rate or a similar index or on a fixed-rate basis referenced on the Federal Home Loan Bank of Boston (FHLBB) index.

Credit extensions are made to established businesses on the basis of an analysis of their financial statements, the nature of collateral to secure the credit extension and, in most instances, the personal guarantee of the owner of the business. The Company also participates in U.S. Government programs such as the Small Business Administration (the SBA) in both the 7A program and as an SBA preferred lender.

The equipment financing portfolio is composed primarily of loans to finance coin-operated laundry, dry cleaning, fitness, and convenience store equipment and, most recently, tow trucks. The borrowers are located primarily in the greater New York/New Jersey metropolitan area, although the customer base extends to locations throughout the United States. Typically, the loans are priced at a fixed rate of interest and require monthly payments over their three- to seven-year life. The yields earned on equipment financing loans are higher than those earned on the commercial loans made by the Banks because they involve a higher degree of credit risk. Equipment financing customers are typically small-business owners who operate with limited financial resources and who face greater risks when the economy weakens or unforeseen adverse events arise. Because of these characteristics, personal guarantees of borrowers are usually obtained along with liens on available assets. The Company focuses on making equipment financing loans and leases in the \$100,000 to \$500,000 range.

The Company's equipment financing divisions focus on market niches in which its lenders have deep experience and industry contacts, and on making loans to customers with business experience. An important part of the Company's equipment financing loan origination volume comes from equipment manufacturers and existing customers as they expand their operations. The size of loan is determined by an analysis of cash flow and other characteristics pertaining to the business and the equipment to be financed, based on detailed revenue and profitability data of similar operations.

Loans to condominium associations are for the purpose of funding capital improvements, are made for five- to ten-year terms and are secured by a general assignment of condominium association revenues. Among the factors considered in the underwriting of such loans are the level of owner occupancy, the financial condition and history of the condominium association, the attractiveness of the property in relation to the market in which it is located and the reasonableness of estimates of the cost of capital improvements to be made. Depending on loan size, funds are advanced as capital improvements are made and, in more complex situations, after completion of engineering inspections.

Indirect Automobile Loans

The indirect automobile loan portfolio of \$479.8 million at June 30, 2013 represented 11.4% of total loans outstanding at June 30, 2013. Indirect automobile loans are down from \$542.3 million at December 31, 2012. Although in 2012 the automobile industry reported the highest sales since 2007 with strong sales continuing into the first six months of 2013, competition for these loans increased significantly as credit unions and large national banks entered indirect automobile lending in a search for additional sources of income. That competition drove interest rates down and, in some cases, changed the manner in which interest rates are developed, i.e. from including a dealer-shared spread to requiring a dealer-based fee to originate the loan. Depending on the terms of the dealer's enrollment agreement with the Company, the dealer earns this fee 90 days after a loan is originated or once the borrower makes at least three payments on the loan.

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Indirect automobile loans are for the purchase of automobiles (both new and used) and light-duty trucks primarily by individuals, but also by corporations and other organizations. The loans are originated through over 200 dealerships located primarily in Massachusetts, but also in Connecticut, Rhode Island and New Hampshire. Dealer relationships are reviewed periodically for application quality, the ratio of loans approved to applications submitted and loan performance.

Loan applications are generated by approved dealers and data are entered into an application processing system. A credit bureau scorecard model is used in the underwriting process. The model is based on data accumulated by nationally recognized credit bureaus and is a risk assessment tool that analyzes an individual's credit history and assigns a numeric credit score. The model meets the requirements of the Equal Credit Opportunity Act. The application processing system sorts each application according to score ranges. Loans must meet criteria established in the Company's loan policy. Credit profile measurements such as debt-to-income ratios, payment-to-income ratios and loan-to-value ratios are utilized in the underwriting process and to monitor the performance of loans falling within specified ratio ranges. Regarding loan-to-value ratios, the Company considers indirect automobile loans to be essentially credits that are less than fully collateralized. When borrowers cease to make required payments, repossession and sale of the vehicle financed usually results in insufficient funds to fully pay the remaining loan balance.

The Company's indirect automobile loan policy limits origination of loans with credit scores of 660 or below to 5% of monthly indirect loan originations. At June 30, 2013, loans with credit scores of 660 or below were 3.3% of loans outstanding. The average-dollar original weighted credit score of loans in the portfolio at that date was 748. See the subsection *Results of Operations Provision for Credit Losses* appearing elsewhere herein for further information regarding loan underwriting and the average credit scores of the borrowers to whom indirect automobile loans were made. All loans require the purchase of single interest insurance by the borrower. The insurance is designed to protect the Company from loss when a loan is in default and the collateral value is impaired due to vehicle damage or the Company is unable to take possession of the vehicle.

Indirect automobile loans are assigned a particular tier based on the credit score determined by the credit bureau. The tier is used for pricing purposes only so as to assure consistency in loan pricing. Tier rates can be modified if certain conditions exist as outlined in the Company's loan policy. The rate paid by a borrower usually differs with the buy rate earned by the Company. The difference is commonly referred to as the spread. All of the spread is paid after the end of the month in which the loan is made and is comprised of the agreed-upon rate differential multiplied by the expected average balance of the loan over its scheduled maturity. If a loan is repaid in its entirety within 90 days or before three payments have been made (depending on the agreement with the dealer), the dealer must pay the remainder of unamortized spread to the Company. If a loan is repaid after 90 days or after three payments have been made (depending on the agreement with the dealer), the dealer is not obliged to repay any part of the spread amount previously received. Spread payments to dealers are amortized as a reduction of interest received from borrowers over the life of the related loans. When loans are prepaid, any remaining unamortized balance is charged to expense at that time.

Various reports are generated to monitor receipt of required loan documents, adherence to loan policy parameters, dealer performance, loan delinquencies and loan charge-offs. Summary reports are submitted to the chief credit officer, the chief financial officer and the board of directors on a monthly basis.

Consumer Loans

The consumer loan portfolio of \$773.5 million at June 30, 2013 is composed of residential mortgage loans, home equity loans and lines of credit, and other consumer loans and represented 18.4% of total loans outstanding at June 30, 2013. The Company focuses its mortgage loans on existing customers within its branch networks in its urban and suburban marketplaces in the greater Boston and Providence metropolitan areas.

The Company originates adjustable- and fixed-rate residential mortgage loans secured by one- to four-family residences on a servicing-released basis. Each residential mortgage loan granted is subject to a satisfactorily completed application, employment verification, credit history and a demonstrated ability to repay the debt. Generally, loans are not made when the loan-to-value ratio exceeds 80% unless private mortgage insurance is obtained and/or there is a financially strong guarantor. Appraisals are performed by outside independent fee appraisers.

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In general, the Company maintains three-, five- and seven-year adjustable-rate mortgage loans and ten-year fixed-rate fully amortizing mortgage loans in its portfolio. Fixed-rate mortgage loans with maturities beyond ten years, such as 15- and 30-year fixed-rate mortgages, are not generally maintained in the Company's portfolio but are, rather, sold into the secondary market. At June 30, 2013, Brookline Bank and BankRI act as brokers in these secondary-market transactions. Loan sales in the secondary market provide funds for additional lending and other banking activities. The Company had \$4.2 million and \$3.2 million in residential mortgage loans held-for-sale at June 30, 2013 and December 31, 2012, respectively.

Underwriting guidelines for home equity loans and lines of credit are similar to those for residential mortgage loans. Home equity loans and lines of credit are limited to no more than 80% of the appraised value of the property securing the loan less the amount of any existing first mortgage liens.

Other consumer loans have historically been a modest part of the Company's loan originations. At June 30, 2013, originated other consumer loans equaled \$7.4 million or 0.2% of total originated loans outstanding at that date. Equity and debt securities were pledged as collateral for a substantial part of the total of those loans.

Asset Quality

Criticized and Classified Assets

The Company's management negatively rates certain assets as special mention, substandard or doubtful based on criteria established under banking regulations. These loans and leases are collectively referred to as criticized assets. Loans and leases rated as special mention have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects of the loan or lease at some future date. Loans and leases rated as substandard are inadequately protected by the payment capacity of the obligor or of the collateral pledged, if any. Substandard loans and leases have a well-defined weakness or weaknesses that jeopardize the liquidation of debt and are characterized by the distinct possibility that the Company will sustain some loss if existing deficiencies are not corrected. At June 30, 2013, the Company had \$53.5 million of total assets, including acquired assets that were designated as criticized. This compares to \$58.6 million of assets that were designated as criticized at December 31, 2012. See Note 5, Allowance for Loan and Lease Losses, to the unaudited consolidated financial statements for more information on the Company's risk-rating system.

Nonperforming Assets

Nonperforming assets consist of nonperforming loans and leases, other real estate owned (OREO) and other repossessed assets. Under certain circumstances, the Company may restructure the terms of a loan or lease as a concession to a borrower, except for acquired loans which are individually evaluated against expected performance on the date of acquisition. These restructured loans and leases are generally considered nonperforming loans and leases until a history of collection of at least six months on the restructured terms of the loan or lease has been established. OREO consists of real estate acquired through foreclosure proceedings and real estate acquired through acceptance of a deed in lieu of foreclosure. Other repossessed assets consist of assets that have been acquired through foreclosure that are not real estate and are included in other assets on the Company's unaudited consolidated balance sheets.

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The following table sets forth information regarding nonperforming assets at the dates indicated:

	At June 30, 2013		At December 31, 2012	
	(Dollars in Thousands)			
Nonaccrual loans and leases:				
Commercial real estate mortgage	\$	2,682	\$	4,014
Multi-family mortgage		1,593		4,233
Commercial		4,680		5,454
Equipment financing		4,014		3,873
Condominium association		4		8
Indirect automobile		156		99
Residential mortgage		2,786		3,804
Home equity		1,557		716
Other consumer		21		45
Total nonaccrual loans and leases		17,493		22,246
Other real estate owned		1,002		903
Other repossessed assets		491		588
Total nonperforming assets	\$	18,986	\$	23,737
Loans and leases 61-90 days past due				
Loans and leases 61-90 days past due	\$	5,059	\$	4,536
Loans and leases past due greater than 90 days		15,823		24,150
Total loans and leases greater than 60 days past due	\$	20,882	\$	28,686
Troubled debt restructurings:				
On accrual	\$	9,631	\$	10,414
On nonaccrual		6,919		6,786
Total troubled debt restructurings	\$	16,550	\$	17,200
Total nonperforming loans and leases as a percentage of total loans and leases				
		0.42%		0.53%
Total nonperforming assets as a percentage of total assets				
		0.37%		0.46%
Total delinquent loans and leases 61-90 days past due as a percentage of total loans and leases				
		0.12%		0.11%
Total delinquent loans and leases past due greater than 90 days and accruing as a percentage of total loans and leases				
		0.38%		0.58%

Total nonperforming assets, which are composed of nonaccrual loans and leases, other real estate owned and other repossessed assets, decreased from \$23.7 million at December 31, 2012 to \$19.0 million at June 30, 2013. From December 31, 2012 to June 30, 2013, nonaccrual loans and leases decreased \$1.3 million (33.2%) in commercial real estate mortgage, \$2.6 million (62.4%) in multi-family mortgage, \$0.8 million in commercial, and \$1.0 million (26.8%) in residential mortgage. The decreases in nonaccrual loans in these categories were partially offset by increases of \$0.1 million (3.6%) in equipment financing, \$0.1 million (57.6%) in indirect automobile and \$0.8 million (117.5%) in home equity. The \$1.3 million decrease in commercial real estate nonaccrual loans is the result of three loans paying off during the period ending June 30, 2013. The \$2.6 million decrease in multi-family nonaccrual loans is primarily attributed to payoff of two loans and the sale of another in this category. The \$0.8 million decrease in commercial is primarily the result of payoff of one loan and charge off of another loan in this category. The \$1.0 million decrease in residential nonaccrual loans is the result of a large loan payoff in this category. The \$0.8 million increase in home equity nonaccrual loans is primarily due to 5 new home equity loans that have been placed on nonaccrual status during the period ending June 30, 2013.

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At June 30, 2013, restructured loans of \$16.6 million included \$5.1 million of commercial real estate mortgage loans, \$0.9 million of multi-family mortgage loans, \$3.4 million of commercial loans, \$2.9 million of equipment financing loans, and \$4.3 million of residential mortgage loans. At December 31, 2012, restructured loans of \$17.2 million included \$5.2 million of commercial real estate mortgage loans, \$0.9 million of multi-family mortgage loans, \$3.3 million of commercial loans, and \$3.8 million of equipment financing loans and leases and \$4.0 million of residential mortgage loans.

Table of Contents*Allowance for Loan and Lease Losses*

The allowance for loan and lease losses consists of general, specific and unallocated allowances and reflects management's estimate of probable loan and lease losses inherent in the loan portfolio at the balance sheet date. Management uses a consistent and systematic process and methodology to evaluate the adequacy of the allowance for loan and lease losses on a quarterly basis. The allowance is calculated by loan type: commercial real estate loans, commercial loans and leases, indirect automobile loans and consumer loans, each category of which is further segregated. A formula-based credit evaluation approach is applied to each group, coupled with an analysis of certain loans for impairment.

The process to determine the allowance for loan and lease losses requires management to exercise considerable judgment regarding the risk characteristics of the loan portfolios and the effect of relevant internal and external factors. While management evaluates currently available information in establishing the allowance for loan and lease losses, future adjustments to the allowance for loan and lease losses may be necessary if conditions differ substantially from the assumptions used in making the evaluations. Management performs a comprehensive review of the allowance for loan and lease losses on a quarterly basis. In addition, various regulatory agencies, as an integral part of their examination process, periodically review a financial institution's allowance for loan and lease losses and carrying amounts of other real estate owned. Such agencies may require the financial institution to recognize additions to the allowance based on their judgments about information available to them at the time of their examination. See Note 1, Basis of Presentation, and Note 5, Allowance for Loan and Lease Losses, to the unaudited consolidated financial statements for descriptions of how management determines the balance of the allowance for loan and lease losses for each portfolio and class of loans.

The following tables present the changes in the allowance for loan and lease losses by portfolio segment for the three months and six months ended June 30, 2013 and 2012, respectively.

	At and for the Three Months Ended June 30, 2013						Total
	Commercial Real Estate	Commercial	Indirect Automobile	Consumer	Unallocated		
	(Dollars in Thousands)						
Balance at March 31, 2013	\$ 20,588	\$ 11,652	\$ 5,000	\$ 2,596	\$ 2,696	\$ 42,532	
Charge-offs	(81)	(477)	(318)	(154)		(1,030)	
Recoveries		182	149	60		391	
Provision (credit) for loan and lease losses	1,512	434	(136)	497	81	2,388	
Balance at June 30, 2013	\$ 22,019	\$ 11,791	\$ 4,695	\$ 2,999	\$ 2,777	\$ 44,281	
Total loans and leases	\$ 2,056,674	\$ 895,090	\$ 479,782	\$ 773,469	N/A	\$ 4,205,015	
Allowance for loan and lease losses as a percentage of total loans and leases	1.07%	1.32%	0.98%	0.39%	N/A	1.05%	

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	At and for the Three Months Ended June 30, 2012						Total
	Commercial Real Estate	Commercial	Indirect Automobile	Consumer	Unallocated		
	(Dollars in Thousands)						
Balance at March 31, 2012	\$ 16,836	\$ 7,078	\$ 5,656	\$ 1,825	\$ 3,033	\$ 34,428	
Charge-offs		(3,416)	(344)	(210)		(3,970)	
Recoveries	40	124	119	12		295	
Provision (credit) for loan and lease losses	1,062	5,176	249	486	(295)	6,678	
Balance at June 30, 2012	\$ 17,938	\$ 8,962	\$ 5,680	\$ 2,113	\$ 2,738	\$ 37,431	
Total loans and leases	\$ 1,922,174	\$ 750,556	\$ 581,063	\$ 758,751	N/A	\$ 4,012,544	
Allowance for loan and lease losses as a percentage of total loans and leases	0.93%	1.19%	0.98%	0.28%	N/A	0.93%	

	At and for the Six Months Ended June 30, 2013						Total
	Commercial Real Estate	Commercial	Indirect Automobile	Consumer	Unallocated		
	(Dollars in Thousands)						
Balance at December 31, 2012	\$ 20,018	\$ 10,655	\$ 5,304	\$ 2,545	\$ 2,630	\$ 41,152	
Charge-offs	(81)	(724)	(680)	(206)		(1,691)	
Recoveries	4	264	279	86		633	
Provision (credit) for loan and lease losses	2,078	1,596	(208)	574	147	4,187	
Balance at June 30, 2013	\$ 22,019	\$ 11,791	\$ 4,695	\$ 2,999	\$ 2,777	\$ 44,281	
Total loans and leases	\$ 2,056,674	\$ 895,090	\$ 479,782	\$ 773,469	N/A	\$ 4,205,015	
Allowance for loan and lease losses as a percentage of total loans and leases	1.07%	1.32%	0.98%	0.39%	N/A	1.05%	

	At and for the Six Months Ended June 30, 2012						Total
	Commercial Real Estate	Commercial	Indirect Automobile	Consumer	Unallocated		
	(Dollars in Thousands)						
Balance at December 31, 2011	\$ 15,477	\$ 5,997	\$ 5,604	\$ 1,577	\$ 3,048	\$ 31,703	
Charge-offs		(3,757)	(783)	(218)		(4,758)	
Recoveries	80	202	266	13		561	
Provision (credit) for loan and lease losses	2,381	6,520	593	741	(310)	9,925	
Balance at June 30, 2012	\$ 17,938	\$ 8,962	\$ 5,680	\$ 2,113	\$ 2,738	\$ 37,431	
Total loans and leases	\$ 1,922,174	\$ 750,556	\$ 581,063	\$ 758,751	N/A	\$ 4,012,544	
Allowance for loan and lease losses as a percentage of total loans and leases	0.93%	1.19%	0.98%	0.28%	N/A	0.93%	

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The allowance for loan and lease losses was \$44.3 million at June 30, 2013 or 1.05% of total loans and leases outstanding. This compared to an allowance for loan and lease losses of \$41.2 million or 0.98% of total loans and leases outstanding at December 31, 2012, and an allowance for loan and lease losses of \$37.4 million or 0.93% of total loans and leases outstanding at June 30, 2012. The increase in the allowance for loan and lease losses and in the

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allowance for loan and lease losses as a percentage of total loans and leases from June 30, 2012 to June 30, 2013 is due to additions to the allowance for continued loan growth in the commercial real estate portfolios and an additional allowance recorded for subsequent deterioration in certain loan pools within the acquired loan portfolios. The allowance for loan and lease losses related to originated loans and leases represents 1.34%, 1.33%, and 1.33% of originated loans and leases at June 30, 2013, December 31, 2012, and June 30, 2012, respectively.

Commercial Real Estate Loans

The allowance for commercial real estate loan losses was \$22.0 million at June 30, 2013 or 1.07% of total commercial real estate loans outstanding. This compared to an allowance for commercial real estate loan losses of \$20.0 million or 1.00% of commercial real estate loans outstanding at December 31, 2012, and an allowance for commercial real estate loan losses of \$17.9 million or 0.93% of commercial real estate loans outstanding at June 30, 2012. Specific reserves on commercial real estate loans of \$0.3 million were unchanged from December 31, 2012 to June 30, 2013. Excluding balances in acquired loan portfolios, the allowance for commercial real estate loan losses as a percentage of total commercial real estate loans outstanding increased to 1.40% at June 30, 2013 from 1.37% at December 31, 2012.

The \$2.1 million increase in the allowance for commercial real estate loan losses during the first half of 2013 was primarily driven by originated loan growth of \$110.7 million or 7.59% from December 31, 2012 and the addition of \$75,000 in allowance for post-acquisition deterioration in certain commercial real estate loan and lease portfolios. The ratio of total criticized and classified commercial real estate loans to total commercial real estate loans decreased to 1.60% at June 30, 2013 from 1.81% at December 31, 2012. The ratio of originated commercial real estate loans on nonaccrual to total originated commercial real estate loans decreased to 0.12% at June 30, 2013 from 0.24% at December 31, 2012.

As a percentage of average commercial real estate loans, annualized net charge-offs for the three- and six-month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were negligible. See the *Results of Operations Provision for Credit Losses* section below for additional information.

Commercial Loans and Leases

The allowance for commercial loan and lease losses was \$11.8 million or 1.32% of total commercial loans and leases outstanding at June 30, 2013, as compared to \$10.7 million or 1.26% at December 31, 2012. Specific reserves on commercial loans and leases remained relatively constant from December 31, 2012 to June 30, 2012 at \$0.7 million. Excluding balances in acquired loan portfolios, the allowance for commercial loan and lease losses as a percentage of total commercial loans and leases outstanding increased to 1.63% at June 30, 2013 from 1.66% at December 31, 2012.

The \$1.1 million increase in the allowance for commercial loan and lease losses during the first half of 2013 was primarily driven by originated loan growth of \$81.0 million or 12.6% from December 31, 2012 and the addition of \$0.1 million in allowances for post-acquisition deterioration in certain commercial loan and lease portfolios. The ratio of total criticized and classified commercial loans and leases to total commercial loans and leases was 2.31% at June 30, 2013 as compared to 2.63% at December 31, 2012 and reflects the resolution of several problem credits in the second quarter 2013. The ratio of originated commercial loans and leases on nonaccrual to total originated commercial loans and leases decreased to 0.79% at June 30, 2013 from 0.91% at December 31, 2012.

Net charge-offs in the commercial loan and lease portfolio for the three-month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were \$0.3 million, \$0.2 million, and \$3.3 million respectively. As a percentage of average commercial loans and leases, annualized net charge-offs for the three-month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were 0.28%, 0.20% and 3.20%, respectively. Net charge-offs in the commercial loan and lease portfolio for the six-month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were \$0.5 million, \$1.4 million, and \$3.6 million, respectively. As a percentage of average commercial loans and leases, annualized net charge-offs for the six month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were 0.11%, 0.34% and 0.95%, respectively. See the *Results of Operations Provision for Credit Losses* section below for additional information.

Indirect Automobile Loans

The allowance for indirect automobile loan losses was \$4.7 million or 0.98% of total indirect automobile loans outstanding at June 30, 2013, compared to \$5.3 million or 0.98% of the indirect automobile portfolio outstanding at December 31, 2012. There were no loans individually evaluated for impairment in the indirect automobile portfolio

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at June 30, 2013. The \$0.6 million decrease in the allowance for indirect automobile loan losses was primarily a result of declines in loan outstanding, which decreased from \$542.3 million at December 31, 2012 to \$480.0 million at June 30, 2013.

The ratio of indirect automobile loans with borrower credit scores below 660 to the total indirect automobile portfolio increased slightly to 3.25% at June 30, 2013 from 3.12% at December 31, 2012. The ratio of indirect automobile loans on nonaccrual to total indirect automobile loans increased slightly to 0.03% at June 30, 2013 compared to 0.02% at December 31, 2012.

Net charge-offs in the indirect automobile portfolio for the three-month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were \$0.2 million, \$0.4 million and \$0.2 million, respectively. As a percentage of average loans and leases, annualized net charge-offs for the three-month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were 0.14%, 0.26% and 0.15% respectively, reflecting the favorable trend in credit quality as the portfolio has been allowed to run down somewhat. Net charge-offs in the indirect automobile portfolio for the six-month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were \$0.4 million, \$0.7 million, and \$0.5 million, respectively. As a percentage of average indirect automobile loans, annualized net charge-offs for the six month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were 0.16%, 0.23% and 0.18%, respectively. See the *Results of Operations Provision for Credit Losses* section below for additional information.

Consumer Loans

The allowance for consumer loan losses, including residential loans and home equity loans and lines of credit, was \$3.0 million or 0.39% of total consumer loans and leases outstanding as compared to \$2.5 million or 0.32% at December 31, 2012. The reserve for loans individually evaluated for impairment at June 30, 2013 was \$0.4 million on loan balances of \$4.6 million, compared to \$0.6 million on loan balances of \$4.8 million at December 31, 2012. Excluding balances in acquired loan portfolios, the allowance for consumer losses as a percentage of total consumer loans outstanding was 0.61%, at June 30, 2013 from 0.54% at December 31, 2012.

The \$0.5 million increase in the allowance for consumer loans during the first half of 2013 was primarily driven by the addition of \$0.4 million in allowance port-acquisition deterioration in residential loans and home equity loans and lines of credit. The ratio of residential and home equity loans with loan-to-value ratios greater than 80% decreased to 6.25% of total residential and home equity loans at June 30, 2013 from 12.79% at December 31, 2012. The ratio of originated consumer loans on nonaccrual to total originated consumer loans (including deferred origination costs) decreased to 0.36% at June 30, 2013 from 0.44% at December 31, 2012. The risk of loss on a home equity loan is higher since the property securing the loan has often been previously pledged as collateral for a first mortgage loan. The Company gathers and analyzes delinquency data, to the extent that data are available on these first liens, for purposes of assessing the collectability of the second liens held for the Company even if these home equity loans are not delinquent. These data are further analyzed for performance differences between amortizing and non-amortizing home equity loans, the percentage borrowed to total loan commitment, and by the amount of payments made by the borrowers. The exposure to loss is not considered to be high due to the combination of current property values, the low level of losses experienced in the past few years and the low level of loan delinquencies at June 30, 2013. If the local economy weakens, however, a rise in losses in those loan classes could occur. Historically, losses in these classes have been low.

Net charge-offs in the consumer portfolio for the three-month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were \$94,000, \$0.3 million and \$0.2 million, respectively. As a percentage of average consumer loans and leases, annualized net charge-offs for the three-month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were 0.05%, 0.14% and 0.10%, respectively. Net charge-offs in the consumer portfolio for the six-month periods ended June 30, 2013, December 31, 2012 and June 30, 2012 were \$0.1 million, \$0.4 million, and \$0.2 million, respectively. As a percentage of average consumer loans and leases, annualized net charge-offs for the three-month periods

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ended June 30, 2013, December 31, 2012 and June 30, 2012 were 0.03%, 0.09% and 0.05%, respectively. See the *Results of Operations Provision for Credit Losses* section below for additional information.

Unallocated Allowance

The unallocated allowance recognizes the estimation risk associated with the allocated general and specific allowances, and incorporates management's evaluation of existing conditions that are not included in the allocated allowance determinations and protects against potential losses outside of the ordinary course of business. These conditions are reviewed quarterly by management and include general economic conditions, credit quality trends, loan and lease mix, and internal loan review and regulatory examination findings. Causes of losses outside the

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normal course of business include but are not limited to fraudulently obtained loans where there is no primary or secondary source of repayment; catastrophic and uninsured property loss where collateral is destroyed with no compensation; and legal documentation flaws that compromise security interests in collateral assets or the availability of guarantors.

The unallocated allowance for loan and lease losses was \$2.8 million at June 30, 2013, compared to \$2.6 million at December 31, 2012. The \$0.2 million or 5.6% increase in the unallocated portion of the allowance for loan and lease losses reflects the 0.7% growth in total loans as leases during the first half of 2013.

The following table sets forth the Company's percent of allowance for loan and lease losses to the total allowance for loan and lease losses and the percent of loans to total loans (including deferred loan origination costs) for each of the categories listed at the dates indicated.

	At June 30, 2013			At December 31, 2012		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans (Dollars in Thousands)	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans
Commercial real estate mortgage	\$ 14,034	31.7%	32.1%	\$ 12,993	31.6%	31.0%
Multi-family	4,445	10.0%	14.1%	4,541	11.0%	14.5%
Construction	3,540	8.0%	2.7%	2,484	6.0%	2.4%
Commercial	4,292	9.7%	9.0%	3,870	9.4%	9.2%
Equipment financing	7,185	16.2%	11.3%	6,454	15.7%	10.1%
Condominium association	314	0.7%	1.0%	331	0.8%	1.1%
Indirect automobile	4,695	10.6%	11.4%	5,304	12.9%	13.0%
Residential mortgage	1,657	3.7%	12.1%	1,516	3.7%	12.2%
Home equity	1,266	2.9%	6.1%	970	2.4%	6.3%
Other consumer	76	0.2%	0.2%	59	0.2%	0.2%
Unallocated	2,777	6.3%	0.0%	2,630	6.3%	0.0%
Total	\$ 44,281	100.0%	100.0%	\$ 41,152	100.0%	100.0%

Investments

The investment portfolio exists primarily for liquidity purposes, and secondarily as sources of interest and dividend income, interest-rate risk management and tax planning as a counterbalance to loan and deposit flows. Securities available-for-sale are employed as part of the Company's asset/liability management and may be sold in response to, or in anticipation of, factors such as changes in market conditions and interest rates, security prepayment rates, deposit outflows, liquidity concentrations and regulatory capital requirements.

The investment policy of the Company, which is reviewed and approved by the Board of Directors on an annual basis, specifies acceptable types of investments, required investment ratings by at least one nationally recognized rating agency, concentration limits and duration guidelines. Compliance with the investment policy is monitored on a regular basis. In general, the Company seeks to maintain a high degree of liquidity and targets cash and equivalents and investment securities available-for-sale balances of between 10% and 30% of total assets.

Cash, cash equivalents, and investment securities decreased \$19.4 million, or 3.3%, since December 31, 2012. Cash, cash equivalents, and investment securities were 11.3% of total assets at June 30, 2013, compared to 11.6% of total assets at December 31, 2012.

Investment Securities Available-for-Sale and Held-to-Maturity

The Company's portfolio of investment securities consists of investment securities available-for-sale and investment securities held-to-maturity. The following table sets forth certain information regarding the amortized

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cost and market value of the Company's investment securities available-for-sale and held-to-maturity at the dates indicated:

	At June 30, 2013		At December 31, 2012		At December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)					
Investment securities available-for-sale:						
Debt securities:						
GSEs	\$ 39,233	\$ 39,336	\$ 69,504	\$ 69,809	\$ 152,036	\$ 151,765
GSE CMOs	259,795	253,712	215,670	217,001	1,297	1,305
GSE MBSs	165,292	163,544	165,996	169,648	97,146	100,561
Private-label CMOs	4,740	4,844	6,719	6,866		
SBA commercial loan asset-backed securities	270	269	383	381		
Auction-rate municipal obligations	1,900	1,796	2,100	1,976	3,200	2,965
Municipal obligations	1,063	1,093	1,058	1,101	750	791
Corporate debt obligations	10,387	10,634	10,481	10,685	42,367	43,552
Trust preferred securities	2,656	2,629	2,786	2,519	3,945	3,169
Total debt securities	485,336	477,857	474,697	479,986	300,741	304,108
Marketable equity securities	1,254	1,320	1,249	1,337	366	432
Total investment securities available-for-sale	\$ 486,590	\$ 479,177	\$ 475,946	\$ 481,323	\$ 301,107	\$ 304,540
Investment securities held-to-maturity	\$ 500	\$ 500	\$ 500	\$ 502	\$	\$

Maturities, calls and principal repayments totaled \$69.8 million for the six months ended June 30, 2013 compared to \$116.9 million for the same period in 2012. During the six months ended June 30, 2013, the Company purchased \$82.3 million of available-for-sale securities compared to \$130.2 million for the same period in 2012. During the six months ended June 30, 2013, the Company did not sell any available-for-sale securities. This compared to \$157.2 million sales and \$0.8 million net realized gains during the six months ended June 30, 2012.

Securities available-for-sale are recorded at fair value, which is primarily obtained from a third-party pricing service. At June 30, 2013, the fair value of all securities available-for-sale was \$479.2 million and carried a total of \$7.4 million of net unrealized losses at the end of the quarter, compared to \$5.4 million of net unrealized gains at December 31, 2012. Of the \$479.2 million in securities available-for-sale at June 30, 2013, \$368.0 million, or 76.8%, of the portfolio, had gross unrealized losses of \$10.1 million. This compares to \$47.6 million or 9.9% of the portfolio with gross unrealized losses of \$0.6 million at December 31, 2012. The shift from an unrealized gain position to an unrealized loss position over the first six months of 2013 was driven by rising interest rates. Management believes that these negative differences between amortized cost and fair value reflect the changes in the level of interest rates between the time of purchase and the time of measurement. It is more likely than not that the Company will not sell the securities before recovery, and, as a result, it will recover the amortized cost basis of the securities. As such, management has determined that the securities are not other-than-temporarily impaired at June 30, 2013. If market conditions for securities worsen or the creditworthiness of the underlying issuers deteriorates, it is possible that the Company may recognize additional other-than-temporary impairments in future periods. For additional discussion on how the Company validates fair values provided by the third-party pricing service, see Note 4, Investment Securities, of the Company's 2012 Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

U.S. Government-Sponsored Enterprises (GSEs) The Company invests in securities issued by of U.S. Government-sponsored enterprises (GSEs), including GSE debt securities, mortgage-backed securities (MBSs), and collateralized mortgage obligations (CMOs). GSE securities

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include obligations issued by the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (Freddie Mac), the Government National Mortgage Association (GNMA), the Federal Home Loan Banks and the Federal Farm Credit Bank. At June 30, 2013, none of those obligations is backed by the full faith and credit of the U.S. Government, except for GNMA MBSs and CMOs, and Small Business Administration (SBA) commercial loan asset-backed securities with an estimated fair value of \$13.9 million, compared to \$10.0 million at December 31, 2012.

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At June 30, 2013, the Company held GSE debentures with a total fair value of \$39.3 million and a net unrealized gain of \$0.1 million. At December 31, 2012, the Company held GSE debentures with a total fair value of \$69.8 million and a net unrealized gain of \$0.3 million.

At June 30, 2013, the Company held GSE mortgage-related securities with a total fair value of \$417.3 million and a net unrealized gain of \$7.8 million. At December 31, 2012, the Company held GSE mortgage-related securities with a total fair value of \$386.6 million and a net unrealized gain of \$5.0 million. During the six months ended June 30, 2013, the Company purchased a total of \$82.3 million in GSE CMOs and GSE MBSs to reinvest matured cash flow, as compared to \$130.2 during the same period in 2012.

Private-Label CMOs At June 30, 2013, the Company held private-issuer CMO-related securities with a total fair value of \$4.8 million and a net unrealized gain of \$0.1 million. At December 31, 2012, the Company held private-issuer CMO-related securities with a total fair value of \$6.9 million and a net unrealized gain of \$0.1 million.

Auction-Rate Municipal Obligations and Municipal Obligations The auction-rate obligations owned by the Company were rated AAA at the time of acquisition due, in part, to the guarantee of third-party insurers who would have to pay the obligations if the issuers failed to pay the obligations when they become due. During the financial crisis certain third-party insurers experienced financial difficulties and were not able to meet their contractual obligations. As a result, auctions failed to attract a sufficient number of investors and created a liquidity problem for those investors who were relying on the obligations to be redeemed at auction. Since then, there has not been an active market for auction-rate municipal obligations.

Based on an evaluation of market factors, the estimated fair value of the auction-rate municipal obligations owned by the Company at June 30, 2013 was \$1.8 million with a corresponding net unrealized loss of \$0.1 million. This compares to an estimated fair value of \$2.0 million and a corresponding net unrealized loss of \$0.1 million at December 31, 2012. Full collection of the obligations is expected because the financial condition of the issuers is sound, none of the issuers has defaulted on scheduled payments, the obligations are rated investment grade and the Company has the ability and intent to hold the obligations for a period of time to recover the unrealized losses.

The Company owns municipal securities with an estimated fair value of \$1.1 million and a corresponding net gain of \$30,000 at June 30, 2013. This compares to an estimated fair value of \$1.1 million and a corresponding net unrealized gain of \$43,000 at December 31, 2012. Full collection of the obligations is expected because the financial condition of the issuers is sound, none of the issuers has defaulted on scheduled payments, the obligations are rated investment grade and the Company has the ability and intent to hold the obligations for a period of time to recover the unrealized losses.

Corporate Debt Obligations From time to time, the Company will invest in high-quality corporate obligations to provide portfolio diversification and improve the overall yield on the portfolio. The Company owned five corporate obligation securities with a total fair value of \$10.6 million and total net unrealized gains of \$0.2 million at June 30, 2013. This compares to eight corporate obligation securities with a total fair value of \$10.7 million and total net unrealized gains of \$0.2 million at December 31, 2012. All of these securities are investment grade which is currently in an unrealized gain position.

Trust Preferred Securities and Pools Trust preferred securities represent subordinated debt issued by financial institutions. These securities are sometimes pooled and sold to investors through structured vehicles known as PreTSLs. When issued, PreTSLs are divided into tranches or

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segments that establish priority rights to cash flows from the underlying trust preferred securities. At June 30, 2013, the Company owned three trust preferred securities and two PreTSL pools with a total fair value of \$2.6 million and a total net unrealized loss of \$27,000. This compares to three trust preferred securities and two PreTSL pools with a total fair value of \$2.5 million and a total net unrealized loss of \$0.3 million at December 31, 2012. The Company monitors these pools closely for impairment due to a history of defaults experienced on the part of the banks underlying the trust preferred securities.

Marketable Equity Securities At June 30, 2013, the Company owned marketable equity securities with a fair value of \$1.3 million, including net unrealized gains of \$66,000. This compares to a fair value of \$1.3 million and net unrealized gains of \$88,000 million at December 31, 2012.

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Restricted Equity Securities

Federal Reserve Bank Stock

The Company invests in the stock of the Federal Reserve Bank of Boston, as required by the Banks' membership in the Federal Reserve System. At June 30, 2013, the Company owned stock in the Federal Reserve Bank of Boston with a carrying value of \$16.1 million.

FHLBB Stock

The Company invests in the stock of the FHLBB as one of the requirements to borrow. The Company maintains an excess balance of capital stock of \$9.6 million which allows for additional borrowing capacity at each Bank. At June 30, 2013, the Company owned stock in the FHLBB with a carrying value of \$50.1 million, which represents a decrease of \$2.1 as compared to December 31, 2012 due to a redemption of excess stock. The FHLBB stated that it remained in compliance with all regulatory capital ratios at June 30, 2013 and, based on the most recent information available, was classified as adequately capitalized by its regulator.

Premises and Equipment

Corporate Headquarters

In addition to building and land costs of \$14.0 million, the Company had previously entered into contracts totaling \$23.6 million for capital expenditures associated with the rehabilitation of its new headquarters in Boston, of which \$21.4 million was incurred in 2012. Of the remaining \$2.2 million in refurbishment expenses owed, \$2.1 million was capitalized in the first six months of 2013. A portion of the Company's new headquarters is rented to third-party tenants and the remaining refurbishment commitments are mostly related to those leases.

Core Operating Systems

The Company has also entered into contracts associated with the conversion of its core operating systems. All three Banks have successfully converted to a new core operating system. Brookline Bank and First Ipswich were converted in 2012, while BankRI completed its conversion in the second quarter of 2013. The useful life of the core processing system is 7.5 years, and ongoing maintenance and operation contracts extend over seven years. During the six months ended June 30, 2013, \$3.2 million in conversion-related expenditures have been capitalized.

Deposits

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The following table presents the Company's deposit mix at the dates indicated.

	At June 30, 2013			At December 31, 2012		
	Amount	Percent of Total	Weighted Average Rate (Dollars in Thousands)	Amount	Percent of Total	Weighted Average Rate
Non-interest-bearing accounts	\$ 644,507	17.6%	0.00%	\$ 623,274	17.2%	0.00%
NOW accounts	196,778	5.4%	0.08%	212,858	5.9%	0.09%
Savings accounts	503,170	13.8%	0.25%	515,367	14.2%	0.39%
Money market accounts	1,340,024	36.6%	0.60%	1,253,819	34.7%	0.63%
Certificate of deposit accounts	972,502	26.6%	0.98%	1,010,941	28.0%	1.06%
Total interest-bearing deposits	3,012,474	82.4%	0.63%	2,992,985	82.8%	0.70%
Total deposits	\$ 3,656,981	100.0%	0.52%	\$ 3,616,259	100.0%	0.58%

Total deposits increased \$40.7 million to \$3.7 billion at June 30, 2013 compared to \$3.6 billion at December 31, 2012. Deposits as percentage of total assets increased slightly from 70.3% at December 31, 2012 to 71.0% at June 30, 2013. During the first half of 2013, core deposits increased \$79.2 million, or 6.1% on an annualized basis, rising from 72.0% of total deposits at December 31, 2012 to 73.4% of total deposits at June 30, 2013. Certificate of deposit

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accounts decreased \$38.4 million, or 7.6% on an annualized basis, during the first half of 2013. Certificates of deposit have also fallen as a percentage of total deposits from 28.0% at December 31, 2012 to 26.6% at June 30, 2013. The Company does not rely on brokered deposits.

The Company believes the ongoing shift toward core deposits is due in part to expansion of its cash management capabilities, more effort in seeking deposits from existing customer relationships and the desire of certain depositors to place their funds in a more strongly capitalized financial institution and in more liquid accounts. A rise in interest rates could cause a shift from core deposit accounts to certificate of deposit accounts with longer maturities. Generally, the rates paid on certificates of deposit are higher than those paid on core deposit accounts.

The following table sets forth the distribution of the average balances of the Company's deposit accounts for the periods indicated and the weighted average interest rates on each category of deposits presented. Averages for the periods presented are based on daily balances.

	Three Months Ended June 30,					
	Average Balance	2013 Percent of Total Average Deposits	Weighted Average Rate	Average Balance	2012 Percent of Total Average Deposits	Weighted Average Rate
Core deposits:						
Non-interest-bearing demand checking accounts	\$ 640,725	17.5%	0.00%	\$ 542,100	15.5%	0.00%
NOW accounts	195,269	5.3%	0.09%	189,118	5.4%	0.12%
Savings accounts	508,451	13.9%	0.25%	505,601	14.5%	0.35%
Money market accounts	1,335,300	36.5%	0.61%	1,204,754	34.4%	0.75%
Total core deposits	2,679,745	73.2%	0.36%	2,441,573	69.8%	0.45%
Certificate of deposit accounts	982,257	26.8%	0.96%	1,056,021	30.2%	1.03%
Total deposits	\$ 3,662,002	100.0%		\$ 3,497,594	100.0%	

	Six Months Ended June 30,					
	Average Balance	2013 Percent of Total Average Deposits	Weighted Average Rate	Average Balance	2012 Percent of Total Average Deposits	Weighted Average Rate
Core deposits:						
Non-interest-bearing demand checking accounts	\$ 624,386	17.2%	0.00%	\$ 525,811	15.2%	0.00%
NOW accounts	192,808	5.2%	0.09%	184,102	5.3%	0.12%
Savings accounts	511,401	14.1%	0.26%	508,374	14.7%	0.37%
Money market accounts	1,315,056	36.2%	0.63%	1,174,149	34.0%	0.76%
Total core deposits	2,643,651	72.7%	0.37%	2,392,436	69.2%	0.46%
Certificate of deposit accounts	992,380	27.3%	0.96%	1,067,148	30.8%	1.04%
Total deposits	\$ 3,636,031	100.0%		\$ 3,459,584	100.0%	

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The following table sets forth the maturity periods for certificates of deposit of \$100,000 or more deposited with the Company at the dates indicated:

	At June 30, 2013		At December 31, 2012	
	Amount	Weighted Average Rate (Dollars in Thousands)	Amount	Weighted Average Rate
Maturity period:				
Six months or less	\$ 241,068	0.87%	\$ 172,176	0.90%
Over six months through 12 months	160,666	0.82%	158,057	1.01%
Over 12 months	172,358	1.42%	114,572	1.41%
	\$ 574,092	1.02%	\$ 444,805	1.07%

Borrowed Funds

Advances from the FHLBB

Although on a long-term basis the Company intends to continue to increase its core deposits, the Company also uses FHLBB borrowings and other wholesale borrowing opportunistically as part of the Company's overall strategy to fund loan growth and manage interest-rate risk and liquidity. The advances are secured by a blanket security agreement which requires the Banks to maintain as collateral certain qualifying assets, principally mortgage loans and securities in an aggregate amount at least equal to outstanding advances. The maximum amount that the FHLBB will advance to member institutions, including the Company, fluctuates from time to time in accordance with the policies of the FHLBB. The Company may also borrow from the Federal Reserve discount window and on \$119.0 million of lines of credit as necessary.

FHLBB borrowings decreased \$5.3 million to \$785.6 million at June 30, 2013 from the December 31, 2012 balance of \$790.9 million. The decrease in FHLBB borrowings was primarily due to deposit growth outpacing loan growth.

The following table sets forth certain information regarding FHLBB advances for the periods indicated:

	Three Months Ended June 30, 2013		Six Months Ended June 30, 2013	
	2013	2012	2013	2012
	(Dollars in Thousands)			
Average balance outstanding	\$ 760,237	\$ 694,746	\$ 756,773	\$ 709,373
Maximum amount outstanding at any month-end during the period	785,565	733,394	785,565	733,394
Balance outstanding at end of period	785,565	733,394	785,565	733,394
Weighted average interest rate for the period	1.41%	1.98%	1.50%	2.01%
Weighted average interest rate at end of period	1.32%	1.78%	1.32%	1.78%

Repurchase Agreements

The Company periodically enters into repurchase agreements with its larger deposit and commercial customers as part of its cash management services which are typically overnight borrowings. Short-term borrowings and repurchase agreements with Company customers decreased \$15.6 million during the six months ended June 30, 2013 from \$51.0 million to \$35.4 million as customers shifted funds into other deposit products.

Table of Contents*Subordinated Debt*

In the acquisition of Bancorp Rhode Island, Inc., the Company assumed three subordinated debentures issued by a subsidiary of Bancorp Rhode Island, Inc. In the first quarter of 2013, the Company repaid a \$3.0 million in subordinated debt before scheduled maturity in 2031 due to the fixed, high cost of the borrowing. The remaining two subordinated debentures are summarized below:

Issue Date	Rate	Maturity Date (Dollars in Thousands)	Next Call Date	Carrying Amount at June 30, 2013
June 26, 2003	Variable; 3-month LIBOR + 3.10%	June 26, 2033	September 26, 2013	\$ 4,649,274
March 17, 2004	Variable; 3-month LIBOR + 2.79%	March 17, 2034	September 17, 2013	\$ 4,473,913

Derivative Financial Instruments

The Company has entered into interest-rate swaps with certain of its commercial customers and concurrently enters into offsetting swaps with third-party financial institutions. The Company did not have derivative fair value hedges or derivative cash flow hedges at June 30, 2013 or December 31, 2012. The following table summarizes certain information concerning the Company's interest-rate swaps at June 30, 2013:

	Interest- Rate Swaps (Dollars in Thousands)
Notional principal amounts	\$ 22,820
Fixed weighted average interest rate from customer to counterparty	5.7%
Floating weighted average rate from counterparty	3.5%
Weighted average remaining term to maturity (in months)	53
Fair value:	
Recognized as an asset	\$ 948
Recognized as a liability	\$ (987)

Stockholders' Equity and Dividends

The Company's total stockholders' equity was \$611.3 million at June 30, 2013, a \$0.8 million decrease compared to \$612.1 million at December 31, 2012. The decrease reflects net income of \$18.3 million for the six months ended June 30, 2013, offset by dividends paid of \$11.9 million in that same period and an unrealized loss on securities available-for-sale of \$7.9 million (after-tax). The dividends paid in the second quarter of 2013 represented the Company's 57th consecutive quarter of dividend payments, and the 45th consecutive quarter in which the Company paid a regular dividend of \$0.085.

Stockholders' equity represented 11.87% of total assets at June 30, 2013, as compared to 11.89% at December 31, 2012. Tangible stockholders' equity (total stockholders' equity less goodwill and identified intangible assets, net) represented 9.10% of tangible assets (total assets less goodwill and identified intangible assets, net) at June 30, 2013, as compared to 9.08% at December 31, 2012.

Results of Operations Comparison of the Three-Month and Six-Month Periods Ended June 30, 2013 and June 30, 2012

The primary drivers of the Company's operating income are net interest income, which is strongly affected by the net yield on interest-earning assets and liabilities (net interest margin), the quality of the Company's assets, its levels of non-interest income and non-interest expense, and its tax provision.

The Company's net interest income represents the difference between interest income earned on its investments, loans and leases, and its cost of funds. Interest income depends on the amount of interest-earning assets outstanding during the period and the yield earned thereon. Cost of funds is a function of the average amount of deposits and

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borrowed money outstanding during the period and the interest rates paid thereon. The net interest margin is calculated by dividing net interest income by average interest-earning assets. Net interest spread is the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. The increases (decreases) in the components of interest income and interest expense, expressed in terms of fluctuation in average volume and rate, are summarized under *Rate/Volume Analysis* on page 75. Information as to the components of interest income, interest expense and average rates is provided under *Average Balances, Net Interest Income, Interest Rate Spread and Net Interest Margin* on pages 73 and 74.

Because the Company's assets and liabilities are not identical in duration and in repricing dates, the differential between the asset and liability repricing and duration is vulnerable to changes in market interest rates as well as the overall shape of the yield curve. These vulnerabilities are inherent to the business of banking and are commonly referred to as interest-rate risk. How interest-rate risk is measured and, once measured, how much interest-rate risk is taken is based on numerous assumptions and other subjective judgments. See the discussion in *Item 3. Quantitative and Qualitative Disclosures about Market Risk* on pages 83 to 84.

The quality of the Company's assets also influences its earnings. Loans and leases that are not paid on a timely basis and exhibit other weaknesses can result in the loss of principal and/or interest income. Additionally, the Company must make timely provisions to the allowance for loan and lease losses based on estimates of probable losses inherent in the loan and lease portfolio. These additions, which are charged against earnings, are necessarily greater when greater probable losses are expected. Further, the Company incurs expenses as a result of resolving troubled assets. These variables reflect the credit risk that the Company takes on in the ordinary course of business and are further discussed under *Financial Condition Asset Quality* on pages 57 to 58.

Result Summary

The Company's net income of \$9.5 million for the three months ended June 30, 2013 increased \$0.7 million, or 7.7%, compared to the three months ended March 31, 2013, and increased \$2.0 million, or 26.0%, compared to the three months ended June 30, 2012. This linked-quarter increase in net income reflects an increase in net interest income of \$1.7 million, offset by a decrease in non-interest income of \$0.2 million, and an increase in provision for credit losses of \$0.6 million.

The Company's operating earnings of \$18.3 million for the six months ended June 30, 2013 increased \$0.5 million, or 2.5%, compared to the six months ended June 30, 2012. While the Company's operating earnings for the six months ended June 30, 2012 was adjusted for acquisition-related expenses of \$4.0 million (after-tax) that were incurred during the first quarter of 2012 and which were associated with the acquisition of Bancorp Rhode Island, Inc., this adjustment was offset by a major provision for credit losses during the same period. Diluted operating EPS increased 7.7% compared to the first quarter of 2013, from \$0.13 to \$0.14, and increased 27.3% compared to the second quarter of 2012, from \$0.11 to \$0.14.

Earnings in the second quarter of 2013 represented an annualized return on average assets of 0.74% and an annualized return on average stockholders' equity of 6.16%, as compared to an annualized return on average assets of 0.70% and an annualized return on average stockholders' equity of 5.72% for the first quarter of 2013, and an annualized return on average assets of 0.61% and a return on average stockholders' equity of 5.04% for the second quarter of 2012. Operating earnings for the six months ended June 30, 2013 represented an annualized operating return on average assets of 0.72% and an annualized operating return on average stockholders' equity of 5.93%, as compared to an annualized operating return on average assets of 0.73% and an annualized operating return on average stockholders' equity of 5.97% for the six months ended June 30, 2012.

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Selected income statement, per share data and operating ratios are presented in the table below for the periods indicated:

	June 30, 2013	Three Months Ended March 31, 2013	June 30, 2012	Six Months Ended June 30, 2013	June 30, 2012
	(Dollars in Thousands, Except Per Share Data)				
Income statement data:					
Net interest income	\$ 45,363	\$ 43,669	\$ 42,759	\$ 89,030	\$ 86,392
Non-interest income	3,138	3,327	4,721	6,466	8,315
Non-interest expense	30,815	30,772	28,621	61,585	61,069
Net income	9,490	8,813	7,529	18,304	13,878
Operating earnings	9,490	8,813	7,529	18,304	17,850
Per share data:					
Basic earnings per share	\$ 0.14	\$ 0.13	\$ 0.11	\$ 0.26	\$ 0.20
Diluted earnings per share	0.14	0.13	0.11	0.26	0.20
Dividends per common share	0.085	0.085	0.085	0.170	0.170
Operating ratios:					
Interest-rate spread	3.62%	3.54%	3.63%	3.58%	3.67%
Net interest margin (1) (4)	3.78%	3.70%	3.81%	3.74%	3.85%
Return on average assets (2) (4)	0.74%	0.70%	0.61%	0.72%	0.57%
Efficiency ratio	63.53%	65.48%	60.28%	64.49%	64.48%
Return on average stockholders' equity (3) (4)	6.16%	5.72%	5.04%	5.93%	4.64%

-
- (1) Calculated as a fully taxable equivalent by dividing annualized net interest income by average interest-earning assets.
- (2) Calculated by dividing annualized net income by average total assets.
- (3) Calculated by dividing annualized net income applicable to common shares by average common stockholders' equity.
- (4) Non-GAAP performance measure.

Net Interest Income

Net interest income of \$45.4 million for the quarter ended June 30, 2013 increased \$2.6 million or 6.1% as compared to the second quarter of 2012. This overall increase on a quarter-over-quarter basis benefited from increases in total interest income of \$1.1 million from \$51.8 million at June 30, 2012 to \$52.9 million at June 30, 2013 and a \$1.5 million reduction in total interest expense from \$9.1 million at June 30, 2012 to \$7.5 million at June 30, 2013. Pricing pressures in all lending areas continued through the second quarter 2013 with decreases in the rates charged on newly originated loans quarter-over-quarter offset by an increase in prepayment penalties as discussed at greater length in *Comparison of the Three-Month and Six-Month Periods Ended June 30, 2013 and June 30, 2012 - Interest Income - Loans and Leases* beginning on page 76.

As a result, net interest margin of 3.78% in the second quarter of 2013 decreased 3 basis points from 3.81% in the second quarter of 2012. Purchase accounting amortization and accretion of \$1.4 million contributed 11 basis points to yields on interest-earning assets during the second

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quarter of 2013, compared to an additional \$1.7 million and 15 basis points in the second quarter of 2012.

Funding costs declined from 0.98% for the three months ended June 30, 2012 to 0.79% for the three months ended June 30, 2013. The Company's reduction in interest rates offered on money market accounts contributed significantly to the reduction in the cost of interest-bearing deposits, which declined 4 basis points and 14 basis points, respectively, from March 31, 2013 and June 30, 2012. Purchase accounting amortization and accretion on certificates of deposit and other funding sources of \$1.0 million and \$1.3 million contributed 8 basis points and 11 basis points to reductions in the costs of funds for the three months ended June 30, 2013 and 2012, respectively.

Net interest income of \$89.0 million for the six months ended June 30, 2013 increased \$2.6 million or 3.1% when compared to the six months ended June 30, 2012. This overall increase on a year-over-year basis was largely a result of a \$3.0 million reduction in total interest expense, from \$18.4 million for the first half of 2012 to \$15.5 million for the first half of 2013.

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Net interest margin of 3.74% in the first half of 2013 decreased 11 basis points from 3.85% in the first half of 2012. Purchase accounting amortization and accretion of \$2.5 million contributed 10 basis points to yields on interest-earning assets during the first six months of 2013, compared to an additional \$1.5 million and 6 basis points in the first six months of 2012.

Funding costs also declined from 1.00% for the first six months of 2012 to 0.82% for the first six months of 2013. Purchase accounting amortization and accretion on certificates of deposit and other funding sources of \$2.1 million and \$2.7 million contributed 9 and 12 basis points to reductions in the costs of yields for the first halves of 2013 and 2012, respectively.

Future net interest income, net interest spread and net interest margin may continue to be negatively affected by the low interest-rate environment; ongoing pricing pressures in both loan and deposit portfolios; and the ability of the Company to increase its core deposit ratio, increase its non-interest-bearing deposits as a percentage of total deposits, decrease its loan-to-deposit ratio, or decrease its reliance on FHLBB advances. They may also be negatively affected by changes in the amount of purchase accounting accretion and amortization included in interest income and interest expense.

Comparison of the Three-Month and Six-Month Periods Ended June 30, 2013 and June 30, 2012

General

	Three Months Ended		Dollar Change	Percent Change	Six Months Ended		Dollar Change	Percent Change
	June 30, 2013	June 30, 2012			June 30, 2013	June 30, 2012		
	(Dollars in Thousands)							
Interest and dividend income	\$ 52,900	\$ 51,839	\$ 1,061	2.0%	\$ 104,511	\$ 104,830	\$ (319)	-0.3%
Interest expense	7,537	9,080	(1,543)	-17.0%	15,481	18,438	(2,957)	-16.0%
Net interest income	45,363	42,759	2,604	6.1%	89,030	86,392	2,638	3.1%
Provision for credit losses	2,439	6,678	(4,239)	-63.5%	4,294	9,925	(5,631)	-56.7%
Net interest income after provision for credit losses	42,924	36,081	6,843	19.0%	84,736	76,467	8,269	10.8%
Non-interest income	3,138	4,721	(1,583)	-33.5%	6,466	8,315	(1,849)	-22.2%
Non-interest expense	30,815	28,621	2,194	7.7%	61,585	61,069	516	0.8%
Provision for income taxes	5,382	4,398	984	22.4%	10,511	9,296	1,215	13.1%
Net income before noncontrolling interest in subsidiary	9,865	7,783	2,082	26.8%	19,106	14,417	4,689	32.5%
Less net income attributable to noncontrolling interest in subsidiary	375	254	121	47.6%	802	539	263	48.8%
Net income attributable to Brookline Bancorp, Inc.	\$ 9,490	\$ 7,529	\$ 1,961	26.0%	\$ 18,304	\$ 13,878	\$ 4,426	31.9%

Reported net income for the three months ended June 30, 2013 was \$2.0 million higher as compared to the same period in 2012. This is primarily the result of an increase in net interest income of \$2.6 million, a decrease in provision for credit losses of \$4.2 million, offset by a decrease in non-interest income of \$1.6 million, an increase of non-interest expense of \$2.2 million, and an increase in provision for income

taxes for \$1.0 million.

Reported net income for the six months ended June 30, 2013 was \$4.4 million higher as compared to the same period in 2012. This is primarily the result of an increase in net interest income of \$2.6 million, a decrease in provision for credit losses of \$5.6 million, offset by a decrease in non-interest income of \$1.8 million, an increase of non-interest expense of \$0.5 million, and an increase in provision for income taxes for \$1.2 million.

Table of Contents*Average Balances, Net Interest Income, Interest Rate Spread and Net Interest Margin*

The following tables set forth information about the Company's average balances, interest income and interest rates earned on average interest-earning assets, interest expense and interest rates paid on average interest-bearing liabilities, interest-rate spread and net interest margin for the three months ended June 30, 2013, March 31, 2013, and June 30, 2012, and for the six months ended June 30, 2013 and June 30, 2012. Average balances are derived from daily average balances and yields include fees, costs and purchase-accounting-related premiums and discounts which are considered adjustments to coupon yields in accordance with GAAP. Certain amounts previously reported have been reclassified to conform to the current period's presentation.

	June 30, 2013		Three Months Ended		June 30, 2012		Average Yield/ Cost
	Average Balance	Interest (1)	Average Yield/ Cost (Dollars in Thousands)	Average Balance	Interest (1)	Average Yield/ Cost	
Assets:							
Interest-earning assets:							
Short-term investments	\$ 52,541	\$ 19	0.14%	\$ 71,675	\$ 68		0.38%
Debt securities (2)	487,271	1,940	1.59%	430,206	1,548		1.44%
Marketable and restricted equity securities (2)							
	66,988	350	2.10%	54,583	110		0.81%
Total investments	606,800	2,309	1.52%	556,464	1,726		1.24%
Commercial real estate loans (3)	2,034,920	23,863	4.67%	1,859,292	23,607		5.10%
Commercial loans (3)	420,194	6,531	6.16%	412,476	4,713		4.58%
Equipment financing (3)	467,156	8,279	7.10%	348,426	7,428		8.53%
Indirect automobile loans (3)	494,571	4,523	3.67%	580,678	6,033		4.18%
Residential mortgage loans (3)	512,975	5,101	3.98%	489,688	5,445		4.45%
Other consumer loans (3)	264,183	2,508	3.81%	266,572	3,003		4.53%
Total loans and leases	4,193,999	50,805	4.83%	3,957,132	50,229		5.09%
Total interest-earning assets	4,800,799	53,114	4.41%	4,513,596	51,955		4.62%
Allowance for loan and lease losses	(42,954)			(35,962)			
Non-interest-earning assets	380,299			427,299			
Total assets	\$ 5,138,144			\$ 4,904,933			
Liabilities and Stockholders Equity:							
Interest-bearing liabilities:							
Interest-bearing deposits:							
NOW accounts	\$ 195,269	\$ 41	0.09%	\$ 189,118	\$ 57		0.12%
Savings accounts	508,451	316	0.25%	505,601	443		0.35%
Money market accounts	1,335,300	2,036	0.61%	1,204,754	2,260		0.75%
Certificates of deposit	982,257	2,350	0.96%	1,056,021	2,703		1.03%
Total interest-bearing deposits (4)	3,021,277	4,743	0.63%	2,955,494	5,463		0.74%
Advances from the FHLBB	760,237	2,682	1.41%	694,746	3,424		1.98%
Other borrowed funds	48,655	112	0.93%	60,550	193		1.28%
Total interest-bearing liabilities	3,830,169	7,537	0.79%	3,710,790	9,080		0.98%
Non-interest-bearing liabilities:							
Demand checking accounts (4)	640,725			542,100			
Other non-interest-bearing liabilities	47,589			50,327			
Total liabilities	4,518,483			4,303,217			
Brookline Bancorp, Inc. stockholders equity	616,327			597,908			
Noncontrolling interest in subsidiary	3,334			3,808			

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Total liabilities and equity	\$	5,138,144		\$	4,904,933
Net interest income (tax-equivalent basis) / Interest-rate spread (5)		45,577	3.62%		42,875 3.63%
Less adjustment of tax-exempt income		214			116
Net interest income	\$	45,363		\$	42,759
Net interest margin (6)			3.78%		3.81%

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- (1) Tax-exempt income on debt securities, equity securities and revenue bonds included in commercial real estate loans is included on a tax-equivalent basis.
- (2) Investment securities available-for-sale, which include marketable equity securities, also include unrealized gains (losses). Dividend payments may not be consistent and average yield on equity securities may vary from month to month.
- (3) Loans on nonaccrual status are included in the average balances.
- (4) Including non-interest-bearing checking accounts, the average interest rate on total deposits was 0.52% and 0.63% in the three months ended June 30, 2013 and June 30, 2012, respectively.
- (5) Interest-rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.
- (6) Net interest margin represents net interest income (tax equivalent basis) divided by average interest-earning assets.

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	June 30, 2013		Six Months Ended		June 30, 2012		Average Yield/ Cost
	Average Balance	Interest (1)	Average Yield/ Cost (Dollars in Thousands)	Average Balance	Interest (1)	Average Yield/ Cost	
Assets:							
Interest-earning assets:							
Short-term investments	\$ 53,586	\$ 50	0.19%	\$ 64,780	\$ 95		0.29%
Debt securities (2)	479,433	3,799	1.58%	460,483	4,785		2.08%
Marketable and restricted equity securities (2)							
	67,764	705	2.09%	55,263	219		0.79%
Total investments	600,783	4,554	1.52%	580,526	5,099		1.76%
Commercial real estate loans (3)	2,018,117	48,159	4.76%	1,844,566	46,845		5.10%
Commercial loans (3)	415,633	11,242	5.39%	405,639	9,326		4.61%
Equipment financing (3)	453,642	16,138	7.15%	342,558	14,465		8.45%
Indirect automobile loans (3)	510,657	9,439	3.73%	577,802	12,280		4.27%
Residential mortgage loans (3)	510,801	10,266	4.04%	490,467	10,989		4.48%
Other consumer loans (3)	264,433	5,124	3.91%	270,065	6,043		4.50%
Total loans and leases	4,173,283	100,368	4.81%	3,931,097	99,948		5.10%
Total interest-earning assets	4,774,066	104,922	4.40%	4,511,623	105,047		4.67%
Allowance for loan and lease losses	(42,225)			(34,515)			
Non-interest-earning assets	371,475			406,052			
Total assets	\$ 5,103,316			\$ 4,883,160			
Liabilities and Stockholders Equity:							
Interest-bearing liabilities:							
Interest-bearing deposits:							
NOW accounts	\$ 192,808	\$ 86	0.09%	\$ 184,102	\$ 110		0.12%
Savings accounts	511,401	660	0.26%	508,374	942		0.37%
Money market accounts	1,315,056	4,097	0.63%	1,174,149	4,412		0.76%
Certificates of deposit	992,380	4,735	0.96%	1,067,148	5,516		1.04%
Total interest-bearing deposits (4)	3,011,645	9,578	0.64%	2,933,773	10,980		0.75%
Advances from the FHLBB	756,773	5,637	1.50%	709,373	7,095		2.01%
Other borrowed funds	54,303	266	0.99%	59,574	363		1.22%
Total interest-bearing liabilities	3,822,721	15,481	0.82%	3,702,720	18,438		1.00%
Non-interest-bearing liabilities:							
Demand checking accounts (4)	624,386			525,811			
Other non-interest-bearing liabilities	35,750			52,754			
Total liabilities	4,482,857			4,281,285			
Brookline Bancorp, Inc. stockholders equity	616,868			598,277			
Noncontrolling interest in subsidiary	3,591			3,598			
Total liabilities and equity	\$ 5,103,316			\$ 4,883,160			
Net interest income (tax-equivalent basis) / Interest-rate spread (5)							
		89,441	3.58%		86,609		3.67%
Less adjustment of tax-exempt income		411			217		
Net interest income		\$ 89,030			\$ 86,392		
Net interest margin (6)			3.74%				3.85%

(1) Tax-exempt income on debt securities, equity securities and revenue bonds included in commercial real estate loans is included on a tax-equivalent basis.

(2) Investment securities available-for-sale, which include marketable equity securities, also include unrealized gains (losses). Dividend payments may not be consistent and average yield on equity securities may vary from month to month.

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- (3) Loans on nonaccrual status are included in the average balances.
- (4) Including non-interest-bearing checking accounts, the average interest rate on total deposits was 0.53% and 0.64% in the six months ended June 30, 2013 and June 30, 2012, respectively.
- (5) Interest-rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.
- (6) Net interest margin represents net interest income (tax equivalent basis) divided by average interest-earning assets.

Table of Contents**Rate/Volume Analysis**

The following table presents, on a tax-equivalent basis, the extent to which changes in interest rates and changes in volume of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (changes in volume multiplied by prior rate), (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume), and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Three Months Ended June 30, 2013 as Compared to the Three Months Ended June 30, 2012			Six Months Ended June 30, 2013 as Compared to the Six Months Ended June 30, 2012		
	Increase (Decrease) Due To		Net (In Thousands)	Increase (Decrease) Due To		Net
Volume	Rate	Volume		Rate		
Interest and dividend income						
Short-term investments	\$ (15)	\$ (34)	\$ (49)	\$ (15)	\$ (30)	\$ (45)
Debt securities	218	174	392	189	(1,175)	(986)
Marketable and restricted equity securities	30	210	240	59	427	486
Total investments	233	350	583	233	(778)	(545)
Loans and leases:						
Commercial real estate loans	2,247	(1,991)	256	4,415	(3,101)	1,314
Commercial loans and leases	94	1,724	1,818	246	1,670	1,916
Equipment financing	2,234	(1,383)	851	4,141	(2,468)	1,673
Indirect automobile loans	(828)	(682)	(1,510)	(1,361)	(1,480)	(2,841)
Residential mortgage loans	247	(591)	(344)	421	(1,144)	(723)
Other consumer loans	(26)	(469)	(495)	(126)	(793)	(919)
Total loans and leases	3,968	(3,392)	576	7,736	(7,316)	420
Total change in interest and dividend income	4,201	(3,042)	1,159	7,969	(8,094)	(125)
Interest expense						
Deposits:						
NOW accounts	2	(18)	(16)	5	(29)	(24)
Savings accounts	3	(130)	(127)	5	(287)	(282)
Money market accounts	231	(455)	(224)	500	(815)	(315)
Certificates of deposit	(180)	(173)	(353)	(379)	(402)	(781)
Total deposits	56	(776)	(720)	131	(1,533)	(1,402)
Advances from the FHLBB	303	(1,045)	(742)	444	(1,902)	(1,458)
Other borrowed funds	(34)	(47)	(81)	(31)	(66)	(97)
Total change in interest expense	325	(1,868)	(1,543)	544	(3,501)	(2,957)
Change in tax-exempt income		98	98		194	194
Change in net interest income	\$ 3,876	\$ (1,272)	\$ 2,604	\$ 7,425	\$ (4,787)	\$ 2,638

Table of Contents*Interest Income**Loans and Leases*

	Three Months Ended		Dollar Change	Percent Change	Six Months Ended		Dollar Change	Percent Change
	June 30, 2013	2012			June 30, 2013	2012		
Interest income loans and leases:								
Commercial real estate loans	\$ 23,702	\$ 23,512	\$ 190	0.8%	\$ 47,854	\$ 46,676	\$ 1,178	2.5%
Commercial loans	6,531	4,713	1,818	38.6%	11,242	9,325	1,917	20.6%
Equipment financing	8,279	7,428	851	11.5%	16,138	14,465	1,673	11.6%
Indirect automobile loans	4,523	6,033	(1,510)	-25.0%	9,439	12,280	(2,841)	-23.1%
Residential mortgage loans	5,101	5,446	(345)	-6.3%	10,266	10,989	(723)	-6.6%
Other consumer loans	2,508	3,003	(495)	-16.5%	5,124	6,043	(919)	-15.2%
Total interest income loans and leases	\$ 50,644	\$ 50,135	\$ 509	1.0%	\$ 100,063	\$ 99,778	\$ 285	0.3%

Declines in the yields on all but the commercial loan portfolio reflect the high rate of loan refinancings and the intense pricing competition which continues to characterize the Company's lending markets.

Interest income from loans and leases was \$50.6 million for the three months ended June 30, 2013, resulting in a yield on total loans and leases of 4.83%. This compares to \$50.1 million of interest on loans and leases and a yield of 5.09% for the three months ended June 30, 2012.

Quarter-over-quarter increases in interest income on loans and leases of \$3.9 million resulting from increased volume offset the \$3.4 million decrease in loan interest income resulting from interest-rate reductions on loans. Accretion and amortization on acquired loans of \$1.4 million contributed 11 basis points to yields on loans and leases during the second quarter of 2013, compared to an additional \$1.7 million and 15 basis points in the second quarter of 2012. The second quarter 2013 also benefited from \$1.4 million in prepayment penalties which contributed 11 basis points to the yield on loans and leases and in particular, to the yield on commercial loans, compared to \$0.5 million and 5 basis points in the second quarter of 2012.

Interest income from loans and leases was \$100.1 million for the six months ended June 30, 2013, resulting in a yield on total loans of 4.81%. This compares to \$99.8 million of interest on loans and a yield of 5.10% for the six months ended June 30, 2012. Period-over-period increases in interest income on loans and leases of \$7.7 million resulting from increased volume offset the \$7.3 million decrease in loan interest income resulting from interest-rate reductions on loans. Accretion and amortization on acquired loans of \$2.5 million contributed 10 basis points to yields on loans and leases during the first half of 2013, compared to an additional \$1.5 million and 6 basis points in the first half of 2012. The second quarter 2013 also benefited from \$1.9 million in prepayment penalties which contributed 8 basis points to the yield on loans and leases and in particular, to the yield on commercial loans, compared to \$1.0 million and 5 basis points during the first half of 2012.

Investments

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	Three Months Ended		Dollar Change	Percent Change (Dollars in Thousands)	Six Months Ended		Dollar Change	Percent Change
	June 30, 2013	June 30, 2012			June 30, 2013	June 30, 2012		
Interest income								
investments:								
Short-term investments	\$ 19	\$ 68	\$ (49)	-72.1%	\$ 50	\$ 95	\$ (45)	-47.4%
Debt securities	1,934	1,541	393	25.5%	3,786	4,770	(984)	-20.6%
Marketable and restricted equity securities	303	95	208	218.9%	612	187	425	227.3%
Total interest income investments	\$ 2,256	\$ 1,704	\$ 552	32.4%	\$ 4,448	\$ 5,052	\$ (604)	-12.0%

The year-over-year decrease in total investment income is largely a result of rate-driven reduction stemming from the paydown of higher-coupon MBSs and CMOs which were replaced by similar but lower-yielding securities.

Total investment income was \$2.3 million for the three months ended June 30, 2013, compared to \$1.7 million for the three months ended June 30, 2012, representing an increase of \$0.6 million, or 32.4%. The yield on investments increased from 1.24% for the quarter ended June 30, 2012 to 1.52% for the quarter ended June 30,

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2013. Of the \$0.6 million year-over-year increase in quarterly interest income on investments, \$0.2 million resulted from increases in volume while \$0.4 million resulted from increases in interest rates.

Total investment income was \$4.4 million for the six months ended June 30, 2013 compared to \$5.1 million for the six months ended June 30, 2012, representing a decrease of \$0.6 million, or 12.0%. The yield on investments decreased from 1.76% for the six months ended June 30, 2012 to 1.52% for the six months ended June 30, 2013. Of the \$0.6 million decrease in interest income on investments from the first half of 2012 to the first half of 2013, \$0.2 million of increases in volume were offset by \$0.8 million of decreases in interest rates.

Interest Expense

	Three Months Ended		Dollar Change	Percent Change	Six Months Ended		Dollar Change	Percent Change
	June 30, 2013	June 30, 2012			June 30, 2013	June 30, 2012		
Interest expense:								
Deposits:								
NOW accounts	\$ 41	\$ 57	\$ (16)	-28.1%	\$ 86	\$ 110	\$ (24)	-21.8%
Savings accounts	316	443	(127)	-28.7%	660	942	(282)	-29.9%
Money market accounts	2,036	2,260	(224)	-9.9%	4,097	4,412	(315)	-7.1%
Certificates of deposit	2,350	2,703	(353)	-13.1%	4,735	5,516	(781)	-14.2%
Total interest expense deposits	4,743	5,463	(720)	-13.2%	9,578	10,980	(1,402)	-12.8%
Borrowed funds:								
Advances from the FHLBB	2,682	3,424	(742)	-21.7%	5,637	7,095	(1,458)	-20.5%
Other borrowed funds	112	193	(81)	-42.0%	266	363	(97)	-26.7%
Total interest expense borrowed funds	2,794	3,617	(823)	-22.8%	5,903	7,458	(1,555)	-20.9%
Total interest expense	\$ 7,537	\$ 9,080	\$ (1,543)	-17.0%	\$ 15,481	\$ 18,438	\$ (2,957)	-16.0%

Deposits

Ongoing declines in the interest rates paid on deposits and continued declines in certificate of deposit balances as a percentage of total deposits contributed to reductions in the Company's overall cost of deposits.

Interest expense on deposits decreased \$0.7 million or 13.2% from \$5.5 million for the quarter ended June 30, 2012 to \$4.7 million for the quarter ended June 30, 2013, largely as a result of decreases in interest rates. As a result, the cost of total interest-bearing deposits decreased from 0.74% during the three months ended June 30, 2012 to 0.63% in the three months ended June 30, 2013. Purchase accounting amortization of \$0.1 million and \$0.3 million improved the Company's net interest margin 1 basis point and 3 basis points, respectively, in the three months ended June 30, 2013 and 2012.

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Similarly, the Company's year-over-year interest expense on interest-bearing deposits decreased \$1.4 million from \$11.0 million for the six months ended June 30, 2012 to \$9.6 million for the same period in 2012, again largely as a result of reductions in interest rates paid. The cost of total interest-bearing deposits decreased from 0.75% in the six months ended June 30, 2012 to 0.64% in the six months ended June 30, 2013. Purchase accounting amortization of \$0.3 million and \$0.7 million improved the Company's net interest margin by 1 basis point and 3 basis points, respectively, in the first half of June 30, 2013 compared to the first half of 2012.

Borrowed Funds

Interest paid on borrowed funds decreased by \$ 0.8 million, or 22.8% from \$3.6 million for the three months ended June 30, 2012 to \$2.8 million for the three months ended June 30, 2013. The cost of borrowed funds declined from 1.93% during the three months ended June 30, 2012 to 1.39% for the quarter ended June 30, 2013. Decreases in borrowing rates resulted in a reduction in debt-related interest expenses of \$1.1 million, partially offset by a \$0.3 million increase in interest expense due to an increase in borrowed funds. Premium amortization on borrowed funds acquired in the BankRI acquisition of \$0.9 million and \$0.9 million improved the Company's net interest margin by 8 basis points and 8 basis points, respectively, in the three months ended June 30, 2013 compared to the three months ended June 30, 2012.

Interest paid on borrowed funds decreased by \$1.6 million, or 20.9% from \$7.5 million for the six months ended June 30, 2013 to \$5.9 million for the six months ended June 30, 2012. The cost of borrowed funds declined from 1.93% on a period-over-period basis to 1.54% for the first half of June 30, 2013. Decreases in borrowing rates

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resulted in a reduction in debt-related interest expenses of \$2.0 million, partially offset by a \$0.4 million increase in interest expense due to an increase in the balance of borrowed funds. Premium amortization on borrowed funds acquired in the BankRI acquisition of \$2.0 million and \$1.8 million improved the Company's net interest margin by 9 basis points and 8 basis points, respectively, in the first half of June 30, 2013 compared to the first half of 2012.

Provision for Credit Losses

The provisions for credit losses are set forth below:

	Three Months Ended		Dollar Change	Percent Change	Six Months Ended		Dollar Change	Percent Change
	June 30, 2013	June 30, 2012			June 30, 2013	June 30, 2012		
Provision (credit) for loan and lease losses:								
Commercial real estate	\$ 1,512	\$ 1,062	\$ 29	2.7%	\$ 2,078	\$ 2,381	\$ (724)	-30.4%
Commercial	434	5,176	(4,456)	-86.1%	1,596	6,520	(4,637)	-71.1%
Indirect automobile	(136)	249	(383)	-153.8%	(208)	593	(799)	-134.7%
Consumer	497	486	(445)	-91.6%	574	741	(623)	-84.1%
Unallocated	81	(295)	965	-327.1%	147	(310)	1,046	-337.4%
Total provision for loan and lease losses	2,388	6,678	(4,290)	-64.2%	4,187	9,925	(5,737)	-57.8%
Unfunded credit commitments	51		48	100.0%	107		103	100.0%
Total provision for credit losses	\$ 2,439	\$ 6,678	\$ (4,242)	-63.5%	\$ 4,294	\$ 9,925	\$ (5,634)	-56.8%

The provisions for credit losses for the second quarters of 2013 and 2012 were \$2.4 million and \$6.7 million, respectively. The provisions for credit losses for the six months ended June 2013 and 2012 were \$4.3 million and \$9.9 million, respectively. The \$4.3 million quarter-over-quarter decrease and the \$5.7 million period-over-period decrease in the provision for loan and lease losses were due in large part to a \$4.2 million provision related to two short-term commercial loans made by BankRI shortly after acquisition in early 2012. The second-quarter 2013 provision for loan and lease losses includes a first-time provision of \$0.6 million for post-acquisition deterioration of certain acquired loans and loan pools. See management's discussion of *Financial Condition Allowance for Loan and Lease Losses* and Note 5, *Allowance for Loan and Lease Losses*, to the unaudited consolidated financial statements for a description of how management determined the allowance for loan and lease losses for each portfolio and class of loans.

During the six months ended June 30, 2013, the liability for unfunded credit commitments increased \$0.2 million to reflect changes in the estimate of loss exposure associated with credit commitments. This increase increased the provision for credit losses by the same amount during the first six months of 2013. No credit commitments were charged off against the liability account in the six-month periods ended June 30, 2013 or 2012.

Non-Interest Income

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The following table sets forth the components of non-interest income for the periods indicated:

	Three Months Ended		Dollar Change	Percent Change (Dollars in Thousands)	Six Months Ended		Dollar Change	Percent Change
	June 30, 2013	June 30, 2012			June 30, 2013	June 30, 2012		
Fees, charges and other income	\$ 3,762	\$ 4,168	\$ (406)	-9.7%	\$ 7,402	\$ 7,901	\$ (499)	-6.3%
Loss from investments in affordable housing	(624)	(244)	(380)	155.7%	(936)	(383)	(553)	144.4%
Gain on sales of securities		797	(797)	-100.0%		797	(797)	-100.0%
Total non-interest income	\$ 3,138	\$ 4,721	\$ (1,583)	-33.5%	\$ 6,466	\$ 8,315	\$ (1,849)	-22.2%

Total non-interest income decreased \$1.6 million, or 33.5%, from \$4.7 million for the three months ended June 30, 2012 to \$3.1 million for the three months ended June 30, 2013, and decreased \$1.8 million, or 22.2%, from \$8.3 million for the six months ended June 30, 2012 to \$6.5 million for the six months ended June 30, 2013. The decrease is due, in part, to larger losses from an investment in affordable housing in 2013 and the absence of any gains on sales of securities in the three-month and six-month periods ended June 30, 2013.

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Fees, charges and other income are the major sources of non-interest income for the Company and include deposit-related fees, indirect automobile and consumer loan fees, and other service fees. Fees, charges, and other income decreased \$0.4 million for the three-month period ended June 30, 2013 as compared to the three-month period ended June 30, 2012, and decreased \$0.5 million for the six-month period ended June 30, 2013 as compared to the six-month period ended June 30, 2012. The decrease is due in part to a reduction in deposit-related service charges due to systems conversion and a smaller gain on sales of mortgage loans due to the higher interest-rate environment.

Non-Interest Expense

The following table sets forth the components of non-interest expense:

	Three Months Ended		Dollar Change	Percent Change	Six Months Ended		Dollar Change	Percent Change
	June 30, 2013	2012			June 30, 2013	2012		
Compensation and employee benefits	\$ 16,697	\$ 14,238	\$ 2,459	17.3%	\$ 32,993	\$ 28,926	\$ 4,067	14.1%
Occupancy	2,865	2,503	362	14.5%	5,948	5,179	769	14.8%
Equipment and data processing	4,150	3,632	518	14.3%	8,163	7,275	888	12.2%
Professional services	1,513	2,554	(1,041)	-40.8%	3,014	9,008	(5,994)	-66.5%
FDIC insurance	936	1,230	(294)	-23.9%	1,870	2,150	(280)	-13.0%
Advertising and marketing	768	774	(6)	-0.8%	1,438	1,476	(38)	-2.6%
Amortization of identified intangible assets	1,177	1,271	(94)	-7.4%	2,343	2,554	(211)	-8.3%
Other	2,709	2,419	290	12.0%	5,816	4,501	1,315	29.2%
Total non-interest expense	\$ 30,815	\$ 28,621	\$ 2,194	7.7%	\$ 61,585	\$ 61,069	\$ 516	0.8%

Non-interest expense for the three months ended June 30, 2013 increased \$2.2 million compared to the year-ago period. The primary driver is an increase of \$2.5 million in compensation and employee benefits expense. Non-interest expense for the six months ended June 30, 2013 remained flat as compared to the six months ended June 30, 2012. The increase of \$4.1 million in compensation and employee benefits expense and the increase of \$1.3 million in other expense were offset by a decrease of \$6.0 million in professional services expense.

The efficiency ratio improved due to increased net interest income during the second quarter of 2013. The efficiency ratio increased from 60.28% for the three-month period ending June 30, 2012 to 63.53% for the three-month period ending June 30, 2013, primarily as a result of costs associated with the Company's infrastructure build, which is now entering its final stages. The efficiency ratio remained flat for the six-month period ending June 30, 2012 when compared to the six-month period ending June 30, 2013 and decreased from 65.48% for the three-month period ending March 31, 2013 to 63.53% for the three-month period ending June 30, 2013.

Compensation and employee benefit expense for the three months ended June 30, 2013 increased \$2.5 million, or 17.3% as compared to the same period in 2012. Comparing the six-month period ended June 30, 2013 and June 30, 2012, the expense increased \$4.1 million, or 14.1%. The increase was a result of the addition of loan officers and other individuals in key support areas of the Company including the Loan Review, Credit Administration, Compliance, Human Resources, Legal and Finance functions. The additions to staff are needed to support systems

conversions and to further the Company's infrastructure build.

Equipment and data processing expense for the three months ended June 30, 2013 increased \$0.5 million, or 14.3%, as compared to the same period in 2012. The increase was mainly due to one-time costs incurred in conjunction with BankRI's core systems conversion in the second quarter of 2013. While the Company incurred additional expenses in both six-month periods ended June 30, 2013 and June 30, 2012 due to BankRI's core systems conversion in the second quarter of 2013 and First Ipswich's core systems conversion in the first quarter of 2012, equipment and data processing expenses for the six months ended June 30, 2013 increased \$0.9 million, or 12.2%, as compared to six months ended June 30, 2012. The increase was, in part, due to continuous upgrades in data processing and purchases of equipment.

Professional services expense for the three months ended June 30, 2013 decreased \$1.0 million, or 40.8% as compared to the same period in 2012. Comparing the six-month period ended June 30, 2013 and June 30, 2012, the expense decreased \$6.0 million, or 66.5%. The decrease was largely a result of reduced costs for integration activities, systems conversions, and bank charter conversion expense.

Other expense increased \$0.3 million and \$1.3 million, respectively, for the three months and six months ended June 30, 2013 and 2012. The increase was due in part to increased expenses for repossessed assets, telecommunications, printing and marketing.

Table of Contents*Provision for Income Taxes*

	Three Months Ended		Dollar Change	Percent Change (Dollars in Thousands)	Six Months Ended		Dollar Change	Percent Change
	June 30, 2013	2012			June 30, 2013	2012		
Income before provision for income taxes	\$ 15,247	\$ 12,181	\$ 3,066	25.2%	\$ 29,617	\$ 23,713	\$ 5,904	24.9%
Provision for income taxes	5,382	4,398	984	22.4%	10,511	9,296	1,215	13.1%
Net income	\$ 9,865	\$ 7,783	\$ 2,082	26.8%	\$ 19,106	\$ 14,417	\$ 4,689	32.5%
Effective tax rate	35.3%	36.1%	N/A	-2.2%	35.5%	39.2%	N/A	-9.5%

The Company recorded income tax expense of \$5.4 million for the three months ended June 30, 2013, compared to \$4.4 million for the three months ended June 30, 2012, representing total effective tax rates of 35.3% and 36.1%, respectively. On a year-to-date basis, the Company recorded income tax expense of \$10.5 million for the first six months of 2013, compared to \$9.3 million for the first six months of 2012, representing total effective tax rates of 35.5% and 39.2%, respectively.

The decrease in the effective state and federal tax rate for the three months and six months ended June 30, 2013 is primarily due to the non-deductibility of \$1.4 million of the \$5.4 million in professional fees incurred related to the BankRI acquisition.

Liquidity and Capital Resources*Liquidity*

Liquidity is defined as the ability to meet current and future financial obligations of a short-term nature. The Company further defines liquidity as the ability to respond to the needs of depositors and borrowers, as well as to earnings enhancement opportunities, in a changing marketplace. Liquidity management is monitored by an Asset/Liability Committee (ALCO), consisting of members of management, which is responsible for establishing and monitoring liquidity targets as well as strategies and tactics to meet these targets.

The primary source of funds for the payment of dividends and expenses by the Company is dividends paid to it by its Banks and Brookline Securities Corp. The primary sources of liquidity for the Banks consist of deposit inflows, loan repayments, borrowed funds and maturing investment securities and sales of securities from the available-for-sale portfolio.

Deposits, which are considered the most stable source of liability liquidity, totaled \$3.7 billion at June 30, 2013, and represented 71.7% of total funding (the sum of total deposits, total borrowings, and stockholders' equity), compared to deposits of \$3.6 billion, or 71.2% of total funding, at

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December 31, 2012. Core deposits, which consist of demand checking, NOW, savings and money market accounts, totaled \$2.7 billion at June 30, 2013 and represented 73.4% of total deposits, compared to core deposits of \$2.6 billion, or 72.0% of total deposits, at December 31, 2012. While deposits are considered the most reliable source of liquidity, the Company is careful to increase deposits without adversely impacting the weighted average cost of those funds.

Borrowings are used to diversify the Company's funding mix and to support asset growth. When profitable lending and investment opportunities exist, access to borrowings provides a means to grow the balance sheet. Borrowings totaled \$830.1 million at June 30, 2013, representing 16.3% of total funding, compared to \$854.0 million, or 16.8% of total funding, at December 31, 2012. As members of the FHLBB, the Banks have access to both short- and long-term borrowings. The Banks also have access to funding through retail repurchase agreements, brokered deposits and \$119.0 million of uncommitted lines of credit, and may utilize additional sources of funding in the future, including borrowings at the Federal Reserve discount window, to supplement its liquidity. At June 30, 2013, the Company's total borrowing limit from the FHLBB for advances and repurchase agreements was \$1.1 billion, based on the level of qualifying collateral available for these borrowings.

In general, the Company seeks to maintain a high degree of liquidity and targets cash and equivalents and available-for-sale security balances of between 10% and 30% of total assets. At June 30, 2013, cash and equivalents and available-for-sale securities totaled \$579.0 million, or 11.3% of total assets. This compares to \$598.4 million, or 11.6% of total assets at December 31, 2012.

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While management believes that the Company has adequate liquidity to meet its commitments, and to fund the Banks' lending and investment activities, the availabilities of these funding sources are subject to broad economic conditions and could be restricted in the future. Such restrictions would impact the Company's immediate liquidity and/or additional liquidity needs.

Off-Balance-Sheet Financial Instruments

The Company is party to off-balance-sheet financial instruments in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include loan commitments, standby and commercial letters of credits, and interest-rate swaps. According to GAAP, these financial instruments are not recorded in the financial statements until they are funded or related fees are incurred or received.

The contract amounts reflect the extent of the involvement the Company has in particular classes of these instruments. Such commitments involve, to varying degrees, elements of credit risk and interest-rate risk in excess of the amount recognized in the consolidated balance sheet. The Company's exposure to credit loss in the event of non-performance by the counterparty is represented by the contractual amount of the instruments. The Company uses the same policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments with off-balance-sheet risk at the dates indicated follow:

	At June 30, 2013	At December 31, 2012
	(In Thousands)	
Financial instruments whose contract amounts represent credit risk:		
Commitments to originate loans and leases:		
Commercial real estate	\$ 58,665	\$ 85,726
Commercial	76,949	67,857
Residential mortgage	6,174	8,726
Unadvanced portion of loans and leases	519,808	421,143
Unused lines of credit:		
Home equity	187,754	165,936
Other consumer	5,804	4,017
Other commercial	972	965
Unused letters of credit:		
Financial standby letters of credit	19,730	19,887
Performance standby letters of credit	2,916	2,916
Commercial and similar letters of credit	158	112
Back-to-back interest-rate swaps	23,021	33,221

Capital Resources

At June 30, 2013, the Company and the Banks are all under the primary regulation of and must comply with the capital requirements of the FRB. At that date, the Company, Brookline Bank, BankRI and First Ipswich exceeded all regulatory capital requirements and were considered

well-capitalized.

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The Company's and the Banks' actual and required capital amounts and ratios are as follows

At June 30, 2013:

Brookline Bancorp, Inc.

Tier 1 leverage capital ratio	(1)	\$	471,509	9.47%	\$	199,159	4.00%	N/A	N/A
Tier 1 risk-based capital ratio	(2)		471,509	11.23%		167,946	4.00%	N/A	N/A
Total risk-based capital ratio	(3)		516,680	12.31%		335,779	8.00%	N/A	N/A

Brookline Bank

Tier 1 leverage capital ratio	(1)	\$	298,867	9.59%		124,658	4.00%	155,822	5.00%
Tier 1 risk-based capital ratio	(2)		298,867	10.69%		111,830	4.00%	167,746	6.00%
Total risk-based capital ratio	(3)		333,844	11.94%		223,681	8.00%	279,601	10.00%

BankRI

Tier 1 leverage capital ratio	(1)	\$	142,449	8.92%		63,878	4.00%	79,848	5.00%
Tier 1 risk-based capital ratio	(2)		142,449	11.83%		48,165	4.00%	72,248	6.00%
Total risk-based capital ratio	(3)		150,208	12.48%		96,287	8.00%	120,359	10.00%

First Ipswich

Tier 1 leverage capital ratio	(1)	\$	29,965	10.02%		11,962	4.00%	14,953	5.00%
Tier 1 risk-based capital ratio	(2)		29,965	13.80%		8,686	4.00%	13,028	6.00%
Total risk-based capital ratio	(3)		31,062	14.31%		17,365	8.00%	21,706	10.00%

At December 31, 2012:

Brookline Bancorp, Inc.

Tier 1 leverage capital ratio	(1)	\$	465,142	9.44%	\$	197,094	4.00%	N/A	N/A
Tier 1 risk-based capital ratio	(2)		465,142	10.85%		171,481	4.00%	N/A	N/A
Total risk-based capital ratio	(3)		507,077	11.83%		342,909	8.00%	N/A	N/A

Brookline Bank

Tier 1 leverage capital ratio	(1)	\$	282,706	9.29%	\$	121,725	4.00%	\$	152,156	5.00%
Tier 1 risk-based capital ratio	(2)		282,706	9.78%		115,626	4.00%		173,439	6.00%
Total risk-based capital ratio	(3)		318,629	11.02%		231,310	8.00%		289,137	10.00%

BankRI

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Tier 1 leverage capital ratio	(1)	\$	136,100	8.50%	\$	64,047	4.00%	\$	80,059	5.00%
Tier 1 risk-based capital ratio	(2)		136,100	11.54%		47,175	4.00%		70,763	6.00%
Total risk-based capital ratio	(3)		141,171	11.97%		94,350	8.00%		117,937	10.00%
First Ipswich										
Tier 1 leverage capital ratio	(1)	\$	29,209	9.72%	\$	12,020	4.00%	\$	15,025	5.00%
Tier 1 risk-based capital ratio	(2)		29,209	13.24%		8,824	4.00%		13,237	6.00%
Total risk-based capital ratio	(3)		30,168	13.68%		17,642	8.00%		22,053	10.00%

-
- (1) Tier 1 leverage capital ratio is calculated by dividing Tier 1 capital by average assets.
- (2) Tier 1 risk-based capital ratio is calculated by dividing Tier 1 capital by risk-weighted assets.
- (3) Total risk-based capital ratio is calculated by dividing total capital by risk-weighted assets.

The Dodd-Frank Consumer Protection and Wall Street Reform Act (the Dodd-Frank Act) requires the federal banking agencies to establish minimum leverage and risk-based capital requirements for insured banks and their holding companies. The federal banking agencies issued a joint final rule, or the Final Capital Rule, that implements the Basel III capital standards and establishes the minimum capital levels required under the Dodd-

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Frank Act. The Company must comply with the Final Capital Rule by January 1, 2015. The Final Capital Rule establishes a minimum common equity Tier I capital ratio of 6.5% of risk-weighted assets for a well capitalized institution and increases the minimum Tier I capital ratio for a well capitalized institution from 6% to 8%. Additionally, the Final Capital Rule requires an institution to maintain a 2.5% common equity Tier I capital conservation buffer over the 6.5% minimum risk-based capital requirement to avoid restrictions on the ability to pay dividends, discretionary bonuses, and engage in share repurchases. The Final Capital Rule permanently grandfathered trust-preferred securities issued before May 19, 2010, subject to a limit of 25% of Tier I capital. The Final Capital Rule increases the required capital for certain categories of assets, including high-volatility construction real estate loans and certain exposures related to securitizations; however, the Final Capital Rule retains the current capital treatment of residential mortgages. Under the Final Capital Rule, the Company may make a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. If the Company does not make this election, unrealized gains and losses will be included in the calculation of the Company's regulatory capital.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market Risk

Market risk is the risk that the market value or estimated fair value of the Company's assets, liabilities, and derivative financial instruments will decline as a result of changes in interest rates or financial market volatility, or that the Company's net income will be significantly reduced by interest-rate changes.

Interest-Rate Risk

The principal market risk facing the Company is interest-rate risk, which can come in a variety of forms, including repricing risk, yield-curve risk, basis risk, and prepayment risk. Repricing risk exists when the change in the average yield of either interest-earning assets or interest-bearing liabilities is more sensitive than the other to changes in market interest rates. Such a change in sensitivity could reflect a number of possible mismatches in the repricing opportunities of the Company's assets and liabilities. Yield-curve risk reflects the possibility that the changes in the shape of the yield curve could have different effects on the Company's assets and liabilities. Basis risk exists when different parts of the balance sheet are subject to varying base rates reflecting the possibility that the spread from those base rates will deviate. Prepayment risk is associated with financial instruments with an option to prepay before the stated maturity often at a time of disadvantage to the person selling the option; this risk is most often associated with the prepayment of loans, callable investments, and callable borrowings.

Asset/Liability Management

Market risk and interest-rate risk management is governed by the Company's Asset/Liability Committee (ALCO). The ALCO establishes exposure limits that define the Company's tolerance for interest-rate risk. The ALCO and Treasury Group measure and manage the composition of the balance sheet over a range of possible changes in interest rates while remaining responsive to market demand for loan and deposit products. The ALCO monitors current exposures versus limits and reports results to the Board of Directors. The policy limits and guidelines serve as benchmarks for measuring interest-rate risk and for providing a framework for evaluation and interest-rate risk-management decision-making. The Company measures its interest-rate risk by using an asset/liability simulation model. The model considers several factors to determine the Company's potential exposure to interest-rate risk, including measurement of repricing gaps, duration, convexity, value-at-risk,

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and the market value of portfolio equity under assumed changes in the level of interest rates, the shape of yield curves, and general market volatility.

Management controls the Company's interest-rate exposure using several strategies, which include adjusting the maturities of securities in the Company's investment portfolio, limiting or expanding the terms of loans originated, limiting fixed-rate deposits with terms of more than five years and adjusting maturities of FHLBB advances. The Company limits this risk by restricting the types of MBSs it invests in to those with limited average life changes under certain interest-rate-shock scenarios, or securities with embedded prepayment penalties. The Company also places limits on holdings of fixed-rate mortgage loans with maturities greater than five years. The Company also may use derivative instruments, principally interest-rate swaps, to manage its interest-rate risk; however, the Company had no derivative fair value hedges or derivative cash flows at June 30, 2013 or December 31, 2012. See Note 8, Derivatives and Hedging Activities, to the unaudited consolidated financial statements.

Table of Contents**Measuring Interest-Rate Risk**

As noted above, interest-rate risk can be measured by analyzing the extent to which the repricing of assets and liabilities are mismatched to create an interest-rate sensitivity gap. An asset or liability is said to be interest-rate sensitive within a specific period if it will mature or reprice within that period. The interest-rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that same time period. A gap is considered positive when the amount of interest-rate-sensitive assets exceeds the amount of interest-rate-sensitive liabilities. A gap is considered negative when the amount of interest-rate-sensitive liabilities exceeds the amount of interest-rate-sensitive assets. During a period of falling interest rates, therefore, a positive gap would tend to adversely affect net interest income. Conversely, during a period of rising interest rates, a positive gap position would tend to result in an increase in net interest income.

The Company's interest-rate risk position is measured using both income simulation and interest-rate sensitivity gap analysis. Income simulation is the primary tool for measuring the interest-rate risk inherent in the Company's balance sheet at a given point in time by showing the effect on net interest income, over a twelve-month period, of a variety of interest-rate shocks. These simulations take into account repricing, maturity and prepayment characteristics of individual products. The ALCO reviews simulation results to determine whether the exposure resulting from changes in market interest rates remains within established tolerance levels over a twelve-month horizon, and develops appropriate strategies to manage this exposure. The Company's interest-rate risk analysis remains modestly asset-sensitive at June 30, 2013.

At June 30, 2013, net interest income simulation indicated that the Company's exposure to changing interest rates was within tolerance. The ALCO reviews the methodology utilized for calculating interest-rate risk exposure and may periodically adopt modifications to this methodology. The following table presents the estimated impact of interest-rate shocks on the Company's estimated net interest income over the twelve-month periods indicated:

Gradual Change in Interest Rate Levels	Estimated Exposure to Net Interest Income over Twelve-Month Horizon Beginning					
	June 30, 2013		March 31, 2013		June 30, 2012	
	Dollar Change	Percent Change	Dollar Change	Percent Change	Dollar Change	Percent Change
Up 200%	\$ 1,848	1.07%	\$ 1,635	0.93%	\$ 3,515	2.13%
Up 100%	803	0.47%	687	0.39%	1,675	1.02%
Down 100%	(2,201)	-1.28%	(2,193)	-1.25%	489	0.30%

The Company also uses interest-rate sensitivity gap analysis to provide a more general overview of its interest-rate risk profile. The interest-rate sensitivity gap is defined as the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period. At June 30, 2013, the Company's one-year cumulative gap was a negative \$618.2 million, or negative 12.0% of total assets, compared with a negative \$502.3 million, or 9.8% of total assets at December 31, 2012 and a negative \$486.5 million, or 9.8% of total assets at June 30, 2012.

For additional discussion on interest-rate risk see Item 7A, **Quantitative and Qualitative Disclosures about Market Risk** on pages 83 to 86 of the Company's 2012 Annual Report on Form 10-K.

The assumptions used in the Company's interest-rate sensitivity simulation discussed above are inherently uncertain and, as a result, the simulations cannot precisely measure net interest income or precisely predict the impact of changes in interest rates.

Item 4. Controls and Procedures

Controls and Procedures

Under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the

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period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer considered that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is (i) recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

In conjunction with the Company's core systems conversions and its ongoing consolidation of its subsidiary banks' back-office operations, shared services, and policies and procedures, the Company continues to focus on consolidating and enhancing internal controls over financial reporting. There has been no change in the Company's internal control over financial reporting identified in connection with the quarterly evaluation that occurred during the Company's last fiscal quarter that has materially and detrimentally affected, or is reasonably likely to materially and detrimentally affect, the Company's internal control over financial reporting.

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Act Rule 13a-15(f). The Company's internal control system was designed to provide reasonable assurance to its management and the Board of Directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. The Company's management assessed the effectiveness of its internal control over financial reporting as of the end of the period covered by this report.

Management's Report on Internal Control Over Financial Reporting as of December 31, 2012 and the related Report of Independent Registered Public Accounting Firm thereon appear on pages F-1 and F-2 of the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

There are no material pending legal proceedings other than those that arise in the normal course. In the opinion of management, after consulting with legal counsel, the consolidated financial position and results of operations of the Company are not expected to be affected materially by the outcome of such proceedings.

Item 1A. Risk Factors

In addition to the risk factor discussed below and other information set forth in this report, you should carefully consider the factors discussed in Item 1A of the Company's Form 10-K for the year ended December 31, 2012.

We will become subject to more stringent capital requirements.

The Dodd-Frank Consumer Protection and Wall Street Reform Act (the Dodd-Frank Act) requires the federal banking agencies to establish minimum leverage and risk-based capital requirements for insured banks and their holding companies. The federal banking agencies issued a joint final rule, or the Final Capital Rule, that implements the Basel III capital standards and establishes the minimum capital levels required under the Dodd-Frank Act. We must comply with the Final Capital Rule by January 1, 2015. The Final Capital Rule establishes a minimum common equity Tier I capital ratio of 6.5% of risk-weighted assets for a well capitalized institution and increases the minimum Tier I capital ratio for a well capitalized institution from 6% to 8%. Additionally, the Final Capital Rule requires an institution to maintain a 2.5% common equity Tier I capital conservation buffer over the 6.5% minimum risk-based capital requirement to avoid restrictions on the ability to pay dividends, discretionary bonuses, and engage in share repurchases. The Final Capital Rule permanently grandfathers trust-preferred securities issued before May 19, 2010, subject to a limit of 25% of Tier I capital. The Final Capital Rule increases the required capital for certain categories of assets, including high-volatility construction real estate loans and certain exposures related to securitizations; however, the Final Capital Rule retains the current capital treatment of residential mortgages. Under the Final Capital Rule, we may make a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. If we do not make this election, unrealized gains and losses will be included in the calculation of our regulatory capital. Implementation of these standards, or any other new regulations, may adversely affect our ability to pay dividends, or require us to reduce business levels or raise capital, including in ways that may adversely affect our results of operations or financial condition.

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

- a) Not applicable.

b) Not applicable.

c) None.

Item 3. Defaults Upon Senior Securities

a) None.

b) None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibits

Exhibit 10.1	Form of Change in Control Agreement dated June 26, 2013 incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on June 26, 2013.
Exhibit 31.1*	Certification of Chief Executive Officer
Exhibit 31.2*	Certification of Chief Financial Officer
Exhibit 32.1**	Section 1350 Certification of Chief Executive Officer
Exhibit 32.2**	Section 1350 Certification of Chief Financial Officer
Exhibit 101***	The following materials from Brookline Bancorp, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Unaudited Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012; (ii) Unaudited Consolidated Statements of Income for the three months and six months ended June 30, 2013 and 2012; (iii) Unaudited Consolidated Statements of Comprehensive Income for the three months and six months ended June 30, 2013 and 2012; (iv) Unaudited Consolidated Statements of Changes in Equity for the six months ended June 30, 2013 and 2012; (v) Unaudited Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012; and (vi) Notes to Unaudited Consolidated Financial Statements at and for the six months ended June 30, 2013 and 2012.

* Filed herewith.

** Furnished herewith.

*** Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.

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SIGNATURES

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

BROOKLINE BANCORP, INC.

Date: August 9, 2013

By: /s/ Paul A. Perrault
Paul A. Perrault
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 9, 2013

By: /s/ Julie A. Gerschick
Julie A. Gerschick
Chief Financial Officer and Treasurer
(Principal Financial Officer)