FIRST BANCORP /PR/
Form 10-Q
September 24, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

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

For the transition period from __________ to __________

COMMISSION FILE NUMBER 0-17224

FIRST BANCORP.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Puerto Rico (State or other jurisdiction of incorporation or organization)	66-0561882 (I.R.S. employer identification number)
1519 Ponce de León Avenue, Stop 23 Santurce, Puerto Rico (Address of principal executive offices)	00908 (Zip Code)

(787) 729-8200
(Registrant s telephone number, including area code)
Not applicable
(Former name, former address and former fiscal year, if changed since last report)

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 o No þ

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

Large accelerated þ filer Accelerated filer o Non-accelerated filer o

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

Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common stock: 92,504,506 outstanding as of August 31, 2007.

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EXPLANATORY NOTE

First BanCorp (the Corporation or First BanCorp) was unable to timely file with the Securities and Exchange Commission (SEC) this Quarterly Report on Form 10-Q for the interim period ended June 30, 2007 as a result of the delay in completing the restatement of the Corporation s audited financial statements for the years ended December 31, 2004, 2003 and 2002, and the unaudited selected quarterly financial information for each of the four quarters of 2004, 2003 and 2002, which resulted in delays in the filing of an amendment of First BanCorp s Annual Report on Form 10-K for the year ended December 31, 2004 and consequent delays in the filing of the Corporation s subsequent reports. For information regarding the restatement of First BanCorp s previously issued financial statements, see the Corporation s Amendment No. 1 to Annual Report on Form 10-K/A for the year ended December 31, 2004, which was filed with the SEC on September 26, 2006.

FORWARD LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in this Form 10-Q or future filings by First BanCorp with the SEC, in the Corporation s press releases or in other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, the word or phrases would be, will allow, intends to, will likely result, expected to, should, anticipate and similar expressions are meant to identify forward-looking statements.

First BanCorp wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and represent First BanCorp s expectations of future conditions or results and are not guarantees of future performance. First BanCorp advises readers that various factors could cause actual results to differ materially from those contained in any forward-looking statement. Such factors include, but are not limited to, the following:

- risks associated with the Corporation s inability to prepare and timely submit SEC and other regulatory filings;
- an adverse change in the Corporation s ability to attract new clients and retain existing ones;
- general economic conditions, including prevailing interest rates and the performance of the financial markets, which may affect demand for the Corporation s products and services and the value of the Corporation s assets, including the value of the interest rate swaps that economically hedge the interest rate risk mainly relating to brokered certificates of deposit and medium-term notes;
- risks arising from worsening economic conditions in Puerto Rico and in the South Florida market;
- risks arising from credit and other risks of the Corporation s lending and investment activities, including the condo conversion loans in its Miami Agency;
- increases in the Corporation s expenses associated with acquisitions and dispositions;
- developments in technology;
- risks associated with changes to the Corporation s business strategy to no longer acquire mortgage loans in bulk;
- risks associated with the failure to obtain a final order from the District Court of Puerto Rico approving the settlement of the class action lawsuit brought against the Corporation;
- the impact of Doral Financial Corporation and R&G Financial Corporation s financial condition on the repayment of their outstanding secured loan to the Corporation;
- risks associated with being subject to the cease and desist orders;

the Corporation s ability to issue brokered certificates of deposit and the ability to fund operations;

potential further downgrades in the credit ratings of the Corporation s securities;

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- general competitive factors and industry consolidation; and

- risks associated with regulatory and legislative changes for financial services companies in Puerto Rico, the United States, and the U.S. and British Virgin Islands.

The Corporation does not undertake, and specifically disclaims any obligation, to update any of the forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements except as required by the federal securities laws.

Investors should carefully consider these factors and the risk factors outlined under Item 1A, Risk Factors, in First BanCorp s 2006 Annual Report on Form 10-K and under Item 1A, Risk Factors, in this Quarterly Report on Form 10-Q.

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FIRST BANCORP
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited)

	June 30, 2007	December 31, 2006
Assets		
Cash and due from banks	$ 134,955,243	$ 112,340,615
Money market instruments, including, for 2007, $4,602,509 of collateral pledged that can be repledged	426,786,590	377,296,017
Federal funds sold and securities purchased under agreements to resell	222,806,260	42,051,281
Time deposits with other financial institutions	58,862,956	37,123,111
Total money market investments	708,455,806	456,470,409
Investment securities available for sale, at fair value:		
Securities pledged that can be repledged	1,151,251,901	1,373,466,630
Other investment securities	581,861,986	326,956,340
Total investment securities available for sale	1,733,113,887	1,700,422,970
Investment securities held to maturity, at amortized cost:		
Securities pledged that can be repledged	2,451,058,790	2,661,088,022
Other investment securities	850,562,409	686,042,717
Total investment securities held to maturity, fair value of $3,185,886,393 (2006 - $3,256,965,610)	3,301,621,199	3,347,130,739
Other equity securities	43,578,685	40,159,185
Loans, net of allowance for loan and lease losses of $165,009,429 (December 31, 2006 - $158,295,662)	11,057,640,411	11,070,446,401
Loans held for sale, at lower of cost or market	26,029,830	35,238,127
Total loans, net	11,083,670,241	11,105,684,528
Premises and equipment, net	158,821,017	155,661,727
Other real estate owned	6,280,266	2,869,713
Accrued interest receivable on loans and investments	114,826,772	112,505,003
Due from customers on acceptances	89,454	149,716
Other assets	319,632,387	356,861,273
Total assets	$ 17,605,044,957	$ 17,390,255,878
Liabilities & Stockholders Equity		
Liabilities:		

Non-interest-bearing deposits	$ 642,833,774	$ 790,985,153
Interest-bearing deposits (includes $4,316,391,667 measured at fair value as of June 30, 2007)	10,990,097,378	10,213,302,047
Federal funds purchased and securities sold under agreements to repurchase	3,265,763,000	3,687,724,000
Advances from the Federal Home Loan Bank (FHLB)	625,000,000	560,000,000
Notes payable (includes $14,666,448 measured at fair value as of June 30, 2007)	32,216,289	182,827,572
Other borrowings	231,767,698	231,719,406
Bank acceptances outstanding	89,454	149,716
Accounts payable and other liabilities	510,965,060	493,994,798
Total liabilities	16,298,732,653	16,160,702,692
Commitments and contingencies (Note 16)		
Stockholders equity:		
Preferred stock, authorized 50,000,000 shares: issued and outstanding 22,004,000 shares at $25 liquidation value per share	550,100,000	550,100,000
Common stock, $1 par value, authorized 250,000,000 shares; issued 93,151,856 shares	93,151,856	93,151,856
Less: Treasury stock (at par value)	(9,897,800)	(9,897,800)
Common stock outstanding	83,254,056	83,254,056
Additional paid-in capital	25,604,944	22,756,994
Legal surplus	276,847,825	276,847,825
Retained earnings	430,758,738	326,761,462
Accumulated other comprehensive loss, net of tax benefit of $426,086 (December 31, 2006 - $221,389)	(60,253,259)	(30,167,151)
Total stockholders equity	1,306,312,304	1,229,553,186
Total liabilities and stockholders equity	$ 17,605,044,957	$ 17,390,255,878

The accompanying notes are an integral part of these statements.

FIRST BANCORP
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Quarter Ended		Six-Month Period Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Interest income:				
Loans	$ 228,911,146	$ 247,603,929	$ 454,549,837	$ 493,693,236
Investment securities	71,672,690	72,040,513	139,344,411	143,681,230
Money market investments	5,288,285	24,799,009	10,562,355	34,773,873
Total interest income	305,872,121	344,443,451	604,456,603	672,148,339
Interest expense:				
Deposits (Note 10)	133,882,215	157,153,731	257,971,740	343,991,804
Federal funds purchased and repurchase agreements	39,389,847	51,133,513	81,159,876	104,699,042
Advances from FHLB	9,001,211	2,867,071	17,198,452	7,044,803
Notes payable and other borrowings	6,383,104	7,051,194	13,476,019	17,356,139
Total interest expense	188,656,377	218,205,509	369,806,087	473,091,788
Net interest income	117,215,744	126,237,942	234,650,516	199,056,551
Provision for loan and lease losses	24,627,867	9,354,590	49,542,335	28,730,477
Net interest income after provision for loan and lease losses	92,587,877	116,883,352	185,108,181	170,326,074
Non-interest income:				
Other service charges on loans	2,417,637	1,467,127	4,208,729	2,953,397
Service charges on deposit accounts	3,185,040	3,278,109	6,376,132	6,555,138
Mortgage banking activities gain (loss)	350,527	427,171	1,112,598	(147,676)
Net (loss) gain on investments and impairments	(1,436,500)	134,224	(3,595,191)	(574,544)
Net gain (loss) on partial extinguishment and recharacterization of secured commercial loans to local financial institutions		(11,640,344)	2,497,166	(11,640,344)
Rental income	669,942	837,380	1,333,438	1,610,670
Gain on sale of credit card portfolio			2,818,972	
Other operating income	5,716,324	7,279,281	11,973,446	13,614,497
Total non-interest income	10,902,970	1,782,948	26,725,290	12,371,138

Non-interest expenses:				
Employees compensation and benefits	33,351,215	29,869,779	69,723,605	63,994,700
Occupancy and equipment	14,495,615	13,623,498	28,878,023	26,329,588
Business promotion	4,863,746	4,324,181	9,794,214	8,098,241
Professional fees	5,608,596	10,143,207	12,005,114	17,536,173
Taxes, other than income taxes	3,652,962	2,558,071	7,234,297	5,113,340
Insurance and supervisory fees	1,798,686	1,909,550	3,490,426	3,610,562
Other operating expenses	9,683,869	8,611,833	21,692,736	18,095,170
Total non-interest expenses	73,454,689	71,040,119	152,818,415	142,777,774
Income before income taxes	30,036,158	47,626,181	59,015,056	39,919,438
Income tax provision	(6,240,676)	(15,823,679)	(12,387,589)	(4,253,694)
Net income	$ 23,795,482	$ 31,802,502	$ 46,627,467	$ 35,665,744
Net income attributable to common stockholders	$ 13,726,483	$ 21,733,503	$ 26,489,469	$ 15,527,746
Net income per common share:				
Basic	$ 0.16	$ 0.26	$ 0.32	$ 0.19
Diluted	$ 0.16	$ 0.26	$ 0.32	$ 0.19
Dividends declared per common share	$ 0.07	$ 0.07	$ 0.14	$ 0.14

The accompanying notes are an integral part of these statements.

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FIRST BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six-Month Period Ended June 30, 2007	Six-Month Period Ended June 30, 2006
Cash flows from operating activities:		
Net income	$ 46,627,467	$ 35,665,744
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	8,393,859	8,355,081
Amortization of core deposit intangible	1,659,863	1,778,206
Provision for loan and lease losses	49,542,335	28,730,477
Deferred income tax benefit	(2,013,334)	(26,536,609)
Stock-based compensation recognized	2,847,950	4,892,361
Loss (gain) on sale of investments, net	732,301	(2,375,344)
Other-than-temporary impairments on available-for-sale securities	2,862,890	2,949,888
Derivative instruments and hedging activities loss	363,122	66,808,911
Net (gain) loss on sale of loans and impairments	(605,809)	412,663
Net (gain) loss on partial extinguishment and recharacterization of secured commercial loans to local financial institutions	(2,497,166)	11,640,344
Net amortization of premiums and discounts and deferred loan fees and costs	(1,042,987)	(921,749)
Amortization of broker placement fees	4,764,937	8,718,909
(Accretion) amortization of basis adjustments on fair value hedges	(2,060,686)	1,303,698
Net accretion of discount and premiums on investment securities	(18,245,821))	(17,820,409)
Gain on sale of credit card portfolio	(2,818,972)	
Increase (decrease) in accrued income tax payable	9,962,943	(8,693,921)
(Increase) decrease in accrued interest receivable	(2,451,369)	5,259,986
(Decrease) increase in accrued interest payable	(26,808,725)	36,556,819
Decrease (increase) in other assets	621,632	(17,486,355)
(Decrease) increase in other liabilities	(4,016,821)	17,472,725
Total adjustments	19,190,142	121,045,681
Net cash provided by operating activities	65,817,609	156,711,425
Cash flows from investing activities:		
Principal collected on loans	1,607,936,801	4,338,010,938
Loans originated	(1,807,981,499)	(2,553,227,124)
Purchase of loans	(99,533,154)	(106,750,392)
Proceeds from sale of loans	69,844,306	36,900,103
Proceeds from sale of repossessed assets	27,903,751	20,920,391
Purchase of servicing assets	(1,035,952)	(378,823)
Proceeds from sale of available for sale securities	3,125,310	22,846,966
Purchase of securities held to maturity	(254,586,376)	(208,568,307)

Purchase of securities available for sale		(21,401,938)
Principal repayments and maturities of securities held to maturity	318,094,294	378,026,709
Principal repayments of securities available for sale	112,920,850	113,168,384
Additions to premises and equipment	(11,553,149)	(15,966,355)
(Increase) decrease in other equity securities	(3,419,500)	18,678,315
Net cash (used in) provided by investing activities	(38,284,318)	2,022,258,867
Cash flows from financing activities:		
Net increase in deposits	785,821,301	1,091,566,504
Net decrease in federal funds purchased and securities sold under repurchase agreements	(421,961,000)	(811,196,500)
Net FHLB advances taken (paid)	65,000,000	(312,000,000)
Repayments of notes payable and other borrowings	(150,000,000)	
Dividends paid	(31,793,567)	(31,772,568)
Exercise of stock options		19,756,483
Net cash provided by (used in) financing activities	247,066,734	(43,646,081)
Net increase in cash and cash equivalents	274,600,025	2,135,324,211
Cash and cash equivalents at beginning of period	568,811,024	1,380,640,086
Cash and cash equivalents at end of period	$ 843,411,049	$ 3,515,964,297
Cash and cash equivalents include:		
Cash and due from banks	$ 134,955,243	$ 154,078,088
Money market instruments	708,455,806	3,361,886,209
	$ 843,411,049	$ 3,515,964,297
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest on borrowings	$ 386,144,903	$ 353,284,025
Income taxes	3,255,376	37,680,255
Non-cash investing and financing activities:		
Additions to other real estate owned	$ 4,906,985	$ 1,569,586
Additions to auto repossessions	57,697,924	52,739,918
Capitalization of servicing assets	594,640	235,191
Recharacterization of secured commercial loans as securities collateralized by loans	183,829,925	

The accompanying notes are an integral part of these statements.

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FIRST BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(Unaudited)

	Six-Month Period Ended	
	June 30, 2007	**June 30, 2006**
Preferred Stock	$ 550,100,000	$ 550,100,000
Common Stock outstanding:		
Balance at beginning of period	83,254,056	80,875,056
Common stock issued under stock option plan		2,379,000
Balance at end of period	83,254,056	83,254,056
Additional Paid-In-Capital:		
Balance at beginning of period	22,756,994	
Shares issued under stock option plan		17,377,483
Stock-based compensation recognized	2,847,950	4,892,361
Balance at end of period	25,604,944	22,269,844
Legal Surplus	276,847,825	265,844,192
Retained Earnings:		
Balance at beginning of period	326,761,462	316,696,971
Net income	46,627,467	35,665,744
Cash dividends declared on common stock	(11,655,569)	(11,634,570)
Cash dividends declared on preferred stock	(20,137,998)	(20,137,998)
Cumulative adjustment for accounting change (adoption of FIN 48)	(2,614,795)	
Cumulative adjustment for accounting change (adoption of SFAS No. 159)	91,778,171	
Balance at end of period	430,758,738	320,590,147
Accumulated Other Comprehensive Loss, net of tax:		
Balance at beginning of period	(30,167,151)	(15,675,284)
Other comprehensive loss, net of tax	(30,086,108)	(66,959,980)
Balance at end of period	(60,253,259)	(82,635,264)
Total stockholders equity	$ 1,306,312,304	$ 1,159,422,975

The accompanying notes are an integral part of these statements.

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FIRST BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(Unaudited)

	Quarter Ended		Six-Month Period Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Net income	$ 23,795,482	$ 31,802,502	$ 46,627,467	$ 35,665,744
Other comprehensive loss:				
Unrealized loss on securities:				
Unrealized holding loss arising during the period	(32,018,023)	(36,633,176)	(33,885,996)	(68,428,461)
Less: Reclassification adjustments for net loss (gain) and other than temporary impairments included in net income	1,436,500	(134,224)	3,595,191	574,544
Income tax benefit related to items of other comprehensive income	229,509	623,433	204,697	893,937
Other comprehensive loss for the period, net of tax	(30,352,014)	(36,143,967)	(30,086,108)	(66,959,980)
Total comprehensive (loss) income	$ (6,556,532)	$ (4,341,465)	$ 16,541,359	$ (31,294,236)

The accompanying notes are an integral part of these statements.

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FIRST BANCORP
PART I NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements (unaudited) have been prepared in conformity with the accounting policies stated in the Corporation s Annual Audited Financial Statements included in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2006. Certain information and note disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) have been condensed or omitted from these statements pursuant to the rules and regulations of the SEC and, accordingly, these financial statements should be read in conjunction with the audited Consolidated Financial Statements of the Corporation for the year ended December 31, 2006, included in the Corporation s 2006 Annual Report on Form 10-K. All adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the statement of financial position, results of operations and cash flows for the interim periods have been reflected. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the quarter and six-month period ended June 30, 2007, are not necessarily indicative of the results to be expected for the entire year.

Recently issued accounting pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. (SFAS) 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 . This Statement allows entities to choose to measure certain financial assets and liabilities at fair value with changes in fair value reflected in earnings. The fair value option may be applied on an instrument-by-instrument basis. This Statement is effective for periods after November 15, 2007, however, early adoption is permitted provided that the entity also elects to apply the provisions of SFAS 157, Fair Value Measurements . The Corporation adopted SFAS 159 and SFAS 157 effective January 1, 2007. The Corporation decided to early adopt SFAS 159 for the callable brokered certificates of deposit (CDs) and a portion of the callable fixed medium-term notes, both of which were hedged with interest rate swaps. First BanCorp had been following the long-haul method of accounting, which was adopted on April 3, 2006, under SFAS 133, Accounting for Derivative Instruments and Hedging Activities , for the portfolio of callable interest rate swaps, callable brokered CDs and callable notes. One of the main considerations in determining to early adopt SFAS 159 for these instruments was to eliminate the operational procedures required by the long-haul method of accounting in terms of documentation, effectiveness assessment, and manual procedures followed by the Corporation to fulfill the requirements specified by SFAS 133.

Upon adoption of SFAS 159, the Corporation selected the fair value measurement for approximately $4.4 billion, or 63%, of the brokered CDs portfolio and approximately $15.4 million, or 9%, of the medium-term notes portfolio (SFAS 159 liabilities). Interest rate risk on the brokered CDs and medium-term notes chosen for the fair value measurement option will continue to be economically hedged through callable interest rate swaps with the same terms and conditions. The cumulative after-tax effect on the opening balance of retained earnings from adopting these standards was an approximate increase of $91.8 million. Under SFAS 159, this one-time credit was not recognized in current earnings.

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With the Corporation s elimination of the use of the long-haul method in connection with the adoption of SFAS 159, the Corporation will no longer amortize or accrete the basis adjustment for the SFAS 159 liabilities. The basis adjustment amortization or accretion is the reversal of the change in value of the hedged brokered CDs and medium-term notes recognized since the implementation of the long-haul method. Since the time the Corporation implemented the long-haul method, it has recognized the basis adjustment and the changes in the value of the hedged brokered CDs and medium-term notes based on the expected call date of the instruments. The adoption of SFAS 159 also requires the recognition, as part of the initial adoption adjustment to retained earnings, of all of the unamortized placement fees that were paid to broker counterparties upon the issuance of the elected brokered CDs and medium-term notes. The Corporation previously amortized those fees through earnings based on the expected call date of the instruments. SFAS 159 also establish that the accrued interest should be reported as part of the fair value of the financial instruments elected to be measured at fair value. The impact of the derecognition of the basis adjustment and the unamortized placement fees as of January 1, 2007 results in a cumulative after-tax reduction to retained earnings of approximately $23.9 million. This negative charge was included in the total cumulative after-tax increase to retained earnings of $91.8 million that resulted with the adoption of SFAS 157 and SFAS 159.

In September 2006, the FASB issued SFAS 157, Fair Value Measurement . This Statement defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. This Statement is effective for periods beginning after November 15, 2007. Effective January 1, 2007, the Corporation elected to early adopt this Statement. For further details and for the effect on the Corporation s financial condition and results of operations upon adoption of SFAS 157 and SFAS 159, refer to Note 14 to these interim unaudited consolidated financial statements.

In June 2006, the FASB issued Financial Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 . This interpretation clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS 109, Accounting for Income Taxes . This interpretation provides a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This interpretation is effective for periods beginning after December 15, 2006. The Corporation adopted FIN 48 effective January 1, 2007. Refer to Note 13 to these interim unaudited consolidated financial statements for required disclosures and further information on the impact of the adoption of this accounting pronouncement.

In March 2006, the FASB issued SFAS 156, Accounting for Servicing of Financial Assets, an amendment of SFAS 140. This Statement allows servicing assets and servicing liabilities to be initially measured at fair value along with any derivative instruments used to mitigate inherent risks. This Statement is effective for fiscal years beginning after September 15, 2006. The adoption of this Statement in 2007 did not have a material effect on the Corporation s financial condition and results of operations as the Corporation continues to utilize the amortization method.

On April 30, 2007, the FASB issued FASB Staff Position No. FIN 39-1 (FSP FIN 39-1), which amends FASB interpretation No. 39, Offsetting of Amounts Related to Certain Contracts (FIN 39) . FSP FIN 39-1 impacts entities that enter into master netting arrangements as part of their derivative transactions by allowing net derivative positions to be offset in the financial statements against the fair value of amounts (or amounts that approximate fair value) recognized for the right to reclaim cash collateral or the obligation to return cash collateral under those arrangements. FSP FIN 39-1 is effective for fiscal years beginning after November 15, 2007, although early application is permitted. The Corporation is currently evaluating the effect, if any, of the adoption of FSP FIN 39-1 on its Financial Statements, commencing on January 1, 2008.

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2 EARNINGS PER COMMON SHARE

The calculations of earnings per common share for the quarters and six-month periods ended on June 30, 2007 and 2006 are as follows:

	Quarter Ended June 30,		Six-Month Period Ended June 30,	
	2007	2006	2007	2006
	(In thousands, except per share data)			
Net Income:				
Net Income	$ 23,795	$ 31,803	$ 46,627	$ 35,666
Less: Preferred stock dividend	(10,069)	(10,069)	(20,138)	(20,138)
Net income available to common stockholders	$ 13,726	$ 21,734	$ 26,489	$ 15,528
Weighted-Average Shares:				
Basic weighted average common shares outstanding	83,254	83,254	83,254	82,410
Average potential common shares	622	158	503	498
Diluted weighted average number of common shares outstanding	83,876	83,412	83,757	82,908
Earnings per common share:				
Basic	$ 0.16	$ 0.26	$ 0.32	$ 0.19
Diluted	$ 0.16	$ 0.26	$ 0.32	$ 0.19

Potential common shares consist of common stock issuable under the assumed exercise of stock options using the treasury stock method. This method assumes that the potential common shares are issued and the proceeds from exercise are used to purchase common stock at the exercise date. The difference between the number of potential shares issued and the shares purchased is added as incremental shares to the actual number of shares outstanding to compute diluted earnings per share. Stock options that result in lower potential shares issued than shares purchased under the treasury stock method are not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect in earnings per share. For the quarter and six-month period ended June 30, 2007, a total of 2,054,600 stock options were not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect on earnings per share.

3 STOCK OPTION PLAN

Since 1997, the Corporation has had a stock option plan (the 1997 stock option plan) covering certain employees. This plan allowed for the granting of up to 8,696,112 purchase options on shares of the Corporation s common stock to certain employees. According to the plan, the options granted cannot exceed 20% of the number of common shares outstanding. Each option provides for the purchase of one share of common stock at a price not less than the fair market value of the stock on the date the option is granted. Stock options are fully vested upon issuance. The maximum term to exercise the options is ten years. The stock option plan provides for a proportionate adjustment in the exercise price and the number of shares that can be purchased in the event of a stock dividend, stock split, reclassification of stock, merger or reorganization and certain other issuances and distributions such as stock appreciation rights.

Under the Corporation s stock option plan, the Compensation Committee had the authority to grant stock appreciation rights at any time subsequent to the grant of an option. Pursuant to the stock appreciation rights, the Optionee surrenders the right to exercise an option granted under the plan in consideration for payment by the Corporation of an amount equal to the excess of the fair market value of the shares of common stock subject to such option surrendered over the total option price of such shares. Any option surrendered shall be cancelled by the Corporation and the shares subject to the option shall not be eligible for further grants under the option plan. The 1997 stock option plan expired in the first quarter of 2007.

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On January 1, 2006, the Corporation adopted SFAS 123R, Share-Based Payment using the modified prospective method. Using this method, and since all previously issued stock options were fully vested at the time of the adoption, the Corporation expenses the fair value of all employee stock options granted after January 1, 2006 (same as the prospective method). The compensation expense associated with stock options for the six-month periods ended June 30, 2007 and 2006 was approximately $2.8 million and $4.9 million, respectively. All employee stock options granted during 2007 and 2006 were fully vested at the time of grant.

The activity of stock options during the first six-months of 2007 is set forth below:

	Six-Month Period Ended June 30, 2007			
	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Beginning of period	3,024,410	$ 13.95		
Options granted	1,170,000	9.20		
End of period outstanding and exercisable	4,194,410	$ 12.63	7.4	$ 4,403

The fair value of options granted in 2007 and 2006, that was estimated using the Black-Scholes option pricing, and the assumptions used are as follows:

	2007	2006
Weighted average stock price at grant date and exercise price	$ 9.20	$ 12.68
Stock option estimated fair value	$ 2.40 $2.45	$ 4.56 $4.60
Weighted-average estimated fair value	$ 2.43	$ 4.57
Expected stock option term (years)	4.31 4.59	4.22 4.31
Expected volatility	32%	46%
Expected dividend yield	3.0%	2.2%
Risk-free interest rate	5.1%	4.7% 5.0%

The Corporation uses empirical research data to estimate option exercises and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected volatility is based on the historical implied volatility of the Corporation s common stock at each grant date. The dividend yield is based on the historical 12-month dividend yield observable at each grant date. The risk-free rate for the periods is based on historical zero coupon curves obtained from Bloomberg L.P. at the time of grant based on the option expected term.

No stock options were exercised during the first half of 2007. The total intrinsic value of options exercised during the first half of 2006 was approximately $10.0 million. Cash proceeds from options exercised during the first half of 2006 amounted to approximately $19.8 million.

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4 INVESTMENT SECURITIES

Investment Securities Available for Sale

The amortized cost, gross unrealized gains and losses, approximate fair value, weighted-average yield and contractual maturities of investment securities available for sale as of June 30, 2007 and December 31, 2006 were as follows:

	June 30, 2007					December 31, 2006				
	Amortized cost	Gross Unrealized gains	Gross Unrealized losses	Fair value	Weighted average yield%	Amortized cost	Gross Unrealized gains	Gross Unrealized losses	Fair value	Weighted average yield%
	(Dollars in thousands)									
Obligations of U.S. Government sponsored agencies:										
After 5 to 10 years	$ 401,874	$	$ 18,815	$ 383,059	4.30	$ 402,542	$ 6	$ 11,820	$ 390,728	4.31
After 10 years	12,984		166	12,818	6.16	12,984		120	12,864	6.16
Puerto Rico Government obligations:										
After 1 to 5 years	5,210	124		5,334	6.23	4,635	126		4,761	6.18
After 5 to 10 years	15,580	102	524	15,158	4.85	15,534	219	508	15,245	4.86
After 10 years	4,948	41	254	4,735	5.86	5,376	98	178	5,296	5.88
United States and Puerto Rico Government obligations	440,596	267	19,759	421,104	4.42	441,071	449	12,626	428,894	4.43
Mortgage-backed securities:										
FHLMC certificates:										
Within 1 year	70			70	5.52	82			82	5.99
After 1 to 5 years	1,100	26		1,126	6.94	1,666	36		1,702	6.98
After 10 years	5,487	44	243	5,288	5.62	5,846	55	110	5,791	5.61
	6,657	70	243	6,484	5.85	7,594	91	110	7,575	5.92
GNMA certificates:										
After 1 to 5 years	655	7		662	6.49	866	10		876	6.44
After 5 to 10 years	799	4	5	798	5.87	795	3	3	795	5.53
After 10 years	350,976	287	14,747	336,516	5.26	379,363	470	7,136	372,697	5.26
	352,430	298	14,752	337,976	5.26	381,024	483	7,139	374,368	5.26

FNMA certificates:										
After 1 to 5 years	58	1		59	7.22	90			90	7.34
After 5 to 10 years	31,557	10	941	30,626	4.78	18,040	10	305	17,745	4.87
After 10 years	778,579	530	23,990	755,119	5.18	864,508	673	11,476	853,705	5.18
	810,194	541	24,931	785,804	5.16	882,638	683	11,781	871,540	5.17
Mortgage pass-through certificates:										
After 10 years	172,520	176	708	171,988	5.92	367	3		370	7.28
Mortgage-backed securities	1,341,801	1,085	40,634	1,302,252	5.29	1,271,623	1,260	19,030	1,253,853	5.21
Corporate bonds:										
After 5 to 10 years	1,300		85	1,215	7.70	1,300		83	1,217	7.70
After 10 years	4,411		688	3,723	7.97	4,412		668	3,744	7.97
Corporate bonds	5,711		773	4,938	7.90	5,712		751	4,961	7.91
Equity securities (without contractual maturity)	5,686		866	4,820	0.07	12,406	452	143	12,715	3.70
Total investment securities available for sale	$ 1,793,794	$ 1,352	$ 62,032	$ 1,733,114	5.07	$ 1,730,812	$ 2,161	$ 32,550	$ 1,700,423	5.01

Maturities of mortgage-backed securities are based on contractual terms assuming no prepayments. Expected maturities of investments might differ from contractual maturities because they may be subject to prepayments and/or call options. The weighted-average yield on investment securities held for sale is based on amortized cost and, therefore, does not give effect to changes in fair value. The net unrealized gains or losses on available for sale securities are presented as part of accumulated other comprehensive income.

The following tables show the Corporation s available-for-sale investments fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of June 30, 2007 and December 31, 2006:

	As of June 30, 2007					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities						
Obligations of U.S. Government sponsored agencies	$	$	$ 395,877	$ 18,981	$ 395,877	$ 18,981
Puerto Rico Government obligations	1,316	13	13,395	765	14,711	778
Mortgage-backed securities						
FHLMC	87		3,490	243	3,577	243
GNMA	804	10	319,459	14,742	320,263	14,752
FNMA	88,397	2,152	673,604	22,779	762,001	24,931
Mortgage pass-through trust certificates	138,096	708			138,096	708
Corporate bonds			4,938	773	4,938	773
Equity securities	2,154	757	1,662	109	3,816	866
	$ 230,854	$ 3,640	$ 1,412,425	$ 58,392	$ 1,643,279	$ 62,032