

FIRST BANCORP /PR/
Form 10-Q
August 20, 2007

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 June 30, 2006

**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 No

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

Large accelerated filer 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

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

Common stock: 83,254,056 outstanding as of June 30, 2007.

Table of Contents

**FIRST BANCORP.
INDEX PAGE**

	PAGE
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements:	
<u>Consolidated Statements of Financial Condition (Unaudited) as of June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004 (As Restated)</u>	5
<u>Consolidated Statements of Income (Loss) (Unaudited) Quarters ended June 30, 2006, June 30, 2005 and June 30, 2004 (As Restated)</u>	6
<u>Consolidated Statements of Income (Unaudited) Six months ended June 30, 2006, June 30, 2005 and June 30, 2004 (As Restated)</u>	7
<u>Consolidated Statements of Cash Flows (Unaudited) Six months ended June 30, 2006, June 30, 2005 and June 30, 2004 (As Restated)</u>	8
<u>Consolidated Statements of Changes in Stockholders Equity (Unaudited) Six months ended June 30, 2006, June 30, 2005 and June 30, 2004 (As Restated)</u>	9
<u>Consolidated Statements of Comprehensive (Loss) Income (Unaudited) Quarters ended June 30, 2006, June 30, 2005 and June 30, 2004 (As Restated)</u>	10
<u>Consolidated Statements of Comprehensive (Loss) Income (Unaudited) Six months ended June 30, 2006, June 30, 2005 and June 30, 2004 (As Restated)</u>	11
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	12
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	58
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	99
<u>Item 4. Controls and Procedures</u>	99
PART II. OTHER INFORMATION	
<u>Item 1. Legal Proceedings</u>	102
<u>Item 1A. Risk Factors</u>	102
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	102
<u>Item 3. Defaults Upon Senior Securities</u>	102
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	102
<u>Item 5. Other Information</u>	102
<u>Item 6. Exhibits</u>	102
SIGNATURES	
<u>EX-31.1 SECTION 302, CERTIFICATION OF THE CEO</u>	
<u>EX-31.2 SECTION 302, CERTIFICATION OF THE CFO</u>	
<u>EX-32.1 SECTION 906, CERTIFICATION OF THE CEO</u>	
<u>EX-32.2 SECTION 906, CERTIFICATION OF THE CFO</u>	

Table of Contents

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, 2006 and the Quarterly Reports on Form 10-Q for the interim periods ended March 31, 2006, September 30, 2005 and June 30, 2005 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, and Note 1 Restatement of Previously Issued Financial Statements to the accompanying unaudited Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 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;

- a reduction 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 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;

- 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;

Table of Contents

the impact of Doral Financial Corporation's financial condition on its repayment of its outstanding secured loan to the Corporation;

risks associated with being subject to the cease and desist order;

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

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 2005 Annual Report on Form 10-K and under Item 1A, Risk Factors, in this Quarterly Report on Form 10-Q.

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited)

	June 30, 2006	December 31, 2005	June 30, 2005	June 30, 2004 (As Restated)
Assets				
Cash and due from banks	\$ 154,078,088	\$ 155,848,810	\$ 120,388,982	\$ 83,322,262
Money market instruments, including \$116,475,352 pledged that can be repledged (December 31, 2005 - \$381,848,364; June 30, 2005 - \$26,935,605; June 30, 2004 - \$79,896,053)	491,216,635	666,856,432	298,575,528	373,647,963
Federal funds sold and securities purchased under agreements to resell	2,854,968,993	508,967,369	76,828,074	71,000,000
Time deposits with other financial institutions	15,700,581	48,967,475	48,600,000	600,000
Total money market investments	3,361,886,209	1,224,791,276	424,003,602	445,247,963
Investment securities available for sale, at fair value:				
Securities pledged that can be repledged	1,491,948,417	1,744,846,054	1,926,356,118	1,057,627,627
Other investment securities	477,337,762	203,331,449	290,759,261	461,231,520
Total investment securities available for sale	1,969,286,179	1,948,177,503	2,217,115,379	1,518,859,147
Investment securities held to maturity, at amortized cost:				
Securities pledged that can be repledged	2,860,091,466	3,115,260,660	3,382,457,892	3,652,401,464
Other investment securities	427,028,096	323,327,297	395,171,791	518,998,384
Total investment securities held to maturity	3,287,119,562	3,438,587,957	3,777,629,683	4,171,399,848
Other equity securities	23,689,185	42,367,500	74,480,500	61,525,000
Loans, net of allowance for loan and lease losses of \$146,527,295 (December 31, 2005 -	10,678,089,256	12,436,257,993	11,677,782,192	7,833,278,755

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

\$147,998,733; June 30, 2005 -
 \$146,154,217; June 30, 2004 -
 \$133,677,676)

Loans held for sale, at lower of cost or market	80,642,512	101,672,531	49,032,689	19,053,120
Total loans, net	10,758,731,768	12,537,930,524	11,726,814,881	7,852,331,875
Premises and equipment, net	124,559,046	116,947,772	109,609,464	85,905,256
Other real estate owned	3,435,018	5,019,106	8,462,735	5,598,892
Accrued interest receivable on loans and investments	98,829,053	103,692,478	90,915,598	51,857,846
Due from customers on acceptances	29,594	353,864	208,180	328,003
Other assets	399,234,133	343,933,937	264,648,604	212,773,470
Total assets	\$ 20,180,877,835	\$ 19,917,650,727	\$ 18,814,277,608	\$ 14,489,149,562

Liabilities & Stockholders

Equity

Liabilities:

Non-interest-bearing deposits	\$ 711,284,391	\$ 811,006,126	\$ 791,509,595	\$ 601,853,783
Interest-bearing deposits	12,801,778,910	11,652,746,080	10,329,950,256	6,404,758,089
Federal funds purchased and securities sold under agreements to repurchase	4,022,685,500	4,833,882,000	5,017,096,000	4,358,019,937
Advances from the Federal Home Loan Bank (FHLB)	194,000,000	506,000,000	638,000,000	1,223,000,000
Notes payable	176,851,393	178,693,249	177,925,832	152,614,465
Other borrowings	231,670,313	231,622,020	231,572,927	147,777,158
Subordinated notes			82,554,150	82,017,643
Bank acceptance outstanding	29,594	353,864	208,180	328,003
Payable for unsettled investment trade	204,716,709			198,574,653
Accounts payable and other liabilities	678,438,050	505,506,453	256,478,764	240,436,594
Total liabilities	19,021,454,860	18,719,809,792	17,525,295,704	13,409,380,325

Commitments and contingencies
 (Note 17)

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	550,100,000	550,100,000
	93,151,856	90,772,856	90,772,856	45,137,055

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Common stock, \$1 par value, authorized 250,000,000 shares; issued 93,151,856 shares (December 31, 2005 - 90,772,856 shares ; June 30, 2005 - 90,772,856 shares; June 30, 2004 - 45,137,055 shares)				
Less: Treasury Stock (at par value)	(9,897,800)	(9,897,800)	(9,897,800)	(4,920,900)
Common stock outstanding	83,254,056	80,875,056	80,875,056	40,216,155
Additional paid-in capital	22,269,844			2,322,541
Capital reserve			82,825,000	80,000,000
Legal surplus	265,844,192	265,844,192	183,019,192	165,709,122
Retained earnings	320,590,147	316,696,971	356,174,402	219,360,864
Accumulated other comprehensive (loss) income, net of tax benefit (expense) of \$1,096,149 (December 31, 2005 - \$16,259; June 30, 2005 - (\$1,131,814); June 30, 2004 (\$1,083,277))	(82,635,264)	(15,675,284)	35,988,254	22,060,555
Total stockholders equity	1,159,422,975	1,197,840,935	1,288,981,904	1,079,769,237
Total liabilities and stockholders equity	\$ 20,180,877,835	\$ 19,917,650,727	\$ 18,814,277,608	\$ 14,489,149,562

The accompanying notes are an integral part of these statements.

Table of Contents

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

	Quarter Ended		
	June 30,	June 30,	June 30,
	2006	2005	2004
			(As Restated)
Interest income:			
Loans	\$ 247,603,929	\$ 173,727,352	\$ 106,648,154
Investment securities	72,040,513	73,279,552	53,407,925
Money market investments	24,799,009	2,149,850	546,271
Total interest income	344,443,451	249,156,754	160,602,350
Interest expense:			
Deposits (Note 11)	157,153,731	(2,293,618)	115,946,948
Federal funds purchased and repurchase agreements	51,133,513	43,683,484	31,859,683
Advances from FHLB	2,867,071	10,864,801	5,816,720
Notes payable and other borrowings	7,051,194	3,831,914	1,995,260
Total interest expense	218,205,509	56,086,581	155,618,611
Net interest income	126,237,942	193,070,173	4,983,739
Provision for loan and lease losses	9,354,590	11,074,364	13,200,150
Net interest income (loss) after provision for loan and lease losses	116,883,352	181,995,809	(8,216,411)
Non-interest income:			
Other service charges on loans	1,467,127	1,537,338	950,278
Service charges on deposit accounts	3,278,109	3,022,163	2,742,265
Mortgage banking activities	427,171	3,060,375	216,512
Loss on partial extinguishment of a secured commercial loan to a local financial institution	(11,640,344)		
Net gain (loss) on investments and impairments	134,224	(1,181,245)	551,249
Rental income	837,380	842,926	702,269
Gain on sale of credit card portfolio			297,141
Other operating income	7,279,281	6,137,747	6,687,174
Total non-interest income	1,782,948	13,419,304	12,146,888
Non-interest expenses:			

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Employees compensation and benefits	29,869,779	26,273,340	21,238,355
Occupancy and equipment	13,623,498	11,765,517	9,441,913
Business promotion	4,324,181	5,085,493	4,587,629
Professional fees	10,143,207	1,512,345	1,206,648
Taxes, other than income taxes	2,558,071	2,285,305	1,950,640
Insurance and supervisory fees	1,909,550	1,126,818	1,010,108
Other operating expenses	8,611,833	8,024,006	6,149,355
Total non-interest expenses	71,040,119	56,072,824	45,584,648
Income (Loss) before income taxes	47,626,181	139,342,289	(41,654,171)
Income tax (provision) benefit	(15,823,679)	(41,936,222)	23,462,553
Net income (loss)	\$ 31,802,502	\$ 97,406,067	\$ (18,191,618)
Net income (loss) attributable to common stockholders	\$ 21,733,503	\$ 87,337,068	\$ (28,260,617)
Net income (loss) per common share:			
Basic	\$ 0.26	\$ 1.08	\$ (0.35)
Diluted	\$ 0.26	\$ 1.05	\$ (0.35)
Dividends declared per common share	\$ 0.07	\$ 0.07	\$ 0.06

The accompanying notes are an integral part of these statements.

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Six Month Period Ended		
	June 30,	June 30,	June 30,
	2006	2005	2004
			(As Restated)
Interest income:			
Loans	\$ 493,693,236	\$ 327,452,238	\$ 210,643,533
Investment securities	143,681,230	130,064,347	99,512,167
Money market investments	34,773,873	4,016,966	1,263,416
Total interest income	672,148,339	461,533,551	311,419,116
Interest expense:			
Deposits (Note 11)	343,991,804	91,688,341	102,566,520
Federal funds purchased and repurchase agreements	104,699,042	78,057,783	60,191,371
Advances from FHLB	7,044,803	22,289,803	11,116,741
Notes payable and other borrowings	17,356,139	11,151,098	3,774,473
Total interest expense	473,091,788	203,187,025	177,649,105
Net interest income	199,056,551	258,346,526	133,770,011
Provision for loan and lease losses	28,730,477	22,028,773	26,400,150
Net interest income after provision for loan and lease losses	170,326,074	236,317,753	107,369,861
Non-interest income:			
Other service charges on loans	2,953,397	2,658,565	2,105,577
Service charges on deposit accounts	6,555,138	5,711,715	5,525,679
Mortgage banking activities (loss) gain	(147,676)	3,570,081	1,761,966
Loss on partial extinguishment of a secured commercial loan to a local financial institution	(11,640,344)		
Net (loss) gain on investments and impairments	(574,544)	8,332,319	4,515,895
Rental income	1,610,670	1,708,824	1,318,943
Gain on sale of credit card portfolio			5,532,684
Other operating income	13,614,497	11,689,059	12,349,685
Total non-interest income	12,371,138	33,670,563	33,110,429
Non-interest expenses:			

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Employees compensation and benefits	63,994,700	49,588,472	40,973,904
Occupancy and equipment	26,329,588	22,404,990	18,819,711
Business promotion	8,098,241	9,633,016	8,056,683
Professional fees	17,536,173	3,407,896	1,940,694
Taxes, other than income taxes	5,113,340	4,554,322	3,898,663
Insurance and supervisory fees	3,610,562	2,190,359	2,086,206
Other operating expenses	18,095,170	17,300,901	12,538,934
Total non-interest expenses	142,777,774	109,079,956	88,314,795
Income before income taxes	39,919,438	160,908,360	52,165,495
Income tax provision	(4,253,694)	(38,287,352)	(4,927,461)
Net income	\$ 35,665,744	\$ 122,621,008	\$ 47,238,034
Net income attributable to common stockholders	\$ 15,527,746	\$ 102,483,010	\$ 27,100,036
Net income per common share:			
Basic	\$ 0.19	\$ 1.27	\$ 0.34
Diluted	\$ 0.19	\$ 1.23	\$ 0.33
Dividends declared per common share	\$ 0.14	\$ 0.14	\$ 0.12

The accompanying notes are an integral part of these statements.

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Month Period Ended		
	June 30, 2006	June 30, 2005	June 30, 2004 (As Restated)
Cash flows from operating activities:			
Net income	\$ 35,665,744	\$ 122,621,008	\$ 47,238,034
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	8,355,081	7,207,113	6,820,263
Amortization of core deposit intangible	1,778,206	1,531,195	1,198,310
Provision for loan and lease losses	28,730,477	22,028,773	26,400,150
Deferred income tax (benefit) provision	(26,536,609)	6,836,248	(23,016,105)
Stock-based compensation recognized	4,892,361		
Gain on sale of investments, net	(2,375,344)	(9,831,385)	(4,571,895)
Other-than-temporary impairments on available-for-sale securities	2,949,888	1,499,066	56,000
Unrealized loss (gain) on derivative instruments	66,808,911	(21,208,082)	39,099,604
Net loss (gain) on sale of loans and impairments	412,663	(3,632,444)	(1,630,338)
Net loss on partial extinguishment of a secured commercial loan to a local financial institution	11,640,344		
Net amortization of premiums and discounts and deferred loan fees and costs	(921,749)	(52,556)	497,921
Amortization of broker placement fees	8,718,909	6,458,804	6,489,595
Amortization of basis adjustments on fair value hedges	1,303,698		
Net (accretion) of discount and premiums on investment securities	(17,820,409)	(13,578,601)	(2,063,011)
Amortization of discount on subordinated notes		273,732	252,255
Gain on sale of credit card portfolio			(5,532,684)
(Decrease) increase in accrued income tax payable	(8,693,921)	10,779,823	(6,990,817)
Decrease (increase) in accrued interest receivable	5,259,986	(31,219,146)	(10,321,401)
Increase (decrease) in accrued interest payable	36,556,819	14,802,998	(591,982)
Increase in other assets	(17,486,355)	(22,369,649)	(13,491,051)
Increase in other liabilities	17,472,725	33,796,853	12,233,579
Total adjustments	121,045,681	3,322,742	24,838,393
Net cash provided by operating activities	156,711,425	125,943,750	72,076,427
Cash flows from investing activities:			
Principal collected on loans	4,338,010,938	1,663,180,818	1,128,004,727
Loans originated	(2,553,227,124)	(3,321,376,774)	(2,136,304,633)
Purchase of loans	(106,750,392)	(198,647,852)	(85,473,896)

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Proceeds from sale of loans	36,900,103	120,682,234	66,854,112
Proceeds from sale of repossessed assets	20,920,391	15,738,479	17,001,718
Purchase of servicing assets	(378,823)		
Proceeds from sale of available for sale securities	22,846,966	214,679,492	19,270,030
Purchase of securities held to maturity	(208,568,307)	(1,346,491,031)	(1,518,661,039)
Purchase of securities available for sale	(21,401,938)	(1,220,389,587)	(287,973,621)
Principal repayments and maturities of securities held to maturity	378,026,709	961,239,896	489,374,732
Principal repayments of securities available for sale	113,168,384	143,229,805	204,490,303
Additions to premises and equipment	(15,966,355)	(13,377,504)	(7,456,117)
Decrease (increase) in other equity securities	18,678,315	9,577,600	(15,500,000)
Cash paid for net assets acquired in acquisition of business		(78,404,804)	
Net cash provided by (used in) investing activities	2,022,258,867	(3,050,359,228)	(2,126,373,684)
Cash flows from financing activities:			
Net increase in deposits	1,091,566,504	2,765,590,448	229,206,892
Net (decrease) increase in federal funds purchased and securities sold under repurchase agreements	(811,196,500)	851,735,087	718,547,594
Net FHLB advances (paid) taken	(312,000,000)	(1,000,000,000)	310,000,000
Net proceeds from issuance of notes payable and other borrowings			300,543,766
Repayments of notes payable and other borrowings		(45,167,616)	
Dividends paid	(31,772,568)	(31,454,295)	(29,781,163)
Exercise of stock options	19,756,483	2,094,354	2,242,556
Treasury stock acquired		(965,079)	
Net cash (used in) provided by financing activities	(43,646,081)	2,541,832,899	1,530,759,645
Net increase (decrease) in cash and cash equivalents	2,135,324,211	(382,582,579)	(523,537,612)
Cash and cash equivalents at beginning of period	1,380,640,086	926,975,163	1,052,107,837
Cash and cash equivalents at end of period	\$ 3,515,964,297	\$ 544,392,584	\$ 528,570,225
Cash and cash equivalents include:			
Cash and due from banks	\$ 154,078,088	\$ 120,388,982	\$ 83,322,262
Money market instruments	3,361,886,209	424,003,602	445,247,963
	\$ 3,515,964,297	\$ 544,392,584	\$ 528,570,225
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest on borrowings	\$ 353,284,025	\$ 257,982,428	\$ 191,191,736
Income Taxes	37,680,255	20,688,295	30,573,369
Non-cash investing and financing activities:			
Additions to other real estate owned	\$ 1,569,586	\$ 2,298,085	\$ 2,879,412
Additions to auto repossessions	52,739,918	27,613,054	20,557,521

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Capitalization of servicing assets	235,191	1,477,600	903,400
Mortgage loans securitized and transferred to securities available-for-sale			51,107,154

The accompanying notes are an integral part of these statements.

8

Table of Contents

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

	Six Month Period Ended		
	June 30, 2006	June 30, 2005	June 30, 2004 (As Restated)
Preferred Stock	\$ 550,100,000	\$ 550,100,000	\$ 550,100,000
Common Stock outstanding:			
Balance at beginning of period	80,875,056	40,389,155	40,027,285
Common stock issued under stock option plan	2,379,000	76,373	188,870
Treasury stock acquired before stock split		(28,000)	
Shares issued as a result of stock split		40,437,528	
Balance at end of period	83,254,056	80,875,056	40,216,155
Additional Paid-In-Capital:			
Balance at beginning of period		4,863,299	268,855
Shares issued under stock option plan	17,377,483	2,017,981	2,053,686
Stock-based compensation recognized	4,892,361		
Treasury stock acquired		(937,079)	
Adjustment for stock split		(5,944,201)	
Balance at end of period	22,269,844		2,322,541
Capital Reserve		82,825,000	80,000,000
Legal Surplus	265,844,192	183,019,192	165,709,122
Retained Earnings:			
Balance at beginning of period	316,696,971	299,501,016	201,903,993
Net income	35,665,744	122,621,008	47,238,034
Cash dividends declared on common stock	(11,634,570)	(11,316,297)	(9,643,165)
Cash dividends declared on preferred stock	(20,137,998)	(20,137,998)	(20,137,998)
Adjustment for stock split		(34,493,327)	
Balance at end of period	320,590,147	356,174,402	219,360,864
Accumulated Other Comprehensive (Loss) Income, net of tax:			
Balance at beginning of period	(15,675,284)	43,635,624	35,812,500

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Other comprehensive loss, net of tax	(66,959,980)	(7,647,370)	(13,751,945)
Balance at end of period	(82,635,264)	35,988,254	22,060,555
Total stockholders' equity	\$ 1,159,422,975	\$ 1,288,981,904	\$ 1,079,769,237

The accompanying notes are an integral part of these statements.

9

Table of Contents

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

	Quarter Ended		
	June 30,	June 30,	June 30,
	2006	2005	2004
			(As Restated)
Net income (loss)	\$ 31,802,502	\$ 97,406,067	\$ (18,191,618)
Other comprehensive (loss) income:			
Unrealized (loss) gain on securities:			
Unrealized holding (loss) gain arising during the period	(36,633,176)	22,377,837	(19,739,660)
Less: Reclassification adjustments for net (gain) loss and other than temporary impairments included in net income	(134,224)	1,181,245	(551,249)
Income tax benefit (expense) related to items of other comprehensive income	623,433	(578,742)	297,219
Other comprehensive (loss) income for the period, net of tax	(36,143,967)	22,980,340	(19,993,690)
Total comprehensive (loss) income	\$ (4,341,465)	\$ 120,386,407	\$ (38,185,308)

The accompanying notes are an integral part of these statements.

Table of Contents

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

	Six Month Period Ended		
	June 30, 2006	June 30, 2005	June 30, 2004 (As Restated)
Net income	\$ 35,665,744	\$ 122,621,008	\$ 47,238,034
Other comprehensive (loss) income:			
Unrealized (loss) gain on securities:			
Unrealized holding (loss) gain arising during the period	(68,428,461)	922,367	(8,765,854)
Less: Reclassification adjustments for net loss (gain) and other than temporary impairments included in net income	574,544	(8,332,319)	(4,515,895)
Income tax benefit (expense) related to items of other comprehensive income	893,937	(237,418)	(470,196)
Other comprehensive loss for the period, net of tax	(66,959,980)	(7,647,370)	(13,751,945)
Total comprehensive (loss) income	\$ (31,294,236)	\$ 114,973,638	\$ 33,486,089

Table of Contents

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

1 RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS

As previously reported, on December 13, 2005 the Corporation concluded that its financial statements for the interim and annual periods from January 1, 2000 through March 31, 2005 should no longer be relied upon and that its consolidated financial statements for some or all of the periods included therein should be restated (the 2004 restatement). On September 26, 2006, the Corporation filed with the SEC an Amended Annual Report on Form 10-K/A restating its audited financial statements for the years ended December 31, 2004, 2003 and 2002. The following provides a brief description of the principal accounting adjustments included in the 2004 restatement of the Corporation s consolidated financial statements and the effect of the adjustments on the Corporation s Consolidated Statement of Financial Condition as of June 30, 2004, its Consolidated Statements of Income for the quarter and six month period ended June 30, 2004 and its Consolidated Statement of Cash Flows for the six month period ended June 30, 2004. In addition, with the filing of its 2006 Annual Report on Form 10-K, First BanCorp restated its 2005 and 2004 Statements of Cash Flows due to some incorrect classifications. The classification errors related to three main items: 1) the treatment of discounts and the related accretion activity on certain investment securities (mostly zero coupon securities), 2) the classification of cash flows from the disposition of repossessed assets, and 3) purchases of zero coupon bonds and agency discount notes amounts presented as part of investing activities (the 2006 restatement). All financial information for the quarter and six month period ended June 30, 2004 included in any subsequent notes is presented on a restated basis. A more detailed description of the accounting adjustments made in connection with the 2004 restatement, as well as a background discussion of the 2004 restatement, is included in Note 1 Restatement of Previously Issued Financial Statements to First Bancorp audited Consolidated Financial Statements, included in the Corporation s amended 2004 Annual Report on Form 10-K. A more detailed description of the accounting adjustments made in connection with the 2006 restatement, is included in Note 1 Restatement of 2005 and 2004 Consolidated Statements of Cash Flows to First BanCorp audited Consolidated Financial Statements, included in the Corporation s 2006 Annual Report on Form 10-K.

As discussed in more detail below, First BanCorp has separately quantified the impact of various accounting adjustments on its interim unaudited Consolidated Financial Statements.

Table of Contents**RECONCILIATION OF PREVIOUSLY REPORTED TO RESTATED FIGURES
CONSOLIDATED STATEMENT OF FINANCIAL CONDITION**

<i>(In thousands)</i>	As of June 30, 2004
Cash and due from banks (no adjustment required)	\$ 83,322
Money market investments, as previously reported	\$ 442,929
Impact of accounting errors and corrections:	
Reclassifications	2,319
Money market investments, as restated	\$ 445,248
Investment securities including FHLB Stock, as previously reported	\$ 5,854,954
Impact of accounting errors and corrections:	
Accounting for investment securities	(4,025)
Recharacterization of pass-through certificates as secured loans	(96,826)
Reclassifications	(2,319)
Investment securities including FHLB stock, as restated	\$ 5,751,784
Total loans, net of allowance for loan and lease losses, as previously reported	\$ 7,758,586
Impact of accounting errors and corrections:	
Accounting for derivative instruments and broker placement fees	232
Accounting for origination fees and costs and premiums and discounts on loans	(2,067)
Recharacterization of pass-through certificates as secured loans	96,826
Reclassifications	539
Other accounting adjustments	(1,784)
Total loans, net of allowance for loan and lease losses, as restated	\$ 7,852,332
Total other assets, as previously reported	\$ 325,029
Impact of accounting errors and corrections:	
Accounting for derivative instruments and broker placement fees	708
Tax impact of accounting adjustments	30,413
Reclassifications	(1,318)
Valuation of financial instruments	1,200
Other accounting adjustments	431
Total other assets, as restated	\$ 356,463

Total assets, as restated	\$ 14,489,149
Total liabilities, as previously reported	\$ 13,335,970
Impact of accounting errors and corrections:	
Accounting for derivative instruments and broker placement fees	73,858
Tax impact of accounting adjustments	1,456
Reclassifications	(779)
Other accounting adjustments	(1,125)
Total liabilities, as restated	\$ 13,409,380
Stockholders' equity, as previously reported	\$ 1,128,850
Impact of accounting errors and corrections:	
Accounting for derivative instruments and broker placement fees	(73,372)
Accounting for investment securities	(2,922)
Accounting for origination fees and costs and premiums and discounts on loans	(2,067)
Valuation of financial instruments	1,200
Tax impact of accounting adjustments	28,957
Impact of accounting adjustments in other comprehensive income	(649)
Other accounting adjustments	(228)
Stockholders' equity, as restated	\$ 1,079,769

Table of Contents**RECONCILIATION OF PREVIOUSLY REPORTED TO RESTATED FIGURES
CONSOLIDATED STATEMENT OF INCOME**

	Quarter Ended June 30, 2004	Six Month Period Ended June 30, 2004
<i>(In thousands, except per share amounts)</i>		
Net interest income, as previously reported	\$ 94,278	\$ 178,481
Impact of accounting errors and corrections:		
Accounting for derivative instruments and broker placement fees	(86,898)	(47,163)
Accounting for investment securities	(4,885)	(4,312)
Accounting for origination fees and costs and premiums and discounts on loans	155	294
Reclassification of late charges, penalty fees on loans and other	2,226	6,242
Other accounting adjustments	108	228
Net interest income, as restated	\$ 4,984	\$ 133,770
Provision for loan and lease losses (no adjustment required)	\$ 13,200	\$ 26,400
Non-interest income, as previously reported	\$ 13,650	\$ 37,648
Impact of accounting errors and corrections:		
Accounting for derivative instruments and broker placement fees	962	1,386
Accounting for origination fees and costs and premiums and discounts on loans	(671)	(1,299)
Reclassification of late charges, penalty fees on loans and other	(2,226)	(6,242)
Valuation of financial instruments		1,200
Other accounting adjustments	431	417
Non-interest income, as restated	\$ 12,146	\$ 33,110
Non-interest expenses, as previously reported	\$ 45,510	\$ 88,668
Impact of accounting errors and corrections:		
Accounting for origination fees and costs and premiums and discounts on loans	(274)	(525)
Other accounting adjustments	349	172
Non-interest expenses, as restated	\$ 45,585	\$ 88,315
Income tax expense, as previously reported	\$ (9,283)	\$ (20,922)
Impact of accounting errors and corrections	32,746	15,995

Income tax benefit (expense), as restated	\$	23,463	\$	(4,927)
Net (loss) income, as restated	\$	(18,192)	\$	47,238
Basic earnings per common share, as previously reported	\$	0.37	\$	0.75
Effect of adjustments		(0.72)		(0.41)
Basic (loss) earnings per common share, as restated	\$	(0.35)	\$	0.34
Diluted earnings per common share, as previously reported	\$	0.36	\$	0.73
Effect of adjustments		(0.71)		(0.40)
Diluted (loss) earnings per common share, as restated	\$	(0.35)	\$	0.33

The Corporation classified the accounting practices and related adjustments that were affected by the restatement into the categories described below.

Accounting for Derivative Instruments and Broker Placement Fees. As part of the restatement, the Corporation reviewed its accounting for derivative instruments and concluded that its use of the short-cut method of hedge accounting under Statement of Financial Accounting Standard No. (SFAS) 133, *Accounting for Derivative Instruments and Hedging Activities*, for interest rate swaps that economically hedge mainly brokered certificates of deposit (CDs) was not consistent with generally accepted accounting principles in the United States of America (GAAP) because the fee received from the swap counterparty at the inception of the relationship caused the swap not to have a fair value of zero at inception (which is required under SFAS 133 to qualify for the short-cut method). In connection with the evaluation of hedge accounting transactions, the Corporation concluded that the short-cut method was also incorrectly used for certain interest rate swaps hedging medium-term notes, certain corporate bonds and certain commercial loan receivables.

Table of Contents

Prior to the restatement, the Corporation recorded, under the short-cut method, the effective portion of the change in fair value of the hedged item as an adjustment to income that offsets the fair value adjustment on the related interest rate swap. Furthermore, prior to the restatement, the broker placement fees were offset with the upfront fees received from the swap counterparties at inception with no separate accounting recognition.

The adjustments related to the correction of the accounting for derivative instruments and broker placement fees primarily consisted of: (1) eliminating the fair value adjustments previously made to the brokered CDs, medium-term notes and other hedged items; (2) recognizing the fair value of the interest rate swaps at inception, which is the equivalent of the upfront fees received from swap counterparties; (3) recognizing the placement fees paid to the brokers that placed the brokered CDs and medium-term notes as deferred costs required to be amortized over the expected maturities of the related economically hedged items; and (4) correcting the fair value of the interest rate swaps as of the end of each reporting period.

The net cumulative pre-tax effect through June 30, 2004 related to the correction of the accounting for derivative instruments and broker placement fees was a decrease of \$73.4 million. The following table details the components of the pre-tax income effect from the correction in the accounting for interest rate swaps and broker placement fees for the quarter and six month period ended June 30, 2004:

	Quarter Ended June 30, 2004	Six Month Period Ended June 30, 2004
Elimination of fair value adjustments previously made to hedged items	\$ (88,770)	\$ (49,154)
Recognition of interest rate swap up-front fees	7,521	12,741
Broker placement fees amortization	(1,240)	(5,535)
Corrections to interest rate swap valuations	(3,447)	(3,829)
Total	\$ (85,936)	\$ (45,777)

Recharacterization of purchases of mortgage loans and pass-through trust certificates as commercial loans secured by mortgage loans. Prior to the restatement, the Corporation had inaccurately recorded as purchases of residential mortgages, commercial mortgage loans and pass-through trust certificates certain mortgage-related transactions with local financial institutions. Certain of these transactions included or likely included recourse provisions, which had not been analyzed as part of the Corporation's financial reporting process. The Corporation determined that such transactions did not satisfy the reasonable assurance standard of SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, regarding the isolation of assets in bankruptcy, with the result that they did not qualify as a true sale for accounting purposes. The restatement reflects these mortgage-related transactions as commercial loans secured by mortgage loans and pass-through trust certificates. This conclusion resulted in the revised classification of approximately \$2.7 billion in mortgage-related loans to secured loans to local financial institutions as of June 30, 2004 and \$96.8 million pass-through trust certificates to secured loans to local financial institutions as of June 30, 2004. The recharacterization of the mortgage-related transactions did not impact the Corporation's retained earnings as of June 30, 2004.

Accounting for Investment Securities. The Corporation historically amortized premiums and discounts related to most of its investment securities into interest income over the life of the related securities using a straight-line method adjusted for prepayment of securities. As part of the restatement, the Corporation concluded that it needed to correct its methodology and adjust its financial statements to reflect the amortization of premiums and discounts into interest income over the terms of the securities using the effective interest method instead of the straight-line method. The cumulative effect of this correction on the Corporation's pre-tax income through June 30, 2004 was a decrease of \$2.9 million. For the quarter and six month period ended June 30, 2004 the effect for the correction of the accounting for investment securities was a decrease on the Corporation's pre-tax income of \$4.9 million and \$4.3 million, respectively.

Table of Contents

In addition, the Corporation identified other types of investment instruments that had not been recognized in the Consolidated Statement of Financial Condition in accordance with the provisions of SFAS 115 Accounting for Certain Investments in Debt and Equity Securities.

Accounting for deferral and recognition of origination fees and costs on loans. As part of the restatement process, the Corporation reviewed the methodology used to measure origination fees and costs associated with its loans origination, in accordance with SFAS 91, Accounting for Nonrefundable Fees and Costs Associated with Origination or Acquiring Loans and Initial Direct Costs of Leases, which establishes the accounting treatment for nonrefundable fees and costs associated with lending, committing to lend or purchasing loans. The Corporation concluded that throughout the restatement period, it did not apply SFAS 91 requirements to one of its consumer loans portfolios. Accordingly, the Corporation concluded that, in order to comply with SFAS 91, it needed to defer and amortize loan origination fees and costs on this portfolio using the interest method. The cumulative effect of this correction on the Corporation's pre-tax income through June 30, 2004 was a decrease of approximately \$2.1 million, of which \$0.2 million and \$0.5 million was recorded as a reduction in pre-tax income for the quarter and six month period ended June 30, 2004, respectively.

Valuation of financial instruments. In connection with a loan restructuring, First BanCorp became the holder of warrants. The warrant certificate gives the Corporation the right to purchase common stock from a privately held company at a fixed price. This transaction was not formally evaluated or documented as part of the Corporation's financial reporting process. As part of the restatement process, the Corporation concluded that this transaction meets the definition of a derivative instrument as stated in SFAS 133. Accordingly, the warrant was marked to market and the valuation recognized in earnings as part of Other operating income. The cumulative effect of this correction on the Corporation's pre-tax income through June 30, 2004 was an increase of \$1.2 million, all of which related to the quarter ended March 31, 2004.

Other Accounting Adjustments and Reclassifications. As part of the restatement, the Corporation also made corrections to various other aspects of its Consolidated Financial Statements, including adjustments to the gain on sale of credit card portfolios, accrual of rental expense on lease contracts and income from a loan origination subsidiary. The cumulative effect of all these other adjustments on the Corporation's pre-tax income through June 30, 2004 was a decrease of \$0.2 million, of which approximately \$0.2 million was recorded as an increase to pre-tax income for the quarter ended June 30, 2004 and \$0.5 million was recorded as an increase to pre-tax income for the six month period ended June 30, 2004.

The reclassifications made to conform to GAAP included, among other things, reclassifying late charges and prepayment fees on loans from non-interest income to interest income on loans, and reclassifying dividends on equity securities from non-interest income to interest income on investments. Other reclassifications included reclassifying loans receivable balances within loan categories, reclassifying certain amounts previously reported as repurchase agreements to other borrowings, and reclassifying certain short-term investments previously reported as part of the available for sale and held to maturity investment portfolio to money market investments.

Income Taxes. As a result of the corrections reflected in the restatement, the Corporation's cumulative income tax expense through June 30, 2004 was reduced by approximately \$29.0 million, of which \$32.7 million was recorded as a reduction to income tax expense for the quarter ended June 30, 2004 and \$16.0 million was recorded as a decrease to income tax expense for the six month period ended June 30, 2004. The cumulative reduction through June 30, 2004 resulted principally from changes in deferred taxes. See Note 15 for additional details regarding the Corporation's income taxes.

Table of Contents

The following table shows the impact of all restatement adjustments on the previously reported unaudited Consolidated Statement of Financial Condition as of June 30, 2004.

FIRST BANCORP
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited)

<i>(Dollars in thousands)</i>	June 30, 2004 (As Previously		June 30,
	Reported)	Adjustments	2004 (As
			Restated)
Assets			
Cash and due from banks	\$ 83,322	\$	\$ 83,322
Money market instruments	371,329	2,319	373,648
Federal funds sold and securities purchased under agreements to resell	71,000		71,000
Time deposits with other financial institutions	600		600
Total money market investments	442,929	2,319	445,248
Investment securities available for sale, at fair value:			
Securities pledged that can be repledged	1,154,453	(96,825)	1,057,628
Other investment securities	461,382	(151)	461,231
Total investment securities available for sale	1,615,835	(96,976)	1,518,859
Investment securities held to maturity, at amortized cost:			
Securities pledged that can be repledged	3,656,370	(3,968)	3,652,402
Other investment securities	521,599	(2,601)	518,998
Total investment securities held to maturity	4,177,969	(6,569)	4,171,400
Other equity securities	61,150	375	61,525
Loans, net of allowance for loan and lease losses	7,736,191	97,088	7,833,279
Loans held for sale, at lower of cost or market	22,395	(3,342)	19,053
Total loans, net	7,758,586	93,746	7,852,332
Premises and equipment, net	85,905		85,905
Other real estate owned	5,599		5,599
Accrued interest receivable	52,149	(291)	51,858
Due from customers on acceptances	328		328
Other assets	181,048	31,725	212,773
Total assets	\$ 14,464,820	\$ 24,329	\$ 14,489,149

Liabilities & Stockholders Equity

Liabilities:

Non-interest-bearing deposits	\$	600,217	\$	1,637	\$	601,854
Interest-bearing deposits		6,352,120		52,638		6,404,758
Federal funds purchased and securities sold under agreements to repurchase		4,413,070		(55,050)		4,358,020
Advances from the Federal Home Loan Bank (FHLB)		1,223,000				1,223,000
Notes payable		153,701		(1,087)		152,614
Other borrowings		102,610		45,167		147,777
Subordinated notes		82,820		(802)		82,018
Bank acceptance outstanding		328				328
Payable for unsettled investment trade		198,575				198,575
Accounts payable and other liabilities		209,529		30,907		240,436
Total liabilities		13,335,970		73,410		13,409,380

Stockholders equity:

Preferred stock, authorized 50,000,000 shares: issued and outstanding 22,004,000 shares at \$25 liquidation value per share		550,100				550,100
Common stock, \$1 par value, authorized 250,000,000 shares; issued 45,137,055 shares		45,137				45,137
Less: Treasury Stock (at par value)		(4,921)				(4,921)
Common stock outstanding		40,216				40,216
Additional paid-in capital		2,323				2,323
Capital reserve		80,000				80,000
Legal surplus		163,106		2,603		165,709
Retained earnings		270,396		(51,035)		219,361
Accumulated other comprehensive income, net of tax		22,709		(649)		22,060
Total stockholders equity		1,128,850		(49,081)		1,079,769
Total liabilities and stockholders equity	\$	14,464,820	\$	24,329	\$	14,489,149

Table of Contents

The following tables show the impact of all restatement adjustments on the previously reported unaudited Consolidated Statements of Income and basic and diluted earnings per share for the quarter and six month period ended June 30, 2004.

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

	June 30, 2004	Quarter Ended	June 30, 2004
<i>(In thousands, except per share data)</i>	<i>(As</i>	Adjustments	<i>(As</i>
Interest income:	Previously	Adjustments	Restated)
	Reported)	Adjustments	Restated)
Loans	\$ 103,074	\$ 3,574	\$ 106,648
Investment securities	57,588	(4,180)	53,408
Money market investments	546		546
Total interest income	161,208	(606)	160,602
Interest expense:			
Deposits	26,610	89,337	115,947
Federal funds purchased and repurchase agreements	32,013	(154)	31,859
Advances from FHLB	5,817		5,817
Notes payable and other borrowings	2,490	(495)	1,995
Total interest expense	66,930	88,688	155,618
Net interest income	94,278	(89,294)	4,984
Provision for loan and lease losses	13,200		13,200
Net interest income (loss) after provision for loan and lease losses	81,078	(89,294)	(8,216)
Non-interest income:			
Other service charges on loans	4,218	(3,268)	950
Service charges on deposit accounts	2,743		2,743
Mortgage banking activities	217		217
Net gain on investments and impairments	551		551
Rental income	702		702
Gain on sale of credit card portfolio	297		297
Other operating income	4,922	1,764	6,686
Total other income	13,650	(1,504)	12,146

Non-interest expenses:			
Employees compensation and benefits	21,513	(275)	21,238
Occupancy and equipment	9,447	(5)	9,442
Business promotion	4,588		4,588
Professional fees	1,206		1,206
Taxes, other than income taxes	1,951		1,951
Insurance and supervisory fees	1,010		1,010
Other operating expenses	5,795	355	6,150
Total other operating expenses	45,510	75	45,585
Income before income tax	49,218	(90,873)	(41,655)
Income tax (provision) benefit	(9,283)	32,746	23,463
Net income (loss)	\$ 39,935	\$ (58,127)	\$ (18,192)
Net income (loss) attributable to common stockholders	\$ 29,866	\$ (58,127)	\$ (28,261)
Net income (loss) per common share:			
Basic	\$ 0.37	\$ (0.72)	\$ (0.35)
Diluted	\$ 0.36	\$ (0.71)	\$ (0.35)

Table of Contents

FIRST BANCORP
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	June 30, 2004 (As Previously Reported)	Six Months Ended Adjustments	June 30, 2004 (As Restated)
<i>(In thousands, except per share data)</i>			
Interest income:			
Loans	\$ 203,122	\$ 7,522	\$ 210,644
Investment securities	103,370	(3,858)	99,512
Money market investments	1,263		1,263
Total interest income	307,755	3,664	311,419
Interest expense:			
Deposits	53,657	48,910	102,567
Federal funds purchased and repurchase agreements	60,346	(155)	60,191
Advances from FHLB	11,117		11,117
Notes payable and other borrowings	4,154	(380)	3,774
Total interest expense	129,274	48,375	177,649
Net interest income	178,481	(44,711)	133,770
Provision for loan and lease losses	26,400		26,400
Net interest income (loss) after provision for loan and lease losses	152,081	(44,711)	107,370
Non-interest income:			
Other service charges on loans	10,163	(8,058)	2,105
Service charges on deposit accounts	5,526		5,526
Mortgage banking activities	1,762		1,762
Net gain on investments and impairments	4,516		4,516
Rental income	1,319		1,319
Gain on sale of credit card portfolio	5,533		5,533
Other operating income	8,829	3,520	12,349
Total non-interest income	37,648	(4,538)	33,110
Non-interest expenses:			

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Employees compensation and benefits	41,499	(525)	40,974
Occupancy and equipment	18,831	(11)	18,820
Business promotion	8,057		8,057
Professional fees	1,940		1,940
Taxes, other than income taxes	3,899		3,899
Insurance and supervisory fees	2,086		2,086
Other operating expenses	12,356	183	12,539
Total non-interest expenses	88,668	(353)	88,315
Income before income tax	101,061	(48,896)	52,165
Income tax provision	(20,922)	15,995	(4,927)
Net income	\$ 80,139	\$ (32,901)	\$ 47,238
Net income attributable to common stockholders	\$ 60,001	\$ (32,901)	\$ 27,100
Net income per common share:			
Basic	\$ 0.75	\$ (0.41)	\$ 0.34
Diluted	\$ 0.73	\$ (0.40)	\$ 0.33

Table of Contents

Restatement of 2004 Consolidated Statement of Cash Flows

During the preparation of the 2006 consolidated financial statements, management became aware of some incorrect classifications in the Consolidated Statements of Cash Flows for the years ended December 31, 2005 and 2004. The classification errors related to three main items: 1) the treatment of discounts and the related accretion activity on certain investment securities (mostly zero coupon securities) purchased by the Corporation which were incorrectly presented as cash flows related to investing activities (principal repayments and maturities of securities held-to-maturity), instead of operating activities (net amortization or accretion of discounts and premiums on investment securities), 2) the classification of cash flows from the disposition of repossessed assets which was included as part of operating activities (decrease or increase in other assets), instead of investing activities (proceeds from sale of repossessed assets), and 3) purchases of zero coupon bonds and agency discount notes amounts presented as part of investing activities (purchases of securities held-to-maturity) were reported at par amount rather than the actual cash paid for the securities and the discounts on such securities were being presented as investing activities (principal repayments and maturities of securities held-to-maturity) rather than being excluded from the Cash Flow Statements.

The cash flows related to the accretion of discount on certain investment securities have been properly classified as cash flows from operating activities and the cash flows from the disposition of repossessed assets have been properly classified as cash flows from investing activities in the restated Consolidated Statement of Cash Flows for the six month period ended June 30, 2004. The amounts presented as purchases, principal repayments and maturities of securities under cash flows from investing activities have also been corrected to reflect actual cash outflows and inflows related to zero coupon bonds and discounts notes. In addition, the Corporation has corrected the classification of other items, including items related to the 2004 restatement (see footnotes in table below), and the classification of short-term held-to-maturity investments (less than 90 days) from investments to cash and cash equivalents.

Also, the Corporation has corrected the classification of cash receipts from sales and repayments as well as cash disbursements in originations of loans classified as held-for-sale on the consolidated statements of cash flows. The Corporation previously reported the cash receipts from sales and repayments as well as cash disbursements in originations of loans classified as held-for-sale that were originally acquired for investment as cash flows of operating activities in the consolidated statements of cash flows. Since these loans were originally acquired by the Corporation for investment purposes, cash receipts from sales and repayments as well as cash disbursements in originations of these loans should be classified as cash flows of investing activities in the consolidated statements of cash flows.

Table of Contents

The following comparative table presents the effects of the aforementioned classification corrections as well as the impact of all restatement adjustments related with the 2004 restatement on the Consolidated Statement of Cash Flows for the six month period ended June 30, 2004:

Six Month Period Ended June 30, (in thousands)	2004		
	As Previously Reported	Adjustments	(As Restated)
Cash flows from operating activities:			
Net income	\$ 80,139	\$ (32,901)	\$ 47,238
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income tax benefit (1)	(5,148)	(17,868)	(23,016)
Unrealized derivatives loss (2)	58	39,042	39,100
Amortization of brokers' placement fees (2)		6,490	6,490
(Accretion) amortization of premiums and discounts on investment securities (3)		(2,063)	(2,063)
Decrease (increase) in other assets (3)	3,440	(16,931)	(13,491)
Other adjustments to cash flows from operating activities (4) (5)	(17,896)	35,714	17,818
Total adjustments to reconcile net income to net cash provided by operating activities	(19,546)	44,384	24,838
Net cash provided by operating activities	60,593	11,483	72,076
Cash flows from investing activities:			
Proceeds from sale of repossessed assets (3)		17,002	17,002
Purchase of securities held to maturity (3)	(4,305,050)	2,786,389	(1,518,661)
Principal repayments and maturities of securities held to maturity (3)	3,257,559	(2,768,184)	489,375
Other adjustments to cash flows from investing activities (4) (5)	(1,087,107)	(26,983)	(1,114,090)
Net cash used in investing activities	(2,134,598)	8,224	(2,126,374)
Cash flows from financing activities:			
Net increase in deposits (2)	237,533	(8,326)	229,207
Other adjustments to cash flows from financing activities (5)	1,302,479	(926)	1,301,553
Net cash provided by financing activities	1,540,012	(9,252)	1,530,760
Net decrease in cash and cash equivalents	(533,993)	10,455	(523,538)
Cash and cash equivalents at beginning of period	1,060,244	(8,136)	1,052,108
Cash and cash equivalents at end of period (6)	\$ 526,251	\$ 2,319	\$ 528,570

- (1) Deferred tax effect of items related to the 2004 restatement; refer to explanation of change in Note 1 Restatement of previously issued financial statements Income Taxes above.
- (2) Refer to explanation of change in Note 1 Restatement of previously issued financial statements Accounting for Derivative Instruments and Broker Placement Fees above.
- (3) Refer to explanation of change in the first paragraph of Restatement of 2004 Consolidated Statements of Cash Flows above.
- (4) Refer to explanation of change in the third paragraph of Restatement of 2004 Consolidated Statements of Cash Flows above.

- (5) Change resulting from certain not significant 2004 restatement adjustments (refer to Note 1 Restatement of previously issued financial statements) and the correction of immaterial classification errors.
- (6) Correction of classification of short-term held-to-maturity investments (less than 90 days) from investments to cash and cash equivalents.

Table of Contents**2 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, 2005. Certain information and note disclosure normally included in the financial statements prepared in accordance with 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, 2005, included in the Corporation's 2005 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 on June 30, 2006, are not necessarily indicative of the results to be expected for the entire year.

On May 24, 2005, the Corporation's Board of Directors declared a two-for-one split in the Corporation's common stock. The record date of the stock split was June 15, 2005, and the distribution date was June 30, 2005. The per share data contained in the Consolidated Financial Statements prior to the quarter ended June 30, 2005 has been adjusted to reflect the two-for-one stock split.

Recently issued accounting pronouncements

In February 2007, the FASB issued SFAS No. 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 effective January 1, 2007. The Corporation decided to early adopt SFAS 159 for the callable brokered CDs and a portion of the callable fixed medium-term notes that were economically 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 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 63% of the brokered CDs portfolio and certain of the medium-term notes portfolio (designated 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 is an approximate increase of \$92.2 million. Under SFAS 159, this one-time credit was not recognized in current earnings. Regulatory capital increased by the positive adjustment to retained earnings, exceeding by higher margins the capital levels required to be classified as well-capitalized and strengthened the Corporation's regulatory capital ratios.

With the Corporation's elimination of the use of the long-haul method in connection with the adoption of SFAS 159 as of January 1, 2007, the Corporation will no longer amortize the basis adjustment. The basis adjustment amortization is the reversal of the change in value of the brokered CDs and medium term notes recognized since the implementation of the long-haul method. Since the time the Corporation implemented the

Table of Contents

long-haul method, it has recognized the basis adjustment and the changes in the value of the 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 adoption adjustment to retained earnings, of all of the unamortized placement fees that were paid to broker counterparties upon the issuance of the brokered CDs and medium term notes. The Corporation previously amortized those fees through earnings based on the expected call date of the instruments. The impact of the de-recognition 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 \$23.8 million. This negative charge is included in the total cumulative after-tax increase to retained earnings of \$92.2 million that results with the adoption of SFAS 157 and SFAS 159.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). This interpretation expresses the SEC staff's views regarding the process of quantifying financial statement misstatements that could result in improper amounts of assets or liabilities. While a misstatement may not be considered material for the period in which it occurred, it may be considered material in a subsequent year if the corporation were to correct the misstatement through current period earnings. SAB 108 requires a materiality evaluation based on all relevant quantitative and qualitative factors and the quantification of the misstatement using both a balance sheet and income statement approach to determine materiality. SAB 108 is effective for periods ending after November 15, 2006. The adoption of this Statement did not have a material effect on the Corporation's financial condition and results of operations.

In September 2006, the FASB issued SFAS No. 158 *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*—an amendment of FASB Statements No. 87, 88, 106 and 132(R). This Statement requires corporations to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement is effective for periods ending after December 15, 2006. This Statement is not applicable to the Corporation and therefore has no impact to the Corporation's financial condition or results of operations.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements*. 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 the discussion on SFAS 159 above.

In June 2006, the FASB issued Financial Interpretation No. 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 No. 109. 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. The cumulative effect of adoption of FIN 48 resulted in an increase of \$2.6 million to tax reserves with offsetting adjustments to retained earnings. Additionally, in connection with the adoption of FIN 48, the Corporation elected to classify interest and penalties related to unrecognized tax portions as components of income tax expense.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets*, an amendment of SFAS No. 140. This Statement requires that servicing assets and servicing liabilities be initially measured at fair value along with any derivative instruments used to mitigate inherent risks. This Statement is

Table of Contents

effective for periods 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.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140. This Statement allows fair value measurement for any hybrid financial instrument that contains an embedded derivative requiring bifurcation. It also establishes a requirement to evaluate interests in securitized financial assets to establish whether the interests are freestanding derivatives or hybrid financial instruments that contain an embedded derivative requiring bifurcation. This Statement is effective for all financial instruments acquired or issued after September 15, 2006. The adoption of this Statement did not have a material effect on the Corporation's financial condition and results of operations.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3. This Statement changes the requirements for the accounting for and reporting of a voluntary change in accounting principle. This Statement requires retrospective application to prior periods' financial statements of a change in accounting principle unless it is impracticable to do so; in which case the earliest period for which retrospective application is practicable should be applied. If it is impracticable to calculate the cumulative effect of a change in accounting principle, the Statement requires prospective application as of the earliest date practicable. This Statement does not change the guidance in APB Opinion No. 20 with regard to the reporting of the correction of an error, or a change in accounting estimate. The Statement's purpose is to improve the comparability of financial information among periods. SFAS No. 154 is effective for fiscal years beginning after December 15, 2005. The adoption of this statement did not have a material effect on the Corporation's financial condition and results of operations.

In December 2004, the Financial Accounting Standard Board (FASB) issued SFAS 123R, Share-Based Payment. This statement is a revision of SFAS 123, Accounting for Stock-Based Compensation and it also supersedes APB No. 25, Accounting for Stock Issued to Employees, (APB 25), and its related implementation guidance.

This Statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). The cost will be recognized over the period during which an employee is required to provide service in exchange for the award—the requisite service period (usually the vesting period). No compensation cost is recognized for equity instruments for which employees do not render the requisite service.

SFAS 123R eliminates the alternative to use APB 25's intrinsic value method of accounting that was provided in SFAS 123 as originally issued. Under APB 25, issuing stock options to employees generally resulted in recognition of no compensation cost.

The Corporation prospectively applied SFAS123R to its financial statements as of January 1, 2006. Refer to Note 4 to these consolidated financial statements for required disclosures and further information on the impact of the adoption of this accounting pronouncement.

Table of Contents**3 EARNINGS PER COMMON SHARE**

The calculations of earnings (loss) per common share for the quarters and six month periods ended on June 30, 2006, 2005 and 2004 are as follows:

	Quarter Ended June 30,		
	2006	2005	2004 (As Restated)
	(In thousands, except per share data)		
Net Income (Loss):			
Net Income (loss)	\$ 31,803	\$ 97,406	\$ (18,192)
Less: Preferred stock dividend	(10,069)	(10,069)	(10,069)
Net income (loss) available to common stockholders	\$ 21,734	\$ 87,337	\$ (28,261)
Weighted-Average Shares:			
Basic weighted average common shares outstanding	83,254	80,852	80,430
Average potential common shares	158	2,020	
Diluted weighted-average number of common shares outstanding	83,412	82,872	80,430
Earnings (loss) per common share:			
Basic	\$ 0.26	\$ 1.08	\$ (0.35)
Diluted	\$ 0.26	\$ 1.05	\$ (0.35)

Table of Contents

	Six Month Period Ended June 30,		
	2006	2005	2004 (As Restated)
	(In thousands, except per share data)		
Net Income:			
Net Income	\$ 35,666	\$ 122,621	\$ 47,238
Less: Preferred stock dividend	(20,138)	(20,138)	(20,138)
Net income available to common stockholders	\$ 15,528	\$ 102,483	\$ 27,100
Weighted-Average Shares:			
Basic weighted average common shares outstanding	82,410	80,818	80,280
Average potential common shares	498	2,323	2,472
Diluted weighted-average number of common shares outstanding	82,908	83,141	82,752
Earnings per common share:			
Basic	\$ 0.19	\$ 1.27	\$ 0.34
Diluted	\$ 0.19	\$ 1.23	\$ 0.33

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, 2006, there were 2,172,600 and 2,568,289 weighted-average outstanding stock options, respectively, that were excluded from the computation of outstanding shares because they were antidilutive. For the quarter and six month period ended June 30, 2005, there were 1,769,248 and 650,942 weighted-average outstanding stock options, respectively, that were excluded from the computation of outstanding shares because they were antidilutive. All options outstanding were excluded from the computation of outstanding shares for the quarter ended June 30, 2004 because the Corporation reported a net loss for such period. For the six month period ended June 30, 2004 a total of 931,800 stock options were not included in the computation of outstanding shares because they were antidilutive.

4 STOCK OPTION PLAN

Since 1997 the Corporation has had a 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 officers and other 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,

Table of Contents

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 may 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.

During the second quarter of 2005, the Corporation issued 76,373 (152,746 as adjusted for the June 2005 stock split) shares of common stock as a result of the exercise of 36,479 stock options and 39,894 shares granted pursuant to stock appreciation rights before the June 2005 stock split, both under the Corporation's stock-based compensation plan.

Prior to the adoption of SFAS 123R on January 1, 2006, the Corporation accounted for stock options under the recognition and measurement principles of APB 25 and related Interpretations. No stock-based employee compensation cost was reflected in net income for the quarters and six month periods ended June 30, 2005 and 2004, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. The table below illustrates the effect on net income and earnings per common share if the Corporation had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation granted during the second quarter and first six months of 2005 and 2004.

Table of Contents**Pro-forma information:**

	Quarter ended June 30, 2004 (As Restated)		Six month period ended June 30, 2004 (As Restated)	
	2005		2005	
	(In thousands, except per share data)			
Net income (loss)				
As reported	\$ 97,406	\$ (18,192)	\$ 122,621	\$ 47,238
Deduct: Stock-based employee compensation expense determined under fair value method			6,118	4,963
Pro forma	\$ 97,406	\$ (18,192)	\$ 116,503	\$ 42,275
Earnings (loss) per common share-basic:				
As reported	\$ 1.08	\$ (0.35)	\$ 1.27	\$ 0.34
Pro forma	\$ 1.08	\$ (0.35)	\$ 1.19	\$ 0.28
Earnings (loss) per common share-diluted:				
As reported	\$ 1.05	\$ (0.35)	\$ 1.23	\$ 0.33
Pro forma	\$ 1.05	\$ (0.35)	\$ 1.16	\$ 0.27

On January 1, 2006, the Corporation adopted SFAS 123R using the modified prospective method. Under 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 expensing stock options for the six month period ended June 30, 2006 was approximately \$4.9 million. All employee stock options granted during 2006 were fully vested at the time of grant.

The activity of stock options during the first six months of 2006 is set forth below:

	Six Month Period Ended June 30, 2006			
	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Beginning of period	5,316,410	\$ 13.28		
Options granted	1,070,000	12.68		
Options exercised	(2,379,000)	8.30		
Options expired unexercised	(964,000)	21.95		
End of period outstanding and exercisable	3,043,410	\$ 14.21	7.3	\$ 682

The fair value of options granted in 2006, 2005 and 2004 that was estimated using the Black-Scholes option pricing, and the assumptions used follow:

	2006		2005		2004
	\$ 12.68		\$ 23.92		\$ 21.45

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Weighted Average Stock Price at grant date and exercise price

Stock option estimated fair value	\$4.56 - \$4.60	\$6.40 - \$6.41	\$5.30 - \$5.45
Weighted-average estimated fair value	\$ 4.57	\$ 6.40	\$ 5.33
Expected stock option term (years)	4.22 - 4.31	4.25 - 4.27	4.08 - 4.33
Expected volatility	46%	28%	28%
Expected dividend yield	2.2%	1.0%	1.0%
Risk-free interest rate	4.7% - 5.0%	4.2%	3.1%

Table of Contents

The Corporation uses empirical research data to estimate options exercises and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. For 2006, the expected volatility is based on the historical implied volatility of the Corporation's common stock at each grant date. For periods prior to 2006, the expected volatility is based on the historical volatility of the Corporation's common stock over a 260 working days period. The dividend yield is based on the historical 12-month dividend yield observable at each grant date. The risk-free rate for periods is based on historical zero coupon curves obtained from Bloomberg at the time of grant based on the option expected term.

No options were exercised during the second quarter of 2006. The total intrinsic value of options exercised during the second quarter of 2005 and 2004 was approximately \$0.5 million, and \$0.1 million, respectively. The total intrinsic value of options exercised during the first half of 2006, 2005 and 2004 was approximately \$10.0 million, \$0.8 million and \$6.5 million, respectively. Cash proceeds from options exercised during the second quarter of 2005 and 2004 amounted to approximately \$0.4 million and \$0.1 million, respectively. Cash proceeds from options exercised during the first half of 2006, 2005 and 2004 amounted to approximately \$19.8 million, \$0.6 million and \$2.7 million, respectively.

Table of Contents**5 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 at June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004 were as follows:

	June 30, 2006					December 31, 2005					
	Amortized cost	Gross Unrealized gains losses		Fair value	Weighted average yield%	Amortized cost	Gross Unrealized gains losses		Fair value	Weighted average yield%	
(Dollars in thousands)											
Obligations of U.S. Government Sponsored Agencies:											
Within 1 year	\$	\$	\$	\$	\$	1,000	\$	\$	\$	1,000	6.00
After 5 to 10 years	402,215		24,131	378,084	4.30	392,939		4,289	388,650	4.27	
After 10 years	12,984		351	12,633	6.16						
Puerto Rico Government Obligations:											
After 1 to 5 years	4,614	140		4,754	6.17	4,594	223		4,817	6.17	
After 5 to 10 years	15,400	136	1,060	14,476	4.85	15,271	196	678	14,789	4.84	
After 10 years	5,343	48	228	5,163	5.88	5,311	131	42	5,400	5.88	
United States and Puerto Rico Government Obligations	440,556	324	25,770	415,110	4.41	419,115	550	5,009	414,656	4.34	
Mortgage-backed Securities:											
FHLMC certificates:											
Within 1 year	3			3	5.70	2			2	4.26	
After 1 to 5 years	2,397	48	1	2,444	7.05	1,762	30		1,792	6.43	
After 5 to 10 years						1,336	82		1,418	7.98	
After 10 years	6,193	38	258	5,973	5.59	6,839	77	166	6,750	5.55	
	8,593	86	259	8,420	6.00	9,939	189	166	9,962	6.03	
GNMA certificates:											
After 1 to 5 years	750	4	1	753	6.39	939	14		953	6.39	
After 5 to 10 years	1,130	6	5	1,131	5.66	291	10		301	6.64	

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

After 10 years	409,479	306	17,343	392,442	5.23	438,565	1,021	1,959	437,627	5.19
	411,359	316	17,349	394,326	5.24	439,795	1,045	1,959	438,881	5.20
FNMA										
certificates:										
After 1 to 5 years	134	1		135	7.47	187	3		190	7.55
After 5 to										
10 years	9,699	10	343	9,366	5.00	124	11		135	11.40
After 10 years	1,148,860	407	33,503	1,115,764	5.35	1,038,126	1,054	10,031	1,029,149	5.14
	1,158,693	418	33,846	1,125,265	5.34	1,038,437	1,068	10,031	1,029,474	5.14
Mortgage										
pass-through										
certificates:										
After 10 years	383	3		386	7.29	400	3		403	7.29
Mortgage-backed										
Securities										
	1,579,028	823	51,454	1,528,397	5.32	1,488,571	2,305	12,156	1,478,720	5.16
Corporate										
Bonds:										
After 1 to 5 years						2,483	84	1	2,566	7.75
After 5 to										
10 years	1,311		283	1,028	7.46	1,912	12	42	1,882	8.09
After 10 years	4,495		1,137	3,358	7.72	21,857	909	1,833	20,933	7.44
Corporate bonds	5,806		1,420	4,386	7.66	26,252	1,005	1,876	25,381	7.52
Equity securities										
(without										
contractual										
maturity)										
	27,441	1,991	8,039	21,393	1.18	29,931	1,131	1,641	29,421	3.70
Total Investment										
Securities										
Available for										
Sale										
	\$ 2,052,831	\$ 3,138	\$ 86,683	\$ 1,969,286	5.08	\$ 1,963,869	\$ 4,991	\$ 20,682	\$ 1,948,178	5.00

Table of Contents

	June 30, 2005				June 30, 2004 (As Restated)					
	Amortized cost	Gross Unrealized gains	losses	Fair value	Weighted average yield %	Amortized cost	Gross Unrealized gains	losses	Fair value	Weighted average yield %
(Dollars in thousands)										
Obligations of U.S. Government Sponsored Agencies: After 5 to 10 years	\$ 392,625	\$ 4,920	\$ 61	\$ 397,484	4.27	\$ 284,333	\$ 2,508	\$ 929	\$ 285,912	4.68
Puerto Rico Government Obligations: After 1 to 5 years	4,539	258		4,797	6.17	298	33		331	6.62
After 5 to 10 years	12,742	187	574	12,355	4.59	7,020	317	75	7,262	5.79
After 10 years	7,720	301	20	8,001	5.94	8,186	381	34	8,533	5.99
United States and Puerto Rico Government Obligations	417,626	5,666	655	422,637	4.33	299,837	3,239	1,038	302,038	4.74
Mortgage-backed Securities: FHLMC certificates: Within 1 year						1			1	5.68
After 1 to 5 years	2,132	52		2,184	6.42	2,929	146		3,075	6.37
After 5 to 10 years	1,724	88		1,812	8.08	2,775	170		2,945	8.14
After 10 years	7,274	240		7,514	5.59	3,296	170		3,466	6.86
	11,130	380		11,510	6.14	9,001	486		9,487	7.09
GNMA certificates: After 1 to 5 years	1,102	23		1,125	6.37	999	47		1,046	5.91
After 5 to 10 years	340	13		353	6.64	1,082	60		1,142	6.90
After 10 years	477,953	5,427	13	483,367	5.14	124,174	1,854	2	126,026	4.08
	479,395	5,463	13	484,845	5.14	126,255	1,961	2	128,214	4.11
FNMA certificates:										

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

After 1 to 5 years	118	3		121	7.53	53	3		56	8.27
After 5 to 10 years	184	10		194	8.98	394	37		431	8.35
After 10 years	1,160,794	12,020	110	1,172,704	5.13	974,084	6,887	185	980,786	4.68
	1,161,096	12,033	110	1,173,019	5.13	974,531	6,927	185	981,273	4.68
Mortgage pass-through certificates:										
After 10 years	428	4		432	7.29	624	6		630	7.28
Mortgage-backed Securities										
	1,652,049	17,880	123	1,669,806	5.14	1,110,411	9,380	187	1,119,604	4.64
Corporate Bonds:										
Within 1 year	20,000			20,000	4.44	20,000	600		20,600	6.37
After 1 to 5 years	3,360	2,122		5,482	7.63	20,875	1,752		22,627	2.74
After 5 to 10 years	3,396	986		4,382	7.81	375	688		1,063	7.74
After 10 years	22,858	1,024	1,221	22,661	7.44					
Corporate bonds	49,614	4,132	1,221	52,525	6.27	41,250	3,040		44,290	4.54
Equity securities (without contractual maturity)										
	60,705	14,837	3,395	72,147	1.49	44,216	11,573	2,862	52,927	0.98
Total Investment Securities Available for Sale										
	\$ 2,179,994	\$ 42,515	\$ 5,394	\$ 2,217,115	4.91	\$ 1,495,714	\$ 27,232	\$ 4,087	\$ 1,518,859	4.55

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, at June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004:

Table of Contents

	Less than 12 months Unrealized		As of June 30, 2006 12 months or more Unrealized		Total Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
Debt Securities						
Obligations of U.S. Government Sponsored Agencies	\$ 390,717	\$ 24,482	\$	\$	\$ 390,717	\$ 24,482
Puerto Rico Government Obligations	1,321	7	\$ 12,878	\$ 1,281	14,199	1,288
Mortgage-Backed Securities						
FHLMC	834	1	4,049	258	4,883	259
GNMA	372,717	17,349			372,717	17,349
FNMA	855,980	31,999	43,222	1,847	899,202	33,846
Corporate Bonds			4,386	1,420	4,386	1,420
Equity Securities	14,898	8,039			14,898	8,039
	\$ 1,636,467	\$ 81,877	\$ 64,535	\$ 4,806	\$ 1,701,002	\$ 86,683

	Less than 12 months Unrealized		As of December 31, 2005 12 months or more Unrealized		Total Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
Debt Securities						
Obligations of U.S. Government Sponsored Agencies	\$ 388,650	\$ 4,289	\$	\$	\$ 388,650	\$ 4,289
Puerto Rico Government Obligations			13,440	720	13,440	720
Mortgage-Backed Securities						
FHLMC	4,440	166			4,440	166
GNMA	369,231	1,959			369,231	1,959
FNMA	939,197	10,031			939,197	10,031
Corporate Bonds	8,711	1,876			8,711	1,876
Equity Securities	16,229	1,641			16,229	1,641
	\$ 1,726,458	\$ 19,962	\$ 13,440	\$ 720	\$ 1,739,898	\$ 20,682

Table of Contents

	Less than 12 months		As of June 30, 2005 12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(Dollars in thousands)			
Debt Securities						
Obligations of U.S. Government Sponsored Agencies	\$ 100,109	\$ 61	\$	\$	\$ 100,109	\$ 61
Puerto Rico Government Obligations	8,644	515	4,921	79	13,565	594
Mortgage-Backed Securities						
GNMA	1,628	13			1,628	13
FNMA	55,081	110			55,081	110
Corporate Bonds	8,190	1,221			8,190	1,221
Equity Securities	12,128	3,395			12,128	3,395
	\$ 185,780	\$ 5,315	\$ 4,921	\$ 79	\$ 190,701	\$ 5,394

	Less than 12 months		As of June 30, 2004 (As Restated)		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(Dollars in thousands)			
Debt Securities						
Obligations of U.S. Government Sponsored Agencies	\$ 95,304	\$ 929	\$	\$	\$ 95,304	\$ 929
Puerto Rico Government Obligations	4,891	109			4,891	109
Mortgage-Backed Securities						
GNMA	275	2			275	2
FNMA	89,962	185			89,962	185
Equity Securities	17,647	2,862			17,647	2,862
	\$ 208,079	\$ 4,087	\$	\$	\$ 208,079	\$ 4,087

The Corporation's investment securities portfolio is comprised principally of (i) mortgage-backed securities issued or guaranteed by FNMA, GNMA or FHLMC and (ii) U.S. Treasury and agencies securities. Thus, payment of a substantial portion of these instruments is either guaranteed or secured by mortgages together with a U.S. government sponsored entity or is backed by the full faith and credit of the U.S. government. Principal and interest on these securities are therefore deemed recoverable. The Corporation's policy is to review its investment portfolio for possible

other-than temporary impairment, at least quarterly. At June 30, 2006, management has the intent and ability to hold these investments for a reasonable period of time for a forecasted recovery of fair value up to (or beyond) the cost of these investments; as a result, the impairments are considered temporary. The increase in the net unrealized loss position during 2006 was principally due to increases in interest rates and the corresponding decrease in prices.

During the first six months of 2006, 2005 and 2004, the Corporation recorded other-than-temporary impairments of \$2.9 million, \$1.5 million and approximately \$56,000, respectively, on certain equity securities held in its investment portfolio. Management concluded that the declines in value of the securities were other-than-temporary; as such, the cost basis of these securities was written down to the market value at the date of the analyses.

Total proceeds from the sale of securities available for sale during the six-month period ended June 30, 2006 amounted to approximately \$22.8 million (2005 \$214.7 million ; 2004-\$19.3 million). The Corporation realized gross gains of approximately \$2.6 million and approximately \$0.2 million in gross realized losses for the first six months of 2006 (2005 \$9.8 million in gross realized gains ; 2004-\$4.6 million in gross realized gains and approximately \$71,000 in gross realized losses).

Table of Contents**Investment Securities Held to Maturity**

The amortized cost, gross unrealized gains and losses, approximate fair value, weighted-average yield and contractual maturities of investment securities held-to-maturity at June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004 were as follows:

	June 30, 2006					December 31, 2005				
	Amortized cost	Gross Unrealized gains	Gross losses	Fair value	Weighted average yield %	Amortized cost	Gross Unrealized gains	Gross losses	Fair value	Weighted average yield %
(Dollars in thousands)										
U.S. Treasury Securities: Due within 1 year	\$ 74,673	\$ 27	\$	\$ 74,700	4.86	\$ 149,156	\$ 48	\$	\$ 149,204	3.97
Obligations of other U.S. Government Sponsored Agencies: After 10 years	2,058,015		137,000	1,921,015	5.83	2,041,558		65,799	1,975,759	5.83
Puerto Rico Government Obligations: After 1 to 5 years	5,000		1	4,999	5.00	5,000	20		5,020	5.00
After 5 to 10 years	9,436	282	275	9,443	5.94					
After 10 years	15,000		171	14,829	5.50	9,163	502	143	9,522	5.94
United States and Puerto Rico Government obligations	2,162,124	309	137,447	2,024,986	5.79	2,204,877	570	65,942	2,139,505	5.70
Mortgage-backed securities: FHLMC certificates: After 5 to 10 years	18,089		931	17,158	3.67	20,211		778	19,433	3.63
FNMA certificates: After 5 to 10 years	16,188		807	15,381	3.79	18,418		602	17,816	3.79
After 10 years	1,090,719		59,971	1,030,748	4.36	1,195,082		35,277	1,159,805	4.32
	1,124,996		61,709	1,063,287	4.34	1,233,711		36,657	1,197,054	4.30

Mortgage-backed
securities

Total Investment
Securities Held

to Maturity	\$ 3,287,120	\$ 309	\$ 199,156	\$ 3,088,273	5.30	\$ 3,438,588	\$ 570	\$ 102,599	\$ 3,336,559	5.20
-------------	--------------	--------	------------	--------------	------	--------------	--------	------------	--------------	------

Table of Contents

	June 30, 2005					June 30, 2004 (As Restated)				
	Amortized cost	Gross Unrealized gains	Unrealized losses	Fair value	Weighted average yield %	Amortized cost	Gross Unrealized gains	Unrealized losses	Fair value	Weighted average yield %
(Dollars in thousands)										
U.S. Treasury Securities: Due within 1 year	\$	\$	\$	\$		\$ 69,987	\$	\$ 8	\$ 69,979	0.98
Obligations of other U.S. Government Sponsored Agencies: Due within 1 year	14,889		15	14,874	3.25	14,975		4	14,971	1.11
After 10 years	2,362,419	2,497	7,508	2,357,408	5.86	2,344,592	89,394		2,255,198	5.31
Puerto Rico Government Obligations: After 1 to 5 years	5,000	41		5,041	5.00	5,000	148		5,148	5.00
After 10 years	8,899	512	145	9,266	5.94	8,394	571	124	8,841	5.93
United States and Puerto Rico Government obligations	2,391,207	3,050	7,668	2,386,589	5.84	2,442,948	719	89,530	2,354,137	5.16
Mortgage-backed securities: FHLMC certificates: After 5 to 10 years	22,956		599	22,357	3.63	30,659		977	29,682	3.51
FNMA certificates: After 5 to 10 years	21,011		321	20,690	3.81	26,339		425	25,914	3.79
After 10 years	1,342,456		17,562	1,324,894	4.32	1,651,471		23,837	1,627,634	3.87
Mortgage-backed securities	1,386,423		18,482	1,367,941	4.30	1,708,469		25,239	1,683,230	3.86

Corporate Bonds:										
Within 1 year					19,983	12			19,995	2.67

Total Investment Securities Held to Maturity	\$ 3,777,630	\$ 3,050	\$ 26,150	\$ 3,754,530	5.28	\$ 4,171,400	\$ 731	\$ 114,769	\$ 4,057,362	4.62
--	--------------	----------	-----------	--------------	------	--------------	--------	------------	--------------	------

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.

Table of Contents

The following tables show the Corporation's held-to-maturity investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004.

	Less than 12 months		As of June 30, 2006		Total	
	Unrealized		12 months or more		Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
			(Dollars in thousands)			
Debt Securities						
Other U.S. Government Sponsored Agencies	\$ 610,934	\$ 36,688	\$ 1,310,081	\$ 100,312	\$ 1,921,015	\$ 137,000
Puerto Rico Government Obligations	19,828	172	3,715	275	23,543	447
Mortgage-Backed Securities						
FHLMC	2,247	114	14,911	817	17,158	931
FNMA			1,046,129	60,778	1,046,129	60,778
	\$ 633,009	\$ 36,974	\$ 2,374,836	\$ 162,182	\$ 3,007,845	\$ 199,156

	Less than 12 months		As of December 31, 2005		Total	
	Unrealized		12 months or more		Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
			(Dollars in thousands)			
Debt Securities						
Other U.S. Government Sponsored Agencies	\$ 1,585,810	\$ 40,379	\$ 389,949	\$ 25,420	\$ 1,975,759	\$ 65,799
Puerto Rico Government Obligations	3,746	143			3,746	143
Mortgage-Backed Securities						
FHLMC			19,433	778	19,433	778
FNMA	11,771	339	1,165,849	35,540	1,177,620	35,879
	\$ 1,601,327	\$ 40,861	\$ 1,575,231	\$ 61,738	\$ 3,176,558	\$ 102,599

Table of Contents

	Less than 12 months Unrealized		As of June 30, 2005 12 months or more Unrealized		Total Unrealized	
	Fair Value	Losses	Fair Value Losses (Dollars in thousands)	Fair Value Losses (Dollars in thousands)	Fair Value	Losses
Debt Securities						
Other U.S. Government Sponsored Agencies Puerto Rico Government Obligations	\$ 944,732	\$ 4,348	\$ 400,586	\$ 3,175	\$ 1,345,318	\$ 7,523
	3,645	145			3,645	145
Mortgage-Backed Securities						
FHLMC	535	16	21,822	583	22,357	599
FNMA	788,052	9,836	557,532	8,047	1,345,584	17,883
	\$ 1,736,964	\$ 14,345	\$ 979,940	\$ 11,805	\$ 2,716,904	\$ 26,150

	Less than 12 months Unrealized		As of June 30, 2004 (As restated) 12 months or more Unrealized		Total Unrealized	
	Fair Value	Losses	Fair Value Losses (Dollars in thousands)	Fair Value Losses (Dollars in thousands)	Fair Value	Losses
Debt Securities						
US Treasury Securities	\$ 69,979	\$ 8	\$	\$	\$ 69,979	\$ 8
Other U.S. Government Sponsored Agencies Puerto Rico Government Obligations	1,624,447	64,969	645,722	24,429	2,270,169	89,398
	3,478	124			3,478	124
Mortgage-Backed Securities						
FHLMC	29,682	977			29,682	977
FNMA	1,653,548	24,262			1,653,548	24,262
	\$ 3,381,134	\$ 90,340	\$ 645,722	\$ 24,429	\$ 4,026,856	\$ 114,769

Held-to-maturity securities in an unrealized loss position at June 30, 2006 are primarily mortgage-backed securities and U.S. agency securities. The vast majority of them are rated the equivalent of AAA by the major rating agencies. Management believes that the unrealized losses in the held-to-maturity portfolio at June 30, 2006 are substantially related to market interest rate fluctuations and not deterioration in the creditworthiness of the issuers; as a result, the impairment is considered temporary.

Table of Contents**6 OTHER EQUITY SECURITIES**

Institutions that are members of the FHLB system are required to maintain a minimum investment in FHLB stock. Such minimum is calculated as a percentage of aggregate outstanding mortgages and an additional investment is required that is calculated as a percentage of total FHLB advances, letters of credit, and the collateralized portion of interest-rate swaps outstanding. The stock is capital stock issued at \$100 par value. Both stock and cash dividends may be received on FHLB stock.

At June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004, there were investments in FHLB stock with book value of \$22.0 million, \$40.9 million, \$73.1 million and \$61.1 million respectively. The estimated market value of such investments is its redemption value determined by the ultimate recoverability of its par value.

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities at June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004 was \$1.7 million, \$1.4 million, \$1.4 million and \$0.4 million, respectively.

7 LOAN PORTFOLIO

The following is a detail of the loan portfolio:

	June 30,	December	June 30,	June 30,
	2006	31,	2005	2004
		2005	2005	(As
		(Dollars in thousands)		Restated)
Residential real estate loans, mainly secured by first mortgages	\$ 2,567,556	\$ 2,245,272	\$ 1,777,044	\$ 1,105,614
Commercial loans:				
Construction loans	1,560,580	1,137,118	715,971	374,845
Commercial mortgage loans	1,152,796	1,090,193	1,000,752	648,690
Commercial loans	2,441,329	2,421,219	2,295,216	1,708,971
Loans to local financial institutions collateralized by real estate mortgages and pass-through trust certificates	992,586	3,676,314	4,211,687	2,708,896
Commercial loans	6,147,291	8,324,844	8,223,626	5,441,402
Finance leases	325,867	280,571	242,765	184,866
Consumer loans	1,783,902	1,733,569	1,580,501	1,235,075
Loans receivable	10,824,616	12,584,256	11,823,936	7,966,957
Allowance for loan and lease losses	(146,527)	(147,999)	(146,154)	(133,678)
Loans receivable, net	10,678,089	12,436,257	11,677,782	7,833,279
Loans held for sale	80,643	101,673	49,033	19,053
Total loans	\$ 10,758,732	\$ 12,537,930	\$ 11,726,815	\$ 7,852,332

The Corporation's primary lending area is Puerto Rico. The Corporation's Bank subsidiary also lends in the U.S. and British Virgin Islands markets and in the state of Florida (USA). The Corporation has a significant lending concentration of \$546.9 million in one mortgage originator in Puerto Rico at June 30, 2006. The Corporation has outstanding \$445.7 million with another mortgage originator in Puerto Rico for total loans granted to mortgage originators amounting to \$992.6 million at June 30, 2006. These commercial loans were secured by individual residential and commercial mortgage loans. The mortgage originators have always paid the loans in accordance with their terms and conditions of the loan agreements.

Of the total net loans portfolio of \$10.8 billion as of June 30, 2006, approximately 77% have credit risk concentration in Puerto Rico, 15% in the state of Florida and 8% in the Virgin Islands.

Table of Contents

On May 25, 2006, the Corporation entered into a series of credit agreements with Doral Financial Corporation (Doral) to formally document as secured borrowings the loan transfers between the parties that previously had been accounted for as sales. The terms of the credit agreements specified: (1) a floating interest payment based on a spread over 90-day LIBOR subject to a cap; (2) an amortization schedule tied to the scheduled amortization of the underlying mortgage loans subject to a maximum maturity of 10 years; (3) mandatory prepayments as a result of actual prepayments from the underlying mortgages; and (4) an option to Doral to prepay the loan without penalty at any time.

On May 31, 2006, First BanCorp received a cash payment from Doral, substantially reducing the balance of approximately \$2.9 billion in secured commercial loans to approximately \$450 million as of that date. In connection with the repayment, the Corporation and Doral entered into a sharing agreement on May 25, 2006 with respect to certain profits or losses that Doral incurs as part of the sales of the mortgages that collateralized the commercial loans. First BanCorp agreed to reimburse Doral for 40% of the net losses incurred by Doral as a result of sales or securitization of the mortgages, subject to certain conditions and subject to a maximum reimbursement of \$9.5 million, which will be reduced proportionately to the extent that Doral does not sell the mortgages. As a result of the loss sharing agreement and the partial extinguishment of the commercial loans by Doral, the Corporation recorded a net loss of \$11.6 million during the second quarter of 2006.

8 ALLOWANCE FOR LOAN AND LEASE LOSSES

The changes in the allowance for loan and lease losses were as follows:

	Quarter Ended		
	June 30,		
	2006	2005	2004
	(Dollars in thousands)		
Balance at beginning of period	\$ 152,596	\$ 144,201	\$ 130,357
Provision for loan and lease losses	9,354	11,075	13,200
Charge-offs	(16,812)	(10,998)	(11,281)
Recoveries	1,389	1,876	1,402
Balance at end of year	\$ 146,527	\$ 146,154	\$ 133,678

	Six Month Period Ended		
	June 30,		
	2006	2005	2004
	(Dollars in thousands)		
Balance at beginning of period	\$ 147,999	\$ 141,036	\$ 126,378
Provision for loan and lease losses	28,730	22,029	26,400
Charge-offs	(33,261)	(21,597)	(21,977)
Recoveries	3,059	3,323	2,877
Other adjustments (1)		1,363	
Balance at end of year	\$ 146,527	\$ 146,154	\$ 133,678

(1) Represents allowance for loan losses from the acquisition of Ponce

General
Corporation.

The allowance for impaired loans is part of the allowance for loan and lease losses. These loans represent loans for which management has determined that it is probable that the debtor will be unable to pay all the amounts due, according to the contractual terms of the loan agreement, and do not necessarily represent loans for which the Corporation will incur a substantial loss. At June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004, impaired loans had a related allowance as follows:

Table of Contents

	As of June 30, 2006	As of December 31, 2005 (Dollars in thousands)	As of June 30, 2005	As of June 30, 2004 (As Restated)
Impaired loans	\$43,567	\$59,801	\$51,603	\$66,767
Allowance for impaired loans	\$ 6,329	\$ 9,219	\$14,185	\$14,982

Interest income in the amount of approximately \$0.8 million, \$1.9 million and \$0.6 million was recognized on impaired loans for the quarters ended June 30, 2006, 2005 and 2004, respectively. Interest income in the amount of approximately \$2.0 million, \$2.6 million and \$1.2 million was recognized on impaired loans for the six month period ended June 30, 2006, 2005 and 2004, respectively.

9 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The primary market risk facing the Corporation is interest rate risk, which includes the risk that changes in interest rates will result in changes in the value of its assets or liabilities and the risk that net interest income from its loan and investment portfolios will change in response to changes in interest rates. The overall objective of the Corporation's interest rate risk management activities is to reduce the variability of earnings caused by changes in interest rates.

The Corporation uses various financial instruments, including derivatives, to manage the interest rate risk related primarily to the values of its brokered CDs and medium-term notes.

Interest rate swap contracts that qualify for hedge accounting

As part of the interest rate risk management, the Corporation has entered into a series of interest rate swap agreements. Under the interest rate swaps, the Corporation agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed notional principal amount. Net interest settlements on interest rate swaps that qualify for hedge accounting and unrealized gains and losses arising from changes in fair value of derivative instruments and hedged items are recorded as an adjustment to interest income or interest expense depending on whether an asset or liability is being hedged.

Effective April 3, 2006, the Corporation adopted the long-haul method of effectiveness testing under SFAS 133, for substantially all of the interest rate swaps that hedge its brokered CDs and medium-term notes. The long-haul method requires periodic assessment of hedge effectiveness and measurement of ineffectiveness. The ineffectiveness results to the extent that changes in the fair value of a derivative do not offset changes in the fair values of the hedged item due to changes in the hedged risk in the Consolidated Statements of Income.

For interest rate swaps accounted for as a fair value hedges using the long-haul method, ineffectiveness is the difference between the changes in the fair value of the interest rate swap and changes in the fair value of the debt attributable to the risk being hedged.

First BanCorp's implementation of the long-haul method resulted from its previously reported determination that it should not have used the short-cut method to account for interest rate swaps related to brokered CDs and medium-term notes because of technical issues involving the interpretation of the use of the method (refer to First BanCorp audited Consolidated Financial Statements, included in the Corporation's amended 2004 Annual Report on Form 10-K for additional information). Accordingly, prior to the implementation of the long-haul method, First BanCorp had reflected changes in the fair value of those swaps as well as swaps related

Table of Contents

to certain loans as non-hedging instruments through operations. Prior to the implementation of fair value hedge, the Corporation recorded unrealized losses in the valuation of derivative instruments of approximately \$68.0 million for 2006. With respect to the brokered CDs and medium term notes (hedge liabilities) the basis differential between the market value and the book value of the hedged liabilities at the inception of fair value hedge accounting in the amount of approximately \$200.0 million amortizes or accretes as a yield adjustment over the expected remaining term of the hedged liabilities as the changes in value since the inception of the long-haul method are recorded to the hedged liabilities. For the second quarter of 2006, the Corporation recorded an amortization of \$1.3 million as a basis adjustment on the hedged liabilities.

The Corporation recognized, as a reduction to interest expense, approximately \$2.0 million for the quarter and six-months ended June 30, 2006, representing ineffectiveness on the hedges of its brokered CDs and medium-term notes that qualified as fair value hedges under SFAS 133.

Interest rate swap contracts not qualifying for hedge accounting

Prior to April 3, 2006, the Corporation used interest rate swaps as economic hedges. These swaps either did not qualify for hedge accounting treatment or were not qualified by the Corporation for hedge accounting treatment. Changes in the fair value of these derivatives and the interest exchanged were recognized in earnings in the interest income or interest expense caption of the Consolidated Statements of Income depending upon whether an asset or liability was being economically hedged. At December 31, 2005, June 30, 2005 and June 30, 2004, all derivative instruments held by the Corporation were considered economic hedges as these did not qualify for hedge accounting under SFAS 133.

Table of Contents

The following table summarizes the notional amounts of all derivative instruments as of June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004:

	Notional amounts			As of June 30, 2004 (As Restated)
	As of June 30, 2006	As of December 31, 2005 (Dollars in thousands)	As of June 30, 2005	
Interest rate swap agreements:				
Pay fixed versus receive floating	\$ 89,320	\$ 109,320	\$ 109,320	\$ 113,165
Received fixed versus pay floating	5,457,923	5,751,128	4,850,107	3,579,521
Embedded written options	13,515	13,515	13,515	13,515
Purchased options	13,515	13,515	13,515	13,515
Written interest rate cap agreements	125,200	150,200	48,000	25,000
Purchased interest rate caps	348,897	386,750	475,299	25,000
	\$ 6,048,370	\$ 6,424,428	\$ 5,509,756	\$ 3,769,716

The following table summarizes the notional amounts of all derivatives by the Corporation's designation as of June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004:

	Notional amounts			As of June 30, 2004 (As Restated)
	As of June 30, 2006	As of December 31, 2005 (Dollars in thousands)	As of June 30, 2005	
Designated hedges:				
Fair value hedge:				
Interest rate swaps used to hedge fixed rate certificates of deposit	\$ 4,874,960	\$	\$	\$
Interest rate swaps used to hedge fixed and step rate notes payable	165,442			
Total fair value hedges	\$ 5,040,402	\$	\$	\$
Economic undesignated hedges:				
Interest rate swaps used to hedge fixed rate certificates of deposit and loans	\$ 506,841	\$ 5,860,448	\$ 4,959,427	\$ 3,692,686
Embedded options on stock index deposits	13,515	13,515	13,515	13,515
Purchased options used to manage exposure to the stock market on embedded stock index options	13,515	13,515	13,515	13,515

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Written interest rate cap agreements	125,200	150,200	48,000	25,000
Purchased interest rate cap agreements	348,897	386,750	475,299	25,000
Total derivatives not designated as hedge	\$ 1,007,968	\$ 6,424,428	\$ 5,509,756	\$ 3,769,716
Total	\$ 6,048,370	\$ 6,424,428	\$ 5,509,756	\$ 3,769,716

As of June 30, 2006, derivatives qualifying for fair value hedge accounting with a negative fair value of \$254.2 million were recorded as part of Accounts payable and other liabilities in the Consolidated Statements of Financial Condition. Changes in the fair value of hedged liabilities since the inception of hedge accounting were recorded to the hedged liabilities.

As of June 30, 2006, derivatives not designated or not qualifying as a hedge with a positive fair value of \$25.4 million (December 31, 2005 \$15.8 million; June 30, 2005 \$10.5 million; June 30, 2004 \$5.4 million) and with a negative fair value of \$31.3 million (December 31, 2005 \$158.1 million; June 30, 2005 \$52.5 million; June 30, 2004 \$117.4 million) were recorded as part of Other Assets and Accounts payable and other liabilities, respectively, in the Consolidated Statements of Financial Condition.

Table of Contents

The majority of the Corporation's derivative instruments represent interest rate swaps and mainly convert long-term fixed-rate brokered CDs to a floating rate. A summary of the types of swaps used at June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004 follows:

	As of June 30, 2006	As of December 31, 2005 (Dollars in thousands)	As of June 30, 2005	As of June 30, 2004 (As Restated)
Pay fixed/receive floating:				
Notional amount	\$ 89,320	\$ 109,320	\$ 109,320	\$ 113,165
Weighted average receive rate at period end	7.24%	6.41%	4.98%	3.39%
Weighted average pay rate at period end	6.51%	6.60%	6.60%	6.97%
Floating rates range from 187 to 251.5 basis points over 3-month LIBOR				
Receive fixed/pay floating:				
Notional amount	\$5,457,923	\$5,751,128	\$4,850,107	\$3,579,521
Weighted average receive rate at period end	4.99%	4.90%	4.98%	5.26%
Weighted average pay rate at period end	5.25%	4.37%	3.32%	1.35%
Floating rates range from 5 basis points under to 19.5 basis points over 3-month LIBOR				

Indexed options are generally over-the-counter (OTC) contracts that the Corporation enters into in order to receive the appreciation of a specified Stock Index (i.e., Dow Jones Industrial Composite Stock Index) over a specified period in exchange for a premium paid at the contract's inception. The option period is determined by the contractual maturity of the notes payable tied to the performance of the Stock Index. The credit risk inherent in these options is the risk that the exchange party may not fulfill its obligation.

Interest rate caps are option-like contracts that require the writer, i.e. the seller, to pay the purchaser at specified future dates the amount, if any, by which a specified market interest rate exceeds the fixed cap rate, applied to a notional principal amount.

To satisfy the needs of its customers, the Corporation may enter into non-hedging transactions. These transactions are structured with the same terms and conditions and the Corporation participates as a buyer in one of the agreements and as the seller in the other agreements.

In addition, the Corporation enters into certain contracts with embedded derivatives that do not require separate accounting as these are clearly and closely related. When the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, it is bifurcated, carried at fair value, and designated as a trading or non-hedging derivative instrument.

10 GOODWILL AND OTHER INTANGIBLES

Goodwill at June 30, 2006 amounted to \$28.7 million (December 31, 2005 \$28.7 million, June 30, 2005 \$27.3 million and June 30, 2004 \$0) and resulted primarily from the acquisition of Ponce General Corporation in 2005. No goodwill was written down during 2006, 2005 and 2004.

At June 30, 2006, the gross carrying amount and accumulated amortization of core deposit intangibles was \$41.2 million and \$13.3 million, respectively, recognized as part of Other Assets in the Consolidated Statements of Financial Condition (December 31, 2005 \$41.2 million and \$11.6 million, respectively ; June 30, 2005 \$41.2 million and \$9.4 million, respectively ; June 30, 2004 \$23.9 million and \$6.7 million,

Table of Contents

respectively). During the quarters ended June 30, 2006, 2005 and 2004, the amortization expense of core deposits amounted to \$0.8 million, \$0.9 million, and \$0.6 million, respectively. For the six month periods ended June 30, 2006, 2005 and 2004, the amortization expense of core deposits amounted to \$1.8 million, \$1.5 million, and \$1.2 million, respectively.

11 DEPOSITS

The following table summarizes deposit balances:

	As of June 30, 2006	As of December 31, 2005 (Dollars in thousands)	As of June 30, 2005	As of June 30, 2004 (As Restated)
Non-interest bearing checking account deposits	\$ 711,284	\$ 811,006	\$ 791,510	\$ 601,854
Saving accounts	1,035,601	1,034,047	1,163,166	921,507
Interest-bearing checking accounts	389,086	375,305	399,512	316,579
Certificates of deposit	1,676,791	1,664,379	1,674,902	1,225,565
Brokered certificates of deposit	9,700,301	8,579,015	7,092,370	3,941,107
	\$ 13,513,063	\$ 12,463,752	\$ 11,121,460	\$ 7,006,612

The interest expense on deposits includes the valuation to market of interest rate swaps that hedge brokered certificates of deposit, the related interest exchanged, the amortization of broker placement fees and the basis adjustment amortization on the brokered CDs designated under fair value hedges.

The following are the components of interest expense on deposits:

	Quarter ended			Six month period ended		
	June 30, 2006	June 30, 2005	June 30, 2004 (As Restated) (Dollars in thousands)	June 30, 2006	June 30, 2005	June 30, 2004 (As Restated)
Interest expense on deposits	\$ 143,801	\$ 67,736	\$ 26,154	\$ 261,053	\$ 114,337	\$ 52,703
Amortization of broker placement fees	4,756	2,796	1,696	8,705	6,447	6,490
Interest expense on deposits excluding unrealized loss (gain) on derivatives (designated and undesignated hedges) and amortization of basis adjustment on fair value hedges	148,557	70,532	27,850	269,758	120,784	59,193
Unrealized loss (gain) on derivatives (designated	7,318	(72,826)	88,097	72,955	(29,096)	43,374

and undesignated hedges)
 Amortization of basis
 adjustment on fair value
 hedges

1,279

1,279

Total interest expense on
 deposits

\$ 157,154

\$ (2,294)

\$ 115,947

\$ 343,992

\$ 91,688

\$ 102,567

Total interest expense on deposits includes interest exchanged on interest rate swaps that hedge designated and undesignated brokered certificates of deposit that for the quarter and six month period ended June 30, 2006 amounted to net interest incurred of \$1.8 million and net interest realized of \$1.7 million, respectively (2005 net interest realized for the quarter and six month period of \$20.5 million and \$45.1 million, respectively ; 2004 net interest realized for the quarter and six month period of \$31.7 million and \$62.0 million, respectively).

Table of Contents**12 NOTES PAYABLE**

Notes payable consist of:

	June 30,	December	June 30,	June 30,
	2006	31,	2005	2004
		2005	2005	(As
		(Dollars in Thousands)		Restated)
Callable fixed rate notes, bearing interest at 6.00%, maturing on October 1, 2024	\$ 147,169	\$ 149,456	\$ 149,448	\$
Callable step-rate notes, bearing step increasing interest from 5.00% to 7.00% maturing on October 18, 2019	15,206	15,245	15,238	
Dow Jones Industrial Average (DJIA) linked principal protected notes:				
Series A maturing on February 28, 2012	6,966	6,752	6,378	6,535
Series B maturing on May 27, 2011	7,510	7,240	6,862	6,821
Callable fixed rate notes, bearing interest at 6.40%, maturing on June 1, 2019				29,883
Callable fixed rate notes, bearing interest at 6.40%, maturing on July 1, 2019				99,500
Callable step-up fixed rate notes, bearing interest at 4.90%, maturing on July 1, 2014				9,875
	\$ 176,851	\$ 178,693	\$ 177,926	\$ 152,614

Table of Contents**13 OTHER BORROWINGS**

Other borrowings consist of:

	June 30,	December	June 30,	June 30,
	2006	31,	2005	2004
		2005	2005	(As
		(Dollars in Thousands)		Restated)
Junior subordinated debentures due in 2034, interest bearing at a floating rate of 2.75% over 3-month LIBOR (8.15% at June 30, 2006 7.25% at December 31, 2005, 6.17% at June 30, 2005 and 3.93% at June 30, 2004)	\$ 102,804	\$ 102,756	\$ 102,707	\$ 102,610
Junior subordinated debentures due in 2034, interest bearing at a floating rate of 2.50% over 3-month LIBOR (7.91% at June 30, 2006 7.00% at December 31, 2005 and 5.94% at June 30, 2005)	128,866	128,866	128,866	
Loan payable to a local financial institution due in July 2004, interest bearing at 1.375%				45,167
	\$ 231,670	\$ 231,622	\$ 231,573	\$ 147,777

14 SUBORDINATED NOTES

On December 20, 1995, the Corporation issued 7.63% subordinated capital notes in the amount of \$100 million maturing on December 20, 2005. The notes were issued at a discount. At June 30, 2006, there was no outstanding balance as the notes payable were paid at their maturity date of December 20, 2005 (carrying value of \$82.6 million as of June 30, 2005 and \$82.0 million as of June 30, 2004). Interest on the notes was paid semiannually and at maturity. The notes represented unsecured obligations of the Corporation ranking subordinate in right of payment to all existing and future senior debt including the claims of depositors and other general creditors. The notes could not be redeemed prior to their maturity.

15 INCOME TAXES

Income tax expense include Puerto Rico and Virgin Islands income taxes as well as applicable federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp is treated as a foreign corporation for U.S. income tax purposes and is generally subject to United States income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is creditable, within certain conditions and limitations, against the Corporation's Puerto Rico tax liability. The Corporation is also subject to U.S. Virgin Islands taxes on its income from sources within this jurisdiction. However, any tax paid, subject to certain conditions and limitations, is creditable against the Corporation's Puerto Rico tax liability.

Under the Puerto Rico Internal Revenue Code of 1994, as amended (PR Code), First BanCorp is subject to a maximum statutory tax rate of 39%, except that in years 2005 and 2006, an additional transitory tax rate of 2.5% was signed into law by the Governor of Puerto Rico. In August 2005, the Government of Puerto Rico approved a transitory tax rate of 2.5% that increased the maximum statutory tax rate from 39.0% to 41.5% for a two-year period. The additional tax related to the income earned from January 1 to the date of enactment of the law was fully recorded in the third quarter of 2005. On May 13, 2006, with an effective date of January 1, 2006, the Governor of Puerto Rico approved an additional transitory tax rate of 2.0% applicable only to companies covered by the Puerto Rico Banking

Act as amended, such as First Bank Puerto Rico (First Bank or the Bank), which raised the maximum statutory tax rate to 43.5% for taxable years that commenced during calendar year 2006. For taxable years beginning after December

Table of Contents

31, 2006, the maximum statutory tax rate will be 39%. The PR Code also includes an alternative minimum tax of 22% that applies if the Corporation's regular income tax liability is less than the alternative minimum tax requirements.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and doing business through international banking units (IBEs) of the Corporation and the Bank and by the Bank's subsidiary, FirstBank Overseas Corporation. The IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico. Since 2004, IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs' net income exceeds predetermined percentages of the bank's total net taxable income; such limitations were 30% of total net taxable income for a taxable year commencing between July 1, 2004 and July 1, 2005, and 20% of total net taxable income for taxable years commencing thereafter.

For the six month period ended June 30, 2006, the Corporation's provision for income tax was \$4.3 million compared to \$38.3 million and \$4.9 million for the same period in 2005 and 2004, respectively. The decrease in income tax expense for the first half of 2006 as compared to the first six months of 2005 was mainly due to an increase in deferred tax benefits resulting principally from higher unrealized losses on derivative instruments. For the first six months of 2006, the Corporation recognized a deferred tax benefit of \$26.5 million compared to a deferred tax provision of \$6.8 million for the same period in 2005. The increase in income tax expense for the first half of 2005 as compared to the same period in 2004 was mainly due to a decrease in deferred tax benefits resulting principally from unrealized gains on derivative instruments coupled with an increase in the current tax provision. For the first six months of 2005, the Corporation recognized a deferred tax provision of \$6.8 million compared to a deferred tax benefit of \$23.0 million recognized for the same period in 2004.

The Corporation evaluated its ability to realize its deferred tax assets and concluded, based on the evidence available, that it is more likely than not that some of the deferred tax assets will not be realized and, thus, established a valuation allowance of \$4.7 million as of June 30, 2006. At June 30, 2006, the deferred tax asset, net of the valuation allowance, amounted to approximately \$162.5 million compared to \$68.5 million at June 30, 2005 and \$91.4 million at June 30, 2004. At June 30, 2005 and 2004, based on the Corporation's analysis and available evidence, the Corporation did not establish a valuation allowance.

16 SEGMENT INFORMATION

Based upon the Corporation's organizational structure and the information provided to the Chief Operating Decision Maker and to a lesser extent to the Board of Directors, the operating segments are driven primarily by the Corporation's legal entities. At June 30, 2006, the Corporation had four reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; and Treasury and Investments, as well as an Other category reflecting other legal entities reported separately on an aggregate basis. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation's organizational chart, nature of the products, distribution channels and the economic characteristics of the products were also considered in the determination of the reportable segments.

The Commercial and Corporate Banking segment consists of the Corporation's lending and other services for large customers represented by the public sector and specialized and middle-market clients. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and other products such as cash management and business management services. The Mortgage Banking segment's operations consist of the origination, sale and servicing of a variety of residential mortgage loans. The Mortgage Banking segment also acquires and sells mortgages in the secondary markets. Certain mortgage loans are purchased

Table of Contents

from other local banks or mortgage brokers. The Consumer (Retail) segment consists of the Corporation's consumer lending and deposit-taking activities conducted mainly through its branch network and loan centers. The Treasury and Investment segment is responsible for the Corporation's investment portfolio and treasury functions executed to manage and enhance liquidity. This segment loans funds to the Commercial and Corporate Banking; Mortgage Banking; and Consumer segments to finance their lending activities and borrows from those segments. The Consumer segment also loans funds to other segments. The interest rates charged or credited by Treasury and Investments and the Consumer segment are allocated based on market rates. The difference between the allocated interest income or expense and the Corporation's actual net interest income from centralized management of funding costs is reported in the Treasury and Investments segment. The Other category is mainly composed of insurance, finance leases and other products.

The accounting policies of the business segments are the same as those described in Note 1 of the Corporation's financial statements for the year ended December 31, 2005 contained in the annual report of the Corporation on Form 10-K.

The Corporation evaluates the performance of the segments based on net interest income after the estimated provision for loan and lease losses, non-interest income and direct non-interest expenses. The segments are also evaluated based on the average volume of their interest-earning assets less the allowance for loan and lease losses.

Table of Contents

The following table presents information about the reportable segments (in thousands):

	Mortgage Banking	Consumer	Commercial and Corporate	Treasury and Investments	Other	Total
For the quarter ended June 30, 2006:						
Interest income	\$ 36,528	\$ 50,539	\$ 132,974	\$ 96,218	\$ 28,184	\$ 344,443
Net (charge) credit for transfer of funds	(26,269)	28,134	(87,038)	90,114	(4,941)	
Interest expense		(17,902)		(194,388)	(5,915)	(218,205)
Net interest income (loss)	10,259	60,771	45,936	(8,056)	17,328	126,238
(Provision) recovery for loan and lease losses	(3,261)	368	865		(7,326)	(9,354)
Other income (loss)	450	5,909	(9,513)	64	4,873	1,783
Direct operating expenses	(3,790)	(21,259)	(3,323)	(1,425)	(11,170)	(40,967)
Segment income (loss)	\$ 3,658	\$ 45,789	\$ 33,965	\$ (9,417)	\$ 3,705	\$ 77,700
Average earnings assets	\$2,270,072	\$1,934,608	\$6,922,171	\$7,563,499	\$1,127,120	\$19,817,470
For the quarter ended June 30, 2005:						
Interest income	\$ 25,932	\$ 42,765	\$ 83,128	\$ 74,744	\$ 22,588	\$ 249,157
Net (charge) credit for transfer of funds	(15,875)	18,501	(57,594)	58,815	(3,847)	
Interest expense		(12,614)		(39,992)	(3,480)	(56,086)
Net interest income	10,057	48,652	25,534	93,567	15,261	193,071
(Provision) recovery for loan and lease losses	(1,033)	(8,703)	1,788		(3,127)	(11,075)
Other income (loss)	3,076	5,504	1,430	(1,012)	4,421	13,419
Direct operating expenses	(3,818)	(18,590)	(1,923)	(1,144)	(8,495)	(33,970)
Segment income	\$ 8,282	\$ 26,863	\$ 26,829	\$ 91,411	\$ 8,060	\$ 161,445
Average earnings assets	\$1,545,849	\$1,658,446	\$7,266,154	\$6,095,977	\$ 874,534	\$17,440,960
For the quarter ended June 30, 2004 (As Restated):						
Interest income	\$ 18,188	\$ 33,508	\$ 43,580	\$ 53,954	\$ 11,372	\$ 160,602
Net (charge) credit for transfer of funds	(11,750)	14,008	(18,184)	17,901	(1,975)	
Interest expense		(9,926)		(145,692)		(155,618)
Net interest income (loss)	6,438	37,590	25,396	(73,837)	9,397	4,984
(Provision) recovery for loan and lease losses	(175)	(9,939)	413		(3,499)	(13,200)

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Other income	223	5,312	2,600	731	3,280	12,146
Direct operating expenses	(2,456)	(16,076)	(1,742)	(800)	(4,406)	(25,480)
Segment income (loss)	\$ 4,030	\$ 16,887	\$ 26,667	\$ (73,906)	\$ 4,772	\$ (21,550)
Average earnings assets	\$1,049,551	\$1,290,103	\$4,871,389	\$5,504,959	\$ 279,383	\$12,995,385

49

Table of Contents

	Mortgage Banking	Consumer	Commercial and Corporate	Treasury and Investments	Other	Total
For the six-month period ended June 30, 2006:						
Interest income	\$ 71,852	\$ 100,512	\$ 267,422	\$ 177,174	\$ 55,188	\$ 672,148
Net (charge) credit for transfer of funds	(49,806)	53,205	(176,169)	182,140	(9,370)	
Interest expense		(33,933)		(427,905)	(11,253)	(473,091)
Net interest income	22,046	119,784	91,253	(68,591)	34,565	199,057
(Provision) recovery for loan and lease losses	(3,587)	(12,917)	33		(12,259)	(28,730)
Other (loss) income	(104)	11,745	(8,595)	(846)	10,171	12,371
Direct operating expenses	(7,375)	(42,672)	(8,562)	(3,281)	(21,651)	(83,541)
Segment income (loss)	\$ 10,980	\$ 75,940	\$ 74,129	\$ (72,718)	\$ 10,826	\$ 99,157
Average earnings assets	\$ 2,203,199	\$ 1,935,327	\$ 7,290,553	\$ 6,980,564	\$ 1,102,771	\$ 19,512,354
For the six-month period ended June 30, 2005:						
Interest income	\$ 48,660	\$ 81,703	\$ 162,644	\$ 133,396	\$ 35,131	\$ 461,534
Net (charge) credit for transfer of funds	(30,070)	35,357	(103,868)	105,020	(6,439)	
Interest expense		(23,618)		(176,089)	(3,480)	(203,187)
Net interest income	18,590	93,442	58,776	62,327	25,212	258,347
Provision for loan and lease losses	(1,494)	(12,519)	(3,807)		(4,209)	(22,029)
Other income	3,588	10,262	2,713	8,590	8,517	33,670
Direct operating expenses	(7,340)	(36,203)	(5,036)	(2,375)	(13,882)	(64,836)
Segment income	\$ 13,344	\$ 54,982	\$ 52,646	\$ 68,542	\$ 15,638	\$ 205,152
Average earnings assets	\$ 1,444,535	\$ 1,600,327	\$ 6,974,788	\$ 5,493,371	\$ 605,390	\$ 16,118,411
For the six-month period ended June 30, 2004 (As Restated):						
Interest income	\$ 36,678	\$ 66,519	\$ 84,976	\$ 100,776	\$ 22,470	\$ 311,419
Net (charge) credit for transfer of funds	(23,368)	25,312	(32,357)	34,174	(3,761)	
Interest expense		(19,893)		(157,756)		(177,649)
Net interest income (loss)	13,310	71,938	52,619	(22,806)	18,709	133,770
Provision for loan and lease losses	(440)	(15,229)	(6,159)		(4,572)	(26,400)
Other income	1,799	15,361	3,929	5,945	6,076	33,110
Direct operating expenses	(4,807)	(31,167)	(3,810)	(1,450)	(8,658)	(49,892)
Segment income (loss)	\$ 9,862	\$ 40,903	\$ 46,579	\$ (18,311)	\$ 11,555	\$ 90,588

Average earnings assets	\$ 1,033,092	\$ 1,265,410	\$ 4,699,943	\$ 5,088,707	\$ 273,786	\$ 12,360,938
-------------------------	--------------	--------------	--------------	--------------	------------	---------------

Table of Contents

The following table presents a reconciliation of the reportable segment financial information to the consolidated totals (in thousands):

	Quarter Ended June 30,		
	2006	2005	2004 (As Restated)
Net income:			
Total income (loss) for segments and other	\$ 77,700	\$ 161,445	\$ (21,550)
Other operating expenses	(30,073)	(22,103)	(20,105)
Income before income taxes	47,627	139,342	(41,655)
Income tax (expense) benefit	(15,824)	(41,936)	23,463
Total consolidated net income (loss)	\$ 31,803	\$ 97,406	\$ (18,192)
Average assets:			
Total average earning assets for segments	\$ 19,817,470	\$ 17,440,960	\$ 12,995,385
Average non-earning assets	744,490	594,079	450,978
Total consolidated average assets	\$ 20,561,960	\$ 18,035,039	\$ 13,446,363

	Six-month Period Ended June 30,		
	2006	2005	2004 (As Restated)
Net income:			
Total income for segments and other	\$ 99,157	\$ 205,152	\$ 90,588
Other operating expenses	(59,237)	(44,244)	(38,423)
Income before income taxes	39,920	160,908	52,165
Income taxes	(4,254)	(38,287)	(4,927)
Total consolidated net income	\$ 35,666	\$ 122,621	\$ 47,238
Average assets:			
Total average earning assets for segments	\$ 19,512,354	\$ 16,118,411	\$ 12,360,938
Average non-earning assets	707,886	524,210	407,239
Total consolidated average assets	\$ 20,220,240	\$ 16,642,621	\$ 12,768,177

17. COMMITMENTS AND CONTINGENCIES

The Corporation enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments may include commitments to extend credit and commitments to sell and purchase mortgage loans at fair value. As of June 30, 2006, commitments to extend credit amounted to approximately \$1.9 billion and stand by letters of credit amounted to approximately \$105.2 million.

Commitments to extend credit are agreements to lend to a customer as long as the conditions established in the contract are met. Commitments generally have fixed expiration dates or other termination clauses. Generally, the Corporation's mortgage banking activities do not enter into interest rate lock agreements with its prospective borrowers.

As of June 30, 2006, First BanCorp and its subsidiaries were defendants in various legal proceedings arising in the ordinary course of business. Management believes, based on the opinion of legal counsel, that the final disposition of these matters will not have a material adverse effect on the Corporation's financial position or results of operations, except as described below.

Table of Contents

On August 1, 2005, the Audit Committee of the Corporation determined that it should review the background and accounting for certain mortgage-related transactions that the Corporation had entered into with Doral Financial Corporation (Doral) and R&G Financial Corporation (R&G) between 1999 and 2005 that did not qualify as true sales for accounting purposes. The Committee retained the law firms of Clifford Chance U.S. LLP and Martínez Odell & Calabria and forensic accountants FTI Consulting Inc. to assist the Audit Committee in its review. On August 25, 2005, the Corporation announced the receipt of a letter from the SEC in which the SEC indicated that it was conducting an informal inquiry into the Corporation. On October 21, 2005, the Corporation announced that the SEC had issued a formal order of investigation into the accounting for the mortgage related transactions with Doral and R&G. The Corporation announced on December 13, 2005 that management, with the concurrence of the Board of Directors, determined to restate its previously reported financial statements to correct its accounting for the mortgage-related transactions. The Corporation has fully cooperated with the SEC's investigation. In August 2006, the Audit Committee completed its review and the Corporation filed the Amended 2004 Form 10-K with the SEC on September 26, 2006, the 2005 Form 10-K on February 9, 2007 and the 2006 Form 10-K on July 9, 2007.

On August 7, 2007, First BanCorp announced that the SEC approved a final settlement with the Corporation, which resolves the previously disclosed SEC investigation of the Corporation. Under the settlement, the Corporation agreed, without admitting or denying any wrongdoing, to be enjoined from future violations of certain provisions of the securities laws. The Corporation also agreed to pay an \$8.5 million civil penalty and the disgorgement of \$1 to the SEC. The SEC may request that the civil penalty be subject to distribution pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's previously filed audited Consolidated Financial Statements for 2005, the Corporation accrued \$8.5 million in 2005 for the potential settlement with the SEC. In connection with the settlement, the Corporation consented to the entry of a final judgment to implement the terms of the agreement. The United States District Court for the Southern District of New York must consent to the entry of the final judgment in order to consummate the settlement.

Following the announcement of the Audit Committee's review, the Corporation and certain of its current and former officers and directors were named as defendants in five separate securities class actions filed between October 31, 2005 and December 5, 2005, alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. At present, all securities class actions have been consolidated into one case named *In Re: First BanCorp Securities Litigations*. Subsequently, in 2007, the Corporation reached an agreement in principle and signed a memorandum of understanding with the lead plaintiff. The agreement specified a payment of \$74.25 million by the Corporation subject to the approval by the United States District Court for the District of Puerto Rico.

On August 1, 2007, the United States District Court for the District of Puerto Rico issued a Preliminary Order approving the stipulation of settlement filed in connection with the proposed settlement of the class action lawsuit brought on behalf of First BanCorp's shareholders against the Corporation in the amount of \$74.25 million.

The effectiveness of a final order to be issued by the Court is subject to:

The payment of \$61 million to be deposited by First BanCorp in a settlement fund within fifteen calendar days of the date of issuance of the Preliminary Order; and

The mailing of a notice to shareholders that describes the general terms of the settlement.

Table of Contents

The court hearing for the final order of approval of the settlement has been set for October 15, 2007. First BanCorp intends to comply with the \$61 million payment requirement within the timeframe set forth in the terms of the settlement. The remaining amount of \$13,250,000 will be paid before December 31, 2007. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's audited Consolidated Financial Statements, included in the Corporation's 2005 Annual Report on Form 10-K, the Corporation accrued \$74.25 million in 2005 for a possible settlement of the class action.

The Corporation expects to seek recovery of a total of approximately \$14.75 million from its insurance companies and from former executives of the Corporation. Since agreements with the insurance carriers have not been executed, the Corporation cannot provide assurances that the monies from the insurance carriers will be received and consequently, the Corporation has not made accruals for any potential payment from its insurance carriers.

Between November 8, 2005 and March 7, 2006, several shareholders of the Corporation commenced five separate derivative actions against certain current and former executive officers and directors of the Corporation. In these actions, the Corporation was included as a nominal defendant. These actions were filed pursuant to Section 304 of the Sarbanes-Oxley Act of 2002 and alleged, among other things, a breach of fiduciary duty on behalf of the defendants. All shareholder derivative actions were consolidated into one case named *In Re: First BanCorp Derivative Litigation* which was dismissed on November 30, 2006 before the U.S. District Court for the District of Puerto Rico.

Table of Contents**18 FIRST BANCORP (Holding Company Only) Financial Information**

The following condensed financial information presents the financial position of the Holding Company only at June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004 and the results of its operations for the quarter and six-month period ended on June 30, 2006, 2005 and 2004.

	As of June 30, 2006	As of December 31, 2005	As of June 30, 2005	As of June 30, 2004 (As Restated)
Assets				
Cash and due from banks	\$ 16,748	\$ 2,772	\$ 16,058	\$ 29,102
Money market instruments	300	300	69,100	51,569
Investment securities available for sale, at market:				
Equity investments	21,394	29,421	68,420	50,836
Other equity securities	1,425	1,425	1,375	375
Loans receivable, net	68,845	74,914	84,429	102,024
Investment in FirstBank Puerto Rico, at equity	1,285,404	1,316,380	1,236,075	1,036,318
Investment in FirstBank Insurance Agency, at equity	2,588	5,953	4,141	1,784
Investment in Ponce General Corporation, at equity	100,359	105,907	103,667	
Investment in PR Finance, at equity	2,550	3,005	2,519	
Accrued interest receivable	387	363	429	358
Investment in FBP Statutory Trust I	3,093	3,093	3,093	
Investment in FBP Statutory Trust II	3,866	3,866	3,866	
Other assets	32,689	29,758	821	5,662
Total assets	\$ 1,539,648	\$ 1,577,157	\$ 1,593,993	\$ 1,278,028
Liabilities & Stockholders Equity				
Liabilities:				
Other borrowings	\$ 231,670	\$ 295,446	\$ 303,499	\$ 197,377
Accounts payable and other liabilities	148,555	83,870	1,512	882
Total liabilities	380,225	379,316	305,011	198,259
Stockholders equity	1,159,423	1,197,841	1,288,982	1,079,769
Total liabilities and stockholders equity	\$ 1,539,648	\$ 1,577,157	\$ 1,593,993	\$ 1,278,028

Table of Contents

	Quarter Ended June 30, 2006	Quarter Ended June 30, 2005	Quarter Ended June 30, 2004 (As Restated)
		(Dollars in thousands)	
Income:			
Interest income on investment securities	\$	\$ 262	\$ 90
Interest income on other investments	164	603	169
Interest income on loans	1,032	1,048	381
Dividend from FirstBank Puerto Rico	1,961	16,886	15,410
Dividend from other subsidiaries	9,500	240	2,770
Other income	134	271	180
	12,791	19,310	19,000
Expense:			
Federal funds purchased and repurchase agreements			2
Notes payable and other borrowings	4,522	3,980	870
Interest on funding to subsidiaries	1,227		
Other operating expenses	1,288	390	197
	7,037	4,370	1,069
(Loss) gain on sale of investments, net	(817)	(1,181)	552
Income before income tax provision and equity in undistributed earnings (loss) of subsidiaries	4,937	13,759	18,483
Income tax provision	(1,925)	(26)	(29)
Equity in undistributed earnings (loss) of subsidiaries	28,791	83,673	(36,646)
Net income (loss)	\$ 31,803	\$ 97,406	\$ (18,192)
	Six-month Period Ended June 30, 2006	Six-month Period Ended June 30, 2005	June 30, 2004

	(As Restated)		
	(Dollars in thousands)		
Income:			
Interest income on investment securities	\$ 178	\$ 342	\$ 241
Interest income on other investments	167	1,722	291
Interest income on loans	2,085	2,032	446
Dividend from FirstBank Puerto Rico	19,088	33,631	30,320
Dividend from other subsidiaries	13,500	240	2,770
Other income	258	474	229
	35,276	38,441	34,297
Expense:			
Federal funds purchased and repurchase agreements			2
Notes payable and other borrowings	8,668	7,516	871
Interest on funding to subsidiaries	1,969		
(Recovery) provision for loan losses	(71)		
Other operating expenses	2,544	648	391
	13,110	8,164	1,264
(Loss) gain on sale of investments, net	(1,850)	1,780	3,915
Income before income tax provision and equity in undistributed earnings of subsidiaries	20,316	32,057	36,948
Income tax provision	(837)	(34)	(74)
Equity in undistributed earnings of subsidiaries	16,187	90,598	10,364
Net income	\$ 35,666	\$ 122,621	\$ 47,238

Table of Contents

19. SUBSEQUENT EVENTS

Following the close of the second quarter of 2006, a number of events have occurred including:

Effective January 1, 2007, the Corporation elected to early adopt SFAS 159 for the callable brokered CDs and a portion of the callable medium-term notes that were previously recognized under the long-haul method as hedged against certain interest rate swaps under SFAS 133. Refer to Note 2 for additional information on the adoption of SFAS 159.

In February 2007, the Corporation entered into various agreements with R&G relating to prior transactions originally treated as purchases of mortgages and pass-through trust certificates from R&G subsidiaries. First, through a mortgage payment agreement, R&G paid the Corporation approximately \$50 million to reduce the commercial loan that R&G Premier has outstanding with the Corporation. In addition, the remaining balance of approximately \$271 million was re-documented as a secured loan from the Corporation to R&G. Second, R&G and the Corporation amended various agreements involving approximately \$218 million of securities collateralized by loans that were originally sold through five grantor trusts. The modifications to the original agreements allow the Corporation to treat these transactions as true sales for accounting and legal purposes. The agreements enable First BanCorp to fulfill the remaining requirement of the Consent Order signed with banking regulators relating to the mortgage-related transactions with R&G that First BanCorp recharacterized for accounting and legal purposes as commercial loans secured by the mortgage loans and pass-through trust certificates.

During the first quarter of 2007, the Corporation announced that it had entered into a definitive agreement to issue approximately 9.250 million shares of its common stock to The Bank of Nova Scotia (Scotiabank), through a private placement offering, valuing the stock at \$10.25 per share for a total purchase price of approximately \$94.8 million. The valuation reflects a premium of approximately 5% over the volume weighted- average closing share price over the 30 trading-day period ending January 30, 2007. After the investment, Scotiabank will hold approximately 10% of First BanCorp s currently outstanding common shares. The original agreement provided that the agreement may be terminated at any time prior to the closing by either the Corporation or Scotiabank if the closing did not occur by July 31, 2007 (the Termination Date). The agreement was subsequently amended to change the Termination Date to August 31, 2007. On August 9, 2007, First BanCorp announced the approval by the Federal Reserve Board of the private placement offering with Scotiabank.

On August 1, 2007, the United States District Court for the District of Puerto Rico issued a Preliminary Order approving the stipulation of settlement filed in connection with the proposed settlement of the class action lawsuit brought on behalf of First BanCorp s shareholders against the Corporation in the amount of \$74.25 million.

The effectiveness of a final order to be issued by the Court is subject to:

- The payment of \$61 million to be deposited by First BanCorp in a settlement fund within fifteen calendar days of the date of issuance of the Preliminary Order; and
- The mailing of a notice to shareholders that describes the general terms of the settlement.

The court hearing for the final order of approval of the settlement has been set for October 15, 2007. First BanCorp intends to comply with the \$61 million payment requirement within the timeframe

Table of Contents

set forth in the terms of the settlement. The remaining amount of \$13,250,000 will be paid before December 31, 2007. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's audited Consolidated Financial Statements, included in the Corporation's 2005 Annual Report on Form 10-K, the Corporation accrued \$74.25 million in 2005 for a possible settlement of the class action.

On August 7, 2007, First BanCorp announced that the SEC approved a final settlement with the Corporation, which resolves the previously disclosed SEC investigation of the Corporation. Under the settlement, the Corporation agreed, without admitting or denying any wrongdoing, to be enjoined from future violations of certain provisions of the securities laws. The Corporation also agreed to pay an \$8.5 million civil penalty and the disgorgement of \$1 to the SEC. The SEC may request that the civil penalty be subject to distribution pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's previously filed audited Consolidated Financial Statements for 2005, the Corporation accrued \$8.5 million in 2005 for the potential settlement with the SEC. In connection with the settlement, the Corporation consented to the entry of a final judgment to implement the terms of the agreement. The United States District Court for the Southern District of New York must consent to the entry of the final judgment in order to consummate the settlement.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (MD&A)

Restatement of Previously Issued Financial Statements

On September 26, 2006, First BanCorp filed with the SEC its amended 2004 Annual Report on Form 10-K/A, which included a restatement of the Corporation's audited financial statements for the years ended December 31, 2004, 2003 and 2002 and unaudited selected quarterly financial information for each of the four quarters of 2004, 2003 and 2002 (the 2004 restatement). This Quarterly Report on Form 10-Q includes financial information for the quarter ended June 30, 2004, as restated. The restatement reflects adjustments necessary to correct accounting errors relating to the following:

Accounting for derivative instruments and broker placement fees;

Recharacterization of purchases of mortgage loans and pass-through trust certificates as commercial loans secured by mortgage loans;

Accounting for investment securities;

Accounting for deferral and recognition of origination fees and costs on loans; and

Other accounting adjustments and reclassifications, including adjustments to the gain on sale of credit card portfolios, accrual for rental expense on lease contracts, valuation of financial instruments and income from a loan origination subsidiary.

In addition, with the filing of its 2006 Annual Report on Form 10-K, First BanCorp restated its 2005 and 2004 Statements of Cash Flows due to some incorrect classifications. The classification errors related to three main items: 1) the treatment of discounts and the related accretion activity on certain investment securities, 2) the classification of cash flows from the disposition of repossessed assets, and 3) purchases of zero coupon bonds and agency discount notes amounts presented as part of investing activities.

The filing of this Quarterly Report on Form 10-Q was delayed because of the time required to complete the 2004 restatement. For more information on the Corporation's 2004 restatement, refer to Item 8, Financial Statements and Supplementary Data, Note 1 Restatement of Previously Issued Financial Statements in the Corporation's amended 2004 Annual Report on Form 10-K. For more information on the Corporation's 2006 restatement, refer to Item 8, Financial Statements and Supplementary Data, Note 1 Restatement of 2005 and 2004 Consolidated Statements of Cash Flows to First BanCorp audited Consolidated Financial Statements, included in the Corporation's 2006 Annual Report on Form 10-K. For more information on the impact of the 2004 and 2006 restatements on the Corporation's financial statements for the quarter and six month period ended June 30, 2004, refer to Note 1 to the accompanying unaudited interim consolidated financial statements contained in this Quarterly Report on Form 10-Q.

Table of Contents**SELECTED FINANCIAL DATA****(In thousands except for per share and financial ratios results)**

	Quarter ended			Six Month Period Ended		
	2006	June 30, 2005	2004 (As Restated)	2006	June 30, 2005	2004 (As Restated)
Condensed Income Statements:						
Total interest income	\$ 344,443	\$ 249,157	\$ 160,602	\$ 672,148	\$ 461,534	\$ 311,419
Total interest expense	218,205	56,086	155,618	473,091	203,187	177,649
Net interest income	126,238	193,071	4,984	199,057	258,347	133,770
Provision for loan and lease losses	9,354	11,075	13,200	28,730	22,029	26,400
Non-interest income	1,783	13,419	12,146	12,371	33,670	33,110
Non-interest expenses	71,040	56,073	45,585	142,778	109,080	88,315
Income (Loss) before income taxes	47,627	139,342	(41,655)	39,920	160,908	52,165
Income tax (expense) benefit	(15,824)	(41,936)	23,463	(4,254)	(38,287)	(4,927)
Net income (loss)	31,803	97,406	(18,192)	35,666	122,621	47,238
Net income (loss) attributable to common stockholders	21,734	87,337	(28,261)	15,528	102,483	27,100
Per Common Share Results (1):						
Net income (loss) per share basic	\$ 0.26	\$ 1.08	\$ (0.35)	\$ 0.19	\$ 1.27	\$ 0.34
Net income (loss) per share diluted	\$ 0.26	\$ 1.05	\$ (0.35)	\$ 0.19	\$ 1.23	\$ 0.33
Cash dividends declared	\$ 0.07	\$ 0.07	\$ 0.06	\$ 0.14	\$ 0.14	\$ 0.12
Average shares outstanding	83,254	80,852	80,430	82,410	80,818	80,280
Average shares outstanding diluted	83,412	82,872	80,430	82,908	83,141	82,752
Book value per share	7.32	9.14	6.59	7.32	9.14	6.59
Selected Financial Ratios (In Percent):						
Profitability:						
Return on Average Assets	0.62	2.17	(0.54)	0.36	1.49	0.74
Interest Rate Spread	2.28	3.03	2.91	2.46	2.99	2.93
Net Interest Margin	2.73	3.37	3.20	2.91	3.34	3.24
Return on Average Total Equity	10.91	31.66	(6.64)	6.05	20.34	8.61
Return on Average Common Equity	14.08	51.22	(20.63)	4.90	31.04	9.88
Average Total Equity to Average Total Assets	5.69	6.84	8.18	5.88	7.31	8.62
Dividend payout ratio	26.81	6.48	(17.08)	74.93	11.04	35.58
Efficiency ratio (2)	55.49	27.16	266.10	67.53	37.35	52.92
Asset Quality:						
Allowance for loan and lease losses to loans receivable	1.35	1.24	1.68	1.35	1.24	1.68
Net charge-offs (annualized) to average loans	0.50	0.32	0.52	0.48	0.34	0.52
Provision for loan and lease losses to net charge-offs	0.61	1.21	1.34	0.95	1.21	1.38
Other Information:						
Common Stock Price: End of period (1)	\$ 9.30	\$ 20.08	\$ 20.38	\$ 9.30	\$ 20.08	\$ 20.38

	As of June 30, 2006	As of December 31, 2005	As of June 30, 2005	As of June 30, 2004 (As Restated)
Balance Sheet Data:				
Loans and loans held for sale	\$ 10,905,259	\$ 12,685,929	\$ 11,872,969	\$ 7,986,010
Allowance for loan and lease losses	146,527	147,999	146,154	133,678
Money market and investment securities	8,641,981	6,653,925	6,493,229	6,197,032
Total assets	20,180,878	19,917,651	18,814,278	14,489,149
Deposits	13,513,063	12,463,752	11,121,460	7,006,612
Borrowings	4,625,207	5,750,197	6,147,149	5,963,429
Total common equity	609,323	647,741	738,882	529,669
Total equity	1,159,423	1,197,841	1,288,982	1,079,769

- 1- Adjusted to reflect two-for-one stock split effective June 30, 2005.
- 2- Non-interest expense to the sum of net interest income and non-interest income. The denominator includes non-recurring items and changes in the fair value of derivative instruments.

Table of Contents**OVERVIEW OF RESULTS OF OPERATIONS**

This discussion and analysis relates to the accompanying consolidated interim unaudited financial statements of First BanCorp (the Corporation or First BanCorp) and should be read in conjunction with the interim unaudited financial statements and the notes thereto.

First BanCorp's results of operations depend primarily upon its net interest income, which is the difference between the interest income earned on its interest-earning assets, including investment securities and loans, and the interest expense on its interest-bearing liabilities, including deposits and borrowings. Net interest income is affected by various factors including the interest rate scenario, the volumes, mix and composition of interest-earning assets and interest-bearing liabilities; and the re-pricing characteristics of these assets and liabilities. The Corporation's results of operations also depend on the provision for loan and lease losses, non-interest expenses (such as personnel, occupancy and other costs), non-interest income (mainly insurance income and service charges and fees on loans and deposits), the result of its hedging activities, gains (losses) on investments, gains (losses) on sale of loans, and income taxes.

As previously reported, on March 31, 2005, the Corporation completed the acquisition of 100% of the outstanding common shares of Ponce General Corporation, the holding company of FirstBank Florida (formerly known as Unibank) a thrift subsidiary, and Ponce Realty. This acquisition will allow First BanCorp to build a larger platform in Florida from which to initiate further expansion into the United States. As of March 31, 2005, excluding the effects of purchase accounting entries, Ponce General had approximately \$546.2 million in assets and \$439.1 million in deposits. Ponce General assets were mainly comprised of \$476.0 million in loans (\$425.8 million commercial and residential mortgage loans; \$28.2 million commercial and construction loans; and \$22.1 million consumer loans). In connection with the purchase, the Corporation paid a cash premium of approximately \$36 million that was mainly allocated to core deposit intangibles and goodwill.

For the quarter ended June 30, 2006, the Corporation's net income amounted to \$31.8 million, compared to a net income of \$97.4 million and a net loss of \$18.2 million for the quarters ended June 30, 2005 and 2004, respectively. For the quarter ended June 30, 2006, diluted earnings per common share amounted to \$0.26, compared to diluted earnings per common share of \$1.05 and losses per common share of \$0.35, for the comparable period in 2005 and 2004, respectively. Return on average assets and return on average common equity were 0.62% and 14.08% respectively, for the quarter ended June 30, 2006 as compared to 2.17% and 51.22% and (0.54)% and (20.63)%, respectively, for the same quarter of 2005 and 2004, respectively. The Corporation's financial performance for the second quarter of 2006, as compared to the second quarter of 2005, was principally impacted by: (1) positive variances in the valuation of derivative instruments, (2) a loss of \$11.6 million on the partial extinguishment of certain secured commercial loan to a local financial institution, and (3) higher non-interest expenses, primarily professional fees associated with the Audit Committee's review and the restatement process.

The highlights and key drivers of the Corporation's financial results for the quarter ended June 30, 2006 included the following:

For the quarter ended June 30, 2006, the Corporation's operations resulted in a net income of \$31.8 million, compared to net income of \$97.4 million and a net loss of \$18.2 million for the quarters ended June 30, 2005 and 2004, respectively. After payment of preferred stock dividends, the Corporation's net income available to common stockholders amounted to \$21.7 million for the second quarter of 2006, \$87.3 million for the second quarter of 2005, and a net loss attributable to common stockholders of \$28.3 million for the second quarter of 2004.

Table of Contents

Diluted earnings per common share for the quarter ended June 30, 2006 was \$0.26, compared to diluted earnings per common share of \$1.05 and losses per common share of \$0.35 for the quarters ended June 30, 2005 and 2004, respectively.

Net interest income for the quarters ended June 30, 2006, 2005, and 2004 was \$126.2 million, \$193.1 million, and \$5.0 million, respectively. Net interest income fluctuated significantly due to changes in the valuation of derivative instruments. For the quarter ended June 30, 2006, the Corporation recorded net unrealized losses of \$2.1 million in the valuation of derivative instruments, compared to net unrealized gains of \$63.4 million and unrealized losses of \$84.9 million for the same period in 2005 and 2004, respectively. Refer to the *Net Interest Income* discussion below for further details.

On a tax equivalent basis, excluding the changes in the fair values of derivative instruments, the ineffective portion resulting from fair value hedge accounting as well as the basis adjustment amortization or accretion (for definition and reconciliation of this non-GAAP measure, refer to the *Net Interest Income* discussion below), net interest income for the quarters ended June 30, 2006, 2005, and 2004 was \$136.2 million, \$147.4 million, and \$104.2 million, respectively. The decrease in tax equivalent net interest income, when excluding the changes in the fair values of derivative instruments, the ineffective portion resulting from fair value hedge accounting as well as the basis adjustment amortization or accretion, was principally due to margin compressions due to the flattening of the yield curve and fluctuations in net interest incurred on interest rate swaps. The interest margin on a tax equivalent basis was 2.73% for the quarter ended June 30, 2006, compared to 3.37% and 3.20% for the same periods in 2005 and 2004, respectively. The decrease in the Corporation's net interest margin on a tax equivalent basis has been particularly significant with respect to the Corporation's portfolio of investment securities. The interest rate spread on the Corporation's portfolio of investment securities, (allocating a funding cost equal to the weighted-average cost of the Corporation's other borrowed funds) was approximately 0.65% for the quarter ended June 30, 2006 compared to 2.18% for the quarter ended June 30, 2005. Increases in short-term rates resulted in a change in net interest settlements on interest rate swaps included as part of interest expense. For the quarter ended June 30, 2006, the net interest settlement on such interest rate swaps resulted in additional charges of \$1.8 million to interest expense, compared to benefits of \$20.5 million recognized as a reduction to interest expense for the same period in 2005, as the rates paid by the Corporation under the variable portion of the swaps exceeded the rates received by the Corporation under the fixed portion of the swap.

The increase in tax equivalent net interest income for 2005, compared to 2004, was mainly driven by higher average balance of loans receivable, particularly residential real estate loans, coupled with an increase in the Corporation's net margin, offset in part by a decrease in net interest realized on interest rate swaps.

For the quarter ended June 30, 2006, the Corporation provided \$9.4 million for loan and lease losses, compared to \$11.1 million and \$13.2 million for quarters ended June 30, 2005 and 2004, respectively. The decrease for the second quarter of 2006 principally reflects a reduction in the Corporation's commercial loans due to the payment of \$2.4 billion received from a local financial institution substantially reducing the amount of secured commercial loans outstanding, offset in part by increasing trends in non-performing loans experienced during 2006. The decrease in the provision for loan and lease losses during 2005 was due in part to the stability experienced in non-performing loans coupled with the seasoning of the corporate commercial loans portfolio and a decrease in net charge-offs.

Non-interest income for the second quarter of 2006 was \$1.8 million, compared to \$13.4 million and \$12.1 million for the same periods in 2005 and 2004, respectively. The decrease in non-interest income for the second quarter of 2006, compared to 2005, was mainly attributable to a loss of \$11.6 million recorded on the partial extinguishment of a secured commercial loan to a local financial institution offset in part by higher net

gains on investments. The increase during 2005 compared to 2004 was principally due to

61

Table of Contents

increases in mortgage banking activities income associated with a higher volume of sales, and higher insurance income partially offset by a decrease in other commissions and fees income.

Non-interest expenses for the second quarter of 2006 amounted to \$71.0 million, compared to \$56.1 million and \$45.6 million, for the same period in 2005 and 2004, respectively. The increase in non-interest expenses for 2006 compared to 2005 was mainly due to increases in professional fees associated with the internal review conducted by the Corporation's Audit Committee, the restatement process and other related legal and regulatory matters as well as increases in employees' compensation and benefits and occupancy and equipment expenses. The increase in non-interest expenses for the second quarter of 2005 compared to 2004 mainly reflects increases in employees' compensation and benefits, occupancy and equipment, professional fees, and servicing and processing fees.

For the quarter ended June 30, 2006, the Corporation reported an income tax expense of \$15.8 million, compared to an income tax expense of \$41.9 million and an income tax benefit of \$23.5 million for the quarters ended June 30, 2005 and 2004, respectively. The decrease in provision for income taxes for the second quarter of 2006, as compared to the second quarter of 2005, was mainly due to an increase in deferred tax benefits mainly as a result of variances in the valuation of derivative instruments. The income tax expense for 2005 compared to a tax benefit recorded in 2004 was mainly due to increases in deferred tax expenses associated with unrealized gains on derivative instruments.

Total assets at June 30, 2006 amounted to \$20.2 billion, an increase of \$0.3 billion, \$1.4 billion and \$5.7 billion as compared to total assets as of December 31, 2005, June 30, 2005 and 2004, respectively. The increase at June 30 2006 compared to balances at December 31, 2005 and June 30, 2005 was mainly the result of increases in money market instruments partially offset by decreases in the Corporation's loans and investments portfolio. The decrease in the Corporation's loans portfolio was due to the payment received on a secured commercial loan extended to a local financial institution. A portion of such proceeds was used to fund temporarily the increase in short-term investment, mainly money market instruments. The decrease in investment securities was due to the Corporation's decision to deleverage its balance sheet by not reinvesting maturities and prepayments received from the Corporation's investment portfolio, mainly mortgage-backed securities. The deleverage of the investment portfolio was influenced, among other things, by the flat-to-inverted yield curve. Also, the Corporation decided to use proceeds from the payment received on secured commercial loans to repay, during the second half of 2006, higher rate maturing liabilities, in particular brokered CDs, rather than investing the proceeds at an interest yield lower than the Corporation's cost of funds. The increase at June 30, 2005, compared to balances at June 30, 2004, was mainly due to increases in the Corporation's loan portfolio, in particular residential real estate, commercial, construction and consumer loans.

Total liabilities at June 30, 2006 were \$19.0 billion, an increase of \$0.3 billion, \$1.5 billion, and \$5.6 billion as compared to balances as of December 31, 2005, June 30, 2005, and 2004, respectively. The increase in total liabilities was mainly due to increases in interest bearing deposits, mainly brokered CDs, partially offset by decreases in FHLB advances and federal funds purchased and securities sold under agreements to repurchase. During 2005, the Corporation experienced a significant increase in brokered CDs as short-term brokered CDs were issued to fund the Corporation's growth and to replace advances from the Federal Home Loan Bank.

Total loan production for the quarter ended June 30, 2006 was \$1.3 billion, compared to \$1.7 billion and \$1.1 billion, for the second quarter of 2005 and 2004, respectively. The decrease in loan production for 2006 compared to 2005 was mainly due to decreases in residential real estate, commercial, construction, and consumer loan originations, mainly due to higher prevailing interest rates, deteriorating economic conditions and stricter underwriting standards.

Table of Contents

Critical Accounting Policies and Practices

The accounting principles of the Corporation and the methods of applying these principles conform with generally accepted accounting principles in the United States and to general practices within the banking industry. The Corporation's critical accounting policies relate to the 1) allowance for loan and lease losses; 2) other-than-temporary impairments; 3) income taxes; 4) classification and related values of investment securities; 5) valuation of financial instruments; and 6) derivative financial instruments. These critical accounting policies involve judgments, estimates and assumptions made by management that affect the recorded assets and liabilities and contingent assets and liabilities disclosed at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from estimates, if different assumptions or conditions prevail. Certain determinations inherently have greater reliance on the use of estimates, assumptions, and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported.

The Corporation's critical accounting policies are described in the Management Discussion and Analysis of Financial Condition and Results of Operations section of First BanCorp's 2005 Annual Report on Form 10-K.

Recently Adopted Accounting Pronouncement

Effective April 3, 2006, the Corporation adopted the long-haul method of effectiveness testing under SFAS No. 133, for substantially all of the interest rate swaps that hedge its brokered CDs and medium-term notes (collectively, the hedged liabilities). The long-haul method requires periodic assessment of hedge effectiveness and measurement of ineffectiveness. The ineffectiveness results to the extent that changes in the fair value of derivatives do not offset changes in the fair values of the debt due to changes in the hedged risk.

For interest rate swaps accounted for as fair value hedges using the long-haul method, ineffectiveness is the difference between the changes in the fair value of the interest rate swap and changes in the fair value of the debt attributable to the risk being hedged (the ineffective portion). Changes in the value of the Corporation's brokered CDs and medium-term notes should substantially offset the changes in the value of the interest rate swaps. After adoption of hedge accounting, the ineffective portion is recorded as part of interest expense.

First BanCorp's implementation of the long-haul method resulted from its previously reported determination that it should not have used the short-cut method to account for interest rate swaps related to brokered CDs and medium-term notes because of technical issues involving the interpretation of the use of the method (refer to First Bancorp audited Consolidated Financial Statements, included in the Corporation's 2004 Annual Report on Form 10-K/A for additional information). Accordingly, First BanCorp has reflected changes in the fair value of those swaps as well as swaps related to certain loans as non-hedging instruments through operations as part of net interest income.

With the implementation of the long-haul method with respect to the brokered CDs and medium-term notes on April 3, 2006, the basis differential between the market value of the interest rate swap and the book value of the hedged liabilities at the inception of fair value hedge accounting, of approximately \$200.0 million, amortizes or accretes as a yield adjustment over the remaining term of the hedged liabilities.

Effective January 1, 2007, the Corporation elected to early adopt SFAS 157, Fair Value Measurements and SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. Following the initial fair value measurement date, ongoing realized gains and losses on items for which fair value reporting has been elected are reported in earnings at each subsequent financial reporting date.

Table of Contents

The Corporation decided to early adopt SFAS 159 for the callable brokered CDs and a portion of the callable fixed medium-term notes that 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 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.

With the Corporation's elimination of the use of the long-haul method in connection with the adoption of SFAS 159 as of January 1, 2007, the Corporation will no longer amortize or accrete the basis adjustment. The basis adjustment amortization or accretion is the reversal of the change in value of the 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 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 adoption adjustment, of all of the unamortized placement fees that were paid to broker counterparties upon the issuance of the brokered CDs and medium term notes. The Corporation previously amortized those fees through earnings based on the expected call date of the instruments.

For additional information and further details on the adoption of SFAS 157 and SFAS 159 as well as other recently adopted accounting pronouncements, refer to Note 2 of the accompanying unaudited interim consolidated financial statements.

Net Interest Income

Net interest income is the excess of interest earned by First BanCorp on its interest-earning assets over the interest incurred on its interest-bearing liabilities. First BanCorp's net interest income is subject to interest rate risk due to the re-pricing and maturity mismatch of the Corporation's assets and liabilities. Net interest income for the quarter and six-month period ended June 30, 2006 was \$126.2 million and \$199.1 million, respectively, compared to \$193.1 million and \$258.3 million, respectively, for the comparable periods in 2005 and \$5.0 million and \$133.8 million, respectively, for the comparable periods in 2004. On a tax equivalent basis, excluding the changes in the fair values of derivative instruments, the ineffective portion resulting from fair value hedge accounting as well as the basis adjustment amortization or accretion, net interest income for the quarters ended June 30, 2006, 2005, and 2004 was \$136.2 million, \$147.4 million, and \$104.2 million, respectively. On a tax equivalent basis, excluding the changes in the fair values of derivative instruments, the ineffective portion resulting from fair value hedge accounting as well as the basis adjustment amortization or accretion, net interest income for the six-month periods ended June 30, 2006, 2005, and 2004 was \$284.6 million, \$269.2 million, and \$200.6 million, respectively.

Part I of the following table presents average volumes and rates on a tax equivalent basis and Part II describes the respective extent to which changes in interest rates and changes in volume of interest-related assets and liabilities have affected the Corporation's interest income and interest expense during the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in volume multiplied by prior period rates), (ii) changes in rate (changes in rate multiplied by prior period volumes). Rate-volume variances (changes in rate multiplied by the changes in volume) have been allocated to the changes in volume and changes in rate based upon their respective percentage of the combined totals.

For periods after the adoption of fair value hedge accounting, the net interest income is computed on a tax equivalent basis by excluding: (1) the change in the value of derivatives for undesignated hedges, (2) the ineffective portion of designated hedges and (3) the basis adjustment amortization or accretion. For periods prior to the

Table of Contents

adoption of hedge accounting, the net interest income is computed on a tax equivalent basis by excluding the impact of the change in the fair value of derivatives (refer to explanation below regarding changes in the fair value of derivative instruments).

Table of Contents**Part I**

Quarter ended June 30,	Average volume			Interest Income (1) / expense			Average rate (1)		
	2006	2005	2004 (As Restated)	2006	2005	2004 (As Restated)	2006	2005	2004 (As Restated)
(Dollars in thousands)									
Earning assets:									
Money market investments	\$ 2,081,151	\$ 313,687	\$ 230,994	\$ 24,904	\$ 2,150	\$ 546	4.80%	2.75%	0.95%
Government obligations (2)	2,944,943	2,779,164	2,360,074	44,347	46,755	38,299	6.04%	6.75%	6.53%
Mortgage-backed securities	2,559,381	2,824,817	2,721,296	31,805	39,704	26,993	4.98%	5.64%	3.99%
Corporate bonds	26,140	66,299	63,696	424	921	(77)	6.50%	5.57%	-0.49%
FHLB stock	24,160	73,187	58,419	479	882	174	7.95%	4.83%	1.20%
Equity securities	29,526	50,810	41,691		262	89	0.00%	2.07%	0.86%
Total investments (3)	7,665,301	6,107,964	5,476,170	101,959	90,674	66,024	5.34%	5.95%	4.85%
Residential real estate loans									
Construction loans	2,583,195	1,749,152	1,055,414	41,836	29,838	18,556	6.50%	6.84%	7.07%
Commercial loans	1,495,293	554,909	377,861	32,094	9,693	4,550	8.61%	7.01%	4.84%
Finance leases	6,194,798	7,386,546	4,809,051	109,287	96,937	40,521	7.08%	5.26%	3.39%
Consumer loans	314,023	235,843	178,542	7,010	5,500	4,282	8.92%	9.35%	9.65%
Total loans (4)(5)	1,783,936	1,523,145	1,209,237	53,353	46,557	38,564	12.00%	12.26%	12.83%
Total earning assets	12,371,245	11,449,595	7,630,105	243,580	188,525	106,473	7.90%	6.60%	5.61%
Total earning assets	\$ 20,036,546	\$ 17,557,559	\$ 13,106,275	\$ 345,539	\$ 279,199	\$ 172,497	6.92%	6.38%	5.29%
Interest-bearing liabilities:									
Interest-bearing deposits	\$ 13,054,199	\$ 9,446,007	\$ 6,256,126	\$ 148,557	\$ 70,532	\$ 27,850	4.55%	2.99%	1.79%
Other borrowed funds	4,761,624	5,123,546	4,299,408	57,946	50,355	34,639	4.88%	3.94%	3.24%
FHLB advances	230,426	1,211,922	974,599	2,867	10,865	5,817	4.99%	3.60%	2.40%
Total interest-bearing liabilities	\$ 18,046,249	\$ 15,781,475	\$ 11,530,133	\$ 209,370	\$ 131,752	\$ 68,306	4.64%	3.35%	2.38%
Net interest income				\$ 136,169	\$ 147,447	\$ 104,191			
Interest rate spread							2.28%	3.03%	2.91%
Net interest margin							2.73%	3.37%	3.20%

months period ended June 30,	Average volume			Interest Income (1) / expense			Average rate (1)		
	2006	2005	2004	2006	2005	2004	2006	2005	2004

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

			(As Restated)			(As Restated)			(As Restated)
	(Dollars in thousands)								
Earning assets:									
Equity market investments	\$ 1,523,506	\$ 314,273	\$ 277,421	\$ 34,879	\$ 4,017	\$ 1,263	4.62%	2.58%	0.00%
Government obligations (2)	2,849,157	2,370,505	1,771,247	87,016	80,708	53,101	6.16%	6.87%	6.66%
Mortgage-backed securities	2,603,591	2,626,960	2,836,295	68,237	75,071	69,583	5.28%	5.76%	4.39%
Corporate bonds	26,278	53,844	70,476	858	1,172	(82)	6.58%	4.39%	-0.00%
U.S. stock	29,537	73,902	50,982	1,261	1,367	330	8.61%	3.73%	1.41%
Other securities	30,424	42,544	44,829	213	477	240	1.41%	2.26%	1.41%
Real estate investments (3)	7,062,493	5,482,028	5,051,250	192,464	162,812	124,435	5.50%	5.99%	4.39%
Residential real estate loans	2,504,730	1,553,226	1,038,539	82,137	52,961	37,387	6.61%	6.88%	7.00%
Construction loans	1,397,757	489,865	360,544	58,903	16,177	8,621	8.50%	6.66%	4.39%
Commercial loans	6,664,728	7,013,498	4,644,162	225,673	171,732	80,204	6.83%	4.94%	3.34%
Lease receivables	303,217	228,392	172,410	13,722	10,352	8,372	9.13%	9.14%	9.14%
Consumer loans	1,774,802	1,464,959	1,192,505	106,202	89,268	76,684	12.07%	12.29%	12.29%
Other loans (4)(5)	12,645,234	10,749,940	7,408,160	486,637	340,490	211,268	7.76%	6.39%	5.50%
Total earning assets	\$ 19,707,727	\$ 16,231,968	\$ 12,459,410	\$ 679,101	\$ 503,302	\$ 335,703	6.95%	6.25%	5.50%
Interest-bearing liabilities:									
Interest-bearing deposits	\$ 12,422,245	\$ 8,480,679	\$ 6,166,119	\$ 269,758	\$ 120,784	\$ 59,193	4.38%	2.87%	1.41%
Other borrowed funds	4,997,313	4,650,712	3,858,316	117,733	91,026	64,750	4.75%	3.95%	3.34%
U.S. advances	301,427	1,339,674	886,242	7,045	22,290	11,117	4.71%	3.36%	2.99%
Total interest-bearing liabilities	\$ 17,720,985	\$ 14,471,065	\$ 10,910,677	\$ 394,536	\$ 234,100	\$ 135,060	4.49%	3.26%	2.99%
Interest income				\$ 284,565	\$ 269,202	\$ 200,643			
Interest rate spread							2.46%	2.99%	2.99%
Interest margin							2.91%	3.34%	3.34%

(1) On a tax equivalent basis. The tax equivalent yield was estimated by dividing the interest rate spread on exempt assets by (1- PR statutory tax rate (43.5% for the Corporation's PR banking subsidiary in

2006, 41.5% for all other subsidiaries in 2006, and 39% for all subsidiaries in 2005 and 2004)) and adding to it the cost of interest-bearing liabilities. When adjusted to a tax equivalent basis, yields on taxable and exempt assets are comparable. Changes in the fair value of derivative instruments (including the ineffective portion of the instruments after the adoption of hedge accounting in the second quarter of 2006) and basis adjustment amortization or accretion are excluded from interest income and interest expense for average rate calculation purposes because the changes in valuation do not affect interest paid or received.

- (2) Government obligations include debt

issued by
government
sponsored
agencies.

- (3) Unrealized holding gains or losses in investments available for sale are excluded from average volumes.
- (4) Average loan balances include the average of non-accruing loans, of which interest income is recognized when collected.
- (5) Interest income on loans includes \$3.4 million, \$2.5 million, and \$2.1 million for the second quarter of 2006, 2005, and 2004, respectively, and \$7.0 million, \$5.0 million, and \$5.9 million for the six month period ended June 30, 2006, 2005 and 2004, respectively, of income from prepayment penalties and late fees related to the Corporation's loans portfolio.

Table of Contents**PART II****Quarter Ended on June 30,**

	2006 compared to 2005 (As Restated)			2005 compared to 2004 (As Restated)		
	Increase (decrease)			Increase (decrease)		
	Volume	Due to: Rate	Total	Volume	Due to: Rate	Total
Interest income on earning assets:						
Money market investments	\$ 20,094	\$ 2,660	\$ 22,754	\$ 256	\$ 1,348	\$ 1,604
Government obligations	2,654	(5,062)	(2,408)	7,102	1,354	8,456
Mortgage-backed securities	(3,537)	(4,362)	(7,899)	1,071	11,640	12,711
Corporate bonds	(606)	109	(497)	16	982	998
FHLB stock	(784)	381	(403)	54	654	708
Equity Securities	(77)	(185)	(262)	24	149	173
Total investments	17,744	(6,459)	11,285	8,523	16,127	24,650
Residential real estate loans	13,890	(1,892)	11,998	12,076	(794)	11,282
Construction loans	19,737	2,664	22,401	2,632	2,511	5,143
Commercial loans	(18,400)	30,750	12,350	27,761	28,655	56,416
Finance leases	1,787	(277)	1,510	1,365	(147)	1,218
Consumer loans	7,898	(1,102)	6,796	9,885	(1,892)	7,993
Total loans	24,912	30,143	55,055	53,719	28,333	82,052
Total interest income	42,656	23,684	66,340	62,242	44,460	106,702
Interest expense on interest-bearing liabilities:						
Deposits	32,895	45,130	78,025	18,403	24,279	42,682
Other borrowed funds	(4,002)	11,593	7,591	7,380	8,336	15,716
FHLB advances	(10,524)	2,526	(7,998)	1,657	3,391	5,048
Total interest expense	18,369	59,249	77,618	27,440	36,006	63,446
Change in net interest income	\$ 24,287	\$ (35,565)	\$ (11,278)	\$ 34,802	\$ 8,454	\$ 43,256

Six month Period Ended on June 30,

	2006 compared to 2005			2005 compared to 2004 (As Restated)		
	Increase (decrease)			Increase (decrease)		
	Volume	Due to: Rate	Total	Volume	Due to: Rate	Total

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

(In thousands)

Interest income on earning assets:

Money market investments	\$ 25,599	\$ 5,263	\$ 30,862	\$ 188	\$ 2,566	\$ 2,754
Government obligations	15,583	(9,275)	6,308	19,574	8,033	27,607
Mortgage-backed securities	(662)	(6,172)	(6,834)	(5,718)	11,206	5,488
Corporate bonds	(754)	440	(314)	14	1,240	1,254
FHLB stock	(1,368)	1,262	(106)	201	836	1,037
Equity Securities	(114)	(150)	(264)	(20)	257	237

Total investments	38,284	(8,632)	29,652	14,239	24,138	38,377
-------------------	--------	---------	--------	--------	--------	--------

Residential real estate loans	31,966	(2,790)	29,176	18,046	(2,472)	15,574
Construction loans	37,187	5,539	42,726	3,644	3,912	7,556
Commercial loans	(10,481)	64,422	53,941	50,104	41,424	91,528
Finance leases	3,404	(34)	3,370	2,625	(645)	1,980
Consumer loans	18,796	(1,862)	16,934	17,019	(4,435)	12,584

Total loans	80,872	65,275	146,147	91,438	37,784	129,222
-------------	--------	--------	---------	--------	--------	---------

Total interest income	119,156	56,643	175,799	105,677	61,922	167,599
-----------------------	---------	--------	---------	---------	--------	---------

Interest expense on interest-bearing liabilities:

Deposits	69,973	79,001	148,974	26,786	34,805	61,591
Other borrowed funds	7,154	19,553	26,707	14,395	11,881	26,276
FHLB advances	(20,879)	5,634	(15,245)	6,791	4,382	11,173

Total interest expense	56,248	104,188	160,436	47,972	51,068	99,040
------------------------	--------	---------	---------	--------	--------	--------

Change in net interest income	\$ 62,908	\$ (47,545)	\$ 15,363	\$ 57,705	\$ 10,854	\$ 68,559
-------------------------------	-----------	-------------	-----------	-----------	-----------	-----------

Table of Contents

A portion of the Corporation's interest-earning assets, mostly investments in obligations of some U.S. Government agencies and sponsored entities, generate interest which is exempt from income tax, principally in Puerto Rico. Also, interest and gains on sale of investments held by the Corporation's international banking entities are tax-exempt under Puerto Rico tax law. To facilitate the comparison of all interest data related to these assets, the interest income has been converted to a taxable equivalent basis. The tax equivalent yield was estimated by dividing the interest rate spread on exempt assets by (1 less the Puerto Rico statutory tax rate (43.5% for the Corporation's Puerto Rico banking subsidiary in 2006, 41.5% for all other subsidiaries in 2006, and 39% for all subsidiaries in 2005 and 2004)) and adding to it the average cost of interest-bearing liabilities. The computation considers the interest expense disallowance required by Puerto Rico tax law.

The exclusion of changes in the fair value on derivative instruments, including the ineffective portion for designated hedges after adoption of hedge accounting, and the basis adjustment amortization or accretion from the detailed analysis of net interest income provides additional information about the Corporation's net interest income and facilitates comparability and analysis. The changes in the fair value of the financial instruments have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively, or on interest payments exchanged with swap counterparties.

The following table reconciles interest income on a tax equivalent basis set forth in Part I above to interest income set forth in the Consolidated Statements of Income:

<i>(In thousands)</i>	Quarter ended June 30,			Six month period ended June 30,		
	2006	2005	2004 (As Restated)	2006	2005	2004 (As Restated)
Interest income on interest-earning assets on a tax equivalent basis	\$ 345,539	\$ 279,199	\$ 172,497	\$ 679,101	\$ 503,302	\$ 335,703
Less: tax equivalent adjustments	(6,554)	(17,821)	(14,351)	(17,394)	(32,063)	(26,573)
Plus: net unrealized gains (losses) on derivatives	5,458	(12,221)	2,456	10,441	(9,705)	2,289
Total interest income	\$ 344,443	\$ 249,157	\$ 160,602	\$ 672,148	\$ 461,534	\$ 311,419

The following table summarizes the components of the changes in fair values of interest rate swaps and interest rate caps agreements, which are included in interest income.

<i>(In thousands)</i>	Quarter ended June 30,			Six month period ended June 30,		
	2006	2005	2004 (As Restated)	2006	2005	2004 (As Restated)
Unrealized gains (losses) on derivatives:						
Interest rate caps	\$ 4,299	\$ (10,147)	\$	\$ 7,619	\$ (8,612)	\$
Interest rate swaps on corporate bonds	1	125	1,740	31	593	1,867
Interest rate swaps on loans	1,158	(2,199)	716	2,791	(1,686)	422
Net unrealized gains (losses) on derivatives	\$ 5,458	\$ (12,221)	\$ 2,456	\$ 10,441	\$ (9,705)	\$ 2,289

Table of Contents

The following table summarizes the components of interest expense for the quarters and six-month periods ended June 30, 2006, 2005 and 2004. As previously stated, the net interest margin analysis excludes the changes in the fair value of interest rate swaps, the ineffective portion of instruments designated as hedges, and the basis adjustment.

<i>(In thousands)</i>	Quarter ended June 30,			Six month period ended June 30,		
	2006	2005	2004 (As Restated)	2006	2005	2004 (As Restated)
Interest expense on interest-bearing liabilities	\$ 202,808	\$ 149,456	\$ 98,333	\$ 387,524	\$ 272,785	\$ 190,599
Net interest incurred (realized) on interest rate swaps	1,799	(20,506)	(31,724)	(1,707)	(45,144)	(62,029)
Amortization of placement fees on brokered CDs	4,756	2,796	1,696	8,705	6,447	6,490
Amortization of placement fees on medium-term notes	7	6		14	12	
Interest expense excluding unrealized losses (gains) on derivatives (designated and economic undesignated hedges) and amortization of basis adjustments on fair value hedges	209,370	131,752	68,306	394,536	234,100	135,060
Net unrealized losses (gains) on derivatives (designated and economic undesignated hedges)	7,531	(75,666)	87,312	77,251	(30,913)	42,589
Amortization of basis adjustment on fair value hedges	1,304			1,304		
Total interest expense	\$ 218,205	\$ 56,086	\$ 155,618	\$ 473,091	\$ 203,187	\$ 177,649

The following table summarizes the components of the unrealized loss (gain) on derivatives (designated and economic undesignated hedges), which is included in interest expense.

<i>(In thousands)</i>	Quarter ended June 30,			Six month period ended June 30,		
	2006	2005	2004 (As Restated)	2006	2005	2004 (As Restated)
Unrealized gains on derivatives (designated						

hedges ineffective portion):						
Interest rate swaps on brokered CDs	\$ (2,187)	\$	\$	\$ (2,187)	\$	\$
Interest rate swaps on medium-term notes	213			213		
Net unrealized gains on derivatives (designated hedges ineffective portion)	(1,974)			(1,974)		
Unrealized losses (gains) on derivatives (economic undesignated hedges):						
Interest rate swaps on brokered CDs	9,505	(72,826)	88,097	75,142	(29,096)	43,374
Interest rate swaps on medium-term notes		(2,840)	(785)	4,083	(1,817)	(785)
Net unrealized losses (gains) on derivatives	9,505	(75,666)	87,312	79,225	(30,913)	42,589
Net unrealized losses (gains) on derivatives (designated and economic undesignated hedges)	\$ 7,531	\$ (75,666)	\$ 87,312	\$ 77,251	\$ (30,913)	\$ 42,589

The following table summarizes the components of the amortization of basis adjustment, which is included in interest expense:

<i>(In thousands)</i>	Quarter ended June 30,			Six month period ended June 30,		
	2006	2005	2004 (As Restated)	2006	2005	2004 (As Restated)
Amortization of basis adjustment:						
Interest rate swaps on brokered CDs	\$ 1,279	\$	\$	\$ 1,279	\$	\$
Interest rate swaps on medium-term notes	25			25		
Amortization of basis adjustment	\$ 1,304	\$	\$	\$ 1,304	\$	\$

Interest income on interest-earning assets primarily represents interest earned on loan receivables and investment securities.

Interest expense on interest-bearing liabilities primarily represents interest paid on brokered CDs, branch-based deposits, repurchase agreements and notes payable.

Net interest incurred or realized on interest rate swaps primarily represents net interest exchanged on swaps that hedge brokered CDs and medium-term notes.

The amortization of broker placement fees represents the amortization of fees paid to brokers upon issuance of related financial instruments (i.e., brokered CDs).

Table of Contents

Unrealized gains or losses on derivatives represent: (1) for economic or undesignated hedges - changes in the fair value of interest rate swaps that economically hedge liabilities (i.e., brokered CDs and medium-term notes) or assets (i.e., loans and corporate bonds), and (2) for designated hedges - the ineffectiveness represented by the difference between the changes in the fair value of the derivative instrument (i.e., interest rate swap) and changes in fair value of the hedged item (i.e., brokered CDs and medium-term notes).

The basis adjustment on fair value hedges represents the amortization or accretion of the basis differential between the market value and the book value of the hedged liabilities recognized at the inception of fair value hedge accounting that amortizes or accretes to interest expense based on the expected maturity of the hedged liabilities as changes in value since the inception of the long-haul method are recorded to these hedged items.

As shown on the tables above, the results of operations for the second quarter and first halves of 2006, 2005 and 2004 were significantly impacted by changes in the valuation of interest rate swaps that hedge economically or under fair value designation the Corporation's brokered CDs and medium-term notes. The change in the valuation of interest rate swaps and the ineffective portion on designated hedges recorded as part of interest expense resulted in an unrealized loss of \$7.5 million and \$77.3 million for the second quarter and first half of 2006, respectively (2005-unrealized gains of \$75.7 million and \$30.9 million for the second quarter and first half, respectively; 2004-unrealized losses of \$87.3 million and \$42.6 million for the second quarter and first half, respectively). Effective April 3, 2006, the Corporation implemented fair value hedge accounting for the majority of its interest rate swaps (98% of the interest rate swap portfolio outstanding) that economically hedge brokered CDs and certain medium-term notes payable which substantially eliminated the impact of fluctuation in the valuation of the interest rate swaps after April 3, 2006. As part of the implementation, the Corporation formally documented the relationship between the interest rate swaps and hedged liabilities under the long-haul method of effectiveness testing.

Derivative instruments, such as interest rate swaps, are subject to market risk. While the Corporation does have certain trading derivatives to facilitate customer transactions, the Corporation does not utilize derivative instruments for speculative purposes. The Corporation's derivatives are mainly composed of interest rate swaps that are used to convert the fixed interest payments on its brokered CDs and medium-term notes to variable payments (received fixed/pay floating). Refer to the Risk Management - Derivatives section below for further detail concerning the notional amounts of derivative instruments and additional information. As is the case with investment securities, the market value of derivative instruments is largely a function of the financial market's expectations regarding the future direction of interest rates. Accordingly, current market values are not necessarily indicative of the future impact of the values of derivative instruments on net interest income. This will depend, for the most part, on the shape of the yield curve as well as the level of interest rates.

2006 compared to 2005. First BanCorp's net interest income decreased by \$66.8 million and \$59.3 million for quarter and six month period ended June 30, 2006, compared to the same periods in 2005. The decrease in net interest income for the second quarter and first half of 2006 was mainly driven by fluctuations in the valuation of derivative instruments and the adoption of fair value hedge accounting, coupled with a reduction in the net interest margin due to the flattening of the yield curve. For the second quarter and first half of 2006, the change in the valuation of interest rate swaps including the ineffective portion on designated hedges recorded as part of interest expense resulted on unrealized losses of \$7.5 million and \$77.3 million, respectively, compared to unrealized gains of \$75.7 million and \$30.9 million, respectively, for the same periods in 2005. The negative fluctuation in the valuation of derivative instruments reflects increasing long-term interest rates during the second quarter and first half of 2006 coupled with a significant reduction in the volume of undesignated derivatives due to the fair value hedge accounting implementation in 2006.

Table of Contents

On a tax equivalent basis, net interest income excluding the changes in the fair values of derivative instruments, the ineffective portion for designated hedges, and basis adjustment amortization or accretion on fair value hedges, decreased by \$11.3 million, or 8%, and increased by \$15.4 million, or 6%, for the second quarter and first half of 2006, respectively, as compared to the same periods in 2005. The decrease in tax equivalent net interest income was principally due to margin compressions due to the flattening of the yield curve and fluctuations in net interest settlements on interest rate swaps. First BanCorp's net interest spread and margin for the quarter and six month period ended June 30, 2006 were 2.28% and 2.73% and 2.46% and 2.91%, respectively, compared to 3.03% and 3.37% and 2.99% and 3.34%, respectively, for the same periods in 2005. The decrease in the net interest rate spread and margin during 2006 was due primarily to the upward trend of short-term interest rates, the flattening of the yield curve, and the re-pricing mismatch of the Corporation's assets and liabilities. On average, the Corporation's liabilities re-price and/or mature earlier than its assets. Thus, increases in short-term interest rates reduce net interest income, which is a significant component of the Corporation's earnings. The decrease in the Corporation's net interest margin has been particularly significant with respect to the Corporation's portfolio of investment securities. The interest rate spread on the Corporation's portfolio of investment securities (allocating a funding cost equal to the weighted-average cost of the Corporation's other borrowed funds) was approximately 0.65% and 0.99% for the quarter and six-month period ended June 30, 2006 compared to 2.18% and 2.25% for the same period in 2005. The tax equivalent yield on interest-earning assets increased by 54 and 70 basis points during the second quarter and first half of 2006, compared to the same periods in 2005, mainly due to the re-pricing of variable rate commercial and construction loans and new commercial and construction loans originated in a rising interest rate environment. A substantial portion of the Corporation's commercial and construction loans are variable rate loans tied to short-term-rates indexes, mainly LIBOR and Prime rate. The average rate paid by the Corporation on its interest-bearing liabilities increased by 129 basis points and 123 basis points during the second quarter and first half of 2006 when compared to the same periods in 2005, mainly due to the re-pricing of the Corporation's interest-bearing deposits, principally time deposits, FHLB advances, and other borrowed funds.

The Corporation used to enter into interest rate swaps that had the effect of converting its fixed-rate brokered CDs as well as its fixed-rate and step rate notes payable to LIBOR-based variable-rate liabilities. For the first half of 2006, the net settlement payments on such interest rate swaps resulted in a benefit of \$1.7 million recognized as a reduction to interest expense, compared to a benefit of \$45.1 million for the first half of 2005, as the rates paid under the variable leg of the swaps significantly increased during.

2005 compared to 2004. First BanCorp's net interest income increased by \$188.1 million and \$124.6 million for quarter and six month period ended June 30, 2005, compared to the same period in 2004. The increase in net interest income for the second quarter and first half of 2005 was mainly driven by fluctuations in the valuation of derivative instruments. For the second quarter and first half of 2005, the change in the valuation of interest rate swaps recorded as part of interest expense resulted on unrealized gains of \$75.7 million and \$30.9 million, respectively, compared to unrealized losses of \$87.3 million and \$42.6 million, respectively, for the same periods in 2004. The positive fluctuation in the valuation of derivative instruments reflects decreasing long-term interest rates during the second quarter and first half of 2005.

On a tax equivalent basis, the Corporation's net interest income, excluding the changes in the fair values of derivative instruments, increased by \$43.3 million or 42% and \$68.6 million or 34% for the second quarter and first half of 2005, respectively, as compared to the same periods in 2004. The increase in tax equivalent net interest income for the second quarter and first half of 2005 was mainly due to an increase in the Corporation's average earning assets, principally increases in the Corporation's commercial, construction and residential mortgage loans portfolio as well as its investment portfolio partially offset by a decrease in net interest margin and net interest realized on interest rate swaps. First BanCorp's net interest spread and margin for the quarter and six month period ended June 30, 2005 were 3.03% and 3.37% and 2.99% and 3.34%, respectively, compared to 2.91% and 3.20% and 2.93% and 3.24%, respectively, for the same periods in 2004. The increase in the net interest rate spread and margin during 2005 was due primarily to the re-pricing of

Table of Contents

variable rate commercial and construction loans and new commercial and construction loans originated in a rising interest rate environment. The tax equivalent yield on interest earning assets increased by 109 and 83 basis points during the second quarter and first half 2005, compared to the same periods in 2004. The average rate paid by the Corporation on its interest-bearing liabilities increased by 97 basis points and 77 basis points during first quarter and first half of 2005 when compared to the same periods in 2004, mainly due to the re-pricing of the Corporation's interest-bearing deposits including net interest settlements on swaps, principally time deposits, FHLB advances, and other borrowed funds.

Provision and Allowance for Loan and Lease Losses

The provision for loan and lease losses is charged to earnings to maintain the allowance for loan and lease losses at a level that the Corporation considers adequate to absorb probable losses inherent in the portfolio. The adequacy of the allowance for loan and lease losses is also based upon a number of additional factors including historical loan loss experience, current economic conditions, the fair value of the underlying collateral, and the financial condition of the borrowers, and, as such, includes amounts based on judgments and estimates made by the Corporation. Although the Corporation believes that the allowance for loan and lease losses is adequate, factors beyond the Corporation's control, including factors affecting the Puerto Rico, Florida (USA), US Virgin Islands and British Virgin Islands economies may contribute to delinquencies and defaults, thus necessitating additional reserves.

For the quarter and six-month period ended on June 30, 2006, the Corporation provided \$9.4 million and \$28.7 million, respectively, for loan and lease losses, as compared to \$11.1 million and \$22.0 million, respectively, for the same periods in 2005, and \$13.2 million and \$26.4 million, respectively, for the same periods in 2004.

Refer to the discussions under **Credit Risk Management** below for analysis of the allowance for loan and lease losses and non-performing assets and related ratios.

2006 compared to 2005. First BanCorp's provision for loan and lease losses for the quarter ended June 30, 2006 decreased by \$1.7 million, or 16%, compared to the same period in 2005. The decrease for the second quarter of 2006 principally reflects a reduction in the provision associated with the Corporation's commercial loans, offset in part by increasing trends in non-performing loans experienced during 2006. The reduction in the Corporation's loan portfolio was primarily due to a partial repayment of \$2.4 billion received in connection with a secured commercial loan extended to a local financial institution.

For the six-month period ended June 30, 2006, the Corporation's provision for loan and lease losses increased by \$6.7 million or 30%, compared to the same period in 2005. The increase in the provision for the first half of 2006 as compared to the first half of 2005 principally reflects growth in the Corporation's consumer, construction and commercial loan portfolio (excluding secured commercial loans to local financial institutions) coupled with increasing trends in non-performing loans and charge-offs experienced during 2006 as compared to 2005 as well as changes to the Corporation's estimate of probable losses for residential real estate loans. The Corporation's net charge offs were affected by the fiscal and economic situation of Puerto Rico. According to the Puerto Rico Planning Board, Puerto Rico is in a midst of a recession. The slowdown in activity is the result of, among other things, higher utilities prices, higher taxes, government budgetary imbalances, the upward trend in short-term interest rates and the flattening of the yield curve, and higher levels of oil prices.

Net charge-offs for the second quarter and first half of 2006 were \$15.4 million and \$30.2 million, respectively (0.50% and 0.48%, respectively, of average loans on an annualized basis), compared to \$9.1 million and \$18.3 million (0.32% and 0.34%, respectively, of average loans) for the same periods in 2005. The increase in net charge-offs for 2006, compared to 2005, was mainly associated with the auto loans portfolio, given higher delinquencies during 2006. Recoveries made from previously written-off accounts were \$1.4 million and \$3.1

Table of Contents

million for the second quarter and first half of 2006, respectively, compared to \$1.9 million and \$3.3 million for the same periods in 2005, respectively.

2005 compared to 2004. For the second quarter and first half of 2005, the Corporation's provision for loan and lease losses decreased by \$2.1 million or 16% and \$4.4 million, or 17%, respectively, compared to the same periods in 2004. The decrease in the provision during 2005 was mainly due to a decrease in net charge-offs. The decrease in the provision during 2005 periods was also associated with the seasoning of the corporate commercial loan portfolio. The Corporation has not incurred significant losses as a percentage of its commercial loans receivable since it started emphasizing the corporate commercial lending activities in the late 1990s, therefore, the provision for inherent losses in this portfolio decreased.

Net charge-offs for the second quarter and first half of 2005 were \$9.1 million and \$18.3 million, respectively (0.32% and 0.34%, respectively, of average loans on an annualized basis), compared to \$9.9 million and \$19.1 million (0.52% and 0.52%, respectively, of average loans) for the same periods in 2004. Recoveries made from previously written-off accounts were \$1.9 million and \$3.3 million in the second quarter of 2005 and first half of 2005, respectively, compared to \$1.4 million and \$2.9 million for the same periods in 2004, respectively.

Non-Interest Income

<i>(In thousands)</i>	Quarter ended June 30,			Six Month Period Ended June 30,		
	2006	2005	2004 (As Restated)	2006	2005	2004 (As Restated)
Other service charges on loans	\$ 1,467	\$ 1,538	\$ 950	\$ 2,953	\$ 2,659	\$ 2,105
Service charges on deposit accounts	3,278	3,022	2,743	6,555	5,712	5,526
Mortgage banking activities gain (loss)	427	3,060	217	(148)	3,570	1,762
Rental income	838	843	702	1,611	1,709	1,319
Insurance income	2,812	2,115	1,490	5,869	4,194	2,976
Other commissions and fees	1,256	147	1,020	1,336	289	1,312
Other operating income	3,211	3,875	4,176	6,410	7,205	8,061
Non-interest income before net gain (loss) on investments, loss on partial extinguishment of secured commercial loans to local financial institution and gain on sale of credit card portfolio	13,289	14,600	11,298	24,586	25,338	23,061
Net gain on sale of investments	951	318	607	2,375	9,831	4,572
Impairment on investments	(817)	(1,499)	(56)	(2,950)	(1,499)	(56)
	134	(1,181)	551	(575)	8,332	4,516

Net gain (loss) on investments						
Loss on partial extinguishment of secured commercial loans to local financial institutions	(11,640)			(11,640)		
Gain on sale of credit card portfolio			297			5,533
Total	\$ 1,783	\$ 13,419	\$ 12,146	\$ 12,371	\$ 33,670	\$ 33,110

Non-interest income primarily consists of other service charges on loans; service charges on deposit accounts; commissions derived from various banking, securities and insurance activities; gains on mortgage banking activities; net gains and losses on investments and impairments; and gains or losses on derivatives that are designated non-economic hedges (non-economic derivatives).

Other service charges on loans consist mainly of service charges on credit card-related activities.

Service charges on deposit accounts include monthly fees and other fees on deposit accounts.

Income from mortgage banking activities includes gains on the sales of loans and revenues earned for administering residential mortgage loans originated by the Corporation and subsequently sold with servicing

Table of Contents

retained. In addition, lower-of-cost-or-market valuation adjustments to the Corporation's residential mortgage loans held for sale portfolio are recorded as part of mortgage banking activities.

Rental income represents income generated by the Corporation's subsidiary, First Leasing and Rental Corporation, on the rental of various types of motor vehicles.

Other commissions and fees income is the result of an agreement with a major investment banking firm to participate in bond issues by the Government Development Bank for Puerto Rico, and an agreement with an international brokerage firm doing business in Puerto Rico to offer brokerage services in selected branches of the Corporation.

Insurance income consists of insurance commissions earned by the Corporation's subsidiary FirstBank Insurance Agency, Inc., and the Bank's subsidiary in the US Virgin Islands, FirstBank Insurance V.I., Inc. These subsidiaries offer a wide variety of insurance business.

The other operating income category is composed of miscellaneous fees such as debit and credit card interchange fees and check fees. Other operating income also includes unrealized gains and losses on certain non-economic derivatives.

The net gain (loss) on investment securities reflects gains or losses as a result of sales that are consistent with the Corporation's investment policies as well as other-than-temporary impairment charges on the Corporation's investment portfolio.

2006 compared to 2005. First BanCorp's non-interest income for the second quarter and first half of 2006 amounted to \$1.8 million and \$12.4 million, respectively, compared to \$13.4 million and \$33.7 million for the same periods in 2005. The decrease in non-interest income during the second quarter and first half of 2006 was mainly attributable to a net loss of \$11.6 million on the partial extinguishment of a secured commercial loan extended to a local financial institution, coupled with lower earnings from the Corporation's mortgage banking activities partially offset by increases in insurance income, service charges on deposit accounts, and other commissions and fees.

During the second quarter of 2006, the Corporation recorded a net loss of \$11.6 million on the partial extinguishment of a secured commercial loan extended to a local financial institution as a result of a series of agreements reached with Doral Financial Corporation (Doral). On May 25, 2006, the Corporation entered into a series of credit agreements with Doral to formally document as secured borrowings the loan transfers between the parties that previously had been accounted for as sales. The terms of the credit agreements specified: (1) a floating interest payment based on a spread over 90-day LIBOR subject to a cap; (2) an amortization schedule tied to the scheduled amortization of the underlying mortgage loans subject to a maximum maturity of 10 years; (3) mandatory prepayments as a result of actual prepayments from the underlying mortgages; and (4) an option to Doral to prepay the loan without penalty at any time.

On May 31, 2006, First BanCorp received a cash payment from Doral, substantially reducing the balance of approximately \$2.9 billion in its secured commercial loan to approximately \$450 million as of that date. In connection with the repayment, the Corporation and Doral entered into a sharing agreement on May 25, 2006 with respect to certain profits or losses that Doral incurs as part of the sales of the mortgages that collateralized the commercial loans. First BanCorp agreed to reimburse Doral for 40% of the net losses incurred by Doral as a result of sales or securitization of the mortgages, subject to certain conditions and subject to a maximum reimbursement of \$9.5 million, which will be reduced proportionately to the extent that Doral does not sell the mortgages. As a result of the loss sharing agreement and the reduction of the secured commercial loan by Doral, the Corporation recorded a net loss of \$11.6 million, composed of losses realized as part of the loss sharing agreement and the difference between the carrying value of the loans and the net payment received from Doral.

Table of Contents

In connection with the repayment, Doral and First BanCorp also agreed to share the profits, if any, received from any subsequent sales or securitization of the mortgage loans, in the same proportion that the Corporation shared in the losses, subject to a maximum of \$9.5 million. However, given the uncertainties of such future possible gains, the Corporation has not recorded any value in this period.

Mortgage banking activities for the second quarter and first half of 2006 resulted in income of \$0.4 million and a loss of \$0.1 million, respectively, as compared to income of \$3.1 million and \$3.6 million, respectively, for the comparable periods in 2005. The decrease in 2006 was principally due to a lower volume of mortgage loan sales coupled with a \$1.0 million lower-of-cost-or-market negative valuation adjustment to the Corporation's loans held for sale portfolio as a result of increases in long-term interest rates. During 2005, the Corporation entered into an arrangement with an unrelated financial institution (the Counterparty) in which, in substance, the parties agreed to sell and purchase similar mortgage loan portfolios. Pursuant to this arrangement, the Corporation purchased mortgage loans with an aggregate unpaid principal balance of \$87.2 million for \$88.9 million in March 2005. In April and May of 2005, the Corporation sold to the Counterparty mortgage loans with aggregate unpaid principal balances of \$60.0 million and \$29.7 million, for \$61.1 million and \$30.3 million, respectively, resulting in gains on the sales of \$1.3 million and \$0.6 million, respectively. Since the Corporation retained the servicing on the mortgage loans sold to the Counterparty, it also recognized a servicing asset of \$1.2 million during the second quarter of 2005. The Corporation entered into these transactions because, among other reasons, they were consistent with its business objectives of developing a mortgage-banking business that would provide liquidity as well as developing new sources for the acquisition of mortgage loans. Notwithstanding that the transactions were in substance the purchase and sale of similar mortgage loan portfolios, generally accepted accounting principles require that the transactions be treated as a separate purchase and a separate sale.

Insurance income for the second quarter and first half of 2006 increased by \$0.7 million or 33% and \$1.7 million or 40%, respectively, compared to the corresponding periods in 2005. The increase for 2006 was due to an increase in volume of business through cross-selling strategies, marketing efforts and the strategic locations of the Corporation's insurance offices.

Service charges on deposit accounts for the second quarter and first half of 2006 increased by \$0.3 million or 8% and \$0.8 million or 15% compared to the same periods in 2005. The increase for 2006 primarily reflects a larger volume of accounts and transactions as compared to 2005.

Other commissions and fees for the second quarter and first half of 2006 increased by \$1.1 million and \$1.0 million, respectively, compared to the same periods in 2005. The increase in other commissions and fees was due to consulting services provided by the Corporation to the Government Development Bank for Puerto Rico for the issuance of certain financial instruments during the second quarter of 2006.

For the second quarter of 2006, net gain on investment securities amounted to \$0.1 million, compared to a net loss of \$1.2 million for the same period in 2005. The improved result in 2006 was principally due to higher volume of sales coupled with lower other-than-temporary impairment charges in the Corporation's available-for-sale portfolio.

Net loss on sale of investments for the first half of 2006 amounted to \$0.6 million compared to a net gain of \$8.3 million for the same period in 2005. The decrease during 2006 was principally due to a lower volume of sales coupled with a \$2.9 million other-than-temporary impairment on certain equity securities held in the Corporation's available-for-sale investment portfolio.

2005 compared to 2004. First BanCorp's non-interest income for the second quarter and first half of 2005 increased by \$1.3 million, or 10%, and \$0.6 million, or 2%, respectively, compared to the same periods in 2004. The increase in non-interest income during 2005 was principally due to higher income derived from its mortgage banking and insurance activities partially offset by a decrease in other commissions and fees income.

Table of Contents

Income from mortgage banking activities during the second quarter and first half of 2005 increased by \$2.8 million and \$1.8 million, respectively, compared to the same periods in 2004. The increase in income from mortgage banking activities for 2005 primarily reflects higher volume of mortgage loan sales. As discussed above, during 2005, the Corporation entered into an arrangement with another unrelated financial institution in which, in substance, the parties agreed to sell and purchase similar mortgage loan portfolios. As a result of transactions derived from this agreement the Corporation recognized a gain on sales of mortgage loans of approximately \$1.9 million during the second quarter of 2005. Since the Corporation retained the servicing on the mortgage loans sold in these transactions, it also recognized a servicing asset of \$1.2 million.

Insurance income for the second quarter and first half of 2005 increased by \$0.6 million or 42% and \$1.2 million or 41%, respectively, compared to the same periods in 2004. The increase for 2005 was due to an increase in volume of business through cross-selling strategies, marketing efforts and the strategic locations of the Corporation's insurance offices.

Other commissions and fees for the second quarter and first half of 2005 decreased by \$0.9 million and \$1.0 million, respectively, compared to the same periods in 2004. The decrease during 2005 principally reflects lower fees as a result of a reduced volume of consulting services. During 2004, the Corporation provided consulting services to the Government Development Bank for Puerto Rico for the issuance of certain financial instruments.

The gain on sales of credit card portfolios during the second quarter and first half of 2004 resulted from portfolios sold pursuant to a strategic alliance agreement reached with a U.S. financial institution in 2003.

The Corporation recorded a net loss on investments of \$1.2 million for the second quarter of 2005 compared to a net gain of \$0.6 million for the same period in 2004. The net loss on investments for the second quarter of 2005 was principally associated with other-than-temporary impairment charges of \$1.5 million on certain equity securities. However, an increased volume of sales of investments resulted in the recognition in the six month period ended June 30, 2005 of a net gain on investments of \$8.3 million compared to a net gain of \$4.5 million for the same period in 2004.

Non-Interest Expenses

The following table presents the detail of non-interest expenses for the periods indicated:

	Quarter ended			Six Month Period Ended		
	June 30,			June 30,		
	2006	2005	2004 (As Restated)	2006	2005	2004 (As Restated)
<i>(In thousands)</i>						
Employees compensation and benefits	\$ 29,870	\$ 26,273	\$ 21,238	\$ 63,995	\$ 49,588	\$ 40,974
Occupancy and equipment	13,624	11,766	9,442	26,330	22,405	18,820
Deposit insurance premium	390	284	252	789	553	493
Other taxes, insurance and supervisory fees	4,078	3,129	2,709	7,935	6,192	5,492
Professional fees	10,143	1,512	1,206	17,536	3,408	1,940
Servicing and processing fees	1,771	1,658	207	3,952	3,045	1,221
Business promotion	4,324	5,085	4,588	8,098	9,633	8,057
Communications	2,012	2,097	1,777	4,468	4,074	3,555
Other	4,828	4,269	4,166	9,675	10,182	7,763
Total	\$ 71,040	\$ 56,073	\$ 45,585	\$ 142,778	\$ 109,080	\$ 88,315

For the quarter ended June 30, 2006, non-interest expenses amounted to \$71.0 million, compared to \$56.1 million and \$45.6 million for the same periods in 2005 and 2004, respectively. For the first half of 2006, non-interest expenses amounted to \$142.8 million, compared to \$109.1 million and \$88.3 million for the same periods in 2005 and 2004, respectively.

2006 compared to 2005. The Corporation's non-interest expenses for the second quarter and first half of 2006

Table of Contents

increased by \$15.0 million, or 27% and \$33.7 million, or 31%, respectively, compared to the same periods in 2005. The increase in non-interest expenses for 2006 was mainly due to increases in professional fees, employees compensation and benefits, and occupancy and equipment expenses partially offset by a decrease in business promotion expenses. The increase in non-interest expenses for the first half of 2006 also includes an increase of \$6.9 million associated with the operations of Ponce General Corporation acquired in March 2005.

Employees compensation and benefits expenses for the second quarter and first half of 2006 increased by \$3.6 million, or 14%, and \$14.4 million or 29%, respectively, compared to the same periods in 2005. A significant portion of the increase for the first half of 2006 was associated with the expensing of the fair value of stock options granted to certain employees following the provisions of SFAS 123R. The Corporation recorded \$4.9 million during the first quarter of 2006 in stock-based compensation expense. The increase in compensation and benefits expenses also was attributable to increases in the average compensation and related fringe benefits paid to employees and an increase in the headcount during 2006. The increase in the headcount was mostly attributable to increases associated with the Corporation's loan origination and deposit gathering efforts, in particular in FirstBank Puerto Rico, FirstBank Florida, FirstMortgage Inc. (First Mortgage), and the Corporation's small loan company, First Federal Finance, as well as increases in support areas, in particular audit and compliance, credit risk management, finance and accounting, information technology and banking operations. For the first half of 2006, compensation and benefits expenses associated with the operations in Florida increased by \$2.2 million, compared to the same period in 2005. The results for Ponce General Corporation in 2006 reflect two quarters of activity compared to one quarter for 2005.

Occupancy and equipment expenses for the second quarter and first half of 2006 increased by \$1.9 million, or 16%, and \$3.9 million or 18%, respectively, compared to the same periods in 2005. The increase in occupancy and equipment expenses in 2006 as compared to 2005 is mainly attributable to increases in costs associated with the expansion of the Corporation's branch network and loan origination offices. The increase also reflects higher electricity costs, security costs and costs associated with the operations of Ponce General Corporation.

Professional fees increased during the second quarter and first half of 2006 by \$8.6 million and \$14.1 million, respectively, compared to the same periods in 2005. The increase for 2006 was primarily due to legal, accounting, and consulting fees associated with the internal review conducted by the Corporation's Audit Committee, the restatement process and other related legal and regulatory proceedings which increased professional fees by \$5.5 million and \$10.4 million for the second quarter and first half of 2006, respectively, compared to the same periods in 2005.

Business promotion expenses decreased during the second quarter and first half of 2006 by \$0.8 million or 15% and \$1.5 million or 16%, respectively, compared to the same periods in 2005. The decrease was due to the Corporation's decision to reduce its marketing expenditures.

2005 compared to 2004. The Corporation's non-interest expenses for the second quarter and first half of 2005 increased by \$10.5 million and \$20.8 million, respectively, compared to the same periods in 2004. The increase in non-interest expenses for 2005 mainly reflects increases in employees compensation and benefits, occupancy and equipment, professional fees, and servicing and processing fees.

Employees compensation and benefits expenses increased during the second quarter and first half of 2005 by \$5.0 million, or 24% and \$8.6 million, or 21%, respectively, compared to the same periods in 2004. The increase in compensation and benefits expenses was primarily attributable to increases in average compensation and related fringe benefits paid to employees and an increase in the headcount for 2005. The increase in the headcount was mainly to support the growth in operations, specifically to support new products and services, in First Mortgage and FirstBank Florida operations.

Occupancy and equipment expenses increased during the second quarter and first half of 2005 by \$2.3 million, or 25%, and \$3.6 million or 19%, compared to the same periods in 2004. The increase is mainly

Table of Contents

attributable to increases in costs associated with the expansion of the Corporation's branch network and loan origination offices.

Professional fees increased during the second quarter of 2005 and first half of 2005 by \$0.3 million and \$1.5 million, respectively, compared to the same periods in 2004. The increase was mainly due to higher expenses related with Sarbanes-Oxley Act compliance.

Servicing and processing fees expenses increased during the second quarter and first half of 2005 by \$1.5 million and \$1.8 million, respectively, compared to the same periods in 2004. Lower non-interest expenses during the first half of 2004 were due primarily to the strategic alliance agreement and sale of the Corporation's credit card portfolio to a U.S. financial institution in 2003. As part of the agreement, the Corporation entered into a service level agreement to temporarily service the credit card portfolio that the US financial institution acquired. During the first half of 2004, the Corporation was reimbursed \$2.1 million in expenses for services provided under the service level agreement.

Table of Contents**Provision for Income Tax**

Income tax expense include Puerto Rico and Virgin Islands income taxes as well as applicable federal and state taxes. The Corporation is subject to Puerto Rico income tax on its income from all sources. As a Puerto Rico corporation, First BanCorp is treated as a foreign corporation for U.S. income tax purposes and is generally subject to United States income tax only on its income from sources within the United States or income effectively connected with the conduct of a trade or business within the United States. Any such tax paid is creditable, within certain conditions and limitations, against the Corporation's Puerto Rico tax liability. The Corporation is also subject to US Virgin Islands (VI) taxes on its income from sources within the VI jurisdiction. Any such tax paid, is creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

Under the Puerto Rico Internal Revenue Code of 1994, as amended (PR Code), First BanCorp is subject to a maximum statutory tax rate of 39%, except that in years 2005 and 2006 an additional transitory tax rate of 2.5% was signed into law by the Governor of Puerto Rico. In August 2005, the Government of Puerto Rico approved a transitory tax rate of 2.5% that increased the maximum statutory tax rate from 39.0% to 41.5% for a two-year period. The additional tax related to the income earned from January 1 to the date of enactment of the law was recorded in the third quarter of 2005. On May 13, 2006, with an effective date of January 1, 2006, the Governor of Puerto Rico approved an additional transitory tax rate of 2.0% applicable only to companies covered by the Puerto Rico Banking Act, as amended, such as FirstBank, which raised the maximum statutory tax rate to 43.5% for taxable years commenced during calendar year 2006. The PR Code also includes an alternative minimum tax of 22% that applies if the Corporation's regular income tax liability is less than the alternative minimum tax requirements.

The Corporation has maintained an effective tax rate lower than the maximum statutory rate mainly by investing in government obligations and mortgage-backed securities exempt from U.S. and Puerto Rico income taxes and doing business through international banking units (IBEs) of the Corporation and the Bank and by the Bank's subsidiary FirstBank Overseas Corporation. The IBEs and FirstBank Overseas Corporation were created under the International Banking Entity Act of Puerto Rico, which provides for total Puerto Rico tax exemption on net income derived by IBEs operating in Puerto Rico. Since 2004, IBEs that operate as a unit of a bank pay income taxes at normal rates to the extent that the IBEs' net income exceeds predetermined percentages of the bank's total net taxable income; such limitations were 30% of total net taxable income for a taxable year commencing between July 1, 2004 and July 1, 2005, and 20% of total net taxable income for taxable years commencing thereafter.

2006 compared to 2005. For the second quarter and first half of 2006, the Corporation's provision for income taxes decreased by \$26.1 million and \$34.0 million, respectively, compared to the same periods in 2005. The decrease in income tax expense for 2006 as compared to 2005 was mainly due to an increase in deferred tax benefits, that itself was, mainly the result of unrealized losses on derivative instruments recognized during 2006 compared to unrealized gains recognized during 2005. For the first half of 2006, the Corporation recognized a deferred tax benefit of \$26.5 million compared to a deferred tax expense of \$6.8 million for the same period in 2005.

As of June 30, 2006, the Corporation evaluated its ability to realize the deferred tax asset and concluded, based on the evidence available, that it is more likely than not that some of the deferred tax assets will not be realized and thus, established a valuation allowance of \$4.7 million. At June 30, 2006, the deferred tax asset, net of the valuation allowance of \$4.7 million, amounted to approximately \$162.5 million compared to \$68.5 million at June 30, 2005. At June 30, 2005, based on the Corporation's analysis and available evidence, the Corporation did not establish a valuation allowance.

Table of Contents

2005 compared to 2004. For the quarter ended June 30, 2005, the Corporation recognized a provision for income tax of \$41.9 million compared to an income tax benefit of \$23.5 million for the same period in 2004. The income tax expense for the second quarter of 2005 as compared to the income tax benefit recorded for the second quarter of 2004 was mainly due to a deferred tax expense of \$24.5 million recognized during the second quarter of 2005 as a result of unrealized gains on derivative instruments. In comparison, for the second quarter of 2004, the Corporation recognized a deferred tax benefit of \$36.0 million mainly as a result of unrealized losses on derivative instruments due to increases in interest rates.

For the first half of 2005, the Corporation's provision for income tax amounted to \$38.3 million (representing an effective tax rate of 24%), compared to \$4.9 million (representing an effective tax rate of 9%). The increase in the provision for income taxes for the first half of 2005, when compared to the first half of 2004, is attributable to increases in deferred tax expense due to unrealized gains on derivative instruments recognized during 2005 compared to unrealized losses recognized in 2004. Also, the provision for income tax for the first half of 2005 increased due to changes in the proportion of exempt and taxable income as a result of increases in the Corporation's taxable income generated from the Corporation's loan portfolios and decreases in tax exempt income mainly from the Corporation's investment portfolios.

FINANCIAL CONDITION AND OPERATING DATA ANALYSIS**Loan Production**

First BanCorp relies primarily on its retail network of branches to originate residential and consumer loans. The Corporation supplements its residential mortgage loan originations with wholesale servicing released mortgage loan purchases from small mortgage bankers. The Corporation manages its construction and commercial loan originations through a centralized unit and most of its originations come from existing customers as well as through referrals and direct solicitations. For commercial loan originations, the Corporation also has regional offices to provide services to designated territories. For purposes of the following table, the Corporation separately presented commercial loans to local financial institutions because it believes this approach provides a better representation of the Corporation's commercial loan production capacity.

Total loan production for the quarter and six-month period ended June 30, 2006 were \$1.3 billion and \$2.7 billion, respectively, compared to \$1.7 billion and \$3.5 billion, respectively, for the comparable periods in 2005, and \$1.1 billion and \$2.2 billion, respectively, for the comparable periods in 2004. The decrease in loan production during 2006, compared to 2005, was mainly due to decreases in residential real estate, commercial loan, and consumer loan originations mainly due to prevailing higher interest rates, worsening economic conditions in Puerto Rico, and stricter underwriting guidelines.

The following table sets the First BanCorp's loan production for the periods indicated:

	Quarter ended June 30,			Six month period ended June 30,		
	2006	2005	2004	2006	2005	2004
<i>(In thousands)</i>						
Residential real estate	\$ 239,462	\$ 284,822	\$ 201,930	\$ 517,405	\$ 588,598	\$ 353,042
Commercial and Construction	802,179	1,097,384	283,290	1,650,032	1,691,200	605,151
Finance Leases	42,651	34,507	28,460	89,860	68,184	55,327
Consumer	180,603	266,114	186,732	402,681	490,636	345,579
	1,264,895	1,682,827	700,412	2,659,978	2,838,618	1,359,099
Commercial loans to local financial institutions			427,646		681,407	862,680
Total Loan Production	\$ 1,264,895	\$ 1,682,827	\$ 1,128,058	\$ 2,659,978	\$ 3,520,025	\$ 2,221,779

Table of Contents*Residential Real Estate Loans*

Residential mortgage loan production for the second quarter and first half of 2006 decreased by \$45.4 million, or 16%, and \$71.2 million, or 12%, respectively, compared to the same periods in 2005, and increased by \$37.5 million, or 19%, and \$164.4 million, or 47%, respectively, compared to the same periods in 2004. The decrease in mortgage loan production for 2006, compared to 2005, was mainly attributable to higher prevailing interest rates, deteriorating economic conditions in Puerto Rico and stricter underwriting standards. The Corporation decided to make certain adjustments to its underwriting standards designed to enhance the credit quality of its mortgage loan portfolio, in light of the worsening economic conditions in Puerto Rico. The implementation of these standards contributed to the reduction in the Corporation's mortgage loan originations.

Residential real estate loans represent 19% of total loans originated and purchased for the first half of 2006. The Corporation's strategy is to penetrate markets by providing customers with a variety of high quality mortgage products. The Corporation's originations of residential mortgage loans continued to be driven by FirstMortgage, its mortgage loan origination subsidiary. The Corporation continues to commit substantial resources to this operation with the goal of becoming a leading institution in the highly competitive residential mortgage loans market. The Corporation established FirstMortgage as a stand-alone subsidiary in 2003. FirstMortgage supplements its internal direct originations through its retail network with an indirect business strategy. The Corporation's Partners in Business, a division of FirstMortgage, partners with mortgage brokers and small mortgage bankers in Puerto Rico to purchase ongoing mortgage loan production. FirstMortgage Realty Group, launched in 2005, focuses on building relationships with realtors by providing resources, office amenities and personnel to them, and to assist real estate brokers in building their individual businesses and closing transactions. FirstMortgage multi-channel strategy has proven to be effective in capturing business.

Commercial and Construction Loans

Commercial and construction loan production for the second quarter and first half of 2006 decreased by \$295.2 million, or 27%, and \$41.2 million, or 2%, respectively, compared to the same periods in 2005, and increased by \$518.9 million and \$1.0 billion, respectively, compared to the same periods in 2004. The decrease in commercial and construction loan production for 2006 compared to 2005 was mainly due to adverse economic conditions in Puerto Rico. However, the loan production of the Corporation's subsidiary bank loan agency in Coral Gables, Florida increased during 2006 and 2005. Loans originated by the agency for the first half of 2006 and 2005 amounted to \$504.6 million and \$278.8 million, respectively.

Commercial loan originations come from existing customers as well as through referrals and direct solicitations. The Corporation follows a strategy aimed to cater to customer needs in the commercial loans middle market segment by building strong relationships and offering financial solutions that meet customers' unique needs. Starting in 2005, the Corporation expanded its distribution network and participation in the commercial loans middle market segment by focusing on customers with financing needs up to \$5 million. The Corporation established 4 regional offices that provide coverage throughout Puerto Rico. The offices are staffed with sales, marketing and credit officers able to provide a high level of personalized service and prompt decision-making.

Consumer Loans

Consumer loan originations are principally driven through the Corporation's retail network. For the second quarter and first half of 2006, consumer loan originations decreased by \$85.5 million or 32% and \$88.0 million, or 18%, respectively, and decreased by \$6.1 million, or 3% and increased by \$57.1 million, or 17%, respectively, compared to the same periods in 2005 and 2004, respectively. The decrease in consumer loan originations for 2006 compared to 2005 was mainly due to adverse economic conditions in Puerto Rico. The increase when compared to 2004 was primarily due to increases in auto loan originations. Auto loan originations come primarily through referrals from the Corporation's network of auto dealers.

Table of Contents*Finance Leases*

During the second quarter and first half of 2006, finance lease originations, which are mostly composed of loans to individuals to finance the acquisition of a motor vehicle, increased by \$8.1 million and \$21.7 million, respectively, compared to the same periods in 2005, and increased by \$14.2 million and \$34.5 million, respectively, when compared to the same periods in 2004.

Assets

Total assets as of June 30, 2006 amounted to \$20.2 billion, an increase of \$0.3 billion, \$1.4 billion and \$5.7 billion as compared to total assets as of December 31, 2005, June 30, 2005 and June 30, 2004, respectively. The increase at June 30, 2006, compared to balances at December 31, 2005 and June 30, 2005, was mainly the result of increases in money market instruments partially offset by decreases in the Corporation's loan and investment portfolio. The decrease in the Corporation's loans portfolio was due to the payment of \$2.4 billion from a local financial institution to reduce its secured commercial loan with the Corporation. The Corporation temporarily used a portion of the proceeds in short-term investment. The Corporation decided to use proceeds from the payment received on the secured commercial loan to repay, during the second half of 2006, higher rate maturing liabilities, in particular brokered CDs, rather than investing the proceeds at an interest yield lower than the Corporation's cost of funds.

The decrease in the investment portfolio resulted mainly from prepayments and maturities received from the Corporation's investment portfolio, mainly mortgage-backed securities and the Corporation's decision to deleverage its investment portfolio. The deleverage of the investment portfolio was influenced, among other things, by the flat to inverted yield curve. As a result, the Corporation decided to repay higher rate maturing liabilities, in particular brokered CDs, rather than investing the proceeds at an effective interest rate lower than the Corporation's cost of funds.

Loan Portfolio

The composition of the Corporation's total loan portfolio for the periods indicated is as follows:

	June 30,	December	June 30,	June 30,
	2006	31,	2005	2004
		2005		(As
				Restated)
<i>(In Thousands)</i>				
Residential real estate loans	\$ 2,648,199	\$ 2,346,945	\$ 1,826,077	\$ 1,124,667
Commercial real estate loans	1,152,796	1,090,193	1,000,752	648,690
Construction loans	1,560,580	1,137,118	715,971	374,845
Commercial loans	2,441,329	2,421,219	2,295,216	1,708,971
Loans to local financial institutions collateralized by real estate mortgages and pass-through trust certificates	992,586	3,676,314	4,211,687	2,708,896
Total commercial loans	6,147,291	8,324,844	8,223,626	5,441,402
Finance leases	325,867	280,571	242,765	184,866
Consumer and other loans	1,783,902	1,733,569	1,580,501	1,235,075
Total	\$ 10,905,259	\$ 12,685,929	\$ 11,872,969	\$ 7,986,010

At June 30, 2006, the Corporation's total loans decreased by \$1.8 billion and \$1.0 billion, when compared with balances as of December 31, 2005 and June 30, 2005, respectively, and increased by \$2.9 billion when

Table of Contents

compared to the balance as of June 30, 2004. The decrease in the Corporation's total loans receivable primarily relates to the partial extinguishment of a secured commercial loan extended to a local financial institution partially offset by a growth in the Corporation's other portfolios through new originations, net of repayments. Refer to the *Loan Production* section of this discussion above for further details on the Corporation's originations by product.

Residential Real Estate Loans

As of June 30, 2006, the Corporation's residential real estate loan portfolio increased by \$301.3 million, \$822.1 million and \$1.5 billion as compared to balances as of December 31, 2005, June 30, 2005, and June 30, 2004, respectively. The Corporation has diversified its loan receivable portfolio by increasing the concentration of residential real estate loans. The residential real estate loans as a percentage of total loans has increased over time from 14% at June 30, 2004 to 24% at June 30, 2006.

Commercial and Construction Loans

As of June 30, 2006, the Corporation's commercial and construction loan portfolio decreased by \$2.2 billion and \$2.1 billion as compared to balances as of December 31, 2005 and June 30, 2005, respectively, and increased by \$705.9 million compared to the balance at June 30, 2004. The decrease was due to the repayment of \$2.4 billion that substantially reduced the Corporation's secured commercial loan extended to a local financial institutions. The Corporation's strategy focuses on growing its commercial loans portfolio principally through commercial real estate and construction loans. A substantial portion of this portfolio is collateralized by real estate. The Corporation's commercial loans are primarily variable- and adjustable-rate loans.

The Corporation had a lending concentration of \$445.7 million in one mortgage originator in Puerto Rico, Doral, at June 30, 2006. The Corporation had outstanding \$546.9 million with another mortgage originator in Puerto Rico, R&G Financial Corporation (R&G), for total loans to mortgage originators amounting to \$992.6 million at June 30, 2006. These commercial loans are secured by individual mortgage loans on residential and commercial real estate. The mortgage originators have always paid the loans in accordance with their terms and conditions. In December 2005, the Corporation obtained a waiver from the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico (Office of the Commissioner) with respect to the statutory limit for individual borrowers (loans-to-one borrower limit). In May 2006, the Corporation received a cash payment from Doral of approximately \$2.4 billion, substantially reducing the balance of the secured commercial loan to that institution. As part of the Cease and Desist Order imposed on the Corporation by its regulators, the Corporation has continued working on the reduction of its exposure to Doral.

During the fourth quarter of 2005, First BanCorp received a partial payment from R&G of \$137 million for its secured commercial loans. In addition, in February 2007, the Corporation entered into various agreements with R&G relating to prior transactions originally treated as purchases of mortgages and pass-through trust certificates from R&G subsidiaries. First, through a mortgage payment agreement, R&G paid the Corporation approximately \$50 million to reduce the commercial loan that R&G Premier Bank, R&G's banking subsidiary, had outstanding with the Corporation. In addition, the remaining balance of approximately \$271 million was re-documented as a secured loan from the Corporation to R&G. Second, R&G and the Corporation amended various agreements involving approximately \$218 million of securities collateralized by loans that were originally sold through five grantor trusts. The modifications to the original agreements allow the Corporation to treat these transactions as true sales for accounting and legal purposes. For further detail, refer to the Corporation's Current Report on Form 8-K filed with the SEC on February 16, 2007. The execution of the agreements enabled First BanCorp to fulfill the remaining requirement of the Consent Order signed with banking regulators relating to the mortgage-related transactions with R&G that First BanCorp recharacterized for accounting and legal purposes as commercial loans secured by the mortgage loans and pass-through trust certificates.

Table of Contents

Consumer Loans

As of June 30, 2006, the Corporation's consumer loans portfolio increased by \$50.3 million, \$203.4 million, and \$548.8 million as compared to the portfolio balances at December 31, 2005, June 30, 2005, and June 30, 2004, respectively. The increase is mainly driven by increases in the Corporation's auto loan portfolio. The growth of this portfolio has been achieved through a strategy of providing outstanding service to selected auto dealers who provide the channel for the bulk of the Corporation's auto loan originations.

The above-mentioned strategy is directly linked to the Corporation's commercial lending activities as the Corporation maintains strong and stable auto floor plan relationships, which are the foundation of a successful auto loan generation operation.

Finance Leases

As of June 30, 2006, finance leases, which are mostly composed of loans to individuals to finance the acquisition of a motor vehicle, increased by \$45.3 million, \$83.1 million and \$141.0 million as compared to portfolio balances as of December 31, 2005, June 30, 2005, and June 30, 2004, respectively. These leases typically have five-year terms and are collateralized by a security interest in the underlying assets. The Corporation's credit risk exposure for this portfolio is similar to the credit exposure of an auto loan (extended to individuals) portfolio.

Investment Activities

As part of its strategy to diversify its revenue sources and maximize its net interest income, First BanCorp maintains an investment portfolio that is classified as available for sale or held-to-maturity. The Corporation's investment portfolio at June 30, 2006 amounted to \$5.3 billion, a decrease of \$149.0 million, \$789.1 million, and \$471.7 million when compared with the investment portfolio at December 31, 2005, June 30, 2005, and June 30, 2004, respectively. The decrease in investment securities was due to the Corporation's decision to deleverage its balance sheet by not reinvesting maturities and prepayments received from the Corporation's investment portfolio, mainly mortgage-backed securities. The Corporation's decision to deleverage its investment portfolio was influenced, among other things, by the flat-to-inverted yield curve. As a result, the Corporation decided to repay during the second half of 2006 higher rate maturing liabilities, in particular brokered CDs, rather than investing the proceeds at an interest yield lower than the Corporation's cost of funds.

Table of Contents

The following table presents the carrying value of investments at the indicated dates:

	June 30,	December	June 30,	June 30,
	2006	31,	2005	2004
<i>(In thousands)</i>		2005	2005	(As
				Restated)
Money market investments	\$ 3,361,886	\$ 1,224,791	\$ 424,004	\$ 445,248
Investment securities held-to-maturity:				
US Government and agencies obligations	2,132,688	2,190,714	2,377,308	2,429,554
PR Government obligations	29,436	14,163	13,899	13,394
Mortgage-backed securities	1,124,996	1,233,711	1,386,423	1,708,469
Corporate Bonds				19,983
	3,287,120	3,438,588	3,777,630	4,171,400
Investment securities available-for-sale:				
US Government and agencies obligations	390,717	389,650	397,484	285,912
PR Government obligations	24,393	25,006	25,153	16,126
Mortgage-backed securities	1,528,397	1,478,720	1,669,806	1,119,604
Corporate bonds	4,386	25,381	52,525	44,290
Equity securities	21,393	29,421	72,147	52,927
	1,969,286	1,948,178	2,217,115	1,518,859
Other equity securities	23,689	42,368	74,480	61,525
Total Investments	\$ 8,641,981	\$ 6,653,925	\$ 6,493,229	\$ 6,197,032

Mortgage-backed securities at the indicated dates consist of:

	June 30,	December	June 30,	June 30,
	2006	31,	2005	2004
<i>(In thousands)</i>		2005	2005	(As
				Restated)
Held-to-maturity				
FHLMC certificates	\$ 18,089	\$ 20,211	\$ 22,956	\$ 30,659
FNMA certificates	1,106,907	1,213,500	1,363,467	1,677,810
	1,124,996	1,233,711	1,386,423	1,708,469
Available-for-sale				
FHLMC certificates	8,420	9,962	11,510	9,487

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

GNMA certificates	394,326	438,881	484,845	128,214
FNMA certificates	1,125,265	1,029,474	1,173,019	981,273
Mortgage pass-through certificates	386	403	432	630
	1,528,397	1,478,720	1,669,806	1,119,604
Total mortgage-backed securities	\$ 2,653,393	\$ 2,712,431	\$ 3,056,229	\$ 2,828,073

85

Table of Contents

The carrying values of investment securities (excluding other equity securities) at June 30, 2006, by contractual maturity (excluding mortgage-backed securities, equity securities and money market investments) are shown below:

<i>(Dollars in thousands)</i>	Carrying amount	Weighted average yield %
US Government and agencies obligations		
Due within one year	\$ 74,673	4.86
Due after five years through ten years	378,084	4.30
Due after ten years	2,070,648	5.83
	2,523,405	5.57
PR Government obligations		
Due after one year through five years	9,754	5.57
Due after five years through ten years	23,912	5.28
Due after ten years	20,163	5.60
	53,829	5.45
Corporate bonds		
Due after five years through ten years	1,028	7.46
Due after ten years	3,358	7.72
	4,386	7.66
	2,581,620	5.57
Mortgage-backed securities	2,653,393	4.90
Equity securities	21,393	1.18
Total investment securities available-for-sale and held-to-maturity	\$ 5,256,406	5.21

Net interest income of future periods may be affected by the acceleration in prepayments of mortgage-backed securities. Acceleration in the prepayments of mortgage-backed securities would lower yields on securities purchased at a premium, as the amortization of premiums paid upon acquisition of these securities would accelerate. Conversely, acceleration in the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the amortization of the discount would accelerate. Lower reinvestment rates and a time lag between calls, prepayments and/or the maturity of investments and actual reinvestment of proceeds into new investments might also affect net interest income. These risks are directly linked to future period market interest rate fluctuations. Refer to the

Risk Management discussion below for further analysis of the effects of changing interest rates on the Corporation's net interest income and for the interest rate risk management strategies followed by the Corporation.

Sources of Funds

The Corporation's principal funding sources are branch-based deposits, retail brokered deposits, institutional deposits, federal funds purchased, securities sold under agreements to repurchase, notes payable and FHLB advances.

As of June 30, 2006, total liabilities amounted to \$19.0 billion, an increase of \$301.6 million, \$1.5 billion, and \$5.6 billion as compared to balances as of December 31, 2005, June 30, 2005, and June 30, 2004, respectively. The net increase in total liabilities was mainly due to increases in interest-bearing deposits, mainly brokered CDs, partially offset by decreases in FHLB advances and federal funds purchased and securities sold under repurchase agreements. The use of brokered CDs has been particularly important to the growth of the Corporation. The

Table of Contents

Corporation encounters intense competition in attracting and retaining deposits, as financial institutions are at a competitive disadvantage since the income generated on other investment products available to investors in Puerto Rico has been taxed at lower rates than tax rates for income generated on deposit products. The brokered CDs market is very competitive and liquid and the Corporation has been able to obtain substantial amounts of funding in short periods of time. This strategy enhances the Corporation's liquidity position, since the brokered CDs are unsecured and can be obtained at substantially longer maturities than other regular retail deposits. Also the Corporation has the ability to convert the fixed-rate brokered CDs to short-term adjustable rate liabilities by entering into interest rate swap agreements.

During 2005, the Corporation's brokered CDs increased significantly. Significant amounts of short-term brokered CDs were issued to fund the Corporation's growth and to replace advances from the Federal Home Loan Bank as these matured since the collateral for these funds was under evaluation by the FHLB. During 2005, the FHLB evaluated the eligibility of collateral that secured the commercial loans to local financial institutions and concluded that such collateral was not eligible to secure advances from the FHLB. The rate of the short-term brokered CDs approximated long-term rates given the flat to inverted yield curve. The Corporation decided to use a significant portion of the funds received from the repayment of \$2.4 billion of a secured commercial loan extended to a local financial institution to repay short-term brokered CDs entered in 2005 as these matured in the second half of 2006. The Corporation's decision to repay maturing brokered CDs was influenced, among other things, by the flat-to-inverted yield curve. The Corporation decided to repay higher-rate maturing liabilities, in particular brokered CDs, rather than investing the proceeds at an interest yield lower than the Corporation's cost of funds.

CDs with denominations of \$100,000 or higher, including brokered CDs, amounted to \$10.5 billion at June 30, 2006. At June 30, 2006, brokered CDs amounted to \$9.7 billion. Brokered CDs are sold by third-party intermediaries in denominations of \$100,000 or less. The following table presents a maturity schedule of brokered CDs at June 30, 2006:

	Total
	(In thousands)
Three months or less	\$ 1,959,809
Over three months to six months	1,030,249
Over six months to one year	2,000,905
Over one year to five years	1,005,250
Over five years	3,704,088
Total	\$ 9,700,301

The Corporation maintains unsecured lines of credit with other banks. At June 30, 2006, the Corporation's total unused lines of credit with these banks amounted to \$335.0 million. At June 30, 2006, the Corporation had an available line of credit with the FHLB, guaranteed with excess collateral in the amount of \$340.2 million.

The Corporation's deposit products include regular savings accounts, demand deposit accounts, money market accounts, CDs, and brokered CDs. Refer to Note 11 Deposits in the accompanying notes to the unaudited interim consolidated financial statements for further details. Total deposits amounted to \$13.5 billion at June 30, 2006, as compared to \$12.5 billion, \$11.1 billion and \$7.0 billion at December 31, 2005, June 30, 2005 and 2004, respectively. The increase in total deposits was mainly due to increases in brokered CDs.

Refer to the Net Interest Income discussion above for information about average balances of interest-bearing deposits, and the average interest rate paid on deposits for the quarters and six month periods ended June 30, 2006, 2005 and 2004.

Table of Contents

Capital

The Corporation's stockholders' equity amounted to \$1.16 billion at June 30, 2006, \$1.20 billion at December 31, 2005, \$1.29 billion at June 30, 2005, and \$1.08 billion at June 30, 2004. Total capital decreased by \$38.4 million and \$129.6 million compared to amounts at December 31, 2005 and June 30, 2005, respectively. The decrease was mainly due to dividends declared and paid coupled with unrealized losses in the Corporation's available for sale portfolio and the accrual by the Corporation during the fourth quarter of 2005 of approximately \$74.25 million for the potential settlement of the class action lawsuits.

On August 1, 2007, the United States District Court for the District of Puerto Rico issued a Preliminary Order approving the stipulation of settlement filed in connection with the proposed settlement of the class action lawsuit brought on behalf of First BanCorp's shareholders against the Corporation in the amount of \$74.25 million.

The effectiveness of a final order to be issued by the Court is subject to:

- The payment of \$61 million to be deposited by First BanCorp in a settlement fund within fifteen calendar days of the date of issuance of the Preliminary Order; and
- The mailing of a notice to shareholders that describes the general terms of the settlement.

The court hearing for the final order of approval of the settlement has been set for October 15, 2007. First BanCorp intends to comply with the \$61 million payment requirement within the timeframe set forth in the terms of the settlement. The remaining amount of \$13,250,000 will be paid before December 31, 2007. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's audited Consolidated Financial Statements, included in the Corporation's 2005 Annual Report on Form 10-K, the Corporation accrued \$74.25 million in 2005 for a possible settlement of the class action.

On August 7, 2007, First BanCorp announced that the SEC approved a final settlement with the Corporation, which resolves the previously disclosed SEC investigation of the Corporation. Under the settlement, the Corporation agreed, without admitting or denying any wrongdoing, to be enjoined from future violations of certain provisions of the securities laws. The Corporation also agreed to pay an \$8.5 million civil penalty and the disgorgement of \$1 to the SEC. The SEC may request that the civil penalty be subject to distribution pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002. The monetary payment will have no impact on the Corporation's earnings or capital in 2007. As reflected in First BanCorp's previously filed audited Consolidated Financial Statements for 2005, the Corporation accrued \$8.5 million in 2005 for the potential settlement with the SEC. In connection with the settlement, the Corporation consented to the entry of a final judgment to implement the terms of the agreement. The United States District Court for the Southern District of New York must consent to the entry of the final judgment in order to consummate the settlement.

During the first quarter of 2007, the Corporation agreed to issue, subject to regulatory approval, approximately 9.250 million shares of its common stock to The Bank of Nova Scotia (Scotiabank), through a private placement offering, valuing the stock at \$10.25 per share for a total purchase price of approximately \$94.8 million. The valuation reflects a premium of approximately 5% over the volume weighted-average closing share price over the 30 trading-day period that ended January 30, 2007. After the investment, Scotiabank will hold approximately 10% of First BanCorp's currently outstanding common shares. The original agreement provided that the agreement may be terminated at any time prior to the closing by either the Corporation or Scotiabank if the

Table of Contents

closing did not occur by July 31, 2007 (the Termination Date). The agreement was subsequently amended to change the Termination Date to August 31, 2007. On August 9, 2007, First BanCorp announced the approval by the Federal Reserve Board of the private placement offering with Scotiabank.

On March 17, 2006, First BanCorp and its banking subsidiary FirstBank entered into consent orders with the Board of Governors of the Federal Reserve System, the FDIC and the Office of the Commissioner relating to mortgage-related transactions with Doral and R&G. For additional information about these orders, please refer to the Current Report on Form 8-K filed with the SEC on March 20, 2006.

Effective January 1, 2007, the Corporation early adopted the provision of SFAS 157 and SFAS 159. Refer to Note 2 of the accompanying unaudited consolidated financial statement for additional information. Regulatory capital increased by the positive adjustment to retained earnings recognized as part of the adoption of SFAS 159, exceeding by higher margins the capital levels required to be classified as well-capitalized and strengthening the Corporation's current regulatory capital ratios.

As of June 30, 2006, First BanCorp, FirstBank Puerto Rico and FirstBank Florida were in compliance with the regulatory capital requirements that were applicable to them as a financial holding company, a state non-member bank and a thrift, respectively (i.e., total capital and Tier 1 capital to risk-weighted assets of at least 8% and 4%, respectively, and Tier 1 capital to average assets of at least 4%). Set forth below are First BanCorp, FirstBank Puerto Rico and FirstBank Florida's regulatory capital ratios as of June 30, 2006, based on existing Federal Reserve, Federal Deposit Insurance Corporation and the Office of Thrift Supervision guidelines.

Table of Contents

	First Bancorp	Banking subsidiaries		
		FirstBank	Florida	To be well capitalized
REGULATORY CAPITAL RATIOS				
Total Capital (Total capital to risk-weighted assets)	12.60%	12.74%	10.08%	10.00%
Tier 1 Capital Ratio (Tier I capital to risk-weighted assets)	11.47%	11.56%	9.73%	6.00%
Leverage Ratio (1)	6.56%	6.53%	7.36%	5.00%

(1) Tier 1 capital to average assets in the case of First BanCorp and First Bank and Tier 1 capital to adjusted total assets in the case of First Bank Florida.

Dividends

For each of the six-months periods ended on June 30, 2006 and 2005, the Corporation declared cash dividends of \$0.14 per common share representing a 16.7% increase over the aggregate cash dividend of \$0.12 per common share declared for the same period in 2004. Total cash dividends paid on common shares amounted to \$11.6 million for the six-month period ended June 30, 2006 (or a 75% dividend payout ratio), \$11.3 million for the same period in 2005 (or an 11% dividend payout ratio) and \$9.6 million for the corresponding 2004 period (or a 36% dividend payout ratio). Dividends declared on preferred stock amounted to approximately \$20.1 million for each of the six month periods ended on June 30, 2006, 2005, and 2004.

Off Balance Sheet Arrangements

In the ordinary course of business, the Corporation engages in financial transactions that are not recorded on the balance sheet, or may be recorded on the balance sheet in amounts that are different than the full contract or notional amount of the transaction. These transactions are designed to (1) meet the financial needs of customers, (2) manage the Corporation's credit, market or liquidity risks, (3) diversify the Corporation's funding sources and (4) optimize capital.

As a provider of financial services, the Corporation routinely commits to financial instruments with off-balance sheet risk to meet the financial needs of its customers. These financial instruments may include loan commitments and standby letters of credit. These commitments are subject to the same credit policies and approval process used for on-balance sheet instruments. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statements of financial position. At June 30, 2006, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately \$1.9 billion and \$105.2 million, respectively. Commitments to extend credit are agreements to lend to customers as long as the conditions established in the contract are met. Generally, the Corporation's mortgage banking activities do not enter into interest rate lock agreements with its prospective borrowers.

Contractual Obligations and Commitments

The following table presents a detail of the maturities of the Corporation's contractual obligations and commitments, which consist of CDs, long-term contractual debt obligations, other contractual obligations, commitments to sell loans and commitments to extend credit:

Table of Contents

	Contractual Obligations and Commitments				
	As of June 30, 2006				
	(In thousands)				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Contractual obligations:					
Certificates of deposits	\$ 11,377,092	\$ 6,332,631	\$ 875,009	\$ 462,808	\$ 3,706,644
Federal funds purchased and securities sold under agreements to repurchase	4,022,686	1,710,186	250,000	387,500	1,675,000
Advances from FHLB	194,000	105,000	89,000		
Notes payable	176,851			7,510	169,341
Other borrowings	231,670				231,670
Total contractual obligations	\$ 16,002,299	\$ 8,147,817	\$ 1,214,009	\$ 857,818	\$ 5,782,655
Commitments to purchase mortgage loans	\$ 10,533	\$ 10,533			
Commitments to sell mortgage loans	\$ 144,173	\$ 144,173			
Standby letters of credit	\$ 105,171	\$ 105,171			
Commitments to extend credit:					
Lines of credit	\$ 1,248,093	\$ 1,248,093			
Letters of credit	52,130	52,130			
Commitments to originate loans	595,798	595,798			
Total commercial commitments	\$ 1,896,021	\$ 1,896,021			

The Corporation has obligations and commitments to make future payments under contracts, such as outstanding debt securities, and under other commitments to sell mortgage loans at fair value and commitments to extend credit. 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. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. In the case of credit cards and personal lines of credit, the Corporation can at any time and without cause cancel the unused credit facility. In the ordinary course of business, the Corporation enters into operating leases and other commercial commitments. There have been no significant changes in such contractual obligations since the end of 2005.

RISK MANAGEMENT

The Corporation has in place a risk management framework to monitor, evaluate and manage the principal risks assumed in conducting its activities. First BanCorp's business is subject to eight broad categories of risks: (1) interest rate, (2) market risk, (3) credit risk, (4) liquidity risk, (5) operational risk, (6) legal and compliance risk, (7) reputation risk, and (8) contingency risk. First BanCorp has adopted policies and procedures which have been designed to identify and manage risks to which the Corporation is exposed specifically those relating to interest rate risk, credit risk, liquidity risk, and operational risk.

Interest Rate Risk Management

First BanCorp manages its asset/liability position in order to limit the effects of changes in interest rates on net interest income. The Management's Investment and Asset Liability Committee of FirstBank (MIALCO) oversees interest rate risk, liquidity management and other related matters. The MIALCO, which reports to the Investment Sub-committee of the Board of Directors Asset/Liability Risk Committee, is composed of senior management officers, including the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer, the Risk Manager of the Treasury and Investment Department, the Economist and the Treasurer.

Table of Contents

Committee meetings focus on, among other things, current and expected conditions in world financial markets, competition and prevailing rates in the local deposit market, liquidity, unrealized gains and losses in securities, recent or proposed changes to the investment portfolio, alternative funding sources and their costs, hedging and the possible purchase of derivatives such as swaps and caps, and any tax or regulatory issues which may be pertinent to these areas. The MIALCO approves funding decisions in light of the Corporation's overall growth strategies and objectives. On a quarterly basis, the MIALCO performs a comprehensive asset/liability review, examining interest rate risk as described below together with other issues such as liquidity and capital.

The Corporation uses scenario analysis to measure the effects of changes in interest rates on net interest income. These simulations are carried out over a one-year and a two-year time horizon, assuming gradual upward and downward interest rate movements of 200 basis points. Simulations are carried out in two ways:

- (1) using a static balance sheet as the Corporation had on the simulation date, and
- (2) using a growing balance sheet based on recent growth patterns and strategies.

The balance sheet is divided into groups of assets and liabilities in order to simplify the projections. As interest rates rise or fall, these simulations incorporate expected future lending rates, current and expected future funding sources and cost, the possible exercise of options, changes in prepayment rates, and other factors which may be important in projecting the future growth of net interest income. These projections are carried out for First BanCorp on a fully consolidated basis.

The Corporation uses asset-liability management software to project future movements in the Corporation's balance sheet and income statement. The starting point of the projections generally corresponds to the actual values of the balance sheet on the date of the simulations. Interest rates used for the simulations also correspond to actual rates at the start of the projection period.

These simulations are highly complex, and use many simplifying assumptions that are intended to reflect the general behavior of the Corporation over the period in question. There can be no assurance that actual events will match these assumptions in all cases. For this reason, the results of these simulations are only approximations of the true sensitivity of net interest income to changes in market interest rates. There have been no significant changes in the Corporation's interest rate risk profile since the end of 2005.

Derivatives. First BanCorp uses derivative instruments and other strategies to manage its exposure to interest rate risk caused by changes in interest rates beyond management's control. The following summarizes major strategies, including derivatives activities, used by the Corporation in managing interest rate risk:

Interest rate swaps Interest rate swap agreements generally involve the exchange of fixed- and floating-rate interest payment obligations without the exchange of the underlying principal. Since a substantial portion of the Corporation's loans, mainly commercial loans, yield variable-rates, the interest rate swaps are utilized to convert fixed-rate brokered CDs (liabilities) to a variable-rate to better match the variable-rate nature of these loans.

Interest rate cap agreements Interest rate cap agreements provide the right to receive cash if a reference interest rate rises above a contractual rate. The value increases as the reference interest rate rises. The Corporation enters into interest rate cap agreements to protect against rising interest rates. Specifically, the interest rate of the Corporation's commercial loans to other financial institutions is generally a variable rate limited to the weighted-average coupon of the referenced residential mortgage collateral, less a contractual servicing fee. The Corporation utilizes interest rate cap agreements to protect against rising interest rates.

Table of Contents

Structured repurchase agreements The Corporation uses structured repurchase agreements, with embedded call options, to reduce the Corporation's exposure to interest rate risk by lengthening the contractual maturities of its liabilities, while keeping funding costs low. Another type of structured repurchase agreement includes repurchased agreements with embedded cap corridors; these instruments also provide protection for a rising rate scenario.

The following table summarizes the notional amount of all derivative instruments as of June 30, 2006, December 31, 2005, June 30, 2005, and June 30, 2004:

	Notional Amount			
	June 30, 2006	December 31, 2005	June 30, 2005	June 30, 2004 (As Restated)
<i>(In thousands)</i>				
Interest rate swap agreements:				
Pay fixed versus receive floating	\$ 89,320	\$ 109,320	\$ 109,320	\$ 113,165
Receive fixed versus pay floating	5,457,923	5,751,128	4,850,107	3,579,521
Embedded written options	13,515	13,515	13,515	13,515
Purchased options	13,515	13,515	13,515	13,515
Written interest rate cap agreements	125,200	150,200	48,000	25,000
Purchased interest rate cap agreements	348,897	386,750	475,299	25,000
	\$ 6,048,370	\$ 6,424,428	\$ 5,509,756	\$ 3,769,716

The following table summarizes the notional amount of all derivatives by the Corporation's designation as of June 30, 2006, December 31, 2005, June 30, 2005 and June 30, 2004:

	Notional amounts			
	As of June 30, 2006	As of December 31, 2005	As of June 30, 2005	As of June 30, 2004
(Dollars in thousands)				
Designated hedges:				
Fair value hedge:				
Interest rate swaps used to hedge fixed rate certificates of deposit	\$ 4,874,960	\$	\$	\$
Interest rate swaps used to hedge fixed and step rate notes payable	165,442			
Total fair value hedges	\$ 5,040,402	\$	\$	\$
Economic undesignated hedges:				
Interest rate swaps used to hedge fixed rate certificates of deposit and loans	\$ 506,841	\$ 5,860,448	\$ 4,959,427	\$ 3,692,686
Embedded options on stock index deposits	13,515	13,515	13,515	13,515
Purchased options used to manage exposure to the stock market on embedded stock index options	13,515	13,515	13,515	13,515

Edgar Filing: FIRST BANCORP /PR/ - Form 10-Q

Written interest rate cap agreements	125,200	150,200	48,000	25,000
Purchased interest rate cap agreements	348,897	386,750	475,299	25,000
Total derivatives not designated as hedge	\$ 1,007,968	\$ 6,424,428	\$ 5,509,756	\$ 3,769,716
Total	\$ 6,048,370	\$ 6,424,428	\$ 5,509,756	\$ 3,769,716

The following tables summarize the fair value changes of the Corporation's derivatives as well as the source of the fair values:

	Six month period ended June 30, 2006
<i>(In thousands)</i>	
Fair value of contracts outstanding at the beginning of the period	\$ (142,347)
Contracts realized or otherwise settled during the period	1,312
Changes in fair value during the period	(119,093)
Fair value of contracts outstanding at June 30, 2006	\$ (260,128)

Table of Contents**Source of Fair Value***(In thousands)*

	Payments Due by Period					Total Fair Value
	Maturity Less Than One Year	Maturity 1-3 Years	Maturity 3-5 Years	Maturity In Excess of 5 Years		
As of June 30, 2006						
Prices provided by external sources	\$(1,511)	\$(8,473)	\$(11,243)	\$(238,901)		\$(260,128)

Prior to April 2006, none of the derivative instruments held by the Corporation were qualified for hedge accounting. Effective April 3, 2006, the Corporation adopted the long-haul method of effectiveness testing under SFAS 133 for substantially all of the interest rate swaps that hedge its brokered CDs and medium-term notes. The long-haul method requires periodic assessment of hedge effectiveness and measurement of ineffectiveness. The ineffectiveness results to the extent the changes in the fair value of the derivative do not offset the changes in fair values of the hedged liabilities due to changes in the hedged risk. Prior to the implementation of fair value hedge accounting, the Corporation recorded unrealized losses in the valuation of interest rate swaps of approximately \$68.0 million during the first quarter of 2006.

With the implementation of the long-haul method with respect to the brokered CDs and medium-term notes on April 3, 2006, the basis differential between the market value and book value of the hedged liabilities at the inception of fair value hedge accounting, of approximately \$200.0 million, amortizes or accretes as a yield adjustment over the remaining term of the hedged liabilities. For the quarter ended June 30, 2006, the Corporation recorded an amortization of \$1.3 million as a basis adjustment.

Effective January 1, 2007, the Corporation decided to early adopt SFAS 159 for the callable brokered CDs and the callable fixed medium-term notes (Notes) that were hedged with interest rate swaps. One of the main considerations to early adopt SFAS 159 for these instruments is 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, First BanCorp selected the fair value measurement for approximately 63% of the brokered CDs portfolio and for certain medium-term notes. The CDs and Notes chosen for the fair value measurement option are the ones hedged at January 1, 2007 by callable interest rate swaps with the same terms and conditions. The adoption of SFAS 159 also resulted on a positive after-tax impact to retained earnings of approximately \$92.2 million. Under SFAS 159, this one-time credit will not be recognized in current earnings.

The use of derivatives involves market and credit risk. The market risk of derivatives stems principally from the potential for changes in the value of derivatives contracts based on changes in interest rates. The credit risk of derivatives arises from the potential of a counterparty's default on its contractual obligations. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. Master netting agreements incorporate rights of set-off that provide for the net settlement of contracts with the same counterparty in the event of default.

Credit Risk Management

First BanCorp is subject to credit risk mainly with respect to its portfolio of loans receivable and off-balance sheet instruments, mainly derivatives and loan commitments. Loans receivable represent loans that First BanCorp holds for investment and, therefore, First BanCorp is at risk for the term of the loan. Loan commitments represent commitments to extend credit, subject to specific condition, for specific amounts and maturities. These commitments may expose the Corporation to credit risk and are subject to the same review and approval process as loans. Refer to Contractual Obligations and Commitments above for further details. The credit risk of

Table of Contents

derivatives arises from the potential of a counterparty's default on its contractual obligations. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. For further details and information on the Corporation's derivative credit risk exposure, refer to Interest Rate Risk Management section above. The Corporation manages its credit risk through credit policy, underwriting, and quality control. The Corporation also employs proactive collection and loss mitigation efforts.

The Corporation may also encounter risk of default in relation to its securities portfolio. The securities held by the Corporation are principally mortgage-backed securities, U.S. Treasury and agency securities. Thus, a substantial portion of these instruments are guaranteed by mortgages, a U.S. government-sponsored entity or the full faith and credit of the U.S. government and are deemed to be of the highest credit quality.

Management's Credit Committee, comprised of the Corporation's Chief Credit Risk Officer and other senior executives, has primary responsibility for setting strategies to achieve the Corporation's credit risk goals and objectives. Those goals and objectives are documented in the Corporation's Credit Policy.

Non-performing Assets and Allowance for Loan and Lease Losses
Allowance for Loan and Lease Losses

The provision for loan and lease losses is charged to earnings to maintain the allowance for loan and lease losses at a level that the Corporation considers adequate to absorb probable losses inherent in the portfolio. The Corporation establishes the allowance for loan and lease losses based on its asset classification report to cover the total amount of any assets classified as a loss, the probable loss exposure of other classified assets, and the estimated losses of assets not classified. The adequacy of the allowance for loan and lease losses is also based upon a number of additional factors including historical loan loss experience, current economic conditions, the fair value of the underlying collateral, and the financial condition of the borrowers, and, as such, includes amounts based on judgments and estimates made by the Corporation. Although management believes that the allowance for loan and lease losses is adequate, factors beyond the Corporation's control, including factors affecting the Puerto Rico, the state of Florida, US VI or British VI economies may contribute to delinquencies and defaults, thus necessitating additional reserves.

For small, homogeneous loans, including residential mortgage loans, auto loans, consumer loans, finance lease loans, and commercial and construction loans under \$1.0 million, the Corporation evaluates a specific allowance based on average historical loss experience for each corresponding type of loans. The methodology of accounting for all probable losses is made in accordance with the guidance provided by Statement of Accounting Standards No. 5, Accounting for Contingencies.

Commercial and construction loans in amounts of over \$1.0 million are individually evaluated on a quarterly basis for impairment following the provisions of SFAS No. 114, Accounting by Creditors for Impairment of a Loan. A loan is impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. The impairment loss, if any, on each individual loan identified as impaired is generally measured based on the present value of expected cash flows discounted at the loan's effective interest rate. As a practical expedient, impairment may be measured based on the loan's observable market price, or the fair value of the collateral, if the loan is collateral dependent.

Table of Contents

The following table sets forth an analysis of the activity in the allowance for loan and lease losses during the periods indicated:

<i>(In thousands)</i>	Quarter ended June 30,			Six Month Period Ended June 30,		
	2006	2005	2004 (As Restated)	2006	2005	2004 (As Restated)
Allowance for loan and lease losses, beginning of period	\$ 152,596	\$ 144,201	\$ 130,357	\$ 147,999	\$ 141,036	\$ 126,378
Provision for loan and lease losses	9,354	11,075	13,200	28,730	22,029	26,400
Loans charged-off:						
Residential real estate	(487)	(677)	(59)	(700)	(742)	(85)
Commercial and Construction	(1,024)	(1,813)	(1,785)	(3,011)	(3,296)	(3,321)
Finance leases	(1,022)	(406)	(765)	(1,716)	(839)	(1,313)
Consumer	(14,279)	(8,102)	(8,672)	(27,834)	(16,720)	(17,258)
Recoveries	1,389	1,876	1,402	3,059	3,323	2,877
Net charge-offs	(15,423)	(9,122)	(9,879)	(30,202)	(18,274)	(19,100)
Other adjustments					1,363	
Allowance for loan and lease losses, end of period	\$ 146,527	\$ 146,154	\$ 133,678	\$ 146,527	\$ 146,154	\$ 133,678
Allowance for loan and lease losses to period end total loans receivable	1.35%	1.24%	1.68%	1.35%	1.24%	1.68%
Net charge-offs annualized to average loans outstanding during the period	0.50%	0.32%	0.52%	0.48%	0.34%	0.52%
Provision for loan and lease losses to net charge-offs during the period	0.61x	1.21x	1.34x	0.95x	1.21x	1.38x

First BanCorp's allowance for loan and lease losses was \$146.5 million at June 30, 2006, compared to \$146.2 million at June 30, 2005 and \$133.7 million at June 30, 2004. The provision for loan and lease losses for the second quarter and first half of 2006 amounted to \$9.4 million and \$28.7 million, respectively, compared to \$11.1 million and \$22.0 million, respectively, for the corresponding periods in 2005 and \$13.2 million and \$26.4 million, respectively, for the corresponding periods in 2004. The decrease in this provision for the second quarter of 2006 compared to the second quarter of 2005 was mainly due to a significant reduction in the Corporation's secured commercial loans to local financial institutions portfolio due to the payment of \$2.4 billion received during

the second quarter of 2006 that reduced the outstanding balance of a secured commercial loan extended to a local financial institution.

The increase in the provision for the first half of 2006, compared to the same period in 2005, principally reflects growth in the Corporation's commercial (other than secured commercial loan to local financial institutions) and consumer portfolios coupled with increasing trends in non-performing loans and charge-offs experienced during 2006 as compared to 2005. The Corporation's net charge-offs were affected by the fiscal and economic situation of Puerto Rico. According to the Puerto Rico Planning Board, Puerto Rico is currently in a midst of a recession. The latest Gross National Product forecast by the Puerto Rico Planning Board expects a 1.4% reduction in fiscal year 2007 compared to fiscal year 2006. The slowdown in activity is the result of, among other things, higher utilities prices, higher taxes, government budgetary imbalances, the upward trend in short-term interest rates and the flattening of the yield curve, and higher levels of oil prices. The decrease in the provision during 2005 as compared to 2004 was primarily attributable to the seasoning of the commercial loans portfolio, a decrease in net charge-offs experienced during 2005, and the stability of non-performing loans.

First BanCorp's ratio of the allowance for loan and lease losses to period end total loans was 1.35% at June 30, 2006, compared to 1.24% at June 30, 2005 and 1.68% at June 30, 2004. During 2005, the Corporation determined that, based on an analysis of credit quality, the composition of the Corporation's loan portfolio, and recent loss experience, specifically for commercial and residential real estate portfolio, a smaller provision was required and hence a smaller ratio resulted during 2005, compared to 2004.

Table of Contents

The Corporation's ratio of the provision for loan and lease losses to net charge-offs for the second quarter and first half of 2006 was 61% and 95%, respectively, compared to 121% for each of the corresponding periods in 2005. During the second quarter of 2006, due to a significant reduction in the Corporation's secured commercial loans to local financial institutions portfolio, the Corporation's provision for loan and lease losses decreased by \$1.7 million compared to the second quarter of 2005. As a result, the Corporation's ratio of the provision for loan and lease losses to net charge-offs decreased by 60 basis points in the second quarter of 2006 compared to the second quarter of 2005. For the first half of 2006, the Corporation's ratio of provision for loan and lease losses to net charge-offs decreased by 26 basis points, compared to the same period in 2005, mainly due to the reduction in the Corporation's commercial portfolio coupled with changes in the mix of the Corporation's as the proportion of loans collateralized by residential real estate to total loans increased during 2006. In 2005 compared to 2004, the ratio of provision for loan and lease losses to net charge-offs decreased due to the Corporation's loss experience, the credit quality of the portfolio, and change in the mix of the loans portfolio.

Non-accruing and Non-performing Assets

Total non-performing assets are the sum of non-accruing loans, foreclosed real estate, and other repossessed properties. Non-accruing loans are loans as to which interest is no longer being recognized. When loans fall into non-accruing status, all previously accrued and uncollected interest is charged against interest income.

Non-accruing Loans Policy

Residential Real Estate Loans - The Corporation classifies real estate loans in non-accruing status when interest and principal have not been received for a period of 90 days or more.

Commercial Loans - The Corporation places commercial loans (including commercial real estate and construction loans) in non-accruing status when interest and principal have not been received in a period of 90 days or more. The risk exposure of this portfolio is diversified as to individual borrowers and industries among other factors. In addition, a large portion is secured with real estate collateral.

Finance Leases - Finance leases are classified in non-accruing status when interest and principal have not been received for a period of 90 days or more.

Consumer Loans - Consumer loans are classified in non-accruing status when interest and principal have not been received for a period of 90 days or more.

Other Real Estate Owned (OREO)

OREO acquired in settlement of loans is carried at the lower of cost (carrying value of the loan) or fair value less estimated costs to sell the real estate at the date of acquisition (estimated realizable value).

Other Repossessed Property

The other repossessed property category includes repossessed boats and autos acquired in settlement of loans. Repossessed boats and autos are recorded at the lower of cost or estimated fair value.

Past Due Loans

Past due loans are accruing commercial loans, which are contractually delinquent for 90 days or more. Past due commercial loans are current as to interest but delinquent in the payment of principal.

The following table presents non-performing assets at the dates indicated:

Table of Contents

	June 30,	December	June 30,	June 30,
	2006	31,	2005	2004
<i>(Dollars in thousands)</i>		2005		(As
				Restated)
Non-accruing loans:				
Residential real estate	\$ 85,542	\$ 54,777	\$ 37,155	\$ 28,207
Commercial, commercial real estate and construction	49,140	35,814	29,210	44,274
Finance leases	6,125	3,272	2,465	2,684
Consumer	43,169	40,459	24,015	15,822
	183,976	134,322	92,845	90,987
Other real estate owned	3,435	5,019	8,463	5,599
Other repossessed property	15,000	9,631	8,259	5,758
Total non-performing assets	\$ 202,411	\$ 148,972	\$ 109,567	\$ 102,344
Past due loans	\$ 31,366	\$ 27,501	\$ 31,426	\$ 16,519
Non-performing assets to total assets	1.00%	0.75%	0.58%	0.71%
Non-accruing loans to total loans receivable	1.70%	1.06%	0.79%	1.14%
Allowance for loan and lease losses	\$ 146,527	\$ 147,999	\$ 146,154	\$ 133,678
Allowance to total non-accruing loans	80%	110%	157%	147%
Allowance to total non-accruing loans, excluding residential real estate loans	149%	186%	262%	213%

Due to deteriorating economic conditions in Puerto Rico, increased delinquencies, and overall growth of the Corporation's loan portfolio, First BanCorp increased its allowance for loan and lease losses from \$133.7 million as of June 30, 2004 to \$146.5 million as of June 30, 2006.

As a result of the increase in delinquencies, the Corporation's non-accruing loans to total loans receivable ratio has increased over time from 1.14% at June 30, 2004 to 1.70% at June 30, 2006. The increase was mainly due to increases in non-accruing loans in the residential real estate portfolio. Historically, the Corporation has experienced the lowest rates of losses for this portfolio. As a consequence, the provision and allowance for loan and lease losses did not increase proportionately with the increase in non-accruing loans. As of June 30, 2006, the Corporation's ratio of the allowance for loan and lease losses to non-performing loans decreased by 67 basis points from 147% as of June 30, 2004 to 80% as of June 30, 2006. Excluding residential real estate loans, the ratio of the allowance for loan and lease losses to non-accruing loans decreased by 64 basis points from 213% at June 30, 2004 to 149% at June 30, 2006.

The increase in consumer non-accrual loans mainly relates to increases in the Corporation's auto and personal unsecured portfolios.

Liquidity Risk Management

Liquidity refers to the level of cash and eligible investments to meet loan and investment commitments, potential deposit outflows and debt repayments. MIALCO, using measures of liquidity developed by management, which involves the use of several assumptions, reviews the Corporation's liquidity position on a weekly basis.

The Corporation utilizes different sources of funding to help ensure that adequate levels of liquidity are available when needed. Diversification of funding sources is of great importance as it protects the Corporation's liquidity from market disruptions. The principal sources of short-term funds are deposits, securities sold under agreements to repurchase, and lines of credit with the FHLB as well as other unsecured lines established with financial institutions.

MIALCO reviews credit availability on a regular basis. In the past, the Corporation has

Table of Contents

securitized and sold auto and mortgage loans as supplementary sources of funding. Additional funding is provided by the sale of commercial paper as well as long-term funding through the issuance of notes and long-term brokered CDs. The cost of these different alternatives, among other things, is taken into consideration. The Corporation's principal uses of funds are the origination of loans and the repayment of maturing deposit accounts and borrowings.

A large portion of the Corporation's funding is retail brokered CDs issued by the banking subsidiaries. In the event that the Corporation's bank subsidiaries are not well-capitalized institutions, they might not be to replace this source of funding. The banking subsidiaries currently comply with the minimum requirements ratios for well-capitalized institutions and the Corporation does not foresee any risks to their ability to issue brokered deposits. In addition, the average life of the retail brokered CDs was approximately 5.5 years at June 30, 2006. Approximately 44% of these certificates are callable, but only at the Corporation's option.

Refer to the *Sources of Funds* section above for further details on the Corporation's brokered CDs.

Operational Risk

The Corporation faces ongoing and emerging risk and regulatory pressures related to the activities that surround the delivery of banking and financial products. Coupled with external influences such as market conditions, security risks, and legal risk, its potential for operational and reputational loss has increased. In order to mitigate and control operational risk, the Corporation has developed, and continues to enhance, specific internal controls, policies and procedures that are designated to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these mechanisms is to provide reasonable assurance that the Corporation's business operations are functioning within the policies and limits established by management.

The Corporation classifies operational risk into two major categories: business specific and corporate-wide affecting all business lines. For business specific risks, a risk assessment group works with the various business units to ensure consistency in policies, processes and assessments. With respect to corporate wide risks, such as information security, business recovery, legal and compliance, the Corporation has specialized groups, such as the Legal Department, Information Security, Corporate Compliance, Information Technology and Operations. These groups assist the lines of business in the development and implementation of risk management practices specific to the needs of the business groups.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding market risk to which the Corporation is exposed, see the information contained under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations Risk Management.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Control and Procedures

First BanCorp's management, with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of First BanCorp's disclosure controls and procedures as of June 30, 2006. Disclosure controls and procedures are defined under SEC rules as controls and other procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within required time periods. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits

Table of Contents

under the Securities Exchange Act of 1934 is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. As a result of this evaluation, First BanCorp's Chief Executive Officer and its current Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures were not effective as of June 30, 2006 due to the existence of the material weaknesses discussed below.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by management or employees in the normal course of their assigned functions.

As reported in the Corporation's 2005 Annual Report on Form 10-K, dated February 9, 2007, management previously concluded that its internal control over financial reporting was not effective as of December 31, 2005. Such conclusion resulted from the identification of the following material weaknesses:

1. Ineffective Control Environment.
2. Ineffective controls over the documentation and communication of relevant terms of certain mortgage loans bulk purchase transactions.
3. Ineffective controls over communications to the Audit Committee.
4. Ineffective controls over communication to the Corporation's independent registered public accounting firm.
5. Ineffective anti-fraud controls and procedures.
6. Insufficient accounting resources and expertise.
7. Ineffective controls over the accounting for mortgage-related transactions.
8. Ineffective controls over the accounting for derivative financial instruments.
9. Ineffective controls over the valuation of premiums and discounts on mortgage-backed securities.

These material weaknesses are discussed in greater detail in our Annual Report on Form 10-K for the year ended December 31, 2005.

Remediation of previously disclosed material weaknesses

During the first quarter of 2006, First BanCorp completed the implementation of the following remediation steps to fully remediate the material weakness number 9 Ineffective controls over the valuation of premiums and discounts on mortgage-backed securities as of March 31, 2006. The remediation steps taken by management were to adjust the balances to reflect the use of the effective interest method. In addition, the Corporation reviewed the accounting policy to require the use of the interest method for the amortization of premiums and discounts on mortgage-backed securities. As a result of such review, effective January 1, 2006, the Corporation implemented the interest method for the amortization of premiums and discounts on mortgage-backed securities.

During the second quarter of 2006, First BanCorp completed the implementation of the following remediation steps to fully remediate the material weaknesses number 7 and 8:

Ineffective controls over the accounting for mortgage-related transactions. The Corporation's management believes that, as of June 30, 2006, the Corporation has fully remediated the material weakness in its internal control over financial reporting with respect to purchases of mortgages in bulk and the purchases of mortgages where the seller of the mortgages retains the servicing responsibilities. The Corporation has implemented controls that specify that the terms of any recourse provisions or retained servicing arrangements must be reviewed by the General Counsel before they are included in purchase agreements. In addition, the Board has reviewed the Corporation's risk management program and enhanced the communication to the Audit Committee.

Table of Contents

Ineffective controls over the accounting for derivative financial instruments. The Corporation's management believes that, as of June 30, 2006, the Corporation has fully remediated the material weakness in its internal control over financial reporting with respect to the identification of derivatives and the measurement of hedge effectiveness. With respect to the identification of derivatives, the Corporation has implemented the following changes:

The Corporation created the Investment and Derivative Risk Manager Position, which is responsible for the evaluation of complex transactions, such as derivatives, implementation of policies and procedures and monitoring of external consultants analyses/computations.

The legal and accounting departments must review any new forms of transactions or any variants of forms of transactions for which the Corporation has not determined the accounting in order to identify any derivatives resulting from the structure of such transactions; and

Periodic testing of the hedge effectiveness process is required to make sure that it is operating effectively to ensure compliance with SFAS 133.

Education of personnel on derivative financial instruments and involvement of outside experts, as necessary.

With respect to the measurement of hedge effectiveness, the Corporation has revised its control accounting procedures to state that the receipt of an upfront payment from interest swap counterparty precludes the use of the short-cut method of accounting under SFAS 133.

Changes in Internal Control over Financial Reporting

In addition to the remediation of the above mentioned material weaknesses, the following are changes in the Corporation's internal control over financial reporting that occurred during the period ended June 30, 2006 that materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

1. Changes in Management and Clarification of the Role, Responsibilities and Authority of Management. In addition to the previous appointments of a new CEO and COO, in February 15, 2006 the Board appointed a new General Counsel, who reports to the CEO.
2. Board Membership Changes. In November 2005, the Board elected Fernando Rodriguez-Amaro as a new independent director to serve as an additional audit committee financial expert, and thereafter appointed him Chairman of the Audit Committee as of January 1, 2006. Also, in the first quarter of 2006, the Board appointed Jose Menendez Cortada as the Lead Independent Director of the Board.
3. Risk Management Program. During the first quarter of 2006, the Board reviewed the Corporation's risk management program with the assistance of outside consultants and legal counsel and began a process of realigning the risk management functions and the adoption of an enterprise risk management process. During the second quarter of 2006, the Board appointed a senior management officer as Chief Risk Officer and appointed this officer to the Risk Management Council with reporting responsibilities to the CEO and the Audit Committee.
4. Corporate Governance Review. During the first quarter of 2006, with the assistance of outside consultants and outside counsel, the Corporate Governance Committee of the Board re-evaluated the Corporation's corporate governance policies and made recommendations to the full Board for changes. This effort is expected to result in a clearer understanding of the responsibilities and duties of the Board and its committees and in an alignment of those responsibilities with the industry's best practices.
5. Ethical training of employees and directors. During the second quarter of 2006, the Corporation designed and started offering enhanced corporate compliance seminars to every employee and director of the Corporation.

Through the corporate compliance training program, the Corporation is emphasizing the importance of compliance with the Corporation's policies and procedures and control

Table of Contents

systems, including the new policy regarding full and complete documentation of agreements and prohibiting oral and side agreements, the Corporation's Code of Ethics and Code of Conduct, the Corporation's various legal compliance programs, and the availability of mechanisms to report possible unethical behavior, such as the Audit Committee's whistleblower hotline.

As discussed in First BanCorp's 2006 Annual Report on Form 10-K filed with the SEC on July 9, 2007, First BanCorp completed the execution of its remediation plan, evaluated and tested the effectiveness of the controls as of December 31, 2006, and determined that the material weaknesses described above had been remediated.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Corporation is subject to various legal proceedings arising as a result of the restatement of the Corporation's financial statements for the years 2004, 2003 and 2002. For information on these proceedings, please refer to Note 17 to the unaudited interim financial statements included in Item 1, Financial Statements, of this Quarterly Report on Form 10-Q.

ITEM 1A. RISK FACTORS

For a detailed discussion of certain risk factors that could affect First BanCorp's operations, financial condition or results for future periods see Item 1A, Risk Factors, in First BanCorp's 2005 Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

31.1 CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 CFO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Corporation has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized:

First BanCorp.

Registrant

Date: August 20, 2007

By: /s/ Luis M. Beauchamp
Luis M. Beauchamp
Chairman, President and Chief
Executive Officer

Date: August 20, 2007

By: /s/ Fernando Scherrer
Fernando Scherrer
Executive Vice President and Chief
Financial Officer