

ORIENTAL FINANCIAL GROUP INC

Form 10-Q

May 09, 2011

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2011

or

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

For the transition period from _____ to _____

**Commission File Number 001-12647
Oriental Financial Group Inc.**

Incorporated in the Commonwealth of Puerto Rico, IRS Employer Identification No. 66-0538893
Principal Executive Offices:
997 San Roberto Street
Oriental Center 10th Floor
Professional Offices Park
San Juan, Puerto Rico 00926
Telephone Number: (787) 771-6800

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

(Do not check if a smaller reporting company)

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

Yes No

Number of shares outstanding of the registrant's common stock, as of the latest practicable date:

45,274,338 common shares (\$1.00 par value per share) outstanding as of April 30, 2011

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FORWARD-LOOKING STATEMENTS

The information included in this quarterly report on Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate to Oriental Financial Group Inc. (the Group) financial condition, results of operations, plans, objectives, future performance and business, including, but not limited to, statements with respect to the adequacy of the allowance for loan and lease losses, delinquency trends, market risk and the impact of interest rate changes, capital markets conditions, capital adequacy and liquidity, and the effect of legal proceedings and new accounting standards on the Group's financial condition and results of operations. All statements contained herein that are not clearly historical in nature are forward-looking, and the words anticipate, believe, continues, expect, estimate, intend, project and expressions and future or conditional verbs such as will, would, should, could, might, can, may, or similar are generally intended to identify forward-looking statements.

These statements are not guarantees of future performance and involve certain risks, uncertainties, estimates and assumptions by management that are difficult to predict. Various factors, some of which, by their nature are beyond the Group's control, could cause actual results to differ materially from those expressed in, or implied by, such forward-looking statements. Factors that might cause such a difference include, but are not limited to:

the rate of growth in the economy and employment levels, as well as general business and economic conditions;

changes in interest rates, as well as the magnitude of such changes;

the fiscal and monetary policies of the federal government and its agencies;

changes in federal bank regulatory and supervisory policies, including required levels of capital;

the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) on our businesses, business practices and cost of operations;

the relative strength or weakness of the consumer and commercial credit sectors and of the real estate market in Puerto Rico;

the performance of the stock and bond markets;

competition in the financial services industry;

additional Federal Deposit Insurance Corporation (FDIC) assessments; and

possible legislative, tax or regulatory changes.

Other possible events or factors that could cause results or performance to differ materially from those expressed in these forward-looking statements include the following: negative economic conditions that adversely affect the general economy, housing prices, the job market, consumer confidence and spending habits which may affect, among other things, the level of non-performing assets, charge-offs and provision expense; changes in interest rates and market liquidity which may reduce interest margins, impact funding sources and affect the ability to originate and distribute financial products in the primary and secondary markets; adverse movements and volatility in debt and equity capital markets; changes in market rates and prices which may adversely impact the value of financial assets and liabilities; liabilities resulting from litigation and regulatory investigations; changes in accounting standards, rules and interpretations; increased competition; the Group's ability to grow its core businesses; decisions to downsize, sell or close units or otherwise change the Group's business mix; and management's ability to identify and manage these and other risks.

All forward-looking statements included in this quarterly report on Form 10-Q are based upon information available to the Group as of the date of this report, and other than as required by law, including the requirements of applicable

securities laws, the Group assumes no obligation to update or revise any such forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

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ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
MARCH 31, 2011 AND DECEMBER 31, 2010

	March 31, 2011	December 31, 2010
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents		
Cash and due from banks	\$ 315,351	\$ 337,218
Money market investments	2,060	111,728
Total cash and cash equivalents	317,411	448,946
Investments:		
Trading securities, at fair value, with amortized cost of \$1,447 (December 31, 2010 - \$1,306)	1,444	1,330
Investment securities available-for-sale, at fair value, with amortized cost of \$3,562,745 (December 31, 2010 - \$3,661,146)	3,587,930	3,700,064
Investment securities held-to-maturity, at amortized cost, with fair value of \$855,816 (December 31, 2010 - \$675,721)	875,494	689,917
Federal Home Loan Bank (FHLB) stock, at cost	22,496	22,496
Other investments	150	150
Total investments	4,487,514	4,413,957
Loans:		
Mortgage loans held-for-sale, at lower of cost or fair value	34,216	33,979
Loans not covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of \$32,727 (December 31, 2010 - \$31,430)	1,108,324	1,117,859
Loans covered under shared-loss agreements with the FDIC, net of allowance for loan and lease losses of \$53,480 (December 31, 2010 - \$49,286)	589,912	620,732
Total loans, net	1,732,452	1,772,570
FDIC shared-loss indemnification asset	436,889	471,872
Foreclosed real estate covered under shared-loss agreements with the FDIC	17,302	15,962
Foreclosed real estate not covered under shared-loss agreements with the FDIC	12,793	11,969
Accrued interest receivable	28,634	28,716
Deferred tax asset, net	30,404	30,350
Premises and equipment, net	23,353	23,941
Forward settlement swaps	7,203	11,023
Investment in equity indexed options	11,764	9,870
Investment in swap options	7,804	7,422
Other assets	62,606	64,422

Total assets	\$ 7,176,129	\$ 7,311,020
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Demand deposits	\$ 947,526	\$ 954,554
Savings accounts	240,863	235,690
Certificates of deposit	1,313,083	1,398,644
Total deposits	2,501,472	2,588,888
Borrowings:		
Short-term borrowings	32,335	42,470
Securities sold under agreements to repurchase	3,456,605	3,456,781
Advances from FHLB	281,687	281,753
FDIC-guaranteed term notes	105,112	105,834
Subordinated capital notes	36,083	36,083
Total borrowings	3,911,822	3,922,921
FDIC net settlement payable	1,774	23,082
Accrued expenses and other liabilities	47,933	43,798
Total liabilities	6,463,001	6,578,689
Stockholders equity:		
Preferred stock, \$1 par value; 10,000,000 shares authorized; 1,340,000 shares of Series A and 1,380,000 shares of Series B issued and outstanding, \$25 liquidation value.	68,000	68,000
Common stock, \$1 par value; 100,000,000 shares authorized; 47,807,984 shares issued; 45,375,090 shares outstanding (December 31, 2010 - 47,807,734; 46,348,667)	47,808	47,808
Treasury stock, at cost, 2,432,894 shares (December 31, 2010 - 1,459,067 shares)	(28,746)	(16,732)
Additional paid-in capital	498,303	498,435
Legal surplus	46,717	46,331
Retained earnings	50,727	51,502
Accumulated other comprehensive income, net of tax of (\$1,807) (December 31, 2010 - (\$2,108))	30,319	36,987
Total stockholders equity	713,128	732,331
Total liabilities and stockholders equity	\$ 7,176,129	\$ 7,311,020

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

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**ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010**

	Quarter ended March 31,	
	2011	2010
	(In thousands, except per share data)	
Interest income:		
Loans		
Loans not covered under shared-loss agreements with the FDIC	\$ 17,841	\$ 17,637
Loans covered under shared-loss agreements with the FDIC	14,226	
Mortgage-backed securities	43,738	43,594
Investment securities and other	2,105	9,105
Total interest income	77,910	70,336
Interest expense:		
Deposits	12,214	11,243
Securities sold under agreements to repurchase	24,159	25,285
Advances from FHLB and other borrowings	3,049	3,012
FDIC-guaranteed term notes	1,021	1,021
Subordinated capital notes	302	298
Total interest expense	40,745	40,859
Net interest income	37,165	29,477
Provision for non-covered loan and lease losses	3,800	4,014
Provision for covered loan and lease losses, net	549	
Net interest income after provision for loan and lease losses	32,816	25,463
Non-interest income:		
Wealth management revenues	4,682	3,978
Banking service revenues	3,835	1,622
Mortgage banking activities	1,959	1,797
Total banking and wealth management revenues	10,476	7,397
Total loss on other-than-temporarily impaired securities		(39,590)
Portion of loss on securities recognized in other comprehensive income		38,958
Other-than-temporary impairments on securities		(632)
Accretion of FDIC loss-share indemnification asset, net	1,211	
Net gain (loss) on:		
Sale of securities	(2)	12,020
Derivatives	(3,968)	(10,636)
Trading securities	(31)	(3)

Foreclosed real estate	(132)	(117)
Other	(27)	9
Total non-interest income, net	7,527	8,038
Non-interest expenses:		
Compensation and employee benefits	11,688	8,250
Professional and service fees	5,451	2,153
Occupancy and equipment	4,405	3,594
Insurance	1,985	1,833
Electronic banking charges	1,454	678
Taxes, other than payroll and income taxes	1,380	857
Advertising and business promotion	1,165	699
Loan servicing and clearing expenses	1,021	724
Foreclosure and repossession expenses	729	302
Communication	397	342
Director and investors relations	287	315
Printing, postage, stationery and supplies	282	203
Other	546	443
Total non-interest expenses	30,790	20,393
Income before income taxes	9,553	13,108
Income tax expense	6,472	1,172
Net income	3,081	11,936
Less: Dividends on preferred stock	(1,201)	(1,201)
Income available to common shareholders	\$ 1,880	\$ 10,735
Income per common share:		
Basic	\$ 0.04	\$ 0.42
Diluted	\$ 0.04	\$ 0.41
Average common shares outstanding and equivalents	46,179	25,932
Cash dividends per share of common stock	\$ 0.05	\$ 0.04

See notes to unaudited consolidated financial statements.

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ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010

	Quarter Ended March 31,	
	2011	2010
	(In thousands)	
Preferred stock:		
Balance at beginning and end of period	\$ 68,000	\$ 68,000
Common stock:		
Balance at beginning of period	47,808	25,739
Issuance of common stock		8,740
Balance at end of period	47,808	34,479
Additional paid-in capital:		
Balance at beginning of period	498,435	213,445
Issuance of common stock		90,896
Stock-based compensation expense	368	263
Exercised restricted stock units with treasury shares	(500)	
Common stock issuance cost		(5,062)
Balance at end of period	498,303	299,542
Legal surplus:		
Balance at beginning of period	46,331	45,279
Transfer from retained earnings	386	1,201
Balance at end of period	46,717	46,480
Retained earnings:		
Balance at beginning of period	51,502	77,584
Net income	3,081	11,936
Cash dividends declared on common stock	(2,269)	(1,322)
Cash dividends declared on preferred stock	(1,201)	(1,201)
Transfer to legal surplus	(386)	(1,201)
Balance at end of period	50,727	85,796
Treasury stock:		
Balance at beginning of period	(16,732)	(17,142)
Stock purchased under the repurchase program	(12,530)	
Exercised restricted stock units with treasury shares	500	
Stock used to match defined contribution plan	16	15
Balance at end of period	(28,746)	(17,127)
Accumulated other comprehensive income (loss), net of tax:		

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Balance at beginning of period	36,987	(82,739)
Other comprehensive income (loss), net of tax	(6,668)	29,743
Balance at end of period	30,319	(52,996)
Total stockholders equity	\$ 713,128	\$ 464,174

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

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**ORIENTAL FINANCIAL GROUP INC.
 UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
 FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010**

	Quarter Ended March 31,	
	2011	2010
	(In thousands)	
Net income	\$ 3,081	\$ 11,936
Other comprehensive income (loss):		
Unrealized gain (loss) on securities available-for-sale arising during the period	(13,738)	44,610
Realized (gain) loss on investment securities included in net income	2	(12,020)
Total loss on other- than-temporarily impaired securities		39,590
Portion of loss on securities recognized in other comprehensive income		(38,958)
Unrealized gains on cash flow hedges arising during the period	7,123	
Income tax effect	(55)	(3,479)
Other comprehensive income (loss) for the period	(6,668)	29,743
Comprehensive income (loss)	\$ (3,587)	\$ 41,679

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

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ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010

	Quarter Ended March 31,	
	2011	2010
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 3,081	\$ 11,936
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization of deferred loan origination fees, net of costs	10	135
Amortization of premiums, net of accretion of discounts	7,638	5,559
Amortization of core deposit intangible	36	
Accretion of FDIC loss-share indemnification asset, net	(1,211)	
Other-than-temporary impairments on securities		632
Depreciation and amortization of premises and equipment	1,468	1,333
Deferred income taxes, net	(109)	(3,979)
Provision for loan and lease losses, net	4,349	4,014
Stock-based compensation	368	263
Fair value adjustment of servicing asset	(440)	(449)
(Gain) loss on:		
Sale of securities	2	(12,020)
Sale of mortgage loans held for sale	(799)	(862)
Derivatives	3,968	10,636
Sale of foreclosed real estate	132	117
Sale of premises and equipment	8	(14)
Originations and purchases of loans held-for-sale	(52,807)	(49,958)
Proceeds from sale of loans held-for-sale	17,970	17,633
Net (increase) decrease in:		
Trading securities	(114)	230
Accrued interest receivable	112	(3,444)
Other assets	2,374	419
Net increase (decrease) in:		
Accrued interest on deposits and borrowings	(312)	(563)
Accrued expenses and other liabilities	(17,143)	4,476
Net cash used in operating activities	(31,419)	(13,906)

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

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ORIENTAL FINANCIAL GROUP INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE QUARTERS ENDED MARCH 31, 2011 AND 2010

	Quarter Ended March 31,	
	2011	2010
	(In thousands)	
Cash flows from investing activities:		
Purchases of:		
Investment securities available-for-sale	(222,947)	(2,104,008)
Investment securities held-to-maturity	(209,112)	
Equity options	(525)	(524)
Maturities and redemptions of:		
Investment securities available-for-sale	303,270	915,890
Investment securities held-to-maturity	22,042	
Proceeds from sales of:		
Investment securities available-for-sale	44,528	1,238,588
Foreclosed real estate	2,397	2,228
Other repossessed assets	589	
Premises and equipment	(26)	(75)
Origination and purchase of loans, excluding loans held-for-sale	(25,155)	(28,153)
Principal repayment of loans	54,868	30,642
Shared-loss agreements reimbursements from the FDIC	39,839	
Additions to premises and equipment		