

ORIENTAL FINANCIAL GROUP INC

Form 10-Q

November 09, 2007

Table of Contents

**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 September 30, 2007

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 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 ☐

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:

24,119,149 common shares (\$1.00 par value per share)

outstanding as of October 31, 2007

TABLE OF CONTENTS

| | Page |
|--|-------------|
| <u>Part I FINANCIAL INFORMATION:</u> | |
| <u>Item 1 Financial Statements</u> | |
| <u>Unaudited consolidated statements of financial condition at September 30, 2007 and December 31, 2006</u> | 1 |
| <u>Unaudited consolidated statements of income for the quarters and nine-month periods ended September 30, 2007 and 2006</u> | 2 |
| <u>Unaudited consolidated statements of changes in stockholders' equity for the nine-month periods ended September 30, 2007 and 2006</u> | 3 |
| <u>Unaudited consolidated statements of comprehensive income for the quarters and nine-month periods ended September 30, 2007 and 2006</u> | 3 |
| <u>Unaudited consolidated statements of cash flows for the nine-month periods ended September 30, 2007 and 2006</u> | 4 |
| <u>Notes to unaudited consolidated financial statements</u> | 5 |
| <u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 18 |
| <u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u> | 35 |
| <u>Item 4 Controls and Procedures</u> | 37 |
| <u>PART II OTHER INFORMATION:</u> | |
| <u>Item 1 Legal Proceedings</u> | 37 |
| <u>Item 1A Risk Factors</u> | 38 |
| <u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u> | 38 |
| <u>Item 3 Defaults Upon Senior Securities</u> | 38 |
| <u>Item 4 Submissions of Matters to a Vote of Security Holders</u> | 38 |
| <u>Item 5 Other Information</u> | 38 |
| <u>Item 6 Exhibits</u> | 39 |
| <u>Signatures</u> | 40 |
| <u>EX-31.1 SECTION 302 CERTIFICATION OF THE CEO</u> | |

EX-31.2 SECTION 302 CERTIFICATION OF THE CFO

EX-32.1 SECTION 906 CERTIFICATION OF THE CEO

EX-32.2 SECTION 906 CERTIFICATION OF THE CFO

Table of Contents

FORWARD-LOOKING STATEMENTS

When used in this Form 10-Q or future filings by Oriental Financial Group Inc. (the "Group") with the Securities and Exchange Commission (the "SEC"), in the Group's press releases or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "would be," "will allow," "intends to," "will likely result," "are expected to," "will continue," "is anticipated," "estimated," "project," "believe," expressions are intended to identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

The future results of the Group could be affected by subsequent events and could differ materially from those expressed in forward-looking statements. If future events and actual performance differ from the Group's assumptions, the actual results could vary significantly from the performance projected in the forward-looking statements.

The Group wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made and are based on management's current expectations, and to advise readers that various factors, including local, regional and national economic conditions, substantial changes in levels of market interest rates, credit and other risks of lending and investment activities, competitive, and regulatory factors, legislative changes and accounting pronouncements, could affect the Group's financial performance and could cause the Group's actual results for future periods to differ materially from those anticipated or projected. The Group does not undertake, and specifically disclaims, any obligation to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

Table of Contents**PART I FINANCIAL INFORMATION****ITEM I FINANCIAL STATEMENTS****UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****SEPTEMBER 30, 2007 AND DECEMBER 31, 2006***(In thousands, except share data)*

| | September 30, 2007 | December 31, 2006 |
|--|-----------------------------------|----------------------------------|
| ASSETS | | |
| Cash and cash equivalents: | | |
| Cash and due from banks | \$ 12,331 | \$ 15,341 |
| Money market investments | 57,554 | 18,729 |
| Total cash and cash equivalents | 69,885 | 34,070 |
| Investments: | | |
| Time deposits with other banks | 5,000 | 5,000 |
| Trading securities, at fair value with amortized cost of \$243 (December 31, 2006 - \$246) | 240 | 243 |
| Investment securities available-for-sale, at fair value with amortized cost of \$2,832,329 (December 31, 2006 \$984,060) | | |
| Securities pledged that can be repledged | 2,663,438 | 947,880 |
| Other investment securities | 165,733 | 27,080 |
| Total investment securities available-for-sale | 2,829,171 | 974,960 |
| Investment securities held-to-maturity, at amortized cost with fair value of \$1,526,876 (December 31, 2006 \$1,931,720) | | |
| Securities pledged that can be repledged | 1,415,549 | 1,814,746 |
| Other investment securities | 140,122 | 152,731 |
| Total investment securities held-to-maturity | 1,555,671 | 1,967,477 |
| Other Investments | 1,613 | 30,949 |
| Federal Home Loan Bank (FHLB) stock, at cost | 21,387 | 13,607 |
| Total investments | 4,413,082 | 2,992,236 |
| Securities sold but not yet delivered | 45,866 | 6,430 |

Loans:

| | | |
|---|--------------|--------------|
| Mortgage loans held-for-sale, at lower of cost or market | 21,607 | 10,603 |
| Loans receivable, net of allowance for loan losses of \$9,055 (December 31, 2006 \$8,016) | 1,175,896 | 1,201,767 |
| Total loans, net | 1,197,503 | 1,212,370 |
| Accrued interest receivable | 33,162 | 27,940 |
| Premises and equipment, net | 20,124 | 20,153 |
| Deferred tax asset, net | 14,136 | 14,150 |
| Foreclosed real estate | 4,349 | 4,864 |
| Other assets | 59,082 | 59,773 |
| Total assets | \$ 5,857,189 | \$ 4,371,986 |

LIABILITIES AND STOCKHOLDERS' EQUITY

Deposits:

| | | |
|-------------------------|------------|------------|
| Demand deposits | \$ 110,172 | \$ 132,434 |
| Savings accounts | 338,128 | 266,184 |
| Certificates of deposit | 821,405 | 834,370 |
| Total deposits | 1,269,705 | 1,232,988 |

Borrowings:

| | | |
|---|-----------|-----------|
| Federal funds purchased and other short term borrowings | 27,246 | 13,568 |
| Securities sold under agreements to repurchase | 3,809,709 | 2,535,923 |
| Advances from FHLB | 348,114 | 182,489 |
| Term notes | | 15,000 |
| Subordinated capital notes | 36,083 | 36,083 |
| Total borrowings | 4,221,152 | 2,783,063 |

| | | |
|--|-----------|-----------|
| Accrued expenses and other liabilities | 24,537 | 19,509 |
| Total liabilities | 5,515,394 | 4,035,560 |

Commitments and Contingencies

Stockholders' equity:

| | | |
|---|--------|--------|
| Preferred stock, \$1 par value; 5,000,000 shares authorized; \$25 liquidation value; 1,340,000 shares of Series A and 1,380,000 shares of Series B issued and outstanding | 68,000 | 68,000 |
| | 25,556 | 25,431 |

Edgar Filing: ORIENTAL FINANCIAL GROUP INC - Form 10-Q

Common stock, \$1 par value; 40,000,000 shares authorized; 25,555,575
shares issued

(December 31, 2006 - 25,430,929 shares)

| | | |
|--|--------------|--------------|
| Additional paid-in capital | 210,006 | 209,033 |
| Legal surplus | 39,298 | 36,245 |
| Retained earnings | 35,773 | 26,772 |
| Treasury stock, at cost 1,436,426 shares (December 31, 2006 - 989,405 shares) | (17,042) | (12,956) |
| Accumulated other comprehensive loss, net of tax of \$7 (December 31, 2006 - \$290) | (19,796) | (16,099) |
| Total stockholders' equity | 341,795 | 336,426 |
| Total liabilities and stockholders' equity | \$ 5,857,189 | \$ 4,371,986 |

See notes to unaudited consolidated financial statements.

- 1 -

Table of Contents

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2007 AND 2006
(In thousands, except per share data)

| | Quarter ended September 30, | | Nine-Month Period Ended | |
|--|--|---------------|------------------------------------|----------------|
| | 2007 | 2006 | September 30, 2007 | 2006 |
| Interest income: | | | | |
| Loans | \$ 21,699 | \$ 20,819 | \$ 65,862 | \$ 55,384 |
| Mortgage-backed securities | 28,480 | 26,030 | 79,246 | 74,416 |
| Investment securities and other | 24,747 | 14,016 | 62,118 | 43,952 |
| Total interest income | 74,926 | 60,865 | 207,226 | 173,752 |
| Interest expense: | | | | |
| Deposits | 13,561 | 11,931 | 39,409 | 33,575 |
| Securities sold under agreements to repurchase | 37,405 | 36,035 | 106,739 | 93,525 |
| Advances from FHLB, term notes and other borrowings | 3,539 | 2,551 | 8,055 | 7,741 |
| Subordinated capital notes | 771 | 1,395 | 2,295 | 4,036 |
| Total interest expense | 55,276 | 51,912 | 156,498 | 138,877 |
| Net interest income | 19,650 | 8,953 | 50,728 | 34,875 |
| Provision for loan losses | 1,614 | 870 | 4,064 | 2,918 |
| Net interest income after provision for loan losses | 18,036 | 8,083 | 46,664 | 31,957 |
| Non-interest income: | | | | |
| Financial service revenues | 3,737 | 3,986 | 12,629 | 11,303 |
| Banking service revenues | 1,862 | 2,025 | 6,001 | 6,712 |
| Investment banking revenues | 113 | 592 | 113 | 3,153 |
| Mortgage banking activities | 1,010 | 1,122 | 1,242 | 2,191 |
| Net gain (loss) on: | | | | |
| Securities available-for-sale | 838 | 2,174 | 1,205 | 2,193 |
| Derivatives | 154 | (1,571) | 8,538 | (713) |
| Trading securities | (2) | 281 | | 303 |
| Income (loss) from other investments | (541) | 928 | 236 | 658 |
| Other | (37) | 348 | 96 | 558 |
| Total non-interest income, net | 7,134 | 9,885 | 30,060 | 26,358 |

Non-interest expenses:

| | | | | |
|--|-------|-------|--------|--------|
| Compensation and employees' benefits | 7,561 | 6,241 | 21,222 | 18,042 |
| Occupancy and equipment | 3,045 | 2,867 | 9,381 | 8,549 |
| Professional and service fees | 1,543 | 1,681 | 5,316 | 4,906 |
| Advertising and business promotion | 1,069 | 950 | 2,980 | 2,964 |
| Directors and investor relations | 308 | 198 | 1,608 | 550 |
| Loan servicing expenses | 349 | 525 | 1,412 | 1,490 |
| Taxes, other than payroll and income taxes | 607 | 440 | 1,543 | 1,613 |
| Electronic banking charges | 431 | 489 | 1,346 | 1,451 |
| Clearing and wrap fees expenses | 321 | 312 | 997 | 1,101 |
| Communication | 354 | 419 | 1,001 | 1,261 |
| Insurance | 210 | 220 | 638 | 652 |
| Printing, postage, stationery and supplies | 177 | 259 | 568 | 803 |
| Other | 547 | 544 | 1,815 | 1,431 |

| | | | | |
|------------------------------------|---------------|---------------|---------------|---------------|
| Total non-interest expenses | 16,522 | 15,145 | 49,827 | 44,813 |
|------------------------------------|---------------|---------------|---------------|---------------|

| | | | | |
|-----------------------------------|--------------|--------------|---------------|---------------|
| Income before income taxes | 8,648 | 2,823 | 26,897 | 13,502 |
| Income tax expense | 196 | 446 | 1,007 | 557 |

| | | | | |
|------------------------------------|--------------|--------------|---------------|---------------|
| Net income | 8,452 | 2,377 | 25,890 | 12,945 |
| Less: Dividends on preferred stock | (1,200) | (1,200) | (3,601) | (3,601) |

| | | | | |
|--|-----------------|-----------------|------------------|-----------------|
| Income available to common shareholders | \$ 7,252 | \$ 1,177 | \$ 22,289 | \$ 9,344 |
|--|-----------------|-----------------|------------------|-----------------|

Income per common share:

| | | | | |
|-------|----------------|----------------|----------------|----------------|
| Basic | \$ 0.30 | \$ 0.05 | \$ 0.91 | \$ 0.38 |
|-------|----------------|----------------|----------------|----------------|

| | | | | |
|---------|----------------|----------------|----------------|----------------|
| Diluted | \$ 0.30 | \$ 0.05 | \$ 0.91 | \$ 0.38 |
|---------|----------------|----------------|----------------|----------------|

| | | | | |
|---|--------|--------|--------|--------|
| Average common shares outstanding | 24,230 | 24,564 | 24,396 | 24,600 |
| Average potential common shares-options | 31 | 97 | 110 | 124 |

| | | | | |
|--|---------------|---------------|---------------|---------------|
| | 24,261 | 24,661 | 24,506 | 24,724 |
|--|---------------|---------------|---------------|---------------|

| | | | | |
|--|----------------|----------------|----------------|----------------|
| Cash dividends per share of common stock | \$ 0.14 | \$ 0.14 | \$ 0.42 | \$ 0.42 |
|--|----------------|----------------|----------------|----------------|

See notes to unaudited consolidated financial statements.

- 2 -

Table of Contents

**UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2007 AND 2006**
(In thousands)

| | Nine-Month Period Ended September 30, | |
|---|--|-----------------|
| CHANGES IN STOCKHOLDERS' EQUITY: | 2007 | 2006 |
| Preferred stock: | | |
| Balance at beginning and end of period | \$ 68,000 | \$ 68,000 |
| Common stock: | | |
| Balance at beginning of period | 25,431 | 25,350 |
| Stock options exercised | 125 | 29 |
| Balance at end of period | 25,556 | 25,379 |
| Additional paid-in capital: | | |
| Balance at beginning of period | 209,033 | 208,454 |
| Stock-based compensation expense | 30 | 16 |
| Stock options exercised | 943 | 200 |
| Balance at end of period | 210,006 | 208,670 |
| Legal surplus: | | |
| Balance at beginning of period | 36,245 | 35,863 |
| Transfer from retained earnings | 3,053 | 1,660 |
| Balance at end of period | 39,298 | 37,523 |
| Retained earnings: | | |
| Balance at beginning of period | 26,772 | 52,340 |
| Net income | 25,890 | 12,945 |
| Cash dividends declared on common stock | (10,235) | (10,322) |
| Cash dividends declared on preferred stock | (3,601) | (3,601) |
| Transfer to legal surplus | (3,053) | (1,660) |
| Balance at end of period | 35,773 | 49,702 |
| Treasury stock: | | |
| Balance at beginning of period | (12,956) | (10,332) |
| Stock used to match defined contribution plan 1165(e) | 244 | 171 |
| Stock purchased | (4,330) | (1,360) |
| Balance at end of period | (17,042) | (11,521) |

Accumulated other comprehensive loss, net of tax:

| | | |
|--|----------|----------|
| Balance at beginning of period | (16,099) | (37,884) |
| Other comprehensive income (loss) for the period, net of tax | (3,697) | 11,844 |

| | | |
|---------------------------------|-----------------|-----------------|
| Balance at end of period | (19,796) | (26,040) |
|---------------------------------|-----------------|-----------------|

| | | |
|-----------------------------------|-------------------|-------------------|
| Total stockholders' equity | \$ 341,795 | \$ 351,713 |
|-----------------------------------|-------------------|-------------------|

**UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE QUARTERS AND NINE-MONTH PERIODS ENDED SEPTEMBER 30, 2007 AND 2006**
(In thousands)

| | Quarter Ended September 30, | | Nine-Month Period Ended | |
|--|--------------------------------|------------------|----------------------------|------------------|
| | 2007 | 2006 | 2007 | 2006 |
| COMPREHENSIVE INCOME | | | | |
| Net income | \$ 8,452 | \$ 2,377 | \$ 25,890 | \$ 12,945 |
| Other comprehensive income (loss), net of tax: | | | | |
| Unrealized gain on securities available-for-sale | 32,877 | 25,039 | 6,790 | 3,689 |
| Realized gain on investment securities available-for-sale included in net income | (838) | (2,174) | (1,205) | (2,193) |
| Unrealized loss on derivatives designated as cash flows hedges arising during the period | | (18,454) | | (432) |
| Realized loss (gain) on derivatives designated as cash flow hedges included in net income | | 1,571 | (773) | 822 |
| Realized gain on termination of derivatives activities, net | | 10,455 | | 10,455 |
| Gain from termination of cash flow hedging | | | (8,225) | |
| Income tax effect related to unrealized loss on securities available-for-sale | (4,023) | (2,067) | (284) | (497) |
| Other comprehensive income (loss) for the period | 28,016 | 14,370 | (3,697) | 11,844 |
| Comprehensive income | \$ 36,468 | \$ 16,747 | \$ 22,193 | \$ 24,789 |