

METRON TECHNOLOGY N V
Form DEF 14A
November 01, 2002

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SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934

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Check the appropriate box:

- ☐ Preliminary Proxy Statement
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☐ Definitive Additional Materials
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METRON TECHNOLOGY N.V.

(Name of Registrant as Specified In Its Charter)

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Date Filed:

METRON TECHNOLOGY N.V.

1350 Old Bayshore Highway
Suite 210
Burlingame, CA 94010
USA

NOTICE OF ANNUAL GENERAL MEETING OF SHAREHOLDERS

TO BE HELD ON NOVEMBER 26, 2002

TO THE SHAREHOLDERS OF METRON TECHNOLOGY N.V.:

NOTICE IS HEREBY GIVEN that the Annual General Meeting of Shareholders (the "Annual Meeting") of Metron Technology N.V., a corporation organized under the laws of The Netherlands (the "Company"), will be held on Tuesday, November 26, 2002 at 5:30 p.m. local time at the offices of Nauta Dutilh, Prinses Irenestraat 59, 1077 WV Amsterdam, The Netherlands for the following purposes:

- 1) To elect supervisory directors to hold office until the next Annual General Meeting of Shareholders and until their successors are elected;
- 2) To elect managing directors to serve until suspended or dismissed by the shareholders or by the Supervisory Board;
- 3) To approve the Company's Amended and Restated Employee Stock Option Plan, as amended, to increase the aggregate number of Common Shares authorized for issuance under such plan by 1,000,000 shares;
- 4) To approve the Company's Amended and Restated Employee Stock Option Plan, as amended, to limit the periods during which stock options may be granted under the plan and to restrict certain sales of the Company's common shares in or from within The Netherlands;
- 5) To approve the amendment to the Option Plan to provide for grants of restricted share awards;
- 6) To approve the adoption of the Annual Accounts ("*jaarrekening*") of the Company for the fiscal year ended May 31, 2002;
- 7) To ratify the selection of (a) PricewaterhouseCoopers N.V. as statutory auditors of the Annual Accounts ("*jaarrekening*") of the Company for the fiscal year ending May 31, 2003 and (b) PricewaterhouseCoopers LLP as independent accountants of the Company for its fiscal year ending May 31, 2003;
- 8) To approve the preparation of the Company's Annual Report for the fiscal year ended May 31, 2002 in the English language;
- 9)

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To authorize the Managing Board, on behalf of the Company, for a period of eighteen months after the date of the Annual Meeting, to repurchase outstanding common shares of the Company from time to time at a price per share not to exceed 130% of the closing price of the Company's common shares as quoted on the NASDAQ National Market System (or other comparable exchange) for the day prior to the date of the repurchase (the "stock market price") or to be less than 70% of their stock market price, provided that (i) for the purposes of repurchases at cost by the Company from current or former employees of or consultants to the Company pursuant to repurchase rights exercisable by the Company upon the termination of such employment or consulting relationship, the foregoing limitation on the price per share payable by the Company will not apply, and the price per share payable by the Company in such repurchases at cost will be the repurchase price specified in the Option Plan or in the agreements governing the original grant or sale (as the case may be) of the shares to be repurchased to the current or former employee of or consultant to the Company, (ii) the number of common shares of the Company so repurchased, when combined with all common shares of the Company held by the Company or its subsidiaries, does not exceed ten percent (10%) of the number of issued common shares of the Company and (iii) the repurchase is in compliance with the other statutory limitations pursuant to Article 9 of the Company's articles of association and the relevant provisions under Dutch law;

- 10) To approve the transfer to the Company by FSI of 1,154,492 of the Company's common shares;
- 11) To ratify the prior transfer to the Company by Entegris of 1,125,000 of the Company's common shares and the actions of the Managing Board taken in connection with such transfer; and
- 12) To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice.

Copies of the Annual Accounts, the Annual Report and the list of nominees for the Supervisory Board are open for inspection at the principal executive offices of the Company, located at 1350 Old Bayshore Highway, Suite 210, Burlingame, CA 94010, USA, and the Company's principal office in The Netherlands, located at Kabelstraat 36, NL-1322 AD Almere, by registered shareholders and other persons entitled to attend meetings of shareholders of the Company. Such copies will be open for inspection from the date hereof until the close of the Annual Meeting.

Under the laws of The Netherlands, one is entitled to attend and address the Annual Meeting if, on the date on which the Annual Meeting is held, one is an actual shareholder of the Company, and to vote thereat according to the number of shares of the Company which one holds on such date. Accordingly, if prior to the meeting you decide to grant a proxy in order to be represented at the meeting and, after you have granted your proxy you transfer some or all the shares of the Company you held at that time, your proxy will be deemed to represent the number of shares of the Company you held on the date you granted the proxy *minus* any shares of the Company you subsequently transferred *plus* any shares of the Company you acquired since such date. On the date of and prior to the commencement of the Annual Meeting, the Company will verify who is a shareholder of the Company.

By Order of the Board of Supervisory Directors

Joel A. Elftmann
Supervisory Director

Burlingame, California
November 1, 2002

ALL SHAREHOLDERS ARE CORDIALLY INVITED TO ATTEND THE MEETING IN PERSON. WHETHER OR NOT YOU EXPECT TO ATTEND THE MEETING, PLEASE COMPLETE, DATE, SIGN AND RETURN THE ENCLOSED PROXY AS PROMPTLY AS POSSIBLE IN ORDER TO ENSURE YOUR REPRESENTATION AT THE MEETING. A RETURN ENVELOPE (WHICH IS POSTAGE PREPAID IF MAILED IN THE UNITED STATES) IS ENCLOSED FOR THAT PURPOSE. EVEN IF YOU HAVE GIVEN YOUR PROXY, YOU MAY STILL VOTE IN PERSON IF YOU ATTEND THE MEETING. PLEASE NOTE, HOWEVER, THAT IF YOUR SHARES ARE HELD OF RECORD BY A BROKER, BANK OR OTHER NOMINEE AND YOU WISH TO VOTE AT THE MEETING, YOU MUST OBTAIN FROM THE RECORD HOLDER A PROXY ISSUED IN YOUR NAME.

METRON TECHNOLOGY N.V.

1350 Old Bayshore Highway
Suite 210
Burlingame, CA 94010
USA

**PROXY STATEMENT
FOR ANNUAL GENERAL MEETING OF SHAREHOLDERS**

November 26, 2002

INFORMATION CONCERNING SOLICITATION AND VOTING

GENERAL

The enclosed proxy is solicited on behalf of the Board of Supervisory Directors (the "Supervisory Board") of Metron Technology N.V., a corporation organized under the laws of The Netherlands ("Metron" or the "Company"), for use at the annual general meeting of shareholders to be held on November 26, 2002, at 5:30 p.m. local time (the "Annual Meeting"), or at any adjournment or postponement thereof, for the purposes set forth herein and in the accompanying Notice of Annual General Meeting. The Annual Meeting will be held at the offices of Nauta Dutilh, Prinses Irenestraat 59, 1077 WV Amsterdam, The Netherlands. The Company intends to mail this proxy statement and accompanying proxy card on or about November 7, 2002, to all shareholders entitled to vote at the Annual Meeting as of the date of the most recent shareholders' register.

SOLICITATION

The Company will bear the entire cost of solicitation of proxies, including preparation, assembly, printing and mailing of this proxy statement, the proxy card and any additional information furnished to shareholders. Copies of solicitation materials will be furnished to banks, brokerage houses, fiduciaries and custodians holding in their names common shares of the Company ("Common Shares") beneficially owned by others to forward to such beneficial owners. The Company may reimburse persons representing beneficial owners of Common Shares for their costs of forwarding solicitation materials to such beneficial owners. Original solicitation of proxies by mail may be supplemented by telephone, telegram or personal solicitation by directors, officers or other regular employees of the Company. No additional compensation will be paid to directors, officers or other regular employees for such services.

VOTING RIGHTS AND OUTSTANDING SHARES

Only holders of record of Common Shares at the close of business on November 26, 2002 will be entitled to vote at the Annual Meeting. At the close of business on September 30, 2002, the Company had outstanding and entitled to vote 13,042,231 Common Shares.

Each holder of record of Common Shares on such date will be entitled to one vote for each share held on all matters to be voted upon at the Annual Meeting.

All votes will be tabulated by the inspector of elections appointed for the meeting, who will separately tabulate affirmative and negative votes, abstentions and broker non-votes. Abstentions and broker non-votes are counted towards a quorum for purposes of Nasdaq's quorum requirement. No quorum is required under Netherlands law in order for the Annual Meeting to constitute a valid meeting of shareholders under Netherlands law. Broker non-votes are not counted for the purpose of determining whether the approval of a majority of the shares present in person or represented by proxy and entitled to vote at the meeting has been obtained, however broker non-votes are counted for the purpose of determining the total issued share capital of the Company.

REVOCABILITY OF PROXIES

Any person giving a proxy pursuant to this solicitation has the power to revoke it at any time before it is voted. It may be revoked by filing with Mr. C.H.T. Koetsier, Esq. at the offices Nauta Dutilh, Prinses Irenestraat 59, 1077 WV Amsterdam, The Netherlands, a written notice of revocation or a duly executed proxy bearing a later date, or it may be revoked by attending the meeting and voting in person. Attendance at the meeting will not, by itself, revoke a proxy.

SHAREHOLDER PROPOSALS

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The deadline for submitting a shareholder proposal for inclusion in the Company's proxy statement and form of proxy for the Company's 2003 annual general meeting of shareholders pursuant to Rule 14a-8 of the Securities Exchange Act of 1934 (the "1934 Act") is May 31, 2003. Shareholders wishing to submit proposals or director nominations that are not to be included in such proxy statement and proxy must do so no earlier than August 28, 2003, and no later than September 27, 2003. Shareholders are also advised to review the Company's Articles of Association ("Articles"), which contain additional requirements with respect to advance notice of shareholder proposals and director nominations.

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PROPOSAL 1

ELECTION OF SUPERVISORY DIRECTORS

There are five nominees for the five Supervisory Board positions presently authorized by the Supervisory Board and the Company's Articles. Each supervisory director to be elected will hold office until the next annual general meeting of shareholders and until his successor is elected and has qualified, or until such director's earlier death, resignation or removal. Each nominee listed below is currently a supervisory director of the Company and was elected by the shareholders. See "Duties of Metron Management" for a discussion of the duties of the Supervisory Board.

Supervisory directors are elected by a plurality of the votes present in person or represented by proxy and entitled to vote, provided that the votes represent more than half of the issued share capital of the Company. Shares represented by executed proxies will be voted, if authority to do so is not withheld, for the election of the five nominees named below. In the event that any nominee should be unavailable for election as a result of an unexpected occurrence, such shares will be voted for the election of such substitute nominee as the Supervisory Board may propose. Each person nominated for election has agreed to serve if elected and the Supervisory Board has no reason to believe that any nominee will be unable to serve.

THE SUPERVISORY BOARD RECOMMENDS A VOTE IN FAVOR OF EACH NAMED NOMINEE.

NOMINEES

The names of the nominees and certain information about them as of May 31, 2002 are set forth below:

NAME	AGE	PRINCIPAL OCCUPATION
Mr. Robert R. Anderson	64	Former Chairman and Chief Executive Officer of Yield Dynamics, Inc.
Mr. James E. Dauwalter	50	President of Entegris, Inc.
Mr. Joel A. Elftmann	62	President of I-Tech Products LLC
Mr. Bruce M. Jaffe	58	Private Investor and Consultant
Mr. Sho Nakanuma	70	Chairman of Ando Electric Company

Robert R. Anderson has been a supervisory director of Metron since November 1995. From October 1998 through October 2000, Mr. Anderson was Chairman of the Board and from October 1998 through April 2000 Chief Executive Officer of Yield Dynamics, Inc., (YDI) a semiconductor yield management software company. Mr. Anderson was Chairman of the Board of Silicon Valley Research, a semiconductor design automation software company, from January 1994 and served as Chief Executive Officer from April 1994 until July 1995 and from December 1996 until October 1997 and as Chief Financial Officer from September 1994 to November 1995. Mr. Anderson co-founded KLA Instruments Corporation, now KLA-Tencor Corporation, a supplier of equipment for semiconductor process control, in 1975 and, until his retirement in 1999, served in various capacities including Chief Operating Officer, Chief Financial Officer, Vice Chairman and Chairman. Mr. Anderson also serves as a director of MKS Instruments, Inc., a manufacturer of systems components for the semiconductor industry, Trikon Technologies, Inc., a manufacturer of semiconductor process equipment, and Aehr Test Systems, Inc., a manufacturer of semiconductor test and burn-in equipment. Mr. Anderson is a member of the Board of Trustees of Bentley College.

James E. Dauwalter has been a supervisory director of Metron since November 1995 and was a managing director from June 1979 until November 1995. Mr. Dauwalter is the Chief Executive Officer

of Entegris, Inc. which is a principal and a large minority shareholder of Metron. Mr. Dauwalter joined Fluoroware Inc., now part of Entegris, in 1973. Mr. Dauwalter also serves as a director of Nippon Fluoroware K.K., Fluoroware-Valqua Japan K.K., Fluoroware Southeast Asia PTE Ltd., and the Community Bank of Chaska.

Joel A. Elftmann, a co-founder of Metron, has been a supervisory director since November 1995 and was a managing director from October 1975 until November 1995. He currently serves as President of I-Tech Products LLC, a custom manufacturer of components and sub assemblies for the semiconductor industry. Mr. Elftmann was previously the Chairman of the Board of FSI International, Inc., a principal and a large minority shareholder of Metron. Mr. Elftmann was a co-founder of FSI and served as a director of FSI from 1973 until January 2002. During that period he served at various times as President, CEO and Chairman of the Board. Mr. Elftmann also serves as a director of Veeco, Inc. Mr. Elftmann is a Director Emeritus and past Chairman of the Board of Directors of Semiconductor Equipment & Materials International, a trade association for suppliers to the semiconductor industry.

Bruce M. Jaffe has been a supervisory director of Metron since November 2000. Mr. Jaffe is currently a private investor and consultant, and has been a director of Pemstar, Inc., a Minnesota-based global contract electronics manufacturer, since August 2000. Mr. Jaffe served as Senior Vice President and Chief Financial Officer of Bell Microproducts, Inc., a California-based distributor of mass storage and computer products, from 1997 to 1999. From 1967 to 1996, Mr. Jaffe was employed by Bell Industries, a California-based distributor of electronic components, where he held several management positions, most recently as President, Chief Operating Officer and a member of the Board of Directors. From 1965 to 1967, Mr. Jaffe was employed as an accountant by Price Waterhouse & Co. (now PricewaterhouseCoopers LLP). Mr. Jaffe holds a B.S. degree in Business from the University of Southern California and is a certified public accountant. Mr. Jaffe currently serves on the board of advisors for the University of Southern California School of Business.

Sho Nakanuma has been a supervisory director of Metron since November 1999. From 1997 to 2001, Mr. Nakanuma served as Chairman of the Board of Directors of Ando Electric Company in Japan. From 1988 to 1997, Mr. Nakanuma served as President of Ando Electric Company. From 1984 to 1986, Mr. Nakanuma served as President of NEC Electronics Inc. in the United States. From 1985 to 1988, Mr. Nakanuma served as a member of the Board of Directors of NEC Corporation in Japan. Mr. Nakanuma is a member of the Board of Directors of Semiconductor Equipment and Materials International in the United States. Mr. Nakanuma holds a B.S. degree in Chemical Engineering from Kyoto University and a Ph.D. in Engineering from Tokyo University.

**THE SUPERVISORY BOARD RECOMMENDS A VOTE
IN FAVOR OF EACH NAMED NOMINEE.**

MANAGING DIRECTORS CONTINUING IN OFFICE AND NOMINEES

See "Proposal 2, Election of Managing Directors" for the names of the managing directors continuing in office and the nominees for managing director and certain information about them.

DUTIES OF METRON MANAGEMENT

Metron has a Supervisory Board and a Board of Managing Directors ("Managing Board"). Under the laws of The Netherlands, supervisory directors cannot be managing directors of a company at the same time. The primary responsibilities of the Supervisory Board are supervising the Managing Board and the general affairs and business of Metron and advising the Managing Board. The Managing Board is responsible for the management of the day-to-day operations of Metron and is required to keep the Supervisory Board informed about such operations. Under Metron's Articles, the Managing Board is required to obtain the prior approval of the Supervisory Board for such resolutions of the Managing

Board as the Supervisory Board has designated by resolution and so informed the Managing Board. No resolution to this effect has been passed to date. Generic references in this proxy statement to directors refer to members of either the Supervisory Board or Managing Board. Other executives do not bear the responsibilities attributed to members of the Managing Board and the Supervisory Board, or the related liabilities, if any.

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The Articles provide for a Supervisory Board of one or more persons. The Articles also provide for the appointment of one or more managing directors A and one or more managing directors B under the supervision of the Supervisory Board. The number of supervisory directors and the number of managing directors is determined by the Supervisory Board. Metron presently has five supervisory directors and one managing director A, Mr. Segal, its Chief Executive Officer, and three managing directors B.

The general meeting of shareholders appoints the supervisory directors and at all times has the power to suspend or dismiss any supervisory director. A resolution to appoint a supervisory director can only be passed upon recommendation by the Supervisory Board. Under the Articles, each member of the Supervisory Board holds office for a one-year term following that member's election as a member of the Supervisory Board, or until that member's earlier resignation, death or removal by a decision of a general meeting. However, a member of the Supervisory Board elected not at the annual general meeting of shareholders but at an extraordinary meeting of shareholders serves until the next annual general meeting of shareholders or until that member's earlier resignation, death or removal by a decision of the annual general meeting. In addition, each supervisory director is required to resign as of the date of the annual general meeting of shareholders held in the year in which that director attains the age of 72. A shareholders' resolution to suspend or dismiss a supervisory director must be adopted by a two-thirds majority of the valid votes cast representing more than half of the issued share capital.

The entire Managing Board, as well as each managing director A individually, has the power to represent Metron and bind Metron in agreements with third parties. A managing director B may only represent Metron together with another managing director. The general meeting of shareholders appoints the managing directors for an unlimited period of time, determines whether the managing director shall serve as a managing director A or as a managing director B and at all times has the power to suspend or dismiss any managing director. A resolution to appoint a managing director can only be passed upon recommendation by the Supervisory Board. Each managing director can at all times also be suspended by the Supervisory Board for a period of up to three months. A shareholders' resolution to suspend or dismiss a managing director must be adopted by a two-thirds majority of the valid votes cast representing more than half of the issued share capital. The Supervisory Board decides on the remuneration and further terms and conditions of employment for each of the managing directors. Managing directors, along with other employees of subsidiaries of Metron, are eligible for options under the terms of Metron's employee option plans.

SUPERVISORY BOARD COMMITTEES AND MEETINGS

During the fiscal year ended May 31, 2002 the Supervisory Board held 4 meetings and did not act by unanimous written consent. The Supervisory Board has an Audit Committee and a Compensation Committee.

The Audit Committee has responsibility for reviewing the internal accounting procedures and controls of the Company and the results and scope of the audit and other services provided by the Company's independent auditors. It met four times during such fiscal year. The following supervisory directors are members of the Audit Committee: Messrs. Anderson, Jaffe and Nakanuma. All members of the Company's Audit Committee are independent (as independence is defined in Rule 4200(a)(14) of the NASD listing standards).

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The Compensation Committee has responsibility for providing recommendations to the Supervisory Board for final decision concerning salaries and incentive compensation for managing directors of the Company. It met two times during such fiscal year. The following supervisory directors are members of the Compensation Committee: Messrs. Anderson, Dauwalter, Elftmann and Nakanuma.

During the fiscal year ended May 31, 2002, each Supervisory Board member attended at least 75% of the aggregate of the meetings of the Supervisory Board and of the committees on which he served, held during the period for which he was a director or committee member, respectively.

REPORT OF THE AUDIT COMMITTEE OF THE SUPERVISORY BOARD(1)

The Metron Technology N.V. Supervisory Board's Audit Committee consists of three directors who are not employees or managing directors of the Company. Under currently applicable rules, all members are independent. The Supervisory Board has adopted a written charter for the Audit Committee, which was included as an appendix to our proxy statement for our 2001 Annual General Meeting of Shareholders.

(1)

The material in this report is not "soliciting material," is not deemed "filed" with the Securities and Exchange Commission ("SEC"), and is not to be incorporated by reference into any filing of the Company under the 1933 Act or 1934 Act, whether made before or

after the date hereof and irrespective of any general incorporation language contained in such filing.

During the Audit Committee's meeting to review the financial statements for the fiscal year ended May 31, 2002, the Audit Committee reviewed and discussed the audited financial statements with management and PricewaterhouseCoopers LLP. The Audit Committee believes that management maintains an effective system of internal controls that results in fairly presented financial statements. Based on these discussions, the Audit Committee recommended to the Supervisory Board that the audited financial statements be included in the Company's Annual Report on Form 10-K.

The discussions with PricewaterhouseCoopers LLP also included the matters required by Statement on Auditing Standards No. 61. The Audit Committee received from PricewaterhouseCoopers LLP written disclosures and the letter regarding its independence as required by Independence Standards Board Standard No. 1. This information was discussed with PricewaterhouseCoopers LLP.

Audit Fees. During the fiscal year ended May 31, 2002, the aggregate fees billed by and accrued for PricewaterhouseCoopers LLP for the audit of the Company's financial statements for such fiscal year and for the reviews of the Company's interim financial statements were \$359,000 and \$664,000, respectively.

Financial Information Systems Design and Implementation Fees. During the fiscal year ended May 31, 2002, the Company was not billed by PricewaterhouseCoopers LLP for any fees relating to information technology consulting fees.

All Other Fees. During the fiscal year ended May 31, 2002, the aggregate fees billed by PricewaterhouseCoopers LLP for professional services other than audit and information technology consulting fees was approximately \$225,000.

The Audit Committee has determined that the rendering of non-audit services by PricewaterhouseCoopers LLP is compatible with maintaining the auditor's independence.

Audit Committee
Robert R. Anderson
Bruce M. Jaffe
Sho Nakanuma

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PROPOSAL 2

ELECTION OF MANAGING DIRECTORS

There are six positions on the Managing Board presently authorized by the Supervisory Board and the Company's Articles. There are currently four managing directors continuing in office and two vacancies.

Managing directors are elected by a plurality of the votes present in person or represented by proxy and entitled to vote, provided that the votes represent more than half of the issued share capital of the Company. Shares represented by executed proxies will be voted, if authority to do so is not withheld, for the election of the nominee named below. In the event that the nominee should be unavailable for election as a result of an unexpected occurrence, such shares will be voted for the election of such substitute nominee as the Supervisory Board may propose. The person nominated for election has agreed to serve if elected, and the Supervisory Board has no reason to believe that the nominee will be unable to serve.

The persons named below are nominated by the Supervisory Board to serve as a managing director A and a managing director B, respectively. For a description of the powers and duties of managing directors A and managing directors B, see "Proposal 1, Election of Supervisory Directors, Duties of Metron Management."

THE SUPERVISORY BOARD RECOMMENDS A VOTE IN FAVOR OF EACH NAMED NOMINEE.

NOMINEES

The names of the nominees and certain information about them as of May 31, 2002 are set forth below:

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NAME	AGE	DIRECTOR CLASS	POSITIONS HELD WITH THE COMPANY
Dennis R. Riccio	55	A	President and Chief Operating Officer
John W. Mathews	53	B	Vice President, Global Manufacturing

Dennis R. Riccio has served as President and Chief Operating Officer since January 2002. Mr. Riccio served as Senior Vice President, Global Customer Operations, for Asyst Technologies, Inc. from August 1998 to December 2001. From January 1997 to August 1998, he served as President of USA Operations of Novellus Systems, Inc., a semiconductor equipment manufacturer. From 1989 to January 1997, he held various senior management positions at Applied Materials, Inc. Mr. Riccio holds a B.S. degree in Public Administration from the University of Arizona.

John W. Mathews has served as Vice President, Global Manufacturing since May 2002. Mr. Mathews served as Vice President, U.S. Engineering Operations, for Adaptec, Inc. from 2000 to 2001. From 1993 to 2000, he directed worldwide service as Vice President with Silicon Valley Group, Inc., a manufacturer of automated wafer processing equipment. During his tenure at KLA-Tencor, from 1979 to 1992, Mr. Mathews held positions in senior management overseeing various product and technology divisions. Mr. Mathews holds a B.S. degree, an M.S. degree in Electrical Engineering, and an M.S. degree in Industrial Administration from Purdue University.

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MANAGING DIRECTORS CONTINUING IN OFFICE

The names of the managing directors continuing in office and certain information about them as of May 31, 2002 are set forth below:

NAME	AGE	POSITIONS HELD WITH THE COMPANY
Edward D. Segal	62	Chief Executive Officer and Managing Director
Gregory M. Claeys	52	Vice President, Materials Division and Managing Director
Peter V. Leigh	57	Vice President, Finance, Chief Financial Officer and Managing Director
Keith Reidy	45	Vice President, Global Fab Solutions and Equipment and Managing Director

Edward D. Segal has been a managing director of Metron since November 1995. He joined Metron as President and Chief Executive Officer in July 1995. Prior to joining Metron, Mr. Segal served as President and Chief Executive Officer of Transpacific Technology Corporation, a company that he founded in 1982. Mr. Segal is a member of the Board of Directors of Semiconductor Equipment & Materials International, a trade association for suppliers to the semiconductor industry. Mr. Segal was a recipient of SEMI's prestigious Bob Graham Award in 2002, given for marketing contributions to the semiconductor materials and equipment industry. Mr. Segal holds a B.S. degree in Metallurgical Engineering from Rensselaer Polytechnic Institute.

Gregory M. Claeys has been a managing director and served as Vice President, Materials Division of Metron since November 2000. He joined Metron as the Company's Vice President, Fluid Handling Products, in July 1998 as a result of the merger between Metron and T.A. Kyser Co. ("Kyser"). From 1993 to 1998, Mr. Claeys served as President of Kyser. Mr. Claeys holds a B.A. degree in Marketing from Texas A&M University.

Peter V. Leigh has served as Vice President, Finance and Chief Financial Officer of Metron since November 1995 and has been a managing director of Metron since November 1996. From 1992 to 1995 Mr. Leigh served as Vice President, Finance and Chief Financial Officer of Sequus Pharmaceuticals, a publicly traded bio-pharmaceutical firm. From 1982 until 1992, Mr. Leigh served as Corporate Controller of Bio-Rad Laboratories, a publicly traded multi-national manufacturer and marketer of analytical chemistry, diagnostic and semiconductor metrology equipment and materials. Mr. Leigh holds a B.A. degree from the University of Oxford and an M.B.A. degree from the Harvard Business School.

Keith E. Reidy has served as Vice President, Global Fab Solutions and Equipment since April 2002. He had served as Vice-President Marketing since March 1999 and has been a managing director of Metron since April 1999. Mr. Reidy has also served as Director, Product Development and Director, U.S. Representative Organization. Prior to joining Metron in July 1995, Mr. Reidy served as Vice President, Sales of Transpacific Technology. Mr. Reidy holds a B.S. degree in Engineering from the University of California, Davis and an M.S. in Engineering

from Purdue University.

DUTIES OF METRON MANAGEMENT

See "Proposal 1, Election of Supervisory Directors, Duties of Metron Management" for a description of the powers and duties of the supervisory directors and managing directors of the Company.

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PROPOSAL 3

APPROVAL OF AMENDMENT TO THE AMENDED AND RESTATED EMPLOYEE STOCK OPTION PLAN TO INCREASE THE NUMBER OF SHARES RESERVED FOR ISSUANCE

In February 1995, the Supervisory Board adopted, and the shareholders subsequently approved, the Company's Employee Stock Option Plan (the "Prior Plan"). In October 1999, in connection with the Company's initial public offering of Common Shares (the "Initial Public Offering"), the Supervisory Board adopted, and the shareholders subsequently approved, the Company's Amended and Restated Employee Stock Option Plan (the "Option Plan"), which is an amended, restated and retitled version of the Prior Plan. In July 2000 and July 2001, the Supervisory Board adopted, and in each case the shareholders subsequently approved, amendments to the Option Plan increasing the number of shares authorized for issuance under the Option Plan.

As of July 31, 2002, options (net of canceled or expired options) covering an aggregate of 3,832,119 Common Shares had been granted under the Option Plan. Options to purchase only 300,632 Common Shares (plus any shares that might in the future be returned to the Option Plan as a result of cancellations or expiration of options) remained available for future grant under the Option Plan.

Shareholders are requested in this Proposal 3 to approve the amendment to the Option Plan to increase the number of shares reserved for issuance under the Option Plan by 1,000,000. The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the meeting will be required to approve the amendment to the Option Plan, provided that the votes represent more than half of the issued share capital of the Company.

THE SUPERVISORY BOARD RECOMMENDS A VOTE IN FAVOR OF PROPOSAL 3.

The essential features of the Option Plan, a copy of which is included as an appendix to this Proxy Statement, are outlined below:

GENERAL

The Option Plan provides for the grant of incentive stock options and nonstatutory stock options. Incentive stock options granted under the Option Plan are intended to qualify as "incentive stock options" within the meaning of Section 422 of the United States Internal Revenue Code of 1986, as amended (the "Code"). Nonstatutory stock options granted under the Option Plan are not intended to qualify as incentive stock options under the Code. See "United States Federal Income Tax Information" for a discussion of the tax treatment of options in the United States. To date, the Company has granted incentive and nonstatutory stock options under the Option Plan.

PURPOSE

The Supervisory Board adopted the Option Plan to provide a means by which employees and consultants of the Company and its group companies may be given an opportunity to purchase shares in the Company, to assist in retaining the services of such persons, to secure and retain the services of persons capable of filling such positions and to provide incentives for such persons to exert maximum efforts for the success of the Company and its group companies. All of the approximately 930 employees and consultants of the Company and its group companies are eligible to participate in the Option Plan.

ADMINISTRATION

The Supervisory Board administers the Option Plan. Subject to the provisions of the Option Plan, the Supervisory Board has the power to construe and interpret the Option Plan and to determine the

persons to whom and the dates on which options will be granted, the number of Common Shares to be subject to each option, the time or times during the term of each option within which all or a portion of such option may be exercised, the exercise price, the type of consideration and other terms of the option.

The Supervisory Board has the power to delegate administration of the Option Plan to a committee composed of one or more members of the Supervisory Board. In the discretion of the Supervisory Board, a committee may consist solely of two or more outside directors in accordance with Section 162(m) of the Code and/or non-employee directors in accordance with Rule 16b-3 of the 1934 Act. The Supervisory Board has delegated administration of the Option Plan to the Administrative Committee of the Metron Technology Employee Stock Option Plan, which consists of Messrs. Anderson, Dauwalter and Elftmann. As used herein with respect to the Option Plan, the "Supervisory Board" refers to any committee the Supervisory Board appoints, including the Administrative Committee, as well as to the Supervisory Board itself.

The regulations under Section 162(m) of the Code require that the directors who serve as members of the committee which grants options to certain highly compensated employees must be "outside directors." The Option Plan provides that, in the Supervisory Board's discretion, directors serving on the committee may be "outside directors" within the meaning of Section 162(m). This limitation would exclude from the committee directors who are (i) current employees of the Company or an affiliate, (ii) former employees of the Company or an affiliate receiving compensation for past services (other than benefits under a tax-qualified pension plan), (iii) current and former managing directors of the Company or an affiliate, (iv) supervisory directors currently receiving direct or indirect remuneration from the Company or an affiliate in any capacity (other than as a supervisory director), and (v) any other person who is otherwise not considered an "outside director" for purposes of Section 162(m). The definition of an "outside director" under Section 162(m) is generally *narrower* than the definition of a "non-employee director" under Rule 16b-3 of the 1934 Act.

ELIGIBILITY

Incentive stock options may be granted under the Option Plan only to employees (including managing directors) of the Company and its affiliates. Employees (including managing directors) and consultants of both the Company and its group companies are eligible to receive nonstatutory stock options under the Option Plan. Supervisory directors of the Company and its group companies are not eligible to receive awards under the Option Plan.

No incentive stock option may be granted under the Option Plan to any person who, at the time of the grant, owns (or is deemed to own) shares possessing more than 10% of the total combined voting power of the Company or any affiliate of the Company, unless the exercise price is at least 110% of the fair market value of the shares subject to the option on the date of grant and the term of the option does not exceed five years from the date of grant. In addition, the aggregate fair market value, determined at the time of grant, of the Common Shares with respect to which incentive stock options are exercisable for the first time by an employee during any calendar year (under the Option Plan and all other such plans of the Company and its affiliates) may not exceed \$100,000.

No person may be granted awards under the Option Plan exercisable for more than 1,000,000 Common Shares during any calendar year ("Section 162(m) Limitation").

SHARES SUBJECT TO THE OPTION PLAN

Subject to this Proposal, an aggregate of 5,750,000 Common Shares is reserved for issuance under the Option Plan. If options granted under the Option Plan expire or otherwise terminate without being exercised, the Common Shares not acquired pursuant to such options again become available for issuance under the Option Plan.

In The Netherlands, stock options vest immediately upon acceptance of a grant by an employee, but are subject to a lapsing right of repurchase that has the same effect as a vesting schedule. If the Company repurchases unvested shares issued under the Option Plan subject to a right of repurchase, the repurchased shares will not again become available for reissuance under the Option Plan.

TERMS OF OPTIONS

The following is a description of the permissible terms of options under the Option Plan. The terms of individual option grants may be more restrictive than the permissible terms described below in some or all respects.

Exercise Price; Payment. The exercise price of options may not be less than 100% of the fair market value of the shares subject to the option on the date of the grant and, in some cases (see "Eligibility" above), may not be less than 110% of such fair market value, but in any event may not be less than the nominal value of such shares. As of July 31, 2002, the closing price of the Company's Common Shares as reported on the Nasdaq National Market System was \$4.48 per share.

The exercise price of options granted under the Option Plan must be paid either in cash at the time the option is exercised or, at the discretion of the Supervisory Board, (i) by delivery of other Common Shares of the Company, (ii) with shares issuable upon exercise of the option, (iii) pursuant to a Regulation T program sponsored by the Company in conjunction with a securities broker or (iv) in any other form of legal consideration acceptable to the Supervisory Board.

Option Exercise. Options granted under the Option Plan may become exercisable in cumulative increments ("vest") as determined by the Supervisory Board. Shares covered by currently outstanding options under the Option Plan typically vest at the rate of 25% per year for four years during the participant's employment by, or service as a consultant to, the Company or a group company (collectively, "service"). Shares covered by options granted in the future under the Option Plan may be subject to different vesting terms. The Supervisory Board has the power to accelerate the time during which an option may vest or be exercised. To the extent provided by the terms of an option, a participant may satisfy any federal, state or local tax withholding obligation relating to the exercise of such option by a cash payment upon exercise, by authorizing the Company to withhold a portion of the shares otherwise issuable to the participant, by delivering already-owned Common Shares or by a combination of these means.

Term. The maximum term of options under the Option Plan is 10 years, except that in certain cases (see "Eligibility") the maximum term is five years. Options under the Option Plan generally terminate 90 days after termination of the participant's service unless (i) such termination is due to the participant's disability, in which case the option shall provide that it may be exercised (to the extent the option was exercisable at the time of the termination of service) at any time within 12 months of such termination; (ii) the participant dies before the participant's service has terminated or within 90 days thereafter, in which case the option may, but need not, provide that it may be exercised (to the extent the option was exercisable at the time of the participant's death) within 90 days of the participant's death by the person or persons to whom the rights to such option pass by will or by the laws of descent and distribution; or (iii) the option by its terms specifically provides otherwise. A participant may designate a beneficiary who may exercise the option following the participant's death. Individual option grants by their terms may provide for exercise within a longer period of time following termination of service.

RESTRICTIONS ON TRANSFER

The participant may not transfer an option otherwise than by will or by the laws of descent and distribution. During the lifetime of the participant, only the participant may exercise an option.

ADJUSTMENT PROVISIONS

Transactions not involving receipt of consideration by the Company, such as a merger, consolidation, reorganization, stock dividend, or stock split, may change the class and number of Common Shares subject to the Option Plan and outstanding options. In that event, the Option Plan will be appropriately adjusted as to the class and the maximum number of Common Shares subject to the Option Plan and the Section 162(m) Limitation, and outstanding options will be adjusted as to the class, number and price per share of Common Shares subject to such options.

EFFECT OF CERTAIN CORPORATE EVENTS

The Option Plan provides that, in the event of a dissolution or liquidation, the options shall terminate. In the event of specified types of mergers or other corporate consolidations (a "change in control"), then, with respect to participants whose service has not terminated, the vesting and the time during which such options may be exercised will be accelerated. An outstanding option will terminate if the participant does not exercise it before a change in control. The acceleration of an option in the event of an acquisition or similar corporate event may be viewed as an anti-takeover provision, which may have the effect of discouraging a proposal to acquire or otherwise obtain control of the Company.

DURATION, AMENDMENT AND TERMINATION

The Supervisory Board may suspend or terminate the Option Plan without shareholder approval or ratification at any time or from time to time. Unless sooner terminated, the Option Plan will terminate in February 2005.

The Supervisory Board may also amend the Option Plan at any time or from time to time. However, no amendment will be effective unless approved by the shareholders of the Company within 12 months before or after its adoption by the Supervisory Board if the amendment would (i) modify the requirements as to eligibility for participation (to the extent such modification requires shareholder approval in order for the Option Plan to satisfy Section 422 of the Code, if applicable, or Rule 16b-3 of the 1934 Act); or (ii) increase the number of shares reserved for issuance upon exercise of awards. The Supervisory Board may submit any other amendment to the Option Plan for shareholder approval, including, but not limited to, amendments intended to satisfy the requirements of Section 162(m) of the Code regarding the exclusion of performance-based compensation from the limitation on the deductibility of compensation paid to certain employees, Section 422 of the Code or any securities exchange listing requirements.

UNITED STATES FEDERAL INCOME TAX INFORMATION

Long-term capital gains currently are generally subject to lower tax rates than ordinary income or short-term capital gains. The maximum long-term capital gains rate for federal income tax purposes is currently 20% while the maximum ordinary income rate and short-term capital gains rate is effectively 38.6%.

Incentive Stock Options. Incentive stock options under the Option Plan are intended to be eligible for the favorable federal income tax treatment accorded "incentive stock options" under the Code.

There generally are no federal income tax consequences to the participant or the Company by reason of the grant or exercise of an incentive stock option. However, the exercise of an incentive stock option may increase the participant's alternative minimum tax liability, if any.

If a participant holds shares acquired through exercise of an incentive stock option for two years from the date on which the option is granted and more than one year from the date on which the shares are transferred to the participant upon exercise of the option, any gain or loss on a disposition of such shares will be a long-term capital gain or loss.

Generally, if the participant disposes of the shares before the expiration of either of these holding periods (a "disqualifying disposition"), then at the time of disposition the participant will realize taxable ordinary income equal to the lesser of (i) the excess of the shares' fair market value on the date of exercise over the exercise price, or (ii) the participant's actual gain, if any, on the purchase and sale. The participant's additional gain or any loss upon the disqualifying disposition will be a capital gain or loss, which will be long-term or short-term depending on whether the shares were held for more or less than one year.

To the extent a participant who is employed by a U.S. subsidiary of the Company recognizes ordinary income by reason of a disqualifying disposition, the U.S. subsidiary will generally be entitled (subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of a tax reporting obligation) to a corresponding business expense deduction in the tax year in which the disqualifying disposition occurs. As a foreign corporation liable for U.S. taxes only on income "effectively connected" with its operations in the United States, the Company has taken deductions that it believes are appropriate for disqualifying dispositions by its U.S.-based employees.

Nonstatutory Stock Options. Nonstatutory stock options granted under the Option Plan generally have the following federal income tax consequences:

There are no tax consequences to the participant or the Company by reason of the grant. Upon exercise of the option, the participant normally will recognize taxable ordinary income equal to the excess, if any, of the shares' fair market value on the exercise date over the exercise price. With respect to employees of its U.S. subsidiaries, the U.S. subsidiary is generally required to withhold from regular wages or supplemental wage payments an amount based on the ordinary income recognized. Subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code and the satisfaction of a tax reporting obligation, the U.S. subsidiary will generally be entitled to a business expense deduction equal to the taxable ordinary income realized by the participant. As a foreign corporation liable for U.S. taxes only on income "effectively connected" with its operations in the United States, the Company has taken deductions that it believes are appropriate for disqualifying dispositions by its U.S.-based employees.

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Upon disposition of the shares, the participant will recognize a capital gain or loss equal to the difference between the selling price and the sum of the amount paid for such shares plus any amount recognized as ordinary income upon exercise of the option. Such gain or loss will be long-term or short-term depending on whether the shares were held for more or less than one year.

Potential Limitation on Company Deductions. Section 162(m) of the Code denies a deduction to any publicly-held corporation for compensation paid to certain "covered employees" in a taxable year to the extent that compensation to such covered employee exceeds \$1 million. It is possible that compensation attributable to options, when combined with all other types of compensation received by a covered employee from the Company, may cause this limitation to be exceeded in any particular year.

Certain kinds of compensation, including qualified "performance-based compensation," are disregarded for purposes of the deduction limitation. In accordance with Treasury regulations issued under Section 162(m), compensation attributable to stock options will qualify as performance-based compensation if the award is granted by a compensation committee comprised solely of "outside directors" and either (i) the plan contains a per-employee limitation on the number of shares for which such options may be granted during a specified period, the per-employee limitation is approved by the shareholders, and the exercise price of the option is no less than the fair market value of the shares on the date of grant, or (ii) the option is granted (or exercisable) only upon the achievement (as certified in writing by the compensation committee) of an objective performance goal established in writing by the compensation committee while the outcome is substantially uncertain, and the option is approved by shareholders.

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Equity Compensation Plan Information

The following table provides certain information with respect to all of the Company's equity compensation plans in effect as of May 31, 2002.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted Average Exercise Price of Outstanding Options, Warrants, and Rights (b)	Number of Securities Remaining Available for Future Issuance (Excluding Securities Reflected in Column (a) (c)
Equity compensation plans approved by security holders	3,384,626	\$ 8.24	1,134,862(1)
Equity compensation plans not approved by security holders			
Total	3,384,626	\$ 8.24	1,134,862(1)

- (1) Includes 990,125 shares reserved for issuance pursuant to options and 144,737 employee stock purchase plan shares available for future issuance.

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PROPOSAL 4

APPROVAL OF AMENDMENTS TO THE AMENDED AND RESTATED EMPLOYEE STOCK OPTION PLAN TO LIMIT THE PERIODS DURING WHICH STOCK OPTIONS MAY BE GRANTED AND TO RESTRICT CERTAIN SALES OF COMMON SHARES IN OR FROM WITHIN THE NETHERLANDS

See "Proposal 3, Approval of Amendment to the Amended and Restated Employee Stock Option Plan to Increase the Number of Shares Reserved for Issuance" for a description of the essential features of the Option Plan.

Grants under the Option Plan may fall within the scope of the reporting requirements of The Netherlands Act on the Supervision of the Securities Trade of 1995 (Wet Toezicht Effectenverkeer 1995, or the "Netherlands Act"). However, Article 46 of the Netherlands Act provides that compliance with these reporting requirements would not be necessary for grants under the Option Plan if (i) the grants are made pursuant to a consistent line of conduct, and (ii) the Netherlands Authority for the Financial Markets is notified of the intention to make a grant under the Option Plan at least two months prior to such grant. Additionally, in order to qualify for this exemption, the grants must be made at approximately the same time each year. With respect to newly hired employees and consultants and grants made in recognition of significant promotions, ad hoc grants are possible under the exemption, provided that (a) the Option Plan explicitly provides for the possibility to make grants to such persons and (b) the Netherlands Authority for the Financial Markets is immediately notified of grants to such persons. In order to qualify the Option Plan for this exemption, on September 11, 2002, the Supervisory Board approved an amendment to the Option Plan to provide that grants under the Option Plan may only be made twice per year, on June 1st and December 1st of each year, except for grants made to newly hired employees and consultants and grants made in recognition of significant promotions. The full text of this amendment is set forth below.

Additionally, the Netherlands Act requires that the Company prepare extensive financial reports in connection with grants under the Option Plan. Article 5 of the Netherlands Act provides that no such reports are required if grantees under the Option Plan are prohibited from selling the Company's common shares acquired under the Option Plan in or from within The Netherlands. This prohibition would not prevent grantees from selling the Company's common shares on the Nasdaq National Market (and other foreign stock exchanges) or from otherwise selling the Company's common shares outside of The Netherlands, because these sales would not be considered to be in or from The Netherlands. In order to qualify the Option Plan for this exemption, on September 11, 2002, the Supervisory Board approved an amendment to the Option Plan to provide that sales of the Company's common shares acquired under the Option Plan in or from within The Netherlands are prohibited, except for sales on foreign stock exchanges, such as the Nasdaq National Market. The full text of this amendment is set forth below.

Because of the administrative nature of the changes to the Option Plan set forth above, the Supervisory Board has the authority to adopt these amendments without action by our shareholders. However, as a matter of good corporate practice, the Supervisory Board wishes to submit these amendments to our shareholders for their approval.

Shareholders are requested in this Proposal 4 to approve amendments to the Option Plan to include the following new paragraphs. A new paragraph 4.5 would be added to the Option Plan to read as follows:

"4.5 Except as set forth in the following sentence, Options may only be granted under the Plan on June 1 and December 1 of each calendar year. Notwithstanding the preceding sentence, Options may be granted at any time or times during each calendar year to eligible Employees and Consultants if either: (i) the grant is made in connection with the hiring by the Company of an eligible Employee or Consultant and such eligible Employee or Consultant was not employed by or

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a consultant to the Company within the previous 6 months or (ii) the grant is made in recognition of a newly granted promotion to an eligible Employee or Consultant and the Committee determines that such promotion involves a significant increase in the duties or responsibilities of such eligible Employee or Consultant."

A new paragraph would be added to Section 20 of the Option Plan, "Compliance with Applicable Legal Requirements", to read as follows:

"Optionees who wish to offer or sell any Shares received under the Plan, and who are residents of The Netherlands, may only do so through a foreign stock exchange (such as the Nasdaq National Market). Optionees who are not residents of The Netherlands may not offer or sell Shares received under the Plan in The Netherlands."

The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the meeting will be required to approve the amendment to the Option Plan, provided that the votes represent more than half of the issued share capital of the Company.

**THE SUPERVISORY BOARD RECOMMENDS
A VOTE IN FAVOR OF PROPOSAL 4.**

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PROPOSAL 5

**APPROVAL OF AMENDMENT TO THE AMENDED AND RESTATED EMPLOYEE STOCK OPTION PLAN
TO PROVIDE FOR THE GRANT OF RESTRICTED SHARE AWARDS**

See "Proposal 3, Approval of Amendment to the Amended and Restated Employee Share Option Plan to Increase the Number of Shares Reserved for Issuance" for a description of the essential features of the Option Plan.

In October 2002, the Supervisory Board amended the Option Plan generally to provide for the grant of restricted share awards to employees and consultants eligible to participate in the Option Plan. The Supervisory Board adopted this amendment so that it may use restricted share awards to motivate key employees and consultants of the Company to improve individual performance by providing long-term incentives for such persons.

Shareholders are requested in this Proposal 5 to approve the amendment to the Option Plan to provide for grants of restricted share awards. The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the meeting will be required to approve the amendment to the Option Plan, provided that the votes represent more than half of the issued share capital of the Company.

**THE SUPERVISORY BOARD RECOMMENDS
A VOTE IN FAVOR OF PROPOSAL 5.**

TERMS OF RESTRICTED SHARE AWARDS

Restricted share awards are generally subject to the terms and conditions of the Option Plan, except as set forth below.

Payment. The Supervisory Board may award restricted share awards in consideration of past services without a purchase payment.

Vesting. Shares awarded under restricted share awards may, but need not be, subject to a forfeiture provision in accordance with a vesting schedule as determined by the Supervisory Board. The Supervisory Board has the power to accelerate the vesting of shares received pursuant to a restricted share award under the Option Plan. Shares forfeited will not again become available for reissuance under the Option Plan.

Restrictions on Transfer. Rights under a restricted share award may not be transferred except where such assignment is required by law or expressly authorized by the terms of the applicable restricted share award.

Effect of Certain Corporate Events. The Option Plan provides that, in the event of specified types of mergers or other corporate consolidations (a "change in control"), then, with respect to participants whose service has not terminated, the vesting of restricted share awards will be accelerated. The acceleration of such restricted share awards in the event of a change in control may be viewed as an anti-takeover provision, which may have the effect of discouraging a proposal to acquire or otherwise obtain control of the Company.

United States Federal Income Tax Information. Upon receipt of a restricted share award, the participant normally will recognize taxable ordinary income equal to the fair market value of the shares on the date of receipt. However, to the extent the shares are subject to certain types of vesting restrictions, the taxable event will be delayed until the vesting restrictions lapse unless the participant elects to be taxed on receipt of the shares. With respect to employees of its U.S. subsidiaries, the U.S. subsidiary is generally required to withhold from regular wages or supplemental wage payments an amount based on the ordinary income recognized. Subject to the requirement of reasonableness, the

provisions of Section 162(m) of the Code and the satisfaction of a tax reporting obligation, the U.S. subsidiary will generally be entitled to a business expense deduction equal to the taxable ordinary income realized by the participant. As a foreign corporation liable for U.S. taxes only on income "effectively connected" with its operations in the United States, the Company has taken deductions that it believes are appropriate.

Upon disposition of the shares, the participant will recognize a capital gain or loss equal to the difference between the selling price and the amount recognized as ordinary income upon receipt (or vesting) of the shares. Such gain or loss will be long-term or short-term depending on whether the shares were held for more than one year.

Potential Limitation on Company Deductions. Restricted share awards will qualify as performance-based compensation under Section 162(m) of the Code only if (i) the award is granted by a compensation committee comprised solely of "outside directors," (ii) the award is granted only upon the achievement of an objective performance goal established in writing by the compensation committee while the outcome is substantially uncertain, (iii) the compensation committee certifies in writing prior to the granting of the award that the performance goal has been satisfied and (iv) prior to the granting of the award, shareholders have approved the material terms of the award (including the class of employees eligible for such award, the business criteria on which the performance goal is based, and the maximum amount or formula used to calculate the amount payable upon attainment of the performance goal).

PROPOSAL 6

APPROVAL OF ANNUAL ACCOUNTS

At the Annual Meeting, the shareholders of the Company will be asked to approve the Annual Accounts ("*jaarrekening*") of the Company drawn up in the English language for the fiscal year ended May 31, 2002, as required under Netherlands law and the Articles. In accordance with Article 2:408 of the Netherlands Civil Code, the Annual Accounts are the annual statutory accounts of the Company prepared in accordance with generally accepted accounting principles of The Netherlands. These Annual Accounts do not represent the consolidated accounts of the Company and all of its subsidiaries prepared in accordance with generally accepted accounting principles of the United States, as presented in the Consolidated Financial Statements contained in the Annual Report of the Company for the year ended May 31, 2002. Copies of the Annual Accounts are open for inspection at the principal executive offices of the Company, located at 1350 Old Bayshore Highway, Suite 210, Burlingame, CA 94010, USA, and the Company's principal office in The Netherlands, located at Kabelstraat 36, NL-1322 AD Almere, by registered shareholders and other persons entitled to attend meetings of shareholders of the Company. Such copies will be open for inspection from the date hereof until the close of the Annual Meeting.

The Annual Accounts will include a note on subsequent developments in the Company's business and industry which summarizes the impact of those developments on the Company's liquidity. The note will include a statement that the Company's current cash flow projections indicate that its current cash and cash equivalents, amounts available under currently available lines of credit, assuming their renewal, and anticipated cash from operations should be sufficient to meet its working capital needs through the end of fiscal 2003. The note will also state that if the Company's cash flows do not meet its projections or its current credit facilities do not continue to be available to the Company, and the Company does not succeed in raising additional working capital, this could result in the Company having insufficient working capital to meet the Company's cash needs for fiscal 2003. For more details on these matters, please refer to the Company's Periodic Report on Form 10-Q filed with the SEC on October 15, 2002 and in particular to Note 2 to the Condensed Consolidated Financial Statements, to the section entitled "Current and future position" under Liquidity and Capital Resources in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations and to the first two risk factors listed under "Risks related to Metron" in Item 5, Other Information.

The affirmative vote of the holders of a majority of the shares present or represented by proxy and entitled to vote at the Annual Meeting is required to adopt the Annual Accounts, provided that the votes represent more than half of the issued share capital of the Company.

THE SUPERVISORY BOARD RECOMMENDS A VOTE IN FAVOR OF PROPOSAL 6.

PROPOSAL 7

RATIFICATION OF SELECTION OF INDEPENDENT AUDITORS

The Supervisory Board has selected (a) PricewaterhouseCoopers N.V. as statutory auditors of the Annual Accounts ("*jaarrekening*") of the Company for the fiscal year ending May 31, 2003 and (b) PricewaterhouseCoopers LLP as the Company's independent accountants for the fiscal year ending May 31, 2003 and has further directed that the selection of auditors of the Annual Accounts and independent accountants be submitted to the shareholders for ratification at the Annual Meeting. KPMG LLP audited the Company's financial statements from 1995 until the fiscal year ended May 31, 2001. PricewaterhouseCoopers LLP audited the Company's financial statements for the fiscal year ended May 31, 2002. Representatives of PricewaterhouseCoopers N.V. are expected to be present at the Annual Meeting, will have an opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

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Shareholder ratification of the selection of PricewaterhouseCoopers N.V. as statutory auditors of the Company's Annual Accounts and PricewaterhouseCoopers LLP as the Company's independent accountants is not required by the Articles or otherwise. However, the Supervisory Board is submitting the selection of PricewaterhouseCoopers N.V. as auditors of the Annual Accounts and PricewaterhouseCoopers LLP as independent accountants to the shareholders for ratification as a matter of good corporate practice. If the shareholders fail to ratify the selections, the Audit Committee and the Supervisory Board will reconsider whether or not to retain that firm. Even if the selection is ratified, the Audit Committee and the Supervisory Board in their discretion may direct the appointment of different auditors of the Annual Accounts and/or independent accountants at any time during the year if they determine that such a change would be in the best interests of the Company and its shareholders.

The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the Annual Meeting will be required to ratify the selection of PricewaterhouseCoopers N.V. as statutory auditors of the Annual Accounts and PricewaterhouseCoopers LLP as independent accountants, provided that the votes represent more than half of the issued share capital of the Company.

On September 7, 2001, the Company's Supervisory Board, upon the recommendation of the Audit Committee, approved the dismissal of KPMG LLP and the appointment of PricewaterhouseCoopers LLP as the Company's independent accountants to audit the Company's financial statements for the year ending May 31, 2002. The Company's Supervisory Board has approved the continuing appointment of PricewaterhouseCoopers LLP as the Company's independent accountants to audit the Company's financial statements for the year ending May 31, 2003.

The independent audit report of KPMG LLP on the Company's consolidated financial statements as of May 31, 2001, and for each of the years in the two-year period ended May 31 2001, dated July 12, 2001 in the Form 10-K filed with the SEC on August 15, 2002, contained no adverse opinion, disclaimer of opinion or qualification or modification as to uncertainty, audit scope or accounting principles.

In connection with the Company's audit for the fiscal year ended May 31, 2001, and in the subsequent interim period prior to KPMG LLP's dismissal, there were no disagreements with between the Company and KPMG LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of KPMG LLP, would have caused KPMG LLP to make reference to the subject matter of the disagreement in connection with their report.

In connection with their audit of the Company's financial statements as of and for the year ended May 31, 2001, KPMG LLP noted one matter involving the Company's internal controls and its

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operations that they considered to be a reportable condition under standards established by the American Institute of Certified Public Accountants ("AICPA"). The reportable condition, which is not deemed a "material weakness" as defined by the AICPA, is related to the design and operation of internal controls over the systems and processes for revenue recognition and deferral. The subject matter of the reportable condition and the subsequent actions taken were discussed with the Company's Audit Committee.

KPMG LLP's letter to the Securities and Exchange Commission stating its agreement with the statements in the two preceding paragraphs is filed as an exhibit to the Company's Current Report on Form 8-K filed September 14, 2001.

During the fiscal year ended May 31, 2001 and the subsequent interim period prior to our engagement of PricewaterhouseCoopers LLP, the Company did not consult with PricewaterhouseCoopers LLP regarding the application of accounting principles to a specified transaction, or the type of audit opinion that might be rendered on the Company's financial statements

THE SUPERVISORY BOARD RECOMMENDS A VOTE IN FAVOR OF PROPOSAL 7.

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PROPOSAL 8

APPROVAL OF THE PREPARATION OF THE ANNUAL REPORT IN ENGLISH

The Company has prepared its Annual Accounts and Annual Report for the fiscal year ended May 31, 2002 in the English language. Netherlands law requires that the Company's shareholders authorize the preparation of the Company's Annual Report in a language other than Dutch. Such authorization will not constitute approval of any matter referred to in the Company's Annual Report.

The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the Annual Meeting is required to approve the preparation of the Company's Annual Report in English, provided that the votes represent more than half of the issued share capital of the Company.

**THE SUPERVISORY BOARD RECOMMENDS
A VOTE IN FAVOR OF PROPOSAL 8.**

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PROPOSAL 9

AUTHORIZATION TO PURCHASE ADDITIONAL OUTSTANDING COMMON SHARES

At the Annual Meeting, the Supervisory Board will ask the shareholders to approve a proposal to authorize the Managing Board, on behalf of the Company, for a period of eighteen months after the date of the Annual Meeting, to repurchase outstanding common shares of the Company from time to time at a price per share not to exceed 130% of the closing price of the Company's common shares as quoted on the NASDAQ National Market System (or other comparable exchange) for the day prior to the date of the repurchase (the "stock market price") or to be less than 70% of their stock market price, provided that (i) for the purposes of repurchases at cost by the Company from current or former employees of or consultants to the Company pursuant to repurchase rights exercisable by the Company upon the termination of such employment or consulting relationship, the foregoing limitation on the price per share payable by the Company will not apply, and the price per share payable by the Company in such repurchases at cost will be the repurchase price specified in the Option Plan or in the agreements governing the original grant or sale (as the case may be) of the shares to be repurchased to the current or former employee of or consultant to the Company, (ii) the number of common shares of the Company so repurchased, when combined with all common shares of the Company held by the Company or its subsidiaries, does not exceed ten percent (10%) of the number of issued common shares of the Company and (iii) the repurchase is in compliance with the other statutory limitations pursuant to Article 9 of the Company's articles of association and the relevant provisions under Dutch law, which require, amongst other things, that the shares be fully paid up, that the Company have sufficient free reserves and that if more than six months have lapsed since the end of the Company's fiscal year and the Annual Accounts ("jaarrekening") of the Company have not been adopted by the shareholders, then no repurchases may occur until after the Annual Accounts have been adopted by the shareholders. The Company has no current plans to repurchase its shares other than (i) the proposed repurchase of shares from FSI International, which is described in Proposal 10, and (ii) from employees of or consultants to the Company upon the termination of such employment or consulting relationship pursuant to existing repurchase rights.

The affirmative vote of the holders of a majority of the shares present or represented by proxy and entitled to vote at the Annual Meeting is required to approve this Proposal 9, provided that the votes cast represent more than half of the issued share capital of the Company.

**THE SUPERVISORY BOARD RECOMMENDS
A VOTE IN FAVOR OF PROPOSAL 9.**

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PROPOSAL 10

**APPROVAL OF TRANSFER TO THE COMPANY OF COMMON SHARES
HELD BY FSI INTERNATIONAL, INC.**

At the Annual Meeting, the Supervisory Board will ask the shareholders to approve a proposal to approve the transfer to the Company by FSI International, Inc. ("FSI") of 1,154,492 of its common shares, on the terms described below.

In September 2002, FSI advised the Company that it proposed to give the required one-year notice of termination under the distribution agreements between FSI and the Company. Since the Company would not have been entitled to any compensation for termination under the one-year notice provision, the Company determined that, for adequate compensation, it would be in its best commercial interests to negotiate early termination of the distribution agreements. Accordingly, in October 2002, the Company and FSI entered into a transition agreement providing for the early termination of their distribution agreements in Europe and Asia. Effective March 1, 2003 (the "closing date"), FSI will assume direct sales, service and applications support and logistics responsibilities for its surface conditioning and microlithography products in Europe and Asia, while the Company will continue to represent FSI products in Israel. Metron has provided sales and service support for all FSI products in Europe since 1975, and in Asia since 1985, and the Company's revenues for FSI products and services in Europe and Asia for the year ended May 31, 2002 were approximately \$36.0 million.

FSI was a founding shareholder, with Entegris, Inc. ("Entegris") and certain of the Company's former management, in the creation of the Company in Europe in 1975. In 1985, FSI and Entegris founded the Metron companies in Asia. In 1995, the Company acquired the Asian companies from FSI and Entegris. As a result of these various transactions, FSI became a significant shareholder of the Company, and as of September 30, 2002, FSI held 2,690,687 (20.6%) of the Company's 13,042,031 outstanding shares.

Under the terms of the transition agreement, FSI advanced \$3.0 million in cash to the Company and has agreed to advance an additional \$1.0 million subject to the review of the FSI inventory held by the Company. On the closing date of the agreement, the advance will be applied toward the repurchase by FSI of inventory and equipment that the Company acquired under the current distribution arrangement. Additionally, in compliance with the provisions in the existing distribution agreements covering the solicitation of the Company's employees, and as consideration for their early termination, FSI has agreed to pay to the Company on the closing date of the agreement an early termination fee of approximately \$2.75 million. Subject to approval by the Company's shareholders, at closing FSI will surrender 1,154,492 of the common shares of the Company now owned by FSI as the form of consideration for the termination fee, resulting in a reduction of FSI's current ownership of approximately 20.6% of the Company's outstanding common shares to approximately 11.8%. These shares were valued at the average closing price on the NASDAQ National Market System for the five trading days immediately preceding the date of signing of the transition agreement. If the Company's shareholders do not approve the transfer of shares to the Company, under the terms of the transition agreement, FSI will be obligated to pay the early termination fee in cash. The negotiations between the parties were conducted at arms' length, and the Company believes that the terms of the transition agreement with FSI are similar to those that would have been reached with an unaffiliated third party.

The Company's Supervisory Board determined that it is in the best interests of the Company and its shareholders for the Company to enter into the transition agreement, and the transfer of 1,154,492 of the common shares of the Company now owned by FSI as consideration for the early termination fee was an integral part of the overall transaction. In its determination, the material factors that the Supervisory Board considered were the fact that the book value of the Company's common shares as of August 31, 2002 was \$6.12 per share, and that consequently the transfer represented an opportunity for the Company to acquire its own shares at a favorable price. Although the price of the Company's

shares on the NASDAQ National Market System on October 31, 2002 was \$1.00 and is below the price used to compute the number of shares that will be transferred if this proposal is approved, the Supervisory Board believes that the transaction remains in the best interests of the Company and its shareholders.

Under the terms of the transition agreement, the Company expects that approximately 90 of its employees who are currently dedicated to sales, technical service and applications engineering activities related to the distribution of FSI products in Europe and Asia will transfer to FSI with the closing of the transition agreement.

For a more detailed discussion of the agreement between the Company and FSI, please see: (1) the Company's Periodic Report on Form 10-Q filed with the SEC on October 15, 2002; and (2) the section of this proxy statement entitled "Certain Transactions".

If the shareholders approve the transfer to the Company by FSI of 1,154,492 of the Company's common shares, the transfer would also have to comply with the other requirements of the Company's articles of association and the relevant provisions under Dutch law, including the requirement that the number of common shares of the Company repurchased, when combined with all common shares of the Company held by the Company or its subsidiaries, does not exceed ten percent (10%) of the number of issued common shares of the Company. To comply with this requirement, the Company would have the option of either canceling or selling shares it currently holds in treasury such that the number of shares held by the Company would not exceed ten percent (10%) after taking into account the transfer of shares to the Company by FSI.

If the shareholders approve the transfer to the Company by FSI of 1,154,492 of the Company's common shares, the Company expects to record a gain equal to the fair market value of the shares on the date of transfer.

The shareholders are requested in this Proposal 10 to approve the transfer to the Company by FSI of 1,154,492 of its common shares, on the terms described above. The affirmative vote of the holders of a majority of the shares present or represented by proxy and entitled to vote at the Annual Meeting is required to approve this Proposal 10, provided that the votes cast represent more than half of the issued share capital of the Company. The Supervisory Directors and Managing Directors of the Company, who together own 881,297 shares of the Company, intend to vote their shares in favor of this proposal, and the Company has been advised by FSI that it intends to vote in favor of Proposal 10.

**THE SUPERVISORY BOARD RECOMMENDS
A VOTE IN FAVOR OF PROPOSAL 10.**

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PROPOSAL 11

RATIFICATION OF PRIOR TRANSFER OF COMMON SHARES TO THE COMPANY

At the Annual Meeting, the Supervisory Board will ask the shareholders to approve a proposal to ratify the prior transfer to the Company by Entegris of 1,125,000 of the Company's common shares, as described below, and the actions of the Managing Board taken in connection with such transfer.

In October 2000, Entegris advised the Company that in order to assume direct sales responsibility for products from its Microelectronics Group, it was planning to give the required one-year notice of termination in July 2001, the earliest allowable date under the distribution agreement between Entegris and the Company. Since the Company would not have been entitled to any compensation for termination under the one-year notice provision, the Company determined that, for adequate compensation, it would be in its best commercial interests to negotiate early termination or modification of the then existing distribution agreement. Accordingly, on January 8, 2001, the Company and Entegris entered into an agreement to modify their existing distribution relationship (the "Entegris Agreement"). In connection with the Entegris Agreement, the Company and Entegris also entered into (i) a transition agreement on February 13, 2001, whereby Entegris assumed direct sales responsibility for products from its Microelectronics Group in Europe (beginning April 1, 2001) and Asia (beginning May 1, 2001) and (ii) a new distribution agreement on March 1, 2001, under which the Company continued to distribute Entegris' Fluid Handling Group product line in all regions in Europe, Asia, and parts of the United States covered under the previous distribution agreements. As consideration for the modification, under the terms of the Entegris Agreement, Entegris transferred to the Company 1,125,000 common shares of the Company and made cash payments totaling \$1.75 million to the Company over a 15-month period. The common shares transferred by Entegris were valued at \$6.6 million, which was equal to their fair market value (\$5.88 per share) on February 13, 2001. These 1,125,000 common shares are currently held by the Company. The negotiations between the parties were conducted at arms' length, and the Company believes that the terms of the Entegris Agreement were similar to those that would have been reached with an unaffiliated third party.

In fiscal 2001, Entegris products represented \$129.7 million or approximately 25% of the Company's total revenues. \$75.2 million or approximately 15% of these revenues came from sales of products of Entegris' Microelectronics Group, and \$54.5 million or approximately 10% came from sales of products of Entegris' Fluid Handling Group. In fiscal 2002, Entegris products represented \$30.4 million or approximately 13% of the Company's total revenues. \$4.3 million or approximately 2% of these revenues came from sales of products of Entegris' Microelectronics Group, and \$26.1 million or approximately 11% came from sales of products of Entegris' Fluid Handling Group.

The Company's Supervisory Board determined that it was in the best interests of the Company and its shareholders for the Company to enter into the Entegris Agreement, and the transfer of 1,125,000 of the common shares of the Company then owned by Entegris as consideration for the early termination fee was an integral part of the overall transaction. In its determination, the material factors that the Supervisory Board considered were the fact that as of November 30, 2000, the book value of the Company's common shares was \$5.89 per share, and that consequently the transfer represented an opportunity for the Company to acquire its own shares at a favorable price.

Entegris was a founding shareholder, with FSI, and certain of the Company's former management, in the creation of the Company in Europe in 1975. In 1985, Entegris and FSI founded the Metron companies in Asia. In 1995, the Company acquired the Asian companies from Entegris and FSI. As a result of these various transactions, Entegris became a significant shareholder of the Company, and as of September 30, 2002, Entegris held 1,565,687 (12.0%) of the Company's 13,042,031 outstanding shares. James E. Dauwalter, President of Entegris, has served as a Supervisory Director of the Company since November 1995, and is a candidate for re-election.

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Before the Company entered into the Entegris Agreement and agreed to the transfer of 1,125,000 shares of the Company, the Company consulted with its Netherlands counsel. At that time, the Company's Netherlands counsel approved the structure of the transaction

arg-in-left:15px; text-indent:-15px">Total stockholders	equity	\$1,401,693	\$1,306,312
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The accompanying notes are an integral part of these statements.

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

	Quarter Ended		Six-Month Period Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
(In thousands)				
Net income	\$ 32,994	\$ 23,795	\$ 66,583	\$ 46,627
Other comprehensive loss:				
Unrealized gain (loss) on securities:				
Unrealized holding loss arising during the period	(66,258)	(32,018)	(48,079)	(33,886)
Less: Reclassification adjustments for net loss (gain) and other-than-temporary impairments included in net income	679	1,436	(6,172)	3,595
Income tax benefit related to items of other comprehensive income	511	230	750	205
Other comprehensive loss for the period, net of tax	(65,068)	(30,352)	(53,501)	(30,086)
Total comprehensive (loss) income	\$ (32,074)	\$ (6,557)	\$ 13,082	\$ 16,541

The accompanying notes are an integral part of these statements.

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

1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements (unaudited) have been prepared in conformity with the accounting policies stated in the Corporation's Audited Consolidated Financial Statements included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2007. Certain information and note disclosures normally included in the financial statements prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) have been condensed or omitted from these statements pursuant to the rules and regulations of the SEC and, accordingly, these financial statements should be read in conjunction with the Audited Consolidated Financial Statements of the Corporation for the year ended December 31, 2007, included in the Corporation's 2007 Annual Report on Form 10-K. All adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the statement of financial position, results of operations and cash flows for the interim periods have been reflected. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the quarter and six-month period ended June 30, 2008 are not necessarily indicative of the results to be expected for the entire year.

Recently issued accounting pronouncements

On April 30, 2007, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FIN 39-1 (FSP FIN 39-1), which amends FIN 39, Offsetting of Amounts Related to Certain Contracts. FSP FIN 39-1 impacts entities that enter into master netting arrangements as part of their derivative transactions by allowing net derivative positions to be offset in the financial statements against the fair value of amounts (or amounts that approximate fair value) recognized for the right to reclaim cash collateral or the obligation to return cash collateral under those arrangements. FSP FIN 39-1 became effective for fiscal years beginning after November 15, 2007. The Corporation analyzed the potential impact of FSP FIN 39-1 on its financial statements. As of June 30, 2008, the Corporation did not apply this pronouncement since FSP FIN 39-1 applies only to cash collateral and all of the collateral received or delivered to counterparties for derivative instruments are investment securities.

In November 2007, the SEC issued Staff Accounting Bulletin No. (SAB) 109, Written Loan Commitments That Are Accounted For At Fair Value Through Earnings Under Generally Accepted Accounting Principles. This interpretation expresses the views of the staff regarding written loan commitments that are accounted for at fair value through earnings under GAAP. SAB 109 supersedes SAB 105, Application of Accounting Principles to Loan Commitments, which provided the prior views of the staff regarding derivative loan commitments that are accounted for at fair value through earnings pursuant to Statement of Financial Accounting Standards No. (SFAS) 133,

Accounting for Derivative Instruments and Hedging Activities. SAB 109 expresses the current view of the staff that, consistent with the guidance in SFAS 156, Accounting for Servicing of Financial Assets, and SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities, the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SAB 109 became effective for fiscal quarters beginning after December 15, 2007. The adoption of this statement in 2008 did not have an effect on the Corporation's financial statements.

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In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51. This Statement amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. It requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 (that is, January 1, 2009, for entities with calendar year-ends). Earlier adoption is prohibited. The Corporation is currently evaluating the possible effect, if any, of the adoption of this statement on its financial statements, commencing on January 1, 2009.

In December 2007, the FASB issued SFAS 141R, Business Combinations. This Statement retains the fundamental requirements in Statement 141 that the acquisition method of accounting (which Statement 141 called the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This Statement defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. This Statement requires an acquirer to recognize the assets acquired, the liabilities assumed, including contingent liabilities, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the Statement. This Statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. The Corporation is currently evaluating the possible effect, if any, of the adoption of this statement on its financial statements.

In March 2008, the FASB issued SFAS 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133. This Statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (b) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Although the Corporation continues to evaluate the disclosure framework dictated by this Statement, most of the required disclosures are included in Note 8 Derivative Instruments and Hedging Activities.

In May 2008, the FASB issued SFAS 162, The Hierarchy of Generally Accepted Accounting Principles. This Statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. Prior to the issuance of SFAS 162, GAAP hierarchy was defined in the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards No. (SAS) 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. SFAS 162 provides and direct the GAAP hierarchy to the entities instead of the auditor as provided by SAS 69 because the entities (not its auditor) are responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. Any effect of applying the provisions of SFAS 162 should be reported as a change in accounting principle in accordance with SFAS 154, Accounting Changes and Error Corrections. SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The adoption of SFAS 162 will not impact the Corporation's current accounting policies or the Corporation's financial results.

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In May 2008, the FASB issued FASB Staff Position No. APB 14-1 (FSP-APB 14-1). FSP-APB 14-1 clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants. Additionally, FSP-APB 14-1 specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP-APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. As of June 30, 2008, the Corporation does not have any convertible debt instrument.

In May 2008, the FASB issued SFAS 163, Accounting for Financial Guarantee Insurance Contracts - an interpretation of FASB Statement No. 60. This Statement requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement also clarifies how SFAS 60 applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. SFAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years, except for some disclosures about the insurance enterprise's risk-management activities. Except for those disclosures, earlier application of SFAS 163 is not permitted. The Corporation is currently evaluating the possible effect, if any, of the adoption of this statement on its financial statements, commencing on January 1, 2009.

In June 2008, the FASB issued FASB Staff Position No. EITF 03-6-1 (FSP EITF 03-6-1), Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. FSP EITF 03-6-1 applies to entities with outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends. Furthermore, awards with dividends that do not need to be returned to the entity if the employee forfeits the award are considered participating securities. Accordingly, under FSP EITF 03-6-1 unvested share-based payment awards that are considered to be participating securities should be included in the computation of EPS pursuant to the two-class method under SFAS 128. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. Early application is not permitted. The Corporation is currently evaluating this statement in light of the recently approved Omnibus Incentive Plan, however, as of June 30, 2008, there are no outstanding unvested share-based payment awards.

Table of Contents**2 EARNINGS PER COMMON SHARE**

The calculations of earnings per common share for the quarters and six-month periods ended on June 30, 2008 and 2007 are as follows:

	Quarter Ended June 30,		Six-Month Period Ended June 30,	
	2008	2007	2008	2007
	(In thousands, except per share data)			
Net Income:				
Net income	\$ 32,994	\$ 23,795	\$ 66,583	\$ 46,627
Less: Preferred stock dividends	(10,069)	(10,069)	(20,138)	(20,138)
Net income available to common stockholders	\$ 22,925	\$ 13,726	\$ 46,445	\$ 26,489
Weighted-Average Shares:				
Basic weighted-average common shares outstanding	92,505	83,254	92,505	83,254
Average potential common shares	203	622	145	503
Diluted weighted-average number of common shares outstanding	92,708	83,876	92,650	83,757
Earnings per common share:				
Basic	\$ 0.25	\$ 0.16	\$ 0.50	\$ 0.32
Diluted	\$ 0.25	\$ 0.16	\$ 0.50	\$ 0.32

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 the 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 on earnings per share. For the quarters and six-month periods ended June 30, 2008 and 2007, a total of 2,020,600 and 2,054,600 weighted-average outstanding stock options, respectively, were not included in the computation of dilutive earnings per share since their inclusion would have an antidilutive effect on earnings per share.

3 STOCK OPTION PLAN

Between 1997 and January 2007, the Corporation had a stock option plan (the 1997 stock option plan) covering certain employees. This plan allowed for the granting of up to 8,696,112 options on shares of the Corporation's common stock to certain employees. The options granted under the plan could not 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 was granted. Stock options are fully vested upon issuance. The maximum term to exercise the options is ten years. The stock option plan provides for a proportionate adjustment in the exercise price and the number of shares that can be purchased in the event of a stock dividend, stock split, reclassification of stock, merger or reorganization and certain other issuances and distributions such as stock appreciation rights.

Under the 1997 stock option plan, the Compensation Committee had the authority to grant stock appreciation rights at any time subsequent to the grant of an option. Pursuant to the stock appreciation rights, the optionee surrenders the right to exercise an option granted under the plan in consideration for payment by the Corporation of an amount equal to the excess of the fair market value of the shares of common stock subject to such option surrendered over the total option price of such shares. Any option surrendered shall be cancelled by the Corporation and the shares subject to the option shall not be eligible for further grants under the option plan. During the second quarter of 2008, the Compensation Committee approved the grant of stock appreciation rights to one employee. The employee surrendered the right to exercise 120,000 stock options in the form of stock appreciation

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rights for a payment of \$0.2 million. On January 21, 2007, the 1997 stock option plan expired; all outstanding awards grants under this plan shall continue in full force and effect, subject to their original terms.

On April 29, 2008, the Corporation's stockholders approved the First BanCorp 2008 Omnibus Incentive Plan (the Omnibus Plan). The Omnibus Plan provides for equity-based compensation incentives (the awards) through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, and other stock-based awards. This plan allows the issuance of up to 3,800,000 shares of common stock subject to adjustments for stock splits, reorganization and other similar events. The Corporation's Board of Directors, upon receiving the relevant recommendation of the Compensation Committee, shall have the power and authority to determine those eligible to receive awards and to establish the terms and conditions of any awards; however, the Omnibus Plan has various limits and vesting restrictions that apply to individual and aggregate awards. As of the date of the filing of this Quarterly Report on Form 10-Q, no awards have been granted under the Omnibus Plan.

The Corporation accounted for stock options using the modified prospective method under SFAS 123R, Share-Based Payment. There were no stock options granted during the first six months of 2008. The compensation expense associated with stock options for the six-month period ended June 30, 2007 was approximately \$2.8 million. All employee stock options granted during 2007 were fully vested at the time of grant.

The activity of stock options during the first six months of 2008 is set forth below:

Six-Month Period Ended June 30, 2008				
	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Beginning of period	4,136,910	\$ 12.60		
Options exercised	(6,000)	8.85		
Options cancelled	(121,000)	9.03		
End of period outstanding and exercisable	4,009,910	\$ 12.71	6.6	\$

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

	2007
Weighted-average stock price at grant date and exercise price	\$ 9.20
Stock option estimated fair value	\$ 2.40 - \$2.45
Weighted-average estimated fair value	\$ 2.43
Expected stock option term (years)	4.31-4.59
Expected volatility	32%
Expected dividend yield	3.0%
Risk-free interest rate	5.1%

The Corporation uses empirical research data to estimate option exercises and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected volatility is based on the historical implied volatility of the Corporation's common stock at each grant date; otherwise, historical volatilities based upon 260 observations (working days) were obtained from Bloomberg L.P. and used as inputs in the model. The dividend yield is based on the historical 12-month dividend yield observable at each grant date. The risk-free rate for the period is based on historical zero coupon curves

obtained from Bloomberg L.P. at the time of grant based on the option's expected term.

The options exercised during the first half of 2008 did not have any intrinsic value and the cash proceeds from these options were approximately \$53,000. No stock options were exercised during 2007.

Table of Contents**4 INVESTMENT SECURITIES****Investment Securities Available-for-Sale**

The amortized cost, gross unrealized gains and losses, approximate fair value, weighted-average yield and contractual maturities of investment securities available for sale as of June 30, 2008 and December 31, 2007 were as follows:

	June 30, 2008				December 31, 2007					
	Amortized	Gross		Fair	Weighted	Amortized	Gross		Fair	Weighted
	cost	Unrealized	losses	value	average	cost	Unrealized	losses	value	average
		gains			yield %		gains			yield %
	(Dollars in thousands)									
U.S. Treasury and Obligations of U.S. Government sponsored agencies:										
Due within one year	\$ 8,324	\$	\$ 9	\$ 8,315	1.11	\$	\$	\$		
After 5 to 10 years						6,975	26		7,001	6.05
After 10 years						8,984	47		9,031	6.21
Puerto Rico Government obligations:										
Due within one year	387	4		391	6.63					
After 1 to 5 years	13,688	122	325	13,485	4.96	13,947	141	347	13,741	4.99
After 5 to 10 years	7,309	222	100	7,431	5.67	7,245	247	99	7,393	5.67
After 10 years	17,755	74	97	17,732	5.30	3,416	37	66	3,387	5.64
United States and Puerto Rico Government obligations	47,463	422	531	47,354	4.53	40,567	498	512	40,553	5.62
Mortgage-backed securities:										
FHLMC certificates:										
Due within 1 year	93			93	5.19	98	1		99	5.50
After 1 to 5 years	318	8		326	7.23	640	20		660	7.01
After 10 years	1,984,413	243	28,732	1,955,924	5.45	158,070	235	111	158,194	5.60
	1,984,824	251	28,732	1,956,343	5.45	158,808	256	111	158,953	5.61

GNMA										
certificates:										
Due within										
1 year	132	1		133	5.83					
After 1 to 5 years	226	7		233	6.73	496	8		504	6.48
After 5 to										
10 years	639	7		646	5.54	708	6	5	709	6.01
After 10 years	344,865	604	3,725	341,744	5.38	42,665	582	120	43,127	5.93
	345,862	619	3,725	342,756	5.38	43,869	596	125	44,340	5.94
FNMA										
certificates:										
Due within one										
year	3			3	6.89					
After 1 to 5 years	16			16	6.78	34	1		35	7.08
After 5 to										
10 years	274,979	319	523	274,775	5.00	289,125	138	750	288,513	4.93
After 10 years	1,326,762	3,216	12,238	1,317,740	5.57	608,942	5,290	582	613,650	5.65
	1,601,760	3,535	12,761	1,592,534	5.47	898,101	5,429	1,332	902,198	5.42
Mortgage										
pass-through										
certificates:										
After 10 years	151,201	2	36,013	115,190	4.72	162,082	3	28,407	133,678	6.14
Mortgage-backed										
securities	4,083,647	4,407	81,231	4,006,823	5.43	1,262,860	6,284	29,975	1,239,169	5.55
Corporate bonds:										
After 5 to										
10 years	1,300		510	790	7.70	1,300		198	1,102	7.70
After 10 years	4,412		1,796	2,616	7.97	4,412		1,066	3,346	7.97
Corporate bonds	5,712		2,306	3,406	7.91	5,712		1,264	4,448	7.91
Equity securities										
(without										
contractual										
maturity)										
	2,149		503	1,646		2,638		522	2,116	
Total investment										
securities										
available for sale	\$ 4,138,971	\$ 4,829	\$ 84,571	\$ 4,059,229	5.42	\$ 1,311,777	\$ 6,782	\$ 32,273	\$ 1,286,286	5.55

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 gain or loss on securities available for sale is presented as part of accumulated other comprehensive income.

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The following tables show the Corporation's available-for-sale investments' fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of June 30, 2008 and December 31, 2007:

	Less than 12 months		As of June 30, 2008 12 months or more		Total	
	Unrealized		Unrealized		Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
(In thousands)						
Debt securities						
U.S. Treasury	\$ 8,315	\$ 9	\$	\$	\$ 8,315	\$ 9
Puerto Rico Government obligations	3,083	43	13,681	479	16,764	522
Mortgage-backed securities						
FHLMC	1,864,111	28,647	3,160	85	1,867,271	28,732
GNMA	301,362	3,723	101	2	301,463	3,725
FNMA	1,199,440	12,761	38		1,199,478	12,761
Mortgage pass-through trust certificates	23,318	6,463	91,552	29,550	114,870	36,013
Corporate bonds			3,406	2,306	3,406	2,306
Equity securities	1,234	503			1,234	503
	\$ 3,400,863	\$ 52,149	\$ 111,938	\$ 32,422	\$ 3,512,801	\$ 84,571

	Less than 12 months		As of December 31, 2007 12 months or more		Total	
	Unrealized		Unrealized		Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
(In thousands)						
Debt securities						
Puerto Rico Government obligations	\$	\$	\$ 13,648	\$ 512	\$ 13,648	\$ 512
Mortgage-backed securities						
FHLMC	48,202	40	3,436	71	51,638	111
GNMA	625	11	26,887	114	27,512	125
FNMA	285,973	274	221,902	1,058	507,875	1,332
Mortgage pass-through certificates	133,337	28,407			133,337	28,407
Corporate bonds			4,448	1,264	4,448	1,264
Equity securities	1,384	522			1,384	522
	\$ 469,521	\$ 29,254	\$ 270,321	\$ 3,019	\$ 739,842	\$ 32,273

The Corporation's investment securities portfolio is comprised principally of (i) mortgage-backed securities issued or guaranteed by FNMA, GNMA or FHLMC and other securities secured by mortgage loans and (ii) U.S. Treasury and agencies securities and obligations of the Puerto Rico Government. 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. or Puerto Rico Government. The troubled housing and mortgage markets in the United States have raised concerns about the capacity of U.S. government sponsored entities to raise

money from investors to cover rising losses from loan defaults and potential bail out by the government. However, the federal government recently passed legislation expanding the government's line of credit to the agencies and allowing the government to buy shares of the agencies if needed. Also, the Federal Reserve agreed to open its discount window to the agencies. Principal and interest on these securities are deemed recoverable.

The unrealized losses in the available-for-sale portfolio as of June 30, 2008 are substantially related to market interest rate fluctuations and not deterioration in the creditworthiness of the issuers. In the case of private label mortgage-backed securities, the unrealized loss is mainly related to increases in the discount rate used to value such instruments resulting from current liquidity and credit concerns in the U.S. mortgage loan market. However, the underlying mortgages are fixed-rate single family loans with a high weighted-average FICO score (over 700)

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and low loan-to-value ratios (under 80%), as well as a very low delinquency level. The Corporation's policy is to review its investment portfolio for possible other-than temporary impairment, at least quarterly. As of June 30, 2008, management has the intent and ability to hold these investments for a reasonable period of time and for a forecasted recovery of fair value up to (or beyond) the cost of these investments; as a result, the impairments are considered temporary.

For the six-month periods ended on June 30, 2008 and 2007, the Corporation recorded other-than-temporary impairments of approximately \$0.5 million and \$2.9 million, respectively, on certain equity securities held in its available-for-sale 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 as of the date of the analyses and reflected in earnings as a realized loss.

Total proceeds from the sale of securities available for sale during the six-month period ended June 30, 2008 amounted to approximately \$389.8 million (2007 \$3.1 million). The Corporation realized gross gains of approximately \$6.9 million and approximately \$0.2 million in gross losses for the first six months of 2008 (2007 \$0.2 million in gross realized gains and approximately \$0.9 million in gross realized losses).

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 as of June 30, 2008 and December 31, 2007 were as follows:

	June 30, 2008					December 31, 2007				
	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)										
U.S. Treasury securities:										
Due within										
1 year	\$ 100	\$	\$	\$ 100	2.36	\$ 254,882	\$ 369	\$ 24	\$ 255,227	4.14
Obligations of other U.S. Government sponsored agencies:										
After 10 years	966,927	888	2,576	965,239	5.77	2,110,265	1,486	2,160	2,109,591	5.82
Puerto Rico Government obligations:										
After 5 to 10 years	17,608	520	103	18,025	5.85	17,302	541	107	17,736	5.85
After 10 years	13,895		1	13,894	5.50	13,920		256	13,664	5.50
United States and Puerto Rico Government obligations	998,530	1,408	2,680	997,258	5.77	2,396,369	2,396	2,547	2,396,218	5.64

Mortgage-backed securities:

FHLMC

certificates:

After 1 to 5 years	9,790	150	9,640	3.82					
After 5 to 10 years					11,274	116	11,158	3.65	

FNMA

certificates:

After 1 to 5 years	9,001	125	8,876	3.88					
After 5 to 10 years	449,566	8,642	440,924	4.49	69,553	1,067	68,486	4.30	
After 10 years	327,225	6,728	320,497	4.55	797,887	61	13,785	784,163	4.42

Mortgage-backed securities

795,582	15,645	779,937	4.50	878,714	61	14,968	863,807	4.40	
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Corporate bonds:

After 10 years	2,000	180	1,820	5.80	2,000	91	1,909	5.80	
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Total investment securities

held-to-maturity	\$ 1,796,112	\$ 1,408	\$ 18,505	\$ 1,779,015	5.21	\$ 3,277,083	\$ 2,457	\$ 17,606	\$ 3,261,934	5.31
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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.

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The following tables show the Corporation's held-to-maturity investments' fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of June 30, 2008 and December 31, 2007:

	As of June 30, 2008					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities						
U.S. Government sponsored agencies	\$ 733,251	\$ 2,118	\$ 11,200	\$ 458	\$ 744,451	\$ 2,576
Puerto Rico Government obligations	13,894	1	4,315	103	18,209	104
Mortgage-backed securities						
FHLMC	8,971	128	669	22	9,640	150
FNMA	52,390	909	717,907	14,586	770,297	15,495
Corporate bonds			1,820	180	1,820	180
	\$ 808,506	\$ 3,156	\$ 735,911	\$ 15,349	\$ 1,544,417	\$ 18,505
	As of December 31, 2007					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Debt securities						
U.S. Government sponsored agencies	\$ 616,572	\$ 1,568	\$ 24,469	\$ 592	\$ 641,041	\$ 2,160
U.S. Treasury Notes	24,697	24			24,697	24
Puerto Rico Government obligations	13,664	256	4,200	107	17,864	363
Mortgage-backed securities						
FHLMC			11,158	116	11,158	116
FNMA			849,341	14,852	849,341	14,852
Corporate Bonds	1,909	91			1,909	91
	\$ 656,842	\$ 1,939	\$ 889,168	\$ 15,667	\$ 1,546,010	\$ 17,606

Held-to-maturity securities in an unrealized loss position as of June 30, 2008 are primarily mortgage-backed securities and U.S. agency securities. The vast majority of them are rated the equivalent of AAA by major rating agencies. The unrealized losses in the held-to-maturity portfolio as of June 30, 2008 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. Refer to the Investment Securities Available-for-Sale discussion above for additional information regarding recent concerns on certain government-sponsored agencies due to the troubled U.S. housing and mortgage markets. At this time, the Corporation has the intent and ability to hold these investments until maturity.

Table of Contents**5 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.

As of June 30, 2008 and December 31, 2007, the Corporation had investments in FHLB stock with a book value of \$80.6 million and \$63.4 million, respectively. The estimated market value of such investments is its redemption value determined by the ultimate recoverability of its par value. Dividend income from FHLB stock for the second quarter and six-month period ended June 30, 2008 amounted to \$1.1 million and \$2.3 million, respectively, compared to \$0.7 million and \$1.2 million, respectively, for the same periods in 2007.

The Corporation has other equity securities that do not have a readily available fair value. The carrying value of such securities as of June 30, 2008 and December 31, 2007 was \$1.6 million. During the first quarter of 2008, the Corporation realized a one-time gain of \$9.3 million on the mandatory redemption of part of its investment in VISA, Inc., which completed its initial public offering (IPO) in March 2008.

6 LOAN PORTFOLIO

The following is a detail of the loan portfolio:

	As of June 30, 2008	As of December 31, 2007
	(In thousands)	
Residential real estate loans, mainly secured by first mortgages	\$ 3,364,740	\$ 3,143,497
Commercial loans:		
Construction loans	1,467,544	1,454,644
Commercial mortgage loans	1,324,509	1,279,251
Commercial loans	3,502,929	3,231,126
Loans to local financial institutions collateralized by real estate mortgages	591,674	624,597
Commercial loans	6,886,656	6,589,618
Finance leases	373,588	378,556
Consumer loans	1,595,867	1,667,151
Loans receivable	12,220,851	11,778,822
Allowance for loan and lease losses	(222,272)	(190,168)
Loans receivable, net	11,998,579	11,588,654
Loans held for sale	29,194	20,924
Total loans	\$ 12,027,773	\$ 11,609,578

The Corporation's primary lending area is Puerto Rico. The Corporation's Puerto Rico banking subsidiary (First Bank or the Bank) also lends in the U.S. and British Virgin Islands markets and in the United States (principally in the state of Florida). Of the total gross loan portfolio, including loans held for sale, of \$12.3 billion as of June 30, 2008, approximately 80% has credit risk concentration in Puerto Rico, 12% in the United States (mainly in the state of Florida) and 8% in the Virgin Islands.

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The Corporation's largest loan concentration of \$360.9 million is with one mortgage originator in Puerto Rico, Doral Financial Corporation, as of June 30, 2008. Together with the Corporation's next larger loan concentration of \$230.8 million with another mortgage originator in Puerto Rico, R&G Financial Corporation (R&G Financial), the Corporation's total loans granted to these mortgage originators amounted to \$591.7 million as of June 30, 2008. These commercial loans are secured by individual mortgage loans on residential and commercial real estate.

7 ALLOWANCE FOR LOAN AND LEASE LOSSES

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

	Quarter Ended June 30,		Six-Month Period Ended June 30,	
	2008	2007	2008	2007
	(In thousands)			
Balance at beginning of period	\$ 210,495	\$ 161,419	\$ 190,168	\$ 158,296
Provision for loan and lease losses	41,323	24,628	87,116	49,542
Charge-offs	(31,602)	(22,419)	(58,988)	(45,596)
Recoveries	2,056	1,381	3,976	2,767
Balance at end of period	\$ 222,272	\$ 165,009	\$ 222,272	\$ 165,009

The allowance for impaired loans is part of the allowance for loan and lease losses. The allowance for impaired loans covers those 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 does not necessarily represent loans for which the Corporation will incur a substantial loss. As of June 30, 2008 and December 31, 2007, impaired loans and their related allowance were as follows:

	As of June 30, 2008	As of December 31, 2007
	(In thousands)	
Impaired loans	\$335,523	\$151,818
Impaired loans with valuation allowance	206,456	66,941
Allowance for impaired loans	31,115	7,523

The Corporation identified in the first half of 2008 several commercial and construction loans amounting to \$239.6 million that it determined should be classified as impaired, of which \$188.6 million had a specific reserve of \$27.4 million. At the same time, the Corporation's impaired loans decreased by approximately \$53.8 million during the first half of 2008 principally as a result of foreclosed loans in the Miami Agency with a principal balance of approximately \$22.4 million which had a related impairment reserve of \$4.2 million at the time of foreclosure and a loan sold in the Miami Agency that carried a principal balance of approximately \$24.1 million with a related impairment reserve of \$2.4 million at the time of sale. The latter was sold for \$22.5 million during the second quarter of 2008.

Interest income in the amount of approximately \$2.2 million and \$1.1 million was recognized on impaired loans for the quarters ended June 30, 2008 and 2007, respectively, and \$7.9 million and \$1.9 million for the six-month period ended June 30, 2008 and 2007, respectively. The average recorded investment in impaired loans for the first six months of 2008 and 2007 was \$205.8 million and \$74.0 million, respectively.

Table of Contents**8 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

One of the primary market risks facing the Corporation is interest rate risk, which includes the risk that changes in interest rates will result in changes in the value of the Corporation's 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 certificates of deposit (CDs) and medium-term notes.

The Corporation designates a derivative as a fair value hedge, a cash flow hedge or an economic undesignated hedge when it enters into the derivative contract. As of June 30, 2008, all derivatives held by the Corporation were considered economic undesignated hedges. These undesignated hedges are recorded at fair value with the resulting gain or loss recognized in current earnings.

The following summarizes most of the derivative 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 notional principal amount. 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 certificates of deposit (liabilities), mainly those with long-term maturities, to a variable rate and mitigate the interest rate risk inherent in these variable rate loans. Similar to unrealized gains and losses arising from changes in fair value, net interest settlements on interest rate swaps are recorded as an adjustment to interest income or interest expense depending on whether an asset or liability is being economically hedged.

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 certain private label mortgage pass-through securities and certain of the Corporation's commercial loans to other financial institutions is generally a variable rate limited to the weighted-average coupon of the pass-through certificate or referenced residential mortgage collateral, less a contractual servicing fee.

Indexed options 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 (e.g., 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.

To satisfy the needs of its customers, the Corporation may enter into non-hedging transactions. On these transactions, generally, the Corporation participates as a buyer in one of the agreements and as the seller in the other agreement under the same terms and conditions.

In addition, the Corporation enters into certain contracts with embedded derivatives that do not require separate accounting as these are clearly and closely related to the economic characteristics of the host contract. 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.

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The following table summarizes the notional amounts of all derivative instruments as of June 30, 2008 and December 31, 2007:

	Notional Amounts	
	As of	As of
	June 30,	December
	2008	31,
		2007
	(In thousands)	
Economic undesignated hedges:		
Interest rate contracts:		
Interest rate swap agreements used to hedge fixed rate brokered certificates of deposit, notes payable and loans	\$ 1,829,801	\$ 4,244,473
Written interest rate cap agreements	128,059	128,075
Purchased interest rate cap agreements	283,770	294,982
Equity contracts:		
Embedded written options on stock index deposits and notes payable	53,515	53,515
Purchased options used to manage exposure to the stock market on embedded stock index options	53,515	53,515
	\$ 2,348,660	\$ 4,774,560

The following table summarizes the fair values of derivative instruments and the location in the Statement of Financial Condition as of June 30, 2008 and December 31, 2007:

		Asset Derivatives			Liability Derivatives	
		As of June 30, 2008	As of December 31, 2007		As of June 30, 2008	As of December 31, 2007
Balance Sheet Location	Fair Value	Fair Value	Fair Value	Balance Sheet Location	Fair Value	Fair Value
(Dollars in thousands)						
Economic undesignated hedges:						
Interest rate contracts:						
Interest rate swap agreements used to hedge fixed rate brokered certificates of deposit, notes payable and loans	Other Assets	\$ 284	\$ 213	Accounts payable and other liabilities	\$ 32,650	\$ 58,057
Written interest rate cap agreements	Other Assets			Accounts payable and other liabilities	62	47

Purchased interest rate cap agreements	Other Assets	6,044	5,149	Accounts payable and other liabilities		
Equity contracts:						
Embedded written options on stock index deposits	Other Assets			Interest bearing deposits	1,723	4,375
Embedded written options on stock index notes payable	Other Assets			Notes payable	2,729	4,673
Purchased options used to manage exposure to the stock market on embedded stock index options	Other Assets	4,706	9,339	Accounts payable and other liabilities		
		\$ 11,034	\$ 14,701		\$ 37,164	\$ 67,152

The following table summarizes the effect of derivative instruments on the Statement of Income for the quarter and six-month periods ended on June 30, 2008 and 2007:

	Location of Unrealized Gain or (Loss) Recognized in Income on Derivatives	Unrealized Gain or (Loss)			
		Quarter Ended		Six-Month Period Ended	
		June 30,		June 30,	
		2008	2007	2008	2007
		(In thousands)			
Interest rate contracts:					
Interest rate swap agreements used to hedge fixed rate:					
Brokered certificates of deposit	Interest Expense on Deposits	\$ (29,805)	\$ (81,839)	\$ 25,552	\$ (62,057)
Notes payable	Interest Expense on Notes payable and other borrowings	(247)	569	(114)	1,054
Loans	Interest Income on Loans	2,548	1,518	40	1,278
Written and purchased interest rate cap agreements					
mortgage-backed securities	Interest Income on Investment Securities	3,041	4,890	857	4,480
Written and purchased interest rate cap agreements loans	Interest Income on Loans	54	159	23	(132)
Equity contracts:					
Embedded written and purchased options on stock index deposits	Interest Expense on Deposits	(129)	154	(150)	(1)
Embedded written and purchased options on stock index notes payable	Interest Expense on Notes payable and other borrowings	(67)	(145)	113	(350)

Total Unrealized (Loss) Gain on derivatives	\$ (24,605)	\$ (74,694)	\$ 26,321	\$ (55,728)
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Derivative instruments, such as interest rate swaps, are subject to market risk. The Corporation's derivatives are mainly composed of interest rate swaps that are used to convert the fixed interest payment on its brokered CDs and medium-term notes to variable payments (receive fixed/pay floating). 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 derivative instruments on earnings. This will depend, for the most part, on the shape of the yield curve as well as the level of interest rates. The unrealized gains and losses in the fair value of derivatives that economically hedge certain callable brokered CDs and medium-term notes are partially offset by unrealized gains and losses on the valuation of such economically hedged liabilities that were elected to be measured at fair value under the provisions of SFAS 159. The Corporation includes the gain or loss on those economically hedged liabilities (brokered CDs and medium-term notes) in the same line item as the offsetting loss or gain on the related derivatives as set forth below:

	Quarter ended June 30,					
	2008		2007			
	Loss on Derivatives	Gain on SFAS 159 liabilities	Net Unrealized Loss	(Loss) / Gain on Derivatives	Gain on SFAS 159 liabilities	Net Unrealized (Loss) / Gain
<i>(In thousands)</i>						
Interest expense on Deposits	\$(29,934)	\$ 28,462	\$(1,472)	\$(81,685)	\$ 75,607	\$(6,078)
Interest expense on Notes payable and other borrowings	(314)	2	(312)	424	252	676

	Six-Month Period ended June 30,					
	2008		2007			
	Gain / (Loss) on Derivatives	(Loss) / Gain on SFAS 159 liabilities	Net Unrealized Gain	(Loss) / Gain on Derivatives	Gain on SFAS 159 liabilities	Net Unrealized (Loss) / Gain
Interest expense on Deposits	\$25,402	\$ (21,095)	\$ 4,307	\$(62,058)	\$ 56,398	\$(5,660)
Interest expense on Notes payable and other borrowings	(1)	899	898	704	130	834

A summary of interest rate swaps as of June 30, 2008 and December 31, 2007 follows:

	As of June 30, 2008	As of December 31, 2007
	(Dollars in thousands)	
Pay fixed/receive floating (generally used to economically hedge variable rate loans):		
Notional amount	\$ 79,840	\$ 80,212
Weighted-average receive rate at period end	4.39%	7.09%
Weighted-average pay rate at period end	6.76%	6.75%
Floating rates range from 167 to 252 basis points over 3-month LIBOR		

Receive fixed/pay floating (generally used to economically hedge fixed-rate brokered CDs and notes payable):

Notional amount	\$1,749,961	\$4,164,261
Weighted-average receive rate at period end	5.32%	5.26%
Weighted-average pay rate at period end	2.82%	5.07%
Floating rates range from 2 basis points to 54 basis points over 3-month		

LIBOR

During the first half of 2008, approximately \$2.4 billion of interest rate swaps were cancelled by the counterparties, mainly due to lower 3-month LIBOR. Following the cancellation of the interest rate swaps, the Corporation exercised its call option on approximately \$2.4 billion swapped to floating brokered CDs. The Corporation recorded a net gain of \$4.4 million as a result of these transactions resulting from the reversal of the cumulative mark-to-market valuation of the swaps and the brokered CDs called.

As of June 30, 2008, the Corporation has not entered into any derivative instrument containing credit-risk-related contingent features.

Table of Contents**9 GOODWILL AND OTHER INTANGIBLES**

Goodwill as of June 30, 2008 amounted to \$28.1 million (December 31, 2007 \$28.1 million), recognized as part of Other Assets, resulting primarily from the acquisition of Ponce General Corporation in 2005. No goodwill impairment was recognized during 2008 and 2007.

As of June 30, 2008, the gross carrying amount and accumulated amortization of core deposit intangibles was \$45.8 million and \$20.0 million, respectively, recognized as part of Other Assets in the Consolidated Statements of Financial Condition (December 31, 2007 \$41.2 million and \$18.3 million, respectively). The increase in the gross amount from December 2007 relates to the acquisition of the Virgin Islands Community Bank on January 28, 2008. During the quarters ended June 30, 2008 and 2007, the amortization expense of core deposits amounted to \$0.9 million and \$0.8 million, respectively. For each of the six-month periods ended June 30, 2008 and 2007, the amortization expense of core deposits amounted to \$1.7 million.

10 DEPOSITS

The following table summarizes deposit balances:

	As of June 30, 2008	As of December 31, 2007
	(In thousands)	
Non-interest bearing checking account deposits	\$ 690,451	\$ 621,884
Savings accounts	1,252,217	1,036,662
Interest-bearing checking accounts	616,152	518,570
Certificates of deposit	1,868,615	1,680,344
Brokered certificates of deposit (includes \$1,689,208 and \$4,186,563 measured at fair value as of June 30, 2008 and December 31, 2007, respectively)	7,100,349	7,177,061
	\$ 11,527,784	\$ 11,034,521

The interest expense on deposits includes the valuation to market of interest rate swaps that economically hedge brokered CDs, the related interest exchanged, the amortization of broker placement fees related to brokered CDs not elected for the fair value option and changes in fair value of callable brokered CDs elected for the fair value option under SFAS 159 (SFAS 159 brokered CDs).

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The following are the components of interest expense on deposits:

	Quarter ended		Six-month period ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
	(In thousands)			
Interest expense on deposits	\$ 94,039	\$ 125,690	\$ 203,192	\$ 248,054
Amortization of broker placement fees (1)	4,256	2,114	7,079	4,258
Interest expense on deposits excluding net unrealized loss (gain) on derivatives and SFAS 159 brokered CDs	98,295	127,804	210,271	252,312
Net unrealized loss (gain) on derivatives and SFAS 159 brokered CDs	1,472	6,078	(4,307)	5,660
Total interest expense on deposits	\$ 99,767	\$ 133,882	\$ 205,964	\$ 257,972

- (1) Related to brokered CDs not elected for the fair value option under SFAS 159.

Total interest expense on deposits includes net cash settlements on interest rate swaps that economically hedge brokered CDs that for the quarter and six-month period ended June 30, 2008 amounted to net interest realized of \$12.9 million and \$19.9 million, respectively (2007 net interest incurred of \$3.5 million for the second quarter and \$7.3 million for the six-month period).

11 FEDERAL FUNDS PURCHASED AND SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Federal funds purchased and securities sold under agreements to repurchase (repurchase agreements) consist of the following:

	June 30, 2008	December, 31 2007
	(In thousands)	
Federal funds purchased, interest ranging from 4.50% to 5.12%	\$	\$ 161,256
Repurchase agreements, interest ranging from 2.24% to 5.39% (2007 - 3.26% to 5.67%)	3,999,590	2,933,390
Total	\$ 3,999,590	\$ 3,094,646

Federal funds purchased and repurchase agreements mature as follows:

	June 30, 2008
	(In thousands)
One to thirty days	\$ 1,115,258
Over thirty to ninety days	596,832

Over ninety days to one year	200,000
One to three years	787,500
Three to five years	500,000
Over five years	800,000
Total	\$ 3,999,590

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Following is a detail of the advances from the FHLB:

	June 30, 2008	December, 31 2007
	(In thousands)	
Advances from FHLB, tied to 3-month LIBOR, with an average interest rate of 2.80% (2007 - 4.98%)	\$ 400,000	\$ 400,000
Fixed-rate advances from FHLB, with a weighted-average interest rate of 3.11% (2007 - 4.58%)	1,060,000	703,000
Total	\$ 1,460,000	\$ 1,103,000

Advances from FHLB mature as follows:

	June 30, 2008
	(In thousands)
One to thirty days	\$ 510,000
Over thirty to ninety days	
Over ninety days to one year	514,000
One to three years	215,000
Three to five years	221,000
Total	\$ 1,460,000

13 NOTES PAYABLE

Notes payable consist of:

	As of June 30, 2008	As of December 31, 2007
	(In thousands)	
Callable step-rate notes, bearing step increasing interest from 5.00% to 7.00% (5.50% as of June 30, 2008 and December 31, 2007) maturing on October 18, 2019, measured at fair value under SFAS 159	\$ 13,407	\$ 14,306
Dow Jones Industrial Average (DJIA) linked principal protected notes:		
Series A maturing on February 28, 2012	6,973	7,845
Series B maturing on May 27, 2011	7,564	8,392
	\$ 27,944	\$ 30,543

Table of Contents**14 OTHER BORROWINGS**

Other borrowings consist of:

	As of June 30, 2008	As of December 31, 2007
	(In thousands)	
Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.75% over 3-month LIBOR (5.56% as of June 30, 2008 and 7.74% as of December 31, 2007)	\$ 102,999	\$ 102,951
Junior subordinated debentures due in 2034, interest-bearing at a floating-rate of 2.50% over 3-month LIBOR (5.30% as of June 30, 2008 and 7.43% as of December 31, 2007)	128,866	128,866
	\$ 231,865	\$ 231,817

15 INCOME TAXES

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. 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. 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%. 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 entities (IBEs) of the Corporation and the Bank and through the Bank's subsidiary, FirstBank Overseas Corporation, in which the interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation. 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 20% of the bank's total net taxable income.

For the six-month period ended June 30, 2008, the Corporation recognized an income tax benefit of \$17.2 million, compared to an income tax expense of \$12.4 million for the same period in 2007. The positive fluctuation on the financial results was mainly due to two non-recurrent transactions: (i) a reversal of \$10.6 million of Unrecognized Tax Benefits (UTBs) during the second quarter of 2008 for positions taken on income tax returns recorded under the provisions of FASB Interpretation (FIN) 48 Accounting for Uncertainty in Income Taxes, as explained below, and (ii) the recognition of an income tax benefit of \$5.4 million in connection with an agreement entered into with the Puerto Rico Department of Treasury during the first quarter of 2008 that establishes a multi-year allocation schedule for deductibility of the payment of \$74.25 million made by the

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Corporation during 2007 to settle the securities class action suit. Also, higher deferred tax benefits were recorded in connection with a higher provision for loan and lease losses, and the current income tax provision was lower, excluding the reversal of the FIN 48 contingency, due to lower taxable income.

As of June 30, 2008, 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 asset will not be realized and, thus, established a valuation allowance of \$6.6 million, compared to a valuation allowance of \$4.9 million as of December 31, 2007. As of June 30, 2008, the deferred tax asset, net of the valuation allowance of \$6.6 million, amounted to approximately \$105.9 million compared to \$90.1 million, net of the valuation allowance of \$4.9 million as of December 31, 2007.

The Corporation adopted FIN 48 as of January 1, 2007. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under FIN 48, income tax benefits are recognized and measured based upon a two-step model: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with FIN 48 and the tax benefit claimed on a tax return is referred to as an unrecognized tax benefit.

As of June 30, 2008, the balance of the Corporation's UTBs amounted to \$15.1 million (excluding accrued interest), all of which would, if recognized, affect the Corporation's effective tax rate. The Corporation classifies all interest and penalties, if any, related to tax uncertainties as income tax expense. As of June 30, 2008, the Corporation's accrual for interest that relates to tax uncertainties amounted to \$6.0 million. As of June 30, 2008, there is no need to accrue for the payment of penalties. For the six-month periods ended on June 30, 2008 and 2007, the total amount of interest recognized by the Corporation as part of income tax expense related with tax uncertainties was \$0.8 million and \$1.1 million, respectively. The amount of UTBs may increase or decrease in the future for various reasons, including changes in the amounts for current tax year positions, expiration of open income tax returns due to the statutes of limitations, changes in management's judgment about the level of uncertainty, status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions. During the second quarter of 2008, the Corporation reversed UTBs by approximately \$7.1 million and accrued interest of \$3.5 million as a result of a lapse of the applicable statute of limitations for taxable year 2003. For the remaining outstanding UTBs, the Corporation cannot make any reasonably reliable estimate of the timing of future cash flows or changes, if any, associated with such obligations.

The Corporation's liability for income taxes includes the liability for UTBs and interest which relate to tax years still subject to review by taxing authorities. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the PR Code is 4 years, and under the Virgin Islands and U.S. income tax purposes is 3 years after a tax return is due or filed, whichever is later. The completion of an audit by the taxing authorities or the expiration of the statute of limitations for a given audit period could result in an adjustment to the Corporation's liability for income taxes. Any such adjustment could be material to results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. All tax years subsequent to 2003 remain open to examination under the PR Code and taxable years subsequent to 2004 remain open to examination for Virgin Islands and U.S. income tax purposes.

16 FAIR VALUE

Effective January 1, 2007, the Corporation adopted SFAS 157, Fair Value Measurement, which provides a framework for measuring fair value under GAAP.

The Corporation also adopted SFAS 159 effective January 1, 2007. SFAS 159 generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. The Corporation

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elected to adopt the fair value option for certain of its brokered CDs and medium-term notes (SFAS 159 liabilities) on the adoption date.

Fair Value Option

Callable Brokered CDs and Certain Medium-Term Notes

The Corporation elected to account for at fair value certain financial liabilities that were hedged with interest rate swaps that were previously designated for fair value hedge accounting in accordance with SFAS 133. As of June 30, 2008, these liabilities included callable brokered CDs with an aggregate fair value of \$1.69 billion and principal balance of \$1.70 billion recorded in interest-bearing deposits, and certain medium-term notes with a fair value of \$13.4 million and principal balance of \$15.4 million recorded in notes payable. Interest paid on these instruments is recorded as part of interest expense and the accrued interest is part of the fair value of the SFAS 159 liabilities. Electing the fair value option allows the Corporation to eliminate the burden of complying with the requirements for hedge accounting under SFAS 133 (e.g., documentation and effectiveness assessment) without introducing earnings volatility. Interest rate risk on the callable brokered CDs and medium-term notes measured at fair value under SFAS 159 continues to be economically hedged with callable interest rate swaps with the same terms and conditions. The Corporation did not elect the fair value option for the vast majority of other brokered CDs because these are not hedged by derivatives. Effective January 1, 2007, the Corporation discontinued the use of fair value hedge accounting for interest rate swaps that hedged a \$150 million medium-term note since the interest rate swaps were no longer effective in offsetting the changes in the fair value of the \$150 million medium-term note and, as a consequence, the Corporation did not elect the fair value option for this note either. The Corporation redeemed the \$150 million medium-term note during the second quarter of 2007.

Callable brokered CDs and medium-term notes for which the Corporation has elected the fair value option are priced using observable market data in the institutional markets.

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Fair Value Measurement

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Level 1 assets and liabilities include equity securities that are traded in an active exchange market, as well as certain U.S. Treasury and other U.S. government and agency securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include (i) mortgage-backed securities for which the fair value is estimated based on the value for identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments and (iii) derivative contracts and financial liabilities (e.g., callable brokered CDs and medium-term notes elected for fair value option under SFAS 159) whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models for which the determination of fair value requires significant management judgment or estimation.

The following is a description of the valuation methodologies used for instruments measured at fair value:

Callable Brokered CDs

The fair value of callable brokered CDs, which are included within deposits, is determined using discounted cash flow analyses over the full term of the CDs. The valuation uses a Hull-White Interest Rate Tree approach for the CDs with callable option components, an industry-standard approach for valuing instruments with interest rate call options. The model assumes that the embedded options are exercised economically. The fair value of the CDs is computed using the outstanding principal amount. The discount rates used are based on US dollar LIBOR and swap rates. At-the-money implied swaption volatility term structure (volatility by time to maturity) is used to calibrate the model to current market prices and value the cancellation option in the deposits.

Medium-Term Notes

The fair value of medium-term notes is determined using a discounted cash flow analysis over the full term of the borrowings. This valuation also uses the Hull-White Interest Rate Tree approach to value the option components of the term notes. The model assumes that the embedded options are exercised economically. The fair value of medium-term notes is computed using the notional amount outstanding. The discount rates used in the valuations are based on US dollar LIBOR and swap rates. At-the-money implied swaption volatility term structure (volatility by time to maturity) is used to calibrate the model to current market

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prices and value the cancellation option in the term notes. Effective January 1, 2007, the Corporation updated its methodology to calculate the impact of its own credit standing. The net gain from fair value changes attributable to the Corporation's own credit to the medium-term notes for which the Corporation has elected the fair value option recorded for the six-month periods ended June 30, 2008 and 2007 amounted to \$0.9 million and \$1.0 million, respectively. The cumulative mark-to-market unrealized gain on the medium-term notes since the adoption of SFAS 159 amounted to \$2.6 million as of June 30, 2008. For the medium-term notes, the credit risk is measured using the difference in yield curves between Swap rates and Treasury rates at a tenor comparable to the time to maturity of the note and option.

Investment Securities

The fair value of investment securities is the market value based on quoted market prices, when available, or market prices for similar instruments. If listed prices or quotes are not available, fair value is based upon models that use unobservable inputs due to the limited market activity of the instrument.

Derivative instruments

The fair value of the derivative instruments was based on observable market parameters and take into consideration the Corporation's own credit standing. Certain derivatives with limited market activity are valued using models that consider unobservable market parameters.

Assets and liabilities measured at fair value on a recurring basis, including financial liabilities for which the Corporation has elected the fair value option, are summarized below:

As of June 30, 2008
Fair Value Measurements Using

<i>(In thousands)</i>	Level 1	Level 2	Level 3	Assets/ (Liabilities) at Fair Value
Callable brokered CDs (1)	\$	\$(1,689,208)	\$	\$ (1,689,208)
Medium-term notes (1)		(13,407)		(13,407)
Securities available for sale (2)	13,367	3,930,672	115,190	4,059,229
Derivative instruments (3)		(32,110)	5,983	(26,127)

(1) Amounts represent items for which the Corporation has elected the fair value option under SFAS 159.

(2) Carried at fair value prior to the adoption of SFAS 159.

(3) Derivatives as of June 30, 2008 include derivative assets of \$11.0 million and derivative

liabilities of
\$37.1 million,
all of which
were carried at
fair value prior
to the adoption
of SFAS 159.

	Changes in Fair Value for the Quarter Ended			Changes in Fair Values for the Six-Month Period Ended		
	June 30, 2008, for items Measured at Fair Value Pursuant to Election of the Fair Value Option			June 30, 2008, for items Measured at Fair Value Pursuant to Election of the Fair Value Option		
	Unrealized Losses	Unrealized Losses	Total Changes in Fair Value Unrealized Losses and Interest Expense included in Interest Expense on Deposits (1)	Unrealized Losses	Unrealized Gains	Total Changes in Fair Value Unrealized (Losses) Gains and Interest Expense Included in Current-Period Earnings (1)
Callible brokered CDs	\$ (1,320)	\$	\$ (1,320)	\$ (99,992)	\$	\$ (99,992)
Medium-term notes		(211)	(211)		474	474
	\$ (1,320)	\$ (211)	\$ (1,531)	\$ (99,992)	\$ 474	\$ (99,518)

(1) Changes in fair value for the quarter and six-month period ended June 30, 2008 include interest expense on callable brokered CDs of \$29.8 million, and \$78.9 million, respectively, and interest expense on medium-term

notes of \$0.2 million and \$0.4 million, respectively. Interest expense on callable brokered CDs and medium-term notes that have been elected to be carried at fair value under the provisions of SFAS 159 are recorded in interest expense in the Consolidated Statements of Income based on their contractual coupons.

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The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarter and six-month period ended June 30, 2008.

Level 3 Instruments Only	Total Fair Value Measurements (Quarter ended June 30, 2008)		Total Fair Value Measurements (Six-month period ended June 30, 2008)	
	Derivatives (1)	Securities Available For Sale (2)	Derivatives (1)	Securities Available For Sale (2)
<i>(In thousands)</i>				
Beginning balance	\$ 2,888	\$ 119,051	\$ 5,103	\$ 133,678
Total gains or (losses) (realized/unrealized):				
Included in earnings	3,095		880	
Included in other comprehensive income		3,025		(7,607)
Principal repayments and amortization		(6,886)		(10,881)
Ending balance	\$ 5,983	\$ 115,190	\$ 5,983	\$ 115,190

(1) Amounts related to the valuation of interest rate cap agreements which were carried at fair value prior to the adoption of SFAS 159.

(2) Amounts mostly related to certain private label mortgage-backed securities.

The table below summarizes changes in unrealized gains recorded in earnings for the quarter and six-month period ended June 30, 2008 for Level 3 assets and liabilities that are still held as of June 30, 2008.

Level 3 Instruments Only	Changes in Unrealized Gains	
	Quarter Ended June 30, 2008	Six-Month Period Ended June 30, 2008
<i>(In thousands)</i>		

Changes in unrealized gains relating to assets still held at reporting date (1) (2):

Interest income on loans	\$ 54	\$ 23
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Interest income on investment securities	3,041	857
	\$ 3,095	\$ 880

(1) Amount represents valuation of interest rate cap agreements which were carried at fair value prior to the adoption of SFAS 159.

(2) Unrealized gain of \$3.0 million and unrealized loss of \$7.6 million on Level 3 available for sale securities were recognized as part of other comprehensive income for the quarter and six-month period ended June 30, 2008, respectively.

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Additionally, fair value is used on a non-recurring basis to evaluate certain assets in accordance with GAAP. Adjustments to fair value usually result from the application of lower-of-cost-or-market accounting (e.g., loans held for sale carried at the lower of cost or fair value and repossessed assets) or write-downs of individual assets (e.g., goodwill, loans).

As of June 30, 2008, impairment or valuation adjustments were recorded for assets recognized at fair value on a non-recurring basis as shown in the following table:

	Carrying value as of June, 2008			Valuation allowance as of June 30, 2008	Losses recorded for the Quarter ended June 30, 2008	Losses recorded for the Six-month period ended June 30, 2008
(In thousands)	Level 1	Level 2	Level 3			
Loans receivable ⁽¹⁾	\$	\$	\$175,341	\$ 31,115	\$ 21,896	\$ 40,685
Loans held for sale ⁽²⁾		29,194		457	457	457
Other Real Estate Owned ⁽³⁾			38,620	2,563	522	843

(1) Mainly impaired commercial and construction loans. The impairment was generally measured based on the fair value of the collateral in accordance with the provisions of SFAS 114, Accounting by Creditors for Impairment of a Loan. The fair values are derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics

and assumptions of the collateral (e.g. absorption rates), which are not market observable.

(2) Fair value is primarily derived from quotations based on the mortgage-backed securities market.

(3) The fair value is derived from appraisals that take into consideration prices in observed transactions involving similar assets in similar locations but adjusted for specific characteristics and assumptions of the properties (e.g. absorption rates), which are not market observable.

Valuation allowance is based on market valuation adjustments after the transference from the loan to the Other Real Estate Owned (OREO) portfolio.

During the first six months of 2008, the Corporation increased its OREO portfolio as a result of the repossession, in settlement of two of the impaired loans in the Miami Agency, of the associated collateral. As of June 30, 2008, the value of such properties amounted to \$18.6 million, net of charge-offs of \$4.2 million.

17 SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information follows:

Six-Month Period Ended
June 30,
2008 2007
(In thousands)

Cash paid for:

Interest on borrowings	\$ 367,767	\$ 386,145
Income tax	2,082	3,255

Non-cash investing and financing activities:

Additions to other real estate owned	36,171	4,907
Additions to auto repossessions	44,497	57,698
Capitalization of servicing assets	515	595
Recharacterization of secured commercial loans as securities collateralized by loans		183,830

On January 28, 2008, the Corporation completed the acquisition of the Virgin Islands Community Bank (VICB) with operations in St. Croix, U.S. Virgin Islands, at a purchase price of \$2.5 million. The Corporation acquired cash of approximately \$7.7 million from VICB.

18 SEGMENT INFORMATION

Based upon the Corporation's organizational structure and the information provided to the Chief Operating Decision Maker and, to a lesser extent, the Board of Directors, the operating segments are driven primarily by the Corporation's legal entities. As of June 30, 2008, the Corporation had four reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; and Treasury and Investments. There is also an Other category reflecting other legal entities reported separately on an aggregate basis. Management determined

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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. In addition, the Mortgage Banking segment includes mortgage loans purchased from other local banks or mortgage brokers. The Consumer (Retail) Banking segment consists of the Corporation's consumer lending and deposit-taking activities conducted mainly through its branch network and loan centers. The Treasury and Investments 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 (Retail) Banking segments to finance their lending activities and borrows from those segments. The Consumer (Retail) Banking segment also loans funds to other segments. The interest rates charged or credited by Treasury and Investments and the Consumer (Retail) Banking segments 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, 2007 contained in the Corporation's annual report 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.

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

	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	Other	Total
For the quarter ended June 30, 2008:						
Interest income	\$ 47,455	\$ 40,022	\$ 85,666	\$ 71,254	\$ 32,211	\$ 276,608
Net (charge) credit for transfer of funds	(35,066)	23,808	(49,502)	64,451	(3,691)	
Interest expense		(19,563)		(114,004)	(8,435)	(142,002)
Net interest income	12,389	44,267	36,164	21,701	20,085	134,606
Provision for loan and lease losses	(1,259)	(14,414)	(20,037)		(5,613)	(41,323)
Non-interest income (loss)	853	6,674	1,137	(587)	3,925	12,002
Direct non-interest expenses	(6,125)	(25,546)	(8,099)	(1,586)	(11,400)	(52,756)
Segment income	\$ 5,858	\$ 10,981	\$ 9,165	\$ 19,528	\$ 6,997	\$ 52,529
Average earnings assets	\$ 2,909,308	\$ 1,720,661	\$ 5,992,390	\$ 5,487,619	\$ 1,357,393	\$ 17,467,371
For the quarter ended June 30, 2007:						
Interest income	\$ 40,944	\$ 46,506	\$ 109,183	\$ 76,148	\$ 33,090	\$ 305,871
Net (charge) credit for transfer of funds	(30,933)	26,202	(72,460)	81,750	(4,559)	
Interest expense		(19,921)		(160,598)	(8,137)	(188,656)
Net interest income (loss)	10,011	52,787	36,723	(2,700)	20,394	117,215
Provision for loan and lease losses	(1,237)	(12,091)	(8,171)		(3,129)	(24,628)
Non-interest income (loss)	372	6,275	1,272	(1,297)	4,281	10,903
Direct non-interest expenses	(5,114)	(22,707)	(3,658)	(2,023)	(11,230)	(44,732)
Segment income (loss)	\$ 4,032	\$ 24,264	\$ 26,166	\$ (6,020)	\$ 10,316	\$ 58,758
Average earnings assets	\$ 2,527,577	\$ 1,835,842	\$ 5,401,162	\$ 5,369,401	\$ 1,307,741	\$ 16,441,723

	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	Other	Total
For the six-month period ended June 30, 2008:						
Interest income	\$ 92,560	\$ 82,412	\$ 179,746	\$ 135,872	\$ 65,105	\$ 555,695
Net (charge) credit for transfer of funds	(69,146)	45,999	(107,276)	135,109	(4,686)	
Interest expense		(38,725)		(240,675)	(17,231)	(296,631)

Net interest income	23,414	89,686	72,470	30,306	43,188	259,064
Provision for loan and lease losses	(6,968)	(28,989)	(33,081)		(18,078)	(87,116)
Non-interest income	1,229	13,968	2,148	15,734	8,303	41,382
Direct non-interest expenses	(12,505)	(53,115)	(17,596)	(3,436)	(22,839)	(109,491)
Segment income (loss)	\$ 5,170	\$ 21,550	\$ 23,941	\$ 42,604	\$ 10,574	\$ 103,839
Average earnings assets	\$ 2,861,979	\$ 1,732,717	\$ 5,923,744	\$ 5,297,547	\$ 1,353,989	\$ 17,169,976
For the six-month period ended June 30, 2007:						
Interest income	\$ 80,818	\$ 93,638	\$ 217,078	\$ 148,352	\$ 64,570	\$ 604,456
Net (charge) credit for transfer of funds	(60,755)	54,161	(145,129)	162,227	(10,504)	
Interest expense		(39,084)		(315,104)	(15,618)	(369,806)
Net interest income (loss)	20,063	108,715	71,949	(4,525)	38,448	234,650
Provision for loan and lease losses	(1,186)	(27,687)	(14,078)		(6,591)	(49,542)
Non-interest income (loss)	1,154	15,143	2,016	(3,316)	9,231	24,228
Net gain on partial extinguishment and recharacterization of secured commercial loan to a local financial institution			2,497			2,497
Direct non-interest expenses	(10,361)	(45,452)	(9,508)	(4,101)	(22,736)	(92,158)
Segment income (loss)	\$ 9,670	\$ 50,719	\$ 52,876	\$ (11,942)	\$ 18,352	\$ 119,675
Average earnings assets	\$ 2,493,630	\$ 1,852,079	\$ 5,446,161	\$ 5,437,931	\$ 1,287,627	\$ 16,517,428

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

	Quarter Ended June 30,		Six-month Period Ended June 30,	
	2008	2007	2008	2007
Net income:				
Total income for segments and other	\$ 52,529	\$ 58,758	\$ 103,839	\$ 119,675
Other operating expenses	(29,007)	(28,722)	(54,459)	(60,660)
Income before income taxes	23,522	30,036	49,380	59,015
Income tax benefit (expense)	9,472	(6,241)	17,203	(12,388)
Total consolidated net income	\$ 32,994	\$ 23,795	\$ 66,583	\$ 46,627
Average assets:				
Total average earning assets for segments	\$ 17,467,371	\$ 16,441,723	\$ 17,169,976	\$ 16,517,428
Average non-earning assets	759,060	684,398	712,651	600,243
Total consolidated average assets	\$ 18,226,431	\$ 17,126,121	\$ 17,882,627	\$ 17,117,671

19 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 mortgage loans at fair value. As of June 30, 2008, commitments to extend credit amounted to approximately \$1.7 billion and standby letters of credit amounted to approximately \$100.3 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, 2008, First BanCorp and its subsidiaries were defendants in various legal proceedings arising in the ordinary course of business. Management believes that the final disposition of these matters will not have a material adverse effect on the Corporation's financial position or results of operations.

Table of Contents**20 FIRST BANCORP (Holding Company Only) Financial Information**

The following condensed financial information presents the financial position of the Holding Company only as of June 30, 2008 and December 31, 2007 and the results of its operations for the quarters and six-month periods ended June 30, 2008 and 2007.

	As of June 30, 2008	As of December 31, 2007
	(In thousands)	
Assets		
Cash and due from banks	\$ 26,888	\$ 43,519
Money market investments	40,250	46,293
Investment securities available for sale, at market:		
Mortgage-backed securities		41,234
Equity investments	1,647	2,117
Other investment securities	1,550	1,550
Loans receivable, net		2,597
Investment in FirstBank Puerto Rico, at equity	1,422,132	1,457,899
Investment in FirstBank Insurance Agency, at equity	5,982	4,632
Investment in Ponce General Corporation, at equity	109,994	106,120
Investment in PR Finance, at equity	2,678	2,979
Accrued interest receivable		376
Investment in FBP Statutory Trust I	3,093	3,093
Investment in FBP Statutory Trust II	3,866	3,866
Other assets	16,590	1,503
 Total assets	 \$ 1,634,670	 \$ 1,717,778
 Liabilities & Stockholders' Equity		
Liabilities:		
Other borrowings	\$ 231,865	\$ 282,567
Accounts payable and other liabilities	1,112	13,565
 Total liabilities	 232,977	 296,132
 Stockholders' equity	 1,401,693	 1,421,646
 Total liabilities and stockholders' equity	 \$ 1,634,670	 \$ 1,717,778

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	Quarter Ended		Six-month Period Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
	(In thousands)		(In thousands)	
Income:				
Interest income on investment securities	\$ 57	\$ 852	\$ 790	\$ 1,435
Interest income on other investments	204	6	733	17
Interest income on loans		89		462
Dividend from FirstBank Puerto Rico	30,001	20,963	41,872	22,991
Dividend from other subsidiaries			2,500	1,000
Other income	93	141	213	279
	30,355	22,051	46,108	26,184
Expense:				
Notes payable and other borrowings	3,126	4,670	7,389	9,340
Interest on funding to subsidiaries		843	550	1,708
(Recovery) Provision for loan losses			(1,398)	1,320
Other operating expenses	563	640	1,034	1,634
	3,689	6,153	7,575	14,002
Net loss on investments and impairments	(489)	(1,437)	(489)	(3,595)
Net loss on partial extinguishment and recharacterization of secured commercial loans to a local financial institution				(1,207)
Income before income taxes and equity in undistributed earnings of subsidiaries	26,177	14,461	38,044	7,380
Income tax (provision) benefit	(1)	1,212	(546)	2,501
Equity in undistributed earnings of subsidiaries	6,818	8,122	29,085	36,746
Net income	\$ 32,994	\$ 23,795	\$ 66,583	\$ 46,627

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (MD&A)****SELECTED FINANCIAL DATA**

(In thousands, except for per share and financial ratios)

	Quarter ended June 30,		Six-month period ended June 30,	
	2008	2007	2008	2007
Condensed Income Statements:				
Total interest income	\$276,608	\$305,871	\$555,695	\$604,456
Total interest expense	142,002	188,656	296,631	369,806
Net interest income	134,606	117,215	259,064	234,650
Provision for loan and lease losses	41,323	24,628	87,116	49,542
Non-interest income	12,002	10,903	41,382	26,725
Non-interest expenses	81,763	73,454	163,950	152,818
Income before income taxes	23,522	30,036	49,380	59,015
Income tax benefit (provision)	9,472	(6,241)	17,203	(12,388)
Net income	32,994	23,795	66,583	46,627
Net income attributable to common stockholders	22,925	13,726	46,445	26,489
Per Common Share Results:				
Net income per share basic	\$ 0.25	\$ 0.16	\$ 0.50	\$ 0.32
Net income per share diluted	\$ 0.25	\$ 0.16	\$ 0.50	\$ 0.32
Cash dividends declared	\$ 0.07	\$ 0.07	\$ 0.14	\$ 0.14
Average shares outstanding	92,505	83,254	92,505	83,254
Average shares outstanding diluted	92,708	83,876	92,650	83,757
Book value per common share	\$ 9.21	\$ 9.08	\$ 9.21	\$ 9.08
Selected Financial Ratios (In Percent):				
Profitability:				
Return on Average Assets	0.72	0.56	0.74	0.54
Interest Rate Spread (1)	2.92	2.34	2.78	2.35
Net Interest Margin (1)	3.28	2.88	3.19	2.91
Return on Average Total Equity	9.16	7.16	9.26	7.45
Return on Average Common Equity	10.29	7.05	10.46	7.55
Average Total Equity to Average Total Assets	7.91	7.76	8.04	7.31
Dividend payout ratio	28.25	42.46	27.88	44.00
Efficiency ratio (2)	55.77	57.33	54.57	58.47
Asset Quality:				
Allowance for loan and lease losses to loans receivable	1.82	1.47	1.82	1.47
Net charge-offs (annualized) to average loans	0.97	0.75	0.91	0.77
Provision for loan and lease losses to net charge-offs	139.86	117.06	158.36	115.67
Non-performing assets to total assets	2.65	1.91	2.65	1.91
Non-accruing loans to total loans receivable	3.67	2.81	3.67	2.81
Allowance to total non-accruing loans	49.56	52.29	49.56	52.29
Allowance to total non-accruing loans, excluding residential real estate loans	101.85	98.45	101.85	98.45

Other Information:

Common Stock Price: End of period	\$ 6.34	\$ 10.99	\$ 6.34	\$ 10.99
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	As of June 30, 2008	As of December 31, 2007
Balance Sheet Data:		
Loans and loans held for sale	\$12,250,045	\$11,799,746
Allowance for loan and lease losses	222,272	190,168
Money market and investment securities	6,086,338	4,811,413
Total assets	18,828,786	17,186,931
Deposits	11,527,784	11,034,521
Borrowings	5,719,399	4,460,006
Total common equity	851,593	871,546
Total equity	1,401,693	1,421,646

1- On a tax equivalent basis (see Net Interest Income discussion below).

2- Non-interest expenses to the sum of net interest income and non-interest income. The denominator includes non-recurring income and changes in the fair value of derivative instruments and financial instruments measured at fair value under SFAS 159.

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OVERVIEW OF RESULTS OF OPERATIONS

This discussion and analysis relates to the accompanying consolidated interim unaudited financial statements of 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 results of its hedging activities, gains (losses) on investments, gains (losses) on sale of loans, and income taxes.

Net income for the quarter ended June 30, 2008 amounted to \$33.0 million or \$0.25 per diluted common share, compared to \$23.8 million or \$0.16 per diluted common share for the quarter ended June 30, 2007. The Corporation's financial performance for the second quarter of 2008, as compared to the second quarter of 2007, was principally impacted by the following factors: (1) an increase of \$17.4 million in net interest income due to a decrease in the average cost of funds resulting from lower short-term interest rates coupled with changes in the mix and volume of the Corporation's balance sheet, and (2) an income tax benefit of \$9.5 million recorded for the second quarter, compared to an income tax expense of \$6.2 million for the same period a year ago, mainly in connection to the reversal of \$10.6 million of Unrecognized Tax Benefits (UTBs) for positions taken on income tax returns recorded under the provisions of Financial Interpretation No. (FIN) 48. These factors were partially offset by an increase of \$16.7 million in the provision for loan and lease losses due to additional reserves allocated to certain impaired commercial and construction loans as well as increases to the reserve factors for potential losses inherent in the loan portfolio associated with weakening economic conditions in Puerto Rico and the slowdown in the United States housing sector and the overall increase in the volume of the portfolio.

The highlights and key drivers of the Corporation's financial results for the quarter ended June 30, 2008 included the following:

Net interest income for the quarter ended June 30, 2008 was \$134.6 million, compared to \$117.2 million for the same period in 2007. The net interest spread and margin, on an adjusted tax equivalent basis, for the quarter ended June 30, 2008 were 2.92% and 3.28%, respectively, compared to 2.34% and 2.88%, respectively, for the same period in 2007. The increase in net interest income, spread and margin was mainly associated with a decrease in the average cost of funds resulting from lower short-term interest rates and changes in the mix and volume of the Corporation's balance sheet. The current interest rate scenario has allowed the Corporation to replace brokered certificates of deposit (CDs) that matured or were called during 2008 with lower rates brokered CDs that are not hedged with interest rate swaps and, to a lesser extent, with other low cost borrowings such as Federal Home Loan Bank (FHLB) advances. Most of the brokered CDs called in 2008 were hedged with interest rate swaps. By reducing the exposure to swapped-to-floating interest rate swaps that hedge brokered CDs, the Corporation locked-in interest rates for longer periods, thus reducing interest rate risk.

Furthermore, given market opportunities, the Corporation increased the volume of earning assets through the purchased, during the second quarter of 2008, of approximately \$2.2 billion in U.S. government agency mortgage-backed securities (MBS) at an average yield of 5.50%, which is significantly higher than the cost of borrowings required to finance the purchase of such assets; thus contributing to a higher net

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interest income. Average earning assets for the second quarter of 2008 increased by approximately \$1.1 billion as compared to the same period in 2007. Refer to the Net Interest Income discussion below for additional information.

For the second quarter of 2008, the Corporation's provision for loan and lease losses amounted to \$41.3 million, compared to \$24.6 million for the same period in 2007. Refer to the discussion under the Risk Management section below for an analysis of the allowance for loan and lease losses and non-performing assets and related ratios. The increase in the provision for 2008 was primarily due to additional reserves allocated to certain impaired commercial and construction loans as well as increases to the reserve factors for potential losses inherent in the loan portfolio associated with the weakening economic conditions in Puerto Rico and the slowdown in the United States housing sector. Additional specific reserves recorded during the second quarter of 2008 for new loans classified as impaired amounted to approximately \$17.7 million. The growth of the Corporation's residential and commercial mortgage loan portfolio also contributed to the increase in the provision for loan and lease losses.

For the quarter ended June 30, 2008, the Corporation's non-interest income amounted to \$12.0 million, compared to \$10.9 million for the quarter ended June 30, 2007. The increase in non-interest income was due to a combination of factors, including lower other-than-temporary impairment charges on equity securities, an increase in point of sale (POS) and ATM interchange fee income, and a recovery in value of servicing rights. Refer to the Non Interest Income discussion below for additional information.

Non-interest expenses for the second quarter of 2008 amounted to \$81.8 million, compared to \$73.5 million for the same period in 2007. The increase in non-interest expenses for 2008 was mainly due to an increase of approximately \$2.9 million in foreclosure-related expenses, mainly maintenance, insurance, repairs and legal expenses for foreclosed properties in the Miami Agency, an increase of \$2.0 million in connection with the new assessment system adopted by the FDIC effective in 2007, an increase of \$1.6 million in employees compensation and benefit expenses due to higher average compensation and related benefits and a \$1.0 million increase in occupancy and equipment expenses to support the expansion of the Corporation's operations. Refer to the Non Interest Expenses discussion below for additional information.

For the second quarter of 2008, the Corporation's income tax benefit amounted to \$9.5 million, compared to an income tax expense of \$6.2 million for the same period in 2007. The positive fluctuation on the financial results was mainly due to the reversal of \$10.6 million of UTBs for positions taken on income tax returns recorded under the provision of FIN 48 because of the lapse of the statute of limitations. Also, higher deferred tax benefits were recorded in connection with a higher provision for

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loan and lease losses and the current income tax provision was lower, excluding the reversal of the FIN 48 contingency, due to lower taxable income.

Total assets as of June 30, 2008 amounted to \$18.8 billion, an increase of \$1.6 billion compared to total assets as of December 31, 2007. The increase in total assets is mainly attributed to the increase in the Corporation's portfolio of investment securities caused by the purchase of approximately \$3.2 billion of MBS during the first six months of 2008 as market conditions presented an opportunity for the Corporation to obtain attractive yields, improve its net interest margin and mitigate the impact of \$1.2 billion of U.S. Agency debentures called by counterparties. Also, the increase in total assets, as compared to the balance as of December 31, 2007, was related to the increase in loan portfolio of \$450.3 million (before the allowance for loan and lease losses) driven by new originations.

As of June 30, 2008, total liabilities amounted to \$17.4 billion, an increase of approximately \$1.6 billion as compared to \$15.8 billion as of December 31, 2007. The increase in total liabilities was mainly attributed to a higher volume of securities sold under repurchase agreements aligned with the increase in MBS. In addition, total liabilities increased due to a higher volume of deposits, an increase of \$493.3 million compared to the balance as of December 31, 2007. Other sources of funding, including FHLB advances increased by \$357.0 million, as compared to December 31, 2007, reflecting the use of alternative sources to replace brokered CDs that matured or were called and to finance lending activities.

Total loan production for the quarter ended June 30, 2008 was \$1.0 billion, compared to \$932.8 million for the comparable period in 2007. The increase in loan production during 2008, as compared to the second quarter of 2007, was mainly due to increases in commercial and residential real estate mortgage loan originations of \$141.2 million and \$54.2 million, respectively. Among other things, residential mortgage loan originations in Puerto Rico were favorably affected by recent legislation approved by the Puerto Rico Government (Act 197) which provides credits when individuals purchase certain new or existing homes. Loan originations of the Corporation covered by Act 197 amounted to approximately \$31.3 million for the second quarter of 2008. The increase in commercial and residential mortgage loan originations was partially offset by a lower loan production of consumer loans, which was negatively impacted by worsening economic conditions in Puerto Rico.

Total non-performing loans as of June 30, 2008 amounted to \$448.5 million compared to \$413.1 million as of December 31, 2007. The increase in non-performing loans was mainly related to the commercial loan portfolio (other than construction loans) and the residential mortgage loan portfolio, which increased by \$53.7 million and \$21.2 million, respectively, partially offset by lower construction and consumer loans in non-accrual status. The increase in non-accruing commercial loans is related to continuing adverse economic conditions in Puerto Rico that caused the classification as non-accrual during the first half of 2008 of several commercial loans originated in Puerto Rico, mainly secured by land and real estate properties, including \$24.6 million of new commercial loans identified as impaired during 2008. Also, there was a classification as non-accrual during the second quarter of 2008 of a participation in a syndicated commercial loan in the U.S. Virgin Islands with a carrying value of \$13.0 million as of June 30, 2008, net of a \$9.1 million charge-off recorded in the second quarter of 2008. The charge-off was lower than the reserve amount of \$11.9 million provided for during the first quarter of 2008, as the loss in this relationship will be lower than originally estimated given recent negotiations for the settlement of the loan.

The decrease in non-accruing construction loans was principally related to the sale of one of the impaired loans in an impaired relationship in the Miami Agency. This relationship was originally identified as impaired during the second quarter of 2007 as reported in previous periodic filings of the Corporation. The loan's carrying amount was \$21.8 million (net of an impairment of \$2.4 million) and was sold for \$22.5 million. Also, during the 2008, the Corporation added approximately \$18.6 million to its other real estate owned (OREO) portfolio, as a result of collateral repossessed in settlement of two other loans in this impaired relationship. As of June 30, 2008, and as a

result of the transactions completed during the fourth quarter of 2007 and first half

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of 2008, there were no outstanding loans associated with this relationship in the Miami Agency. The reduction to \$18.6 million held in the OREO portfolio, net of charge-offs of \$4.2 million, is a significant decrease in the balance of this impaired relationship from the \$60.5 million balance when it was identified as impaired during the first half of 2007. As of the date of the filing of this Form 10-Q, the Corporation has identified interested purchasers for the two foreclosed properties. However, the Corporation cannot predict whether the properties will be ultimately sold to these parties.

The decrease in non-accruing consumer loans resulted from successful collection efforts and net charge-offs of approximately \$13.4 million and \$27.3 million for the second quarter and first half of 2008, respectively.

Consumer loans delinquencies have shown signs of improvement, particularly in the auto loan portfolio, and the net charge offs to average loans ratio on the consumer portfolio (including finance leases) improved during the quarter to 3.02% from 3.20% for the first quarter of 2008.

Although the balance of non-accruing residential mortgage loans increased by \$21.2 million due to adverse economic conditions in Puerto Rico, as compared to the balance as of December 31, 2007, this portfolio has remained stable since the end of the first quarter of 2008 due to improved collection efforts and, to some extent, the impact of loans modified through the loan loss mitigation program that were returned to accruing status as borrowers have made consistent payments over a sustained period. Refer to Risk Management Non-accruing and Non-performing Assets section below for additional information.

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; 6) derivative financial instruments; and 7) income recognition on loans. 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 as of 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 those 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 2007 Annual Report on Form 10-K. There have not been any material changes in the Corporation's critical accounting policies since December 31, 2007.

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, 2008 was \$134.6 million and \$259.1 million, respectively, compared to \$117.2 million and \$234.7 million, respectively, for the comparable periods in 2007. On an adjusted tax equivalent basis, excluding the changes in the fair value of derivative instruments and unrealized gains and losses on SFAS 159 liabilities, net interest income for the quarter and six-month period ended June 30, 2008 was \$144.5 million and \$275.8 million, respectively, compared to \$119.5 million and \$241.3 million, respectively, for the same periods in 2007.

Part I of the following table presents average volumes and rates on an adjusted tax equivalent basis and Part II presents, also on an adjusted tax equivalent basis, the extent to which changes in interest rates and changes in volume of interest-related assets and liabilities have affected the Corporation's net interest income. 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) and, (ii) changes in rate (changes in rate multiplied by prior period volumes). Rate-volume variances (changes in rate multiplied by changes in volume) have been allocated to the changes in volume and rate based upon their respective percentage of the combined totals.

The net interest income is computed on an adjusted tax equivalent basis (for definition and reconciliation of this non-GAAP measure, refer to discussions below) and excluding: (1) the change in the fair value of derivative instruments and (2) unrealized gains or losses on SFAS 159 liabilities.

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Quarter ended June 30,	Average volume		Interest income (1) / expense		Average rate (1)	
	2008	2007	2008	2007	2008	2007
(Dollars in thousands)						
Interest-earning assets:						
Money market investments	\$ 374,559	\$ 424,877	\$ 1,813	\$ 5,288	1.95%	4.99%
Government obligations ⁽²⁾	1,303,468	2,634,794	20,566	39,139	6.35%	5.96%
Mortgage-backed securities	3,806,115	2,340,279	58,034	29,295	6.13%	5.02%
Corporate bonds	6,103	6,964	141	143	9.29%	8.24%
FHLB stock	66,703	44,099	1,140	748	6.87%	6.80%
Equity securities	4,183	8,515		2	0.00%	0.09%
Total investments ⁽³⁾	5,561,131	5,459,528	81,694	74,615	5.91%	5.48%
Residential real estate loans	3,308,950	2,877,844	54,239	46,847	6.59%	6.53%
Construction loans	1,475,995	1,447,779	20,745	31,403	5.65%	8.70%
Commercial loans	5,379,906	4,740,338	73,461	90,738	5.49%	7.68%
Finance leases	376,007	381,609	8,108	8,342	8.67%	8.77%
Consumer loans	1,613,563	1,737,817	46,479	50,794	11.59%	11.72%
Total loans ^{(4) (5)}	12,154,421	11,185,387	203,032	228,124	6.72%	8.18%
Total interest-earning assets	\$ 17,715,552	\$ 16,644,915	\$ 284,726	\$ 302,739	6.46%	7.30%
Interest-bearing liabilities:						
Interest-bearing deposits	\$ 11,045,132	\$ 10,503,431	\$ 98,295	\$ 127,804	3.58%	4.88%
Other borrowed funds	3,724,955	3,648,460	32,351	46,449	3.49%	5.11%
FHLB advances	1,151,861	675,530	9,572	9,001	3.34%	5.34%
Total interest-bearing liabilities ⁽⁶⁾	\$ 15,921,948	\$ 14,827,421	\$ 140,218	\$ 183,254	3.54%	4.96%
Net interest income			\$ 144,508	\$ 119,485		
Interest rate spread					2.92%	2.34%
Net interest margin					3.28%	2.88%

Six-Month Period Ended June 30,	Average volume		Interest income (1) / expense		Average rate (1)	
	2008	2007	2008	2007	2008	2007
(Dollars in thousands)						
Interest-earning assets:						
Money market investments	\$ 402,774	\$ 416,244	\$ 5,072	\$ 10,666	2.53%	5.17%
Government obligations ⁽²⁾	1,786,011	2,681,953	57,711	79,480	6.50%	5.94%
Mortgage-backed securities	3,102,385	2,361,926	92,025	59,268	5.97%	5.06%
Corporate bonds	6,185	6,983	282	288	9.17%	8.27%

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FHLB stock	64,274	42,817	2,261	1,202	7.07%	5.66%
Equity securities	4,186	10,368	11	3	0.53%	0.06%
Total investments ⁽³⁾	5,365,815	5,520,291	157,362	150,907	5.90%	5.51%
Residential real estate loans	3,249,913	2,840,729	105,959	92,368	6.56%	6.56%
Construction loans	1,474,252	1,466,238	44,465	63,216	6.07%	8.69%
Commercial loans	5,301,551	4,755,577	158,901	180,703	6.03%	7.66%
Finance leases	377,004	375,825	16,396	16,579	8.75%	8.90%
Consumer loans	1,633,598	1,755,532	94,535	102,480	11.64%	11.77%
Total loans ^{(4) (5)}	12,036,318	11,193,901	420,256	455,346	7.02%	8.20%
Total interest-earning assets	\$ 17,402,133	\$ 16,714,192	\$ 577,618	\$ 606,253	6.67%	7.31%
Interest-bearing liabilities:						
Interest-bearing deposits	\$ 10,779,267	\$ 10,462,227	\$ 210,271	\$ 252,312	3.92%	4.86%
Other borrowed funds	3,697,892	3,742,210	70,845	95,470	3.85%	5.14%
FHLB advances	1,109,465	646,242	20,720	17,198	3.76%	5.37%
Total interest-bearing liabilities ⁽⁶⁾	\$ 15,586,624	\$ 14,850,679	\$ 301,836	\$ 364,980	3.89%	4.96%
Net interest income			\$ 275,782	\$ 241,273		
Interest rate spread					2.78%	2.35%
Net interest margin					3.19%	2.91%

(1) On an adjusted tax equivalent basis. The adjusted tax equivalent yield was estimated by dividing the interest rate spread on exempt assets by (1 less Puerto Rico statutory tax rate of 39%) 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 and unrealized gains or losses on SFAS 159 liabilities 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 gains and losses in available-for-sale securities are excluded from the average volumes.
- (4) Average loan balances include the average of non-accruing loans, on which interest income is recognized when collected.
- (5) Interest income on loans includes \$2.9 million and \$2.4 million for the second quarter of 2008 and 2007, respectively, and \$5.4 million and \$5.9 million for

the six-month
period ended
June 30, 2008 and
2007,
respectively, of
income from
prepayment
penalties and late
fees related to the
Corporation's loan
portfolio.

- (6) Unrealized gains
and losses on
SFAS 159
liabilities are
excluded from the
average volumes.

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	Quarter ended June 30, 2008 compared to 2007 Increase (decrease) Due to:			Six-month period ended June 30, 2008 compared to 2007 Increase (decrease) Due to:		
	Volume	Rate	Total	Volume	Rate	Total
	(In thousands)					
Interest income on interest-earning assets:						
Money market investments	\$ (565)	\$ (2,910)	\$ (3,475)	\$ (334)	\$ (5,260)	\$ (5,594)
Government obligations	(20,470)	1,897	(18,573)	(28,387)	6,618	(21,769)
Mortgage-backed securities	21,234	7,505	28,739	20,858	11,899	32,757
Corporate bonds	(20)	18	(2)	(36)	30	(6)
FHLB stock	384	8	392	707	352	1,059
Equity securities	(1)	(1)	(2)	(10)	18	8
Total investments	562	6,517	7,079	(7,202)	13,657	6,455
Residential real estate loans	6,941	451	7,392	13,506	85	13,591
Construction loans	493	(11,151)	(10,658)	435	(19,186)	(18,751)
Commercial loans	10,452	(27,729)	(17,277)	18,999	(40,801)	(21,802)
Finance leases	(136)	(98)	(234)	76	(259)	(183)
Consumer loans	(3,704)	(611)	(4,315)	(6,823)	(1,122)	(7,945)
Total loans	14,046	(39,138)	(25,092)	26,193	(61,283)	(35,090)
Total interest income	14,608	(32,621)	(18,013)	18,991	(47,626)	(28,635)
Interest expense on interest-bearing liabilities:						
Interest-bearing deposits	5,635	(35,144)	(29,509)	7,432	(49,473)	(42,041)
Other borrowed funds	797	(14,895)	(14,098)	(1,109)	(23,516)	(24,625)
FHLB advances	5,159	(4,588)	571	10,580	(7,058)	3,522
Total interest expense	11,591	(54,627)	(43,036)	16,903	(80,047)	(63,144)
Change in net interest income	\$ 3,017	\$ 22,006	\$ 25,023	\$ 2,088	\$ 32,421	\$ 34,509

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 sales of investments held by the Corporation's international banking entities are tax-exempt under the 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 of 39.0%) and adding to it the average cost of interest-bearing liabilities. The computation considers the interest expense disallowance required by the Puerto Rico tax law.

The presentation of net interest income excluding the effects of the changes in the fair value of derivative instruments and unrealized gains or losses on SFAS 159 liabilities provides additional information about the Corporation's net interest income and facilitates comparability and analysis. The changes in the fair value of the derivative instruments and unrealized gains or losses on SFAS 159 liabilities 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.

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The following table reconciles interest income on an adjusted 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,	
	2008	2007	2008	2007
Interest income on interest-earning assets on a tax equivalent basis	\$ 284,726	\$ 302,740	\$ 577,618	\$ 606,254
Less: tax equivalent adjustments	(13,761)	(3,436)	(22,843)	(7,424)
Plus: net unrealized gain on derivatives	5,643	6,567	920	5,626
Total interest income	\$ 276,608	\$ 305,871	\$ 555,695	\$ 604,456

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

<i>(In thousands)</i>	Quarter ended June 30,		Six-month period ended June 30,	
	2008	2007	2008	2007
Unrealized gain on derivatives (economic undesignated hedges):				
Interest rate caps	\$ 3,095	\$ 5,049	\$ 880	\$ 4,348
Interest rate swaps on loans	2,548	1,518	40	1,278
Net unrealized gain on derivatives (economic undesignated hedges)	\$ 5,643	\$ 6,567	\$ 920	\$ 5,626

The following table summarizes the components of interest expense for the quarter and six-month periods ended June 30, 2008 and 2007. As previously stated, the net interest margin analysis excludes the changes in the fair value of derivatives and unrealized gains or losses on SFAS 159 liabilities.

<i>(In thousands)</i>	Quarter ended June 30,		Six-month period ended June 30,	
	2008	2007	2008	2007
Interest expense on interest-bearing liabilities	\$ 148,867	\$ 177,147	\$ 314,704	\$ 352,868
Net interest (realized) incurred on interest rate swaps	(12,905)	3,507	(19,947)	7,347
Amortization of placement fees on brokered CDs	4,256	2,114	7,079	4,258
Amortization of placement fees on medium-term notes		486		507
Interest expense excluding net unrealized loss (gain) on derivatives (economic undesignated hedges), net unrealized (gain) loss on SFAS 159 liabilities and accretion of basis adjustment	140,218	183,254	301,836	364,980
Net unrealized loss (gain) on derivatives (economic undesignated hedges) and SFAS 159 liabilities	1,784	7,348	(5,205)	6,887
Accretion of basis adjustment		(1,946)		(2,061)

Total interest expense	\$ 142,002	\$ 188,656	\$ 296,631	\$ 369,806
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The following table summarizes the components of the net unrealized gains and losses on derivatives (economic undesignated hedges) and net unrealized gains and losses on SFAS 159 liabilities which are included in interest expense.

	Quarter ended June 30,		Six month period ended June 30,	
<i>(In thousands)</i>	2008	2007	2008	2007
Unrealized loss (gain) on derivatives (economic undesignated hedges):				
Interest rate swaps and other derivatives on brokered CDs	\$ 29,934	\$ 81,685	\$ (25,402)	\$ 62,058
Interest rate swaps and other derivatives on medium-term notes	314	1,522	1	1,357
Net unrealized loss (gain) on derivatives (economic undesignated hedges)	\$ 30,248	\$ 83,207	\$ (25,401)	\$ 63,415
Unrealized (gain) loss on SFAS 159 liabilities:				
Unrealized (gain) loss on brokered CDs	(28,462)	(75,607)	21,095	(56,398)
Unrealized gain on medium-term notes	(2)	(252)	(899)	(130)
Net unrealized (gain) loss on SFAS 159 liabilities	\$ (28,464)	\$ (75,859)	\$ 20,196	\$ (56,528)
Net unrealized loss (gain) on derivatives (economic undesignated hedges) and SFAS 159 liabilities	\$ 1,784	\$ 7,348	\$ (5,205)	\$ 6,887

The following table summarizes the components of the accretion of basis adjustment which are included in interest expense for 2007:

	Quarter ended June 30,		Six month period ended June 30,	
<i>(In thousands)</i>	2008	2007	2008	2007
Accretion of basis adjustment:				
Interest rate swaps on medium-term notes	\$	\$ (1,946)	\$	\$ (2,061)

Interest income on interest-earning assets primarily represents interest earned on loans receivable 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 economically 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 not elected for fair value option under SFAS 159).

Unrealized gains or losses on derivatives represent changes in the fair value of derivatives, primarily interest rate swaps, that economically hedge liabilities (i.e., brokered CDs and medium-term notes) or assets (i.e., loans).

Unrealized gains or losses on SFAS 159 liabilities represent the change in the fair value of liabilities (medium-term notes and brokered CDs), other than the accrual of interests, for which the Corporation elected the fair value option under SFAS 159.

Effective January 1, 2007, the Corporation discontinued the use of fair value hedge accounting under SFAS 133 for interest rate swaps that hedge the Corporation's \$150 million medium-term note. The Corporation's decision was based on the determination that the interest rate swaps were no longer effective in offsetting the changes in the fair value of the \$150 million medium-term note. The basis adjustment represents the basis differential between the market value and the book value of the \$150 million medium-term note recognized at the inception of fair value hedge accounting on April 3, 2006, as well as changes in fair value recognized after the inception until the discontinuance of fair value hedge accounting on January 1, 2007, that was amortized or accreted based on the expected maturity of the liability as a yield adjustment. The \$150 million medium-term note was redeemed prior to its maturity during the second quarter of 2007.

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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 (receive fixed/pay floating). Refer to Note 8 Derivative Instruments and Hedging Activities of the accompanying unaudited consolidated financial statements for further details 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.

Net interest income increased 15% to \$134.6 million for the second quarter of 2008 from \$117.2 million in the second quarter of 2007 and by 10% to \$259.1 million for the first six months of 2008 from \$234.7 million in the first half of 2007. First BanCorp's net interest spread and margin, on an adjusted tax equivalent basis, for the quarter and six-month period ended June 30, 2008 were 2.92% and 3.28% and 2.78% and 3.19%, respectively, compared to 2.34% and 2.88% and 2.35% and 2.91%, respectively, for the same periods in 2007. The increase in net interest income, spread and margin reflects the effect of both changes in interest rates and changes in the mix and volume of the Corporation's balance sheet. The average rate paid by the Corporation on its interest-bearing liabilities decreased by 142 and 107 basis points during the second quarter and first half of 2008 when compared to same periods in 2007, mainly due to the decrease in short-term rates and its effect in the mix of borrowings. The decrease in short-term interest rates resulted in the call by counterparties of approximately \$1.4 billion of interest rate swaps used by the Corporation to convert fixed-rate brokered CDs to a floating rate, during the second quarter of 2008 (\$2.4 billion for the first half of 2008). Following the cancellation of these swaps, the Corporation exercised its call option on approximately \$1.3 billion swapped-to-floating brokered CDs (\$2.4 billion for the first half of 2008). The current interest rate scenario has allowed the Corporation to replace brokered CDs that matured or were called with brokered CDs that are not hedged with interest rate swaps and has lower rates than the brokered CDs that were hedged with interest rate swaps and, to a lesser extent, with other lower cost borrowings such as FHLB advances. This has reduced the overall cost of funding. By reducing the exposure to swapped-to-floating interest rate swaps that hedged brokered CDs, the Corporation locked-in interest rates for longer periods, thus reducing interest rate risk.

The drop in rates in the long end of the yield curve adversely affected interest income due to the early redemption through call exercises in the second quarter of 2008 of approximately \$1.1 billion of U.S. Agency debentures with an average yield of 5.87% (\$1.2 billion for the first half of 2008 with an average yield of 5.88%). In spite of this, and given market opportunities, the Corporation bought U.S. government sponsored agency MBS amounting to \$2.2 billion at an average yield of 5.50% during the second quarter of 2008 (\$3.2 billion at an average yield of 5.44% for the first half of 2008) which is significantly higher than the cost of borrowings used to finance the purchase of such assets. The increase in the volume of the investment portfolio also contributed to a higher net interest income during the first half of 2008 as reflected in the increase on the weighted-average yield of investment securities of 43 and 39 basis points during the second quarter and first half of 2008, respectively, compared to the same periods in 2007. Average earning assets increased by approximately \$1.1 billion for the second quarter of 2008, as compared to the same period in 2007 and by \$687.9 million for the first half of 2008, as compared to the same period a year ago.

Also, a lower overall average cost of funds is related to the repricing of borrowings as reflected to some extent by net interest settlement income of approximately \$12.9 million and \$19.9 million for the second quarter and first half of 2008, respectively, compared to net interest settlement expenses of \$3.5 million and \$7.3 million,

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respectively, for the comparable periods in 2007. Meanwhile, net interest income was adversely affected by lower yields in the loan portfolio attributed to the re-pricing of variable rate commercial and construction loans tied to short-term indexes, the increase in the balance of non-performing loans, and market disruptions in the U.S. mainland which have increased the spread between the interest rates on Brokered CDs and LIBOR/swap rates and have kept the Corporation from capturing the full benefit of the decrease in interest rates in the wholesale funding source.

As shown on the tables above, the results of operations for the second quarter and first half of 2008 and 2007 were impacted by changes in the valuation of derivative instruments that economically hedge the Corporation's brokered CDs and medium-term notes and unrealized gains and losses on SFAS 159 liabilities. The change in the valuation of derivative instruments, net unrealized gains and losses on SFAS 159 liabilities and the basis adjustment (for 2007 results) recorded as part of net interest income resulted in a net gain of \$3.9 million and \$6.1 million for the second quarter and first half of 2008, respectively, compared to a net gain of \$1.2 million and \$0.8 million, respectively, for the comparable periods in 2007. The results for 2008 include a net gain of \$4.0 million for the second quarter and of \$4.4 million for the first half, resulting from the reversal of the cumulative mark-to-market valuation of swaps and brokered CDs called. During the first half of 2008, approximately \$2.4 billion of interest rate swaps were cancelled by the counterparties, mainly due to lower 3-month LIBOR and the Corporation, following the swaps cancellation, exercised its call option on approximately \$2.4 billion swapped to floating brokered CDs.

On an adjusted tax equivalent basis, net interest income, excluding the changes in the fair value of derivative instruments and unrealized gains and losses on SFAS 159 liabilities, increased by \$25.0 million, or 21%, and \$34.5 million, or 14%, for the second quarter and first half of 2008, respectively, compared to the same periods in 2007. The increase in the adjusted tax equivalent net interest income was principally due to an increase in tax-equivalent adjustments and the above mentioned discussions about declining interest rates and changes in the mix and volume of the Corporation's balance sheet. The adjusted tax equivalent basis includes an adjustment that increases interest income on tax-exempt securities and loans by an amount which makes tax-exempt income comparable, on a pre-tax basis, to the Corporation's taxable income. For the second quarter and first half of 2008, tax-equivalent adjustments amounted to \$13.8 million and \$22.8 million, respectively, compared to \$3.4 million and \$7.4 million, respectively, for the comparable periods in 2007. The increase in tax-equivalent adjustments was mainly related to increases in the interest rate spread on tax-exempt assets due to the declines in short-term interest rates.

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 and lease 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 economies of Puerto Rico, the United States (principally the state of Florida), the U.S. Virgin Islands and the British Virgin Islands may contribute to delinquencies and defaults, thus necessitating additional reserves.

For the quarter and six-month period ended on June 30, 2008, the Corporation provided \$41.3 million and \$87.1 million, respectively, for loan and lease losses, as compared to \$24.6 million and \$49.5 million, respectively, for the same periods in 2007.

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

First BanCorp's provision for loan and lease losses for the quarter and six-month period ended June 30, 2008 increased by \$16.7 million, or 68%, and by \$37.6 million, or 76%, respectively, compared to the same period in 2007. The increase in the provision for the 2008 periods was primarily due to additional reserves allocated to certain impaired commercial and construction loans as well as increases to the reserve factors for potential losses inherent in the loans portfolio associated with the weakening economic conditions in Puerto Rico and the slowdown in the United States housing sector. Increases to reserve factors due to economic conditions in Puerto Rico include higher provisions for the residential mortgage loan portfolio. Puerto Rico's economy continued in a recession caused by, among other things, higher utilities prices, higher taxes, government budgetary imbalances and higher oil prices. The increase in non-accruing loans coupled with the growth of the Corporation's commercial and residential mortgage loans portfolio also contributed to the increase in the provision for loan and lease losses.

The Corporation identified in the first half of 2008 several commercial and construction loans amounting to \$239.6 million that it determined should be classified as impaired, of which \$188.6 million had a specific reserve of \$27.4 million. Refer to the discussion under **Credit Risk Management** below for additional information regarding the composition of impaired loans.

The increase in the provision for 2008 periods, as compared to 2007, also reflects higher reserve factors for the Miami Agency construction loan portfolio since the second half of 2007.

The Corporation maintains a constant monitoring of the Miami Agency portfolio. Recent loan reviews showed that the Miami Agency construction loan portfolio has an added susceptibility to current general market conditions and real estate trends in the U.S. market due to the overbuilding in certain areas and downward price pressures. Based on these factors and a detailed review of the portfolio, the Corporation determined it was prudent to further increase general provisions allocated to this portfolio.

Refer to the discussion under **Credit Risk Management** below for additional information concerning the economy in geographic areas where the Corporation does business and the Corporation's outlook for the performance of its loan portfolio.

Table of Contents**Non-Interest Income**

	Quarter Ended June 30,		Six-Month Period Ended June 30,	
	2008	2007	2008	2007
	(In thousands)			
Other service charges on loans	\$ 1,418	\$ 2,418	\$ 2,731	\$ 4,209
Service charges on deposit accounts	3,191	3,185	6,555	6,376
Mortgage banking activities	804	351	1,123	1,113
Rental income	579	669	1,122	1,333
Insurance income	2,551	2,625	5,279	5,574
Other operating income	4,138	3,091	9,058	6,399
Non-interest income before net (loss) gain on investments, net gain on partial extinguishment and recharacterization of a secured commercial loan to a local financial institution and gain on sale of credit card portfolio	12,681	12,339	25,868	25,004
Gain on VISA shares			9,342	
Net (loss) gain on sale of investments	(190)		6,661	(732)
Impairment on investments	(489)	(1,436)	(489)	(2,863)
Net (loss) gain on investments	(679)	(1,436)	15,514	(3,595)
Gain on partial extinguishment and recharacterization of a secured commercial loan to a local financial institution				2,497
Gain on sale of credit card portfolio				2,819
Total	\$ 12,002	\$ 10,903	\$ 41,382	\$ 26,725

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 and losses on mortgage banking activities; and net gains and losses on investments and impairments.

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 sales of loans and revenues earned for administering residential mortgage loans originated by the Corporation and subsequently sold with servicing retained. In addition, lower-of-cost-or-market valuation adjustments to the Corporation's residential mortgage loans held for sale and servicing rights portfolio, if any, 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.

Insurance income consists of insurance commissions earned by the Corporation's subsidiary, FirstBank Insurance Agency, Inc., and the Bank's subsidiary in the U.S. 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, credit card and point of sale (POS) interchange fees and check and cash management fees.

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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.

Non-interest income increased 10% to \$12.0 million for the second quarter of 2008 from \$10.9 million for the same period a year ago. This is due to a combination of factors, including lower other-than-temporary impairment charges on equity securities, an increase in POS and ATM interchange fee income and a recovery in value of servicing rights. For the second quarter of 2008, other-than-temporary impairment charges on investment securities amounted to \$0.5 million, compared to a \$1.4 million charge recorded for the same period a year ago. POS and ATM interchange fee income increased by approximately \$0.7 million, based on a change in the calculation of interchange fees charged between financial institutions in Puerto Rico from the fixed fee calculation to a percentage of the sale amount since the second half of 2007. Recent increases in long-term rates and lower prepayment rates caused a recovery of \$0.7 million in the value of servicing rights for the second quarter of 2008, as compared to \$0.1 million for the comparable period a year ago. The above mentioned factors were partially offset by a decrease of \$1.0 million in fees and service charges on loans primarily related to certain non-recurrent transactions recorded during the second quarter of last year including income of \$0.5 million related to syndication fees on a commercial loan and fees of approximately \$0.6 million in connection with a credit card portfolio interim servicing agreement. This interim servicing agreement was related to a credit card portfolio sold by the Corporation early in 2007.

First BanCorp's non-interest income for the first half of 2008 amounted to \$41.4 million, compared to \$26.7 million for the same period in 2007. Aside from the items mentioned above, the increase in non-interest income was mainly attributable to a one-time gain of \$9.3 million on the sale of part of the Corporation's investment in VISA, Inc. in connection with VISA's initial public offering, coupled with a realized gain of \$6.9 million on the sale of approximately \$242 million of 5.5% FNMA fixed-rate MBS during the first quarter of 2008. Also, on a comparative basis to the first half of 2007, non-interest income was favorably affected by the lower other-than-temporary impairment charges on investment securities which decreased to \$0.5 million for the first half of 2008 compared to an impairment charge of \$2.9 million recorded in the first half of 2007. The impact of these transactions is partially offset, when compared to the first quarter of 2007, by the recognition during the first quarter of 2007 of gains of \$2.8 million on the sale of a credit card portfolio and of \$2.5 million on the partial extinguishment and recharacterization of a secured commercial loan to a local financial institution.

Table of Contents**Non-Interest Expenses**

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

	Quarter Ended		Six-Month Period	
	June 30,		Ended	
	2008	2007	2008	2007
	(In thousands)			
Employees compensation and benefits	\$ 34,994	\$ 33,352	\$ 71,320	\$ 69,724
Occupancy and equipment	15,541	14,496	30,520	28,878
Deposit insurance premium	2,345	328	4,691	684
Other taxes, insurance and supervisory fees	5,588	5,124	11,252	10,041
Professional fees recurring	3,620	3,343	8,180	6,745
Professional fees non-recurring	1,299	2,265	1,798	5,260
Servicing and processing fees	2,381	1,656	4,969	3,375
Business promotion	4,802	4,864	9,067	9,794
Communications	2,250	2,169	4,523	4,397
Foreclosure-related expenses	3,172	266	6,428	541
Other	5,771	5,591	11,202	13,379
Total	\$ 81,763	\$ 73,454	\$ 163,950	\$ 152,818

Non-interest expenses increased 11% to \$81.8 million for the second quarter of 2008 from \$73.5 million for the same period a year ago and by 7% to \$164.0 million for the first half of 2008 from \$152.9 million for the first half of 2007. Expenses increased primarily due to higher foreclosure-related expenses, deposit insurance premium payments, employees compensation and benefits and occupancy and equipment expenses partially, offset by a decrease in professional fees and in other operating expenses.

Foreclosure-related expenses increased by approximately \$2.9 million and \$5.9 million for the second quarter and first half of 2008, respectively, as compared to the same periods a year ago mainly associated with repairs, maintenance, insurance and legal expenses for foreclosed properties in the Miami Agency and includes valuation adjustments and losses on sale of foreclosed properties amounting to approximately \$0.7 million for the second quarter of 2008 on certain residential and commercial income properties in Puerto Rico.

Deposit insurance premium expense increased by \$2.0 million and \$4.0 million for the second quarter and first half of 2008, respectively, as compared to the same periods a year ago because of the new assessment system adopted by the FDIC effective in 2007. The Corporation used available one-time credits to offset the premium increase during the first and second quarter of 2007.

Employees compensation and benefit expenses increased by \$1.6 million for both the second quarter and first half of 2008, as compared to the same periods a year ago, primarily due to a higher average compensation and related fringe benefits, partially offset by a decrease in expenses related to the fair value of stock options granted to employees. During the first quarter of 2007, the Corporation recorded \$2.8 million in stock-based compensation expense; no stock options were granted during 2008.

Occupancy and equipment expenses increased by \$1.0 million and \$1.6 million for the second quarter and first half of 2008, respectively, as compared to the same periods a year ago primarily due to higher software and leasehold improvements amortization to support the expansion of the Corporation's operations.

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Professional fees decreased by \$0.7 million and \$2.0 million during the second quarter and first half of 2008, respectively, as compared to the same periods a year ago. The decrease was primarily attributable to lower legal, accounting and consulting fees due to, among other things, the conclusion of the process to file all required reports under the federal securities laws and the settlement of legal and regulatory matters.

For the first half of 2008, other expenses decreased by \$2.2 million, compared to the first half of 2007. The decrease reflects the impact of approximately \$3.3 million in costs associated with capital raising efforts recorded in the first half of 2007.

Notwithstanding the above mentioned increases in non-interest expenses, the Corporation's efficiency ratio for the second quarter and first half of 2008 was 55.77% and 54.57%, respectively, compared to 57.33% and 58.47% for the same periods a year ago, as the Corporation has been able to continue the expansion of its operations without incurring substantial additional operating expenses.

Provision for Income Tax

Income tax expense includes Puerto Rico and Virgin Islands income taxes as well as applicable U.S. 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. 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%. 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 entities (IBEs) of the Corporation and the Bank and through the Bank's subsidiary, FirstBank Overseas Corporation, in which the interest income and gain on sales is exempt from Puerto Rico and U.S. income taxation. 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 20% of the bank's total net taxable income.

For the quarter and six-month period ended June 30, 2008, the Corporation recognized an income tax benefit of \$9.5 million and \$17.2 million, respectively, compared to an income tax expense of \$6.2 million and \$12.4 million, respectively, for the same periods in 2007. The positive fluctuation on the financial results was mainly due to two non-recurrent transactions: (i) a reversal of \$10.6 million of UTBs during the second quarter of 2008 for positions taken on income tax returns recorded under the provisions of FIN 48, as explained below, and (ii) the recognition of an income tax benefit of \$5.4 million in connection with an agreement entered into with the Puerto Rico Department of Treasury during the first quarter of 2008 that establishes a multi-year allocation schedule for deductibility of the payment of \$74.25 million made by the Corporation during 2007 to settle the securities class action suit. Also, higher deferred tax benefits were recorded in connection with a higher provision for loan and lease losses, and the current income tax provision was lower, excluding the reversal of the FIN 48 contingency, due to lower taxable income.

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During the second quarter of 2008, the Corporation reversed UTBs by approximately \$7.1 million and accrued interest of \$3.5 million as a result of a lapse of the applicable statute of limitations for taxable year 2003. The Corporation does not anticipate any significant changes to its UTBs within the next 12 months. The amount of UTBs may increase or decrease in the future for various reasons, including changes in the amounts for current tax year positions, expiration of open income tax returns due to the applicable statute of limitations, changes in management's judgment about the level of uncertainty, status of examinations, litigation and legislative activity and the addition or elimination of uncertain tax positions.

As of June 30, 2008, 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 asset will not be realized and, thus, established a valuation allowance of \$6.6 million, compared to a valuation allowance of \$4.9 million as of December 31, 2007. As of June 30, 2008, the deferred tax asset, net of the valuation allowance of \$6.6 million, amounted to approximately \$105.9 million compared to \$90.1 million, net of the valuation allowance of \$4.9 million as of December 31, 2007.

For additional information relating to income taxes, see Note 15 in the accompanying notes to the unaudited interim consolidated financial statements.

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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.

Total loan production for the quarter and six-month period ended June 30, 2008 was \$1.0 billion and \$2.1 billion, respectively, compared to \$932.8 million and \$1.9 billion, respectively, for the comparable periods in 2007. The increase in loan production was mainly due to increases in commercial and residential real estate mortgage loan originations. The increase in commercial and residential mortgage loan originations was partially offset by a lower loan production of consumer loans and finance leases, which was negatively impacted by worsening economic conditions in Puerto Rico.

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

<i>(In thousands)</i>	Quarter ended June 30,		Six-month period ended June 30,	
	2008	2007	2008	2007
Residential real estate	\$ 205,542	\$ 151,362	\$ 391,360	\$ 319,701
Commercial and construction	652,884	575,954	1,337,874	1,161,881
Finance leases	28,784	35,973	58,086	83,145
Consumer	140,064	169,473	277,637	342,788
Total loan production	\$ 1,027,274	\$ 932,762	\$ 2,064,957	\$ 1,907,515

Residential Real Estate Loans

Residential mortgage loan production for the second quarter and first half of 2008 increased by \$54.2 million, or 36%, and \$71.7 million, or 22%, respectively, compared to the same periods in 2007. These loans are mainly fully amortizing fixed-rate loans. The residential mortgage loan production was favorably affected by recent legislation approved by the Puerto Rico Government (Act 197) which provides credits to lenders and borrowers when individuals purchase certain new or existing homes.

The incentives are as follows: (a) for a new constructed home that will constitute the individual's principal residence, a credit equal to 20% of the sales price or \$25,000, whichever is lower; (b) for new constructed homes that will not constitute the individual's principal residence, a credit of 10% of the sales price or \$15,000, whichever is lower; and (c) for existing homes, a credit of 10% of the sales price or \$10,000, whichever is lower.

From the homebuyer's perspective: (1) the individual may benefit from the credit no more than twice; (2) the amount of credit granted will be credited against the principal amount of the mortgage; (3) the individual must acquire the property before December 31, 2008; and (4) for new constructed homes constituting the principal residence and existing homes, the individual must live in it as his or her principal residence for at least three consecutive years. Noncompliance with this requirement will affect only the homebuyer's credit and not the tax credit granted to the financial institution.

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From the financial institution's perspective: (1) the credit may be used against income taxes, including estimated taxes, for years commencing after December 31, 2007 in three installments, subject to certain limitations, between January 1, 2008 and June 30, 2011; (2) the credit may be ceded, sold or otherwise transferred to any other person; and (3) any tax credit not used in a given tax year, as certified by the Secretary of Treasury, may be claimed as a refund.

Loan originations of the Corporation covered by Act 197 amounted to approximately \$31.3 million and \$62.7 million for the second quarter and first half of 2008, respectively. Residential mortgage loan originations increase was also related to higher purchases, which amounted to \$57.7 million and \$116.9 million for the second quarter and first half of 2008, respectively, compared to \$49.7 million and \$99.5 million, respectively, for the comparable periods in 2007.

Residential real estate loans represent 19% of total loans originated and purchased for the first half of 2008. The Corporation's strategy is to penetrate markets by providing customers with a variety of high quality mortgage products. The Corporation's residential mortgage loan originations 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. 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 focuses on building relationships with realtors by providing resources, office amenities and personnel to assist real estate brokers in building their individual businesses and closing transactions. FirstMortgage's 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 2008 increased by \$76.9 million, or 13%, and by \$176.0 million, or 15%, compared to the same periods in 2007. The increase in commercial and construction loan production was experienced in both geographic segments, Puerto Rico and Miami. Commercial loans originations in Puerto Rico increased by approximately \$226.5 million for the first half of 2008, as compared to the same period in 2007, and in the Miami Agency increased by \$61.1 million driven by a commercial loan secured by real estate amounting to \$52.5 million to finance the acquisition of a commercial office complex. This was partially offset by lower construction loan originations in the Miami Agency, which decreased by \$74.2 million for the first half of 2008, as compared to the first half of 2007 due to the slowdown in the U.S. housing market and the strategic decision by the Corporation to reduce its exposure to condo-conversion loans in the Miami Agency. Also, there was a decrease in construction loan originations in Puerto Rico due to current weakening economic conditions.

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. The Corporation has expanded its distribution network and participation in the commercial loans middle-market segment by focusing on customers with financing needs in amounts up to \$5 million. The Corporation established 5 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 2008, consumer loan originations decreased by \$29.4 million, or 17%, and by

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\$65.2 million, or 19%, respectively, compared to the same periods in 2007. The decrease in consumer loan originations was mainly due to adverse economic conditions in Puerto Rico.

Finance Leases

For the second quarter and first half of 2008, finance lease originations, which are mostly composed of loans to individuals to finance the acquisition of a motor vehicle, decreased by \$7.2 million, or 20%, and by \$25.1 million, or 30%, as compared to the same periods in 2007 also affected by adverse economic condition in Puerto Rico.

Assets

Total assets as of June 30, 2008 amounted to \$18.8 billion as compared to \$17.2 billion as of December 31, 2007, an increase of \$1.6 billion. This is mainly attributable to the increase in the Corporation's portfolio of MBS resulting from the aforementioned purchase of approximately \$3.2 billion during the first half of 2008 as market conditions presented an opportunity for the Corporation to obtain attractive yields, improve its net interest margin and mitigate the impact of \$1.2 billion U.S. Agency debentures called by counterparties. Also, the increase in total assets, as compared to the balance as of December 31, 2007, was related to the increase in the loan portfolio of \$450.3 million (before allowance for loan and lease losses) driven by new originations.

Loan Portfolio

The composition of the Corporation's loan portfolio, including loans held for sale, for the periods indicated is as follows:

<i>(In thousands)</i>	June 30, 2008	December 31, 2007
Residential real estate loans	\$ 3,393,934	\$ 3,164,421
Commercial loans:		
Construction loans	1,467,544	1,454,644
Commercial real estate loans	1,324,509	1,279,251
Commercial loans	3,502,929	3,231,126
Loans to local financial institutions collateralized by real estate mortgages	591,674	624,597
Commercial loans	6,886,656	6,589,618
Finance leases	373,588	378,556
Consumer and other loans	1,595,867	1,667,151
Total loans	\$ 12,250,045	\$ 11,799,746

As of June 30, 2008, the Corporation's total loans increased by \$450.3 million, when compared with the balance as of December 31, 2007. The increase in the Corporation's total loans primarily relates to new loans originated, in particular residential real estate and commercial loans.

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Of the total gross loan portfolio of \$12.3 billion as of June 30, 2008, approximately 80% has credit risk concentration in Puerto Rico, 12% in the United States (mainly in the state of Florida) and 8% in the Virgin Islands, as shown in the following table.

As of June 30, 2008	Puerto Rico	Virgin Islands	United States	Total
	(In thousands)			
Residential real estate loans, including loans held for sale	\$ 2,534,253	\$ 461,157	\$ 398,524	\$ 3,393,934
Construction loans (1)	725,778	158,650	583,116	1,467,544
Commercial real estate loans	838,986	61,341	424,182	1,324,509
Commercial loans	3,332,846	136,626	33,457	3,502,929
Loans to local financial institutions collateralized by real estate mortgages	591,674			591,674
Total commercial loans	5,489,284	356,617	1,040,755	6,886,656
Finance leases	373,588			373,588
Consumer loans	1,417,815	133,241	44,811	1,595,867
Total loans, gross	\$ 9,814,940	\$ 951,015	\$ 1,484,090	\$ 12,250,045

(1) United States construction loans include approximately \$250.4 million of condo-conversion loans originated by the Miami Agency.

Residential Real Estate Loans

As of June 30, 2008, the Corporation's residential real estate loan portfolio increased by \$229.5 million, or 7%, as compared to the balance as of December 31, 2007. The Corporation has diversified its loan portfolio by increasing the concentration of residential real estate loans. More than 90% of the Corporation's residential mortgage loan portfolio consists of fixed-rate, fully amortizing, full documentation loans. In accordance with the Corporation's underwriting guidelines, residential real estate loans are mostly fully documented loans, and the Corporation is not actively involved in the origination and purchase of negative amortization loans or adjustable-rate mortgage loans.

Commercial and Construction Loans

As of June 30, 2008, the Corporation's commercial and construction loan portfolio increased by \$297.0 million, as compared to the balance as of December 31, 2007. The Corporation has been able to grow its portfolio with new originations from corporate customers as well as 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's largest loan concentration of \$360.9 million is with one mortgage originator in Puerto Rico, Doral Financial Corporation, as of June 30, 2008. Together with the Corporation's next larger loan concentration of \$230.8 million with another mortgage originator in Puerto Rico, R&G Financial Corporation (R&G Financial), the Corporation's total loans granted to these mortgage originators amounted to \$591.7 million as of June 30, 2008. These commercial loans are secured by individual mortgage loans on residential and commercial real estate. In December 2005, the Corporation obtained a waiver from the Office of the Commissioner of Fina