FIRST FINANCIAL BANCORP /OH/
Form 10-Q
August 01, 2006

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

þ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2006

OR

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ____________________ to ____________________

Commission file number 0-12379
FIRST FINANCIAL BANCORP.
(Exact name of registrant as specified in its charter)

Ohio	**31-1042001**
(I.R.S. Employer incorporation or organization)	**(State or other jurisdiction of Identification No.)**
300 High Street, Hamilton, Ohio	**45011**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (513) 867-5447

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

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

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

Yes o No þ

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

Class	**Outstanding at July 28, 2006**
Common stock, No par value	**39,661,241**

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PART I FINANCIAL INFORMATION
ITEM I FINANCIAL STATEMENTS
FIRST FINANCIAL BANCORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	June 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Cash and due from banks	$ 152,581	$ 163,281
Federal funds sold and securities purchased under agreements to resell	79,000	98,000
Investment securities held-to-maturity	8,571	12,555
(market value $8,681 at June 30, 2006 and $12,768 at December 31, 2005)		
Investment securities available-for-sale, at market value	326,633	554,673
Other investments	34,827	40,755
Loans:		
Commercial	646,662	582,594
Real estate construction	95,603	86,022
Real estate commercial	640,869	646,079
Real estate retail	721,383	772,334
Installment, net of unearned	478,437	515,200
Credit card	22,563	22,936
Lease financing	1,396	2,258
Total loans	2,606,913	2,627,423
Less:		
Allowance for loan losses	30,085	42,485
Net loans	2,576,828	2,584,938
Loans held for sale	30,747	0
Premises and equipment	78,707	73,025
Goodwill	28,261	28,116
Other intangibles	6,927	7,920
Accrued interest and other assets	132,303	127,545
TOTAL ASSETS	$ 3,455,385	$ 3,690,808
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 433,372	$ 440,988
Interest-bearing	2,495,040	2,484,451
Total deposits	2,928,412	2,925,439
Short-term borrowings:		
Federal funds purchased and securities sold under agreements to repurchase	48,596	66,634

Other	36,500	45,000
Total short-term borrowings	85,096	111,634
Federal Home Loan Bank long-term debt	82,025	286,655
Other long-term debt	30,930	30,930
Accrued interest and other liabilities	36,688	36,269
TOTAL LIABILITIES	3,163,151	3,390,927
SHAREHOLDERS EQUITY		
Common stock no par value		
Authorized 160,000,000 shares		
Issued 48,558,614 shares in 2006 and 2005	391,566	392,607
Retained earnings	70,997	75,357
Accumulated comprehensive income	(11,875)	(7,876)
Treasury Stock, at cost, 8,898,273 shares in 2006 and 8,995,134 shares in 2005	(158,454)	(160,207)
TOTAL SHAREHOLDERS EQUITY	292,234	299,881
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 3,455,385	$ 3,690,808

See notes to consolidated financial statements.

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FIRST FINANCIAL BANCORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(Dollars in thousands, except per share data)
(Unaudited)

	Six months ended June 30,		Three months ended June 30,	
	2006	2005	2006	2005
Interest income				
Loans, including fees	$ 87,243	$ 85,748	$ 44,386	$ 43,370
Investment securities				
Taxable	8,939	10,797	3,798	5,389
Tax-exempt	2,161	2,469	1,057	1,239
Total investment securities interest	11,100	13,266	4,855	6,628
Interest-bearing deposits with other banks	0	1	0	0
Federal funds sold and securities purchased under agreements to resell	3,082	225	1,500	121
Total interest income	101,425	99,240	50,741	50,119
Interest expense				
Deposits	31,487	21,860	16,554	11,434
Short-term borrowings	1,788	968	892	507
Long-term borrowings	2,767	7,589	709	3,781
Subordinated debentures and capital securities	1,237	938	639	492
Total interest expense	37,279	31,355	18,794	16,214
Net interest income	64,146	67,885	31,947	33,905
Provision for loan losses	1,112	1,205	360	750
Net interest income after provision for loan losses	63,034	66,680	31,587	33,155
Noninterest income				
Service charges on deposit accounts	10,520	8,775	5,431	4,609
Trust revenues	7,935	7,973	3,882	3,879
Bankcard interchange income	3,393	2,988	1,745	1,568
Investment advisory fees	1,647	1,668	801	828
Gains from sales of loans	504	944	259	480
Losses on sales of investment securities	(476)	(6)	0	0
Other	7,072	7,532	3,723	3,474
Total noninterest income	30,595	29,874	15,841	14,838
Noninterest expenses				
Salaries and employee benefits	43,327	38,067	23,110	19,157
Net occupancy	5,537	4,590	2,698	2,241
Furniture and equipment	2,814	3,285	1,334	1,664
Data processing	4,989	3,050	3,182	1,461

Marketing	1,330	1,225	647	714
Communication	1,309	1,496	642	715
Professional services	2,976	2,913	1,669	1,527
Amortization of intangibles	441	440	224	220
Debt extinguishment	4,295	0	0	0
Other	14,338	11,679	7,190	5,886
Total noninterest expenses	81,356	66,745	40,696	33,585

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	Six months ended June 30, 2006	Six months ended June 30, 2005	Three months ended June 30, 2006	Three months ended June 30, 2005
Earnings from continuing operations before income taxes	12,273	29,809	6,732	14,408
Income tax expense	3,948	9,654	2,374	4,785
Earnings from continuing operations	8,325	20,155	4,358	9,623
Discontinued operations				
Earnings from discontinued operations before income taxes	0	723	0	416
Income tax expense	0	263	0	150
Earnings from discontinued operations	0	460	0	266
Net earnings	$ 8,325	$ 20,615	$ 4,358	$ 9,889
Earnings per share from continuing operations:				
Basic	$ 0.21	$ 0.46	$ 0.11	$ 0.22
Diluted	$ 0.21	$ 0.46	$ 0.11	$ 0.22
Earnings per share from discontinued operations:				
Basic	$ 0.00	$ 0.01	$ 0.00	$ 0.01
Diluted	$ 0.00	$ 0.01	$ 0.00	$ 0.01
Earnings per share:				
Basic	$ 0.21	$ 0.47	$ 0.11	$ 0.23
Diluted	$ 0.21	$ 0.47	$ 0.11	$ 0.23
Cash dividends declared per share	$ 0.32	$ 0.32	$ 0.16	$ 0.16
Average basic shares outstanding	39,582,995	43,551,614	39,605,631	43,502,193
Average diluted shares outstanding	39,616,238	43,624,879	39,619,729	43,575,499

See notes to consolidated financial statements.

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FIRST FINANCIAL BANCORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, dollars in thousands)

	Six months ended June 30, 2006	Six months ended June 30, 2005
Operating activities		
Net earnings	$ 8,325	$ 20,615
Adjustments to reconcile net cash provided by operating activities		
Provision for loan losses	1,112	1,205
Provision for depreciation and amortization	4,211	3,534
Stock-based compensation expense	775	967
Net amortization of premiums and accretion of discounts on investment securities	(215)	796
Losses on sales of investment securities	476	6
Originations of loans held for sale	(40,105)	(49,950)
Gains from sales of loans held for sale	(504)	(944)
Proceeds from sale of loans held for sale	40,198	50,457
Deferred income taxes	2,535	(60)
Decrease (increase) in interest receivable	1,009	(44)
Increase in cash surrender value of life insurance	(1,523)	(3,959)
Increase in prepaid expenses	(917)	(699)
Increase (decrease) in accrued expenses	746	(260)
Increase in interest payable	50	573
Other	(5,205)	(697)
Net increase from discontinued operations	0	267
Net cash provided by operating activities	10,968	21,807
Investing activities		
Proceeds from sales of securities available-for-sale	184,902	680
Proceeds from calls, paydowns and maturities of securities available-for-sale	45,283	53,795
Purchases of securities available-for-sale	(2,805)	(21,392)
Proceeds from calls, paydowns and maturities of securities held-to-maturity	3,984	4,197
Purchases of securities held-to-maturity	0	(8,815)
Net decrease in interest-bearing deposits with other banks	0	495
Net decrease in federal funds sold and securities purchased under agreements to resell	19,000	12,049
Net increase in loans and leases	(26,614)	(3,471)
Recoveries from loans and leases previously charged off	1,764	2,164
Proceeds from disposal of other real estate owned	1,986	1,484
Purchases of premises and equipment	(8,591)	(6,999)
Net increase from discontinued operations	0	4,200
Net cash provided by investing activities	218,909	38,387
Financing activities		
Net increase in total deposits	2,973	13,861

Net decrease in short-term borrowings	(26,538)	(20,728)
Repayments of long-term borrowings	(204,630)	(9,136)
Cash dividends	(12,685)	(13,926)
Purchase of common stock	0	(7,099)
Proceeds from exercise of stock options	254	191
Excess tax benefit on share-based compensation	49	0
Net decrease from discontinued operations	0	(4,753)
Net cash used in financing activities	(240,577)	(41,590)
Cash and cash equivalents:		
Net (decrease) increase in cash and cash equivalents	(10,700)	18,604
Cash and cash equivalents at beginning of period	163,281	155,353
Cash and cash equivalents at end of period	$ 152,581	$ 173,957
Cash and cash equivalents consist of the following:		
Cash and cash equivalents from continuing operations	152,581	170,867
Cash and cash equivalents from discontinued operations	0	3,090
Cash and cash equivalents at end of period	$ 152,581	$ 173,957

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FIRST FINANCIAL BANCORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, dollars in thousands)

	Six months ended June 30,	
	2006	2005
Supplemental disclosures		
Interest paid	$ 37,230	$ 30,783
Income taxes paid	$ 3,809	$ 10,077
Recognition of deferred tax assets attributable to SFAS No. 115	$ 2,327	$ 1,041
Acquisition of other real estate owned through foreclosure	$ 1,101	$ 2,676
Issuance of restricted stock awards	$ 1,608	$ 1,446
Transfer of loans to loans held for sale	$ 30,747	$ 0

See notes to consolidated financial statements.

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FIRST FINANCIAL BANCORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
(Unaudited, dollars in thousands)

	Six months ended June 30,	
	2006	2005
Balances at January 1	$ 299,881	$ 371,455
Net earnings	8,325	20,615
Other comprehensive income, net of taxes:		
Changes in unrealized losses on securities, available for sale	(3,999)	(1,741)
Comprehensive income	4,326	18,874
Cash dividends declared	(12,685)	(13,926)
Purchase of common stock	0	(7,099)
Excess tax benefit on share-based compensation	49	0
Exercise of stock options, net of shares purchased	239	191
Restricted stock awards	(351)	(640)
Share-based compensation expense	775	967
Balances at June 30	**$ 292,234**	**$ 369,822**

See notes to consolidated financial statements.

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FIRST FINANCIAL BANCORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006
(Unaudited, dollars in thousands, except per share data)

The consolidated financial statements for interim periods are unaudited; however, in the opinion of the management of First Financial Bancorp. (First Financial), all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation have been included.

NOTE 1: BASIS OF PRESENTATION

The consolidated financial statements of First Financial, a bank holding company, include the accounts of First Financial and its wholly-owned subsidiaries First Financial Bank, N.A. and First Financial Capital Advisors LLC, a registered investment advisory company. All significant intercompany transactions and accounts have been eliminated in consolidation.

The accompanying financial statements have been prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all information and footnotes necessary to be in conformity with U.S. generally accepted accounting principles for annual financial statements.

The consolidated balance sheet at December 31, 2005, has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements for annual periods. For further information, refer to the consolidated financial statements and footnotes thereto included in the First Financial Bancorp. Annual Report on Form 10-K for the year ended December 31, 2005.

First Financial adopted the provisions of SFAS No. 123(R), Share-Based Payment, effective January 1, 2006, using the modified-prospective transition method which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation expense over the service period for awards expected to vest. This Statement applies to all awards granted after January 1, 2006 and to awards modified, repurchased, or cancelled after that date. Prior to January 1, 2006, First Financial accounted for its stock options under the intrinsic value method of APB Opinion No. 25, Accounting for Stock Issued To Employees and related Interpretations, and applied the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation. First Financial s employee stock options have fixed terms and the exercise price of the stock options equals the market price on the date of grant. Therefore, no compensation cost was recognized for stock options prior to January 1, 2006.

Certain reclassifications of prior year s amounts have been made to conform to current year presentation. Such reclassifications had no effect on earnings.

NOTE 2: DISCONTINUED OPERATIONS

On September 16, 2005, First Financial completed the sale of substantially all of the assets and certain liabilities of its Fidelity Federal Savings Bank subsidiary to Mutual Federal Savings Bank, a subsidiary of *MutualFirst* Financial, Inc. of Muncie, Indiana. Fidelity Federal is reported as a discontinued operation for financial reporting purposes for all prior periods presented. The results of its operations and its cash flows have been removed from First Financial s results of continuing operations for all periods presented.

The results of Fidelity Federal are presented as discontinued operations in a separate category on the income statement following the results from continuing operations. The income from discontinued operations for the six months and three months ended June 30, 2005 is as follows:

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	Six months ended June 30, 2005	Three months ended June 30, 2005
Interest income		
Loans, including fees	$ 2,871	$ 1,430
Investment securities	253	123
Interest-bearing deposits with other banks	41	19
Federal funds sold and securities purchased under agreements to resell	74	45
Total interest income	3,239	1,617
Interest expense		
Deposits	806	416
Long-term borrowings	605	304
Total interest expense	1,411	720
Net interest income	1,828	897
Provision for loan losses	50	0
Net interest income after provision for loan losses	1,778	897
Noninterest income		
Service charges on deposit accounts	105	54
Other	77	40
Total noninterest income	182	94
Noninterest expenses		
Salaries and employee benefits	595	281
Net occupancy	45	21
Furniture and equipment	31	14
Data processing	267	131
Other	299	128
Total noninterest expenses	1,237	575
Income before taxes	723	416
Income tax expense	263	150
Net earnings	$ 460	$ 266

NOTE 3: FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

In the normal course of business, First Financial offers a variety of financial instruments with off-balance sheet risk to its customers to aid them in meeting their requirements for liquidity and credit enhancement and to reduce its own exposure to fluctuations in interest rates. These financial instruments include standby letters of credit and commitments outstanding to extend credit. A discussion of these instruments follows.

First Financial s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit and commitments outstanding to extend credit is represented by the contractual amounts of those instruments. First Financial uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Following is a discussion of these transactions.

Standby letters of credit are conditional commitments issued by First Financial to guarantee the performance of a customer to a third party. First Financial s portfolio of standby letters of credit consists primarily of performance assurances made on behalf of customers who have a contractual commitment to produce or deliver goods or services. The risk to First Financial arises from its obligation to make payment in the event of the customers contractual default. As of June 30, 2006, First Financial had issued standby letters of credit aggregating $27,328 compared to $38,296 issued as of December 31, 2005. Management conducts regular reviews of these instruments on an individual customer basis, and the results are considered in assessing the need to provide for losses. Management does not anticipate any material losses as a result of these letters of credit.

Loan commitments are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. First Financial evaluates each customer s creditworthiness on an individual basis. The amount of collateral obtained, if deemed necessary by First Financial upon extension of credit, is based on management s credit evaluation of the counterparty. The collateral held varies, but may include securities, real estate, inventory, plant, or equipment. First Financial had commitments outstanding to extend credit totaling $571,884 at June 30, 2006, and $523,276 at December 31, 2005. Management does not anticipate any material losses as a result of these commitments.

NOTE 4: COMPREHENSIVE INCOME

First Financial discloses comprehensive income in the Consolidated Statements of Changes in Shareholders Equity. Disclosure of the reclassification adjustments for the six and three months ended June 30, 2006, and 2005 are shown in the table below.

	Six months ended June 30,		Three months ended June 30,	
	2006	2005	2006	2005
Net Income	$ 8,325	$ 20,615	$ 4,358	$ 9,889
Other comprehensive income, net of tax:				
Unrealized holding (losses) gains arising during period	(4,300)	(1,745)	(2,865)	3,220
Less: Reclassification adjustment for (losses) included in net income	(301)	(4)	0	0
Other comprehensive income	(3,999)	(1,741)	(2,865)	3,220
Comprehensive income	$ 4,326	$ 18,874	$ 1,493	$ 13,109

At June 30, 2006, the unfunded pension losses, net of taxes, recorded as accumulated comprehensive income are $7,562.

NOTE 5: DERIVATIVES

The use of derivative instruments allows a bank to meet the needs of its customers while reducing the interest-rate risk associated with certain transactions. In 2001, First Financial s board of directors approved a policy authorizing the use of certain derivative products. The approved derivative instruments included interest rate caps, floors, and swaps. Currently, First Financial utilizes interest rate swaps as a means to offer long-term fixed-rate loans to commercial borrowers while maintaining the variable-rate income that better suits First Financial s funding position.

First Financial designates its derivatives based upon criteria established by SFAS No. 133, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, an Amendment to FASB Statement No. 133, and SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. The following table summarizes the derivative financial instruments utilized by First Financial:

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	June 30, 2006			December 31, 2005			June 30, 2005		
	Notional Amount	Estimated Fair Value Gain	(Loss)	Notional Amount	Estimated Fair Value Gain	(Loss)	Notional Amount	Estimated Fair Value Gain	(Loss)
Fair Value Hedges									
Pay fixed interest rate swaps	$ 29,633	$ 1,294	$ (27)	$ 23,909	$ 389	$ (146)	$ 16,371	$ 71	$ (367)
Matched Customer Hedges									
Customer interest rate swaps	8,340	37	(2)	0	0	0	0	0	0
Customer interest rate swaps with counterparty	8,340	2	(37)	0	0	0	0	0	0
Total	$ 46,313	$ 1,333	$ (66)	$ 23,909	$ 389	$ (146)	$ 16,371	$ 71	$ (367)

NOTE 6: OTHER LONG-TERM DEBT

Other long-term debt, which appears on the balance sheet, consists of junior subordinated debentures owed to two unconsolidated subsidiary trusts. Capital securities were issued in the third quarter of 2003 by a statutory business trust First Financial (OH) Statutory Trust II and in the third quarter of 2002 by another statutory business trust First Financial (OH) Statutory Trust I. First Financial owns 100% of the common equity of both of the trusts. The trusts were formed with the sole purpose of issuing the capital securities and investing the proceeds from the sale of such capital securities in the debentures. The debentures held by the trust are the sole assets of each trust. Distributions on the capital securities are payable quarterly at a variable rate of interest, which is equal to the interest rate being earned by the trust on the debentures and are recorded as interest expense of First Financial. The interest rate is variable and is subject to change every three months. The base index is the three-month LIBOR (London Inter-Bank Offered Rate). On June 30, 2006, the rates on Trust I and Trust II were 8.86% and 8.06%, respectively. First Financial has the option to defer interest for up to five years on the debentures. However, the covenants prevent the payment of dividends on common stock if the interest is deferred. The capital securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. First Financial has entered into agreements which, taken collectively, fully or unconditionally guarantee the capital securities subject to the terms of the guarantees. The debentures qualify as Tier I capital under Federal Reserve Board guidelines. The debentures issued in 2003 are first redeemable, in whole or in part, by First Financial on September 30, 2008 and mature on September 30, 2033. The amount outstanding, net of offering costs, as of June 30, 2006, was $20,000. The debentures issued in 2002 are first redeemable, in whole or in part, by First Financial on September 25, 2007, and mature on September 25, 2032. The amount outstanding, net of offering costs, as of June 30, 2006, was $10,000.

NOTE 7: STOCK OPTIONS

First Financial adopted the provisions of SFAS No. 123(R) effective January 1, 2006, using the modified-prospective transition method, which requires measurement of compensation cost for all stock-based awards at fair value on the date of grant and recognition of compensation expense over the service period for awards expected to vest. Share-based compensation expense for stock options and restricted stock awards included in salaries and employee benefits expense for the first six months of 2006 was $775 and for the second quarter of 2006 was $456. Total unrecognized compensation cost related to nonvested share-based compensation was $5,476 at June 30, 2006 and is expected to be recognized over a weighted average period of 2.6 years.

Under the intrinsic method of accounting, compensation expense had not been recognized in the prior year statements of earnings for stock-based compensation plans, other than for restricted stock awards. The following table illustrates the effect on net earnings and earnings per share if First Financial had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation for the six and three months ended June 30, 2005:

	Six Months Ended June 30, 2005	Three Months Ended June 30, 2005
Net earnings, as reported	$ 20,615	$ 9,889
Add: Restricted stock expense, net of taxes, included in net income	628	351
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	736	415
Pro forma net earnings	$ 20,507	$ 9,825
Earnings per share		
Basic as reported	$ 0.47	$ 0.23
Basic pro forma	$ 0.47	$ 0.23
Diluted as reported	$ 0.47	$ 0.23
Diluted pro forma	$ 0.47	$ 0.23

As of June 30, 2006, First Financial had two stock-based compensation plans. The 1991 Stock Incentive Plan provides incentive stock options and stock awards to certain key employees and non-qualified stock options to directors of First Financial who are not employees for up to 1,691,036 common shares of First Financial. The options are not exercisable for at least one year from the date of grant and are thereafter exercisable for such periods (which may not exceed 10 years) as the board of directors, or a committee thereof, specifies, provided that the optionee has remained in the employment of First Financial and its subsidiaries. All options expire at the end of the exercise period, and forfeited or expired options become available for re-issuance. On April 27, 1999, the shareholders approved the 1999 Stock Incentive Plan that provides for 7,507,500 shares for similar awards and options.

The fair value of stock options is determined using the Black-Scholes valuation model. The expected dividend yield is based on historical dividend payouts; the expected volatility is based on historical volatilities of company stock for a period approximating the expected life; the risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option; and the expected life represents the period of time the options are expected to be outstanding and is based on historical trends. The weighted average assumptions used in the computations are as follows:

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	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005 Pro Forma
Fair value of options granted	$ 2.89	$ 2.78
Expected dividend yield	3.99%	3.64%
Expected volatility	0.210	0.210
Risk-free interest rate	4.95%	3.90%
Expected life	6.88	5.23

Activity in the above plan for the six months ended June 30, 2006 is summarized as follows:

	Six Months Ended June 30, 2006 Number of shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at beginning of year	1,609,945	$ 17.43		
Granted	542,600	16.06		
Exercised	(59,013)	14.65		
Forfeited or expired	(109,722)	17.79		
Outstanding at end of quarter	1,983,810	$ 17.12	6.87	$ 48,761
Exercisable at end of quarter	1,143,219	$ 17.49	4.96	$ 48,761

Intrinsic value for stock options is defined as the difference between the current market value and the grant price. The total intrinsic value of options exercised during the first six months of 2006 was $188 and for the second quarter of 2006 was $8. The weighted average grant date fair value of options granted during the first six months of 2006 was $2.89 and for the second quarter of 2006 was $2.88. Cash received from stock options exercised during the first six months of 2006 was $254 and for the second quarter of 2006 was $18, and the related tax benefit for tax deductions from stock options exercised for the first six months of 2006 was $236 and for the second quarter of 2006 was $135. First Financial uses treasury shares purchased under the company s share repurchase program to satisfy share-based exercises.

Restricted stock awards have historically been recorded as deferred compensation, a component of shareholders equity at the fair value of these awards at the grant date and amortized on a straight-line basis to salaries and benefits expense over the specified vesting periods, which is currently four years. For awards granted prior to 2005, the vesting of the awards only required a service period to be met. Therefore, 25% of each grant would vest each of the four years. For the 2005 and 2006 restricted stock awards to vest, the company must meet a performance goal of 12.00% return on equity. Since the return on equity goal was not met in 2005 and the first two quarters of 2006, 25% of the awards granted in 2005 and the first two quarters of 2006 will not vest. However, if average return on equity for 2005 and 2006 is 12.00% or higher, the first year s awards, as well as the second year s awards, will vest in 2006.

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The following is a summary of activity in restricted stock for the six months ended June 30, 2006:

	Six Months Ended June 30, 2006	
	Number of shares	Weighted Average Grant Date Fair Value
Nonvested at beginning of year	218,054	$ 17.22
Granted	100,198	16.05
Vested	(64,145)	16.97
Forfeited	(7,848)	17.12
Nonvested at end of quarter	246,259	$ 16.81

The fair value of restricted stock is determined based on the number of shares granted and the quoted price of First Financial s common stock. The total fair value of restricted stock vested during the first six months of 2006 was $1,089 and for the second quarter of 2006 was $0, as no restricted stock vested during the second quarter of 2006.

NOTE 8: EMPLOYEE BENEFIT PLANS

First Financial sponsors a non-contributory defined benefit pension plan covering substantially all employees. First Financial expects to contribute $7,578 to its pension plan in 2006. The following table sets forth information concerning amounts recognized in First Financial s Consolidated Balance Sheets and Consolidated Statements of Earnings.

	Six months ended June 30,		Three months ended June 30,	
	2006	2005	2006	2005
Service cost	$ 1,942	$ 1,910	$ 844	$ 955
Interest cost	1,504	1,495	760	748
Expected return on plan assets	(1,421)	(1,355)	(734)	(678)
Amortization of transition asset	(28)	(32)	(14)	(16)
Amortization of unrecognized prior service cost	28	30	14	15
Amortization of actuarial loss	622	496	280	248
Net periodic benefit cost	$ 2,647	$ 2,544	$ 1,150	$ 1,272

Some of First Financial s subsidiaries maintain health care and, in limited instances, life insurance plans for current retired employees. The following table sets forth the components of net periodic postretirement benefit costs.

	Six months ended June 30,		Three months ended June 30,	
	2006	2005	2006	2005
Service cost	$ 42	$ 40	$ 21	$ 20
Amortization of unrecognized prior service cost	(2)	(2)	(1)	(1)
Amortization of actuarial loss	(2)	(17)	(1)	(8)
Net periodic postretirement benefit cost	$ 38	$ 21	$ 19	$ 11

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NOTE 9: LOANS HELD FOR SALE

As of June 30, 2006, First Financial had identified $38,986 in primarily substandard commercial, commercial real estate, and retail real estate loans that were transferred to held for sale at the lower of cost or estimated fair value of $30,747. First Financial has engaged the Loan Portfolio Sales Group of Keefe, Bruyette and Woods, Inc. to market these loans during the third quarter of 2006 and anticipates closing on the loan sales prior to the end of the third quarter of 2006.

A summary of loans held for sale is as follows:

	June 30, 2006 Loans Held for Sale
Commercial	$ 5,952
Real estate commercial	17,091
Real estate retail	7,704
Total	$ 30,747

NOTE 10: OTHER MATTERS

Core deposit intangibles are amortized on a straight-line basis over their useful lives. Core deposit balances are being amortized over varying periods, none of which exceeds 10 years.

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ITEM 2-MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FIRST FINANCIAL BANCORP. AND SUBSIDIARIES (Unaudited, dollars in thousands)

SELECTED QUARTERLY FINANCIAL DATA

	2006			2005	
	June 30	Mar. 31	Dec. 31	Sep. 30	June 30
Average Consolidated Balance Sheet Items:					
Loans less unearned income	$ 2,614,248	$ 2,596,755	$ 2,657,156	$ 2,783,315	$ 2,795,754
Investment securities	380,532	497,528	620,868	625,418	635,982
Other earning assets	122,413	141,513	127,701	20,938	17,188
Total earning assets	3,117,193	3,235,796	3,405,725	3,429,671	3,448,924
Total assets	3,428,839	3,545,412	3,719,197	3,827,395	3,846,259
Noninterest-bearing deposits	424,227	417,061	433,228	428,881	433,379
Interest-bearing deposits	2,477,026	2,486,336	2,488,062	2,473,697	2,476,112
Total deposits	2,901,253	2,903,397	2,921,290	2,902,578	2,909,491
Borrowings	202,792	313,743	418,388	446,939	445,141
Shareholders equity	296,087	298,578	350,934	367,472	369,477
Key Ratios:					
Average equity to average total assets	8.64%	8.42%	9.44%	9.60%	9.61%
Return on average total assets	0.51%	0.45%	0.30%	1.50%	1.03%
Return on average equity	5.90%	5.39%	3.20%	15.64%	10.74%
Return on average tangible equity	6.70%	6.12%	3.57%	17.32%	11.90%
Net interest margin	4.11%	4.04%	3.72%	3.83%	3.94%
Net interest margin (fully tax equivalent)	4.20%	4.12%	3.80%	3.92%	4.03%

These ratios include earnings from continuing and discontinued operations.

SUMMARY

STRATEGIC PLAN UPDATE

On March 14, 2005, First Financial announced its new strategic plan for the organization. First Financial has made steady progress toward completing the plan in 2006. The areas of focus are the organizational restructure which was completed in 2005 with the consolidation to a single banking charter, the balance-sheet restructure which was completed in the first quarter of 2006, the growth plan, and the Performance Improvement Plan.

Organic restructuring continues through shifting the mix of the loan portfolio to commercial-based credits. Since June 30, 2005, First Financial has increased its concentration of commercial lending from 47% of the loan portfolio to 53%.

The growth plan for the company is moving forward with the recent announcement of a new branding strategy on June 1, 2006 when company officials rang the opening bell on the NASDAQ exchange. The company will now begin operating all its branches under one brand name, First Financial Bank. Plans are underway to roll out the new logo design and convert all offices to the new name and brand late in the third quarter of 2006. First Financial will continue to recruit sales staff, evaluate metropolitan markets for expansion, and consider strategic acquisitions to extend and expand the franchise.

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The objective of the Performance Improvement Plan is to maximize revenue and develop the proper cost structure for the consolidated organization to achieve a peer-level efficiency ratio. First Financial has established a long-term target efficiency ratio of between 55% and 60%. Management remains confident that it can achieve this target. The largest component of the improvement is a $7,500 to $8,000 planned reduction in salary and benefits through eliminating approximately 200 staff positions, excluding staff associated with the branch sales and closures. Approximately half of the staff changes occurred in the second quarter of 2006, with the remainder expected to occur before the end of the fourth quarter of 2006. Estimated severance charges associated with the 200 staff reductions are $1,300, of which $831 was recognized in the second quarter of 2006. Remaining charges will be recognized when incurred.

To date, approximately $1,500 to $2,000 in annualized revenue enhancements have been identified. Enhancements are associated with better management of internal processes such as cash balances in branches and a planned redeployment in low and nonearning assets. The full effect of these improvements is expected to begin in the fourth quarter of 2006.

BRANCH PLAN

The previously announced sale of 10 branches and closure of 7 offices is proceeding on schedule. Regulatory approval has been received for sales to three different purchasers. The anticipated closing date for the three transactions is August 18, 2006. Total net gains on sale are expected to be $12,500 or $0.21 per share. Current deposits and loans for the sold offices are $101,000 and $102,000, respectively, as of June 30, 2006. The estimated proforma financial impact of the branch sales and closures, excluding the gains on sales, remains earnings neutral.

First Financial will continue to concentrate future growth plans and capital investments in larger metropolitan markets. Smaller markets have historically provided stable, low-cost funding sources to First Financial and are an important part of the funding plan for the expansion in the commercial lending market. Furthermore, First Financial s historical strength in a number of these markets should enable it to hold market share.

First Financial s branch strategy is to serve a combination of metropolitan and non-metropolitan markets in Indiana, Ohio, and Kentucky. In addition to geographic fit, each market must have growth potential and the ability to meet profit targets.

At the completion of the branch plan, First Financial will have 87 offices serving 9 distinct markets with an average branch size of approximately $33,000. The operating model for growth includes market presidents managing distinct markets with the authority to make decisions at the point of client contact.

INFORMATION TECHNOLOGY UPDATE

First Financial has entered into an agreement with Jack Henry & Associates Inc. to license their software applications, which will be used to provide primary core data processing. This in-house solution provides First Financial with a more cost-effective model. It is expected that the conversion to the Jack Henry system will occur in October of 2006, and should enhance First Financial s capability to deliver client services in a better, faster, and more efficient manner. This decision is consistent with our strategic plan and is an integral component of our comprehensive review of the use of technology. This review includes analysis of our data and voice telecommunication usage, on-line and ATM services, and other ancillary services. Expected savings as a result of this comprehensive review are estimated to be between $3,000 and $4,000 per year and should be fully recognized in 2007. Costs associated with this conversion will include the early termination of some existing contracts. To-date, $1,073 in early termination penalties have been recorded with an additional $3,100 expected to be recognized in the fourth quarter of 2006.

OPERATING RESULTS

Net earnings for the first six months of 2006 were $8,325 or $0.21 in diluted earnings per share versus $20,615 or $0.47 for the first six months of 2005. Income from continuing operations for the six months ended June 30, 2006, was $8,325 or $0.21 in diluted earnings per share versus $20,155 or $0.46 in diluted earnings per share for the same period in 2005. The $11,830 decrease in income from continuing operations was due to several material items, including severance charges of $2,601 or $0.04 per share, data processing conversion-related expenses of $1,073 or $0.02 per share, additional health care accruals of $582 or $0.01 per share, and professional services of $542 or $0.01 per share. First Financial has had increased recurring expenses related to the execution of its strategic plan of $528 or $0.01 per share in reduced net interest income due to parent company borrowings used in the repurchase of shares in the fourth quarter of 2005. Additionally, the effects of both the mortgage and indirect loan runoff as part of the intended loan mix shift discussed in the strategic plan totaled approximately $600 or $0.01 per share in reduced net interest income. Other recurring items include increased pension expense and the effects of FAS 123R and state franchise taxes of approximately $557 or $0.01 per share.

Net earnings for the second quarter of 2006 were $4,358 or $0.11 in diluted earnings per share, compared to $9,889 or $0.23 in diluted earnings per share for the second quarter of 2005.

Return on average assets for the second quarter of 2006 was 0.51% compared to 1.03% for the same period in 2005. Return on average shareholders equity was 5.90% for the second quarter of 2006, versus 10.74% for the comparable period in 2005. Year-to-date return on average assets was 0.48% for 2006, compared to 1.08% for 2005, while return on equity was 5.65% for 2006 versus 11.23% for 2005.

Second-quarter 2006 noninterest income was $15,841, an increase of $1,003 or 6.76% from the second quarter of 2005. First Financial had quarterly increases in service charges on deposit accounts income of $822 which included the positive effects of its new overdraft program. Bankcard interchange income increased $177 due to both increased debit card issuance and usage; and bank-owned life insurance income increased $425, while gains on mortgage loan sales decreased $221.

On a linked-quarter basis (second quarter 2006 compared to first quarter 2006), total noninterest income increased $1,087 or 7.37%. This increase was primarily due to the $476 loss on securities sold in the first quarter, a $342 increase in service charges on deposit accounts related to increases in nonsufficient funds charges in the second quarter, and an increase of $203 in bank-owned life insurance income in the second quarter.

Year-to-date noninterest income increased $721 or 2.41% from the comparable period in 2005 due to increases in service charges on deposit accounts of $1,745, offset by a decrease in gain on loan sales of $440, and a $476 loss on investment securities sold.

Total noninterest expense increased $7,111 or 21.17% for the second quarter of 2006 from the second quarter of 2005. This increase was primarily due to increases in salaries and benefits of $3,953, $457 in occupancy expense, $1,721 in data processing expenses, and $1,304 in other noninterest expense, somewhat offset by a decrease in equipment expense of $330. Salaries and benefits increased $3,953 due to $2,601 in severance-related salaries and benefits expense, $438 in increased health care costs, $425 in increased retirement-related expenses, and $153 in increased bonuses. Excluding these items, salaries and benefits were up $336 or 1.75% due largely to overtime associated with the upcoming data processing conversion. Occupancy expense increased $457 due primarily to increased maintenance costs, utilities, and new building rent consistent with First Financial s growth plans. The increase in data processing of $1,721 is primarily attributable to early termination fees for the conversion of various systems. The increase in other noninterest expense of $1,304 consists of increases in various accounts, including $227 in intangible state tax, $193 in credit and collection fees, $257 in travel-related expenses, $180 in credit card and merchant interchange expense more than offset by the increase in interchange income and merchant discount, and $150 in stationery and supplies. The $330 decrease in equipment expense is primarily due to a decrease in equipment expense rent of $179 and service contracts of $103 that are not expected to continue.

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On a linked-quarter basis, noninterest expense was $36 more than the first quarter. This increase was due to the offsetting e