CAMTEK LTD
Form 20-F
April 07, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 20-F

(Mark One)

o Registration statement pursuant to Section 12(b) or (g) of the Securities Exchange Act of 1934

or

x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2010

or

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

or

o Shell Company report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 \

Date of event requiring this shall Company report ___________

For the transition period from ________ to ________

Commission file number 000-30664

Camtek Ltd.
(Exact name of Registrant as specified in its charter)

Israel
(Jurisdiction of incorporation or organization)

Ramat Gavriel Industrial Zone, P.O. BOX 544, Migdal Ha'Emek, Israel
(Address of principal executive offices)

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Ramat Gavriel Industrial Zone, P.O. BOX 544, Migdal Ha'Emek, Israel
(Name, Telephone, E-Mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:
Ordinary Shares, nominal value NIS 0.01 per share

(Title of each Class)

Nasdaq Global Market
(Name of each Exchange on which registered)

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
None
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report:

29,277,983 Ordinary Shares, par value NIS 0.01 per share.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

£ Yes SNo

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

£ Yes SNo

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.

S Yes £ No

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

£ Yes £ No

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

£ Large Accelerated Filer £ Accelerated Filer T
Non-Accelerated Filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

US GAAP ý

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o Item 18 o

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

£ Yes T No

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Cautionary Language Regarding Forward-Looking Statements

Statements in this Annual Report about our future results, levels of activity, performance, goals or achievements or other future events constitute forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in our forward-looking statements. These factors include, among others, those listed under "Risk Factors" or described elsewhere in this Annual Report.

In some cases, you can identify forward-looking statements by our use of words such as "may," "will," "should," "could," "expects," "plans," "intends," "anticipates," "believes," "estimates," "predicts," "seeks," "strategy," "potential" or "continue" or other variations of these words, or other comparable words or phrases.

Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements or other future events. We are under no duty to update any of our forward-looking statements after the date of this Annual Report, other than as required by law. You should not place undue reliance on forward-looking statements.

As used in this Annual Report, the terms "we", "us", "our", the "Company" and "Camtek" mean Camtek Ltd. and subsidiaries, unless otherwise indicated.

PART I

Item 1. Identity of Directors, Senior Management and Advisers.

Not applicable.

Item 2. Offer Statistics and Expected Timetable.

Not Applicable.

Item 3. Key Information.

A. Selected Consolidated Financial Data.

We derived the selected data under the captions “Selected Statement of Operations Data” for the years ended December 31, 2010, 2009 and 2008, and "Selected Balance Sheet Data" as of December 31, 2010 and 2009 from the audited consolidated financial statements included elsewhere in this Annual Report. We derived the selected data under the captions “Selected Statement of Operations Data” for the years ended December 31, 2007 and 2006 and "Selected Balance Sheet Data" as of December 31, 2008, 2007 and 2006 from audited financial statements that are not included in this Annual Report.

For all fiscal periods for which consolidated financial data are set forth below, our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	(in thousands, except per share data)				
Selected Statement of Operations Data:					
Revenues:					
Sales of products	$70,235	$39,196	$62,135	$59,654	$92,470
Service fees	17,545	14,325	13,328	11,315	7,585
Total revenuesTotal revenues	87,780	53,521	75,463	70,969	100,055
Cost of revenues:					
Cost of products sold	38,464	25,069	37,073	32,769	42,600
Cost of services	10,897	10,970	10,542	9,171	5,842
Total cost of revenues	49,361	36,039	47,615	41,940	48,442
Gross profit	38,419	17,482	27,848	29,029	51,613
Research and development costs	12,906	10,319	12,801	12,111	11,831
Selling, general and administrative expenses	20,662	17,667	24,834	24,119	27,850
Total operating expenses	33,568	27,986	37,635	36,230	39,681
Operating income (loss)	4,851	(10,504)	(9,787)	(7,201)	11,932
Financial income (expenses), net	(1,478)	(952)	1,000	(128)	(288)
Income (loss) before income taxes	3,373	(11,456)	(8,787)	(7,329)	11,644
Income taxes	(557)	(386)	(770)	(362)	(41)
Net income (loss)	$2,816	$(11,842)	$(9,557)	$(7,691)	$11,603
Earnings (loss) per ordinary share:					
Basic	$0.10	$(0.40)	$(0.32)	$(0.25)	$0.40
Diluted	$0.09	$(0.40)	$(0.32)	$(0.25)	$0.39
Weighted average number of ordinary shares outstanding:					
Basic	29,259	29,218	29,916	30,145	29,176
Diluted	30,360	29,218	29,916	30,145	29,553

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	(in thousands)				
Selected Balance Sheet Data:					
Cash and cash equivalents	$9,577	$15,802	$15,949	$18,601	$23,358
Restricted deposit	5,182	-	-	-	-
Total assets	96,271	79,415	84,735	98,465	110,806
Bank credit	2,600	-	-	-	-
Convertible loan	-	1,666	3,333	5,000	5,000
Total liabilities	42,279	28,394	22,020	25,559	30,668
Additional paid in capital	60,452	60,279	60,281	60,010	59,552
Shareholders' equity	53,992	51,021	62,715	72,906	80,138
Ordinary issued and outstanding shares	29,277,983	29,235,743	29,135,108	30,133,715	30,040,855

B. Capitalization and Indebtedness.

Not applicable.

C. Reasons for the Offer and Use of Proceeds.

Not applicable.

D. Risk Factors

There is a high degree of risk associated with our company and business. If any of the following risks occur, our business, revenues, operating results and financial condition could be materially adversely affected and the trading price of our ordinary shares could decline.

Risk Factors Related to Our Business and Our Markets

The markets we target are highly cyclical and we do not have information that enables us to predict with accuracy the cycles in these markets. Also, these markets are negatively affected by periods of economic downturns.

The semiconductor industry is characterized by cyclicality. As a result of our market penetration to the semiconductor industry, we experienced growth from this market from 2004 until the second quarter of 2006. From third quarter 2006 to first half of 2008 we experienced both upturns and downturns. During the second half of 2008 and the first half of 2009 the semiconductor industry experienced a significant downturn, as a result of severe global economic recession and industry overcapacity. During the second half of 2009 and 2010 we experienced growth due to the increased capacity and demand in this industry.

The printed circuit board ("PCB") and the integrated circuit substrate ("IC substrate") industries are also cyclical and experienced a prolonged and severe downturn in 2002 and 2003, an expansion and growth during 2004, and significant fluctuations on a quarterly and annual basis thereafter. During the second half of 2008 and during 2009 our sales of automated optical inspection ("AOI") systems to manufacturers of printed circuit boards and the IC substrate industry were severely affected by the global economic recession. During 2010 we experienced growth due to the increased capacity and demand.

The cyclical variations in our industries are very difficult to predict. In the event of a reduction in demand during cyclical downturns, as those we have experienced in the past and are likely to experience in the future, we may have only a limited ability to reduce expenses without harming our ability to rapidly grow when our markets recover and demand increases again. For example, in order to maintain such ability, we are required to incur significant ongoing expenditures related to engineering, research and development and worldwide customer service and support operations. Accordingly, we may incur losses during downturns or capacity adjustments, affecting the markets we serve.

We have a history of losses, and we cannot assure you that we will not incur additional losses in the future. Moreover, if our business deteriorates, we could face liquidity problems.

In 2010 we recorded net income of $2.8 million. Despite having had net income in 2010, we incurred net losses of $11.8 million, $9.6 million and $7.7 million in 2009, 2008 and 2007, respectively. We may not be able to achieve or increase profitability on a quarterly or annual basis. The failure to generate consistent profitability could have a material adverse effect on the market price of our shares.

In 2010 we used $0.04 million in cash in our operations, while in 2009 our operations provided $3.9 million in cash. On December 31, 2010, we had cash and cash equivalents of $9.6 million, in addition to which we have $5.2 million in restricted cash. We may use cash in our operations during 2011 for working capital and may continue to incur significant additional legal expenses and other costs associated with certain patent infringement actions. In 2009, the District Court of Minnesota rendered a judgment in favor of a competitor in a patent infringement case against the Company awarding damages of approximately $6.8 million and pre-judgment interest of approximately $1.2 million. On August 10, 2010 the Company filed its appeal of t his judgment. The Company posted an $8.5 million bond to stay execution of any money judgment pending resolution of the appeal. Payment or exercise of the bond, if

required, may adversely affect our liquidity and require us to further reduce our expenses and/or to arrange for additional financing. In 2011, the Company was ordered to pay an additional $645,946 in supplemental damages, and the plaintiffs filed motions seeking $1.5 million for alleged contempt and related attorney fees. Camtek believes it has strong defenses to these charges and intends to vigorously oppose these motions. See below “Our products may infringe on the intellectual property rights of others, which could result in claims against us”.

If available liquidity is not sufficient to meet our operating and other obligations as they come due, our plans include pursuing additional financing arrangements from banks or others, the availability and terms of which are not assured, or further reducing expenditures as necessary to meet our cash requirements.

We may experience fluctuations in our future operating results, making it difficult to predict future results.

Our revenues and net income (loss), in any particular period may be lower (or greater) than revenues and net income (loss), in a preceding or comparable period. This complicates our planning processes and reduces the predictability of our earnings. Period-to-period comparisons of our results of operations may be meaningless, and you should not rely on them as indications of our future performance.

Our quarterly results of operations may be subject to significant fluctuations due to the following factors:

- the size, timing and shipment of substantial orders;
- product mixtures;
- customer budget cycles and installation schedules;
- product introductions and the penetration period of new products;
- timing of evaluation and qualification of our products by new customers;
- temporary shifts in industry capacity;
- pricing of our products;
- timing of new product upgrades or enhancements;
- timing of installation or, in some cases, of acceptance of our products by our customers;
- interest and exchange rates; and
- possible impairment of goodwill and other assets.

Our future success depends on our ability to increase revenues from sales of AOI systems to both the final manufacturing (“back end”) and wafer processing (“front end”) markets and from the automated sample preparation systems to the front end market of the semiconductor industry. If our share in these markets fails to grow or we will fail to acquire customers for our new systems and applications, our results of operations will be adversely affected.

We are planning to increase our revenues from sales of AOI systems to both the back end and front end markets. Our future success in the semiconductor industry depends on our ability to continue to sustain and increase the acceptance rate of our AOI systems and new applications we included in our AOI systems offered to the back end market. From 2009 and during 2010 we started to record initial revenues from both the Gannet, our AOI system to the front end market, and the Xact, our automated sample preparation system, acquired through the acquisition of SELA - Semiconductor Engineering Laboratories Ltd ("Sela"). Our success also depends on the acceptance rate of both new systems. If the markets for our systems in the semiconductor industry do not develop at the rate we expect, whether as a result of our inability to obtain repeat orders from our customers or to acquire customers who would adopt our new systems, as well as our new applications to other AOI systems, an economic downturn, intensified competition,

presentation to the market of alternative technologies, costly penetration of our new systems, changes in technology, changes in product standards, or otherwise - our results will be adversely affected.

In 2008 our revenues from the semiconductor industry increased by 48% above 2007 to $30 million, as a result of several multiple orders of technology-driven purchases and penetration to new customers with new applications. In 2009 our revenues from the semiconductor industry amounted to $20 million, a decrease which resulted from the global economic recession experienced at that time. In 2010 our revenues from the semiconductor industry, amounted to approximately $46.7 million as a result of the increase in capacity in this industry and our initial sales of the Gannet and Xact.

Since an injunction was issued in the lawsuit brought against us by Rudolph Technologies Inc. (see "Our products may infringe on the intellectual property rights of others, which could result in claims against us" below), we are prohibited from selling our Falcon systems in the United States. In the United States we sell our advanced AOI systems to the back end market of the semiconductor industry, the Condor. Therefore, although we faced some decline in our revenues in the United States as a result of the injunction, we continue to sell there and to generate revenues from the Condor.

Longer sales process for new products may increase our costs and delay time to market of our products, both of which may negatively impact our revenues, results of operations, cash flow and inventory. Excess inventory can lead to material inventory write-offs.

Our sales process to new and existing customers involves: demonstrations and testing against industry benchmarks in our sales centers; sales and technical presentations and presentations regarding our products' competitive advantages; and installation of the systems at the customer's site for side-by-side competitive evaluations for a period of approximately six months. More evaluation time is devoted during the initial penetration period for new products, currently the Gannet and the sample preparation system, the Xact (see Item 4.B – Business Overview – Product Lines), and for new customers in new markets, since these circumstances usually require qualification of the systems by the customers, and engineering efforts to fix errors, customize tasks and add new features. Considering the above factors, the length of time until we recognize revenue can vary and influence our revenues, cash flow and results of operations.

The long sales process may cause an increase in inventory levels and a risk for inventory to decline in value. In the second half of 2009 we increased our products offering to our customers in the semiconductor industry by introducing the Gannet and sample preparation systems, which increases this risk.

Moreover, our customers often require that we deliver our products with short lead times. In order to meet our customers' needs in the timeframe they require, we usually need to pre-order components and subsystems based on our forecasts of future orders, rather than on actual orders. In order to compensate for unexpected delays, we have had to predict our needs further into the future. Our predictions may not correspond to our actual future needs.

We operate an international sales and manufacturing organization. A substantial majority of our sales has been to manufacturers in the Asia Pacific region. The concentration of our sales and other resources within a particular geographical region subjects us to additional risks that could impede our plans for expansion and growth.

The majority of our sales were in the Asia Pacific region. In 2010, our sales in the Asia Pacific region accounted for approximately 83% of our total revenues, of which approximately 38% of our total revenues are from sales in China and Hong Kong, 19% from sales in Korea and 9% from sales in Taiwan. In addition, parts of the assembly of our AOI systems for the printed circuit board industry are made in our manufacturing facility in Suzhou, China. A number of Asian countries have experienced or could experience political and economic instability. For example, Taiwan and China have had a number of disputes, North and South Korea, and Japan has for a number of years experienced significant economic instability. Changes in local legislation, changes in governmental controls and regulations, changes in tariffs and taxes, trade restrictions, a downturn in economic or financial conditions, political instability, an outbreak of hostilities or other political upheaval as well as any extraordinary events having an adverse effect on the

economy or business environment in this region would likely harm the operations of our customers in these countries and may cause a significant decline in our future revenues and may have an adverse effect on our results of operations and cash flow. These general risks are heightened in China, where the nature of the economy and the legal parameters are rapidly evolving and where foreign companies may face cultural obstacles.

The markets we serve are highly competitive. There are dominant market participants in each of the markets we operate in and some of our competitors have greater resources, all of which may make it difficult for us to maintain profitability or plan our cash flow.

Competition in the markets we serve is intense. During market downturns competition has intensified due to the reduced demand for the type of products that we manufacture. When competitors respond to declining demand by offering discounts, free evaluation machines or more favorable credit terms, we may need to implement some or all of the same methods in order to maintain our market position. These could mean lower prices for our products and a corresponding reduction in our gross margin, as well as favorable payment terms to our customers and a corresponding decline in cash flow. If we have to lower prices to remain competitive and are unable to reduce our costs to offset price reductions or are unable to introduce new, higher performance products with higher prices, our operating results may be adversely affected. If we have to implement more favorable payment terms to our customers, our cash flow may be adversely affected.

In the back end and front end markets of the semiconductor industry, our principal competitor and the dominant market participant for AOI systems is Rudolph Technologies Inc., with additional competitors including KLA-Tencor Corporation, Topcon Corporation, Toray Industries, Inc., Nidec Tosok Corporation and Hitachi Ltd. Sample preparation competitors are FEI Company, SII Nanotechnology Japan., Hitachi Ltd. and Carl Zeiss, Inc.

In addition, there have been several mergers and acquisitions that changed the competitive map in our market. For example, Rudolph Technologies Inc.'s acquisition of August Technologies Corporation in 2005 and the acquisition of the bumped wafer inspection line of RVSI Inspection, LLC, in January 2008, continuing with Solvision Inc.'s acquisition by Zygo Corporation in February 2008 and the purchase of 96% of ICOS Vision Systems Corp. NV's shares by KLA-Tencor in May 2008. These acquisitions can reinforce the previously smaller competitors with resources, financial backing and the better market position of the acquiring companies, while bringing new forces to the marketplace. As a result, Camtek may need to overcome unfavorable market share perception and invest more R&D efforts in maintaining its technological position.

In the printed circuit board and IC substrate industry, our principal competitor and the dominant market participant is Orbotech Ltd., with additional competitors including Dainippon Screen Manufacturing Company, Lloyd-Doyle Limited, Gigavis Co. Ltd., Shirai Electronics Industrial Co. Ltd., ATI Electronics Pty Ltd., local AOI vendors in China and Taiwan and Utechzone Co. Ltd., with whom we have entered into cooperation for the sale of Utechzone's automated final inspection (“AFI”) products by us. In addition, there is a market for used AOI systems for printed circuit board manufacturers, which may reduce the demand for our products and force us to lower our prices in certain cases.

Some of our competitors have greater financial, personnel and other resources and offer a broader range of products and services. These competitors may be able to respond more quickly to new or emerging technologies or changes in customer requirements, develop additional or superior products, benefit from greater purchasing economies, offer more aggressive pricing or devote greater resources to the promotion of their products.

Technology in the markets in which we operate is rapidly evolving, and we may not be able to keep pace with these changes or with emerging industry standards. This could result in a loss of revenues.

The markets for our products are characterized by changing technology, evolving industry standards, changes in end-user requirements and new product introductions. Potential new technologies and improvements to existing production equipment and methods could improve production yields, thereby reducing the need to use our AOI systems or our sample preparation systems in these industries. In addition, new technologies could emerge as alternatives to using our products.

Our future success will depend on our ability to enhance our existing products and to develop and introduce new technologies for the printed circuit boards, IC substrates and silicon wafers markets. These products must keep pace with technological developments and address the increasingly sophisticated needs of our customers. If we fail to keep pace with technological changes, with products offered by our competitors or with emerging industry standards, our ability to attract new business and generate revenues may be damaged.

We seek to expand our activity into unsaturated markets adjacent to our existing served markets, such as the inspection of silicon wafers at various steps during their manufacturing process inside the wafer fabrication facility. Technological developments in production processes and in process control may reduce the growth we anticipate in demand for inspection systems. If this happens, we may not be able to cover our investments in penetrating these markets, or will have to increase our R&D and marketing expense to adapt our products to such changes.

Our products may infringe on the intellectual property rights of others, which could result in claims against us.

Third parties have asserted claims, and may assert additional claims in the future, that we have violated their patents or that we have infringed upon their intellectual property rights. Any intellectual property claims against us, even if without merit, could lead to protracted litigation, could cost us a significant amount of money to defend and could divert management’s attention from our business. Successful claims against us could limit our ability to sell products in certain jurisdictions.

On July 14, 2005, a lawsuit was filed against us in the United States District Court for the District of Minnesota (“Court”) by one of the Company's competitors in the field of semiconductor wafer inspection equipment, August Technology Corporation (today Rudolph Technologies Inc., hereinafter “Rudolph,” having acquired August Technology Corporation), alleging infringement of U.S. Patent No. 6,826,298 (“’298 patent”) and seeking injunctive relief and damages. On March 5, 2009 a jury verdict was rendered in favor of Rudolph, awarding damages of approximately $6.8 million with regard to sales of Camtek's Falcon products in the United States. The jury also found that the infringement was not willful. On August 28, 2009, the Court entered judgment ordering the Company to pay the jury award, as well as an additional $1.2 million in prejudgment interest. The Court also issued an injunction (“Injunction”) ordering the Company to discontinue all sales and marketing of Falcon in the United States. Pursuant to the terms of the Injunction, service and repair of Falcons sold prior to the jury verdict is permitted to keep the systems in original operating condition. The Injunction relates only to the Company's Falcon operations in the United States, and should not have an effect on any of the Company's other operations. The Company filed an appeal with the Court of Appeals for the Federal Circuit on August 10, 2010, after the Court’s denial of the Company’s post-judgment motions. On November 17, 2010, the Magistrate Judge found that Rudolph was entitled to $645,946 in supplemental damages reflecting Falcon sales occurring after the time period considered by the jury, and on January 7, 2011, the Court upheld the supplemental damages award. The Company has posted a bond in the Court, staying collection of any award pending resolution of the appeal. On March 9, 2011, Rudolph filed a motion seeking $322,973 in enhanced damages for an allegedly willful post-verdict Falcon sale, as well a motion seeking $1.2 million and unspecified attorneys fees for alleged contempt of the Injunction. The Company believes it has strong defenses to these charges and intends to vigorously oppose these motions. An appeal hearing is scheduled for April 7, 2011, but we expect final

decision on our appeal to be received no earlier then the second half of 2011. We believe that we have good grounds to be ultimately successful with the appeal, but see also "We have a history of losses, and we cannot assure you that we will not incur additional losses in the future. Moreover, if our business deteriorates, we could face liquidity problems" above.

On May 10, 2004, a lawsuit was filed against the Company in the District Court in Nazareth, Israel, by our competitor, Orbotech Ltd., alleging that the Dragon and Falcon systems infringe upon a patent held by Orbotech Ltd. and requesting injunctive relief and damages. The patent upon which the claim is asserted expired in February 2008. The court advised the parties to turn to mediation. The parties participated in one mediation meeting, after which they have decided to end the mediation and to hold direct negotiations. Despite the unsuccessful direct negotiations, the court ordered another mediation meeting which is scheduled for July 2011. Currently, court sessions have been postponed for as long as the mediation process continues. We believe that we have substantial defenses against the validity of Orbotech's patent and substantial defenses against Orbotech's claims.

On February 23, 2005, a lawsuit was filed against us in the District Court in Jerusalem by Orbotech Ltd., alleging infringement of patent held by Orbotech Ltd. regarding a specific illumination block (an apparatus for illuminating and controlling the illumination of scanned objects), seeking injunctive relief and damages. The court ruled, based on a court's scientific advisor's opinion and prima facie evidence, that Camtek infringed the patent, and granted Orbotech a provisional remedy, i.e. interim relief, which prevents Camtek from manufacturing the allegedly infringing illumination block in suit. The claim currently awaits the court's decisions in several preliminary motions filed by both parties. The patent upon which the claim is asserted expired in February 2007. At the court's recommendation, the parties held one mediation meeting, after which they have decided to conduct direct negotiations between them, without the mediator. These negotiations were unsuccessful. We believe that we have good defenses in the infringement aspect of the claim. We further believe that we have claims with respect to the validity of the asserted patent, as well as other defenses such as estoppel and lack of good faith on the part of Orbotech.

On June 1, 2010, Rudolph filed a complaint against us in the United States District Court for the District of Minnesota in which Rudolph alleged infringement of their U.S. Patent 7,779,528 relating to semiconductor wafer inspection technology similar to that described in the '298 patent. The complaint has not yet been served. However, we believe that we have good defenses and intend to aggressively defend ourselves from the allegations in this claim and our right to sell our tools in the United States.

We cannot assure you that we will be successful in our defense against these claims. If these claims will be ultimately successful, they could have a negative impact on our business by impairing our ability to sell our systems, and they could result in pecuniary damages against us and significant legal and other defense costs, which would impact our cash resources and profitability. In the event we do not prevail against these claims, we may also be liable for any court costs and attorney's fees incurred by the claimants in connection with these litigations. Even if we will be successful in our defense against these claims, we will still incur significant legal expenses while resolving these matters.

We depend on a limited number of suppliers, and in some cases a sole supplier and/or subcontractor. If one or more of our third-party suppliers or subcontractors does not provide us with key components or subsystems, we may not be able to deliver our products to our customers in a timely manner, and we may incur substantial costs to obtain these components from alternate sources.

We rely on single source and limited source suppliers and subcontractors for a number of essential components and subsystems of our products. We do not have agreements with all of these suppliers and subcontractors for the continued supply of the components or subsystems they provide. If some of our key suppliers encounter difficulties and financial problems or rapid increases in demands, they might be unable to supply us with the necessary components or subsystems and meet our requirements in a timely manner. An interruption in supply from these sources or an unexpected termination of the manufacture of key components or subsystems would disrupt production and adversely affect our ability to deliver products to our customers, hence could have an adverse effect on our business, revenues and results of operation. Although we have taken and currently take precautions against this kind of events, an unexpected termination or disruption of supply would require an investment in capital and manpower resources in order to shift to other suppliers and might cause a significant delay in introducing replacement products or a significant increase in inventory which could have an adverse effect on our revenues, cash flow and results of operation.

Certain of the components for our machines are supplied, directly or indirectly, from Japan. At this stage we are unable to evaluate what effect, if any, the recent earthquake in Japan may have on our supply chain and therefore on our revenues.

Since the beginning of 2010 our AOI systems to the back end semiconductor industry, the Falcon and Condor, are manufactured by a single subcontractor who performs part of the material planning, material procurement including key components from our approved suppliers, manufacturing, testing, assembly and packaging work with respect to these systems. If this subcontractor should encounter financial difficulties or the inability to meet our requirements in a timely manner, we could suffer from an unexpected termination or disruption of supply from this subcontractor, which would cause late deliveries of our products to our customers, require an investment in resources in order to shift to another supplier and might adversely affect our business, revenues and results of operation.

The cleaving process in Sela division’s MC600 systems use diamond knives. Such knives are manufactured by a single source in Europe, with whom Sela has an exclusive agreement. The knives are consumable items with a limited life cycle. The manufacturing process for these knives demands expertise and experience. Breakdown of the manufacturing process has happen in the past, and was treated by the manufacturer in a prompt and effective manner. Sela has over ten years of experience with this supplier and has never encountered a situation that compromised its ability to supply consumables to its customers. Nevertheless, at present, we are experiencing such breakdown that has depleted our stock surplus. As in the past the manufacturer is in the process of locating the root cause of this breakdown and applying corrective measures, but we cannot be sure what would be the time required to solve this current issue or its affect on our sales and service to our current installed base.

We may encounter difficulties in purchasing key components and subsystems, or overestimate our needs, to meet customer demand.

In the current highly-competitive business environment, our customers require us to fill orders within a very short period of time. Our products are complex and require essential components and subsystems that are produced by a number of suppliers and subcontractors. These suppliers and subcontractors cannot always supply such components and subsystems within the time frame demanded by our customers. Therefore, we are required to predict future demands. We believe that we have sufficient inventory to fill our customers' orders on time. However, if market conditions rapidly change and customer demand increases, we will be required to order additional components and subsystems. If our suppliers and subcontractors are unable to timely meet our increased demand, we might not be able to adequately meet our customers’ demands. Our inability to satisfy any increase in customer orders could result in the loss of sales and could cause customers to seek products from our competitors.

We may also overestimate or incorrectly estimate the product mix of our future needs, which could result in an excess inventory of certain components and subsystems.

If we are unable to protect our proprietary technologies, we may not be able to compete effectively.

We differentiate our products and technologies from those of our competitors by using our proprietary software, our image processing algorithms, ink formulations, ion gun design and advanced image acquisition systems and the integration of our advanced hardware components. We rely on a combination of copyrights, trade secrets, patents, trademarks, confidentiality and non-disclosure agreements to protect our proprietary know-how and intellectual property, including with respect to hardware and software components of our products, our digital ink formula and our adaptive ion milling (“AIM”) technology. These measures may not be adequate to protect our proprietary technologies and it may be possible for a third party, including a competitor, to copy or otherwise obtain and use our products or technologies without authorization or to develop similar technologies independently. Additionally, our products may be sold in countries, particularly in the Asia Pacific region, that provide less protection to intellectual property than that provided under U.S. or Israeli laws. In addition we have a manufacturing facility in China, in which we assemble most of our AOI systems for the printed circuit board industry, where the intellectual property laws may not be strictly enforced. Therefore, potential risk may be associated with the protection of our intellectual property which in turn may affect our competitive advantage.

Fluctuations in currency exchange rates may result in the prices of our products becoming less competitive or in additional expenses being recorded.

Currency exchange rate fluctuations may affect the prices of our products. Our products' prices in most countries are denominated in dollars except for Europe, Japan and as of 2011 also part of our revenues from products in China. In those countries, if there is a significant devaluation in the local currency compared to the dollar, the prices of our products will increase relative to that local currency and may be less competitive. In addition, much of our service income is denominated in local currencies. If a larger number of our sales were to be denominated in currencies other than dollars, our reported revenue and earnings would be subject to a greater degree of foreign exchange fluctuations.

We generate most of our revenues from products in U.S. dollars but incur a significant portion of our salary and operating expenses in NIS. As most of our revenues are denominated in dollars and as our financial results are reported in dollars, we believe that inflation and fluctuations in the NIS/dollar exchange rate have no material effect on our revenues. However, a major portion of the costs of our Israeli operations, such as personnel, subcontractors, materials and facility-related costs, are incurred in NIS. An increase in the NIS value relative to the dollar will increase our costs expressed in dollars, and a decrease in the NIS value relative to the dollar will decrease our costs expressed in dollars. In addition, starting 2011, part of our revenues from products in China will be denominated in

local currency. Most of the expenses and purchases in China are also denominated in local currency. As our financial results are reported in dollars, fluctuations in the CNY/dollar exchange rate may affect our revenues and level of expenses. We may, from time to time, take various measures designed to reduce our exposure to these effects, but any such steps may be inadequate to protect us from currency rate fluctuations. Failure to protect adequately against currency rate fluctuations could have a material adverse effect on our financial condition and results of operations.

We may face risks of interruptions in our production capabilities.

Our major manufacturing facility is located in Migdal Ha'Emek, in the Northern part of Israel. Any event affecting this site, including natural disaster, labor stoppages or armed conflict, may disrupt or indefinitely discontinue our manufacturing capabilities and could significantly impair our ability to fulfill orders and generate revenues, thus negatively impacting our business (see also in "We depend on a limited number of suppliers, and in some cases a sole supplier and/or subcontractor" above).

We also have a manufacturing facility in China, in which we assemble most of our AOI systems for the printed circuit board industry. Therefore, we may be influenced by changing events in China; for example, our manufacturing activity in China may suffer as a result of changes in China's geopolitical status or fluctuations in its economic stability. In addition, we may be exposed to sourcing risks, such as supply-chain and business interruption issues. Any event affecting this site may disrupt our manufacturing capabilities and could significantly impair our ability to fulfill orders and generate revenues, thus negatively impacting our business.

We have expanded and may attempt to expand further our activity in the markets we operate in through M&A activity. Such activity may result in operating difficulties, losses and other adverse consequences.

In 2009, we invested in the development of new growth engines by acquiring the assets and certain liabilities of Printar Ltd. ("Printar") and the entire share capital of SELA – Semiconductor Engineering Laboratories Ltd. ("SELA"), both Israeli companies; see below in Item 4.B "Business Overview – Our Business. We plan to grow our business, in part through acquisitions. Our existing operations, as well as any future acquired businesses or assets, could involve numerous risks, including: post-merger integration difficulties; diversion of management's attention from our core business and the operations acquired in 2009 ; failure to estimate the acquired business future performance and failure to execute on such expectations; failure to launch new products to our existing or new markets; inaccurate evaluation of expected competition and/or of the fair value of certain assets acquired, liabilities assumed and contingent liabilities; and the loss of key employees of the acquired operations.

In addition, we cannot be certain that any future acquisition will be successful. If the operation of the business of any acquisition disrupts our operations, our business may suffer. Even if we successfully integrate the acquired businesses with our own, we may not receive the intended benefits of these acquisitions as a result of, for example, performances below expectations, changes in the economic or market conditions and the entering of stronger competitors or new technologies.

In addition, principally as a result of acquisition activity, our future results of operations would be influenced by the possibility of impairment charges being incurred as a result of decline in value of goodwill and other intangible assets, an ongoing amortization of intangible assets acquired and financing expenses due to re-evaluation of contingent liabilities and other liabilities assumed presented at fair value (see also in Item 5 below - "Critical Accounting Policies").

Future acquisitions could also result in potentially dilutive issuances of equity securities, decrease in our cash resources, incurrence of debt, contingent liabilities or impairment charges related to goodwill and other intangible assets, any of which could harm our business. Furthermore, we compete for acquisition and investment opportunities with other well-established and well-capitalized entities. There can be no assurance that we will be able to locate acquisition or investment opportunities upon favorable terms.

The unavailability of credit insurance may adversely affect our willingness to sell to certain customers.

Since the second quarter of 2006, we have purchased credit insurance from an Israeli insurance company to cover certain sales. During crisis periods, credit insurance which previously covered some of our customers may be unavailable. In addition the insurance company can refuse to insure certain customers mainly small and private companies, in general, specifically in China. This could adversely affect our willingness to sell products to these customers.

We depend on a limited number of key personnel who would be difficult to replace.

Our continued growth and success significantly depend on the managerial and technical skills of the members of our senior management and key employees. If our operations rapidly expand, we believe that we will need to promote and hire qualified engineering, administrative, operational, financial and marketing personnel. In particular, we may find it difficult to hire key personnel with the requisite knowledge of our business, products and technologies. The process of locating, training and successfully integrating qualified personnel into our operations can be lengthy and expensive. During periods of economic growth, competition for qualified engineering and technical personnel is intense.

As a result of the acquisition of Sela and Printar's assets we employ certain key employees of these two operations. There is no assurance that these key employees will continue to be employed by us, and a discontinuation of their employment could result in negative effect on our business.

Our relationship with Priortech may give rise to conflicts of interest.

We purchase products of, or sell products to, Priortech Ltd., our principal shareholder, and other companies owned or controlled by it, directly or indirectly, and act jointly with respect to governmental and administrative matters and the purchase from third parties of various products and services, which may create conflicts of interest. Despite Israeli law procedural requirements, including obtaining special shareholder approvals for interested party transactions, we cannot be certain that those procedures will eliminate the possible detrimental effects of any of these transactions and activities. In addition, Mr. Rafi Amit acts as the Active Chairman of the Board of Directors of the Company, on a 75% basis, as well as acting as Priortech's Chairman of the Board of Directors and providing consulting and management services to Priortech on a 25% basis. Mr. Yotam Stern, our Executive Vice President, Business & Strategy, spends 40% of his time serving as the Chief Executive Officer of Priortech and other positions in the Priortech group (for more details regarding recent changes in senior management see Item 6 B below - "Compensation – Employment Agreements").

We may decide to obtain additional capital which would cause dilution to our shareholders' holdings.

If we decide to raise additional funds through the issuance of equity or convertible debt securities and are successful at raising such capital, the percentage ownership of our shareholders could be diluted.

If we are classified as a passive foreign investment company, our U.S. shareholders may suffer adverse tax consequences.

Generally, if for any taxable year, after applying certain look-through rules, 75% or more of our gross income is passive income, or at least 50% of our assets (averaged quarterly) are held for the production of, or produce, passive income, we may be characterized as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. This characterization could result in adverse tax consequences to our U.S. shareholders, including gain realized on the sale of our ordinary shares being taxed at as ordinary income rates rather than capital gain rates, and could result in punitive interest charges being applied to such sales proceeds. Rules similar to those applicable to

dispositions generally will apply to certain “excess distributions” with respect to our ordinary shares. U.S. shareholders should consult with their own U.S. tax advisors with respect to the U.S. tax consequences of investing in our ordinary shares.

Based on an analysis of our assets and income, we believe that in 2010 we were not a PFIC. We currently expect that we will not be a PFIC in 2011. However, PFIC status is determined as of the end of the taxable year and is dependent on a number of factors, including the relative value of our passive assets and our non-passive assets, our market capitalization and the amount and type of our gross income. Therefore, there can be no assurance that we will not become a PFIC for the year ending December 31, 2011 or in any future taxable year. For a discussion of how we might be characterized as a PFIC and the related tax consequences, please see “U.S. Federal Income Tax Considerations-Tax Consequences if We Are a Passive Foreign Investment Company".

Our share price has been volatile in the past and may continue to fluctuate in the future.

Our ordinary shares have experienced significant market price and volume fluctuations in the past. During the period from January 1, 2010 through March 31, 2011, the closing price of our ordinary shares ranged from $2.21 to $4.65. During the period from January 1, 2009 through March 31, 2010, the closing price of our ordinary shares ranged from $0.25 to $3.23. Our ordinary shares may experience significant market price and volume fluctuations in response to factors, some of which are beyond our control, such as the following:

- global economic conditions, which generally influence stock market prices and volume fluctuations;
- quarterly variations in our operating results;
- market conditions relating to our customers’ industries;
- operating results that vary from the expectations of securities analysts and investors;
- changes in expectations as to our future financial performance, including financial estimates or recommendations by securities analysts and investors;
- large block transactions in our ordinary shares;
- an absence of an active trading market may limit our shareholders’ ability to sell our ordinary shares in short time periods.
- announcements of technological innovations or new products by us or our competitors;
- announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, M&A transactions, joint ventures or capital commitments;
- changes in the status of our intellectual property rights;
- announcements of significant claims or proceedings against us and developments in such proceedings;
- adverse decisions in litigation matter;
- additions or departures of our key personnel; and
- future sales of our ordinary shares.

Stock markets often experience extreme price and volume fluctuations. Market fluctuations, as well as general economic conditions, such as a recession, interest rate or currency rate fluctuations, political events or hostilities in

Israel, the surrounding region or worldwide could adversely affect the market price of our ordinary shares.

In the past, securities class action litigation has often been brought against companies following periods of volatility in the market price of their securities. Currently, we are facing a class action complaint, as detailed in Item 8A – Legal Proceedings. This class action complaint could be protracted and divert management's attention and resources.

Our principal shareholder, Priortech, holds a controlling interest in us and will be able to exercise its control in ways that may be adverse to your interests.

Priortech beneficially holds 60.5% of our issued and outstanding ordinary shares. As a result, Priortech has the power to control the outcome of matters submitted to a vote of our shareholders, including the election of members of our board and the approval of significant corporate transactions. This concentration of ownership may also have the effect of making it more difficult to obtain approval for a change in control of us. Messrs. Rafi Amit, Yotam Stern, Itzhak Krell, David Kishon, heirs of Haim Langmas, Zehava Wineberg and Hanoch Feldstien control Priortech and may be deemed to control us.

Changes in accounting standards or practices can have a significant effect on our reported results.

We prepare our financial statements to conform to U.S. GAAP. From time to time, recognized authoritative bodies, including the Financial Accounting Standards Board of the United States (the "FASB") and the SEC, issue new and/or revised accounting standards or guidance. Changes to existing standards or the questioning of current practices may adversely or significantly affect the way in which the Company records and reports its operating results, cash flows and financial position.

We may fail to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002.

We have documented and tested our internal control systems and procedures in order for us to comply with the requirements of Section 404. While our assessment of our internal control over financial reporting resulted in our conclusion that as of December 31, 2010, our internal control over financial reporting was effective, we cannot predict the outcome of our testing in future periods. If we fail to maintain the adequacy of our internal controls, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities, and could have a material adverse effect on our operating results, investor confidence in our reported financial information, and the market price of our ordinary shares.

Risks Relating to Our Operations in Israel

Conducting business in Israel entails special risks.

Our principal offices, sole research and development facility and one of our manufacturing facilities are located in the State of Israel. We depend on components imported from outside of Israel and almost all of our sales occur outside of Israel. Accordingly, we are directly influenced by the political, economic and military conditions affecting Israel. Specifically, we could be adversely affected by:

- any major hostilities involving Israel;
- a full or partial mobilization of the reserve forces of the Israeli army;
- the interruption or curtailment of trade between Israel and its present trading partners; and

- a significant downturn in the economic or financial condition of Israel.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Since September 2000, there has been a marked increase in violence, civil unrest and hostility, including armed clashes, between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza. In July 2006 there were extensive hostilities along Israel's northern border, with Lebanon, in proximity to where we are located, and in the winter of 2008-2009 Israel was engaged in an armed conflict in the Gaza Strip. None of the above had any material impact on our operations. Further, in the last couple of months throughout the Middle East there has been political turmoil and outbreaks of violence, the effects of which are yet to unfold but contribute to the general atmosphere of instability in the region. Increased hostilities, current and future armed conflicts, further adverse developments in other states in the region, or continued or increased terrorism could make it more difficult for us to conduct our operations in Israel, which could increase our costs and adversely affect our financial results. Furthermore, there are a number of countries, primarily in the Middle East, that restrict business with Israel or Israeli companies, and we are precluded from marketing our products to these countries. Restrictive laws or policies of those countries directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

Our operations could be disrupted as a result of the obligation of our key personnel in Israel to perform military service. Some of our employees in Israel, including certain key employees, are obligated to perform annual reserve duty in the Israeli army and are subject to being called up for reserve duty at any time. The absence of one or more of our officers and key employees for significant periods of time due to military service could be disruptive to our operations.

The Israeli government programs and tax benefits in which we have participated in the past and in which we currently participate or from which we receive benefits require us to meet several conditions. These programs or benefits may be terminated or reduced in the future, which could increase our tax expenses.

We, Camtek Ltd., and our subsidiary Sela, benefit from certain Israeli government programs and tax benefits, particularly from tax exemptions, from the Approved Enterprise status of our manufacturing facilities in Israel. To be eligible for these programs and tax benefits or similar program in the future, we must continue to meet certain conditions, including making specified investments in fixed assets and equipment. If we fail to meet such conditions in the future, these tax benefits could be cancelled, and we could be required to refund those tax benefits already received. These programs and tax benefits may not be continued in the future at their current levels, and our requests for tax exemption on income from our manufacturing facilities may not be approved.

The government grants we receive for research and development expenditures restrict our ability to manufacture products or to transfer technologies outside of Israel.

From our inception through 2000, we received government grants from the Office of the Chief Scientist of the Ministry of Industry and Trade (the “OCS”), for the financing of a significant portion of our product development expenditures. In March 2001, we commenced repayment of many of these grants pursuant to an understanding reached with the OCS. As of June 1, 2005, we have fully repaid our previously received grants from the OCS. Except for special circumstances and if we obtain governmental consents and pay to the OCS amounts which may be substantial, the terms of these grants prohibit us from selling or transferring rights in the technology developed with the grants outside of Israel and allow sale or transfer of rights within Israel only with special governmental approvals, even after full repayment of the grants. Elements of our technologies, including in the areas of electronic hardware, image processing, electro-optics, physics and mechanics, were developed with OCS grants. In addition, we may only manufacture products developed with these grants outside of Israel pursuant to the approval of a special governmental committee, and any approval of this nature may also require us to pay a further significant amount of royalties than the

terms of the grants required, unless the amount of production outside Israel is less than 10% of the original rate of production and the OCS has not objected to the transfer of products. The restrictions regarding the sale or transfer of technology or manufacturing rights out of Israel could have a material adverse effect on our ability to enter into strategic alliances or enter into merger or acquisition transactions in the future that provide for the sale or transfer of our technology or manufacturing rights.

As of December 31, 2010, a dispute has arisen between us and the OCS in Israel in the amount of approximately $600 thousand regarding the royalty rate to be paid in respect of certain of our supported products, the assembly of which has been moved to a foreign subsidiary.

Based on an opinion of our legal advisors, we believe that the probability that we will be required to pay this amount is less than 50%. Accordingly, no provision has been recorded in our financial statements in respect of this matter.

Sela received government grants from the OCS for the financing of a significant portion of its product development expenditures in previous years. As of December 31, 2010 the amount of unpaid grants received, including interest accrued by Sela, amounted to $3.0 million. As part of the acquisition of Printar's assets and certain liabilities, we assumed Printar's liability to the OCS. In addition, in 2009 and 2010 we received additional grants with respect to the development programs of the digital material deposition systems in the amount of $0.6 million. As of December 31, 2010 the amount of unpaid grants received including interest accrued by Camtek, including the liabilities assumed from Printar, amounted to $5.2 million.

It may be difficult to enforce a U.S. judgment against us, our officers and directors and some of the experts named in this Annual Report or to assert U.S. securities law claims in Israel.

We are incorporated in Israel. Substantially all of our executive officers and directors and our Israeli attorneys are nonresidents of the United States, and a substantial portion of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult to enforce a judgment obtained in the United States against us or any of these persons, including one based on the civil liability provisions of the U.S. federal securities laws. Additionally, it may be difficult for you to assert U.S. federal securities laws claims or to enforce civil liabilities under U.S. federal securities laws in actions originally instituted in Israel.

Some provisions of Israeli law could inhibit the acquisition of us by others.

Some provisions of Israeli corporate law may have the effect of delaying, preventing or making more difficult a merger with, or acquisition of, us. The Israeli Companies Law generally provides that a merger be approved by the board of directors and by a majority of the shares present and voting on the proposed merger at a shareholders' meeting called upon at least 21 days' notice of each of the merging companies. A merger may not be completed until at least 50 days have passed since the filing of the merger proposal by each of the merging companies with the Israeli Registrar of Companies, and 30 days have passed since the resolution was adopted by the general meeting of each of the merging companies. The Israeli Companies Law also provides that an acquisition of shares in a public company must be made by means of a special tender offer if, as a result of the acquisition, someone would become a 25% or greater shareholder of the company, unless there is already another 25% or greater shareholder of the company. Similarly, an acquisition of shares must be made by way of a special tender offer if, as a result of the acquisition, the purchaser would become a 45% or greater shareholder of the company, unless there is already another 45% or greater shareholder of the company. In any event, if, as a result of an acquisition of shares, the acquirer will hold more than 90% of a company's shares, the acquisition must be made by means of a tender offer for all of the shares. Finally, Israeli tax law treats some acquisitions, such as stock-for-stock exchanges between an Israeli company and a foreign company, less favorably than U.S. tax laws. For example, Israeli tax law may, under certain circumstances, subject a shareholder who exchanges his ordinary shares for shares in another corporation to taxation prior to the sale of the shares received in such stock-for-stock swap. For more information on the provisions of Israeli law in these contexts, please see sections "Share Capital" and "Israeli Taxation."

Item 4. Information on the Company.

A. History and Development of the Company

Our legal and commercial name is Camtek Ltd. We were incorporated under the laws of the State of Israel in 1987. We operate under the Israeli Companies Law. In our first years of operation, we provided manual optical inspection equipment to address the needs of the printed circuit board, or PCB, manufacturing industry. In 1994, we introduced our first automated optical inspection, or AOI, system for the inspection of PCBs. In late 1998, we introduced our Orion system, which gained wide acceptance in the high-end PCB market and represented a breakthrough for us. Applying our core technologies, we developed our Pegasus system, which was introduced in the third quarter of 2002, for the inspection of integrated circuits (IC) substrates. See below in Item 4(c) “Organizational Structure”.

In September 2001, we acquired a developer and producer of AOI systems for the semiconductor manufacturing and packaging industry, or MEP. This acquisition allowed us to enter the back end semiconductor inspection market. After a period of intense internal research and development, we shipped our first new Falcon system for the back end market in the semiconductor industry in the fourth quarter of 2003. The first revenue recognition of the Falcon system was in the second quarter of 2004 and since then, Falcon sales increased. Applying our core technologies, we developed the Gannet, our AOI system for the front end market, which was introduced in 2009 and first sold in the fourth quarter of 2009.

In 2009 we entered into two new fields of activity: in June 2009 we acquired assets and certain liabilities of Printar, which was engaged in manufacturing, sale and marketing of direct digital material deposition systems and inks for the PCB industry, with two major fields of activity: Solder Mask, an epoxy layer selectively covering the PCB, while leaving the connection pads uncovered, currently under beta testing, and Legend, applying the identification nomenclature on the PCB, commonly used in the PCB industry. Printar introduced its first Legend system six years ago and maintains an installed base of more than 45 Legend systems. We are not manufacturing new Legend systems, but support the installed base and sell ink products used by Legend machines. Printar's technology could also be used in the future for various other applications in the field of electronic manufacturing. In 2009 we also completed the acquisition of Sela, which is engaged in the development, manufacturing and marketing of automated SEM (Scanning Electron Microscope) and TEM (Transmission Electron Microscope) sample preparation equipment, primarily for the front end semiconductor industry. Sela has more than 285 systems installed worldwide. Many of these systems are located at leading semiconductor fabrication facilities. Sela developed the Xact, a TEM sample preparation tool using Adaptive Ion Milling (AIM) technology. The first Xact system was sold in the first quarter of 2009, and sales continued with two additional Xact systems during 2010.

In July 2000, we sold 5,835,000 ordinary shares in an initial public offering, in which we received net proceeds of approximately $35 million. In August 2002, we sold 5,926,730 ordinary shares in a rights offering of ordinary shares to our then existing shareholders (of which 5,922,228 were sold to Priortech Ltd.), in which we received net proceeds of $6.1 million. On August 23, 2005 we raised $5 million as a convertible loan from FIMI Opportunity Fund L.P and FIMI Israel Opportunity Fund, Limited Partnership (FIMI) – the whole amount was repaid ($1.66 million was paid in August 2008, another $1.66 million was paid in August 2009, and the remaining $1.66 million was paid in August 2010). On April 30, 2006, we completed a private placement in which we issued 2,525,252 ordinary shares to Israeli institutional investors at a price of $5.94 per share, raising $14.5 million. This private placement also included warrants that, during a period of four years, were exercisable into additional 1,262,626 ordinary shares at a price of $6.83 per share, but all these warrants expired in April 2010.

We have been a public company since July 2000. In December 2005, we re-listed on the Tel-Aviv Stock Exchange and became a dual listed company (see below in Item 9.A. "Offer and Listing Details"). Our headquarters are located in Israel, and we have operations in the Asia Pacific region, North America and Europe.

For discussion of capital expenditures, see Item 5- "Operating and Financial Review and Prospects- Liquidity and Capital Resources."

Our principal executive offices are located in Ramat Gavriel Industrial Zone, P.O. Box 544, Migdal Ha'Emek 23150, Israel, and our telephone number is 011-972-4-604-8100. Our agent for service of process in the United States is Camtek USA, Inc., located at 2000 Wyatt Dr., Santa Clara CA 95054, Tel: (408) 986 9640. Our website is located at www.camtek.co.il. The information on our website is not incorporated by reference into this Annual Report.

B. Business Overview.

Our Business

Camtek provides automated solutions dedicated for enhancing production processes and yield for the semiconductor manufacturing and packaging and the printed circuit board and IC substrate industries.

Camtek addresses the specific needs of these interconnected industries with dedicated solutions based on an advanced platform of technologies including intelligent imaging, image processing, sample preparation and digital material deposition. Camtek's solutions range from micro-to-nano by applying its technologies to the industry-specific requirements.

We design, develop, manufacture and market products based on three core technologies: automated optical inspection or AOI; Digital Material Deposition or DMD; and adaptive ion milling, or AIM. AOI systems are computerized systems that optically inspect various types of electronic product components for defects caused during the manufacturing process. Our AOI systems are used to enhance both production processes and yields for manufacturers in the printed circuit board and IC substrate industry and in the semiconductor industry. Our systems provide our customers with a high level of defect detection ability, are easy to operate and offer high productivity. We have sold more than 2,400 AOI systems in 34 countries around the world. Our PCB customer base includes the majority of the largest 100 PCB manufacturers worldwide. Since the introduction of our Falcon line for the semiconductor industry, we have sold over 200 Falcon systems to more than 30 semiconductor manufacturers, among them outsourced semiconductor assembly and test (OSAT), Integrated Device Manufacturers (IDM) and wafer level packaging subcontractors, including 12 out of the top 15 semiconductors companies.

Our AOI products incorporate proprietary advanced image processing software and algorithms, as well as advanced electro-optics and precision mechanics. They are designed for easy operation and maintenance. In addition, our AOI systems use technology that enables our customers to handle a wide range of inspection and verification needs.

Our global direct customer support organization provides responsive, localized pre and post sales support for our customers through our wholly-owned subsidiaries.

Printar Ltd. was engaged in manufacturing, sale and marketing of direct digital material deposition systems and inks for the PCB industry, with two major fields of activity: Solder Mask, an epoxy layer selectively covering the PCB, while leaving the connecting pads uncovered ("SM") and Legend, applying the identification nomenclature on the PCB, commonly used in the PCB industry ("Legend"). Printar introduced its first Legend system six years ago and maintains an installed base of more than 45 Legend systems.

Printar's technology provides a high performance one-step, environment-friendly and relatively low-cost process, in comparison with traditional printing methods. The technology can also be applicable in the future to various other applications in the field of electronic manufacturing.

The SM technology is currently in beta testing. The acquisition of Printar's assets will enable us to offer to our customers in the PCB industry a broader range of products, while relying on existing operational, R&D and sales and marketing infrastructure.

Sela is engaged in the development, manufacturing and marketing of automated SEM (Scanning Electron Microscope) and TEM (Transmission Electron Microscope) sample preparation equipment, primarily for the semiconductor industry. Sample preparation is a process enabling the material characterization and failure analysis serving the semiconductor and nanotechnology markets.

Sela developed the Xact, a TEM sample preparation tool using AIM technology. The AIM technology brings numerous advantages to traditional FIB (Focused Ion Beam) technology and overcomes the limitations of FIB technology in delivering wide-area, ultra-thin (reducing the sample thickness to below 20nm over a large area), artifact-free specimens with high throughput and precise end-point detection. This complement of attributes is essential to meet the requirements for nano-scale material analysis, both in the semiconductor segment and in the wider field of advanced material development, including delivery of significantly reduced turnaround times and enhanced productivity. The continuous device shrinking trend and material complexity increases the TEM utilization and consequently increases the served available market for SELA’s Xact sample preparation solutions. A SEM-oriented microcleaving solution provides high-quality, automated cleaving without artifacts.

Sela has over 285 systems in operation worldwide. Customers include major semiconductor fabrications, including top 20 companies, as well as leading research institutes. This, combined with Camtek's well-established infrastructure in manufacturing, sales, service, R&D and facilities, allows Camtek to increase its revenues, shorten time-to-market of Sela's products and further strengthen Camtek's presence in the semiconductor market.

Our Markets

We target the semiconductor industry and the PCB and IC substrate industry, all part of the electronic packaging industries and the electronics supply chain.

The Semiconductor Industry

The semiconductor manufacturing industry produces circuits (ICs) on silicon or other semiconductor materials; each wafer consists of numerous IC dies (“chips”). AOI is implemented at various stages along the manufacturing process: both at the front end manufacturing processes such as lithography and CMP and the back end processes such as bump, probe mark and post dice. The inspection process is looking for defects such as cracks, foreign materials or mechanical damage, it also ensures dimensional conformity, thus eliminating subsequent testing of defective products, increasing yield and reducing overall production costs. In the failure analysis laboratories at the front end of the manufacturing process, samples are being taken from failed products and reviewed with electronic microscopes. Sela’s products are used to prepare these samples for review.

At the back end, our AOI systems inspect the wafer for various defects. At this stage, AOI systems verify that the dies are free of defects, and that the electronic probe tips used for functional testing of the finished dies on the wafer have caused no critical damage to the terminal pads on the die. AOI is essential at this stage to help ensure the reliability and service life of the electronic device after its assembly and packaging.

In the semiconductor packaging process, the finished wafers are diced, or separated, into individual ICs, which are then mounted onto substrates, interconnected and encapsulated to produce semiconductor packages. AOI equipment, together with electrical probe testing, determines which ICs and substrates are non-defective. AOI equipment is also used to inspect for any defects that may have been caused to the ICs during electrical probe testing and the dicing of

the wafer.

In “flip-chip” packaging technology, the face of the IC is attached to the top of a substrate via an array of bumps, rather than being wire bonded. Wafers designed for flip-chip assembly interconnect go through a process in which solder bumps ranging from 15 to 150 microns in height, or gold bumps about 15 microns tall, are plated or stenciled on pads on the face of the IC. In a similar technology termed “chip-scale wafer level packaging (CS-WLP), larger bumps/balls up to 300 to 500 micron tall are placed on the die and the entire wafer is coated with a thick layer of polymer - usually epoxy. After dicing, the individual die is actually a finished device, ready to be mounted directly on the PCB. AOI with 3-D measurement capabilities is used to detect any missing, misplaced or deformed bump and to determine bumps conformity to shape and height specifications. Size, shape and placement deviations may cause damage to the IC or the substrate during the packaging process, leading to device failure.

A relatively fast growing segment is “micro-electro mechanical systems” (MEMS), which utilize materials, manufacturing technologies and facilities from the semiconductor industry to produce miniature mechanisms, such as inkjet print heads, accelerometers, image sensors, video projection devices (DLP), sensors and microphones. Many MEMS products are packaged between layers of glass while still at the wafer format, and diced in several steps afterwards. The MEMS manufacturing segment relies heavily on testing to ensure the product performance and reliability. This testing may amount to a significant amount of the overall product cost. AOI is implemented at various stages along the manufacturing process to detect cracks, foreign materials or mechanical damage, as well as confirm dimensional conformity, thus eliminating subsequent testing of defective products, increasing yield and reducing overall production costs.

An additional small, but fast growing segment is “light emitting diodes” (LED), which utilizes materials, manufacturing technologies and facilities from the semiconductor industry to produce LEDs. The LED manufacturing segment relies heavily on testing to ensure the product performance and reliability. This testing may amount to a significant amount of the overall product cost.

The Gannet was designed to inspect front end applications of the semiconductor industry. In semiconductor device manufacturing, dozens of fine pattern layers are exposed onto a wafer (lithography). Those patterns are then inspected after each set of exposure and development to ensure the patterns are formed with the required design position and accuracy. In addition, inspection data can be used by customers to monitor and characterize the production processes.

The AIM technology brings numerous advantages to traditional FIB technology by reducing the sample thickness to below 20nm over a large area, with high precision and throughput and with superior image quality. This complement of attributes is essential to meet the growing requirements for nano-scale material analysis, both in the semiconductor segment and in the wider field of advanced material development, including delivery of significantly reduced turnaround times and enhanced productivity. The continuous device shrinking trend and material complexity increases the TEM utilization and consequently increases the served available market for Sela’s Xact sample preparation solutions.

The Printed Circuit Board and IC Substrate Industry

A PCB is the basic platform that supports and interconnects a broad range of electronic components, such as IC devices, resistors, capacitors, coils and the like, and enables them to operate as an electronic system. PCBs consist of traces, or lines, of conductive material, such as copper, laminated on either a rigid or a flexible insulating base. These conductive lines provide electrical interconnections between the components. The trace integrity and conformance to exact dimensions are essential to the functioning of the electronic product. Imperfections in the various stages of the PCB manufacturing process may result in defects or flaws, like open conductive lines, electrical short circuits, nicks and inappropriate line widths.

The trend towards compact, high-performance and highly reliable electronic products, such as mobile phones, notebook computers, digital cameras and personal digital assistants, drives the demand for increased complexity and miniaturization of PCBs. In response to this demand, PCB manufacturers are producing multi-layer PCBs with increasingly narrower and denser lines, as well as boards with higher layer counts. Multi-layer boards consist of several layers of circuitry laminated together to form a single board with both horizontal and vertical electrical interconnections. In addition, multi-layer boards are continuing to evolve with new technologies. Currently, high-end PCBs (excluding substrates) use conductive lines and spaces 50 to 120 microns (0.002 to 0.005 inch). The scan time required to inspect a given PCB surface increases substantially in relation to the reduction in line width.

The manufacturing process for multi-layer boards is comprised of three stages: the manufacture of production tools, including artwork and masks; the production of inner layers and their lamination into a single board; and the production of external layers. The majority of AOI systems in the PCB industry are used for inspection of inner layers. Today, the number of inner layers in typical multi-layer PCBs usually ranges from 4 to 14, though certain high layer-count boards may consist of as many as 52 layers. Inspection by AOI systems during the manufacturing process for the detection of defects in the inner layers prior to the lamination process is crucial, so that any defective individual layers may be repaired or replaced while still accessible. Once the multi-layer board is laminated, any undetected defect in any specific layer will result in discarding the entire board.

Traditional printing on PCBs includes screen-printing and photo imaging. These printing technologies involve high production costs, time-consuming procedures and several production steps. Camtek's DMD - Legend printing and SM printing (the latter currently under beta testing) allows significant simplification of the Legend and SM process, which leads to faster cycle time and reduces operational costs.

The pursuit of electronic products that deliver more functionality, and at the same time are smaller, lighter and less power-consuming, drive the semiconductor industry to produce ICs (dies) requiring more input/output connections. These dies must fit into smaller packages. The IC substrate industry, in turn, supports these trends with high-density interconnect substrates that serve as carriers for the IC die, providing it mechanical and electrical connection to the printed circuit board. These substrates feature conductive lines that are 10 to 50 µm (microns) in width. Although IC substrates are produced using technologies derived from those used for the production of traditional PCBs, the complexity and high density of these substrates require separate, specialized manufacturing facilities.

The die is connected to the upper side of the substrate, either by wire bonding by means of thin metal wires, or by "flipping" the IC and directly connecting conductive bumps on its face to a matching array of pads or bumps on the substrate. The latter technology is known as flip chip die attach ("Flip-Chip"). The die substrate is connected to the PCB via an array of conductive solder balls, known as a ball grid array, or BGA.

The complexity of IC substrates requires advanced inspection systems with high magnification power for detecting minuscule defects that hinder production yields. Optical inspection of IC substrates is implemented along the manufacturing process, where the substrates are still in panel form, similar to PCB, and at the end of the production process, where the substrates are cut to strips or packed in trays. Due to the high integration level of today's electronic products, defective substrates, that pass undetected, may render the entire product unusable. Or, if assembled in a mission-critical system, they may cause a catastrophic failure.

Product Lines

Our AOI systems consist of:

- An electro-optical assembly unit, either movable or fixed, which consists of a video camera, precision optics and illumination sources. The electro-optical unit captures the image of the inspected product;
- A precise, either movable or fixed table, that holds the inspected product; and
- An electronic hardware unit, which operates the entire system and includes embedded components that process and analyze the captured image by using our proprietary algorithms.

The inspected product is placed on the movable table and is scanned under the optical assembly unit. The optical assembly unit then captures images of the product, while the electronic hardware unit processes the image using the analysis algorithms. Detected discrepancies are logged and reported as defects per the user preferences. The image of

the defect is immediately available for verification by the system operator. Our systems can also compile and communicate statistical reports of inspection findings via the customer's factory information system.

We offer a broad range of systems for automated optical inspection of semiconductor wafers, IC substrates and PCBs. These systems are used to enhance production yields and assist in controlling manufacturing processes at wafer fabrication, test and assembly houses, and PCB plants worldwide. We invest significant resources in research and development to provide our customers with advantageous performance, low cost of ownership, high reliability and ease of operation. We believe that a significant part of our competitive advantage and of our ability to adapt our technologies to evolving market needs comes from our design philosophy and applicable know-how in basing our products on software-intensive architectures.

Semiconductor Industry

AOI Systems

Falcon

Our Falcon systems were designed for the back end market of the semiconductor industry. The Falcon's advanced algorithms and inspection capabilities enable its dedicated models to detect defects in the die, which, if left undetected, may cause failure. In addition, inspection data can be used by customers to monitor and characterize several wafer finishing processes, troubleshoot functional issues or control the integrity of the interconnect and performs various metrology tasks.

Condor

The Condor is designed to meet the current and future inspection needs of the semiconductor industry. The Condor through its state of the art algorithms and advanced hardware configuration is designed to enhance the 2D and 3D detection abilities and increased throughput. The Condor includes 2D inspection and metrology abilities combined with 3D metrology capabilities such as bump, micro bump and TSV (through silicon via) measurements.
The Condor family currently includes models for:

- 3D and 2D metrology and inspection of bumped-wafer prepared for packaging in the flip-chip technology;
- 2D metrology and inspection of finished wafers at the end of their manufacturing process and in test houses, where inspection adds the value of monitoring the marks left by the testing probe or protects expensive probe cards from damage by dust particles;
- Post-dicing inspection of frame-mounted wafers at assembly and packaging facilities, where it adds the value of detecting dicing-related damage; and
- Inspection and metrology of MEMS and other special applications, where customized handling solutions and inspection capabilities are required for complex structures and non-standard materials.

Condor 5LED

Condor 5LED is a new AOI system designed to provide solutions to a variety of requirements that are unique to LED semiconductor manufacturers. The LED market's special inspection requirements are characterized by 3-6 inch wafers, each of which may contain between 100 to over 200 thousand LED devices per wafer. Typically, the wafer is made of a translucent compound semiconductor such as gallium arsenide, gallium phosphide and/or indium phosphide. The customers' defect specifications and unique inspection processes raise a significant challenge for AOI suppliers to solve. The new Condor 5LED incorporates all our experience in this space, into a singular and focused designated solution, targeted at the LED market.

Gannet

The Gannet system is our new system designed for the front end market of the semiconductor industry. In semiconductor device manufacturing dozens of fine pattern layers are exposed onto a wafer. Those patterns are then inspected after each set of exposure and development to ensure the patterns are formed with the required design accuracy. The Gannet's advanced algorithms and inspection capabilities enable it to detect defects in the die, which, if left undetected, may cause failure. In addition, inspection data can be used by customers to monitor and characterize several production processes. The first Gannet system was introduced and sold in the fourth quarter of 2009. In 2010 we made sales to strategic customers and expect growth in the future.

Sample preparation systems

MC600i

The MC600i enables cleaving of smaller wafer segments and dies and allows cleaving as close as 0.5mm to a sample edge. The MC600i system achieves fully automatic, reliable and rapid cross sectioning of wafer segments and dies. Dedicated software enables automatic mapping and navigating to targets, and features automatic off-loading for immediate inspection. These features, together with high throughput (9 minutes/sample), high accuracy (better than 300nm) and the excellent quality of the cross-sections produced, significantly reduce the diagnostic cycle for both failure analysis and process monitoring.

EM3

A dedicated, automated, timesaving and user-friendly system that enables TEM and SEM sample preparation for both cross section and plan view in a wide range of applications. Featuring a cryo-cooled, dry sawing process, the EM3 system prepares specimens of either crystalline or amorphous materials. The output sample is mounted onto a compatible stub or standard TEM mount that allows rework.

Xact

The Xact performs cutting-edge TEM/STEM sample preparation in line with the semiconductor and nanotechnology roadmap requirements for next generation physical failure analysis and characterization. The Xact utilizes the new AIM technology, delivering excellent sample quality, significantly reduced turnaround times and enhanced productivity. AIM is superior to the traditional FIB technology; it can reduce lamella thickness below 20 nm over a large area with high precision, artifact-free quality and higher throughput. Xact introduces a twin-beam solution configured for more artifact-free sample clarity and precise end-point detection.

PCB and IC Substrate Industry

AOI Systems

Our AOI products for this industry consist of four product lines: the Dragon and Orion for the inspection of inner and outer layers of PCB panels; the Pegasus and Mustang for final inspection (AFI) of IC substrates and high density interconnect (HDI) panels; the Planet for inspection of ultra-fine-line IC substrate; and large area masks (LAM) dedicated for inspection of artwork and photo masks.

Dragon

Dragon systems are high-throughput, automation-ready systems for inspection of all PCB types in a mass production environment. Dragon models are optimized for specific PCB technology ranges – from mainstream circuits of typically 100 µm (microns) conductor line width, up to high density substrates having 12 µm (microns) wide conductive lines. All Dragon models are designed to interface with automated material handling mechanisms provided by us or other automation suppliers. We believe that the combination of detection ability, scanning speed, real-time data collection for process control and automated material handling deliver outstanding value to customers. The Dragon was first introduced in March 2003.

Orion

Orion systems are stand-alone AOI systems for high volume inspection of all PCB types designed to operate in "Inspectify™" mode of operation. Inspectify™ is a unique mode of operation enabling the operator to perform verification immediately after inspection on the same system, thus saving time and eliminating handling-related defects. The Orion family has evolved gradually since its introduction in 1999. All Orion models retain an ergonomic user interface that supports high productivity and flexibility, allowing successive on-line inspection and verification, or solely inspection followed by off-line verification on a separate station. Like the Dragon family, Orion models are dedicated for various PCB technology ranges.

Pegasus

The Pegasus line includes systems for automated inspection of finished IC substrates that are subsequently used in packaging of BGA and Chip Scale Package (CSP) devices. The Pegasus inspects both sides of the substrate, detecting process and mechanical defects in particular in the gold-plated areas where the substrate will interconnect with the silicon die or the PCB and in the solder-mask areas. Pegasus models handle substrates in strip format in magazines. In December 2006 we introduced the Pegasus 200S, an enhanced product for inspecting IC substrates in strip format.

Mustang

The Mustang line includes systems for automated inspection of finished HDI panels that are subsequently used in mobile consumer electronics, such as mobile phones, digital cameras, PDAs and other consumer electronic devices. The Mustang inspects both sides of the panel, detecting process and mechanical defects, in particular in the gold-plated areas where the substrate will interconnect with the silicon die or the PCB and in the solder-mask areas. Mustang models handle panels in panel format (up to 150 x 300mm) in magazines. The Mustang 600 was first introduced in the first quarter of 2008.

In 2009 Camtek signed a memorandum of understanding (MOU) with a competitor, Utechzone, according to which Camtek markets and sells Utechzone's systems for the IC Substrate industry, for consideration as was defined in the MOU. The Company will continue to sell the Mustang and the Pegasus as long as they exist in its inventory, and also continue to service and support Pegasus and Mustang systems sold prior to the MOU. Camtek recorded its first sale under this MOU in the first quarter of 2010.

Planet

lanet is designed for the inspection of ultra-fine-line IC substrate, down to 8µm line–technologies. Introduced in June 2007, the Planet addresses the inspection needs of the very high end of the IC substrate industry - ultra-fine line. The Planet integrates our experience from both the semiconductor and PCB markets into a-totally new hardware architecture to deliver the robustness and high resolution required for high speed detection of micron-scale defects.

LAM

LAM is specially designed for main-stream LAM inspection. It offers unparalleled detection ability on LAM with down to 25 µm line/space width technology. The LAM incorporates advanced technology innovations to ensure the level of detection that these fine masks require at this critical production stage. Since large area masks are made of glass and transparent for light, the LAM inspection system contains specially designed image acquisition system, where the mask under inspection is located in between illumination sources and digital camera.

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Verification Systems

Camtek offers various stand-alone verification systems that enable verification of panels after inspection. Camtek designed the verification stations to meet operator's comfort during work while delivering high image quality and productivity.

* CVR-100 is designed for verification of panels after inspection on the Dragon, Planet or Orion AOI;

* PVS-200 is designed for the verification of IC Substrates (strips or units) and HD panels after they were inspected by the Pegasus or by the Mustang.

DMD systems

GREENJET

A SM digital printing system aimed to replace the conventional SM application lines for prototypes and high mix low volume production. The GreenJet system offers manufacturers flexible and high-performance digital SM printing technology solution, accompanied by a wide range of cost-effective, and technological benefits.

The GreenJet incorporates state of the art printing technology, using a specially developed hybrid ink which was tailored to the tough requirements of the PCB industry. The system is currently under beta testing in two customers' sites in Israel and has not yet launched for sales.

LGP

Designed to meet a variety of PCB industry challenges, from mass production and prototypes to limited PCB runs - the LGP system offers manufacturers flexible and high-performance digital legend printing technology solution, accompanied by a wide range of cost-effective benefits.

The LGP system incorporates PCB digital legend printing technologies with specially developed heat curable ink, resulting in very high quality output and system performance. Significant cost-saving can be realized by eliminating the need for silk screens. Production cycle times are shortened and the demands upon professional resources reduced.

INK

Camtek has developed the inks for both LGP and GreenJet, which involves different chemicals mixed together in order to reach the required ink characterization.

Customers

Our customer base includes the majority of the largest 100 PCB manufacturers worldwide and over25 out of the 30 largest semiconductor manufacturing, testing and packaging companies, among others. Our customers, many of whom have multiple facilities, are located in 34 countries throughout Asia, Europe and North America. In 2008, 2009 and 2010, no individual customer accounted for more than 10% of our total revenues. In the IC substrate industry, our customers are typically dedicated substrate manufacturers, but also include large PCB manufacturers who have separate substrate manufacturing facilities. Our IC substrate customers are located predominantly in Taiwan and the Asia Pacific region. In the semiconductor manufacturing and packaging industry, we target wafer manufacturers and companies involved in the testing, assembly and packaging of semiconductor devices. In the front end market of the semiconductor manufacturing industry, we target wafer manufacturers and companies involved in the device

manufacturing processes.

The following table shows our revenues classified by geographical region for each of the last three years:

	Year Ended December 31,		
	2010	2009	2008
	U.S. Dollars (In thousands)		
China and Hong Kong	33,614	19,512	25,973
Korea	16,621	8,391	11,974
Other Asia	11,089	9,403	8,102
United States	10,075	5,531	10,759
Taiwan	7,862	4,763	7,629
Western Europe	4,033	3,335	7,654
Japan	3,270	1,984	2,640
Rest of the world	1,216	602	732
Total	87,780	53,521	75,463

The following table shows our revenues classified by our sales to both industries and our sales from services for each of the last three years:

	Year Ended December 31,		
	2010	2009	2008
	U.S. Dollars (In thousands)		
PCB and IC substrates (1)	26,378	19,988	33,312
MEP (2)	43,857	19,208	28,823
Service Fees	17,545	14,325	13,328
Total Revenues	87,780	53,521	75,463

(1) 2010 and 2009 numbers include sales of Printar's legend and ink products

(2) 2010 and 2009 numbers include sales of Sela's sample preparation products

Sales, Marketing and Customer Support

We have established a global distribution and support network throughout the territories in which we sell our products, including the Asia Pacific region, North America and Europe. We believe that this is an essential factor in our customers' decision to purchase our products. We primarily utilize our own employees to provide these customer support services. We may expand our network into additional territories as market conditions warrant.

In March 2010, we signed an exclusive distribution rights agreement with Canon Marketing Japan Inc., for sales of our AOI systems that address the semiconductor industry in Japan. During 2010 we extended this agreement to include the sample preparation systems.

Also, in March 2010 we entered into a Memorandum of Understanding with a European company, according to which, as of June 2010, this company began to distribute our products for the PCB and IC substrate industry in Europe.

As of December 31, 2010, 40 of our employees were engaged in our worldwide sales, marketing and support efforts, including support and sales administration staff. Due to the concentration of sales in the Asia Pacific region in the last couple of years, we adjusted our sales organization accordingly, and significantly expanded our sales, marketing and

support teams in this region.

Our marketing efforts include participation in various trade shows and conventions, publications and trade press, product demonstrations performed at our facilities and regular contact with customers by sales personnel. We generally provide a 12-month warranty to our customers. In addition, for a fee, we offer service and maintenance contracts commencing after the expiration of the warranty period, which is typically one year. Under our service and maintenance contracts, we provide prompt on-site customer support.

In 2006, we purchased a credit insurance policy from the ICIC – the Israeli Credit Insurance Policy Company, in order to minimize the risk contemplated in transactions with customers which are located overseas and which are granted with certain amount of credit. The policy covers, among other risks, political and financial risks of such customers. During 2010 most of the requests for coverage were accepted.

Manufacturing

Our manufacturing activities consist primarily of the assembly and integration of parts, components and subassemblies, which are acquired from third-party vendors and subcontractors. The manufacturing process for our products generally lasts four to six weeks. We utilize subcontractors for the production of subsystems. Since the beginning of 2010 our Falcon and condor systems are manufactured by a single subcontractor who performs most of the material planning, procurement, manufacturing, testing, assembly and packaging work with respect to these systems.

We rely on single source and limited source suppliers and subcontractors for a number of essential components and subsystems of our products. We generally maintain several months of inventory of critical components used in the manufacture and assembly of our products. Due to the recent rapid increase in demands in the PCB and semiconductor industries, the delivery time of suppliers in these industries have extended. We believe that to date, we have been able to obtain sufficient units of these components to meet our needs.

Certain of the components for our machines are supplied, directly or indirectly, from Japan. At this stage we are unable to evaluate what effect, if any, the recent earthquake in Japan may have on our supply chain and therefore on our revenues.

We have two manufacturing facilities: one in Migdal Ha'Emek, Israel, and another one in Suzhou, China, in which we manufacture certain components and assemble most of our AOI systems for the printed circuit board industry.

Competition

The markets in which we operate are highly competitive. In the semiconductor industry, our primary competitor is Rudolph Technologies Inc., with additional competitors including KLA-Tencor Corporation and several Japanese competitors whom we face mostly in Japan – Topcon Corporation, Toray Industries, Inc., Hitachi Ltd. and Nidec Tosok Corporation. Sample preparation competitors are FEI Company, Hitachi Ltd., SII Nanotechnology Japan, and Carl Zeiss, Inc. In the PCB and IC Substrate industry, our principal competitor is Orbotech Ltd., with additional competitors including Dainippon Screen Manufacturing Company, Lloyd-Doyle Limited, Gigavis Co. Ltd., ATI Electronics Pty Ltd., Shirai Electronics Industrial Co. Ltd., local AOI vendors in China and Taiwan and up to 2009 also Utechzone Co. Ltd., the systems of which are sold by us (see also in "Product Lines – Pegasus and Mustang" above). DMD competitors are Orbotech Ltd, First EIE SA and MicroCraft K.K.

We believe that the principal elements of a sustainable competitive advantage are:

On-going research, development and commercial implementation of new image acquisition, processing and analysis technologies;

Product architecture based on proprietary core technologies and commercially-available hardware. Such architecture supports shorter time-to-market, flexible cost structure, longer service life and higher margins;

Fast response to evolving customer needs;

Product compatibility with customer automation environment; and

Strong pre and post-sale support (applications, service and training) deployed in immediate proximity to customer sites.

We believe that we compete effectively on all of these factors.

Capital Expenditures

The following table shows our capital expenditures in fixed assets for the last three years:

	December 31,		
	2010	2009	2008
		(in thousands)	
Building and leasehold improvements**	869	82	270
Machinery and equipment*	41	1,317	1,449
Office furniture and equipment	311	215	328
Automobiles	-	26	-
Total	$ 1,221	$ 1,640	$ 2,047

*including transfer of inventory to fixed assets in the sum of $(141,000) and $1,238,000 in 2010 and 2009, respectively.

**Building and leasehold improvements includes mainly leasehold improvement in the amount of $561 thousand in our new manufacturing facility in China.

Material Effects of Governmental Regulations

The following EU directives, which represent the European standard required in order to sell in Europe, apply: Low Voltage Directive (LVD) 2009/95/EC and Machinery Directive 2006/42/EC. The following SEMI Standards, which define uniform standards for manufacturers in the semiconductor manufacturing and packaging industry and production equipment producers, apply: SEMI S-2 (safety requirements for sale of equipment in the semiconductor manufacturing and packaging industry) and SEMI S-8 (ergonomic requirements for sale of equipment in the semiconductor manufacturing and packaging industry). We comply with the above-mentioned governmental regulations during the systems' design process, which is conducted in accordance with the Company's quality assurance manual. In addition, all systems types are tested by independent laboratories who certify their compliance with these governmental regulations.

C. Organizational Structure

Priortech Ltd., our principal shareholder, through its affiliated companies, engages in various aspects of electronic packaging, including the production and assembly of PCBs and the development and sale of IC substrates. Based on sales, PCB Technologies, a subsidiary of Priortech, is one of the largest PCB manufacturers in Israel. Priortech currently holds 60.5% of our outstanding ordinary shares. Our revenues from sales to affiliated and subsidiaries of Priortech, totaled $83,000, $843,000 and $467,000 in 2010, 2009 and 2008, respectively. In addition to these sales of products, we act jointly with Priortech with regard to various governmental, administrative and commercial matters, which we believe is to the mutual advantage of both parties.

The following table shows the Company's significant subsidiaries, all of which are wholly owned (except for Camtek HK Ltd. , in which Priortech Ltd., our controlling shareholder, holds one share, or less than one percent), together with each subsidiary's jurisdiction of incorporation, as of the date of this report. For a complete list of subsidiaries, see Exhibit 8.1.

Name of Subsidiary	Jurisdiction of Incorporation
Camtek H.K. Ltd.	Hong Kong
Camtek USA Inc.	New Jersey, USA
Camtek Electronic Technologies (Suzhou) Co. Ltd. (CET)	China
Camtek Imaging Technology (CIT)	China
SELA - Semiconductor Engineering Laboratories Ltd	Israel

D. Property, Plants and Equipment

Our main office, manufacturing and research and development facilities are located in the Ramat Gavriel Industrial Zone of Migdal Ha'Emek in northern Israel. These facilities occupy 74,000 square feet, of which 16,000 square feet are devoted to the manufacturing of our products.

We also lease a manufacturing facility in China, in which we manufacture certain components and assemble most of our AOI systems for the PCB industry. The Chinese facility occupies 53,500 square feet.

Our sales offices and demonstration centers, which we lease in various locations around the world, occupy an aggregate of approximately 36,000 square feet.

Aggregate leasing costs in 2010 amounted to approximately $1 million.

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects.

A. Operating Results

The following discussion of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and the notes to those statements included herein, which have been prepared in accordance with accounting principles generally accepted in the United States, or United States GAAP.

Overview

We design, develop, manufacture and market automated solutions dedicated for enhancing production processes and yield for the semiconductor manufacturing and packaging and the PCB and IC substrate industries.

We design, develop, manufacture and market automated optical inspection, or AOI, systems and related products. Our AOI systems are used to enhance both production processes and yields for manufacturers in the printed circuit board, or PCB, industry, the integrated circuit substrate, or IC substrate, industry and the semiconductor manufacturing and packaging industry.

Through the acquisition of Printar's assets and certain of its liabilities we are also engaged in developing, manufacturing, sale and marketing of direct digital material deposition systems and inks for the PCB industry, with two major fields of activity: Solder Mask, an epoxy layer selectively covering the PCB, while leaving the connection pads uncovered (currently in beta testing) and Legend, applying the identification nomenclature on the PCB, commonly used in the PCB industry.

In addition, through the acquisition of Sela we are also engaged in the development, manufacturing and marketing of automated SEM (Scanning Electron Microscope) and TEM (Transmission Electron Microscope) sample preparation equipment, primarily for the semiconductor industry (See also in Item 4.B above – "Business Overview - Our Business").

We sell our systems internationally. The majority of sales of our systems in 2010 was to manufacturers in the Asia Pacific region, China, South East Asia, Korea and Taiwan. This fact is due, among other factors, to the migration of the electronic manufacturers into this region following the development and growth of electronics industry centers in the region.

In 2010, our sales to customers in the Asia Pacific region accounted for approximately 83% of our total revenues, including approximately 38% of our total revenues from sales in China and Hong Kong, 19% in Korea and 9% in Taiwan. We expect this trend of the major portion of our revenues coming from customers in the Asia Pacific region to continue in the foreseeable future.

In addition to revenues derived from the sale of systems and related products, we generate revenues from providing maintenance and support services for our products. We expect our service revenues to increase as our installed base increases. We generally provide a one-year warranty with our systems. Accordingly, service revenues are not earned during the warranty period.

In regular market conditions, the demand for our systems is characterized by short notice. To meet customers' needs for quick delivery and to realize the competitive advantage of the ability to do so, we have to pre-order components and subsystems based on our forecast of future orders, rather than on actual orders. This need is compounded by the fact that, in times of increasing demand in our markets, our suppliers and subcontractors tend to extend their delivery schedules or fail to meet their delivery deadlines. To compensate for these unscheduled delays, we build inventories further into the future, which increases the risk that our forecast may not correspond to our actual future needs. The uncertainties involved in these longer-term estimates during regular times of business expansion tend to increase the level of component and subsystem inventories (See also in "Longer sales process for new products may increase our costs and delay time to market of our products both of which may negatively impact our inventory and results of operations" under “Risk Factors” above and “Valuation of Inventory” under ”Critical Accounting Policies” below). Compared to our sales cycles for repeat orders from existing customers, we have longer sales cycles for new customers as well as for new customers in new markets. In addition, the selling cycle in our markets may typically take several quarters from first contact to revenue recognition, including on-site evaluation. Naturally, repeat orders take less time. Still, a

significant portion of our finished goods inventory consists of systems under evaluation and demonstration systems.

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On November 11, 2008 and February 17, 2009 we announced cost reduction measures, the purpose of which was to align Camtek with then market conditions due to the global economic recession. These measures resulted in a reduction in our human resources related expenses of about 12% in November 2008 and 14% in February 2009. At the end of 2009 and beginning of 2010 we canceled the salary reductions implemented in 2008 and 2009 as part of the cost reduction measures, resulting in an increase in our salary expenses in 2010 as compared to 2009.

Critical Accounting Policies

Critical accounting policies are those that are, in management's view, most important to the portrayal of a company's financial condition and results of operations and most demanding on their calls on judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. We believe our most critical accounting policies relate to:

Revenue Recognition.

The Company recognizes revenue from sales of its products when the products are installed at the customer's premises and are operating in accordance with its specifications, signed documentation of the arrangement, such as a signed contract or purchase order, has been received, the price is fixed or determinable and collectability is reasonably assured.

Our revenue recognition policy requires that we use judgment to determine whether collectability is reasonably assured. Judgment is used for each customer on a case-by-case basis, and, among other factors, we take into consideration the individual customer's payment history and its financial strength, as demonstrated by its financial reports or through a third-party credit check. In some cases, we secure payments by a letter of credit or other instrument.

Our products are only installed by our qualified technicians. Thus, before we recognize the revenue from the sale of a product and consider the sales cycle completed, our technicians must install our product at the customer's premises, activate the product according to its specifications and then certify completion of such installation and activation.

Service revenues consist mainly of revenues from maintenance contracts and are recognized ratably over the contract period.

In 2010, we elected to adopt early recently issued ASU 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements, and therefore for multiple-element arrangements the overall arrangement fee is allocated to each element (both delivered and undelivered items) based on management's best estimate of their selling price where other sources of evidence are unavailable. Our multiple deliverables usually consist of product sales and non-standard warranties. A non-standard warranty is one that is for a period longer than 12 months.

Accordingly, a non-standard warranty is deferred as unearned revenue and is recognized ratably as revenue commencing with and over the applicable warranty term. The adoption of ASU 2009-13 did not have a material effect on our financial position, results of operations or cash flows.

We routinely evaluate our products for inclusion of any embedded software that is more than incidental thereby requiring consideration of ASC Subtopic 985-605, "Software Revenue Recognition". Based on such evaluation, we concluded that none of our products have such embedded software. In 2010, we have elected to adopt early recently issued ASU 2009-14, "Software (Topic 985)", which amends ASC Subtopic 985-605 to exclude from its scope tangible products which contain both software and nonsoftware components that function together to deliver a tangible

product's essential functionality. The adoption of ASU 2009-14 did not have a material effect on our financial position, results of operations or cash flows.

Valuation of Accounts Receivable. We review accounts receivable to determine which are doubtful of collection. In making this determination of the appropriate allowance for doubtful accounts, we consider information at hand regarding specific customers, including aging of the receivable balance, evaluation of the security received from customers, our history of write-offs, relationships with our customers and the overall credit worthiness of our customers. Changes in the credit worthiness of our customers, the general economic environment and other factors may impact the level of our future write-offs.

Valuation of Inventory. Inventories consist of completed systems, partially completed systems and components, and are recorded at the lower of cost, determined by the moving – average basis, or market. We review inventory for obsolescence and excess quantities to determine that items deemed obsolete or excess inventory are appropriately reserved. In making the determination, we consider forecasted future sales of related products and the quantity of inventory at the balance sheet date, assessed against each inventory items past usage rates and future expected usage rates. Changes in factors such as technology, customer demand, competing products and other matters could affect the level of our obsolete and excess inventory in the future.

In the years 2010, 2009 and 2008 we wrote-off inventory in the amount of $0.2 million, $4.2 million and $4.5 million respectively. The write off amount is included in the line item “Cost of products sold", in the consolidated statements of operations. The write off creates a new cost basis and is a permanent reduction of inventory cost. The write-off in the amount of $4.2 million in 2009 relates to (i) $2.6 million due to a strategic decision by the Company to discontinue certain old products; (ii) $0.6 million resulting from a write down of software purchased from a former single source supplier which was partially expected to be replaced upon completion of an internally developed software; and (iii) $1.0 million slow moving inventory and items deemed obsolete. In 2010 the company recorded an additional $0.2 million inventory write off. Inventory that is not expected to be converted or consumed in 2011 is classified as non-current. As of December 31, 2010, a $2.3 million portion of our inventory was in excess of our estimated requirements for 2011, based on our best estimates and the recent level of sales. Management periodically evaluates its inventory composition, giving consideration to factors such as the probability and timing of anticipated usage and the physical condition of the items, and then estimates a charge (reducing the inventory) to be provided for slow moving, technological obsolete or damaged inventory. These estimates could vary significantly from actual requirements based upon future economic conditions, customer inventory levels or competitive factors that were not foreseen or did not exist when the inventory write-downs were established.

Business Acquisitions. On January 1, 2009, we adopted revised principles of ASC Topic 805, Business Combinations, related to business combinations and non-controlling interests. The revised principle on business combinations applies to all transactions or other events in which an entity obtains control over one or more businesses. It requires an acquirer to recognize the assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date. This revision also changes the requirements for recognizing assets acquired and liabilities assumed arising from contingencies, and requires direct acquisition costs to be expensed. In addition, it provides certain changes to income tax accounting for business combinations which apply to both new and previously existing business combinations. The long-term liabilities arising from the business acquisitions are revalued at each balance sheet date with the revaluation difference being recorded to finance income, net line item in the consolidated statements of operations. In April 2009, additional guidance was issued which revised certain business combination guidance related to accounting for contingent liabilities assumed in a business combination. We have adopted this guidance in conjunction with the adoption of the revised principles related to business combinations. We applied the revised principles to the acquisitions of Printar and Sela (See also in "We expanded and may attempt to expand our activity in the markets we operate in through M&A activity. Such activity may result in operating difficulties, losses and other adverse consequences” under “Risk Factors” above).

On June 15, 2009, the Company completed the final aspects of acquisition of all of Printar’s assets, knowledge, technology and IP rights and liabilities to the OCS, pursuant to an agreement entered into in October 2008. The transaction is considered a business combination under ASC Topic 805.

The following table summarizes the consideration paid for Printar's assets and the amount of the assets acquired and liabilities assumed at the acquisition date:

	June 2009 Million US$
Consideration	
Cash	0.5
Fair value of contingent consideration	1.8
Total consideration	2.3
Recognized amounts of identifiable assets acquired and liabilities assumed	
Other assets	0.5
Fixed assets	0.1
In process research and development (IPR&D)	1.0
Technology	0.4
Liability to Office of the Chief Scientist	(1.7)
Total identifiable net assets	0.2
Goodwill	2.1
Acquisition-related costs (included in selling, general, and administrative expenses in the income statement for the year ending December 31, 2009)	30 thousand US$

In consideration for the purchase, Camtek may pay Printar a total amount of up to $2.5 million; an initial payment of $0.5 million was already paid in July 2009, and an additional consideration of $2.0 million will be paid subject to certain agreed conditions and provided that such amount, if due, be paid by the later of May 2011 or upon the fulfillment of certain conditions specified in the agreement.

The additional amount bears interest of 3-month Libor plus 1.5%.

The fair value of the contingent payment is based on the $2.5 million transaction price, discounted from the estimated payment dates to the valuation date using a rate of 13%, which represents the average of the weighted average cost of capital and the Company’s effective interest on financial debt. That measure is based on significant inputs that are not observable in the market, which ASC Section 820-10-35 (Statement 157) refers to as Level 3 inputs.

The amortization period for the technology acquired in the transaction is 5 years. The IPR&D will be amortized over a period of 10 years starting at the initial date of recording revenues from this technology. As of December 31, 2010, the IPR&D had not commenced amortization.

The goodwill of $2.1 million arising from the acquisition represents, inter alia, the synergies between the technology acquired and the Company’s existing operational, R&D and sales and marketing infrastructure.

The goodwill recognized is deductible for income tax purposes.

The liability to the OCS is based on the estimated timing of future payments, discounted using the weighted average cost of capital of 22%.

The carrying values of the IPR&D, technology, liability to the OCS and contingent consideration at December 31, 2010 were $1.0 million, $0.3 million, $(2.3) million and $(1.7) million, respectively (December 31, 2009 - $1.0 million, $0.3 million, $(1.9) million and $(1.9) million, respectively).

In September 2009, the Company signed an agreement to acquire the entire share capital of Sela. The transaction was completed in November 2009. The operations of SELA have been included in the consolidated financial statements of the Company from October 1, 2009, According to the agreement from September 2009, we agreed to manage and finance the operations of Sela until the completion of the transaction. The service income and operating expenses included in the results of Sela's operations for this period were immaterial. As such, there was no effective difference between recording the financed transactions in our books and full consolidation of Sela's results of operations. Similarly, Sela's results of operations in the period from the signing of the agreement to October 1, 2009 were immaterial.

The following table summarizes the consideration paid for Sela and the amounts of the assets acquired and liabilities assumed at the acquisition date:

	September 2009 Million US$
Consideration	
Fair value of contingent consideration	3.7
Total consideration	3.7
Recognized amounts of identifiable assets acquired and liabilities assumed	
Inventories and other assets	1.3
Fixed assets	0.1
Technology	2.4
Customer relationships	0.05
Liability to Office of the Chief Scientist	(1.7)
Total identifiable net assets	2.2
Goodwill	1.5
Acquisition-related costs (included in selling, general, and administrative expenses in the income statement for the year ending December 31, 2009)	66 thousand US$

According to the agreement, in consideration for the shares Camtek will pay to Sela's shareholders future payments in the aggregate amount of up to $9.5 million by way of earn-out payments, contingent upon Sela's future revenues. The fair value of the contingent consideration arrangement of $3.7 million was estimated based on future earn-out payments discounted to the valuation date, using the weighted average cost of capital of 19%. This measure is based on significant inputs that are not observable in the market, which Statement 157 (ASC Section 820-10-35) refers to as Level 3 inputs. Key assumptions include management's estimation about future sales.

The liability to the OCS is based on estimated timing of future payment, discounted using the Company's weighted average cost of capital of 19%.

The weighted average amortization period for the identified intangible assets acquired in the transaction is 12 years.

The carrying values of the technology, customer relationships, liability to the OCS and contingent consideration at December 31, 2010 were $2,220 thousand, $34 thousand, $(1,856) thousand and $(4,505) thousand respectively (December 31, 2009 - $2,469 thousand, $45 thousand, $(1,704) thousand and $(3,932) thousand respectively).

The goodwill arising from the acquisitions of Printar's assets and Sela of $2.1 million and $1.5 million, respectively, represent, inter alia, the synergies between the technologies acquired and our existing operational, R&D and sales and marketing infrastructure.

Intangible assets. Patent registration costs are capitalized at cost and amortized, beginning with the first year of utilization, over its expected life of ten years.

Intangible assets as part of a business combination are recorded at their fair value and amortized based on their estimated revenue producing life span. Acquired in-process research and development is amortized starting at the initial date of recording revenues from the associated technology. We review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the long lived asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized as computed by subtracting the fair market value of the asset from its carrying value. See Note 10 (B) – Goodwill and Intangible Assets, Net, of the financial statements.

Goodwill. Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is reviewed for impairment at least annually in accordance with the provisions of FASB ASC Topic 350, Intangibles - Goodwill and Other (Statement No. 142, Goodwill and Other Intangible Assets). We have set our annual impairment testing date at December 31.The goodwill impairment test is a two –step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. This requires significant judgments including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our reporting units, the period over which cash flows will occur and determination of our weighted average cost of capital. Changes in these estimates and assumptions could materially affect the determination of fair value and/or goodwill impairment for each reporting unit.

We allocate goodwill to reporting units based on the reporting unit's expected benefit from the acquisition. We evaluate our reporting units on an annual basis and, if required, reassign goodwill using a relative fair value allocation approach. No impairment charge was recognized in 2010 or 2009.

Provisions for contingent liabilities. A contingency (provision) in accordance with ASC Topic 450-10-05, Contingencies, is an existing condition or situation involving uncertainty as to the range of possible loss to the entity. A provision for claims is recognized if it is probable (likely to occur) that a liability has been incurred and the amount can be estimated reasonably. Provisions in general are highly judgmental, especially in cases of legal disputes. We assess the probability of an adverse event if the probability is evaluated to be probable, we are required to fully provide for the total amount of the estimated contingent liability. We continually evaluate our pending provisions to determine if accruals are required. It is often difficult to accurately estimate the ultimate outcome of a contingent liability. Different variables can affect the timing and amount we provide for certain contingent liabilities. Our assessments are therefore subject to estimates made by us and our legal counsel, adverse revision in our estimates of the potential liability could materially impact our financial condition, results of operations or liquidity. As of December 31, 2010 we did not record contingent liability with respect to our legal disputes (see also "Our products may infringe on the intellectual property rights of others, which could result in claims against us" under "Risk Factors" and "Business Acquisitions" under "Critical Accounting Policies" above), since we believe it is more than 50% likely that our legal disputes will end in our favor.

Valuation of Long- Lived Assets. We apply FASB ASC Subtopic 360-10, "Property, Plant and Equipment (Formerly SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets"). This Statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the long lived asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized as computed by subtracting the fair market value of the asset from its carrying value. We prepared future cash flows based on our best estimates including projections and financial statements, future plans and growth estimates.

Income Taxes. We account for income taxes under FASB ASC Subtopic 740-10 Income Taxes – Overall (including SFAS No. 109, "Accounting for Income Taxes"). Under SFAS 109 deferred tax assets or liabilities are recognized in

respect of temporary differences between the tax bases of assets and liabilities and their financial reporting amounts as well as in respect of tax losses and other deductions which may be deductible for tax purposes in future years, based on tax rates applicable to the periods in which such deferred taxes will be realized. The rates applied are those enacted in law as of December 31, 2010. In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible and during which the carry-forwards are available. Valuation allowances are established when necessary to reduce deferred tax assets to the amount considered more likely than not to be realized.

Our financial statements include deferred tax assets, net, which are calculated according to the above methodology. If there is an unexpected critical deterioration in our operating results and forecasts, we would have to increase the valuation allowance with respect to those assets. We believe that it is more likely than not that those net deferred tax assets included in our financial statements will be realized in subsequent years.

Stock Option and Restricted Share Plans. We account for our employee stock-based compensation awards in accordance with ASC Topic 718, Compensation - Stock Compensation. ASC Topic 718 requires that all employee stock-based compensation is recognized as a cost in the financial statements and that for equity-classified awards such cost is measured at the grant date fair value of the award. We estimate grant date fair value using the Black-Scholes-Merton option-pricing model. When calculating this equity-based compensation expense we took into consideration awards that are ultimately expected to vest. Therefore, this expense has been reduced for estimated forfeitures.

Recently Issued and Adopted Accounting Standards

In October 2009, the FASB issued ASU 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (EITF Issue No. 08-1, Revenue Arrangements with Multiple Deliverables). (For discussion regarding effects of adoption see Revenue recognition above).

In October 2009, ASU 2009-14, Software (Topic 985): Certain Revenue Arrangements that Include Software Elements was issued that amends the accounting rules addressing software revenue recognition for tangible products that contain both software and non-software components that function together to deliver the tangible product's essential functionality. The guidance also amends the determination of how arrangement consideration should be allocated to deliverables in a multiple-deliverable revenue arrangement. (For discussion regarding effects of adoption see Revenue recognition above).

In July 2010, the FASB issued ASU 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which significantly increases disclosures about credit quality of financing receivables and the allowance for credit losses, and requires disclosures to be made at a greater level of disaggregation. ASU 2010-20 is effective for public companies in fiscal years ending on or after December 15, 2010. The adoption of this guidance in 2010 did not have a material effect on the Company's financial statement disclosures.

ASU 2010-6 - Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements; This ASU amends FASB ASC Topic 820, Fair Value Measurements and Disclosures, to require reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information about purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. The ASU also clarifies existing fair-value measurement disclosure guidance about the level of disaggregation, inputs, and valuation techniques.

Except for the detailed Level 3 roll forward disclosures, the guidance in the ASU is effective for interim and annual reporting periods beginning after December 15, 2009. The new disclosures about purchases, sales, issuances, and settlements in the roll forward activity for Level 3 fair-value measurements are effective for fiscal years beginning after December 15, 2010. Early adoption is permitted. The adoption of this standard did not have any effect on the Company's consolidated financial position and results of operations.

New Standards and Interpretations - Not Yet Adopted

In December 2010, the FASB issued ASU 2010-29 "Disclosure of Supplementary Pro Forma Information for Business Combinations". This ASU specifies that if a public entity presents comparative pro forma financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The ASU also expands disclosure requirements as to material pro forma adjustments. This ASU is effective as of the beginning of each reporting entity's first annual reporting period that begins after December 15, 2010. The Company expects that the adoption of ASU 2010-28 will not have a material effect on its consolidated financial statements.

Results of Operations

Year Ended December 31, 2010 compared to Year Ended December 31, 2009.

Revenues. Revenues in 2010 increased by 64.1% to $87.8 million from $53.5 million in the year ended December 31, 2009. In 2010, sales to the PCB and IC substrate and MEP industries increased by 29% and 116%, respectively, compared to previous year. Sales of all products increased by 79.2% to $70.2 million in the year ended December 31, 2010, from $39.2 million in the year ended December 31, 2009. The increase in sales to the PCB and MEP industries is attributed mainly to increased demand for our products as a result of the high capacity and increased demands driven by new electronic devices and technology evolving in these two industries and the recovery from the recent global economic recession. In addition the increase in the revenues from the MEP industry was also a result of initial sales by us of the sample preparation products and new AOI system to the front end market of the MEP industry. The mixture of products sold and their configuration and throughput varieties make it very difficult to estimate average selling prices and pricing trends.

Service fees increased by 22.45% to $17.6 million in the year ended December 31, 2010, from $14.3 million for the year ended December 31, 2009, primarily due to increased revenue from continuing service as our installed base increased.

Gross Profit. Gross profit consists of revenues less cost of revenues, which includes the cost of components, production materials, labor, depreciation, factory and service center overhead and provisions for warranties. These expenditures are only partially affected by sales volume. Our total gross profit increased by $20.9 million to $38.4 million in 2010 from $17.5 million in 2009, representing an increase of 119.5%. Our gross margin increased to 43.8% in 2010, compared to a gross margin of 32.6% in 2009, primarily due to increased revenues as described above. In addition, in 2009 we reported an inventory write-off in the amount of $4.2 million which significantly influenced our gross margin in 2009 compared with only a $0.2 million write-off in 2010. Our gross profit on product sales increased by $17.7 million to $31.8 million in 2010, compared to $14.1 million in 2009. Our gross profit on service revenue increased by $3.3 million in 2010 to $6.6 million, compared to $3.3 million in 2009, mainly due to increase in service revenues accompanied with smaller increase in direct expenses like service engineers, which is the main service expense component.

Research and Development Costs. Research and development expenses consist primarily of salaries, materials consumption and costs associated with subcontracting certain development efforts. Total research and development expenses for 2010 were $12.9 million, compared to $10.3 million in 2009. Research and development expenses increased in 2010 by $2.6 million, primarily due to increase in salary expenses, as well as the recording of the research and development costs and expansion of certain research and development plans mainly with respect to the Company’s future products to the MEP and PCB industries.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of expenses associated with salaries, commissions, promotion and travel, doubtful debt, professional services and rent costs. Our selling, general and administrative expenses increased by 16.7% to $20.7 million in 2010 from $17.7 million in 2009. Selling expenses have increased mainly due to the variable expenses associated with the increased revenues which resulted from the increase in demands for our products in the markets we operate, as described above and due to increase in our salary expenses. This increase was offset by a decrease in professional fees related to the lawsuit that Rudolph Technologies has filed against us. Selling, general and administrative expenses as a percentage of revenues was 24% in 2010, compared to 33% in 2009.

Financial Expenses, Net. We had net financial expense of $1.5 million in 2010, as compared to net financial expense of $1.0 million in 2009. These changes relate mainly to an expense recorded in 2010 of $1.4 million revaluation of

contingent consideration and certain future liabilities recorded with respect to the acquisitions of Printar and Sela, compared to $0.6 million in 2009. Foreign currency income (expense), net, resulting from transactions not denominated in U.S. Dollars amounting to $(3) thousand and $(124) thousand in 2010 and 2009, respectively.

Provision for Income Taxes. Income tax expenses increased to $0.6 million in 2010, compared to $0.4 million in 2009, mainly due to increased revenues.

Net Income. We realized net income of $2.8 million in 2010 compared to net loss of $11.8 million in 2009, in view of the factors discussed above.

Year Ended December 31, 2009 compared to Year Ended December 31, 2008.

Revenues. Revenues in 2009 decreased by 29.1% to $53.5 million from $75.5 million in the year ended December 31, 2008. In 2009, sales to the PCB and IC substrate and MEP industries decreased by 30% and 28%, respectively, compared to previous year. Sales of all products decreased by 36.9% to $39.2 million in the year ended December 31, 2009, from $62.1 million in the year ended December 31, 2008. The decrease in sales to the PCB and MEP industries is attributed to low demand for our products as a result of the severe global economic recession that started in the second half of 2008. The mixture of products sold and their configuration and throughput varieties make it very difficult to estimate average selling prices and pricing trends.

Service fees increased by 7.5% to $14.3 million in the year ended December 31, 2009, from $13.3 million for the year ended December 31, 2008, primarily due to increased revenue from continuing service as our installed base increased.

Gross Profit. In 2009 we experienced a decrease in gross profit and gross margins primarily due to decreased revenues resulted from the global economic recession which started in the second half of 2008. Our gross profit on product sales decreased by $10.9 million to $14.1 million in 2009, compared to $25 million in 2008. Our gross profit on service revenue increased by $0.5 million in 2009 to $3.3 million, compared to $2.8 million in 2008. In 2009 our cost of revenues includes $4.2 million inventory write down compared to $4.5 million in 2008. Our total gross profit decreased by $10.3 million to $17.5 million in 2009 from $27.8 million in 2008, representing a decrease of 37%. Our gross margin decreased to 32.6% in 2009, compared to a gross margin of 36.9% in 2008.

Research and Development Costs. Total research and development expenses for 2009 were $10.3 million, compared to $12.8 million in 2008. Research and development expenses decreased in 2009 by $2.5 million, primarily due to cost reduction measures implemented at the end of 2008 and the beginning of 2009, which resulted in a decline in our salary expenses. The research and development expenses recorded in the first half of 2009 prior to the completion of the Printar assets include expenses related to the assessment of the SM technology.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses decreased by 28.6% to $17.7 million in 2009 from $24.8 million in 2008. Selling expenses have decreased mainly due to the decreased revenues resulting from the severe economic crisis that started in the second half of 2008 and due to cost reduction measures implemented at the end of 2008 and the beginning of 2009, which resulted in a decline in our salary expenses. This decrease was offset by an increase in professional fees related to the lawsuit that Rudolph Technologies has filed against us. Selling, general and administrative expenses as a percentage of revenues was 33% in 2009, compared to 32.9% in 2008.

Financial Income (Expenses), Net. We had net financial expense of $0.9 million in 2009, as compared to net financial income of $1.0 million in 2008. These changes relate mainly to $0.6 million revaluation of contingent consideration and certain future liabilities recorded at fair value with respect to the acquisitions of Printar and Sela and $0.1 million expenses resulted from changes in currency rates (compared to income of $1.2 million in 2008). Foreign currency income (expense) resulting from transactions not denominated in U.S. Dollars amounted to $(124) thousand and $1.2 million in 2009 and 2008, respectively.

Provision for Income Taxes. Income tax expenses decreased to $0.4 million in 2009, compared to $0.77 million in 2008.

Net Loss. We incurred a net loss of $11.8 million in 2009 compared to a net loss of $9.6 million in 2008, in view of the factors discussed above.

B. Liquidity and Capital Resources

Our cash and cash equivalent balances totaled approximately $9.6 million at December 31, 2010 and $15.8 million at December 31, 2009. In addition, at December 31, 2010 we had $5.2 million classified as restricted deposits.

From our inception through December 31, 2010 we raised approximately $36.0 million from our initial public offering in 2000, approximately $6.1 million in a rights offering of ordinary shares to our then existing shareholders in 2002, $5.0 million as a convertible loan from FIMI Opportunity Fund, L.P. and FIMI Israel Opportunity Fund, L.P. (all of which was paid in three equal portions in 2008, 2009 and 2010), and $14.5 million from a private placement to Israeli institutional investors.

Our working capital was approximately $32.3 million at December 31, 2010 and $31.7 million at December 31, 2009. The increase is mainly attributed to the increase in accounts receivable and inventory, offset by the increase in accounts payable and other current liabilities.

On August 12, 2008, our Board of Directors authorized a share repurchase program, involving the repurchase from time to time of our ordinary shares, in a sum not to exceed a total aggregate price of $2 million. The timing and exact number of shares purchased will be at the Company's discretion. The buyback of shares may occur in open market, negotiated or block transactions. We do not intend to purchase any shares from our management team or other insiders. This share repurchase program does not obligate us to acquire any specific number of shares and may be suspended or discontinued at any time. There were no purchases in 2010 and as of the date of this Annual Report, there is no current intention to buy shares. As of December 31, 2010, $1.1 million remains of the $2 million authorized for the share repurchase program.

On August 28, 2009, the court entered a judgment against us in the lawsuit brought by Rudolph, our competitor in the semiconductor manufacturing and packaging industry, awarding damages of approximately $6.8 million in favor of Rudolph, with regard to sales of Camtek's Falcon products in the United States, plus an interest of approximately $1.2 million. In 2011, the Company was ordered to pay an additional $645,946 in supplemental damages, and the plaintiffs filed motions seeking $1.5 million for alleged contempt and related attorney fees. Camtek filed an appeal with the Federal Circuit on August 10, 2010, seeking to overturn the District Court's rulings regarding validity, infringement and damages. In connection with that appeal we were required to post a bond in the amount of $8.5 million. On September 2, 2010, the District Court entered an order accepting our appeal bond and staying execution of the money judgment pending appeal.

Should we fail in our appeal of this lawsuit, or fail in reducing the awarded damages, we will be forced to pay damages which will adversely affect our cash resources. (See also in Item 8.A - Legal Proceedings).

In connection with the issuance of the appeal bond, we signed an agreement with Bank Leumi L'Israel, according to which the bank provided us with a bank guarantee in the amount of $8.925 million in order to support the appeal bond, which was issued by a surety company in the United States, together with a long-term loan of approximately $1.3 million. The loan has a term of three years and bears interest at the rate of Libor + 2.875% per annum. In addition, we received short-term loans in the amount of $1.4 million, and factoring facilities of additional $1.3 million (As of December 31, 2010 the factoring facility has not been utilized). Our obligations to the bank are secured by a lien on our facility in Israel, restricted deposits in the amount of approximately $5.2 million and a floating charge on our assets. In addition, we signed a covenant agreement with the bank which requires us to comply with various ongoing financial covenants, relating to our minimum cash balance, EBITDA minimums, equity minimums, revenue

minimums, and bank debt to open receivables ratio.

As of December 31, 2010, we did not comply with the financial covenants relating to the ratio of adjusted shareholders' equity to the total balance sheet, in which adjusted shareholders' equity is defined in the agreement as shareholders' equity as presented in the financial statements, minus deferred expenses, intangible assets, and balances due from affiliates ("shareholder's equity ratio"); and to the maintenance of cash balances of not more than $1 million in the bank accounts of one of our foreign subsidiaries ("maximum cash balance").

On March 31, 2011, we signed an amended agreement with the bank which amended the definition of the shareholders' equity ratio to increase the equity in the sum of the liabilities for contingent consideration and the Office of the Chief Scientist in respect of acquisitions. This amendment is retroactively effective as of December 31, 2010.

In addition, a waiver was retroactively received from the bank in respect of the maximum cash balance in the foreign subsidiary as of December 31, 2010 and as of March 31, 2011.
Accordingly, we are in full compliance with the amended financial covenants as of the December 31, 2010 and expect to comply with the amended covenants in the following year.

As of the date of this filing, we are undergoing negotiations with an Israeli banking institution for an additional credit line.

We anticipate that our existing capital resources and cash flows from operations will be adequate to satisfy our liquidity requirements through 2011. If available liquidity is not sufficient to meet our operating and loan obligations as they come due, our plans include pursuing alternative financing arrangements or reducing expenditures as necessary to meet our cash requirements (see also in "We had a history of losses, and we cannot assure you that we will not incur additional losses in the future. Moreover, if our business deteriorates, we could face liquidity problems" under "Risk Factors" above).

Cash flow from operating activities

For the year ended December 31, 2010, we had negative cash flow from operations of $39 thousand, primarily due to the increase in accounts payable and other current liabilities, partially offset by the increase in accounts receivable and inventory. For the year ended December 31, 2009, we had positive cash flow from operations of $3.9 million, primarily due to a decrease in inventories, partially offset by our losses. We expect to continue to incur in 2011 additional legal expenses and other costs associated with certain patent infringement actions which will impact our cash flow from operations. See "Our products may infringe on the intellectual property rights of others, which could result in claims against us" under "Risk Factors" above.

Cash flow from investing activities

Cash flow used in investing activities in 2010 was $7.1 million, due to the restricted deposit of $5.2 million and capital expenditures of $1.9 million. Cash flow used in investing activities in 2009 was $0.4 million, primarily due to capital expenditures of $0.4 million and $0.5 million investment in Printar, offset by $0.5 million net cash acquired in the investment in Sela.

Our capital expenditures in 2010 were used primarily for the purpose of relocating our manufacturing facilities in China and maintaining our facilities in Israel, and in 2009 primarily for the purpose of maintaining our facilities in Israel.

Cash flow from financing activities

Cash flow provided by financing activities in 2010 was $0.7 million, mainly due to the receipt of $2.7 million in loans from banks and grants from the OCS of $0.2 million offset by the repayment of the last portion of the long-term loan from FIMI, in a sum of $1.67 million as well as earn-out payments for SELA of $0.2 million, repayments to the OCS of $0.2 million and repayment of loans from banks of $0.1 million.

Cash flow used in financing activities in 2009 was $3.6 million, due to the repayment of $2.0 million short-term loans from banks and $1.67 million payment of the long-term loan from FIMI.

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Effective Corporate Tax Rate

Camtek's production facility in Israel has been granted “Approved Enterprise” status under the Investment Law. We participate in the Alternative Benefits Program and, accordingly, income from our Approved Enterprises will be tax exempt for a period of 10 years, commencing in the first year in which the Approved Enterprise first generates taxable income due to the fact that we operate in Zone ”A” in Israel.

On April 1, 2005, an amendment to the Investment Law came into effect ("the Amendment") and has significantly changed the provisions of the Investment Law. The Amendment limits the scope of an enterprise which may be approved by the Investment Center by setting criteria for the approval of a facility as a "Beneficiary Enterprise", such provisions generally require that at least 25% of the Beneficiary Enterprise's income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer require Investment Center approval in order to qualify for tax benefits.

In addition, the Amendment provides that terms and benefits included in any certificate of approval issued prior to December 31, 2004 will remain subject to the provisions of the Investment Law as they were on the date of such prior approval. Therefore, our existing Approved Enterprise will generally not be subject to the provisions of the Amendment. As a result of the Amendment, tax-exempt income generated under the provisions of the new law, as part of a new Beneficiary Enterprise, will subject us to taxes upon distribution or liquidation.

Camtek has been granted the status of Approved Enterprises, under the Investment Law, for investment programs for the periods which ended in 2007 and 2010, and the status of Beneficiary Enterprise according to the Amendment, for the period ending in 2014 ("Programs"). Sela has also been granted the status of Beneficiary Enterprise according to the Amendment, for the period ending in 2014.

On December 29, 2010, the Investment Law was amended to significantly revise the tax incentive regime in Israel commencing on January 1, 2011. For more information, see Item 10 – “Taxation – Taxation of Companies in Israel - Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959.”

Out of Camtek's retained earnings as of December 31, 2010 approximately $20.8 million are tax-exempt earnings attributable to its Approved Enterprise and approximately $3.0 million are tax-exempt earnings attributable to its Beneficiating Enterprise. The tax-exempt income attributable to the Approved and Beneficiating Enterprises cannot be distributed to shareholders without subjecting the Company to taxes. If these retained tax-exempt profits are distributed, the Company would be taxed at the reduced corporate tax rate applicable to such profits (currently - 25% pursuant to the implementation of the Investment Law). According to the Amendment, tax-exempt income generated under the Beneficiating Enterprise will be taxed upon dividend distribution or complete liquidation, whereas tax exempt income generated under the Approved Enterprise will be taxed only upon dividend distribution (but not upon complete liquidation, as the tax liability will be incurred by the shareholders).

As of December 31, 2010, if the income attributed to the Approved Enterprise were distributed as dividend, we would incur a tax liability of approximately $5.2 million. If income attributed to the Beneficiating Enterprise were distributed as dividend, or upon liquidation, we would incur a tax liability in the amount of approximately $ 0.8 million. These amounts will be recorded as an income tax expense in the period in which we declare the dividend.

We intend to indefinitely reinvest the amount of our tax-exempt income and not distribute any amounts of our undistributed tax-exempt income as dividend. Accordingly, no deferred tax liabilities have been provided on income attributable to our Approved and Beneficiary Enterprise Programs as the undistributed tax exempt income is essentially permanent in duration.

The entitlement to the above benefits is conditional upon our fulfilling the conditions stipulated by the law and the regulations published thereunder as well as the criteria set forth in the approval for the specific investments in Approved Enterprises. In the event of failure to meet such requirements in the future, income attributable to our Programs could be subject to the statutory Israeli corporate tax rates and we could be required to refund a portion of the tax benefits already received, with respect to such Program. Our management believes that we have met the aforementioned conditions.

Inflation and Foreign Currency Fluctuation

The currency of the primary economic environment in which our operations are conducted is the dollar. Most of our revenues are derived in dollars. The prices of part of our materials and components are purchased in dollars or are linked to changes in the dollar/NIS exchange rate effective on the date of delivery of the goods to our factory. Most of our marketing expenses are also denominated in dollars or are dollar linked. Our product prices in most countries except in Europe, Japan and as of 2011 part of our revenues from products in China, are denominated in dollars. However, most of our service income is denominated in local currency. Due to the fact that our financial results are reported in dollars, in Europe, Japan or China, if there is a significant devaluation in the local currency as compared to the dollar, the prices of our products will decrease and negatively affect our revenues and income. The opposite effect occurs when the dollar increases in value in comparison to these currencies. As most of our revenues are denominated in dollars, we believe that inflation and fluctuations in the NIS/dollar exchange rate have no material effect on our revenues. However, a major portion of the costs of our Israeli operations, such as personnel, subcontractors, materials and facility-related, are incurred in NIS. As a result, we bear the risk that our NIS costs, as expressed in dollars, increase to the extent by which the continued significant appreciation of the NIS in relation to the dollar, will increase our costs expressed in dollars and have an effect on our net income. In 2010 we experienced devaluation of the NIS in relation to the dollar which decreased our costs expressed in dollars. In addition, starting 2011, part of our revenues from products in China will be denominated in local currency. Most of the expenses and purchases in China are also denominated in local currency. As our financial results are reported in dollars, fluctuations in the CNY/dollar exchange rate may affect our revenues and level of expenses. In order to secure part of the risk, we are engaged from time to time in hedging transactions.

In our consolidated financial statements, transactions and balances originally denominated in dollars are presented at their original amounts. Gains and losses arising from non-dollar transactions and balances are included in the determination of net income as part of financial expenses, net.

Effects of Government Regulations and Location on the Company's Business

For a discussion of the effects of Israeli governmental regulations and our location in Israel on our business, see "Risks relating to our Operations in Israel" in item 3, above.

C. Research and Development, Patents and Licenses.

We believe that intensive research and development is essential to our business. We devote substantial research and development resources to developing new products and to improving our existing products to meet our customers' evolving needs. We have dedicated teams with expertise in image processing software and algorithms, electronic hardware, electro-optics, physics, mechanics and systems design.

Our product development efforts over the past couple of years have resulted in the introduction of several new AOI systems, including new models and improvements in the Dragon, Orion, Pegasus, Planet, Lam, certain Falcon product lines and the Gannet.

Our research and development efforts are primarily focused on:

- increasing the throughput of our AOI systems;
- improving our defect detection capabilities;
-

reducing the number of false alarms while simplifying operation and reducing the level of user expertise required to realize the benefits of our systems;

- providing unique technological solutions to our customers;

- adding capabilities to expand our market segments

- completing the development and beta testing of our digital material deposition systems in the solder mask activity; and

- increasing resolution and enhancing imaging capabilities of our Xact, the SEM/STEM systems

In addition, we are focusing our efforts on leveraging our core technologies, expertise and experience into continually enhancing the value to the user and the return on investment from our products. We believe that our internal multi-disciplinary expertise will enable us to maintain and enhance our technological edge.

As of December 31, 2010, we had 92 employees engaged in research and development, almost all of whom are based in our headquarters in Israel. We also use subcontractors for the development of some of the hardware components of our systems. Our research and development expenses were $12.9 million, $10.3 million and $12.8 million for the years ended December 31, 2010, 2009 and 2008, respectively, representing 14.7%, 19.3% and 17.0% of the total revenues for the years then ended.

We will continue to devote our research and development resources to maintaining and extending our technology leadership position.

Our research and development costs are expensed as incurred.

In general, we rely on a combination of our copyrights, trade secrets, patents, trademarks and non-disclosure agreements to protect our proprietary know-how and intellectual property. We also enter into confidentiality agreements with key employees and with all of the subcontractors who develop and manufacture components for use in our products. We also employ specialists whose main role is to maintain and protect our intellectual property from both professional and legal perspectives. We cannot be certain that actions we take to protect our proprietary rights will be adequate nor can we be certain that we will be able to deter reverse engineering or that there will not be independent third-party development of our technology.

We have 125 patents pending in Israel and worldwide and 14 US provisional applications. In addition, we have 52 registered patents in the following countries: USA (14), Israel (11), Europe (7), Korea (6), Japan (4), Singapore (4), China (3) and Taiwan (3). These patents relate to our proprietary technology and know-how developed for products in the PCB and semiconductor industries. We also have 9 registered trademarks in Israel and 1 registered trademark in Japan.

D. Trend Information

Following the global economic recession of 2008-2009, as of the second half of 2009 and through 2010 we experienced constant improvement in our revenues from the semiconductor manufacturing and packaging industry, as customers' demand for capacity and technology in this industry increased. We anticipate this trend to continue in the first half of 2011.

During 2010 we experienced continued improvement in our revenues from the printed circuit board and IC substrate industry, after these were severely affected by the global economic recession of 2008-2009. We currently expect this industry to remain in high utilization and capacity demands in the first half of 2011.

E. Off-Balance Sheet Arrangements

We do not have any arrangements or relationships with entities that are not consolidated into our financial statements and are reasonably likely to materially affect our liquidity or the availability of our capital resources.

However, we have entered into various non-cancelable operating lease agreements, principally for office space and vehicles, as disclosed in our consolidated financial statements.

As of December 31, 2010, minimum future rental payments under such non-cancelable operating leases were approximately $3.0 million.

F. Contractual Obligations and Other Commercial Commitments.

As of December 31, 2010, we had contractual obligations and commercial commitments of:

	Payment Due in				
Contractual Obligations	Total	Less than 1 Year	1-3 years	3-5 years	More than 5 years
	(in thousands)				
Contingent consideration in respect of business combinations	6,246	2,554	1,294	1,595	803
Purchase obligations (1)	8,050	8,050	-	-	-
OCS	4,728	536	1,038	1,118	2,036
Severance obligation	626	-	-	-	626
Other long-term obligations (2)	3,006	1,600	1,313	93	-
Total	22,656	12,740	3,645	2,806	3,465

(1) Purchase obligations mainly represent outstanding purchase commitments for inventory components ordered in the normal course of business.
(2) In 2010, we entered into a new framework agreement for non-cancelable operating leases for vehicles for a period of 36 months. As of December 31, 2010, the minimum future rental payments (including future vehicle rental of our subsidiaries) were approximately $939.

Our subsidiaries have entered into various operating lease agreements, principally for office space. As of December 31, 2010, minimum future rental payments under these leases amounted to $2,067.

Item 6. Directors, Senior Management and Key Employees.

A. Directors and Senior Management.

The following table sets forth information with respect to our directors and executive officers as of the date of this Annual Report. The address of our directors and executive officers is c/o Camtek Ltd., Ramat Gavriel Industrial Zone, P.O. Box 544, Migdal Ha'Emek 23150, Israel.

Name	Age	Title
Rafi Amit	62	Active Chairman of the Board of Directors
Yotam Stern	58	Executive Vice President, Business & Strategy and director
Gabriela Heller*	46	Director
Rafi Koriat*	64	Director
Eran Bendoly	46	Director
Roy Porat	44	Chief Executive Officer and President of Camtek USA Inc.
Mira Rosenzweig	39	Vice President - Chief Financial Officer
Ayelet Peled	46	Vice President – Human Resources
Gilad Golan	46	Vice President – Research and Development
Colin Smith	61	Vice President – Sela Division Manager
Moshe Grencel	57	Vice President - Operations

Michael Lev	57	Vice President - Intellectual Property
Aharon Sela	58	VP Sales and President of Camtek Hong Kong
Amir Tzhori	43	Vice President - PCB Manager and GM of Camtek China

*Outside directors (as such term is defined under Israeli Companies Law)

Rafi Amit is serving as our Active Chairman of the Board of Directors since August 2010. Mr. Amit has served as our Chief Executive Officer from January 1998 until August 2010 and has served as Chairman of the Board of Directors since 1987 and until April 2009. Since 1981, Mr. Amit has also served as the President and director of Priortech and has been the Chairman of the Board of Directors of Priortech since 1988. From 1981 until 2004, Mr. Amit served as Priortech's Chief Executive Officer. Mr. Amit holds a B.Sc. in Industrial Engineering and Management from Technion - Israel Institute of Technology.

Yotam Stern has served as an executive of ours since January 1998 and since February 2001 has served as our Executive Vice President, Business & Strategy. He has also served as a member of our Board of Directors since 1987 and as Chairman of the Board of Directors since May 2009 and until August 2010. From January 1998 until February 2001, Mr. Stern served as our Chief Financial Officer. Mr. Stern has also served as the Chief Financial Officer of Priortech since 1981 and as Priortech's Chief Executive Officer since 2004 as well as serving as a director of Priortech since 1985. Mr. Stern holds a B.A. in Economics from Hebrew University of Jerusalem.

Gabriela Heller has served on our Board of Directors since September 2006. Ms. Heller has an extensive financial experience as an accountant, Chief Financial Officer and internal controller. Currently Ms. Heller serves as Chief Financial Officer of The Trendlines Group Ltd an investment company holding two technology incubators. From 1994 until 2010 Ms. Heller served as the CFO of Walden Israel Ltd., which is the management company of Walden Israel Ventures, managing various venture capital funds operating in Israel. From 1989 to 1994 Ms. Heller served as Manager with Kost Forer Gabbay & Kasierer - Ernst & Young Israel, one of the leading accounting firms in Israel. In addition, from 1998 to 2000 Ms. Heller served as Internal Controller to Vilar International Ltd., traded on TASE. Ms. Heller is currently serving on the Boards of Directors of Kerur Holdings Ltd and Elco Holdings Ltd, both traded on TASE, and on the Board of Directors of Kolhey Misgav, the water company for the Misgav Regional Counsel. From 2004 until 2007 she served on the Board of Directors of Electra Consumer Products Ltd., from 1999 to 2003 Ms. Heller served on the Board of Directors of Priortech, and from 2000 to 2003 served on the Board of Directors of One1 Products Ltd. Ms. Heller is a CPA (Israel), holds a B.A. in Accounting and Economics from the Hebrew University of Jerusalem, School of Business Administration, and an LL.M from Bar Ilan University, Faculty of Law.

Rafi Koriat has served on our Board of Directors since September 2006. Mr. Koriat has extensive experience as Chief Executive Officer ("CEO") and Board member in the fields of semiconductor assembly and processing equipment, optical network components and related emerging fields. Prior to his present position as founder and CEO of Korel Business Ltd., which specializes in strategic positioning and guiding high tech companies and management, Mr. Koriat was CEO of Lambda Crossing engaged in the manufacturing of optical components for networks (2001-2006) and Founder and CEO of Steag CVD Systems Ltd. and its subsidiary, Steag CVD Inc. in San Jose, California; both companies are manufacturers of advanced front-end semiconductor capital equipment (1992-2001). Previously, he worked for 20 years (1972 -1992) at Kulicke and Soffa Industries Inc. in the United States and Israel as Corporate Vice President for Engineering and Technology, Corporate Director for Business and Marketing and Division Manager. Mr. Koriat is also the founder and chairman of the Sub Micron Semiconductor Consortium, OptiPac Consortium (optical communication networks) and nanotechnology consortium (NES), under the Israel Chief Scientist Magnet program. Mr. Koriat holds a B.Sc. from the Technion-Israel Institute of Technology, a M.Sc. from Drexel University in Philadelphia, Pennsylvania and completed an Executive Management Program at Stanford University.

Eran Bendoly has served on our Board of Directors since November 2000. Currently, Mr. Bendoly serves as the Chief Financial Officer of Expand Networks Ltd. Expand is a leading provider of WAN optimization technology. From 2006 to 2008 Mr. Bendoly served as Chief Financial Officer of Personeta Inc., a leading vendor of intelligent network service creation platforms. From 2003 to 2006, Mr. Bendoly served as Chief Executive Officer of Xenia Management Ltd., which is the managing partner of Xenia Ventures LP, a limited partnership that operates a technology incubator in Kiryat Gat, Israel. From 2000 to 2002, Mr. Bendoly served as Director of Finance for Europe, Middle East & Africa of Mindspeed Technologies, Inc., a U.S.-based fabless semiconductor manufacturer. From 1998 to 2000, Mr. Bendoly served as Chief Financial Officer of Novanet Semiconductor Ltd., and from 1996 to 1998, he served as Vice President, Finance and Operations of Novacom Technologies Ltd. Mr. Bendoly holds a B.A. in International Relations from the Hebrew University of Jerusalem and an M.B.A. from the KU Leuven University of Belgium.

Roy Porat has served as our Chief Executive Officer since August 2010, and as President of our U.S. subsidiary, Camtek USA Inc. since March 2008. Previously, he served as General Manager for Camtek Ltd. from March 2008 and until August 2010. Prior to that, he served as President of Camtek Hong Kong from September 2003 until March 2008. From 2001 until September 2003, Mr. Porat served as President of Camtek USA, Inc. From 1999 to 2000, Mr. Porat served as the Chief Executive Officer of Aeronautics Ltd. From 1994 to 1999, Mr. Porat served in various executive positions at our affiliate, PCB Technologies. Mr. Porat holds a B.Sc. in Industrial Engineering from Technion - Israel Institute of Technology.

Mira Rosenzweig has been employed by us since September 2008 as our Vice President - Chief Financial Officer. Previously, from 2001 to 2008, Ms. Rosenzweig served as Director of Finance and in various other positions for Elron Electronic Industries Ltd., traded on the TASE and previously on Nasdaq. Ms. Rosenzweig is a CPA (Israel) and holds a B.A in Accounting and Economics from University of Haifa, Israel.

Ayelet Peled has served as our Vice President - Human Resources since October 2010. Between 2005-2010, Mrs. Peled served as HR Director of the Israeli Region and HR Business Partner for a global business unit within the Security field at NICE Systems Ltd. Prior to that, from 2000-2005, Mrs. Peled served as Product Division HR Manager within the Enterprise business at NICE Systems. Prior to that, Mrs. Peled held various professional and managerial positions at Pilat Ltd., an Israeli diagnosis and consulting company. Mrs. Peled holds a BA in Human Sciences and has MA studies in Organizational Behavior from the Tel-Aviv University.

Amir Tzhori serves as our corporate Vice President - PCB (AOI) and President of Camtek China since December 2010. From July 2008 to July 2010, Mr. Tzhori served as President of Camtek Imaging Technology China. From July 2005 till July 2008 Mr. Tzhori served as VP Operation and COO of Camtek Hong Kong. Previously Mr. Tzhori served as Marketing Manager for Applied Materials and held several managerial positions for Camtek USA. Mr. Tzhori holds a B.Sc. in Mechanical Engineering from Tel-Aviv University and an MBA from Kellogg Northwestern University and Tel Aviv University.

Gilad Golan serves as our Vice President - Research and Development since November 2009. Mr. Golan has been employed by the Company since November 2006 as R&D manager for Micro Electronics Division, and since February 2009 as Camtek's R&D Division Manager. Between 2005 and November 2006, Mr. Golan served as Chief Executive Officer of Ellumina Vision Ltd., a start-up in the semiconductor equipment industry. From 2000 until 2005, Mr. Golan was the General Manager of Accretech Israel, the R&D site of Accretech (TSK) for wafer inspection. Prior to that, Mr. Golan held various managerial positions with Accretech Israel and Opal Technologies, both semiconductor inspection and metrology equipment manufacturers. Mr. Golan holds a B.Sc. and a M.Sc. in electrical engineering from Ben-Gurion University and MEI (Master of Entrepreneurial Innovation) from ISEMI/Swinburne University of Technology.

Colin Smith serves as our Vice President – Sela Division Manager since November 2009. Formerly, Mr. Smith served as Chief Executive Officer, director and founder of Sela; Mr. Smith founded Sela in 1992 after a career in multi-disciplinary engineering and design at Rafael, Israel's Armament Development Corporation. Mr. Smith participated in the design, manufacturing, and quality control of a variety of advanced electro-optical equipment. He has extensive knowledge in the fields of electronics, CAD/CAM assimilation, thermal imaging, and electro-optical systems. Mr. Smith retired from the active reserves of the Israel Defense Force with the rank of Lieutenant Colonel, and holds a B.S. in Mechanical Engineering from the Technion - Israel Institute of Technology.

Moshe Grencel has been employed by us since January 2007, as Vice President - Operations. Between 2004 and 2006 Mr. Grencel served as the Executive Vice President of Supply Chain of Delta Galil, a leading company in the textile industry. From 2001 until 2004, Mr. Grencel served as Senior Vice President Operations of Lumenis, a medical lasers manufacturer. From 1983 until 2000, Mr. Grencel held various executive positions with Elscint Ltd., a medical diagnostic equipment manufacturer. Mr. Grencel holds a B.Sc. in Industrial Management from the Technion – Israel Institute of Technology.

Michael Lev has been employed by us since 1994 and has served as our Vice President - Intellectual Property, since April 2007. From 1994 until April 2007 Mr. Lev held various positions with the Company, in the printed circuit board and semiconductor manufacturing and packaging areas. Mr. Lev holds a M.Sc. in Electrical Communication from Azerbaijan Polytechnic Institute.

Aharon Sela serves as President of Camtek Hong Kong since March 2008 and as our Vice President Sales.Previously, from 2004 until March 2008, he served as V.P. Sales of the Micro Electronics Division at Camtek Europe and Camtek Hong Kong. From 2002 until 2004 Mr. Sela served as Manager of Camtek Japan and previously he served as Executive V.P. Sales and Marketing at Inspectech Ltd. (which was merged with Camtek in 2001). Mr. Sela holds a B.Sc. in Electrical Engineering from Technion - Israel Institute of Technology.

B. Compensation.

Compensation of Executive Officers and Directors

The aggregate remuneration paid by us in the year ended December 31, 2010 to all the persons listed in Section A above (Directors and Senior Management), was approximately $3.3 million, which includes $0.3 million paid to provide pension, retirement or similar benefits, as well as amounts expended by us for automobiles made available to all our executive officers, and other fringe benefits commonly reimbursed or paid by companies in Israel. Regulations promulgated under the Israeli Companies Law regulate the annual remuneration and remuneration for participation in meetings of outside directors and the reimbursement of their expenses. Messrs. Rafi Amit and Yotam Stern did not receive any additional compensation for their service as our directors.

Employment Agreements

We maintain written employment agreements with our employees, including all of our executive officers, that contain customary provisions, including non-compete and confidentiality agreements. In recent years, Israeli courts have required employers seeking to enforce non-compete undertakings of a former employee to demonstrate that the competitive activities of the former employee will harm one of a limited number of material interests of the employer. If we cannot demonstrate that we will be harmed by the competitive activities of a former employee, we may be unable to prevent our competitors from benefiting from the expertise of our former employees.

Effective January 1, 1998, we entered into an employment agreement with Mr. Rafi Amit, today our Active Chairman. The agreement has a two-year term, which is automatically renewed at the end of every two years thereafter. The agreement contains confidentiality and non-compete provisions for the term of Mr. Amit’s employment and for a two-year period after the termination of his employment. Furthermore, the agreement provides that all intellectual property developed by Mr. Amit, or in which he took part, in connection with his employment, is our sole property. As a result of changes in senior management, approved in August 2010, Roy Porat has been appointed as the Company's Chief Executive Officer and Mr. Amit, in his new position as Active Chairman, has decreased his scope of work for the Company from 100% to 75% of his time. The scope and level of Mr. Amit's responsibilities in his position as Active Chairman have been set by the Company's Board of Directors and in general include responsibility over strategic planning, acquisitions and strategic ventures and alliances, as well as overall direction of the Asian

activity of the Company. The employment agreement of Mr. Amit may be terminated by either party at any time, or not renewed at the end of any successive two-year extension of its term, by written notice of termination or non-renewal delivered to the other party six months in advance. We may, however, immediately terminate the employment of Mr. Amit in various circumstances, including a breach of fiduciary duty.

Effective January 1, 1998, we entered into an employment agreement with Mr. Yotam Stern, our Executive Vice President, Business & Strategy. The agreement has a two-year term, which is automatically renewed at the end of every two years thereafter. The agreement contains confidentiality and non-compete provisions for the term of Mr. Stern's employment and for a two-year period after the termination of his employment. Pursuant to his employment agreement, Mr. Stern may dedicate up to 40% of his time to work for Priortech or any of the Priortech entities. The employment agreement may be terminated by either party at any time, or not renewed at the end of any successive two-year extension of its term, by written notice of termination or non-renewal delivered to the other party six months in advance. We may, however, terminate Mr. Stern's employment immediately upon the occurrence of various circumstances, including a breach of fiduciary duty.

Starting 2001, we entered into employment agreements with Mr. Roy Porat, our CEO as of August 24, 2010, and President of our U.S. subsidiary, Camtek USA Inc., since March 2008. Mr. Porat's current employment agreement has an unlimited term. The agreement contains confidentiality and non-compete provisions for the duration of Mr. Porat's employment and for a two-year period after the termination of his employment. The employment agreement may be terminated by either party at any time, by written notice of termination delivered to the other party three months in advance. We may, however, terminate Mr. Porat's employment immediately upon the occurrence of various circumstances, including a breach of fiduciary duty.

C. Board Practices.

Composition of the Board of Directors

Our Articles provide that our Board of Directors shall consist of not less than five not more than ten directors, including the outside directors. Currently, our board consists of five directors.

Directors, other than outside directors, are elected by a resolution of the shareholders at the annual general meeting and serve until the conclusion of the next annual general meeting of the shareholders. Directors may be removed at any time by a resolution of the shareholders. Since directors may be elected and removed by a majority vote, Priortech Ltd., which holds a majority of our voting shares, has the power to elect all of our directors, subject to the restrictions placed on the election of outside directors as described below. The Chief Executive Officer is appointed by our Board of Directors. Each of the other officers is appointed by the Chief Executive Officer.

Our Articles provide that any director may appoint as an alternate director, by written notice to us or to the Chairman of the Board, any individual who is qualified to serve as director and who is not then serving as a director or alternate director for any other director. An alternate director has all of the rights and obligations of a director, excluding the right to appoint an alternate for him-self. Currently no alternate directors serve on our board.

Messrs. Rafi Amit, Yotam Stern and Eran Bendoly are each serving an approximately one-year term, which will expire at our 2011 annual general meeting of shareholders. Each of our outside directors, Messrs. Gabriela Heller and Rafi Koriat, served a three-year term in accordance with the Israeli Companies Law, which expired in September 2009. At our 2009 annual general meeting of shareholders, both of them were reappointed for a further three-year-term, until September 2012.

None of the members of our Board of Directors, except Messrs. Rafi Amit and Yotam Stern, is a party to a service contract with us, which would provide them with benefits upon termination of employment.

Outside Directors; Independent Directors

Under the Israeli Companies Law, public Israeli companies are required to appoint at least two directors who qualify as outside directors under Israeli law.

The outside directors must not have any "relationship" with us. For this purpose, "relationship" means any employment, business or professional relations, either in the present or in the preceding two years. An individual whose relatives, business partners, employers or controlled companies have a relationship with us may not serve as an outside director. In addition, an individual whose other business affairs may cause a conflict of interest with the performance of his duties as an outside director or interfere with his ability to serve as such may not serve as an outside director. Also, at least one of the outside directors must have financial and accounting expertise and the other must have professional qualifications, as defined in regulations promulgated under the Israeli Companies Law.

Outside directors are elected by a majority of the shares present and voting at the shareholders meeting. In addition, the shares voted in favor of their election must include at least one third of the shareholdings present and voting at the meeting, not counting abstentions, which are not held by controlling shareholders of the company. This minority approval requirement need not be met if the total number of shares not held by controlling shareholders of the company which are voted against the election of an outside director represents 1% or less of all of the voting rights.

Each of our outside directors serves a three-year term, and may be re-elected to serve in this capacity for one additional term of up to three years, and afterwards, as the Company is a dual listed company, may be re-elected for additional terms of up to three years each, provided that prior to their election by a majority of the shares present and voting at the shareholders meeting, such election is approved by the Company's Audit Committee and Board of Directors, on terms referred to in relevant regulations. An outside director can be removed from office only by either the same percentage of shareholders that may elect him, or by a court order. In either case, an outside director may be removed only if the outside director ceases to meet the statutory qualifications for serving as an outside director or breaches his fiduciary duty. The court may also remove an outside director from office if he or she is unable to perform his or her duties on a regular basis. If at the time an outside director is appointed by the shareholders, all other directors are of the same gender, the outside director to be appointed shall be of the other gender.

Neither we nor our subsidiaries may, prior to the lapse of two years after the termination of membership on our board of any of our outside directors, employ such former outside director, engage him or her to serve as an executive officer or director for us or retain his or her professional services.

Ms. Gabriela Heller and Mr. Rafi Koriat currently serve as our outside directors.

The Sarbanes-Oxley Act of 2002, as well as related rules subsequently implemented by the Securities and Exchange Commission, or the SEC, and the Nasdaq Global Market, or Nasdaq, require foreign private issuers, such as us, to comply with various corporate governance practices. Nevertheless, the Company has decided to opt-out of certain of these practices and follows its home country practice pursuant to Nasdaq Rule 4350(a), as disclosed in Item 16G - "Corporate Governance".

We believe that we are currently in compliance with, and we intend to take all actions necessary for us to maintain compliance with, the applicable corporate governance requirements of the Sarbanes-Oxley Act, the rules adopted by the SEC and the listing standards of Nasdaq.

Under the Nasdaq listing requirements, we are required to have a majority of independent directors on our Board of Directors. Ms. Gabriela Heller and Messrs. Rafi Koriat and Eran Bendoly all qualify as our independent directors under Nasdaq rules.

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Internal Auditor

The board of directors of an Israeli public company must appoint an internal auditor proposed by the audit committee. The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business procedures. An internal auditor may not hold any other position in the company, have any business affairs outside of the company which may create a conflict of interest with his or her duties as internal auditor or be an "interested party". For this purpose, an "interested party" is a person who holds 5% or more of the company's shares, serves as or has the power to appoint a director or the chief executive officer of the company, is otherwise personally employed by the company or serves on its board or is a relative of any of these parties. The only exception to the rule against an internal auditor being employed by the company is that the internal auditor may serve as an ombudsman, provided that this does not interfere with the performance of the duties of the internal auditor. In addition, the internal auditor may not be a member of the company's independent accounting firm. We currently have an internal auditor who meets the independence requirements of Israeli law.

Committees of the Board of Directors

The Israeli Companies Law provides that a public company must appoint an audit committee and may also appoint other committees to the board of directors, unless otherwise specified in the Company's Articles. The board of directors may delegate its powers to such committees of the board of directors as it deems appropriate, subject to the provisions of the Israeli Companies Law. Powers that may not be delegated include, among others, the power to distribute dividends, the determination of general company policy, the issuance of securities, the issuance of shares (unless such issuance is under an employee share option plan) and the approval of financial reports. However, those matters can be delegated to committees for the purpose of making recommendations to the full board of directors. According to the Companies Law, a committee to which powers have been delegated shall be composed only of directors. However, a committee whose purpose is only to make a recommendation can be composed of non-directors unless otherwise specified in the Company's Articles. According to the Companies Law, at least one outside director must be appointed to serve on each committee of the board, excluding the audit committee, which must be comprised of at least three directors, including all of the outside directors of the Company. However, the Sarbanes-Oxley Act and the Nasdaq listing requirements require that all members of the audit committee be independent. The audit committee may not include the chairman of the board, any director who is employed by the company or regularly provides service to it, a controlling shareholder, or a relative of any such individual. Our Board of Directors has an audit committee and a compensation committee.

Audit Committee. The Audit Committee oversees and approves the retention, performance and compensation of our independent registered public accounting firm and establishes and oversees the implementation of procedures concerning our systems of internal accounting and auditing control. The Audit Committee is also responsible for identifying deficiencies in the management of our business and proposing solutions for any such deficiencies, and, in accordance with the Israeli Companies Law and the Sarbanes-Oxley Act, approving certain acts and transactions that involve conflicts of interest or that involve interested parties. The members of our Audit Committee are Ms. Gabriela Heller and Messrs. Eran Bendoly and Rafi Koriat, all of whom are independent directors in accordance with Nasdaq listing requirements. Mr. Bendoly and Ms. Heller qualify as financial experts for purposes of the Sarbanes-Oxley Act and the Nasdaq listing requirements, and Ms. Heller and Mr. Koriat qualify as outside directors under Israeli Companies Law.

Compensation Committee. The Compensation Committee reviews and makes recommendations to our board concerning the terms of the compensation packages provided to our employees, including our executive officers, and the terms of any bonus, share options or other awards to be provided to our employees, including our executive officers. Under Israeli law, all compensation arrangements with a general manager who is not a director require the approval of the board of directors. Arrangements regarding the compensation of directors require approval of the audit

committee, the board of directors and the shareholders, in that order, and if the director holds a controlling interest in the company, special shareholder approvals are required. See "Duties of Office Holders and Approval of Transactions under Israeli Law." The members of our Compensation Committee are Ms. Heller and Messrs. Koriat and Bendoly.

Financial Statement Review Committee. The Companies Regulations (Provisions and conditions regarding the approval procedure of the financial reports) of 2010, which were enacted in February 2010, also require public companies to appoint a committee for the review of the company's financial reports ("the Financial Statement Review Committee") and sets forth a procedure for the approval of the financial reports. Under the said Companies Regulations, the composition of the Financial Statement Review Committee must meet a number of conditions including the requirement that all its members must be Board of Directors members and the majority of the members must be independent directors as defined in the Companies Law. In addition, under the regulations, an audit committee that fulfills the required composition conditions set out in the Companies Regulations can be considered as the Financial Statement Review Committee.

Accordingly, since the Company's Audit Committee has already been operating in compliance with U.S. legal requirements (as described above), which satisfy the conditions of the Israeli Financial Statement Review Committee, the Board of Directors, after confirming that the requirements of the said regulations are fulfilled, decided that the Audit Committee will serve as the Financial Statement Review Committee.

Amendment no. 16 to the Companies Law

On March 7, 2011 amendment no. 16 ("Amendment 16") to the Companies Law was enacted by the Israeli Knesset. Amendment 16, which will come into effect mid May, 2011, places a special emphasis on the autonomy of the board of directors and the external directors and on the composition and responsibilities of the audit committee. Under Amendment 16, among others: (i) the approval of certain interested party transactions will require the affirmative vote of a majority of the shares and in addition either that (a) the majority (rather than one third) of the shares held by shareholders who do not have a personal interest in the transaction attending in person or represented by proxy have voted in favor of the proposal (shares held by abstaining shareholders shall not be considered) or (b) that the total number of disinterested shares voted against the proposal does not exceed 2% (rather than 1%) of the aggregate voting rights; (ii) the approval of the appointment of an external director will require the affirmative vote of a majority of the shares and in addition either that (a) the majority (rather than one third) of the shares held by shareholders who are not controlling shareholders attending in person or represented by proxy have voted in favor of the proposal (shares held by abstaining shareholders shall not be considered) or (b) that the total number of disinterested shares voted against the proposal does not exceed 2% (rather than 1%) of the aggregate voting rights; (iii) the majority of members of the audit committee shall be independent directors (as defined under Amendment 16), and the audit committee chairman shall be an external director (which is currently the composition of our audit committee); (iv) the quorum required to determine a decision of the audit committee shall be not less than a majority of the independent directors, including at least one external director; and (v) the audit committee shall determine whether certain related party transactions are considered extraordinary transactions for the purpose of the Companies Law and should be approved as such.

Duties of Office Holders and Controlling Shareholders and Approval of Transactions under Israeli Law

Office Holders

The Israeli Companies Law codifies the duty of care and the fiduciary duties that office holders have towards the company. An office holder's duty of care includes the duty to act as a "reasonable" office holder would have acted in the same position and under the same circumstances. An office holder's fiduciary duty requires the office holder to act in good faith and for the good of the company, which includes:

- avoiding conflicts of interest between the office holder's position with the company and his personal affairs;
- avoiding any competition with the company;
- avoiding the exploitation of the company's business opportunities for personal gain; and
- revealing to the company any information or documents relating to the company's affairs which the office holder has received due to his position.

An "office holder," under the Israeli Companies Law, is anyone serving, regardless of formal title, as a director, general manager, chief executive officer, executive vice president, vice president, or any other executive reporting directly to the general manager. Each person listed in the table under "Directors and Senior Management" is one of our office holders. All arrangements as to compensation of office holders who are neither directors nor controlling shareholders are approved by our compensation committee. The compensation of office holders who are directors or controlling shareholders, and any other employee who is a controlling shareholder or a close relative of such controlling shareholder, as defined in the Companies Law, must also be approved by our Audit Committee, our Board of Directors and our shareholders, in that order. Special shareholder voting procedures are required for the approval of compensation of office holders or employees who are also controlling shareholders or any relative thereof.

Disclosure of Personal Interest

The Israeli Companies Law requires an office holder or controlling shareholder of a public company to disclose any personal interest in an existing or proposed transaction with the company, no later than at the first board meeting in which the transaction is discussed. A personal interest also includes an interest in any company in which the person, his or her close relative or any entity in which such person or close relative has a personal interest, is a direct or indirect 5% or greater shareholder, is a director or the general manager or has the right to appoint at least one director or the general manager. Board approval is required to approve the transaction, and no transaction that is adverse to the company's interest may be approved. Approval by the company's audit committee and board of directors is required for an extraordinary transaction, meaning any transaction that is not in the ordinary course of business, is not on market terms or is likely to have a substantial effect on the company's profitability, assets or liabilities. A director who has a personal interest in a matter may not be present at a board of directors or audit committee meeting during discussions or vote on the matter. However, a director with a personal interest may be present if the transaction to be discussed is not an extraordinary transaction, or if a majority of the audit committee members or the directors, as the case may be, has a personal interest in the matter. If a majority of the board of directors or the audit committee has a personal interest in the transaction, shareholder approval is also required.

Transactions with Controlling Shareholders

A controlling shareholder is a shareholder who has the ability to direct the activities of a company, including a shareholder who holds 25% or more of the voting rights if no other shareholder holds more than 50% of the voting rights. Under Israeli law, the disclosure requirements regarding personal interests that apply to directors and office holders also apply to a controlling shareholder of a public company.

Required Approval. Extraordinary transactions with a controlling shareholder and a controlling shareholder's close relative or in which a controlling shareholder (or its relative) has a personal interest, and the terms of compensation of a controlling shareholder or a relative of a controlling shareholder who is a director, executive officer or employee, require the approval of the audit committee, the board of directors and the shareholders of the company. This shareholder approval must include the majority of shares voted at the meeting. In addition, either:

- the majority must include at least one-third of the shares of disinterested shareholders voted at the meeting; or

- the total number of shares of disinterested shareholders voted against the transaction must not exceed one percent of the aggregate voting rights in the company (but see expected changes in the required majority under Amendment No. 16 to the Companies Law above).

A shareholder who participates in this vote must provide notice to the company prior to voting, stating whether such shareholder has a personal interest in the transaction. In the absence of this notice, the shareholder may not vote on the matter, and his or her vote shall not be counted.

Approval of Certain Specific Extraordinary Transactions. According to regulations promulgated under the Israeli Companies Law, the following specific kinds of extraordinary transactions with a controlling shareholder do not require shareholder approval, provided that the audit committee and the board of directors have approved the transaction and determined that it is one of the following:

- the extension of an existing transaction which was previously approved in accordance with the Israeli Companies Law, provided no material change has been made to the terms of the extended transaction;

- a transaction that benefits only the company;

- a transaction made in accordance with the terms of a framework transaction previously approved in accordance with the requirements of the Israeli Companies Law;

- a transaction constituting part of a transaction with a third party or a joint offer to contract with a third party, provided that the benefit to the company does not materially differ than that to the controlling shareholder, taking into account the proportional interest of each of the parties; or

- a transaction between companies controlled by a common controlling shareholder or between a public company and its controlling shareholder or a third party, in whom the controlling shareholder has a personal interest, provided that the transaction is on market terms, is in the ordinary course of business and does not adversely affect the interests of the company.

Insurance, Indemnification and Exemption

Our Articles provide that, subject to the provisions of the Israeli Companies Law, we may:

(1) Obtain insurance for our office holders covering their liability for any act performed in their respective capacities as an office holder with respect to:

- a violation of the duty of care to us or to another person;

- a breach of fiduciary duty, provided that the office holder acted in good faith and had reasonable grounds to assume that the act would not cause us harm; and

- a monetary liability imposed on an office holder for the benefit of another person.

(2) Undertake to indemnify our office holders or to indemnify an office holder retroactively for a liability imposed or approved by a court, and for reasonable legal fees incurred by the office holder in his or her capacity as an office holder, in proceedings instituted against the office holder by the company, on its behalf or by a third party, in connection with criminal proceedings in which the office holder was acquitted, or in connection with criminal proceedings or other proceedings in which the office holder was investigated but not indicted, or as a result of a conviction for a crime that does not require proof of criminal intent or as result of proceeding in which a monetary liability was imposed regarding a crime that does not require proof of criminal intent. An advance undertaking to indemnify an office holder must be limited to categories of events that can be reasonably foreseen in light of the Company's activities, and to an amount which is reasonable under the circumstances, as determined by the board of directors.

We may exempt, in advance, an office holder from all or part of his or her responsibility for damages occurring as a result of a breach of his or her duty of care. However, we may not exempt, in advance, an office holder for breach of his or her duty of care in respect of distribution of dividends. We may also approve an action taken by the office holder, even if performed in breach of his or her fiduciary duty, if the office holder was acting in good faith, the action does not adversely affect us and the office holder has revealed to the board his or her personal interest in the action.

Notwithstanding the foregoing, we may not insure, indemnify or exempt an office holder for any breach of his or her fiduciary duty, or for a violation of his or her duty of care (1) if the act was committed recklessly or with intent, or (2) if the act was committed with the intent to realize improper personal gain, or (3) for any fine imposed on the office holder, except as provided above.

As required under Israeli law, our Audit Committee, Board of Directors and shareholders have approved the indemnification and insurance of our office holders, as well as the resolutions necessary both to exempt our office holders in advance from any liability for damages arising from a breach of their duty of care to us, and to provide them with the indemnification undertakings and insurance coverage they have received from us in accordance with our Articles.

The Israeli Securities Law- 1968 and the Securities Law Amendment

On February 27, 2011, an amendment to the Israeli Securities Law- 1968, came into effect ("Securities Law Amendment"); this amendment applies to Israeli public companies, including companies the securities of which are also listed on NASDAQ Capital Market. The main purpose of the Securities Law Amendment is creating an administrative enforcement procedure to be used by the Israeli Securities Authority, or ISA, to enhance the efficacy of enforcement in the securities market in Israel. The new administrative enforcement procedure may be applied to any company or person (including director, officer or shareholder of a company) performing any of the actions specifically designated as breaches of law under the Securities Law Amendment. Furthermore, the Securities Law Amendment requires that the chief executive officer of a company supervise and take all reasonable measures to prevent the company or any of its employees from breaching the Israeli Securities Law. The chief executive officer is presumed to have fulfilled such supervisory duty if the company adopts internal enforcement procedures designed to prevent such breaches, appoints a representative to supervise the implementation of such procedures and takes measures to correct the breach and prevent its reoccurrence.

Under the Securities Law Amendment, a company cannot obtain insurance against or indemnify a third party (including its officers and/or employees) for any administrative procedure and/or monetary fine (other than for payment of damages to an injured party). The Securities Law Amendment permits insurance and/or indemnification for expenses related to an administrative procedure, such as reasonable legal fees, provided that it is permitted under the company's articles of association.

We are currently examining the implications of the Securities Law Amendment; however, its effect and consequences, as well as our scope of exposure, are yet to be determined in practice. There is no assurance that we will not be required to take certain actions in order to enhance our compliance with the provisions of the Securities Law Amendment, such as adopting and implementing an internal enforcement plan to reduce our exposure to potential breaches of the Israeli Securities Law, or amending our articles of association to permit insurance and/or indemnification as contemplated by the Securities Law Amendment.

D. Employees.

Employees

The following table sets forth for the last three years, the number of our employees engaged in the specified activities at the end of each year:

	As of December 31,		
	2010	2009	2008
Executive management	11	11	11
Research and development	92	97	97
Sales support	188	162	151
Sales and marketing	41	32	62
Administration	67	61	68
Operations	114	86	98
Total	513	449	487

The following table sets forth for the last three years, the number of our employees located in the following geographic regions at the end of each year:

	As of December 31,		
	2010	2009	2008
China (including Hong Kong)	178	148	159
Taiwan	66	40	35
Japan	6	6	14
Other Asia	28	24	30
Europe	3	11	14
North America	18	21	19
Israel	214	199	216
Total	513	449	487

The increase in our workforce is related to higher demand for our products in 2010 compared to 2009. See Item 5 "Results of operations".

With respect to our Israeli employees, we have no collective bargaining agreements with our employees. However, by administrative order, certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations, relating primarily to the length of the work day, minimum wages, pension contributions, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment, are applicable to our employees. In accordance with these provisions, the salaries of our Israeli employees are partially indexed to the Consumer Price Index in Israel, depending on the rate of increase of the Consumer Price Index.

We consider our relationship with our employees to be good, and we have never experienced a labor dispute, strike or work stoppage.

E. Share Ownership.

The following table sets forth certain information with respect to the beneficial ownership of our outstanding ordinary shares by our directors and executive officers.

Beneficial ownership is determined in accordance with the rules of the SEC and generally means sole or shared power to vote or direct the voting or to dispose or direct the disposition of any ordinary shares. Except as indicated by footnote, the persons named in the table below have sole voting and investment power with respect to all ordinary shares shown as beneficially owned by them. The percentage of beneficial ownership is based upon 29,277,983 ordinary shares outstanding as of December 31, 2010.

Name	Number of Ordinary Shares Owned(1)	Percentage of Total Outstanding Ordinary Shares	
Rafi Amit(2)	17,790,022	60.76	%
Yotam Stern(3)	17,843,187	60.94	%
	18,153,140	62.00	%

Directors and executive officers as a group (14 persons)(4)

(1) Ordinary shares relating to options currently exercisable or exercisable within 60 days of the date of this Annual Report are deemed outstanding for computing the percentage of the persons holding such securities but are not deemed outstanding for computing the percentage of any other person. As of the date of this Annual Report, the total number of options held by the persons included in the above table, that are currently exercisable or exercisable within 60 days of the date hereof, is 213,313.

(2) Mr. Amit directly owns 45,060 of our ordinary shares. In addition, as a result of a voting agreement relating to a majority of Priortech's voting equity, Mr. Amit may be deemed to control Priortech. As a result, Mr. Amit may be deemed to beneficially own the shares of Camtek held by Priortech. Mr. Amit disclaims beneficial ownership of such shares.

(3) Mr. Stern directly owns 106,400 of our ordinary shares. In addition, as a result of a voting agreement relating to a majority of Priortech's voting equity, Mr. Stern may be deemed to control Priortech. As a result, Mr. Stern may be deemed to beneficially own the shares of Camtek held by Priortech. Mr. Stern disclaims beneficial ownership of such shares.

(4) Includes Messrs. Amit's and Stern's interest in ordinary shares beneficially owned by Priortech. Our directors and executive officers as a group directly own 429,803 of our ordinary shares. Each of our directors and executive officers, other than Messrs. Amit and Stern, beneficially owns less than 1% of our outstanding ordinary shares as of May 31, 2010 (including options held by each such person which have vested or will vest within 60 days of May 31, 2010) and have therefore not been listed separately.

Restricted Share Unit and Option Plans

General. We currently maintain one restricted share unit plan and one active share option plan.

The purpose of our restricted share unit and option plans is to afford an incentive to our officers, directors, employees and consultants and those of our subsidiaries, to acquire a proprietary interest in us, to increase their efforts on our behalf and to promote the success of our business.

Restricted Share Unit Plan. In August 2007, the Company approved the 2007 Restricted Share Unit Plan (the "RSU Plan"), for the grant of restricted share units, each of which imparts the right to an ordinary share of the Company, to selected employees, officers, directors and consultants of the Company. The RSU Plan is being administered by our Board of Directors.

No RSUs were granted in 2010. In 2009, 832,500 RSUs were granted.

The total number of RSUs to be granted pursuant to the RSU Plan is 1,500,000, out of which 583,229 are available for grant as of the date of this Annual Report.

Under the RSU Plan, RSUs are granted for no consideration and the exercise price for each grantee is no more than the underlying share's nominal value, unless otherwise determined by the Board. The RSUs vest according to a four-year vesting schedule, with 25% of the shares vest on the first anniversary of the date of grant and the remaining vesting on a quarterly basis, unless otherwise determined by our Board of Directors.

Option Plans

General. As of December 31, 2010, there were 489,701 outstanding options to acquire our ordinary shares pursuant to our share option plans at a weighted average exercise price of $3.21, exercisable at various dates through July 2015. Future options to be granted by us to our employees, officers, directors and consultants or those of our affiliates will only be made pursuant to the 2003 Share Option Plan.

In January 2011, the Company's Board of Directors authorized the increase in the number of shares available under its share option plans by 600,000 to 1,598,800. In January 2011 we granted 615,000 share options to employees.

Administration of Our Share Option Plans. Our option plans are administered by our Board of Directors. Under these option plans, options to purchase our ordinary shares may also be granted to our officers, directors, employees or consultants and those of our subsidiaries. The exercise price of options is determined, under our option plans, by our Board of Directors, and is generally set as the fair market value (although some options are exercisable for no additional consideration and are the equivalent of restricted stock grants). The vesting schedule of the options is also determined by the Board of Directors; generally the options vest over a four-year period. Each option granted under the option plans is exercisable between four to ten years from the date of the grant of the option, according to the plan under which they were granted and subject to certain early expiration provisions, such as in the event of termination.

The Share Option Plans. In September 1997, we adopted a share option plan under which options to purchase our ordinary shares were granted to employees, as determined by the board from time to time. This plan was amended in 2000 and in 2003, each time in order to comply with new Israeli tax legislation.

In November 2000, we adopted three share option plans: the Executive Share Option Plan, the US Incentive Stock Option Plan and the European Employee Share Option Plan. Under these plans, options were granted to employees, directors, executive officers and consultants of our company and our affiliates around the world.

In October 2003, we adopted our 2003 Share Option Plan and its corresponding Sub-Plan for Grantees Subject to United States Taxation and Sub-Plan for Grantees Subject to Israeli Taxation. The total number of options that may be granted under the 2003 Share Option Plan is 998,800 options.

During 2010 and 2009 we did not grant any options to employees.

As of December 31, 2010, there were options exercisable and vested for 480,701 ordinary shares (out of the total outstanding options of 489,701) at a weighted average exercise price of $3.19 per share, and unvested options exercisable for 9,000 ordinary shares at a weighted average exercise price of $4.133.

Item 7. Major Shareholders and Related Party Transactions.

A. Major Shareholders.

The following table provides information regarding the beneficial ownership of our ordinary shares as of March 31, 2011, as to each person or entity who beneficially owns more than 5.0% of our outstanding ordinary shares. None of these shareholders has different voting rights than any of the Company's other shareholders.

Beneficial ownership is determined in accordance with the rules of the SEC and generally means sole or shared power to vote or direct the voting or to dispose or direct the disposition of any ordinary shares. Except as indicated by footnote, the person named in the table below has sole voting and investment power with respect to all ordinary shares shown as beneficially owned by it. The percentage of beneficial ownership is based upon 29,333,569 ordinary shares outstanding as of March 31, 2011.

	Beneficial Ownership	
	Number of Ordinary Shares*	Percentage
Priortech Ltd.	17,723,337	60.6 %
Avigdor Willenz	1,604,758	5.48 %

*A majority of the voting equity in Priortech Ltd. is subject to a voting agreement. As a result of this agreement, Messrs. Rafi Amit, Yotam Stern, Itzhak Krell, David Kishon, heirs of Haim Langmas, Zehava Wineberg and Hanoch Feldstien may be deemed to control Priortech Ltd. The voting agreement does not provide for different voting rights for our major shareholder than the voting rights of other holders of our ordinary shares. Priortech's principal executive offices are located at South Industrial Zone, Migdal Ha'Emek 23150, Israel.

As of March 31, 2011, there were a total of 10 holders of record of our issued and outstanding ordinary shares, of which 7 were registered with addresses in the United States. Such United States holders were, as of such date, the holders of record of approximately 34.1% of our issued and outstanding ordinary shares. The number of record holders in the United States is not representative of where such beneficial holders are resident because many of these ordinary shares were held of record by brokers or other nominees.

B. Related Party Transactions.

Ordinary Course Transactions and Activities with Priortech and its Affiliates

From time to time we have entered into transactions in the ordinary course of business with Priortech and its affiliates. Our purchases of materials, such as PCBs and assembled PCBs from Priortech and its affiliates, totaled $1,955,000 $684,000 and $1,804,000 in 2010, 2009 and 2008, respectively. In addition, we purchase bare PCBs and assembled PCBs from a Priortech subsidiary for the development and manufacture of our systems so long as the price charged and other payment terms are comparable to the best offer we could obtain from a third party. Our total revenues from sales to affiliates of Priortech totaled $83,000, $843,000 and $467,000 in 2010, 2009 and 2008, respectively. We act jointly with Priortech with regard to various governmental, administrative and commercial matters, which we believe is to the mutual advantage of both parties. Unpaid balances between Priortech and its subsidiaries in Israel and us bear interest at 5.5%. As of December 31, 2010, the remaining balance Priortech and its affiliates owed us under transactions made in the ordinary course of business with them was $401,000. We believe that these transactions and activities were conducted on terms and conditions as favorable to us as those which we could have entered into with unaffiliated third parties.

Registration Rights Agreement with Priortech

On March 1, 2004, we entered into a registration rights agreement providing for us to register with the SEC certain of our ordinary shares held by Priortech. This registration rights agreement may be used in connection with future offerings of our ordinary shares, and includes, among others, the following terms: (a) Priortech is entitled to make up to three demands that we register our ordinary shares held by Priortech, subject to delay due to market conditions; (b) Priortech will be entitled to participate and sell our ordinary shares in any future registration statements initiated by us, subject to delay due to market conditions; (c) we will indemnify Priortech in connection with any liabilities incurred in connection with such registration statements due to any misstatements or omissions other than information provided by Priortech, and Priortech will indemnify us in connection with any liabilities incurred in connection with such registration statements due to any misstatements or omissions in written statements by Priortech made for the purpose of their inclusion in such registration statements; and (d) we will pay all expenses related to registrations which we have initiated, except for certain underwriting discounts or commissions or legal fees, and Priortech will pay

all expenses related to a registration initiated at its demand in which we are not participating.

On December 30, 2004, the Registration Rights Agreement with Priortech was amended. The amendment concerns primarily the grant of unlimited shelf registration rights thereunder to Priortech with respect to its holdings in us, and the assignability of those shelf registration rights to its transferees.

Employment Agreements with Messrs. Rafi Amit and Yotam Stern

For a description of the employment agreements with our Active Chairman of the Board, Mr. Rafi Amit, and our Director and Executive Vice President – Business and Strategy – Mr. Yotam Stern, see above in Item 6 B "Compensation – Employment Agreements".

C. Interests of Experts and Counsel.

Not Applicable.

Item 8. Financial Information.

A. Consolidated Statements and Other Financial Information.

Please see the consolidated financial statements listed in Item 18 for audited consolidated financial statements prepared in accordance with this Item.

Legal Proceedings

On May 10, 2004, a lawsuit was filed against us in the District Court in Nazareth, Israel, by our competitor, Orbotech Ltd., alleging that the Dragon and Falcon systems infringe upon a patent held by Orbotech Ltd. and requesting injunctive relief and damages. The patent upon which the claim is asserted expired in February 2008. The court advised the parties to turn to mediation. The parties participated in one mediation meeting, after which they decided to end the mediation and to hold direct negotiations between them. Despite the unsuccessful direct negotiations, the court ordered another mediation meeting which is scheduled for July 2011. Currently, court sessions have been postponed for as long as the mediation process continues. We can not estimate the range of loss for this claim, as it is still at an early stage. However, we believe that we have substantial defenses against the validity of Orbotech's patent and substantial defenses against Orbotech's claims. So far no evidence has been filed by Orbotech with the court to support the claim of infringement, and we expect the infringement allegation would be difficult to prove. Also, the allegedly infringing element is only optional and was hardly used in Camtek's system, regardless of this claim. Therefore, we estimate the probability of an unfavorable outcome in this litigation to be remote and accordingly, no provision has been recorded by the Company.

On February 23, 2005, a lawsuit was filed against us in the District Court in Jerusalem by Orbotech Ltd., alleging infringement of a patent held by Orbotech Ltd. regarding a specific illumination block (an apparatus for illuminating and controlling the illumination of scanned objects), seeking injunctive relief and damages. The court ruled, based on a court's scientific advisor's opinion and prime facie evidence only, that Camtek infringed the patent, and granted Orbotech a provisional remedy, i.e. interim relief, which prevents Camtek from manufacturing the allegedly infringing illumination block in suit. The claim currently awaits the court's decisions in several pending preliminary motions filed by both parties. The patent upon which the claim is asserted expired in February 2007. At the court's recommendation, the parties held one mediation meeting, after which they have decided to conduct direct negotiations between them, without the mediator. These direct negotiations were unsuccessful. We believe that we have good defenses in the infringement aspect of the claim. The Company further believes that it has claims with respect to the validity of the asserted patent, as well as other defenses such as estoppel and lack of good faith on the part of Orbotech. We cannot currently estimate the range of loss for this claim, as it is still at an early stage. However, we believe that we have a strong invalidity defense due to a prior publication of the alleged invention; The allegedly infringing element is an illumination block referred to as "new block – 155", which due to an Interlocutory injunction was never installed in any of Camtek's systems. Orbotech is trying to expand the scope of the lawsuit to an "old block", but we consider their chances in succeeding to do so minute. Therefore, we estimate the probability of an

unfavorable outcome in this litigation to be remote and accordingly, no provision has been recorded by the Company.

On July 14, 2005, a lawsuit was filed against us in the United States District Court for the District of Minnesota ("Court") by one of the Company's competitors in the field of semiconductor wafer inspection equipment, August Technology Corporation (today Rudolph Technologies Inc., hereinafter "Rudolph," having acquired August Technology Corporation), alleging infringement of U.S Patent No. 6,826,298 ("'298 patent") and seeking injunctive relief and damages. On March 5, 2009 a jury verdict was rendered in favor of Rudolph, awarding damages of approximately $6.8 million with regard to sales of Camtek's Falcon products in the United States. The jury also found that the infringement was not willful. On August 28, 2009, the Court entered judgment ordering the Company to pay the jury award, as well as an additional $1.2 million in prejudgment interest. The Court also issued an injunction ("Injunction") ordering the Company to discontinue all sales and marketing of Falcon in the United States. Pursuant to the terms of the Injunction, service and repair of Falcons sold prior to the jury verdict is permitted to keep the systems in original operating condition. The Injunction relates only to the Company's Falcon operations in the United States, and should not have an effect on any of the Company's other operations. The Company filed an appeal with the Court of Appeals for the Federal Circuit on August 10, 2010, after the Court's denial of the Company's post-judgment motions. On November 17, 2010, the Magistrate Judge found that Rudolph was entitled to $645,946 in supplemental damages reflecting Falcon sales occurring after the time period considered by the jury, and on January 7, 2011, the Court upheld the supplemental damages award. The Company has posted a bond in the Court, staying collection of any award pending resolution of the appeal. On March 9, 2011, Rudolph filed a motion seeking $322,973 in enhanced damages for an allegedly willful post-verdict Falcon sale, as well a motion seeking $1.2 million and unspecified attorneys fees for alleged contempt of the Injunction. The Company believes it has strong defenses to these charges and intends to vigorously oppose these motions. An appeal hearing is scheduled for April 7, 2011, but we expect final decision on our appeal to be received no earlier then the second half of 2011. See also "We have a history of losses, and we cannot assure you that we will not incur additional losses in the future. Moreover, if our business deteriorates, we could face liquidity problems" above. Although it is difficult to estimate the outcome of a patent infringement case, and while estimating the outcome of litigation can never be a precise exercise, we believe that although judgment has been entered, the probability of an unfavorable outcome of this litigation after the appeal process is less than 50% and accordingly, no provision has been recorded by the Company. We currently estimate the possible range of loss in this case, if any, to be $0 to $9 million (including interest).

On March 7, 2008, a purported Class Action Complaint ("CAC"), Yuval Lapiner v. Camtek, Ltd. et al., was filed in the United States District Court for the Northern District of California on behalf of purchasers of our common stock between November 22, 2005 and December 20, 2006. Mr. Lapiner filed a Consolidated Amended Class Action Complaint on January 2, 2009, naming the Company and certain of its directors and officers as defendants. It alleges that the defendants violated Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated there under, and breached fiduciary duties by making false and misleading statements in the Company's SEC filings and press releases. The plaintiff seeks unspecified compensatory damages against the defendants, as well as attorneys' fees and costs. We filed a motion to dismiss the CAC, as amended, on February 17, 2009, and the Court granted this motion on June 2, 2009. However, the Court gave plaintiff leave to amend his complaint, which he did when he filed a Second Consolidated Amended Class Action Complaint ("SAC") on July 10, 2009. We filed a motion to dismiss the SAC and the court granted this motion on February 2, 2011. The Court, however, gave plaintiff leave to amend his complaint which he did when he filed a Third Amended Complaint ("TAC") on April 1, 2011. Defendants intend to move to dismiss the TAC and their motion is due on May 16, 2011. Camtek is unable to estimate a range of loss for this claim, given the fact that it is still at an early stage. Accordingly, no provision has been made in our financial statements in respect of this claim. The court granted Camtek's initial and second motions to dismiss this claim and we do not believe that these complaints have merit. The Company expects that the loss, if any, will be covered by the Company's directors and officers' insurance policy.

On June 1, 2010, Rudolph filed a complaint against us in the United States District Court for the District of Minnesota in which Rudolph alleged infringement of their U.S. Patent 7,779,528 relating to semiconductor wafer inspection technology similar to that described in the '298 patent. The complaint has not yet been served. However,

Camtek believes that it has good defenses and intends to aggressively defend itself from the allegations in this claim and its right to sell its tools in the United States. At this preliminary stage it is impossible for the Company to assess the probability of the outcome of the lawsuit or to reasonably estimate its effect on the Company's activities and financial results, if any.

On November 1, 2010, a lawsuit has been filed by Fish & Richardson P.C. ("F&R") in the United States District Court for the District of Minnesota against us. The suit arises from F&R's representation of Camtek in an action against it by Rudolph Technologies Inc., referred to above. F&R alleges that Camtek owes it approximately $2.25 million in unpaid attorney's fees arising from F&R's representation of Camtek at this trial level proceeding. Camtek disputes this claim, asserting that F&R inflated its fees by defending the matter inefficiently, and that F&R charged fees which were substantially beyond the estimated legal costs provided to Camtek periodically in advance of incurring such fees. Camtek also has potential malpractice counterclaims against F&R and is in the process of evaluating whether or not to bring such claims. The current status of the matter is that F&R has obtained a default judgment against Camtek, after asserting that service of the Summons and Complaint was properly effected upon Camtek, and Camtek failed to timely answer or otherwise appear in the action. Camtek only learned of F&R's alleged service after F&R's motion for default and currently has retained local counsel in Minnesota to seek to vacate the default judgment, as Camtek's position is that service was, in fact, never made upon Camtek. All these amounts were already recorded in our results of operations in the respective month they were received and as such a provision for the full amount has been made in our financial statements in respect of this claim.

In July 2005, the Company, together with our parent company, Priortech Ltd., filed a lawsuit in Israel against Orbotech Ltd., in respect of damages in the amount of $4.1 million incurred by it due to a claim and a motion for injunction filed against the Company by Orbotech in May 2004, in the District Court in Nazareth. The Company believes that Orbotech's claim and motion against it were not filed in good faith, but in order to thwart Camtek's secondary public offering that was scheduled few days after the submission of Orbotech's claim and motion and was supposed to approximately $40 million for the Company and Priortech Ltd. Trial is now expected to continue after the submission of primary affidavit and expert opinion by Orbotech on March 9, 2011.

On November 3, 2010, the Company filed a lawsuit in Germany against Rudolph Technologies Inc., alleging that Rudolph's edge inspection equipment sold under the "Axi" and "Edge Inspection module E25, 30, 35" trademark infringes Camtek's patent no. DE 101 31 665 B4. As the claim has been filed in German, it is currently being translated into English. It will be delivered to Rudolph Technologies Inc. as the next step of the proceedings. An oral hearing is scheduled for July 13, 2011.

We are not a party to any other material legal proceedings.

B. Significant Changes.

None.

Item 9. The Offer and Listing.

A. Offer and Listing Details.

Price History of Ordinary Shares

Since April 22, 2004, the primary trading market for our ordinary shares has been the Nasdaq Global Market, where our ordinary shares are listed and traded under the symbol "CAMT". From July 28, 2000 through February 4, 2003, our ordinary shares were listed and traded on the Nasdaq National Market and from February 5, 2003 through April 21, 2004, our ordinary shares were listed and traded on the Nasdaq SmallCap Market (now the Nasdaq Capital Market).

For the period between November 26, 2001 and October 21, 2003, our ordinary shares were also listed on the Tel Aviv Stock Exchange, or TASE. During such period, the trading activity in our ordinary shares on the TASE was insignificant. At our request, our ordinary shares were de-listed from the TASE. In December 2005, we re-listed our

ordinary shares on the TASE.

6.97

United States and Puerto

Rico government

obligations

621,664

-

193

5,856

616,001

1.70

Mortgage-backed securities:

FHLMC certificates:

After 5 to 10 years

18,658

-

14

63

18,609

2.14

After 10 years

297,733

-

217

4,853

293,097

2.23

316,391

-

231

4,916

311,706

2.23

GNMA certificates:

After 1 to 5 years	
	81
	-
	1
	-
	82
	3.23
After 5 to 10 years	
	69,661

-

1,244

-

70,905

3.05

After 10 years

145,067

-

5,910

334

150,643

3.81

214,809

-

7,155

334

221,630

3.56

FNMA certificates:

After 1 to 5 years	20,831
	-
	294

109

21,016

2.69

After 5 to 10 years

49,934

-

-

818

49,116

1.83

After 10 years	
	613,129
	-
	3,180
	6,401
	609,908
	2.43
	683,894
	-
	3,474

7,328

680,040

2.39

Collateralized mortgage obligations

issued or guaranteed by

FHLMC and GNMA:

After 1 to 5 years	5,918
	-
	14
	-
	5,932

2.21

After 5 to 10 years

2,556

-

11

-

2,567

2.23

After 10 years

35,331

-

231

-

35,562

2.22

43,805

-

256

-

44,061

2.22

Other mortgage pass-through

trust certificates:

After 10 years	
	22,791
	5,731
	-
	-
	17,060
	2.44
Total mortgage-backed	

securities

1,281,690

5,731

11,116

12,578

1,274,497

2.54

Other

Due within one year	100
	-
	-
	-
	100
	1.48

Equity Securities (1)	
	424
	-
	-
	6

418

2.11

Total investment securities

available for sale

$

1,903,878

$

5,731

$

11,309

$

18,440

$

1,891,016

2.27

(1)

As of January 1, 2018, the Corporation adopted ASU 2016-01, resulting in the reclassification of equity securities from available-for-sale investment securities to other investment securities.

Maturities of mortgage-backed securities (“MBS”) 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 available 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 and the noncredit loss component of OTTI are presented as part of OCI.

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 March 31, 2018 and December 31, 2017. The tables also include debt securities for which an OTTI was recognized and only the amount related to a credit loss was recognized in earnings. For unrealized losses for which OTTI was recognized, the related credit loss was charged against the amortized cost basis of the debt security.

	As of March 31, 2018					
	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:						
Puerto Rico-government obligations	$ -	$ -	$ 2,734	$ 1,301	$ 2,734	$ 1,301
U.S. Treasury and U.S. government agencies obligations	238,248	3,306	360,298	5,017	598,546	8,323
Mortgage-backed securities:						
FNMA	354,552	7,690	259,076	11,104	613,628	18,794
FHLMC	138,510	2,916	157,598	6,768	296,108	9,684
GNMA	68,490	1,123	-	-	68,490	1,123
Collateralized mortgage obligations issued or guaranteed by FHLMC and GNMA	5,907	11	-	-	5,907	11
Other mortgage pass-through trust certificates	-	-	16,074	5,235	16,074	5,235
	$ 805,707	$ 15,046	$ 795,780	$ 29,425	$ 1,601,487	$ 44,471

	As of December 31, 2017					
	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:						
Puerto Rico-government obligations	$ -	$ -	$ 2,695	$ 1,277	$ 2,695	$ 1,277
U.S. Treasury and U.S. government agencies obligations	136,459	494	362,050	4,085	498,509	4,579
Mortgage-backed securities:						
FNMA	189,699	1,705	274,963	5,623	464,662	7,328
FHLMC	91,174	590	166,331	4,326	257,505	4,916

GNMA	39,145	334	-	-	39,145	334
Other mortgage pass-through trust certificates	-	-	17,060	5,731	17,060	5,731
Equity securities (1)	-	-	407	6	407	6
	$ 456,477	$ 3,123	$ 823,506	$ 21,048	$ 1,279,983	$ 24,171

(1) As of January 1, 2018, the Corporation adopted ASU 2016-01, resulting in the reclassification of equity securities from available-for-sale investment securities to other investment securities.

Assessment for OTTI

Debt securities issued by U.S. government agencies, U.S. government-sponsored entities, and the U.S. Treasury accounted for approximately 98% of the total available-for-sale portfolio as of March 31, 2018, and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government. The Corporation's OTTI assessment was concentrated mainly on private label MBS, and on Puerto Rico government debt securities, for which credit losses are evaluated on a quarterly basis. The Corporation considered the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis;
- Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the financial condition of the issuer, credit ratings, the failure of the issuer to make scheduled principal or interest payments, recent legislation and government actions affecting the issuer's industry, and actions taken by the issuer to deal with the present economic climate;
- Changes in the near term prospects of the underlying collateral for a security, if any, such as changes in default rates, loss severity given default, and significant changes in prepayment assumptions; and
- The level of cash flows generated from the underlying collateral, if any, supporting the principal and interest payments of the debt securities.

The Corporation recorded OTTI losses on available-for-sale debt securities as follows:

	Quarter ended March 31,			
	2018		**2017**	
(In thousands)				
Total other-than-temporary impairment losses	$	-	$	(12,231)
Portion of other-than-temporary impairment recognized in OCI		-		-
Net impairment losses recognized in earnings [1]	$	-	$	(12,231)

(1)Credit losses on Puerto Rico government debt securities, recorded in the first quarter of 2017.

The following tables summarize the roll-forward of credit losses on debt securities held by the Corporation for which a portion of an OTTI is recognized in OCI:

Cumulative OTTI credit losses recognized in earnings on securities still held

	December 31, 2017 Balance	Credit impairments recognized in earnings on securities that have been previously impaired	March 31, 2018 Balance
(In thousands)			
Available-for-sale securities			
Private label MBS	$ 6,792	$ -	$ 6,792

	Cumulative OTTI credit losses recognized in earnings on securities still held		
	December 31, 2016 Balance	Credit impairments recognized in earnings on securities that have been previously impaired	March 31, 2017 Balance
(In thousands)			
Available for sale securities			
Puerto Rico government obligations	$ 22,189	$ 12,231	$ 34,420
Private label MBS	6,792	$ -	6,792
Total OTTI credit losses for available-for-sale debt securities	$ 28,981	$ 12,231	$ 41,212

During the second quarter of 2017, the Corporation sold for an aggregate of $23.4 million three Puerto Rico government available-for-sale debt securities, specifically bonds of the Government Development Bank for Puerto Rico (the "GDB") and the Puerto Rico Public Buildings Authority, carried on its book at an amortized cost at the time of sale of $23.0 million (net of $34.4 million in cumulative OTTI impairment charges). Approximately $12.2 million of the cumulative OTTI charges on these securities was recorded in the first quarter of 2017.

For the OTTI charge recorded on the Puerto Rico government debt securities in the first quarter of 2017, the Corporation considered the latest available information about the Puerto Rico government's financial condition, including but not limited to credit ratings downgrades, revised estimates of recovery rates, and other relevant developments such as government actions, including debt exchange proposals and the fiscal plan published by the Puerto Rico government in March 2017, as applicable. The Corporation applied a discounted cash flow analysis to its Puerto Rico government debt securities in order to calculate the cash flows expected to be collected and to determine if any portion of the decline in market value of these securities was considered a credit-related OTTI. The analysis derived an estimate of value based on the present value of risk-adjusted cash flows of the underlying securities and included consideration of the following components:

- The contractual future cash flows of the bonds were projected based on the key terms as set forth in the official statements for each security. Such key terms include, among others, the interest rate, amortization schedule, if any, and maturity date.

- The risk-adjusted cash flows were calculated based on a probability of default analysis and recovery rate assumptions, including the weighting of different scenarios of ultimate recovery, considering the credit rating of each security. Constant monthly default rates were assumed throughout the life of the bonds, which considered the respective security's credit rating as of the date of the analysis.

- The adjusted future cash flows were then discounted at the original effective yield of each investment based on the purchase price and expected risk-adjusted future cash flows as of the purchase date of each investment.

The discounted risk-adjusted cash flow analysis for the three Puerto Rico government bonds mentioned above assumed a default probability of 100%, as these three non-performing bonds had been in default since the third quarter of 2016. Based on this analysis, the Corporation recorded in the first quarter of 2017 credit-related OTTI amounting to $12.2 million, assuming recovery rates ranging from 15% to 80% (with a weighted average of 41%).

In addition, the Corporation performed on OTTI assessment on its private label MBS, which are collateralized by fixed-rate mortgages on single-family residential properties in the United States. The interest rate on these private-label MBS is variable, tied to 3-month LIBOR and limited to the weighted-average coupon on the underlying collateral. The underlying mortgages are fixed-rate, single-family loans with original FICO scores (over 700) and moderate loan-to-value ratios (under 80%), as well as moderate delinquency levels. Based on the expected cash flows, and since the Corporation does not have the intention to sell the securities and has sufficient capital and liquidity to

hold these securities until a recovery of the fair value occurs, only the credit loss component, if any, is reflected in earnings. Significant assumptions in the valuation of the private label MBS were as follows:

	As of March 31, 2018		**As of December 31, 2017**	
	Weighted Average	**Range**	**Weighted Average**	**Range**
Discount rate	14.5%	14.5%	14.0%	14.0%
Prepayment rate	15.2%	7.5% - 24.5%	16.4%	12.0% - 29.0%
Projected Cumulative Loss Rate	4%	0% - 9%	3%	0% - 6.8%

No OTTI charges on private label MBS were recorded in either the first quarter of 2018 or the first quarter of 2017.

Investments 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 March 31, 2018 and December 31, 2017 were as follows:

	March 31, 2018				
		Gross Unrealized			
	Amortized cost	gains	losses	Fair value	Weighted-average yield%
Puerto Rico Municipal Bonds:					
After 1 to 5 years	$ 3,712	$ -	$ 161	$ 3,551	5.39
After 5 to 10 years	39,523	-	2,703	36,820	5.35
After 10 years	107,251	-	12,766	94,485	5.21
Total investment securities held to maturity	$ 150,486	$ -	$ 15,630	$ 134,856	5.25

	December 31, 2017				
		Gross Unrealized			
	Amortized cost	gains	losses	Fair value	Weighted average-yield%
Puerto Rico Municipal Bonds:					
After 1 to 5 years	$ 3,853	$ -	$ 173	$ 3,680	5.38
After 5 to 10 years	39,523	-	3,048	36,475	5.28
After 10 years	107,251	-	16,374	90,877	4.93
Total investment securities held to maturity	$ 150,627	$ -	$ 19,595	$ 131,032	5.03

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 March 31, 2018 and December 31, 2017:

	As of March 31, 2018					
	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:						
Puerto Rico Municipal Bonds	$ -	$ -	$ 134,856	$ 15,630	$ 134,856	$ 15,630

	As of December 31, 2017					
	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:						
Puerto Rico Municipal Bonds	$ -	$ -	$ 131,032	$ 19,595	$ 131,032	$ 19,595

The Corporation determines the fair market value of Puerto Rico Municipal Bonds based on a discounted cash flow analysis using risk-adjusted discount rates. A security with similar characteristics traded in the open market is used as a proxy for each municipal bond. Then the cash flow is discounted at the average spread over the discount curve exhibited by the proxy security at the end of each quarter.

Approximately 70% of the held-to-maturity municipal bonds were issued by three of the largest municipalities in Puerto Rico. The vast majority of revenues of these three municipalities is independent of the Puerto Rico central government. These obligations typically are not issued in bearer form, nor are they registered with the SEC and are not rated by external credit agencies. In most cases, these bonds have priority over the payment of operating costs and expenses of the municipality, which are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and loans. The PROMESA oversight board has not designated any of Puerto Rico's 78 municipalities as covered entities under PROMESA. However, while the fiscal plan recently certified by the PROMESA oversight board did not contemplate a restructuring of the debt of Puerto Rico's municipalities, the plan did call for the gradual elimination of budgetary subsidies provided to municipalities by the central government. Furthermore, municipalities are also likely to be affected by the negative economic and other effects resulting from the recent hurricanes and from expense, revenue or cash management measures taken by the Puerto Rico government to address its fiscal and liquidity shortfalls, or measures included in fiscal plans of other

government entities, such as the fiscal plans of the GDB and the Puerto Rico Electric Power Authority (“PREPA”). Given the uncertain effect that the negative fiscal situation of the Puerto Rico central government and the measures taken or to be taken by other government entities may have on municipalities, the Corporation cannot be certain if future impairment charges will be required relating to these securities.

From time to time, the Corporation has securities held to maturity with an original maturity of three months or less that are considered cash and cash equivalents and classified as money market investments in the consolidated statements of financial condition. As of March 31, 2018 and December 31, 2017, the Corporation had no outstanding securities held to maturity that were classified as cash and cash equivalents.

NOTE 6 – OTHER INVESTMENT SECURITIES

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

As of each March 31, 2018 and December 31, 2017, the Corporation had investments in FHLB stock with a book value of $40.9 million. The net realizable value is a reasonable proxy for the fair value of these instruments. Dividend income from FHLB stock for the quarters ended March 31, 2018 and 2017 was $0.7 million and $0.5 million, respectively.

The FHLB of New York issued the shares of FHLB stock owned by the Corporation. The FHLB of New York is part of the Federal Home Loan Bank System, a national wholesale banking network of 11 regional, stockholder-owned congressionally chartered banks. The Federal Home Loan Banks are all privately capitalized and operated by their member stockholders. The system is supervised by the Federal Housing Finance Agency, which ensures that the Federal Home Loan Banks operate in a financially safe and sound manner, remain adequately capitalized and able to raise funds in the capital markets, and carry out their housing finance mission.

As of January 1, 2018, the Corporation adopted ASU 2016-01, resulting in the reclassification of equity securities with readily determinable fair value of approximately $0.4 million from available-for-sale investment securities to other investment securities. During the first quarter of 2018, the Corporation measured these equity securities at fair value through earnings resulting in the recognition of a market-to-market loss of $7 thousand recorded as part of other non-interest income in the statement of income.

The Corporation has other equity securities that do not have a readily-available fair value. The carrying value of such securities as of each March 31, 2018 and December 31, 2017 was $2.2 million.

NOTE 7 – LOANS HELD FOR INVESTMENT

The following provides information about the loan portfolio held for investment:

(In thousands)		As of March 31, 2018		As of December 31, 2017
Residential mortgage loans, mainly secured by first mortgages	$	3,267,868	$	3,290,957
Commercial loans:				
Construction loans (1)		79,150		111,397
Commercial mortgage loans (1)		1,552,503		1,614,972
Commercial and Industrial loans (2)		2,061,773		2,083,253
Total Commercial loans		3,693,426		3,809,622
Finance leases		262,863		257,462
Consumer loans		1,471,733		1,492,435
Loans held for investment [2]		8,695,890		8,850,476
Allowance for loan and lease losses		(225,856)		(231,843)
Loans held for investment, net	$	8,470,034	$	8,618,633

(1) During the first quarter of 2018, the Corporation transferred $57.2 million (net of fair value write-downs of $9.7 million) in non-performing loans to held for sale. Loans transferred to held for sale consisted of a $30.0 million non-performing construction loan (net of a $5.1 million fair value write-down) and two non-performing commercial mortgage loans totaling $27.2 million (net of fair value write-downs of $4.6 million).

(2) As of March 31, 2018 and December 31, 2017, includes $823.2 million and $833.5 million, respectively, of commercial loans that are secured by real estate but are not dependent upon the real estate for repayment.

Loans held for investment on which accrual of interest income had been discontinued were as follows:

	As of March 31, 2018	As of December 31, 2017
(In thousands)		
Non-performing loans:		
Residential mortgage	$ 171,380	$ 178,291
Commercial mortgage (1)	115,179	156,493
Commercial and Industrial	85,325	85,839
Construction:		
Land	14,949	15,026
Construction-commercial (1)	-	35,100
Construction-residential	1,287	1,987
Consumer:		
Auto loans	13,453	10,211
Finance leases	1,801	1,237
Other consumer loans	8,603	5,370
Total non-performing loans held for investment (2)(3)(4)	$ 411,977	$ 489,554

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(1) During the first quarter of 2018, the Corporation transferred $57.2 million (net of fair value write-downs of $9.7 million) in non-performing loans to held for sale. Loans transferred to held for sale consisted of a $30.0 million non-performing construction loan (net of a $5.1 million fair value write-down) and two non-performing commercial mortgage loans totaling $27.2 million (net of fair value write-downs of $4.6 million).

(2) Excludes $64.9 million and $8.3 million of non-performing loans held for sale as of March 31, 2018 and December 31, 2017, respectively.

(3) Amount excludes purchased-credit impaired ("PCI") loans with a carrying value of approximately $155.3 million and $158.2 million as of March 31, 2018 and December 31, 2017, respectively, primarily mortgage loans acquired from Doral Bank in the first quarter of 2015 and from Doral Financial in the second quarter of 2014, as further discussed below. These loans are not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using an estimated cash flow analysis.

(4) Non-performing loans exclude $366.4 million and $374.7 million of Troubled Debt Restructuring ("TDR") loans that are in compliance with the modified terms and in accrual status as of March 31, 2018 and December 31, 2017, respectively.

During the first quarter of 2018, the Corporation transferred to held for sale three non-performing commercial and construction loans. The aggregate recorded investment in these loans was written down to $57.2 million, which resulted in charge-offs of $9.7 million of which $4.1 million was taken against previously-established reserves for loan losses, resulting in a charge to the provision for loan and lease losses of $5.6 million for the first quarter of 2018. Loans transferred to held for sale consisted of a $30.0 million non-performing construction loan (net of a $5.1 million fair value write-down) and two non-performing commercial mortgage loans totaling $27.2 million (net of fair value write-downs of $4.6 million).

Loans in Process of Foreclosure

As of March 31, 2018, the recorded investment of residential mortgage loans collateralized by residential real estate property that are in the process of foreclosure amounted to $152.3 million, including $22.7 million of loans insured by the FHA or guaranteed by the VA, and $18.2 million of PCI loans. The Corporation commences the foreclosure process on residential real estate loans when a borrower becomes 120 days delinquent in accordance with the guidelines of the Consumer Financial Protection Bureau ("CFPB"). Foreclosure procedures and timelines vary depending on whether the property is located in a judicial or non-judicial state. Judicial states (Puerto Rico, Florida and USVI) require the foreclosure to be processed through the state's court while foreclosure in non-judicial states (BVI) is processed without court intervention. Foreclosure timelines vary according to state law and investor guidelines. Occasionally, foreclosures may be delayed due to, among other reasons, mandatory mediations, bankruptcy, court delays and title issues.

The Corporation's aging of the loans held for investment portfolio is as follows:

As of March 31, 2018

(In thousands)	**30-59 Days Past Due**	**60-89 Days Past Due**	**90 days or more Past Due (1)**	**Total Past Due**	**Purchased Credit-Impaired Loans**	**Current**	**Total loans held for investment**	**90 days past due and still accruing**
Residential mortgage:								
FHA/VA and other government-guaranteed loans (2)(3)(4)	$ -	$ 3,665	$107,693	$111,358	$ -	$ 35,927	$ 147,285	$107,693
Other residential mortgage loans (4)	-	57,505	186,535	244,040	151,067	2,725,476	3,120,583	15,155
Commercial:								
Commercial and Industrial loans	13,137	2,419	86,095	101,651	-	1,960,122	2,061,773	770
Commercial mortgage loans (4)	-	49,807	119,156	168,963	4,214	1,379,326	1,552,503	3,977
Construction:								
Land (4)	-	12	17,108	17,120	-	9,330	26,450	2,159
Construction-commercial	-	1,012	-	1,012	-	45,227	46,239	-
Construction-residential (4)	-	-	2,488	2,488	-	3,973	6,461	1,201
Consumer:								
Auto loans	32,438	7,891	13,453	53,782	-	784,711	838,493	-
Finance leases	5,843	2,216	1,801	9,860	-	253,003	262,863	-
Other consumer loans	13,701	4,577	10,434	28,712	-	604,528	633,240	1,831
Total loans held for investment	$ 65,119	$129,104	$544,763	$738,986	$ 155,281	$7,801,623	$8,695,890	$132,786

(1) Includes non-performing loans and accruing loans that are contractually delinquent 90 days or more (i.e., FHA/VA guaranteed loans and credit cards). Credit card loans continue to accrue finance charges and fees until charged-off at 180 days.

(2) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include $30.6 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 15 months delinquent, and are no longer accruing interest as of March 31, 2018.

(3) As of March 31, 2018, includes $73.3 million of defaulted loans collateralizing Government National Mortgage Association ("GNMA") securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.

(4) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage, commercial mortgage, and construction loans are considered past due when the borrower is in arrears two or more monthly payments. FHA/VA and other government-guaranteed loans, other residential mortgage loans, commercial mortgage loans, land loans, and construction-residential loans past due 30-59 days as of March 31, 2018 amounted to $6.8 million, $122.0 million, $5.2 million, $0.6 million, and $0.2 million respectively.

As of December 31, 2017

	30-59 Days Past Due	**60-89 Days Past Due**	**90 days or more Past Due (1)**	**Total Past Due**	**Purchased Credit-Impaired Loans**	**Current**	**Total loans held for investment**	**90 days past due and still accruing (2) (3)**
(In thousands)								
Residential mortgage:								
FHA/VA and other government-guaranteed loans (2)(3)(4)	$ -	$ 6,792	$ 102,815	$ 109,607	$ -	$ 29,332	$ 138,939	$ 102,815
Other residential mortgage loans (4)	-	92,502	193,750	286,252	153,991	2,711,775	3,152,018	15,459
Commercial:								
Commercial and Industrial loans	8,971	576	88,156	97,703	-	1,985,550	2,083,253	2,317
Commercial mortgage loans (4)	-	7,525	163,180	170,705	4,183	1,440,084	1,614,972	6,687
Construction:								
Land (4)	-	124	15,177	15,301	-	11,630	26,931	151
Construction-commercial	-	-	35,100	35,100	-	41,456	76,556	-
	-	95	1,987	2,082	-	5,828	7,910	-

Construction-residential								
Consumer:								
Auto loans	57,560	23,783	10,211	91,554	-	752,777	844,331	-
Finance leases	10,549	3,484	1,237	15,270	-	242,192	257,462	-
Other consumer loans	10,776	5,052	9,361	25,189	-	622,915	648,104	3,991
Total loans held for investment	$ 87,856	$ 139,933	$ 620,974	$ 848,763	$ 158,174	$ 7,843,539	$ 8,850,476	$ 131,420

(1) Includes non-performing loans and accruing loans that are contractually delinquent 90 days or more (i.e., FHA/VA guaranteed loans and credit cards). Credit card loans continue to accrue finance charges and fees until charged-off at 180 days.

(2) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to non-performing loans since the principal repayment is insured. These balances include $29.9 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 15 months delinquent, and are no longer accruing interest as of December 31, 2017.

(3) As of December 31, 2017, includes $62.1 million of defaulted loans collateralizing GNMA securities for which the Corporation has an unconditional option (but not an obligation) to repurchase the defaulted loans.

(4) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage, commercial mortgage, and construction loans are considered past due when the borrower is in arrears on two or more monthly payments. FHA/VA and other government-guaranteed loans, other residential mortgage loans, commercial mortgage loans, and land loans past due 30-59 days as of December 31, 2017 amounted to $6.0 million, $224.0 million, $9.0 million, and $2.5 million, respectively.

The Corporation's credit quality indicators by loan type as of March 31, 2018 and December 31, 2017 are summarized below:

	Commercial Credit Exposure-Credit Risk Profile Based on Creditworthiness Category:				
March 31, 2018	**Substandard**	**Doubtful**	**Loss**	**Total Adversely Classified (1)**	**Total Portfolio**
(In thousands)					
Commercial mortgage	$ 269,926	$ 2,117	$ -	$ 272,043	$ 1,552,503
Construction:					
Land	15,971	391	-	16,362	26,450
Construction-commercial	-	-	-	-	46,239
Construction-residential	1,287	-	-	1,287	6,461
Commercial and Industrial	144,205	7,745	729	152,679	2,061,773

	Commercial Credit Exposure-Credit Risk Profile Based on Creditworthiness Category:				
December 31, 2017	**Substandard**	**Doubtful**	**Loss**	**Total Adversely Classified (1)**	**Total Portfolio**
(In thousands)					
Commercial mortgage	$ 257,503	$ 4,166	$ -	$ 261,669	$ 1,614,972
Construction:					
Land	15,971	490	-	16,461	26,931
Construction-commercial	35,100	-	-	35,100	76,556
Construction-residential	1,987	-	-	1,987	7,910
Commercial and Industrial	154,416	3,854	676	158,946	2,083,253

(1) Excludes non-peforming loans held for sale of $64.9 million ($27.2 million commercial mortgage, $30.0 million construction-commercial, and $7.7 million construction-land) and $8.3 million (construction-land) as of March 31, 2018 and December 31, 2017, respectively.

The Corporation considers a loan as adversely classified if its risk rating is Substandard, Doubtful or Loss. These categories are defined as follows:

Substandard – A Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful – Doubtful classifications have all of the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full highly questionable and improbable, on the basis of currently known facts, conditions and values. A Doubtful classification may be appropriate in cases where significant risk exposures are perceived, but loss cannot be determined because of specific reasonable pending factors, which may strengthen the credit in the near term.

Loss – Assets classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this asset even though partial recovery may occur in the future. There is little or no prospect for near term improvement and no realistic strengthening action of significance pending.

March 31, 2018	**Consumer Credit Exposure-Credit Risk Profile Based on Payment Activity**				
	Residential Real-Estate		**Consumer**		
	FHA/VA/ Guaranteed (1)	**Other residential loans**	**Auto**	**Finance Leases**	**Other Consumer**
(In thousands)					
Performing	$ 147,285	$ 2,798,136	$ 825,040	$ 261,062	$ 624,637
Purchased Credit-Impaired (2)	-	151,067	-	-	-
Non-performing	-	171,380	13,453	1,801	8,603
Total	$ 147,285	$ 3,120,583	$ 838,493	$ 262,863	$ 633,240

(1) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as 90 days past-due loans and still accruing as opposed to non-performing loans since the principal repayment is insured. This balance includes $30.6 million of residential mortgage loans insured by the FHA or guaranteed by the VA, which are over 15 months delinquent, and are no longer accruing interest as of March 31, 2018.

(2) PCI loans are excluded from non-performing statistics due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analyses.

December 31, 2017	Consumer Credit Exposure-Credit Risk Profile Based on Payment Activity				
	Residential Real-Estate		Consumer		
	FHA/VA/ Guaranteed (1)	Other residential loans	Auto	Finance Leases	Other Consumer
(In thousands)					
Performing	$ 138,939	$ 2,819,736	$ 834,120	$ 256,225	$ 642,734
Purchased Credit-Impaired (2)	-	153,991	-	-	-
Non-performing	-	178,291	10,211	1,237	5,370
Total	$ 138,939	$ 3,152,018	$ 844,331	$ 257,462	$ 648,104

(1) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as 90 days past due loans and still accruing as opposed to non-performing loans since the principal repayment is insured. This balance includes $29.9 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 15 months delinquent, and are no longer accruing interest as of December 31, 2017.

(2) PCI loans are excluded from non-performing statistics due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analyses.

The following tables present information about impaired loans held for investment, excluding PCI loans, which are reported separately as discussed below:

Impaired Loans

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Specific Allowance	Average Recorded Investment	Interest Income Recognized On Accrual Basis	Interest Income Recognized On Cash Basis
As of March 31, 2018						
With no related specific allowance recorded:						
FHA/VA-Guaranteed loans	$ -	$ -	$ -	$ -	$ -	$ -
Other residential mortgage loans	94,817	126,672	-	95,274	723	170
Commercial:						
Commercial mortgage loans	60,811	99,837	-	61,445	82	37
Commercial and Industrial loans	24,712	27,679	-	24,825	246	11
Construction:						
Land	-	-	-	-	-	-
Construction-commercial	-	-	-	-	-	-
Construction-residential	-	-	-	-	-	-
Consumer:						
Auto loans	387	387	-	394	2	-
Finance leases	-	-	-	-	-	-
Other consumer loans	2,266	3,051	-	2,327	29	17
	$ 182,993	$ 257,626	$ -	$ 184,265	$ 1,082	$ 235
With a related specific allowance recorded:						
FHA/VA-Guaranteed loans	$ -	$ -	$ -	$ -	$ -	$ -
Other residential mortgage loans	322,793	359,048	22,546	324,110	3,654	231
Commercial:						
Commercial mortgage loans	101,315	117,838	13,451	102,304	661	47
Commercial and Industrial loans	95,066	117,400	14,375	92,382	302	20
Construction:						
Land	11,815	20,001	1,432	11,864	25	8
Construction-commercial	-	-	-	-	-	-
Construction-residential	252	355	52	252	-	-
Consumer:						
Auto loans	20,424	20,424	3,379	20,943	397	-
Finance leases	1,876	1,876	84	1,958	35	-
Other consumer loans	9,746	10,092	1,611	9,913	283	27
	$ 563,287	$ 647,034	$ 56,930	$ 563,726	$ 5,357	$ 333
Total:						
FHA/VA-Guaranteed loans	$ -	$ -	$ -	$ -	$ -	$ -
Other residential mortgage loans	417,610	485,720	22,546	419,384	4,377	401
Commercial:						
Commercial mortgage loans	162,126	217,675	13,451	163,749	743	84
Commercial and Industrial loans	119,778	145,079	14,375	117,207	548	31

Construction:						
Land	11,815	20,001	1,432	11,864	25	8
Construction-commercial	-	-	-	-	-	-
Construction-residential	252	355	52	252	-	-
Consumer:						
Auto loans	20,811	20,811	3,379	21,337	399	-
Finance leases	1,876	1,876	84	1,958	35	-
Other consumer loans	12,012	13,143	1,611	12,240	312	44
	$ 746,280	$ 904,660	$ 56,930	$ 747,991	$ 6,439	$ 568

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Impaired Loans

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Specific Allowance	Average Recorded Investment
As of December 31, 2017				
With no related specific allowance recorded:				
FHA/VA-Guaranteed loans	$ -	$ -	$ -	$ -
Other residential mortgage loans	116,818	154,048	-	120,241
Commercial:				
Commercial mortgage loans	65,100	100,612	-	86,563
Commercial and Industrial loans	28,292	31,254	-	28,567
Construction:				
Land	48	49	-	48
Construction-commercial	-	-	-	-
Construction-residential	-	-	-	-
Consumer:				
Auto loans	267	267	-	290
Finance leases	-	-	-	-
Other consumer loans	2,521	3,688	-	2,745
	$ 213,046	$ 289,918	$ -	$ 238,454
With a related specific allowance recorded:				
FHA/VA-Guaranteed loans	$ -	$ -	$ -	$ -
Other residential mortgage loans	316,616	349,284	22,086	318,606
Commercial:				
Commercial mortgage loans	87,814	124,084	9,783	93,720
Commercial and Industrial loans	90,008	112,005	12,359	92,666
Construction:				
Land	11,865	19,973	1,402	14,126
Construction-commercial	35,101	38,595	560	35,996
Construction-residential	252	355	55	252
Consumer:				
Auto loans	22,338	22,338	3,665	24,328
Finance leases	2,184	2,184	104	2,428
Other consumer loans	11,084	11,830	1,396	11,579
	$ 577,262	$ 680,648	$ 51,410	$ 593,701
Total:				
FHA/VA-Guaranteed loans	$ -	$ -	$ -	$ -
Other residential mortgage loans	433,434	503,332	22,086	438,847
Commercial:				
Commercial mortgage loans	152,914	224,696	9,783	180,283
Commercial and Industrial loans	118,300	143,259	12,359	121,233
Construction:				
Land	11,913	20,022	1,402	14,174
Construction-commercial	35,101	38,595	560	35,996
Construction-residential	252	355	55	252
Consumer:				
Auto loans	22,605	22,605	3,665	24,618

Finance leases	2,184	2,184	104	2,428
Other consumer loans	13,605	15,518	1,396	14,324
	$ 790,308	$ 970,566	$ 51,410	$ 832,155

Interest income of approximately $6.9 million ($6.4 million on an accrual basis and $0.5 million on a cash basis) was recognized on impaired loans for the first quarter of 2017.

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The following table shows the activity for impaired loans and the related specific reserve during the first quarter of 2018 and 2017:

	Quarter ended			
	March 31, 2018		March 31, 2017	
Impaired Loans:	(In thousands)			
Balance at beginning of period	$	790,308	$	887,905
Loans determined impaired during the period		61,408		19,628
Charge-offs (1) (2)		(17,213)		(17,404)
Loans sold, net of charge-offs		(4,121)		(53,245)
Increases to existing impaired loans		6,998		541
Foreclosures		(11,675)		(9,457)
Loans no longer considered impaired		(1,507)		(892)
Loans transferred to held for sale		(57,213)		-
Paid in full or partial payments		(20,705)		(19,878)
Balance at end of period	$	746,280	$	807,198

(1) The first quarter of 2018 includes charge-offs totaling $9.7 million associated with the $57.2 million in non-performing loans transferred to held for sale.

(2) The first quarter of 2017 includes a charge-off of $10.7 million related to the sale of the PREPA credit line as further discussed below.

	Quarter ended			
	March 31, 2018		March 31, 2017	
Specific Reserve:	(In thousands)			
Balance at beginning of period	$	51,410	$	64,421
Provision for loan losses		22,703		18,862
Net charge-offs		(17,183)		(16,972)
Balance at end of period	$	56,930	$	66,311

Purchased Credit Impaired Loans (PCI)

The Corporation acquired PCI loans accounted for under ASC 310-30 as part of a transaction that closed on February 27, 2015 in which FirstBank acquired 10 Puerto Rico branches of Doral Bank, and acquired certain assets, including PCI loans, and assumed deposits, through an alliance with Banco Popular of Puerto Rico, that was the successful lead bidder with the FDIC on the failed Doral Bank, as well as other co-bidders. The Corporation also acquired PCI loans in previously completed asset acquisitions that are accounted for under ASC 310-30. These previous transactions include the acquisition from Doral Financial in the second quarter of 2014 of all its rights, title and interest in first and second residential mortgages loans in full satisfaction of secured borrowings owed by such entity to FirstBank.

Under ASC 310-30, the acquired PCI loans were aggregated into pools based on similar characteristics (i.e. delinquency status and loan terms). Each loan pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows. Since the loans are accounted for under ASC 310-30, they are not considered non-performing and will continue to have an accretable yield as long as there is a reasonable expectation about the timing and amount of cash flows expected to be collected. The Corporation recognizes additional losses on this portfolio when it is probable that the Corporation will be unable to collect all cash flows expected as of the acquisition date plus additional cash flows expected to be collected arising from changes in estimates after the acquisition date.

The carrying amounts of PCI loans were as follows:

	As of			
		March 31, 2018		**December 31, 2017**
(In thousands)				
Residential mortgage loans	$	151,067	$	153,991
Commercial mortgage loans		4,214		4,183
Total PCI loans	$	155,281	$	158,174
Allowance for loan losses		(11,251)		(11,251)
Total PCI loans, net of allowance for loan losses	$	144,030	$	146,923

The following tables present PCI loans by past due status as of March 31, 2018 and December 31, 2017:

As of March 31, 2018	**30-59 Days**	**60-89 Days**	**90 days or more**	**Total Past Due**	**Current**	**Total PCI loans**
(In thousands)						
Residential mortgage loans	$ -	$ 8,291	$ 27,025	$ 35,316	$ 115,751	$ 151,067
Commercial mortgage loans	-	-	3,234	3,234	980	4,214

Total (1)	$ -	$ 8,291	$ 30,259	$ 38,550	$ 116,731	$ 155,281

(1) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage and commercial mortgage loans are considered past due when the borrower is in arrears two or more monthly payments. PCI residential mortgage loans and commercial mortgage loans past due 30-59 days as of March 31, 2018 amounted to $13.5 million and $0.2 million, respectively.

As of December 31, 2017	**30-59 Days**	**60-89 Days**	**90 days or more**	**Total Past Due**	**Current**	**Total PCI loans**
(In thousands)						
Residential mortgage loans	$ -	$ 16,600	$ 26,471	$ 43,071	$ 110,920	$ 153,991
Commercial mortgage loans	-	355	2,834	3,189	994	4,183
Total (1)	$ -	$ 16,955	$ 29,305	$ 46,260	$ 111,914	$ 158,174

(1) According to the Corporation's delinquency policy and consistent with the instructions for the preparation of the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) required by the Federal Reserve Board, residential mortgage and commercial mortgage loans are considered past due when the borrower is in arrears two or more monthly payments. PCI residential mortgage loans and commercial mortgage loans past due 30-59 days as of December 31, 2017 amounted to $28.1 million and $0.2 million, respectively

Initial Fair Value and Accretable Yield of PCI Loans

At acquisition, the Corporation estimated the cash flows the Corporation expected to collect on PCI loans. Under the accounting guidance for PCI loans, the difference between the contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. This difference is neither accreted into income nor recorded on the Corporation's consolidated statements of financial condition. The excess of cash flows expected to be collected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loans, using the effective-yield method.

Changes in Accretable Yield of Acquired Loans

Subsequent to the acquisition of loans, the Corporation is required to periodically evaluate its estimate of cash flows expected to be collected. These evaluations, performed quarterly, require the continued use of key assumptions and estimates, similar to the initial estimate of fair value. Subsequent changes in the estimated cash flows expected to be collected may result in changes in the accretable yield and non-accretable difference or reclassifications from non-accretable yield to accretable yield. Increases in the cash flows expected to be collected will generally result in an increase in interest income over the remaining life of the loan or pool of loans. Decreases in expected cash flows due to further credit deterioration will generally result in an impairment charge recognized in the Corporation's provision for loan and lease losses, resulting in an increase to the allowance for loan and lease losses. As of March 31, 2018, the reserve related to PCI loans acquired from Doral Financial in 2014 and from Doral Bank in 2015 amounted to $11.3 million.

Changes in the accretable yield of PCI loans for the quarters ended March 31, 2018 and 2017 were as follows:

	March 31, 2018		March 31, 2017	
(In thousands)				
Balance at beginning of period	$	103,682	$	116,462
Accretion recognized in earnings		(2,623)		(2,797)
Balance at end of period	$	101,059	$	113,665

Changes in the carrying amount of loans accounted for pursuant to ASC 310-30 were as follows:

(In thousands)	Quarter ended March 31, 2018	Quarter ended March 31, 2017
Balance at beginning of period	$ 158,174	$ 165,818
Accretion	2,623	2,797
Collections	(3,396)	(4,593)
Foreclosures	(2,120)	(922)
Ending balance	$ 155,281	$ 163,100
Allowance for loan losses	(11,251)	(6,857)
Ending balance, net of allowance for loan losses	$ 144,030	$ 156,243

Changes in the allowance for loan losses related to PCI loans were as follows:

(In thousands)	Quarter ended March 31, 2018	Quarter ended March 31, 2017
Balance at beginning of period	$ 11,251	$ 6,857
Provision for loan losses	-	-
Balance at the end of period	$ 11,251	$ 6,857

The outstanding principal balance of PCI loans, including amounts charged off by the Corporation, amounted to $192.0 million as of March 31, 2018 (December 31, 2017- $196.6 million).

Purchases and Sales of Loans

During the first quarter of 2018, the Corporation purchased $14.5 million of residential mortgage loans consistent with a strategic program to purchase ongoing residential mortgage loan production from mortgage bankers in Puerto Rico. In general, the loans purchased from mortgage bankers were conforming residential mortgage loans. Purchases of conforming residential mortgage loans provide the Corporation the flexibility to retain or sell the loans, including through securitization transactions, depending upon the Corporation's interest rate risk management strategies. When the Corporation sells such loans, it generally keeps the servicing of the loans.

In the ordinary course of business, the Corporation sells residential mortgage loans (originated or purchased) to GNMA and government-sponsored entities ("GSEs"), such as FNMA and FHLMC, which generally securitize the transferred loans into mortgage-backed securities for sale into the secondary market. During the first quarter of 2018, the Corporation sold $54.4 million of FHA/VA mortgage loans to GNMA, which packaged them into mortgage-backed securities. Also during the first quarter of 2018, the Corporation sold approximately $20.1 million of performing residential mortgage loans to FNMA and FHLMC. The Corporation's continuing involvement in these sold loans consists primarily of servicing the loans. In addition, the Corporation agreed to repurchase loans when it breaches any of the representations and warranties included in the sale agreement. These representations and warranties are consistent with the GSEs' selling and servicing guidelines (i.e., ensuring that the mortgage was properly underwritten according to established guidelines).

For loans sold to GNMA, the Corporation holds an option to repurchase individual delinquent loans issued on or after January 1, 2003 when the borrower fails to make any payment for three consecutive months. This option gives the Corporation the ability, but not the obligation, to repurchase the delinquent loans at par without prior authorization from GNMA.

Under ASC Topic 860, *Transfer and Servicing*, once the Corporation has the unilateral ability to repurchase the delinquent loan, it is considered to have regained effective control over the loan and is required to recognize the loan and a corresponding repurchase liability on the balance sheet regardless of the Corporation's intent to repurchase the loan. As of March 31, 2018 and December 31, 2017, rebooked GNMA delinquent loans included in the residential mortgage loan portfolio amounted to $73.3 million and $62.1 million, respectively.

During the first quarters of 2018 and 2017, the Corporation repurchased, pursuant to its repurchase option with GNMA, $1.1 million and $10.7 million, respectively, of loans previously sold to GNMA. The principal balance of these loans is fully guaranteed and the risk of loss related to the repurchased loans is generally limited to the difference between the delinquent interest payment advanced to GNMA, which is computed at the loan's interest rate, and the interest payments reimbursed by FHA, which are computed at a pre-determined debenture rate. Repurchases of GNMA loans allow the Corporation, among other things, to maintain acceptable delinquency rates on outstanding GNMA pools and remain as a seller and servicer in good standing with GNMA. During the fourth quarter of 2017, the Corporation requested and received approval from GNMA for the exclusion of loans in the areas affected by

Hurricanes Irma and Maria from calculations of delinquency and default ratios established in the GNMA Mortgage-Backed Securities Guide. The Corporation generally remediates any breach of representations and warranties related to the underwriting of such loans according to established GNMA guidelines without incurring losses. The Corporation does not maintain a liability for estimated losses as a result of breaches in representations and warranties.

Loan sales to FNMA and FHLMC are without recourse in relation to the future performance of the loans. The Corporation repurchased at par loans previously sold to FNMA and FHLMC in the amount of $3 thousand and $6 thousand during the first quarters of 2018 and 2017, respectively. The Corporation's risk of loss with respect to these loans is also minimal as these repurchased loans are generally performing loans with documentation deficiencies.

In addition, during the first quarter of 2018, the Corporation sold a $5.6 million commercial and industrial adversely-classified loan in Puerto Rico, recording a charge-off of $1.3 million, and a $9.2 million commercial and industrial loan participation in the Florida region.

Sale of the Puerto Rico Electric Power Authority ("PREPA") Loan

During the first quarter of 2017, the Corporation received an unsolicited offer and sold its outstanding participation in the PREPA line of credit with a book value of $64 million at the time of sale (principal balance of $75 million), thereby reducing its direct exposure to the Puerto Rico government. A specific reserve of approximately $10.2 million had been allocated to this loan. Gross proceeds of $53.2 million from the sale resulted in an incremental loss of $0.6 million recorded as a charge to the provision for loan and lease losses in the first quarter of 2017.

Loan Portfolio Concentration

The Corporation's primary lending area is Puerto Rico. The Corporation's banking subsidiary, First Bank, also lends in the USVI and BVI markets and in the United States (principally in the state of Florida). Of the total gross loans held for investment of $8.7 billion as of March 31, 2018, credit risk concentration was approximately 75% in Puerto Rico, 19% in the United States, and 6% in the USVI and BVI.

As of March 31, 2018, the Corporation had $54.8 million outstanding loans extended to the Puerto Rico government, its municipalities and public corporations, compared to $55.9 million as of December 31, 2017. Approximately $33.1 million of the outstanding loans as of March 31, 2018 consisted of loans extended to municipalities in Puerto Rico, which in most cases are supported by assigned property tax revenues. The vast majority of revenues of the municipalities included in the Corporation's loan portfolio are independent of the Puerto Rico central government. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and notes. Late in 2015, the GDB and the Municipal Revenue Collection Center ("CRIM") signed and perfected a deed of trust. Through this deed, the GDB, as fiduciary, is bound to keep the CRIM funds separate from any other deposits and must distribute the funds pursuant to applicable law. The CRIM funds are deposited at another commercial depository financial institution in Puerto Rico. In addition to loans extended to municipalities, the Corporation's exposure to the Puerto Rico government as of March 31, 2018 includes a $6.7 million loan extended to a unit of the central government, and a $15.0 million loan granted to an affiliate of PREPA.

Furthermore, as of March 31, 2018, the Corporation had three loans granted to the hotel industry in Puerto Rico that were previously guaranteed by the Puerto Rico Tourism Development Fund ("TDF") with an outstanding principal balance of $116.2 million (book value $61.6 million), compared to $120.2 million outstanding (book value of $70.8 million) as of December 31, 2017. Historically, the borrower and the operations of the underlying collateral of these loans have been the primary sources of repayment and the TDF, which is a subsidiary of the GDB, provided a secondary guarantee for payment performance. As part of agreements executed in the second quarter of 2017 and first quarter of 2018, the TDF paid $7.6 million and $4.0 million, respectively, to honor a portion of its guarantee on these loans. As provided in the agreements, the cash payments received by the Corporation released the TDF from its liability as a guarantor of these loans. All three of the commercial mortgage loans previously guaranteed by the TDF have been classified as non-performing and impaired since the first quarter of 2016, and interest payments have been applied against principal since then. In addition, the GDB agreed to issue to the Bank a fixed income financial instrument pursuant to the GDB's Restructuring Support Agreement approved by the PROMESA oversight board. During the first quarter of 2018, two of these three commercial mortgage loans, with an aggregate outstanding principal balance of $50.4 million (book value of $27.2 million) were transferred to held for sale.

In addition, the Corporation had $115.9 million in exposure to residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority. Residential mortgage loans guaranteed by the Puerto Rico Housing Finance Authority are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. The Puerto Rico government guarantees up to $75 million of the principal under the mortgage loan insurance program. According to the most recently released audited financial statements of the Puerto

Rico Housing Finance Authority, as of June 30, 2015, the Puerto Rico Housing Finance Authority's mortgage loans insurance program covered loans in an aggregate of approximately $552 million. The regulations adopted by the Puerto Rico Housing Finance Authority require the establishment of adequate reserves to guarantee the solvency of the mortgage loan insurance fund. As of June 30, 2015, the most recent date as to which information is available, the Puerto Rico Housing Finance Authority had a restricted net position for such purposes of approximately $77.4 million.

The Corporation also has credit exposure to USVI government entities. As of March 31, 2018, the Corporation had $76.7 million in loans to USVI government instrumentalities and public corporations, compared to $70.4 million as of December 31, 2017. Of the amount outstanding as of March 31, 2018, public corporations of the USVI owed approximately $53.5 million and an independent instrumentality of the USVI government owed approximately $23.2 million. As of March 31, 2018 all loans were currently performing and up to date on principal and interest payments.

The Corporation cannot predict at this time the ultimate effect that the current fiscal situation of the Commonwealth of Puerto Rico, the uncertainty about the debt restructuring process, the various legislative and other measures adopted and to be adopted by the Puerto Rico government and the PROMESA oversight board in response to such fiscal situation, and Hurricane Maria will have on the Puerto Rico economy, the Corporation's clients, and the Corporation's financial condition and results of operations.

Troubled Debt Restructurings

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico that is similar to the U.S. government's Home Affordable Modification Program guidelines. Depending upon the nature of borrowers' financial condition, restructurings or loan modifications through this program, as well as other restructurings of individual commercial, commercial mortgage, construction, and residential mortgage loans, fit the definition of a TDR. A restructuring of a debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include, among others, the extension of the maturity of the loan and modifications of the loan rate. As of March 31, 2018, the Corporation's total TDR loans held for investment of $572.4 million consisted of $350.0 million of residential mortgage loans, $96.3 million of commercial and industrial loans, $85.8 million of commercial mortgage loans, $6.6 million of construction loans, and $33.7 million of consumer loans. Outstanding unfunded commitments on TDR loans amounted to $1.9 million as of March 31, 2018. In addition, the loans held for sale portfolio includes a $30.0 million TDR construction loan.

The Corporation's loss mitigation programs for residential mortgage and consumer loans can provide for one or a combination of the following: movement of interest past due to the end of the loan, extension of the loan term, deferral of principal payments and reduction of interest rates either permanently or for a period of up to six years (increasing back in step-up rates). Additionally, in certain cases, the restructuring may provide for the forgiveness of contractually-due principal or interest. Uncollected interest is added to the end of the loan term at the time of the restructuring and not recognized as income until collected or when the loan is paid off. These programs are available only to those borrowers who have defaulted, or are likely to default, permanently on their loan and would lose their homes in a foreclosure action absent some lender concession. Nevertheless, if the Corporation is not reasonably assured that the borrower will comply with its contractual commitment, properties are foreclosed.

Prior to permanently modifying a loan, the Corporation may enter into trial modifications with certain borrowers. Trial modifications generally represent a six-month period during which the borrower makes monthly payments under the anticipated modified payment terms prior to a formal modification. Upon successful completion of a trial modification, the Corporation and the borrower enter into a permanent modification. TDR loans that are participating in or that have been offered a binding trial modification are classified as TDRs when the trial offer is made and continue to be classified as TDRs regardless of whether the borrower enters into a permanent modification. As of March 31, 2018, the Corporation classified an additional $0.5 million of residential mortgage loans as TDRs that were participating in or had been offered a trial modification.

For the commercial real estate, commercial and industrial, and construction loan portfolios, at the time of a restructuring, the Corporation determines, on a loan-by-loan basis, whether a concession was granted for economic or legal reasons related to the borrower's financial difficulty. Concessions granted for loans in these portfolios could include: reductions in interest rates to rates that are considered below market; extension of repayment schedules and maturity dates beyond original contractual terms; waivers of borrower covenants; forgiveness of principal or interest; or other contractual changes that would be considered a concession. The Corporation mitigates loan defaults for these

loan portfolios through its collection function. The function’s objective is to minimize both early stage delinquencies and losses upon default of loans in these portfolios. In the case of the commercial and industrial, commercial mortgage, and construction loan portfolios, the Corporation’s Special Asset Group (“SAG”) focuses on strategies for the accelerated reduction of non-performing assets through note sales, short sales, loss mitigation programs, and sales of OREO.

In addition, the Corporation extends, renews, and restructures loans with satisfactory credit profiles. Many commercial loan facilities are structured as lines of credit, which generally have one year terms and, therefore, are required to be renewed annually. Other facilities may be restructured or extended from time to time based upon changes in the borrower’s business needs, use of funds, timing of completion of projects, and other factors. If the borrower is not deemed to have financial difficulties, extensions, renewals, and restructurings are done in the normal course of business and not considered concessions, and the loans continue to be recorded as performing.

Selected information on TDR loans held for investment that includes the recorded investment by loan class and modification type is summarized in the following tables. This information reflects all TDRs held for investment:

	March 31, 2018						
(In thousands)	**Interest rate below market**	**Maturity or term extension**	**Combination of reduction in interest rate and extension of maturity**	**Forgiveness of principal and/or interest**	**Forbearance Agreement**	**Other (1)**	**Total**
Troubled Debt Restructurings:							
Non-FHA/VA Residential Mortgage loans	$ 24,390	$ 8,396	$ 255,731	$ -	$ -	$ 61,463	$ 349,980
Commercial Mortgage loans	6,518	36,411	30,739	-	2,020	10,146	85,834
Commercial and Industrial loans	2,497	20,448	15,705	-	3,197	54,418	96,265
Construction loans:							
Land	17	3,860	2,177	-	-	324	6,378
Construction-commercial (2)	-	-	-	-	-	-	-
Construction-residential	-	-	-	-	-	217	217
Consumer loans - Auto	-	1,235	12,944	-	-	6,632	20,811
Finance leases	-	196	1,680	-	-	-	1,876
Consumer loans - Other	952	1,775	6,356	166	-	1,766	11,015
Total Troubled Debt Restructurings (2)	$ 34,374	$ 72,321	$ 325,332	$ 166	$ 5,217	$ 134,966	$ 572,376

(1) Other concessions granted by the Corporation included deferral of principal and/or interest payments for a period longer than what would be considered insignificant, payment plans under judicial stipulation, or a combination of the concessions listed in the table.
(2) Excludes TDRs held for sale amounting to $30.0 million as of March 31, 2018.

	December 31, 2017						
(In thousands)	Interest rate below market	Maturity or term extension	Combination of reduction in interest rate and extension of maturity	Forgiveness of principal and/or interest	Forbearance Agreement	Other (1)	Total
Troubled Debt Restructurings:							
Non- FHA/VA Residential Mortgage loans	$ 25,964	$ 8,318	$ 267,578	$ -	$ -	$ 62,070	$ 363,930
Commercial Mortgage loans	6,563	2,094	31,870	-	-	10,285	50,812
Commercial and Industrial loans	2,510	20,648	16,049	-	6,623	48,282	94,112
Construction loans:							
Land	18	3,941	2,186	-	-	331	6,476
Construction-commercial	-	-	-	35,100	-	-	35,100
Construction-residential	-	-	-	-	-	217	217
Consumer loans - Auto	-	1,347	14,233	-	-	7,025	22,605
Finance leases	-	238	1,946	-	-	-	2,184
Consumer loans - Other	892	2,097	6,891	217	-	1,686	11,783
Total Troubled Debt Restructurings	$ 35,947	$ 38,683	$ 340,753	$ 35,317	$ 6,623	$ 129,896	$ 587,219

(1) Other concessions granted by the Corporation included deferral of principal and/or interest payments for a period longer than what would be considered insignificant, payment plans under judicial stipulation, or a combination of the concessions listed in the table.

The following table presents the Corporation's TDR loans held for investment activity:

	Quarter Ended			
	March 31, 2018		March 31, 2017	
(In thousands)				
Beginning Balance of TDRs	$	587,219	$	647,048
New TDRs		43,419		40,899
Increases to existing TDRs		6,771		424
Charge-offs post modification [(1)] [(2)]		(9,171)		(14,662)
Sales, net of charge-offs		-		(53,245)
Foreclosures		(7,043)		(4,371)
TDR transferred to held for sale, net of charge-off		(30,000)		-
Paid-off and partial payments		(18,819)		(13,729)
Ending balance of TDRs	$	572,376	$	602,364

(1) The first quarter of 2018 includes a charge-off of $5.1 million associated with a $30.0 million construction loan transferred to held for sale.

(2) The first quarter of 2017 includes a charge-off of $10.7 million related to the sale of the PREPA credit line.

TDR loans are classified as either accrual or nonaccrual loans. Loans in accrual status may remain in accrual status when their contractual terms have been modified in a TDR if the loans had demonstrated performance prior to the restructuring and payment in full under the restructured terms is expected. Otherwise, loans on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can, and are likely to, continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of the restructuring or after a shorter performance period. If the borrower’s ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan. Loan modifications increase the Corporation’s interest income by returning a non-performing loan to performing status, if applicable, increase cash flows by providing for payments to be made by the borrower, and limit increases in foreclosure and OREO costs. A TDR loan that specifies an interest rate that at the time of the restructuring is greater than or equal to the rate the Corporation is willing to accept for a new loan with comparable risk may not be reported as a TDR, or an impaired loan in the calendar years subsequent to the restructuring, if it is in compliance with its modified terms. The Corporation did not remove any loans from the TDR classification during the first quarter of 2018 and 2017.

The following table provides a breakdown of the TDR loans held for investment by those in accrual and non-accrual status:

	As of March 31, 2018		
(In thousands)	Accrual	Non-accrual (1)(2)	Total TDRs
Non-FHA/VA Residential Mortgage loans	$ 272,659	$ 77,321	$ 349,980
Commercial Mortgage loans	24,010	61,824	85,834
Commercial and Industrial loans	43,251	53,014	96,265
Construction loans:			
Land	1,197	5,181	6,378
Construction-commercial (2)	-	-	-
Construction-residential	-	217	217
Consumer loans - Auto	14,082	6,729	20,811
Finance leases	1,653	223	1,876
Consumer loans - Other	9,570	1,445	11,015
Total Troubled Debt Restructurings	$ 366,422	$ 205,954	$ 572,376

(1) Included in non-accrual loans are $53.2 million in loans that are performing under the terms of the restructuring agreement but are reported in nonaccrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and are deemed fully collectible.

(2) Excludes a $30.0 million non-performing construction loans transferred to held for sale during the first quarter of 2018.

	As of December 31, 2017		
(In thousands)	Accrual	Non-accrual (1)	Total TDRs
Non-FHA/VA Residential Mortgage loans	$ 280,729	$ 83,201	$ 363,930
Commercial Mortgage loans	23,329	27,483	50,812
Commercial and Industrial loans	41,536	52,576	94,112
Construction loans:			
Land	1,291	5,185	6,476
Construction-commercial	-	35,100	35,100
Construction-residential	-	217	217
Consumer loans - Auto	15,548	7,057	22,605
Finance leases	1,968	216	2,184
Consumer loans - Other	10,294	1,489	11,783
Total Troubled Debt Restructurings	$ 374,695	$ 212,524	$ 587,219

(1) Included in non-accrual loans are $88.6 million in loans that are performing under the terms of the restructuring agreement but are reported in non-accrual status until the restructured loans meet the

criteria of sustained payment performance under the revised terms for reinstatement to accrual status and are deemed fully collectible.

TDR loans exclude restructured residential mortgage loans that are guaranteed by the U.S. federal government (i.e., FHA/VA loans) totaling $62.1 million as of March 31, 2018 (December 31, 2017 - $62.1 million). The Corporation excludes FHA/VA guaranteed loans from TDR loan statistics given that, in the event that the borrower defaults on the loan, the principal and interest (at the specified debenture rate) are guaranteed by the U.S. government; therefore, the risk of loss on these types of loans is very low. The Corporation does not consider loans with U.S. federal government guarantees to be impaired loans for the purpose of calculating the allowance for loan and lease losses.

Loan modifications that are considered TDR loans completed during the first quarters of 2018 and 2017 were as follows:

	Quarter ended March 31, 2018		
(Dollars in thousands)	**Number of contracts**	**Pre-modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Troubled Debt Restructurings:			
Non-FHA/VA Residential Mortgage loans	24	$ 2,608	$ 2,614
Commercial Mortgage loans	3	36,746	36,758
Commercial and Industrial loans	3	2,597	2,582
Consumer loans - Auto	45	680	680
Consumer loans - Other	136	785	785
Total Troubled Debt Restructurings	211	$ 43,416	$ 43,419

	Quarter ended March 31, 2017		
(Dollars in thousands)	**Number of contracts**	**Pre-modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Troubled Debt Restructurings:			
Non-FHA/VA Residential Mortgage loans	40	$ 4,650	$ 4,508
Commercial Mortgage loans	6	22,438	22,198
Commercial and Industrial loans	3	10,748	10,748
Construction loans:			
Land	1	25	28
Consumer loans - Auto	152	2,247	2,247
Finance leases	8	186	186
Consumer loans - Other	210	969	984
Total Troubled Debt Restructurings	420	$ 41,263	$ 40,899

Recidivism, or the borrower defaulting on its obligation pursuant to a modified loan, results in the loan once again becoming a non-performing loan. Recidivism on a modified loan occurs at a notably higher rate than do defaults on

new origination loans, so modified loans present a higher risk of loss than do new origination loans. The Corporation considers a loan to have defaulted if the borrower has failed to make payments of either principal, interest, or both for a period of 90 days or more.

Loan modifications considered TDR loans that defaulted during the quarters ended March 31, 2018 and March 31, 2017, and had become TDR during the 12-month period preceding the default date, were as follows:

	Quarter ended March 31,			
	2018		2017	
	Number of contracts	Recorded Investment	Number of contracts	Recorded Investment
(Dollars in thousands)				
Non-FHA/VA Residential Mortgage loans	4	$ 387	3	$ 277
Commercial Mortgage loans	-	-	1	57
Consumer loans - Auto	2	23	4	61
Finance leases	1	22	-	-
Consumer loans - Other	11	54	17	61
Total	18	$ 486	25	$ 456

For certain TDR loans, the Corporation splits the loans into two new notes, A and B notes. The A note is restructured to comply with the Corporation's lending standards at current market rates, and is tailored to suit the customer's ability to make timely interest and principal payments. The B note includes the granting of the concession to the borrower and varies by situation. The B note is charged off but the obligation is not forgiven to the borrower, and any payments collected are accounted for as recoveries. At the time of the restructuring, the A note is identified and classified as a TDR loan. If the loan performs for at least six months according to the modified terms, the A note may be returned to accrual status. The borrower's payment performance prior to the restructuring is included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of the restructuring. In the periods following the calendar year in which a loan is restructured, the A note may no longer be reported as a TDR loan if it is in accrual status, is in compliance with its modified terms, and yields a market rate (as determined and documented at the time of the restructuring).

The recorded investment in loans held for investment restructured using the A/B note restructure workout strategy was approximately $35.6 million as of March 31, 2018. The following table provides additional information about the volume of this type of loan restructuring and the effect on the allowance for loan and lease losses in the first quarters of 2018 and 2017:

(In thousands)	March 31, 2018	March 31, 2017
Principal balance deemed collectible at end of period	$ 35,553	$ 36,564
Amount charged off	$ -	$ -
Charges to the provision for loan losses	$ 1,412	$ 915
Allowance for loan losses at end of period	$ 5,258	$ 6,056

Approximately $3.1 million of the loans restructured using the A/B note restructure workout strategy were in accrual status as of March 31, 2018. These loans continue to be individually evaluated for impairment purposes.

NOTE 8 – ALLOWANCE FOR LOAN AND LEASE LOSSES

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

(In thousands) Quarter ended March 31, 2018	Residential Mortgage Loans	Commercial Mortgage Loans	Commercial & Industrial Loans	Construction Loans	Consumer Loans	Total
Allowance for loan and lease losses:						
Beginning balance	$ 58,975	$ 48,493	$ 48,871	$ 4,522	$ 70,982	$ 231,843
Charge-offs	(3,371)	(6,810)	(1,930)	(5,177)	(12,072)	(29,360)
Recoveries	335	49	62	13	2,370	2,829
Provision	447	8,661	656	4,764	6,016	20,544
Ending balance	$ 56,386	$ 50,393	$ 47,659	$ 4,122	$ 67,296	$ 225,856
Ending balance: specific reserve for impaired loans	$ 22,546	$ 13,451	$ 14,375	$ 1,484	$ 5,074	$ 56,930
Ending balance: purchased credit-impaired loans (1)	$ 10,873	$ 378	$ -	$ -	$ -	$ 11,251
Ending balance: general allowance	$ 22,967	$ 36,564	$ 33,284	$ 2,638	$ 62,222	$ 157,675
Loans held for investment:						
Ending balance	$ 3,267,868	$ 1,552,503	$ 2,061,773	$ 79,150	$ 1,734,596	$ 8,695,890
Ending balance: impaired loans	$ 417,610	$ 162,126	$ 119,778	$ 12,067	$ 34,699	$ 746,280
Ending balance: purchased credit-impaired loans	$ 151,067	$ 4,214	$ -	$ -	$ -	$ 155,281
Ending balance: loans with general allowance	$ 2,699,191	$ 1,386,163	$ 1,941,995	$ 67,083	$ 1,699,897	$ 7,794,329

(In thousands) Quarter ended March 31, 2017	Residential Mortgage Loans	Commercial Mortgage Loans	Commercial & Industrial Loans	Construction Loans	Consumer Loans	Total
Allowance for loan and lease losses:						
Beginning balance	$ 33,980	$ 57,261	$ 61,953	$ 2,562	$ 49,847	$ 205,603
Charge-offs	(8,225)	(1,362)	(12,052)	(63)	(11,192)	(32,894)
Recoveries	749	30	875	445	2,981	5,080
Provision (release)	9,271	12,539	(4,806)	942	7,496	25,442
Ending balance	$ 35,775	$ 68,468	$ 45,970	$ 3,886	$ 49,132	$ 203,231
Ending balance: specific reserve for impaired loans	$ 8,551	$ 36,638	$ 12,711	$ 2,835	$ 5,576	$ 66,311
Ending balance: purchased credit-impaired loans (1)	$ 6,545	$ 312	$ -	$ -	$ -	$ 6,857
Ending balance: general allowance	$ 20,679	$ 31,518	$ 33,259	$ 1,051	$ 43,556	$ 130,063

Loans held for investment:						
Ending balance	$ 3,272,598	$ 1,596,176	$ 2,108,532	$ 137,887	$ 1,707,156	$ 8,822,349
Ending balance: impaired loans	$ 432,798	$ 193,035	$ 86,059	$ 51,801	$ 43,505	$ 807,198
Ending balance: purchased credit-impaired loans	$ 158,940	$ 4,160	$ -	$ -	$ -	$ 163,100
Ending balance: loans with general allowance	$ 2,680,860	$ 1,398,981	$ 2,022,473	$ 86,086	$ 1,663,651	$ 7,852,051

(1) Refer to Note 7 - Loans Held for Investment-PCI Loans for a detail of changes in the allowance for loan losses related to PCI loans.

As of March 31, 2018, the Corporation maintained a $0.6 million reserve for unfunded loan commitments (December 31, 2017 - $0.7 million), mainly related to outstanding commitments on floor plan revolving lines of credit. The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance sheet loan commitments to borrowers that are experiencing financial difficulties at the balance sheet date. It is calculated by multiplying an estimated loss factor by an estimated probability of funding, and then by the period-end amounts for unfunded commitments. The reserve for unfunded loan commitments is included as part of accounts payable and other liabilities in the consolidated statement of financial condition and any change to the reserve is included as part of other non-interest expenses in the consolidated statements of income.

During the first quarter of 2018, the Corporation implemented enhancements to the methodology behind the calculation of the allowance for commercial loans, which includes, among others, the following: (i) a revised procedure to determine the historical loss rates applicable for each commercial loan regulatory-based credit risk categories (i.e., pass, special mention, substandard and doubtful) that changed the previous blending of loss rates for loans risk-rated special mention, substandard and doubtful with an aggregation methodology whereas historical losses and portfolio balances of special mention loans are allocated to pass or substandard categories based on the historical proportion of the loans in this risk category that ultimate cured or resulted uncollectible; (ii) a quarterly sensitivity analysis using actual historical loss rates for loans risk-rated pass, special mention and substandard to compare the results of such sensitivity to the calculated reserves under the revised procedure, and (iii) establishment of sensitivity thresholds that could trigger further reviews and/or adjustments prior to reaching a conclusion as to the adequacy of the allowance for loan and lease losses for the Corporation's commercial portfolios.

The comparison of the revised procedure with the sensitivity analysis resulted in an immaterial increase to the qualitative reserve for commercial mortgage loans that was recorded as of March 31, 2018. The Corporation engaged an independent third party to assess the allowance framework and the appropriateness of assumptions used in the analysis and expects such review to be completed during the second quarter of 2018.

Refer to Note 2, – "*Updates on Effects of Natural Disasters,*" for information about changes to the hurricane-related allowance established by the Corporation in 2017.

NOTE 9 – LOANS HELD FOR SALE

The Corporation's loans held-for-sale portfolio as of the dates indicated was composed of:

	As of	
	March 31, 2018	**December 31, 2017**

(In thousands)				
Residential mortgage loans	$	26,430	$	24,690
Construction loans (1)		37,732		8,290
Commercial mortgage loans (1)		27,213		-
Total (1)	$	91,375	$	32,980

(1) During the first quarter of 2018, the Corporation transferred $57.2 million (net of fair value write-downs of $9.7 million) in non-performing loans to held for sale. Loans transferred to held for sales consisted of a $30.0 million non-performing construction loan (net of a $5.1 million fair value write-down) and two non-performing commercial mortgage loans totaling $27.2 million (net of fair value write-downs of $4.6 million).

NOTE 10 – OTHER REAL ESTATE OWNED

The following table presents OREO inventory as of the dates indicated:

		March 31, 2018		December 31, 2017
(In thousands)				
OREO				
OREO balances, carrying value:				
Residential (1)	$	60,240	$	54,381
Commercial		83,911		82,871
Construction		10,488		10,688
Total	$	154,639	$	147,940

(1) Excludes $17.8 million and $21.3 million as of March 31, 2018 and December 31, 2017, respectively, of foreclosures that meet the conditions of ASC 310-40 and are presented as a receivable (other assets) in the statement of financial condition.

NOTE 11 – DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

One of the 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 will adversely affect the Corporation's net interest income from its loan and investment portfolios. 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 designates a derivative as a fair value hedge, cash flow hedge or economic undesignated hedge when it enters into the derivative contract. As of March 31, 2018 and December 31, 2017, 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 the principal derivative activities used by the Corporation in managing interest rate risk:

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 for protection from rising interest rates.

Forward contracts - Forward contracts are sales of to-be-announced ("TBA") mortgage-backed securities that will settle over the standard delivery date and do not qualify as "regular way" security trades. Regular-way security trades are contracts that have no net settlement provision and no market mechanism to facilitate net settlement and that provide for delivery of a security within the time frame generally established by regulations or conventions in the market-place or exchange in which the transaction is being executed. The forward sales are considered derivative instruments that need to be marked-to-market. These securities are used to economically hedge the FHA/VA residential mortgage loan securitizations of the mortgage-banking operations. Unrealized gains (losses) are recognized as part of mortgage banking activities in the consolidated statement of income.

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

The following table summarizes the notional amounts of all derivative instruments:

	Notional Amounts (1)	
(In thousands)	**As of March 31, 2018**	**As of December 31, 2017**
Undesignated economic hedges:		
Interest rate contracts:		
Written interest rate cap agreements	$ 90,510	$ 91,010
Purchased interest rate cap agreements	90,510	91,010
Forward Contracts:		
Sale of TBA GNMA MBS pools	25,000	26,000
	$ 206,020	$ 208,020

(1) Notional amounts are presented on a gross basis with no netting of offsetting exposure positions.

The following table summarizes for derivative instruments their fair values and location in the consolidated statements of financial condition:

(In thousands)	Asset Derivatives			Liability Derivatives		
	Statement of Financial Condition Location	March 31, 2018 Fair Value	December 31, 2017 Fair Value	Statement of Financial Condition Location	March 31, 2018 Fair Value	December 31, 2017 Fair Value
Undesignated economic hedges:						
Interest rate contracts:						
Written interest rate cap agreements	Other assets	$ -	$ -	Accounts payable and other liabilities	$ 668	$ 305
Purchased interest rate cap agreements	Other assets	668	305	Accounts payable and other liabilities	-	-
Forward Contracts:						
Sales of TBA GNMA MBS pools	Other assets	3	7	Accounts payable and other liabilities	67	19
		$ 671	$ 312		$ 735	$ 324

The following table summarizes the effect of derivative instruments on the statement of income:

	Location of Loss Recognized in Statement of Income on Derivatives	(Loss) Quarter Ended March 31, 2018	2017
		(In thousands)	
UNDESIGNATED ECONOMIC HEDGES:			
Interest rate contracts:			
Written and purchased interest rate cap agreements	Interest income - Loans	$ -	$ (1)
Forward contracts:			
Sales of TBA GNMA MBS pools	Mortgage Banking Activities	(52)	(56)
Total loss on derivatives		$ (52)	$ (57)

Derivative instruments are subject to market risk. 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, and the level of interest rates, as well as the expectations for rates in the future.

As of March 31, 2018, the Corporation had not entered into any derivative instrument containing credit-risk-related contingent features.

NOTE 12 – OFFSETTING OF ASSETS AND LIABILITIES

The Corporation enters into master agreements with counterparties, primarily related to derivatives and repurchase agreements, that may allow for netting of exposures in the event of default. In an event of default, each party has a right of set-off against the other party for amounts owed under the related agreement and any other amount or obligation owed with respect to any other agreement or transaction between them. The following table presents information about the offsetting of financial assets and liabilities as well as derivative assets and liabilities:

Offsetting of Financial Assets and Derivative Assets

As of March 31, 2018

				Gross Amounts Not Offset in the Statement of Financial Position		
(In thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral	Net Amount
Description						
Derivatives	$ 668	$ -	$ 668	$ (45)	$ (623)	$ -
Securities purchased under agreements to resell	200,000	(200,000)	-	-	-	-
Total	$ 200,668	$ (200,000)	$ 668	$ (45)	$ (623)	$ -

As of December 31, 2017

				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts	Gross Amounts	Net Amounts of			

(In thousands) **Description**	**of Recognized Assets**	**Offset in the Statement of Financial Position**	**Assets Presented in the Statement of Financial Position**	**Financial Instruments**	**Cash Collateral**	**Net Amount**
Derivatives	$ 305	$ -	$ 305	$ (305)	$ -	$ -
Securities purchased under agreements to resell	200,000	(200,000)	-	-	-	-
Total	$ 200,305	$ (200,000)	$ 305	$ (305)	$ -	$ -

Offsetting of Financial Liabilities and Derivative Liabilities

As of March 31, 2018

(In thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
				Financial Instruments	Cash Collateral	Net Amount
Description						
Securities sold under agreements to repurchase	$ 400,000	$ (200,000)	$ 200,000	$ (200,000)	$ -	$ -

As of December 31, 2017

(In thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
				Financial Instruments	Cash Collateral	Net Amount
Description						
Securities sold under agreements to repurchase	$ 500,000	$ (200,000)	$ 300,000	$ (300,000)	$ -	$ -

NOTE 13 – GOODWILL AND OTHER INTANGIBLES

Goodwill as of March 31, 2018 and December 31, 2017 amounted to $28.1 million, recognized as part of "Other Assets" in the consolidated statements of financial condition. The Corporation conducted its annual evaluation of goodwill and other intangibles during the fourth quarter of 2017. The Corporation's goodwill is related to the acquisition of FirstBank Florida in 2005.

There have been no significant events related to the Florida reporting unit that could indicate potential goodwill impairment since the date of the last evaluation; therefore, no goodwill impairment evaluation was performed during the first quarter of 2018. Goodwill and other indefinite life intangibles are reviewed at least annually for impairment.

In connection with the acquisition of the FirstBank-branded credit card loan portfolio, in the second quarter of 2012, the Corporation recognized a purchased credit card relationship intangible of $24.5 million, which is being amortized over the remaining estimated life of 3.6 years on an accelerated basis based on the estimated attrition rate of the purchased credit card accounts, which reflects the pattern in which the economic benefits of the intangible asset are consumed. These benefits are consumed as the revenue stream generated by the cardholder relationship is realized.

The core deposit intangible includes the core deposit intangible acquired in the February 2015 Doral Bank transaction amounting to $3.6 million as of March 31, 2018.

In the first quarter of 2016, FirstBank Insurance Agency acquired certain insurance customer accounts and related customer records and recognized an insurance customer relationship intangible of $1.1 million ($0.7 million as of March 31, 2018), which is being amortized over the next 4.7 years on a straight-line basis. The acquired accounts have a direct relationship to the previous mortgage loan portfolio acquisitions from Doral Bank and Doral Financial in 2015 and 2014.

The following table shows the gross amount and accumulated amortization of the Corporation's intangible assets recognized as part of Other Assets in the consolidated statements of financial condition:

		As of March 31, 2018		**As of December 31, 2017**
(Dollars in thousands)				
Core deposit intangible:				
Gross amount, beginning of period	$	51,664	$	51,664
Accumulated amortization [1]		(46,580)		(46,186)

Net carrying amount	$	5,084	$	5,478
Remaining amortization period		6.8 years		7.0 years
Purchased credit card relationship intangible:				
Gross amount	$	24,465	$	24,465
Accumulated amortization (2)		(17,039)		(16,465)
Net carrying amount	$	7,426	$	8,000
Remaining amortization period		3.6 years		3.9 years
Insurance customer relationship intangible:				
Gross amount	$	1,067	$	1,067
Accumulated amortization (3)		(330)		(292)
Net carrying amount	$	737	$	775
Remaining amortization period		4.7 years		5.0 years

(1) For the quarters ended March 31, 2018 and 2017, the amortization expense of core deposit intangibles amounted to $0.4 million and $0.5 million, respectively.
(2) For each of the quarters ended March 31, 2018 and 2017, the amortization expense of the purchased credit card relationship intangible amounted to $0.6 million.
(3) For each of the quarters ended March 31, 2018 and 2017, the amortization expense of the insurance customer relationship intangible amounted to $38 thousand.

The estimated aggregate annual amortization expense related to the intangible assets for future periods is as follows:

		Amount (In thousands)
2018	$	2,585
2019		3,088
2020		2,851
2021		2,658
2020		915
2023 and after		1,150

NOTE 14 – NON-CONSOLIDATED VARIABLE INTEREST ENTITIES (“VIE”) AND SERVICING ASSETS

The Corporation transfers residential mortgage loans in sale or securitization transactions in which it has continuing involvement, including servicing responsibilities and guarantee arrangements. All such transfers have been accounted for as sales, as required by applicable accounting guidance.

When evaluating the need to consolidate counterparties to which the Corporation has transferred assets or with which the Corporation has entered into other transactions, the Corporation first determines if the counterparty is an entity for which a variable interest exists. If no scope exception is applicable and a variable interest exists, the Corporation then evaluates if it is the primary beneficiary of the VIE and whether the entity should be consolidated or not.

Below is a summary of transfers of financial assets to VIEs for which the Corporation has retained some level of continuing involvement:

GNMA

The Corporation typically transfers first lien residential mortgage loans in conjunction with GNMA securitization transactions in which the loans are exchanged for cash or securities that are readily-redeemed for cash proceeds and servicing rights. The securities issued through these transactions are guaranteed by the issuer and, under seller/servicer agreements, the Corporation is required to service the loans in accordance with the issuers’ servicing guidelines and standards. As of March 31, 2018, the Corporation serviced loans securitized through GNMA with a principal balance of $1.7 billion.

Trust Preferred Securities

In 2004, FBP Statutory Trust I, a financing trust that is wholly owned by the Corporation, sold to institutional investors $100 million of its variable-rate trust-preferred securities. FBP Statutory Trust I used the proceeds of the issuance, together with the proceeds of the purchase by the Corporation of $3.1 million of FBP Statutory Trust I variable-rate common securities to purchase $103.1 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures. Also in 2004, FBP Statutory Trust II, a financing trust that is wholly owned by the Corporation, sold to institutional investors $125 million of its variable-rate trust-preferred securities. FBP Statutory Trust II used the proceeds of the issuance, together with the proceeds of the purchase by the Corporation of $3.9 million of FBP Statutory Trust II variable-rate common securities to purchase $128.9 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures. The debentures are presented in the Corporation's consolidated statement of financial condition as Other Borrowings, net of related issuance costs. The variable-rate trust-preferred securities are fully and unconditionally guaranteed by the Corporation. The Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and September 2004 mature on June 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of Junior Subordinated Deferrable Debentures may be shortened (such shortening would result in a mandatory redemption of the variable-rate trust-preferred securities).

During the first quarter of 2018, the Corporation completed the repurchase of $23.8 million of trust preferred securities of the FBP Statutory Trust I that were auctioned in a public sale at which the Corporation was invited to participate. The Corporation repurchased and cancelled the repurchased trust preferred securities, resulting in a commensurate reduction in the related Floating Rate Junior Subordinated Debentures. The Corporation's winning bid equated to 90% of the $23.8 million par value. The 10% discount resulted in a gain of approximately $2.3 million, which is reflected in the statement of income as a "Gain on early extinguishment of debt."

The Collins Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act eliminated certain trust-preferred securities from Tier 1 Capital; however, these instruments may remain in Tier 2 capital until the instruments are redeemed or mature. Under the indentures, the Corporation has the right, from time to time, and without causing an event of default, to defer payments of

interest on the Junior Subordinated Deferrable Debentures by extending the interest payment period at any time and from time to time during the term of the subordinated debentures for up to twenty consecutive quarterly periods. During the second quarter of 2016, the Corporation, having received approval from the Federal Reserve, paid $31.2 million for all of the accrued but deferred interest payments plus the interest for the second quarter of 2016 on the Corporation’s subordinated debentures associated with its trust preferred securities. Subsequently, the Corporation has received quarterly approvals that have enabled it to make scheduled quarterly interest payments. As of March 31, 2018, the Corporation was current on all interest payments due on its subordinated debt. In October 2017, the New York FED terminated the formal written agreement (the “Written Agreement”) entered into on June 3, 2010 between the Corporation and the Reserve Bank. However, the Corporation has agreed with its regulators to continue to obtain approval before paying dividends, receiving dividends from the Bank, making payments on subordinated debt or trust-preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock. The Corporation has received approval to make the subordinated debentures’ quarterly payment for June 30, 2018.

Grantor Trusts

During 2004 and 2005, an unaffiliated party, referred to in this subsection as the seller, established a series of statutory trusts to effect the securitization of mortgage loans and the sale of trust certificates (the “Grantor Trusts”). The seller initially provided the servicing for a fee, which is senior to the obligations to pay trust certificate holders. The seller then entered into a sales agreement through which it sold and issued the trust certificates in favor of the Corporation’s banking subsidiary. Currently, the Bank is the sole owner of the trust certificates; the servicing of the underlying residential mortgages that generate the principal and interest cash flows is performed by another third party, which receives a servicing fee. The securities are variable-rate securities indexed to 90-day LIBOR plus a spread. The principal payments from the underlying loans are remitted to a paying agent (servicer), who then remits interest to the Bank. Interest income is shared to a certain extent with the FDIC, which has an interest only strip (“IO”) tied to the cash flows of the underlying loans and is entitled to receive the excess of the interest income less a servicing fee over the variable-rate income that the Bank earns on the securities. This IO is limited to the weighted-average coupon on the securities. The FDIC became the owner of the IO upon its intervention of the seller, a failed financial institution. No recourse agreement exists, and the Bank, as the sole holder of the certificates, absorbs all risks from losses on non-accruing loans and repossessed collateral. As of March 31, 2018, the amortized cost and fair value of the Grantor Trusts amounted to $21.3 million and $16.1 million, respectively, with a weighted average yield of 4.49%.

Investment in unconsolidated entity

On February 16, 2011, FirstBank sold an asset portfolio consisting of performing and non-performing construction, commercial mortgage and commercial and industrial loans with an aggregate book value of $269.3 million to CPG/GS, an entity organized under the laws of the Commonwealth of Puerto Rico and majority owned by PRLP Ventures LLC ("PRLP"), a company created by Goldman, Sachs & Co. and Caribbean Property Group. In connection with the sale, the Corporation received $88.5 million in cash and a 35% interest in CPG/GS, and made a loan in the amount of $136.1 million representing seller financing provided by FirstBank. The loan has a seven-year maturity and bears variable interest at 30-day LIBOR plus 300 basis points and is secured by a pledge of all of the acquiring entity's

assets as well as PRLP's 65% ownership interest in CPG/GS. As of March 31, 2018, the carrying amount of the loan was $4.1 million, which was included in the Corporation's commercial and industrial loans held for investment portfolio. The loan matured in February 2018 and is in the process of refinancing. As of March 31, 2018, the loan is current on its interest payments. FirstBank's equity interest in CPG/GS is accounted for under the equity method. The loss recorded in 2014 reduced to zero the carrying amount of the Bank's investment in CPG/GS. No negative investment needs to be reported as the Bank has no legal obligation or commitment to provide further financial support to this entity; thus, no further losses have been or will be recorded on this investment.

FirstBank also provided an $80 million advance facility to CPG/GS to fund unfunded commitments and costs to complete projects under construction, which was fully disbursed in 2011, and a $20 million working capital line of credit to fund certain expenses of CPG/GS. The working capital line expired in September 2016. During 2012, CPG/GS repaid the outstanding balance of the advance facility to fund unfunded commitments, and the funds became available for rewithdrawal under a one-time revolver agreement. This facility loan bears variable interest at 30-day LIBOR plus 300 basis points. As of March 31, 2018, the carrying value of the amount outstanding under the revolver agreement was $6.8 million, which was included in the Corporation's commercial and industrial loans held for investment portfolio.

Cash proceeds received by CPG/GS have been first used to cover operating expenses and debt service payments, including those related to the note receivable, and the revolver agreement, described above, which must be substantially repaid before proceeds can be used for other purposes, including the return of capital to both PRLP and FirstBank. FirstBank will not receive any return on its equity interest until PRLP receives an aggregate amount equivalent to its initial investment and a priority return of at least 12%, which has not occurred, resulting in FirstBank's interest in CPG/GS being subordinate to PRLP's interest. CPG/GS will then begin to make payments pro rata to PRLP and FirstBank, 35% and 65%, respectively, until FirstBank has achieved a 12% return on its invested capital and the aggregate amount of distributions is equal to FirstBank's capital contributions to CPG/GS.

The Bank has determined that CPG/GS is a VIE in which the Bank is not the primary beneficiary. In determining the primary beneficiary of CPG/GS, the Bank considered applicable guidance that requires the Bank to qualitatively assess the determination of the primary beneficiary (or consolidator) of CPG/GS based on whether it has both the power to direct the activities of CPG/GS that most significantly impact the entity's economic performance and the obligation to absorb losses of CPG/GS that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. The Bank determined that it does not have the power to direct the activities that most significantly impact the economic performance of CPG/GS as it does not have the right to manage the loan portfolio, impact foreclosure proceedings, or manage the construction and sale of the property; therefore, the Bank concluded that it is not the primary beneficiary of CPG/GS.

Servicing Assets

The Corporation sells residential mortgage loans to GNMA, which generally securitizes the transferred loans into mortgage-backed securities. Also, certain conventional conforming loans are sold to FNMA or FHLMC with servicing retained. The Corporation recognizes as separate assets the rights to service loans for others, whether those servicing assets are originated or purchased.

The changes in servicing assets are shown below:

	Quarter ended	
	March 31, 2018	**March 31, 2017**
(In thousands)		
Balance at beginning of period	$ 25,255	$ 26,244
Capitalization of servicing assets	887	875
Amortization	(737)	(788)
Adjustment to fair value	713	(160)
Other (1)	17	159
Balance at end of period	$ 26,135	$ 26,330

(1) Amount represents the adjustment to fair value related to the repurchase of loans serviced for others.

Impairment charges are recognized through a valuation allowance for each individual stratum of servicing assets. The valuation allowance is adjusted to reflect the amount, if any, by which the cost basis of the servicing asset for a given stratum of loans being serviced exceeds its fair value. Any fair value in excess of the cost basis of the servicing asset for a given stratum is not recognized.

Changes in the impairment allowance were as follows:

Quarter ended

	March 31, 2018		March 31, 2017	
(In thousands)				
Balance at beginning of period	$	1,451	$	461
Temporary impairment charges		17		160
OTTI of servicing assets		(65)		(621)
Recoveries		(730)		-
Balance at end of period	$	673	$	-

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The components of net servicing income are shown below:

	Quarter ended			
	March 31, 2018		March 31, 2017	
		(In thousands)		
Servicing fees	$	2,120	$	2,024
Late charges and prepayment penalties		120		99
Adjustment for loans repurchased		17		159
Other		-		(7)
Servicing income, gross		2,257		2,275
Amortization and impairment of servicing assets		(24)		(948)
Servicing income, net	$	2,233	$	1,327

The Corporation's servicing assets are subject to prepayment and interest rate risks. As of March 31, 2018, fair values of the Corporation's servicing assets were based on a valuation model that incorporates market-driven assumptions regarding discount rates and mortgage prepayment rates, adjusted by the particular characteristics of the Corporation's servicing portfolio. The Corporation used constant prepayment rate assumptions for the Corporation's servicing assets for the government-guaranteed mortgage loans of 5.6% and 6.0% for the quarters ended March 31, 2018 and 2017, respectively. For conventional conforming mortgage loans, the Corporation used 6.2% and 6.3% for the quarters ended March 31, 2018 and 2017, respectively, and, for the conventional non-conforming mortgage loans, the Corporation used 9.1% and 9.5% for the quarters ended March 31, 2018 and 2017, respectively. Discount rate assumptions used were 12% for government-guaranteed mortgage loans; 10% for conventional conforming mortgage loans; and 14.3% for conventional non-conforming mortgage loans for each of the quarters ended March 31, 2018 and 2017.

The weighted averages of the key economic assumptions that the Corporation used in its valuation model and the sensitivity of the current fair value to immediate 10% and 20% adverse changes in those assumptions for mortgage loans as of March 31, 2018 were as follows:

	(Dollars in thousands)	
Carrying amount of servicing assets	$	26,135
Fair value	$	30,720
Weighted-average expected life (in years)		8.56
Constant prepayment rate (weighted-average annual rate)		5.89%
Decrease in fair value due to 10% adverse change	$	725
Decrease in fair value due to 20% adverse change	$	1,421
Discount rate (weighted-average annual rate)		11.23%
Decrease in fair value due to 10% adverse change	$	1,503
Decrease in fair value due to 20% adverse change	$	2,876

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship between the change in assumption and the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the servicing asset is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments), which may magnify or counteract the sensitivities.

NOTE 15 – DEPOSITS

The following table summarizes deposit balances as of the dates indicated:

	March 31, 2018	December 31, 2017
(In thousands)		
Type of account:		
Non-interest bearing checking accounts	$ 2,019,823	$ 1,833,665
Savings accounts	2,413,446	2,401,385
Interest-bearing checking accounts	1,242,957	1,207,511
Certificates of deposit	2,434,162	2,429,585
Brokered certificates of deposit (CDs)	956,077	1,150,485
	$ 9,066,465	$ 9,022,631

Brokered CDs mature as follows:

(In thousands)	March 31, 2018
Three months or less	$ 133,119
Over three months to six months	149,170
Over six months to one year	265,986
Over one year but less than three years	316,191
Three to five years	90,231
Over five years	1,380
Total	$ 956,077

The following are the components of interest expense on deposits:

	Quarter Ended	
	March 31, 2018	March 31, 2017
(In thousands)		
Interest expense on deposits	$ 16,607	$ 15,468
Accretion of premium from acquisition	(3)	(23)
Amortization of broker placement fees	367	527
Interest expense on deposits	$ 16,971	$ 15,972

NOTE 16 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase (repurchase agreements) consisted of the following:

(Dollars in thousands)		March, 31 2018		December 31, 2017
Short-term fixed-rate repurchase agreement with a rate of 1.53%	$	-	$	100,000
Long-term fixed-rate repurchase agreements, interest ranging from 1.96% to 2.26% (1)(2)		200,000		200,000
	$	200,000	$	300,000

(1)Reported net of securities purchased under agreements to repurchase (reverse repurchase agreements) by counterparty, when applicable, pursuant to ASC 210-20-45-11.

(2)As of March 31, 2018, includes $200 million with an average rate of 2.11% that lenders have the right to call before their contractual maturities at various dates beginning on May 6, 2018. Subsequent to March 31, 2018, no lender has exercised its call option on repurchase agreements.

Repurchase agreements mature as follows:

		March 31, 2018 (In thousands)
Three to four years		200,000
Total	$	200,000

As of March 31, 2018 and December 31, 2017, the securities underlying such agreements were delivered to the dealers with which the repurchase agreements were transacted.

Repurchase agreements as of March 31, 2018, grouped by counterparty, were as follows:

(Dollars in thousands) Counterparty		Amount	Weighted-Average Maturity (In Months)
JP Morgan Chase	$	200,000	46

NOTE 17 – ADVANCES FROM THE FEDERAL HOME LOAN BANK (FHLB)

The following is a summary of the advances from the FHLB:

(In thousands)	March 31, 2018	December 31, 2017
Long-term fixed-rate advances from FHLB, with a weighted-average interest rate of 1.91%	$ 715,000	$ 715,000

Advances from FHLB mature as follows:

(In thousands)	March 31, 2018
Over three months to six months	$ 25,000
Over six months to one year	70,000
Over one to three years	300,000
Over three to five years	320,000
Total	$ 715,000

As of March 31, 2018, the Corporation had additional capacity of approximately $689.5 million on this credit facility based on collateral pledged at the FHLB, including a haircut reflecting the perceived risk associated with the collateral.

NOTE 18 – OTHER BORROWINGS

Other borrowings, as of the indicated dates, consisted of:

	March 31, 2018	December 31, 2017
	(In thousands)	
Junior subordinated debentures due in 2034, interest-bearing at a floating rate of 2.75% over 3-month LIBOR (4.92% as of March 31, 2018		

and 4.35% as of December 31, 2017) (1)	$	65,593	$	90,078
Junior subordinated debentures due in 2034, interest-bearing at a floating rate of 2.50% over 3-month LIBOR (4.70% as of March 31, 2018 and 4.12% as of December 31, 2017)		118,557		118,557
	$	184,150	$	208,635

(1) Refer to Note 14, - "Non-Consolidated Variable Interest Entities and Servicing Assets-Trust Preferred Securities," for additional information about the Corporation repurchase and cancellation in the first quarter of 2018 of $23.8 million in trust-preferred securities associated with these junior subordinated debentures.

NOTE 19 – STOCKHOLDERS' EQUITY

Common Stock

As of March 31, 2018 and December 31, 2017, the Corporation had 2,000,000,000 authorized shares of common stock with a par value of $0.10 per share. As of March 31, 2018 and December 31, 2017, there were 220,877,719 and 220,382,343 shares issued, respectively, and 216,390,329 and 216,278,040 shares outstanding, respectively. Refer to Note 4 for information about transactions related to common stock under the Omnibus Plan.

Preferred Stock

The Corporation has 50,000,000 authorized shares of preferred stock with a par value of $1.00, redeemable at the Corporation's option, subject to certain terms. This stock may be issued in series and the shares of each series have such rights and preferences as are fixed by the Board of Directors when authorizing the issuance of that particular series. As of March 31, 2018, the Corporation has five outstanding series of non-convertible, non-cumulative preferred stock: 7.125% non-cumulative perpetual monthly income preferred stock, Series A; 8.35% non-cumulative perpetual monthly income preferred stock, Series B; 7.40% non-cumulative perpetual monthly income preferred stock, Series C; 7.25% non-cumulative perpetual monthly income preferred stock, Series D; and 7.00% non-cumulative perpetual monthly income preferred stock, Series E. The liquidation value per share is $25.

Effective January 17, 2012, the Corporation delisted all of its outstanding series of non-convertible, non-cumulative preferred stock from the New York Stock Exchange. The Corporation has not arranged for listing and/or registration on another national securities exchange or for quotation of the Series A through E Preferred Stock in a quotation medium. In December 2016, for the first time since July 2009, the Corporation paid dividends on its non-cumulative perpetual monthly income preferred stock, after receiving regulatory approval. Since then, the Corporation has continued to pay monthly dividend payments on the non-cumulative perpetual monthly income preferred stock. The Corporation intends to request approval in future periods to continue monthly dividend payments on the non-cumulative perpetual monthly income preferred stock. The Corporation has received regulatory approval to pay the monthly dividends on the Corporation's Series A through E Preferred Stock through June 2018.

On October 3, 2017, the Federal Reserve terminated the Written Agreement entered into on June 3, 2010 between the Corporation and the Federal Reserve. However, the Corporation has agreed with its regulators to continue to obtain approval before paying dividends, receiving dividends from the Bank, making payments on subordinated debt or trust preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock.

Treasury stock

During the first quarter of 2018 and 2017, the Corporation withheld an aggregate of 383,087 shares and 98,300 shares, respectively, of the common stock paid to certain senior officers as additional compensation and restricted stock that vested during the first quarter of 2018 and 2017 to cover employees' payroll and income tax withholding liabilities; these shares are held as treasury stock. As of March 31, 2018 and December 31, 2017, the Corporation had 4,487,390 and 4,104,303 shares held as treasury stock, respectively.

FirstBank Statutory Reserve (Legal Surplus)

The Banking Law of the Commonwealth of Puerto Rico requires that a minimum of 10% of FirstBank's net income for the year be transferred to a legal surplus reserve until such surplus equals the total of paid-in-capital on common and preferred stock. Amounts transferred to the legal surplus reserve from the retained earnings account are not available for distribution to the Corporation, including for payment as dividends to the stockholders, without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The Puerto Rico Banking Law provides that, when the expenditures of a Puerto Rico commercial bank are greater than receipts, the excess of the expenditures over receipts must be charged against the undistributed profits of the bank, and the balance, if any, must be charged against the legal surplus reserve, as a reduction thereof. If there is no legal surplus reserve sufficient to cover such balance in whole or in part, the outstanding amount must be charged against the capital account and the Bank cannot pay dividends until it can replenish the legal surplus reserve to an amount of at least 20% of the original capital contributed. During the fourth quarter of 2017, $7.3 million was transferred to the legal surplus reserve. FirstBank's legal surplus reserve, included as part of retained earnings in the Corporation's consolidated statement of financial condition, amounted to $59.7 million as of March 31, 2018. There were no transfers to the legal surplus reserve during the quarter ended March 31, 2018.

NOTE 20 - INCOME TAXES

Income tax expense includes Puerto Rico and USVI 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. and USVI income tax purposes and is generally subject to U.S. and USVI income tax only on its income from sources within the U.S. and USVI or income effectively connected with the conduct of a trade or business in those regions. Any such tax paid in the U.S. and USVI is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

Under the Puerto Rico Internal Revenue Code of 2011, as amended (the "2011 PR Code"), the Corporation and its subsidiaries are treated as separate taxable entities and are generally not entitled to file consolidated tax returns and, thus, the Corporation is generally not entitled to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operating loss ("NOL"), a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable NOL carry-forward period. The 2011 PR Code allows entities organized as limited liability companies to perform an election to become a non-taxable "pass-through" entity and utilize losses to offset income from other "pass-through" entities, subject to certain limitations, with the remaining net income passing-through to its partner entities. The 2011 PR Code also provides a dividend received deduction of 100% on dividends received from "controlled" subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

On March 1, 2017, the Corporation completed the applicable regulatory filings to change the tax status of its subsidiary, First Federal Finance, from a taxable corporation to a non-taxable "pass-through" entity. This election allows the Corporation to realize tax benefits of its deferred tax assets associated with pass-through ordinary net operating losses available at the banking subsidiary, FirstBank, which were subject to a full valuation allowance as of December 31, 2016, against now pass-through ordinary income from this profitable subsidiary.

On March 1, 2017, the Corporation also completed the applicable regulatory filings to change the tax status of its subsidiary, FirstBank Insurance, from a taxable corporation to a non-taxable "pass-through" entity. This election allows the Corporation to offset pass-through income projected to be earned by FirstBank Insurance with net operating losses available at the Holding Company level.

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 by doing business through an International Banking Entity ("IBE") unit of the Bank, and through the Bank's subsidiary, FirstBank Overseas Corporation, whose interest income and gain on sales is exempt from Puerto Rico income taxation. The IBE 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 on the specific activities identified in the IBE Act. An IBE that operates as a unit of a bank pays income taxes at the corporate standard rates to the extent that the IBE's net income exceeds 20% of the bank's total net taxable income.

For the first quarter of 2018, the Corporation recorded a income tax expense of $7.8 million, compared to an income tax benefit of $8.1 million for the same period in 2017. The variance was mostly attributable to a $13.2 million tax benefit recorded in the first quarter of 2017 as a result of the above discussed change in tax status of certain subsidiaries from taxable corporations to limited liability companies that elected to be treated as partnerships for income tax purposes in Puerto Rico, higher pre-tax earnings in the first quarter of 2018, and a higher estimated effective tax rate for 2018.

For the quarter ended March 31, 2018, the Corporation calculated the provision for income taxes by applying the estimated annual effective tax rate for the full fiscal year to ordinary income or loss. In the computation of the consolidated worldwide annual estimated effective tax rate, ASC 740-270 requires the exclusion of legal entities with pre-tax losses from which a tax benefit cannot be recognized. The Corporation's estimated annual effective tax rate in the first quarter of 2018, excluding entities from which a tax benefit cannot be recognized and discrete items, was 27% compared to 24% for the first quarter of 2017. The estimated annual effective tax rate including all entities for 2018 was 19% (23% excluding discrete items) compared to 13% for the first quarter of 2017 (25% excluding discrete items, primarily the tax benefit resulting from the previously mentioned change in the tax status of the two subsidiaries).

The Corporation's net deferred tax asset amounted to $289.3 million as of March 31, 2018, net of a valuation allowance of $186.1 million, and management concluded, based upon the assessment of all positive and negative evidence, that it is more likely than not that the Corporation will generate sufficient taxable income within the applicable NOL carry-forward periods to realize such amount. The net deferred tax asset of the Corporation's banking subsidiary, FirstBank, amounted to $289.2 million as of March 31, 2018, net of a valuation allowance of $150.0 million, compared to net deferred tax asset of $294.7 million, net of a valuation allowance of $150.7 million, as of December 31, 2017.

During the third quarter of 2017, the Corporation completed a formal ownership change analysis within the meaning of Section 382 of the U.S. Internal Revenue Code ("Section 382") covering a comprehensive period, and concluded that an ownership change occurred during such period. Section 382 limits the ability to utilize U.S. and USVI NOLs for income tax purposes at such jurisdictions following an event of an ownership change. The Section 382 limitation could result in higher U.S. and USVI liabilities in the future than we would incur in the absence of such limitation. As of March 31, 2018, and as a result of the Section 382 limitation, the Corporation incurred an income tax expense of approximately $1.6 million related to its U.S. operations. The limitation did not affect the USVI operations in the first quarter of 2018. Prospectively, the Corporation expects that it will be able to mitigate the adverse effects associated with the Section 382 limitation as any such tax paid in the U.S. or USVI could be creditable against Puerto Rico tax liabilities or taken as deduction against taxable income. However, our ability to reduce our Puerto Rico tax liability through such a credit or deduction depends on our tax profile at each annual taxable period, which is dependent on various factors.

As of March 31, 2018, the Corporation did not have Unrecognized Tax Benefits ("UTBs") recorded on its books. The Corporation classifies all interest and penalties, if any, related to tax uncertainties as income tax expense. Audit periods remain open for review until the statute of limitations has passed. The statute of limitations under the 2011 PR Code is four years; the statute of limitations for U.S. and USVI income tax purposes is three years after a tax return is due or filed, whichever is later, for each. 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 the results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. For U.S. and USVI income tax purposes, all tax years subsequent to 2012 remain open to examination. For Puerto Rico tax purposes, all tax years subsequent to 2012 remain open to examination.

On December 22, 2017, the United States president signed H.R.1, The Tax Cuts and Jobs Acts, which includes an overhaul of individual, business and international taxes and has affected our branch operations in the U.S. and the USVI. The bill includes measures reducing corporate taxes from 35% to 21%, a repeal of the corporate alternative minimum tax regime, changes to business deductions and NOLs, a 15.5% tax on mandatory repatriation of liquid assets, 10% tax on base erosion payments, and a minimum 10.5% tax on inclusion of global intangible low-tax income by U.S. shareholders, among other significant changes. The main provisions affecting our operations in the U.S. and the USVI in the first quarter for 2018 include: the change in tax rate to 21%, the limitation to the amount certain financial institutions may deduct for premiums paid to the FDIC, and changes in permanent differences, such as the meals and entertainment deductions. Other significant provisions, such as the base erosion and anti-abuse tax, do not affect the Corporation's U.S. and USVI branch operations since these operations' receipts do not exceed the annual threshold of U.S. effectively connected gross receipts.

NOTE 21 – FAIR VALUE

Fair Value Measurement

The FASB authoritative guidance for fair value measurement 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. This guidance also establishes a fair value hierarchy for classifying financial instruments. The hierarchy is based on whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. Three levels of inputs may be used to measure fair value:

Level 1	Valuations of Level 1 assets and liabilities are obtained from readily-available pricing sources for market transactions involving identical assets or liabilities. Level 1 assets and liabilities include equity securities that trade in an active exchange market, as well as certain U.S. Treasury and other U.S. government and agency securities and corporate debt securities that are traded by dealers or brokers in active markets.
Level 2	Valuations of Level 2 assets and liabilities are based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, 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 of identical or comparable assets, (ii) debt securities with quoted prices that are traded less frequently than exchange-traded instruments, and (iii) derivative contracts 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	Valuations of Level 3 assets and liabilities are based on unobservable inputs that are supported by little or no market activity and 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 judgments estimation.

For the first quarter of 2018, there were no transfers into or out of Level 1, Level 2 or Level 3 of the fair value hierarchy.

Financial Instruments Recorded at Fair Value on a Recurring Basis

Investment securities available for sale

The fair value of investment securities was the market value based on quoted market prices (as is the case with Treasury notes and non-callable U.S. Agency debt securities), when available (Level 1), or, when available, market prices for identical or comparable assets (as is the case with MBS and callable U.S. agency debt) that are based on observable market parameters, including benchmark yields, reported trades, quotes from brokers or dealers, issuer spreads, bids, offers and reference data, including market research operations (Level 2). Observable prices in the market already consider the risk of nonperformance. If listed prices or quotes are not available, fair value is based upon discounted cash flow models that use unobservable inputs due to the limited market activity of the instrument, as is the case with certain private label MBS held by the Corporation (Level 3).

Private label MBS are collateralized by fixed-rate mortgages on single-family residential properties in the United States; the interest rate on the securities is variable, tied to 3-month LIBOR and limited to the weighted-average coupon of the underlying collateral. The market valuation represents the estimated net cash flows over the projected life of the pool of underlying assets applying a discount rate that reflects market observed floating spreads over LIBOR, with a widening spread based on a nonrated security. The market valuation is derived from a model that utilizes relevant assumptions, such as the prepayment rate, default rate, and loss severity on a loan level basis. The Corporation modeled the cash flow from the fixed-rate mortgage collateral using a static cash flow analysis according to collateral attributes of the underlying mortgage pool (i.e., loan term, current balance, note rate, rate adjustment type, rate adjustment frequency, rate caps, and others) in combination with prepayment forecasts based on historical portfolio performance. The variable cash flow of the security is modeled using the 3-month LIBOR forward curve. Loss assumptions were driven by the combination of default and loss severity estimates, using an asset-level risk assessment method taking into account loan credit characteristics (loan-to-value, state jurisdiction, delinquency, property type and pricing behavior, and others) to provide an estimate of default and loss severity.

Refer to the table below for further information regarding qualitative information for all assets and liabilities measured at fair value using significant unobservable inputs (Level 3).

Derivative instruments

The fair value of most of the Corporation's derivative instruments is based on observable market parameters and takes into consideration the credit risk component of paying counterparties, when appropriate. On interest caps, only the seller's credit risk is considered. The caps were valued using a discounted cash flow approach based on the related LIBOR and swap rate for each cash flow.

A credit spread is considered for those derivative instruments that are not secured. The cumulative mark-to-market effect of credit risk in the valuation of derivative instruments for the quarters ended March 31, 2018 and 2017 was immaterial.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	As of March 31, 2018 Fair Value Measurements Using				**As of December 31, 2017 Fair Value Measurements Using**			
(In thousands)	**Level 1**	**Level 2**	**Level 3**	**Assets/Liabilities at Fair Value**	**Level 1**	**Level 2**	**Level 3**	**Assets/Liabilities at Fair Value**
Assets:								
Securities available for sale :								
Equity securities (1)	$ -	$ -	$ -	$ -	$ 418	$ -	$ -	$ 418
U.S. Treasury Securities	57,169	-	-	57,169	7,401	-	-	7,401
Noncallable U.S. agency debt	-	329,170	-	329,170	-	361,971	-	361,971
Callable U.S. agency debt and MBS	-	1,406,283	-	1,406,283	-	1,497,253	-	1,497,253
Puerto Rico government obligations	-	4,074	2,734	6,808	-	4,118	2,695	6,813
Private label MBS	-	-	16,074	16,074	-	-	17,060	17,060
Other investments	-	-	-	-	-	-	100	100
Equity securities (1)	413	-	-	413	-	-	-	-
Derivatives, included in assets:								
Purchased interest rate cap agreements	-	668	-	668	-	305	-	305
Forward contracts	-	3	-	3	-	7	-	7
Liabilities:								
Derivatives, included in								

liabilities:								
Written interest rate cap agreement	-	668	-	668	-	305	-	305
Forward contracts	-	67	-	67	-	19	-	19

(1) As of January 1, 2018, the Corporation adopted ASU 2016-01, resulting in the reclassification of equity securities from available-for-sale investment securities to other investment securities. As of December 31, 2017, equity securities had a net unrealized loss of $6 thousand.

The table below presents a reconciliation of the beginning and ending balances of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarters ended March 31, 2018 and 2017.

Level 3 Instruments Only (In thousands)	Quarter ended March 31, 2018 Securities Available For Sale[(1)]		Quarter ended March 31, 2017 Securities Available For Sale[(1)]	
Beginning balance	$	19,855		22,914
Total gains (losses) (realized/unrealized):				
Included in other comprehensive income		472		518
Principal repayments and amortization		(1,519)		(2,050)
Ending balance	$	18,808	$	21,382

(1) Amounts mostly related to private label MBS.

The table below presents qualitative information for significant assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of March 31, 2018:

(In thousands)	March 31, 2018 Fair Value	Valuation Technique	Unobservable Input	Range
Investment securities available-for-sale:				
Private label MBS	$ 16,074	Discounted cash flows	Discount rate	14.5%
			Prepayment rate	7.5% - 24.5% (Weighted Average 15.2%)
			Projected Cumulative Loss Rate	0.00% - 9.0% (Weighted Average 4.0%)
Puerto Rico government obligations	2,734	Discounted cash flows	Discount rate	6.24%
			Prepayment rate	3.00%

Information about Sensitivity to Changes in Significant Unobservable Inputs

Private label MBS: The significant unobservable inputs in the valuation include probability of default, the loss severity assumption, and prepayment rates. Shifts in those inputs would result in different fair value measurements. Increases in the probability of default, loss severity assumptions, and prepayment rates in isolation would generally result in an adverse effect on the fair value of the instruments. Meaningful and possible shifts of each input were modeled to assess the effect on the fair value estimation.

Puerto Rico Government Obligations: The significant unobservable input used in the fair value measurement is the assumed prepayment rate of the underlying residential mortgage loans that collateralize these obligations that are guaranteed by the Puerto Rico Housing Finance Authority. A significant increase (decrease) in the assumed rate would lead to a higher (lower) fair value estimate. The fair value of these bonds was based on a discounted cash flow analysis that contemplates the credit quality of the holder of second mortgages and a discount for liquidity constraints on the bonds considering the absence of an active market for them. Due to the guarantee of the Puerto Rico Housing Finance Authority and other applicable contractual safeguards, no additional credit spread is applied for services default.

There were no changes in unrealized gains and losses recorded in earnings for the quarters ended March 31, 2018 and 2017 for Level 3 assets and liabilities that were still held at the end of each period.

Additionally, fair value is used on a nonrecurring 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 and loans).

As of March 31, 2018, 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 March 31, 2018			(Losses) Gains recorded for the Quarter Ended March 31, 2018
(In thousands)	Level 1	Level 2	Level 3	
Loans receivable (1)	$ -	$ -	$ 392,493	$ (4,224)
Other real estate owned (2)	-	-	154,639	(287)
Mortgage servicing rights (3)	-	-	26,135	713

Loans held for sale (4)	-	-	64,945	(6,203)

(1) Consists mainly of impaired commercial and construction loans. The impairments were generally measured based on the fair value of the collateral. The fair values were derived from external 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) The fair values were 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 and net operating income of income producing properties), which are not market observable. Losses were related to market valuation adjustments after the transfer of the loans to the OREO portfolio.

(3) Fair value adjustments to mortgage servicing rights were mainly due to assumptions associated with mortgage prepayment rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, measured at fair value on a non-recurring basis. Assumptions for the value of mortgage servicing rights include: Prepayment rate 5.89%, Discount Rate 11.23%.

(4) The value of these loans was primarily derived from external appraisals, adjusted for specific characteristics of the loans.

As of March 31, 2017, 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 March 31, 2017						(Losses) recorded for the Quarter Ended March 31, 2017	
(In thousands)	Level 1		Level 2		Level 3			
Loans receivable (1)	$	-	$	-	$	430,162	$	(15,211)
Other real estate owned (2)		-		-		137,784		(4,180)
Mortgage servicing rights (3)		-		-		26,330		(160)

(1) Consists mainly of impaired commercial and construction loans. The impairments were generally measured based on the fair value of the underlying collateral. The fair values were derived from external 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) The fair values were 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 and net operating income of income producing properties), which are not market observable. Losses were related to market valuation adjustments after the transfer of the loans to the OREO portfolio.

(3) Fair value adjustments to mortgage servicing rights were mainly due to assumptions associated with mortgage prepayments rates. The Corporation carries its mortgage servicing rights at the lower of cost or market, measured at fair value on a non-recurring basis. Assumptions for the value of mortgage servicing rights include: Prepayment Rate 6.17%, Discount Rate 11.20%.

Qualitative information regarding the fair value measurements for Level 3 financial instruments are as follows:

	March 31, 2018	
	Method	Inputs
Loans	Income, Market, Comparable Sales, Discounted Cash Flows	External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors
OREO	Income, Market, Comparable Sales, Discounted Cash Flows	External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors
Mortgage servicing rights	Discounted Cash Flows	Weighted average prepayment rate of 5.89%; weighted average discount rate of 11.23%

The following is a description of the valuation methodologies used for instruments that are not measured or reported at fair value on a recurring basis or reported at fair value on a non-recurring basis. The estimated fair value was calculated using certain facts and assumptions, which vary depending on the specific financial instrument.

Cash and due from banks and money market investments

The carrying amounts of cash and due from banks and money market investments are reasonable estimates of their fair value. Money market investments include held-to-maturity securities, which have a contractual maturity of three months or less. The fair value of these securities is based on quoted market prices in active markets that incorporate the risk of nonperformance.

Investment securities held to maturity

Investment securities held to maturity consist of financing arrangements with Puerto Rico municipalities issued in bond form but underwritten as loans with features that are typically found in commercial loan transactions. These obligations typically are not issued in bearer form, nor are they registered with the SEC and are not rated by external credit agencies. The fair value of these financing arrangements was based on a discounted cash flow analysis using risk-adjusted discount rates (Level 3). A security with similar characteristics traded in the open market is used as a proxy for each municipal bond. Then the cash flow is discounted at the average spread over the discount curve exhibited by the proxy security at the end of each quarter.

Other investment securities

Equity or other securities that do not have a readily available fair value are stated at their net realizable value, which management believes is a reasonable proxy for their fair value. This category is principally composed of stock that the Corporation owns to comply with FHLB regulatory requirements. The realizable value of the FHLB stock equals its cost as this stock can be freely redeemed at par.

Loans receivable, including loans held for sale

The fair value of loans held for investment and of mortgage loans held for sale is estimated using discounted cash flow analyses, based on interest rates currently being offered for loans with similar terms and credit quality and with adjustments that the Corporation's management believes a market participant would consider in determining fair value. Loans are classified by type, such as commercial, residential mortgage, and automobile. These asset categories are further segmented into fixed- and adjustable-rate categories. Valuations are carried out based on categories and not on a loan-by-loan basis. Prepayment assumptions are considered for non-residential loans. For residential mortgage loans, prepayment estimates are based on a prepayment model that combined both a historical calibration and current market prepayment expectations. Discount rates are based on the U.S. Treasury and LIBOR/Swap Yield Curves at the date of the analysis, and included appropriate adjustments for expected credit losses and liquidity.

Deposits

The estimated fair value of demand deposits and savings accounts, which are deposits with no defined maturities, equals the amount payable on demand at the reporting date. The fair values of retail fixed-rate time deposits and brokered CDs, with stated maturities, are based on the present value of the future cash flows expected to be paid on the deposits. The discount rates used were based on retail and brokered CDs market rates as of March 31, 2018. The cash flows were based on contractual maturities; no early repayments were assumed.

Securities sold under agreements to repurchase

Some repurchase agreements reprice at least quarterly, and their outstanding balances are estimated to be their fair value. Where longer commitments are involved, fair value is estimated using exit price indications of the cost of unwinding the transactions as of the end of the reporting period. The brokers who are the counterparties provide these indications, which the Corporation evaluates. Securities sold under agreements to repurchase are fully collateralized by investment securities.

Advances from FHLB

The fair value of advances from the FHLB is estimated using exit price indications provided by the counterparty. Advances from the FHLB are fully collateralized by mortgage loans and, to a lesser extent, investment securities.

Other borrowings

Other borrowings consist of junior subordinated debentures. Projected cash flows from the debentures were discounted using the Bloomberg BB Finance curve plus a credit spread. This credit spread was estimated using the difference in yield curves between swap rates and a yield curve that considers the industry and credit rating of the Corporation as issuer of the debenture at a tenor comparable to the time to maturity of the debentures.

The following tables present the carrying value, estimated fair value and estimated fair value level of the hierarchy of financial instruments as of March 31, 2018 and December 31, 2017:

(In thousands)	Total Carrying Amount in Statement of Financial Condition March 31, 2018	Fair Value Estimate March 31, 2018	Level 1	Level 2	Level 3
Assets:					
Cash and due from banks and money market investments (amortized cost)	$ 843,824	$ 843,824	$ 843,824	$ -	$ -
Investment securities available for sale (fair value)	1,815,504	1,815,504	57,169	1,739,527	18,808
Investment securities held to maturity (amortized cost)	150,486	134,856	-	-	134,856
Equity Securities (fair value)	413	413	413	-	-
Other investment securities (amortized cost)	43,119	43,119	-	43,119	-
Loans held for sale (lower of cost or market)	91,375	91,736	-	26,791	64,945
Loans held for investment (amortized cost)	8,695,890				
Less: allowance for loan and lease losses	(225,856)				
Loans held for investment, net of allowance	$ 8,470,034	8,262,128	-	-	8,262,128
Derivatives, included in assets (fair value)	668	668	-	668	-
Liabilities:					
Deposits (amortized cost)	9,066,465	9,070,024	-	9,070,024	-
Securities sold under agreements to repurchase (amortized cost)	200,000	226,076	-	226,076	-
Advances from FHLB (amortized cost)	715,000	701,079	-	701,079	-
Other borrowings (amortized cost)	184,150	171,378	-	-	171,378
Derivatives, included in liabilities (fair value)	735	735	-	735	-

(In thousands)	Total Carrying Amount in Statement of Financial Condition December 31, 2017	Fair Value Estimate December 31, 2017	Level 1	Level 2	Level 3
Assets:					
Cash and due from banks and money					

market investments (amortized cost)	$ 716,395	$ 716,395	$ 716,395	$ -	$ -
Investment securities available for sale (fair value)	1,891,016	1,891,016	7,819	1,863,342	19,855
Investment securities held to maturity (amortized cost)	150,627	131,032	-	-	131,032
Other investment securities (amortized cost)	43,119	43,119	-	43,119	-
Loans held for sale (lower of cost or market)	32,980	34,979	-	25,237	9,742
Loans held for investment (amortized cost)	8,850,476	-	-	-	-
Less: allowance for loan and lease losses	(231,843)	-	-	-	-
Loans held for investment, net of allowance	$ 8,618,633	8,372,865	-	-	8,372,865
Derivatives, included in assets (fair value)	312	312	-	312	-
Liabilities:					
Deposits (amortized cost)	9,022,631	9,026,600	-	9,026,600	-
Securities sold under agreements to repurchase (amortized cost)	300,000	325,913	-	325,913	-
Advances from FHLB (amortized cost)	715,000	707,272	-	707,272	-
Other borrowings (amortized cost)	208,635	189,424	-	-	189,424
Derivatives, included in liabilities (fair value)	324	324	-	324	-

The short-term nature of certain assets and liabilities result in their carrying value approximating fair value. These include cash and due from banks and other short-term assets, such as FHLB stock. Certain assets, the most significant being premises and equipment, mortgage servicing rights, deposits base, and other customer relationship intangibles, are not considered financial instruments and are not included above. Accordingly, this fair value information is not intended to, and does not, represent the Corporation's underlying value. Many of these assets and liabilities subject to the disclosure requirements are not actively traded, requiring management to estimate fair values. These estimates necessarily involve the use of judgment about a wide variety of factors, including but not limited to, relevancy of market prices of comparable instruments, expected futures cash flows, and appropriate discount rates.

NOTE 22 – REVENUE FROM CONTRACTS WITH CUSTOMERS

As noted in Note 1, the Corporation adopted the provisions of ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* on January 1, 2018. Results for reporting periods beginning after December 31, 2017 are presented under Topic 606, while prior period amounts have not been adjusted and continue to be reported in accordance with Topic 605.

Revenue Recognition

In accordance with Topic 606, revenues are recognized when control of promised goods or services is transferred to customers in an amount that reflects the consideration to which the Corporation expects to be entitled in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Corporation performs the following five steps: (i) identifies the contract(s) with a customer; (ii) identifies the performance obligations in the contract; (iii) determines the transaction price; (iv) allocates the transaction price to the performance obligations in the contract; and (v) recognizes revenue when (or as) the Corporation satisfies a performance obligation. The Corporation only applies the five-step model to contracts when it is probable that the entity will collect the consideration to which it is entitled in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, the Corporation assesses the goods or services that are promised within each contract and identifies those that contain performance obligations, and assesses whether each promised good or service is distinct. The Corporation then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

Disaggregation of Revenue

The following table summarizes the Corporation's revenue, which includes net interest income on financial instruments and non-interest income, disaggregated by type of service and business segments for the quarter ended March 31, 2018:

(In thousands)	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	United States Operations	Virgin Islands Operations	Total
For the quarter ended March 31, 2018:							
Net interest income (1)	**$ 21,205**	**$ 51,049**	**$ 18,920**	**$ 12,518**	**$ 13,392**	**$ 7,609**	**$ 124,693**

Service charges and fees on deposit accounts	-	3,165	1,092	-	134	697	5,088
Insurance commissions	-	3,144	-	-	12	199	3,355
Merchant-related income	-	645	161	-	-	185	991
Credit and debit card fees	-	4,169	255	-	128	542	5,094
Other service charges and fees	33	800	300	-	1,039	82	2,254
Not in scope of Topic 606 (1)	4,051	7	(549)	2,378	95	20	6,002
Total non-interest income	4,084	11,930	1,259	2,378	1,408	1,725	22,784
Total Revenue	**$ 25,289**	**$ 62,979**	**$ 20,179**	**$ 14,896**	**$ 14,800**	**$ 9,334**	**$ 147,477**

(1) Most of the Corporation's revenue is not within the scope of ASU No. 2014-09, *Revenue from Contracts with Customers*. The guidance explicitly excludes net interest income from financial assets and liabilities, as well as other noninterest income from loans, leases, investment securities and derivative financial instruments.

For the three months ended March 31, 2018, substantially all of the Corporation's revenue under the scope of Topic 606 was related to performance obligations satisfied at a point in time.

The following is a discussion of revenues within the scope of Topic 606.

Service Charges and Fees on Deposit Accounts

Service charges and fees on deposit accounts relate to fees generated from a variety of deposit products and services rendered to customers. Charges include, but are not limited to, overdraft fees, non-sufficient fund fees, dormant fees and monthly service charges. Such fees are recognized concurrently with the event on a daily basis or on a monthly basis depending upon the customer's cycle date. These depository arrangements are considered day-to-day contracts that do not extend beyond the services performed, as customers have the right to terminate these contracts with no penalty or, if any, nonsubstantive penalties. As a consequence, the income recognition under the standard is not different for the Corporation's practice before the adoption of this guidance.

Insurance Commissions

For insurance commissions, which include regular and contingent commissions paid to the Corporation's insurance agency, the agreements contain a performance obligation related to the sale/issuance of the policy and ancillary administrative post-issuance support. The performance obligation will be satisfied as the policies are issued and revenue will be recognized at that point in time. In addition, contingent commission income was found to be constrained, as defined under the new standard. Contingent commission income will be included in the transaction price only to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur or payments are received, which is consistent with the Corporation's practice before the adoption of this guidance. For the quarter ended March 31, 2018, the Corporation recognized revenue of $2.1 million as payments were received and constraints were released.

Merchant-related Income

For merchant-related income, the determination of which included the consideration of a 2015 sale of merchant contracts that involved sales of point of sale ("POS") terminals and entry into a marketing alliance under a revenue-sharing agreement, the Corporation concluded that control of the POS terminals and merchant contracts was transferred to the customer at the contract's inception. With respect to the related revenue-sharing agreement, the Corporation satisfies the marketing alliance performance obligation over the life of the contract, and the associated transaction price is recognized as the entity performs and any constraints over the variable consideration are resolved. There was no material change in the timing or measurement of revenues. The overall effect on an ongoing basis of the new revenue guidance, as compared the Corporation's practice before the adoption of this guidance, is expected to be immaterial.

Credit and Debit Card Fees

Credit and debit card fees primarily represent revenues earned from interchange fees and ATM fees. Interchange and network revenues are earned on credit and debit card transactions conducted with payment networks. ATM fees are primarily earned as a result of surcharges assessed to non-FirstBank customers who use a FirstBank ATM. Such fees are generally recognized concurrently with the delivery of services on a daily basis. As a consequence, the income recognition is unchanged from the Corporation's practice before the adoption of this guidance.

Other Fees

Other fees primarily include revenues generated from wire transfers, lockboxes, and bank issuances of checks. Such fees are recognized concurrently with the event or on a monthly basis.

Contract Balances

A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer. As mentioned above, during 2015, the Bank entered into a long-term strategic marketing alliance with another entity to which the Bank sold its merchant contracts portfolio and related POS terminals. Merchant services are marketed through FirstBank's branches and offices in Puerto Rico and the Virgin Islands. Under the marketing and referral agreement, FirstBank shares with this entity revenues generated by the merchant contracts over the term of the 10-year agreement. As of March 31, 2018 and December 31, 2017, this contract liability amounted to $2.3 million and $2.4 million, respectively, which will be recognized over the remaining term of the contract. For the quarter ended March 31, 2018, the Corporation recognized revenue and contract liabilities decreased by approximately $0.1 million due to the passage of time. There were no changes in contract liabilities due to changes in transaction price estimates**.**

A contract asset is the right to consideration for transferred goods or services when the amount is conditioned on something other than the passage of time. As of March 31, 2018 and December 31, 2017, there were no receivables from contracts with customers or contract assets recorded on the Corporation's consolidated financial statements.

Other

Except for the contract liabilities noted above, the Corporation did not have any significant performance obligations as of March 31, 2018. The Corporation also did not have any material contract acquisition costs and did not make any significant judgments or estimates in recognizing revenue for financial reporting purposes.

NOTE 23 – SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information is as follows:

	Quarter Ended March 31,			
		2018		2017
(In thousands)				
Cash paid for:				
Interest on borrowings	$	24,353	$	22,001
Non-cash investing and financing activities:				
Additions to OREO		15,867		13,597
Additions to auto and other repossessed assets		17,508		11,516
Capitalization of servicing assets		887		875
Loan securitizations		54,382		60,525
Loans held for investment transferred to held for sale		67,937		-
Property plant and equipment transferred to other assets		-		1,185

NOTE 24 – SEGMENT INFORMATION

Based upon the Corporation’s organizational structure and the information provided to the Chief Executive Officer of the Corporation and, to a lesser extent, the Board of Directors, the operating segments are based primarily on the Corporation’s lines of business for its operations in Puerto Rico, the Corporation’s principal market, and by geographic areas for its operations outside of Puerto Rico. As of March 31, 2018, the Corporation had six reportable segments: Commercial and Corporate Banking; Mortgage Banking; Consumer (Retail) Banking; Treasury and Investments; United States Operations; and Virgin Islands Operations. Management determined the reportable segments based on the internal reporting used to evaluate performance and to assess where to allocate resources. Other factors such as the Corporation’s organizational chart, nature of the products, distribution channels, and the economic characteristics of the product were also considered in the determination of the reportable segment.

The Commercial and Corporate Banking segment consists of the Corporation's lending and other services for large customers represented by specialized and middle-market clients and the public sector. The Commercial and Corporate Banking segment offers commercial loans, including commercial real estate and construction loans, and floor plan financings, as well as other products, such as cash management and business management services. The Mortgage Banking segment consists 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 and mortgage bankers. 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 that are executed to manage and enhance liquidity. This segment also lends funds to the Commercial and Corporate Banking, Mortgage Banking and Consumer (Retail) Banking segments to finance their lending resources and also borrows from those segments. The Consumer (Retail) Banking and the United States Operations segments also lend funds to the other segments. The interest rates charged or credited by Treasury and Investments, the Consumer (Retail) Banking, and the United States Operations 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 United States Operations segment consists of all banking activities conducted by FirstBank in the United States mainland, including commercial and retail banking services. The Virgin Islands Operations segment consists of all banking activities conducted by the Corporation in the USVI and BVI, including commercial and retail banking services.

The accounting policies of the segments are the same as those referred to in Note 1, "Nature of Business and Summary of Significant Accounting Policies," in the audited consolidated financial statements of the Corporation for the year ended December 31, 2017, which are included in the Corporation's 2017 Annual Report on Form 10-K.

The Corporation evaluates the performance of the segments based on net interest income, the 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.

The following table presents information about the reportable segments:

(In thousands)	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	United States Operations	Virgin Islands Operations	Tota
For the quarter ended March 31, 2018:							
Interest income	$ 32,321	$ 42,550	$ 32,337	$ 14,254	$ 19,527	$ 8,429	$ 149
Net (charge) credit for transfer of funds	(11,116)	15,222	(13,417)	9,974	(663)	-	
Interest expense	-	(6,723)	-	(11,710)	(5,472)	(820)	(24,
Net interest income	21,205	51,049	18,920	12,518	13,392	7,609	124
Provision for loan and lease losses	(381)	(5,793)	(6,800)	-	(1,459)	(6,111)	(20,
Non-interest income	4,084	11,930	1,259	2,378	1,408	1,725	22
Direct non-interest expenses	(7,720)	(26,901)	(6,714)	(948)	(7,956)	(7,622)	(57,
Segment income (loss)	$ 17,188	$ 30,285	$ 6,665	$ 13,948	$ 5,385	$ (4,399)	$ 69
Average earnings assets	$ 2,293,482	$ 1,566,795	$ 2,632,220	$ 2,470,830	$ 1,709,918	$ 571,199	$ 11,244

(In thousands)	Mortgage Banking	Consumer (Retail) Banking	Commercial and Corporate	Treasury and Investments	United States Operations	Virgin Islands Operations	Tota
For the quarter ended March 31, 2017:							
Interest income	$ 33,958	$ 42,917	$ 29,411	$ 13,757	$ 15,789	$ 9,396	$ 145
Net (charge) credit for transfer of funds	(11,698)	4,909	(9,318)	16,233	(126)	-	
Interest expense	-	(5,900)	-	(11,806)	(4,195)	(778)	(22,
Net interest income	22,260	41,926	20,093	18,184	11,468	8,618	122
(Provision) release for loan and lease losses	(8,936)	(7,142)	(8,055)	-	35	(1,344)	(25,
Non-interest income (loss)	3,586	13,379	1,237	(12,170)	505	1,706	8
Direct non-interest expenses	(9,879)	(27,418)	(9,367)	(1,207)	(7,859)	(6,750)	(62,
Segment income	$ 7,031	$ 20,745	$ 3,908	$ 4,807	$ 4,149	$ 2,230	$ 42
Average earnings assets	$ 2,500,750	$ 1,775,931	$ 2,548,936	$ 2,157,882	$ 1,393,215	$ 617,820	$ 10,994

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

	Quarter Ended March 31, 2018	2017
Net income:		
Total income for segments and other	$ 69,072	$ 42,870
Other operating expenses (1)	(28,166)	(25,402)
Income before income taxes	40,906	17,468
Income tax (expense) benefit	(7,758)	8,073

Total consolidated net income	$	33,148	$	25,541
Average assets:				
Total average earning assets for segments	$	11,244,444	$	10,994,534
Average non-earning assets		947,460		886,492
Total consolidated average assets	$	12,191,904	$	11,881,026

(1) Expenses pertaining to corporate administrative functions that support the operating segment but are not specifically attributable to or managed by any segment are not included in the reported financial results of the operating segments. The unallocated corporate expenses include certain general and administrative expenses and related depreciation and amortization expenses.

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NOTE 25 – REGULATORY MATTERS, COMMITMENTS AND CONTINGENCIES

The Corporation and FirstBank are each subject to various regulatory capital requirements imposed by the federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material adverse effect on the Corporation’s financial statements and activities. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation must meet specific capital guidelines that involve quantitative measures of the Corporation’s and FirstBank’s assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Corporation’s capital amounts and classifications are also subject to qualitative judgments and adjustment by the regulators with respect to minimum capital requirements, components, risk weightings, and other factors.

On October 3, 2017, the New York FED terminated the Written Agreement entered into on June 3, 2010 between the Corporation and the New York FED. However, the Corporation has agreed with the New York FED to continue to obtain the approval of the New York FED before paying dividends, receiving dividends from the Bank, making payments on subordinated debt or trust preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock.

Although the Corporation and FirstBank became subject to the U.S. Basel III capital rules (“Basel III rules”) beginning on January 1, 2015, certain requirements of the Basel III rules are being phased-in over several years and, in general, will be fully effective as of January 1, 2019, although certain elements of the new rules have recently been deferred by the federal banking agencies. The Corporation and FirstBank compute risk-weighted assets using the Standardized Approach required by the Basel III rules.

The Basel III rules require the Corporation to maintain an additional capital conservation buffer of 2.5% to avoid limitations on both (i) capital distributions (e.g., repurchases of capital instruments, dividends and interest payments on capital instruments), and (ii) discretionary bonus payments to executive officers and heads of major business lines. The phase-in of the capital conservation buffer began on January 1, 2016 with a first year requirement of 0.625% of additional Common Equity Tier 1 Capital (“CET1”), which is being progressively increased over a four-year period, increasing by that same percentage amount on each subsequent January 1 until it reaches the fully phased-in 2.5% CET1 requirement on January 1, 2019.

Under the fully phased-in Basel III rules, in order to be considered adequately capitalized, the Corporation will be required to maintain: (i) a minimum CET1 capital to risk-weighted assets ratio of at least 4.5%, plus the 2.5% capital conservation buffer, resulting in a required minimum CET1 ratio of at least 7%, (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5%, (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5%, and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average

on-balance sheet (non-risk adjusted) assets.

In addition, as required under the Basel III rules, the Corporation's trust preferred securities ("TRuPs") were fully phased-out from Tier 1 capital as of January 1, 2016. However, the Corporation's TRuPs may continue to be included in Tier 2 capital until the instruments are redeemed or mature.

On November 21, 2017, the Federal Reserve Board, the FDIC, and the Office of the Comptroller of the Currency finalized an extension of the phase-in of certain Basel III capital rules for banks not using the Basel advanced approaches. The extension, which was effective January 1, 2018, pauses the full transition to the Basel III treatment of mortgage servicing assets, certain deferred tax assets, investments in the capital of unconsolidated financial institutions and minority interests, pending the banking agencies' broader efforts, announced in September 2017, to simplify the regulatory capital rules that apply to banking organizations that are not subject to the advanced approaches capital rules. Because the advanced approaches capital rules apply to banking organizations with more than $250 billion in total consolidated assets or at least $10 billion in total on-balance sheet foreign exposure, the extension relief applies broadly to community, midsize, and regional banks, including the Corporation and FirstBank.

Please refer to the discussion in "Part I, – Item 1, – Business – Supervision and Regulation," included in the Corporation's 2017 Annual Report on Form 10-K for a more complete discussion of supervision and regulatory matters and activities that affect the Corporation and its subsidiaries.

The Corporation's and its banking subsidiary's regulatory capital positions as of March 31, 2018 and December 31, 2017 were as follows:

		Regulatory Requirements				
	Actual		For Capital Adequacy Purposes		To be Well-Capitalized-General Thresholds	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
As of March 31, 2018						
Total Capital (to Risk-Weighted Assets)						
First BanCorp.	$ 1,990,146	22.98%	$ 692,691	8.0%	N/A	N/A
FirstBank	$ 1,950,261	22.52%	$ 692,671	8.0%	$ 865,838	10.0%
Common Equity Tier 1 Capital (to Risk-Weighted Assets)						
First BanCorp.	$ 1,665,842	19.24%	$ 389,639	4.5%	N/A	N/A
FirstBank	$ 1,532,690	17.70%	$ 389,627	4.5%	$ 562,795	6.5%
Tier I Capital (to Risk-Weighted Assets)						
First BanCorp.	$ 1,701,946	19.66%	$ 519,518	6.0%	N/A	N/A
FirstBank	$ 1,840,690	21.26%	$ 519,503	6.0%	$ 692,671	8.0%
Leverage ratio						
First BanCorp.	$ 1,701,946	14.18%	$ 480,078	4.0%	N/A	N/A
FirstBank	$ 1,840,690	15.35%	$ 479,527	4.0%	$ 599,408	5.0%
As of December 31, 2017						
Total Capital (to Risk-Weighted Assets)						
First BanCorp.	$ 1,989,873	22.53%	$ 706,432	8.0%	N/A	N/A
FirstBank	$ 1,947,627	22.06%	$ 706,218	8.0%	$ 882,772	10.0%
Common Equity Tier 1 Capital (to Risk-Weighted Assets)						
First BanCorp.	$ 1,674,164	18.96%	$ 397,368	4.5%	N/A	N/A
FirstBank	$ 1,562,431	17.70%	$ 397,248	4.5%	$ 573,802	6.5%
Tier I Capital (to Risk-Weighted Assets)						
First BanCorp.	$ 1,675,282	18.97%	$ 529,824	6.0%	N/A	N/A
FirstBank	$ 1,835,445	20.79%	$ 529,663	6.0%	$ 706,218	8.0%
Leverage ratio						
First BanCorp.	$ 1,675,282	14.03%	$ 477,643	4.0%	N/A	N/A
FirstBank	$ 1,835,445	15.39%	$ 477,056	4.0%	$ 596,320	5.0%

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 March 31, 2018, commitments to extend credit amounted to approximately $1.2 billion, of which $650.5 million relates to credit card loans. Commercial and Financial standby letters of credit amounted to approximately $43.3 million. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to making additional disbursements. In the case of credit cards and personal lines of credit, the Corporation can cancel the unused credit facility at any time and without cause.

As of March 31, 2018, First BanCorp. and its subsidiaries were defendants in various legal proceedings arising in the ordinary course of business. On at least a quarterly basis, the Corporation assesses its liabilities and contingencies in connection with threatened and outstanding legal cases, matters and proceedings, utilizing the latest information available. For cases, matters and proceedings where it is both probable the Corporation will incur a loss and the amount can be reasonably estimated, the Corporation establishes an accrual for the loss. Once established, the accrual is adjusted as appropriate to reflect any relevant developments. For cases, matters or proceedings where a loss is not probable or the amount of the loss cannot be estimated, no accrual is established.

Any estimate involves significant judgment, given the varying stages of the proceedings (including the fact that some of them are currently in preliminary stages), the existence of multiple defendants in some of the current proceedings whose share of liability has yet to be determined, the numerous unresolved issues in the proceedings, and the inherent uncertainty of the various potential outcomes of such proceedings. Accordingly, the Corporation's estimate will change from time-to-time, and actual losses may be more or less than the current estimate.

While the final outcome of legal cases, matters, and proceedings is inherently uncertain, based on information currently available, Management believes that the final disposition of the Corporation's legal cases, matters or proceedings, to the extent not previously provided for, will not have a material negative adverse effect on the Corporation's consolidated financial position as a whole.

If management believes that, based on available information, it is at least reasonably possible that a material loss (or additional material loss in excess of any accrual) will be incurred in connection with any legal actions, the Corporation discloses an estimate of the possible loss or range of loss, either individually or in the aggregate, as appropriate, if such an estimate can be made, or discloses that an estimate cannot be made. Based on the Corporation's assessment as of March 31, 2018, no such disclosures were necessary. However, in the event of unexpected future developments, it is possible that the ultimate resolution of these cases, matters and proceedings, if unfavorable, may be material to the Corporation's consolidated financial position on a particular period.

NOTE 24 – SEGMENT INFORMATION

Ramirez Torres, et al. v Banco Popular de Puerto Rico, et al. FirstBank Puerto Rico is named a defendant in a class action complaint, filed on February 17, 2017 at the Court of First Instance in San Juan, Puerto Rico, captioned *Ramirez Torres, et al. v. Banco Popular de Puerto Rico, et al.* The complaint seeks damages and preliminary and permanent injunctive relief on behalf of the purported class against Banco Popular de Puerto Rico and other financial institutions with insurance agency subsidiaries in Puerto Rico. Plaintiffs contend that in November 2015, Antilles Insurance Company obtained approval from the Puerto Rico Insurance Commissioner to market an endorsement that allowed its customers to obtain a reimbursement of their insurance premium for good experience, but that defendants failed to offer this product or disclose its existence to their customers, favoring other products instead, in violation of their fiduciary duties as insurance producers. Plaintiffs seek a determination that defendants unlawfully failed to comply with their fiduciary duty to disclose the existence of this new insurance benefit from this carrier, as well as double or treble damages (the latter subject to a determination that defendants engaged in anti-monopolistic practices in failing to offer this product). On July 31, 2017, the court entered judgment dismissing the complaint with prejudice. On August 30, 2017, Plaintiffs filed an Appeal before the Court of Appeals and FirstBank filed its opposition. On March 20, 2018, the Court of Appeals entered Judgment revoking the Court of First Instance, ordering a class certification hearing as well as a preliminary injunction hearing. Our lawyers intend to file a writ of Certiorari in the Supreme Court.

NOTE 26 – FIRST BANCORP. (HOLDING COMPANY ONLY) FINANCIAL INFORMATION

The following condensed financial information presents the financial position of the Holding Company only as of March 31, 2018 and December 31, 2017, and the results of its operations for the quarters ended March 31, 2018 and 2017.

Statements of Financial Condition

(In thousands)		As of March 31, 2018		As of December 31, 2017
Assets				
Cash and due from banks	$	16,866	$	20,864
Money market investments		6,111		6,111
Other investment securities		285		285
Loans held for investment, net		178		191
Investment in First Bank Puerto Rico, at equity		2,015,111		2,028,641
Investment in First Bank Insurance Agency, at equity		14,933		12,400
Investment in FBP Statutory Trust I		1,963		2,698
Investment in FBP Statutory Trust II		3,561		3,561
Other assets		5,671		3,799
Total assets	$	2,064,679	$	2,078,550
Liabilities and Stockholders' Equity				
Liabilities:				
Other borrowings	$	184,150	$	208,635
Accounts payable and other liabilities		3,425		818
Total liabilities		187,575		209,453
Stockholders' equity		1,877,104		1,869,097
Total liabilities and stockholders' equity	$	2,064,679	$	2,078,550

Statements of Income

	Quarter Ended	
	March 31, 2018	**March 31, 2017**
	(In thousands)	
Income:		
Interest income on money market investments	$ 5	$ 5
Dividends from banking subsidiary	21,584	1,930
Other income	63	62
	21,652	1,997
Expense:		
Other borrowings	2,085	1,963
Other operating expenses	596	967
	2,681	2,930
Gain on early extinguishment of debt	2,316	-
Income (loss) income before income taxes and equity in undistributed earnings of subsidiaries	21,287	(933)
Equity in undistributed earnings of subsidiaries	11,861	26,474
Net income	$ 33,148	$ 25,541
Other comprehensive (loss) income, net of tax	(24,047)	10,696
Comprehensive income	$ 9,101	$ 36,237

NOTE 27 – SUBSEQUENT EVENTS

The Corporation has performed an evaluation of events occurring subsequent to March 31, 2018; management has determined that there were no events occurring in this period that require disclosure in or adjustment to the accompanying financial statements.

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 March 31, 2018**	**2017**
Condensed Income Statements:		
Total interest income	$ 149,418	$ 145,228
Total interest expense	24,725	22,679
Net interest income	124,693	122,549
Provision for loan and lease losses	20,544	25,442
Non-interest income	22,784	8,243
Non-interest expenses	86,027	87,882
Income before income taxes	40,906	17,468
Income tax (expense) benefit	(7,758)	8,073
Net income	33,148	25,541
Net income attributable to common stockholders	32,479	24,872
Per Common Share Results:		
Net earnings per common share-basic	$ 0.15	$ 0.12
Net earnings per common share-diluted	$ 0.15	$ 0.11
Cash dividends declared	$ -	$ -
Average shares outstanding	214,646	213,340
Average shares outstanding diluted	216,214	217,373
Book value per common share	$ 8.51	$ 8.18
Tangible book value per common share (1)	$ 8.32	$ 7.97
Selected Financial Ratios (In Percent):		
Profitability:		
Return on Average Assets	1.10	0.87
Interest Rate Spread	4.05	4.15
Net Interest Margin	4.40	4.42
Interest Rate Spread - tax equivalent basis (2)	4.22	4.31
Net Interest Margin - tax equivalent basis (2)	4.57	4.58
Return on Average Total Equity	7.22	5.77
Return on Average Common Equity	7.37	5.88
Average Total Equity to Average Total Assets	15.27	15.12
Tangible common equity ratio (1)	14.80	14.70
Dividend payout ratio	-	-
Efficiency ratio (3)	58.33	67.19
Asset Quality:		
Allowance for loan and lease losses to total loans held for investment	2.60	2.30
Net charge-offs (annualized) to average loans (4)	1.21	1.26
Provision for loan and lease losses to net charge-offs	77.43	91.47
Non-performing assets to total assets (4)	5.22	5.44
Non-performing loans held for investment to total loans held for investment (4)	4.74	5.41

Allowance to total non-performing loans held for investment (4)	54.82	42.56
Allowance to total non-performing loans held for investment, excluding residential real estate loans	93.87	62.98
Other Information:		
Common Stock Price: End of period	$ 6.02	$ 5.65

	As of March 31, 2018	As of December 31, 2017
Balance Sheet Data:		
Loans, including loans held for sale	$ 8,787,265	$ 8,883,456
Allowance for loan and lease losses	225,856	231,843
Money market and investment securities	2,109,937	2,095,177
Intangible assets	41,345	42,351
Deferred tax asset, net	289,338	294,809
Total assets	12,200,386	12,261,268
Deposits	9,066,465	9,022,631
Borrowings	1,099,150	1,223,635
Total preferred equity	36,104	36,104
Total common equity	1,885,662	1,853,608
Accumulated other comprehensive loss, net of tax	(44,662)	(20,615)
Total equity	1,877,104	1,869,097

(1) Non-GAAP financial measures. Refer to "Capital" below for additional information about the components and a reconciliation of these measures.

(2) On a tax-equivalent basis and excluding the changes in fair value of derivative instruments (see "Net Interest Income" below for a reconciliation of these non-GAAP financial measures).

(3) Non-interest expenses to the sum of net interest income and non-interest income.

(4) Loans used in the denominator in calculating each of these ratios include purchased credit-impaired ("PCI") loans. However, the Corporation separately tracks and reports PCI loans and excludes these from non-performing loan and non-performing asset amounts.

The following MD&A relates to the accompanying unaudited consolidated financial statements of First BanCorp. (the "Corporation" or "First BanCorp.") and should be read in conjunction with such financial statements and the notes thereto. This section also presents certain financial measures that are not based on generally accepted accounting principles in the United States ("GAAP"). Refer to *Basis of Presentation* below for information about why the non-GAAP financial measures are being presented and the reconciliation of the non-GAAP financial measures for which the reconciliation is not presented earlier.

EXECUTIVE SUMMARY

First BanCorp. is a diversified financial holding company headquartered in San Juan, Puerto Rico offering a full range of financial products to consumers and commercial customers through various subsidiaries. First BanCorp. is the holding company of FirstBank Puerto Rico ("FirstBank" or the "Bank") and FirstBank Insurance Agency. Through its wholly-owned subsidiaries, the Corporation operates offices in Puerto Rico, the United States Virgin Islands and British Virgin Islands, and the State of Florida (USA), concentrating on commercial banking, residential mortgage loan originations, finance leases, credit cards, personal loans, small loans, auto loans, and insurance agency and broker-dealer activities.

OVERVIEW OF RESULTS OF OPERATIONS

First BanCorp.'s results of operations depend primarily on 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 incurred 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, the deposit insurance premium and other costs), non-interest income (mainly service charges and fees on deposits, insurance income and revenues from broker-dealer operations), gains (losses) on sales of investments, gains (losses) on mortgage banking activities, and income taxes.

The Corporation had net income of $33.1 million, or $0.15 per diluted common share, for the quarter ended March 31, 2018, compared to $25.5 million, or $0.11 per diluted common share, for the same period in 2017.

The key drivers of the Corporation's GAAP financial results include the following:

- Net interest income increased by $2.1 million to $124.7 million for the quarter ended March 31, 2018 compared to $122.5 million for the same period in 2017. The increase in net interest income was driven primarily by: (i) a $3.0 million increase in interest income on commercial and construction loans, primarily associated with the upward repricing of variable-rate commercial loans; (ii) a $1.8 million increase in interest income from interest-bearing cash balances, primarily deposits maintained at the Federal Reserve Bank of New York ("New York FED"), due to both higher average balance and increases in the Federal Funds target rate; and (iii) a $0.7 million increase in interest income on investment securities primarily due to the gradual investment of liquidity in higher-yielding U.S agency debt securities.

The aforementioned variances were partially offset by: (i) a $2.0 million increase in interest expense primarily reflecting the effect of higher market interest rates on the cost of Federal Home Loan Bank of New York ("FHLB") advances, brokered certificates of deposit ("CDs"), retail CDs, and commercial money market accounts tied to short-term interest rates, partially offset by a $262.4 million decrease in the average balance of total interest-bearing liabilities, primarily brokered CDs and repurchase agreements; (ii) a $0.9 million decrease in interest income on residential mortgage loans associated with both a $33.7 million decrease in the average balance of this portfolio and higher inflows of loans to non-performing status as compared to the first quarter of 2017; and (iii) a $0.4 million decrease in interest income on consumer loans primarily due to higher non-performing auto loan levels.

The net interest margin decreased slightly to 4.40% for the first quarter of 2018 compared to 4.42% for the same period a year ago, primarily related to higher non-performing residential and consumer loan levels. Refer to *Net Interest Income* below for additional information.

- The provision for loan and lease losses decreased by $4.9 million to $20.5 million for the first quarter of 2018 compared to $25.4 million for the same period in 2017. The decrease was driven by: (i) an $8.8 million decrease in the provision for residential mortgage loans, primarily related to lower charge-off levels and the effect in the first quarter of 2017 of adjustments to the loss severity estimates used in the calculation of the general reserve, including adjustments to liquidation cost assumptions, and (ii) a $1.5 million decrease in the provision for consumer loans, primarily related to a $2.0 million reserve release in the first quarter of 2018 resulting from payments received that reduced the balance of the consumer loan portfolio outstanding on the dates of the hurricanes. These variances were partially offset by a $5.4 million increase in the provision for commercial and construction loans driven by a $5.6 million charge recorded in connection with $57.2 million in loans transferred to held for sale during the first quarter of 2018, and the downgrade in the credit risk classification of a $46.8 million commercial mortgage loan in Florida,

partially offset by a net loan loss reserve release of approximately $4.2 million related to revised estimates to the reserves associated with the effects of Hurricanes Maria and Irma resulting from updated assessments of financial performance and repayment prospects of certain individually-assessed commercial credits.

During the first quarter of 2018, the Corporation transferred to held for sale three non-performing commercial and construction loans. The aggregate recorded investment in these loans was written down to $57.2 million, which resulted in charge-offs of $9.7 million and an incremental loss of $5.6 million reflected in the provision for loan and lease losses for the first quarter of 2018.

Net charge-offs totaled $26.5 million for the first quarter of 2018, or 1.21% of average loans on an annualized basis, compared to $27.8 million, or 1.26% of average loans for the same period in 2017. The decrease reflects a reduction of $4.4 million in net charge-offs taken on residential mortgage loans, partially offset by a $1.7 million increase in net charge-offs of commercial and construction loans and a $1.5 million increase in net charge-offs of consumer loans. The increase in net charge-offs of commercial and construction loans reflects the effects of the aforementioned $9.7 million in charge-offs taken on loans transferred to held for sale, a $1.3 million charge-off taken on a $5.6 million adversely classified loan sold during the first quarter of 2018, and a $1.2 million decrease in loan loss recoveries, partially offset by a $10.7 million charge-off recorded on the sale of the Corporation's participation in the Puerto Rico Electric Power Authority ("PREPA") line of credit in the first quarter of 2017. The increase in net charge-offs of consumer loans primarily reflects the effect in the first quarter of 2017 of a loan loss recovery of $1.2 million on the sale of certain credit card loans that had been fully charged-off in prior periods. Refer to *Provision for loan and lease losses* and *Risk Management* below for an analysis of the allowance for loan and lease losses and non-performing assets and related ratios.

- The Corporation recorded non-interest income of $22.8 million for the first quarter of 2018, compared to $8.2 million for the same period in 2017. The increase was primarily driven by: (i) the impact in the first quarter of 2017 of a $12.2 million other-than-temporary impairment ("OTTI") charge on bonds of the Government Development Bank for Puerto Rico (the "GDB") and the Puerto Rico Public Buildings Authority that were subsequently sold in the second quarter of 2017; (ii) a $2.3 million gain on the repurchase and cancellation of $23.8 million in trust preferred securities, and (iii) a $0.5 million increase in revenues from the mortgage banking activities driven by a $0.7 million adjustment recorded in the first quarter of 2018 to reduce the valuation allowance of mortgage servicing rights. These variances were partially offset by a $0.7 million decreases in service charges on deposit accounts. Refer to Non-Interest Income below for additional information.

- Non-interest expenses for the first quarter of 2018 was $86.0 million compared to $87.9 million for the same period in 2017. The decrease in non-interest expenses was largely driven by: (i) a $3.9 million decrease in losses on OREO operations, driven by a $3.6 million decrease in write-downs to the value of OREO properties; (ii) a $1.1 million decrease in the Federal Deposit Insurance Corporation ("FDIC") insurance premium expense reflecting, among other things, the effect of reductions in brokered CDs, a strengthened capital position, and higher liquidity levels tied to the growth in non-interest bearing deposits; and (iii) a $0.9 million decrease in professional service fees, primarily

due to reductions in attorneys' collection fees.

These variances were partially offset by: (i) a $2.0 million increase in employees' compensation and benefits expenses, reflecting costs associated with a cash transition award paid to certain senior officers of $0.6 million in connection with the previously-reported executive compensation program that became effective in the third quarter of 2017, a $0.4 million increase in stock-based compensation expense, and an increase of approximately $0.9 million in bonus expenses; (ii) a $1.0 million increase in occupancy and equipment costs, primarily resulting from hurricane-related expenses, such as repairs and security matters; and (iii) a $0.7 million increase resulting from lower net reserve releases related to unfunded loan commitments. Refer to *Non Interest Expenses* below for additional information.

- For the first quarter of 2018, the Corporation recorded income tax expense of $7.8 million, compared to an income tax benefit of $8.1 million for the same period in 2017. The variance was mostly attributable to the aforementioned $13.2 million tax benefit recorded in the first quarter of 2017 as a result of the change in tax status of certain subsidiaries from taxable corporations to limited liability companies that elected to be treated as partnerships for income tax purposes in Puerto Rico, as well as higher pre-tax earnings in the first quarter of 2018 and a higher estimated effective tax rate for 2018. The Corporation's estimated annual effective tax rate in the first quarter of 2018, excluding entities from which a tax benefit cannot be recognized and discrete items, was 27% compared to 24% for the first quarter of 2017. The estimated annual effective tax rate including all entities for 2018 was 19% (23% excluding discrete items), compared to 13% for the first quarter of 2017 (25% excluding discrete items, primarily the tax benefit resulting from the above-mentioned change in the tax status of certain subsidiaries). As of March 31, 2018, the Corporation had a net deferred tax asset of $289.3 million (net of a valuation allowance of $186.1 million). Refer to *Income Taxes* below for additional information.

- As of March 31, 2018, total assets were $12.2 billion, a decrease of $60.9 million from December 31, 2017. The decrease was mainly due to a $96.2 million decrease in total loans, primarily reflecting reductions of $83.8 million and $15.5 million in the Puerto Rico and Virgin Island regions, respectively, partially offset by a $3.1 million increase in the Florida region. The decrease reflects the effect of three large loans totaling $28.3 million that were paid off during the first quarter, two large loans totaling $14.8 million that were sold during the first quarter, and significant payments received, including payments that reduced the outstanding balance of three revolving commercial lines of credit in Puerto Rico by $24.2 million. Total investment securities decreased by $75.2 million, driven by U.S. agency MBS prepayments and a decrease in the fair value of available-for-sale investment securities. Accrued interest receivables on loans and investment securities decreased by $13.1 million, primarily related to interest payments collected on loans after the expiration in the first quarter of 2018 of the three-month payment deferral program extended to eligible customers affected by Hurricanes Maria and Irma. These variances were partially offset by a $127.4 million increase in cash and cash equivalents, largely driven by the growth in non-interest bearing deposits during the first quarter of 2018 and proceeds from U.S. agency MBS and loan repayments, partially offset by liquidity used to pay off maturing brokered CDs and a $100 million short-term repurchase agreement as well as for the repurchase of $23.8 million of trust preferred securities. Refer to *Financial Condition and Operating Data Analysis* below for additional information.

- As of March 31, 2018, total liabilities were $10.3 billion, a decrease of $68.9 million from December 31, 2017. The decrease was mainly due to the repayment at maturity of a $100 million short-term repurchase agreement, the repurchase and cancellation of $23.8 million in trust preferred securities, and a $194.4 million decrease in brokered CDs. These variances were partially offset by a $194.6 million increase in deposits, excluding government deposits and brokered CDs, primarily reflected in non-interest bearing deposits. Hurricane-related factors, such as the effect of payment deferral programs, disaster relief funds, and settlements of insurance claims contributed to this accumulation. Government deposits increased by $43.7 million, primarily related to an increase in the balance of a Puerto Rico government-owned corporation's transactional deposit account. Refer to *Risk Management – Liquidity Risk and Capital Adequacy* below for additional information about the Corporation's funding sources.

- As of March 31, 2018, the Corporation's stockholders' equity was $1.9 billion, an increase of $8.0 million from December 31, 2017. The increase was mainly driven by the earnings generated in the first quarter, partially offset by a decrease in the fair value of available-for-sale investment securities recorded as part of other comprehensive loss. The Corporation's Total Capital, Common Equity Tier 1 Capital, Tier 1 Capital and Leverage ratios calculated under the Basel III rules as currently in effect were 22.98%, 19.24%, 19.66%, and 14.18%, respectively, as of March 31, 2018, compared to Total Capital, Common Equity Tier 1 Capital, Tier 1 Capital and Leverage ratios of 22.53%, 18.96%, 18.97%, and 14.03%, respectively, as of December 31. 2017. Refer to *Risk Management – Capital* below for additional information.

- Total loan production, including purchases, refinancings, renewals and draws from existing revolving and non-revolving commitments, was $606.3 million for the quarter ended March 31, 2018, excluding the utilization activity on outstanding credit cards, compared to $867.6 million for the same period in 2017. The decrease was largely affected by the effect in the first quarter of 2017 of the refinancing and renewal of three large commercial loans in Puerto Rico totaling $176.4 million, and lower origination volumes on residential and consumer loans spread through all of the regions served by the Corporation.

- Total non-performing assets were $637.2 million as of March 31, 2018, a decrease of $13.4 million from December 31, 2017. The decrease was primarily attributable to charge-offs totaling $11.4 million taken on four commercial and construction loans, including $9.7 million associated with the aforementioned loans transferred to held for sale during the first quarter, and payments totaling $4.0 million received in the first quarter to reduce the outstanding balance of commercial mortgage loans that were previously guaranteed by the TDF.

- Adversely classified commercial and construction loans, including loans held for sale, increased by $24.9 million to $507.3 million as of March 31, 2018, driven by the downgrade in the credit risk classification of a $46.8 million commercial mortgage loan in the Florida region, partially offset by the sale of a $5.6 million commercial and industrial loan, collections, and charge offs.

The Corporation's financial results for the first quarter of 2018 and 2017 included the following items that management believes are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts (the "Special Items"):

Quarter ended March 31, 2018

- Positive effect in earnings of $4.8 million ($2.9 million after-tax) related to a $6.4 million net loan loss reserve release in connection with revised estimates of the reserves associated with the effects of Hurricanes Irma and Maria, partially offset by $1.6 million of hurricane-related expenses recorded in the first quarter. Refer to *Provision for Loan and Lease Losses* below for additional information.

- Charge to the provision for loan and lease losses of $5.6 million ($3.4 million after-tax) associated with three non-performing commercial and construction loans totaling $57.2 million that were transferred to held for sale during the first quarter. Refer to *Provision for Loan and Lease Losses* below for additional information.

- Gain of $2.3 million on the repurchase and cancellation of $23.8 million in trust preferred securities, reflected in the consolidated statement of income as "Gain on early extinguishment of debt." The gain, realized at the holding company level, had no effect on the income tax expense in 2018. Refer to *Non-Interest Income* below for additional information.

Quarter ended March 31, 2017

- Tax benefit of $13.2 million related to the change in tax status of certain subsidiaries from taxable corporations to limited liability companies that make an election to be treated as partnerships for income tax purposes in Puerto Rico. Refer to *Income Taxes* below for additional information.

- OTTI charge of $12.2 million on Puerto Rico government debt securities, specifically bonds of the GDB and the Puerto Rico Public Buildings Authority. No tax benefit was recognized for the OTTI charge in 2017.

- Charge to the provision for loan and lease losses of $0.6 million ($0.3 million after-tax) related to the sale of the Corporation's participation in the PREPA line of credit with a book value of $64 million at the time of sale. Refer

to *Provision for Loan and Lease Losses* below for additional information.

- Costs of $0.3 million associated with a secondary offering of the Corporation's common stock by certain of the existing stockholders. The costs, incurred at the holding company level, had no effect on the income tax expense in the quarter ended March 31, 2017 based on available operating expenses and net operating losses at the holding company level.

The following table reconciles for the first quarter of 2018 and 2017, the reported net income to adjusted net income, a non-GAAP financial measure that excludes the Special Items identified above:

	Quarter ended March 31,	
	2018	**2017**
(In thousands)		
Net income, as reported (GAAP)	$ 33,148	$ 25,541
Adjustments:		
Hurricane-related loan loss reserve release	(6,407)	-
Hurricane-related expenses	1,596	-
Charge to the provision related to loans transferred to held for sale	5,645	-
Gain on early extinguishment of debt	(2,316)	-
Income tax benefit related to change in tax-status of certain subsidiaries	-	(13,161)
Charge to the provision related to the sale of the PREPA credit line	-	569
Secondary offering costs	-	274
Other-than-temporary impairment on debt securities	-	12,231
Income tax impact of adjustments (1)	(324)	(222)
Adjusted net income	$ 31,342	$ 25,232

(1) See *Basis of Presentation* below for the individual tax impact for each reconciling item.

Critical Accounting Policies and Practices

The accounting principles of the Corporation and the methods of applying these principles conform to GAAP. The Corporation's critical accounting policies relate to: 1) the allowance for loan and lease losses; 2) other-than-temporary impairments; 3) income taxes; 4) the classification and values of financial instruments; 5) income recognition on loans; 6) loans acquired; and 7) loans held for sale. These critical accounting policies involve judgments, estimates and assumptions made by management that affect the amounts recorded for assets, liabilities and contingent liabilities 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 require 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's Discussion and Analysis of Financial Condition and Results of Operations included in First BanCorp.'s 2017 Annual Report on Form 10-K. There have not been any material changes in the Corporation's critical accounting policies since December 31, 2017.

RESULTS OF OPERATIONS

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 repricing and maturity mismatch of the Corporation's assets and liabilities. Net interest income for the quarter ended March 31, 2018 was $124.7 million compared to $122.5 million for the comparable period in 2017. On a tax-equivalent basis and excluding the changes in the fair value of derivative instruments, net interest income for the quarter ended March 31, 2018 was $129.5 million compared to $126.2 million for the comparable period in 2017.

The following tables include a detailed analysis of net interest income. Part I presents average volumes (based on the average daily balance) 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 the 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 and excluding the change in the fair value of derivative instruments. For the definition and reconciliation of this non-GAAP financial measure, refer to the discussions below.

Part I

Quarter ended March 31,	Average Volume		Interest income [1] / expense		Average Rate [1]	
	2018	**2017**	**2018**	**2017**	**2018**	**2017**
(Dollars in thousands)						
Interest-earning assets:						
Money market & other short-term investments	$ 618,468	$ 268,934	$ 2,256	$ 484	1.48%	0.73%
Government obligations (2)	798,186	729,307	6,193	4,360	3.15%	2.42%
Mortgage-backed securities	1,260,142	1,334,560	10,625	11,614	3.42%	3.53%
FHLB stock	40,937	39,560	693	461	6.87%	4.73%
Other investments	2,705	2,699	2	2	0.30%	0.30%
Total investments (3)	2,720,438	2,375,060	19,769	16,921	2.95%	2.89%
Residential mortgage loans	3,227,222	3,260,885	43,350	44,280	5.45%	5.51%
Construction loans	118,907	130,494	922	1,144	3.14%	3.56%
Commercial and Industrial and commercial mortgage loans	3,688,415	3,760,594	45,189	41,820	4.97%	4.51%
Finance leases	260,119	234,729	4,660	4,314	7.27%	7.45%
Consumer loans	1,484,305	1,475,569	40,306	41,070	11.01%	11.29%
Total loans (4) (5)	8,778,968	8,862,271	134,427	132,628	6.21%	6.07%
Total interest-earning assets	$ 11,499,406	$ 11,237,331	$ 154,196	$ 149,549	5.44%	5.40%
Interest-bearing liabilities:						
Brokered CDs	$ 1,043,255	$ 1,413,667	$ 4,355	$ 4,805	1.69%	1.38%
Other interest-bearing deposits	6,021,699	5,884,772	12,616	11,167	0.85%	0.77%
Other borrowed funds	414,488	516,187	4,382	4,585	4.29%	3.60%
FHLB advances	715,000	642,222	3,372	2,122	1.91%	1.34%
Total interest-bearing liabilities	$ 8,194,442	$ 8,456,848	$ 24,725	$ 22,679	1.22%	1.09%
Net interest income			$ 129,471	$ 126,870		
Interest rate spread					4.22%	4.31%
Net interest margin					4.57%	4.58%

(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 the Puerto Rico statutory tax rate of 39.0% and adding to it the cost of interest-bearing liabilities. The tax-equivalent adjustment recognizes the income tax savings when comparing taxable and tax-exempt assets. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread and net interest margin on a fully tax-equivalent basis. Therefore, management believes these measures provide useful information to investors by allowing them to make peer comparisons. Changes in the fair value of derivatives are excluded from interest income and interest expense because the changes in valuation do not affect interest received or paid.
(2)	Government obligations include debt issued by government-sponsored agencies.

(3)	Unrealized gains and losses on available-for-sale securities are excluded from the average volumes.
(4)	Average loan balances include the average of non-performing loans.
(5)	Interest income on loans included $1.8 million and $2.1 million for the first quarter of 2018 and 2017, respectively, of income from prepayment penalties and late fees related to the Corporation's loan portfolio.

Part II

(In thousands)	Quarter ended March 31, 2018 compared to 2017 Increase (decrease) Due to: Volume	Rate	Total
Interest income on interest-earning assets:			
Money market and other short-term investments	$ 990	$ 782	$ 1,772
Government obligations	441	1,392	1,833
Mortgage-backed securities	(635)	(354)	(989)
FHLB stock	17	215	232
Other investments	-	-	-
Total investments	813	2,035	2,848
Residential mortgage loans	(455)	(475)	(930)
Construction loans	(96)	(126)	(222)
Commercial and Industrial and Commercial mortgage loans	(879)	4,248	3,369
Finance leases	465	(119)	346
Consumer loans	249	(1,013)	(764)
Total loans	(716)	2,515	1,799
Total interest income	97	4,550	4,647
Interest expense on interest-bearing liabilities:			
Brokered CDs	(1,419)	969	(450)
Other interest-bearing deposits	265	1,184	1,449
Other borrowed funds	(1,002)	799	(203)
FHLB advances	262	988	1,250
Total interest expense	(1,894)	3,940	2,046
Change in net interest income	$ 1,991	$ 610	$ 2,601

Portions of the Corporation's interest-earning assets, mostly investments in obligations of some U.S. government agencies and sponsored entities, generate interest that 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 ("IBEs") are tax-exempt under Puerto Rico tax law (refer to *Income Taxes* below for additional information). To facilitate the comparison of all interest data related to these assets, the interest income has been converted to an adjusted 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, as adjusted for changes to enacted tax rates (39.0%) and adding to it the average cost of interest-bearing liabilities. The computation considers the interest expense disallowance required by Puerto Rico tax law.

The presentation of net interest income excluding the effects of the changes in the fair value of the derivative instruments ("valuations") 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 have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively.

The following table reconciles net interest income in accordance with GAAP to net interest income, excluding valuations, and net interest income on an adjusted tax-equivalent basis. The table also reconciles net interest spread and net interest margin on a GAAP basis to these items excluding valuations and on an adjusted tax-equivalent basis:

	Quarter Ended March 31,	
(Dollars in thousands)	2018	2017
Interest Income - GAAP	$ 149,418	$ 145,228
Unrealized loss on derivative instruments	-	1
Interest income excluding valuations	149,418	145,229
Tax-equivalent adjustment	4,778	4,320
Interest income on a tax-equivalent basis excluding valuations	154,196	149,549
Interest Expense - GAAP	24,725	22,679
Net interest income - GAAP	$ 124,693	$ 122,549
Net interest income excluding valuations - Non-GAAP	$ 124,693	$ 122,550
Net interest income on a tax-equivalent basis and excluding valuations- Non-GAAP	$ 129,471	$ 126,870
Average Balances		
Loans and leases	$ 8,778,968	$ 8,862,271
Total securities, other short-term investments and interest-bearing cash balances	2,720,438	2,375,060
Average Interest-Earning Assets	$ 11,499,406	$ 11,237,331
Average Interest-Bearing Liabilities	$ 8,194,442	$ 8,456,848
Average Yield/Rate		
Average yield on interest-earning assets - GAAP	5.27%	5.24%
Average rate on interest-bearing liabilities - GAAP	1.22%	1.09%
Net interest spread - GAAP	4.05%	4.15%
Net interest margin - GAAP	4.40%	4.42%
Average yield on interest-earning assets excluding valuations- Non-GAAP	5.27%	5.24%
Average rate on interest-bearing liabilities	1.22%	1.09%
Net interest spread excluding valuations- Non-GAAP	4.05%	4.15%
Net interest margin excluding valuations- Non-GAAP	4.40%	4.42%
Average yield on interest-earning assets on a tax-equivalent basis and excluding valuations - Non-GAAP	5.44%	5.40%
Average rate on interest-bearing liabilities	1.22%	1.09%
Net interest spread on a tax-equivalent basis and excluding valuations- Non-GAAP	4.22%	4.31%
Net interest margin on a tax-equivalent basis and excluding valuations- Non-GAAP	4.57%	4.58%

Interest income on interest-earning assets primarily represents interest earned on loans held for investment and investment securities.

Interest expense on interest-bearing liabilities primarily represents interest paid on brokered CDs, branch-based deposits, repurchase agreements, advances from the FHLB and junior subordinated debentures.

Unrealized gains or losses on derivatives represent changes in the fair value of derivatives, primarily interest rate caps used for protection against rising interest rates.

For the quarter ended March 31, 2018, net interest income increased $2.1 million to $124.7 million, compared to $122.5 million for the same period in 2017. The $2.1 million increase in net interest income was primarily due to:

- A $3.0 million increase in interest income on commercial and construction loans, primarily associated with the upward repricing of variable-rate commercial loans.

- A $1.8 million increase in interest income from interest-bearing cash balances due to both an increase of $305.5 million in the average balance of deposits maintained at the New York FED and increases in the Federal Funds target rate. The growth in non-interest bearing deposits provided higher liquidity levels in the first quarter of 2018 as compared to the same period a year ago. In addition, the Federal Funds target rate has increased three times since the end of the first quarter of 2017 from a range of 0.75% - 1.00% to its current range of 1.50% - 1.75%.

- A $0.7 million increase in interest income on investment securities primarily due to the gradual investment of liquidity in higher-yielding U.S agency debt securities.

Partially offset by:

- A $2.0 million increase in interest expense, primarily reflecting the effect of higher market interest rates on the cost of FHLB advances, brokered CDs, retail CDs, and commercial money market accounts tied to short-term interest rates, partially offset by a $262.4 million decrease in the average balance of total interest-bearing liabilities, primarily brokered CDs and repurchase agreements. Over the last 12 months, the Corporation repaid $744.5 million of maturing brokered CDs with an all-in cost of 1.18% and new issuances amounted to $341.3 million with an all-in cost of 1.69%. While the Corporation continues to reduce its reliance in brokered CDs, it is increasing the core deposit base. For the first quarter of 2018 the average balance of non-brokered interest-bearing deposits increased by $136.9 million and the average balance of non-interest-bearing deposits increased by$468.9 million, as compared to the same period in 2017.

- A $0.9 million decrease in interest income on residential mortgage loans associated with both a $33.7 million decrease in the average balance of this portfolio and higher inflows of loans to non-performing status as compared to the first quarter of 2017.

- A $0.4 million decrease in interest income on consumer loans primarily due to higher non-performing auto loan levels.

The net interest margin decreased by 2 basis points to 4.40% for the first quarter of 2018, compared to 4.42% for the first quarter of 2017, driven by higher non-performing residential and consumer loan levels and the change in mix of earning assets, partially offset by an improved funding mix driven by the increase in the proportion of interest-earning assets funded by the growth in non-interest bearing deposits. Loans decreased as a percentage of interest-earning assets from 78.8% in the first quarter of 2017 to 76.3% in the first quarter of 2018.

On an adjusted tax-equivalent basis, net interest income for the first quarter of 2018 increased by $2.6 million to $129.5 million when compared to the same period in 2017. In addition to the facts discussed above, the increase for the first quarter of 2018 also included an increase of $0.5 million in the tax-equivalent adjustment primarily attributable to a higher volume of tax exempt U.S agency debt securities.

Provision 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 trends in charge-offs and delinquencies, 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. Important factors that influence this judgment are re-evaluated on a quarterly basis to respond to changing conditions.

As described in Note 2, "Update on Effects of Natural Disasters to the accompanying consolidated financial statements," two strong hurricanes affected the Corporation's service areas during September 2017. These hurricanes caused widespread property damage, flooding, power outages, and water and communication service interruptions, and severely disrupted normal economic activity in the affected areas. Relationship officers continued to closely monitor the performance of hurricane-affected loan customers during the first quarter of 2018, and data became available on the performance of consumer and residential credits that had been under payment deferral programs. This information was factored into the determination of the allowance for loan and lease losses as of March 31, 2018. Although the identification and evaluation of hurricane-affected credits has been substantially completed, management's assessment of the hurricanes' effect is still subject to uncertainties, both those specific to some individual customers, such as the resolution of insurance claims, and those applicable to the overall economic prospects of the hurricane affected areas as a whole. During the first quarter of 2018, the Corporation recorded a net loan loss reserve release of approximately $6.4 million in connection with revised estimates associated with the effects of the hurricanes. The reserve release consisted of a $4.2 million release attributable to updated assessments of financial performance and repayment prospects of certain individually-assessed commercial credits and a $2.2 million release related to lower reserve requirements resulting from payments received during the first quarter that reduced the balance of consumer and, to a lesser extent, residential mortgage loans outstanding on the dates of the hurricanes. As of March 31, 2018, the hurricane-related allowance amounted to $62.1 million (net of a $2.8 million charge-off taken on a hurricane-affected construction credit during the fourth quarter of 2017). With the ongoing collection of information on individual commercial customers and statistics on the consumer and residential loan portfolios, the loss estimate will be revised as needed. The methodologies that the Corporation used to determine the hurricane-related qualitative estimate and for the review of individual large commercial credits are discussed in detail in Note 1, "Nature of Business and Summary of Significant Accounting Policies," in the

audited consolidated financial statements of the Corporation's for the year ended December 31, 2017, which are included in the Corporation's 2017 Annual Report on Form 10-K.

In addition, during the first quarter of 2018, the Corporation transferred to held for sale three non-performing commercial and construction loans. The aggregate recorded investment in these loans was written down to $57.2 million, which resulted in charge-offs of $9.7 million and an incremental loss of $5.6 million reflected in the provision for loan and lease losses for the first quarter of 2018. Loans transferred to held for sale consisted of a $30.0 million non-performing construction loans in the Virgin Islands (net of a $5.1 million write-down to fair value recorded at the time of the transfer) and two non-performing commercial mortgage loans totaling $27.2 million (net of write-downs to fair value of $4.6 million recorded at the time of the transfer).

Further, the provision for loan and lease losses for the first quarter of 2017 included a $0.6 million charge related to the PREPA credit line. Refer to Note 7, "Loans Held For Investment – Purchases and Sales of Loans," for additional information about this transaction.

On a non-GAAP basis, excluding the effect of the above mentioned changes related to the hurricanes, the loans transferred to held for sale, and the sale of the PREPA credit line, the adjusted provision for loan and lease losses of $21.3 million for the first quarter of 2018 decreased by $3.6 million as compared to the adjusted provision of $24.9 million for the first quarter of 2017. The $3.6 million decrease in the adjusted provision was driven by:

- An $8.7 million decrease in the adjusted provision for residential mortgage loans, primarily related to lower charge-off levels and the effect in the first quarter of 2017 of adjustments to the loss severity estimates used in the calculation of the general reserve, including adjustments to liquidation cost assumptions.

Partially offset by:

- A $4.6 million increase in the adjusted provision for commercial and construction loans, driven by the downgrade in the credit risk classification of a $46.8 million commercial mortgage loan in Florida.

- A $0.6 million increase in the adjusted provision for consumer loans, primarily reflecting the effect in the first quarter of 2017 of a loan loss recovery of $1.2 million on the sale of certain credit card loans that had been fully charged-off in prior periods.

Refer to *Basis of Presentation* below for a reconciliation of the GAAP provision for loan and lease losses to the non-GAAP provision for loan and lease losses excluding the effect of the hurricane-related reserve release, the loans transferred to held for sale, and the sale of the PREPA credit line. Also refer to *Risk Management – Credit Risk Management* below for an analysis of the allowance for loan and lease losses, including enhancements to the calculation of the allowance for loan losses for commercial and construction loans implemented in the first quarter of 2018, non-performing assets, impaired loans and related information, and refer to *Financial Condition and Operating Data Analysis – Loan Portfolio* and *Risk Management — Credit Risk Management* below for additional information concerning the Corporation's loan portfolio exposure in the geographic areas where the Corporation does business.

Non-Interest Income

	Quarter Ended March 31,			
		2018		**2017**
(In thousands)				
Service charges on deposit accounts	$	5,088	$	5,790
Mortgage banking activities		4,165		3,616
Insurance income		3,355		3,587
Other operating income		7,860		7,481
Non-interest income before OTTI on debt securities and gain on early extinguishment of debt		20,468		20,474
OTTI on debt securities		-		(12,231)
Gain on early extinguishment of debt		2,316		-
Total	$	22,784	$	8,243

Non-interest income primarily consists of income from service charges on deposit accounts, commissions derived from various banking, securities and insurance activities, gains and losses on mortgage banking activities, interchange and other fees related to debit and credit cards, and net gains and losses on investments and impairments.

Service charges on deposit accounts include monthly fees, overdraft fees, and other fees on deposit accounts, as well as corporate cash management fees.

Income from mortgage banking activities includes gains on sales and securitization of loans, revenues earned for administering residential mortgage loans originated by the Corporation and subsequently sold with servicing retained, and unrealized gains and losses on forward contracts used to hedge the Corporation's securitization pipeline. In addition, lower-of-cost-or-market valuation adjustments to the Corporation's residential mortgage loans held-for-sale portfolio and servicing rights portfolio, if any, are recorded as part of mortgage banking activities.

Insurance income consists mainly of insurance commissions earned by the Corporation's subsidiary, FirstBank Insurance Agency, Inc.

The other operating income category is composed of miscellaneous fees such as debit, credit card and point of sale ("POS") interchange fees, as well as contractually shared revenues from merchant contracts sold in 2015.

The net gain on investment securities reflects gains or losses as a result of sales that are consistent with the Corporation's investment policies, as well as OTTI charges on the Corporation's investment portfolio.

The gain on early extinguishment of debt is related to the repurchase and cancellation in the first quarter of 2018 of $23.8 million in trust preferred securities of FBP Statutory Trust I that were auctioned in a public sale at which the Corporation was invited to participate. The Corporation repurchased and cancelled the repurchased trust preferred securities, resulting in a commensurate reduction in the related Floating Rate Junior Subordinated Debentures. The Corporation's winning bid equated to 90% of the $23.8 million par value. The 10% discount resulted in a gain of $2.3 million, which is reflected in the statement of income as a "Gain on early extinguishment of debt." As of March 31, 2018, the Corporation still had Floating Rate Junior Subordinated Debentures ("subordinated debt") outstanding in the aggregate amount of $184.2 million.

Non-interest income for the first quarter of 2018 amounted to $22.8 million, compared to $8.2 million for the same period in 2017. The $14.5 million increase in non-interest income was primarily related to:

- The effect in the first quarter of 2017 of a $12.2 million OTTI charge on three Puerto Rico Government debt securities held by the Corporation as part of its available-for-sale securities portfolio, specifically bonds of the GDB and the Puerto Rico Public Buildings Authority. These bonds were sold in the second quarter of 2017.

- The $2.3 million gain recorded in the first quarter of 2018 on the repurchase and cancellation of $23.8 million in trust preferred securities.

- A $0.5 million increase in revenues from mortgage banking activities driven by a $0.7 million adjustment recorded in the first quarter of 2018 to reduce the valuation allowance of mortgage servicing rights, partially offset by lower conforming loan originations and sales in the secondary market resulting in a $0.3 million decrease in gain on sale of residential mortgage loans. Total loans sold in the secondary market to U.S. government-sponsored entities amounted to $74.5 million with a related gain of $1.9 million in the first quarter of 2018, including gains of $0.6 million on To-Be-Announced MBS (“TBA”) hedges, compared to $85.1 million with a related gain of $2.3 million in the first quarter of 2017, net of TBA hedge losses of $60 thousand.

- A $0.4 million increase in “other operating income” in the table above, reflecting the effect of a $0.8 million gain on the sale of fixed assets of a closed banking branch in Florida and a $0.3 million increase in transaction fee income from credit and debit cards, POS, and ATMs, partially offset by a $0.6 million lower of cost or market adjustment recorded in the first quarter of 2017 to reduce the carrying value of a construction loan held for sale.

Partially offset by:

- A $0.7 million decrease in service charges on deposit accounts, primarily related to a decrease in the volume of returned item and overdraft fee transactions.

- A $0.2 million decrease in seasonal contingent insurance commissions received by the insurance agency based on the prior year’s production of insurance policies.

Non-Interest Expenses

The following table presents the components of non-interest expenses:

(In thousands)	Quarter Ended March 31, 2018	2017
Employees' compensation and benefits	$ 40,684	$ 38,653
Occupancy and equipment	15,105	14,088
Insurance and supervisory fees	3,855	4,909
Taxes, other than income taxes	3,856	3,676
Professional fees:		
Collections, appraisals and other credit-related fees	1,599	2,072
Outsourcing technology services	5,123	5,354
Other professional fees	3,338	3,530
Credit and debit card processing expenses	3,537	2,831
Business promotion	2,576	3,281
Communications	1,482	1,543
Net loss on OREO and OREO operations	190	4,076
Other	4,682	3,869
Total	$ 86,027	$ 87,882

Non-interest expenses for the first quarter of 2018 were $86.0 million, compared to $87.9 million for the same period in 2017. The $1.9 million decrease in non-interest expenses was mainly due to:

- A $3.9 million decrease in losses from OREO operations, primarily reflecting a $3.6 million decrease in write downs to the value of OREO properties.

- A $1.1 million decrease in the FDIC insurance premium expense, included as part of "Insurance and supervisory fees" in the table above, reflecting, among other things, the effect of reductions in brokered CDs, a strengthened capital position, and improved liquidity metrics tied to the growth in non-interest-bearing deposits.

- A $0.9 million decrease in total professional service fees, primarily reflecting lower attorneys' collection fees.

- A $0.7 million decrease in business promotion expenses, primarily due to the timing of marketing related-activities and lower charitable contribution expenses.

These decreases were partially offset by:

- A $2.0 million increase in employee's compensation and benefits, primarily reflecting costs associated with a cash transition award paid to certain senior officers of $0.6 million in connection with the previously-reported executive compensation program that became effective in the third quarter of 2017, a $0.4 million increase in stock-based compensation expense, and an increase of approximately $0.9 million in bonuses expense.

- A $1.0 million increase in occupancy and equipment expenses, primarily related to hurricane-related expenses amounting to $1.6 million recorded in the first quarter of 2018, mostly attributable to repairs and security matters. These variances were partially offset by lower electricity and property tax expenses. The Corporation has incurred a variety of costs to operate in disaster response mode, and some facilities and their contents were damaged by the storms. The Corporation maintains insurance for casualty losses, as well as for reasonable and necessary disaster response costs and certain revenue lost through business interruption. Most of the significant disaster response costs were incurred by the end of the first quarter of 2018. These costs were included, where appropriate, in an insurance claim receivable based on management's understanding of the underlying coverage. An insurance claim receivable of $5.3 million was included in other assets as of March 31, 2018. The Corporation has incurred $9.3 million of hurricane-related disaster response costs and casualty losses, including the aforementioned $1.6 million charge to operations in the first quarter of 2018.

- A $0.8 million increase in "other operating expenses" in the table above, primarily reflecting related to lower net reserve releases related to unfunded loan commitments.

- A $0.7 million increase in credit and debit card processing expenses, mainly related to higher transaction volumes.

Income Taxes

Income tax expense includes Puerto Rico and USVI 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. and USVI income tax purposes and is generally subject to U.S. and USVI income tax only on its income from sources within the U.S. and USVI or income effectively connected with the conduct of a trade or business in those regions. Any such tax paid in the U.S. and USVI is also creditable against the Corporation's Puerto Rico tax liability, subject to certain conditions and limitations.

Under the Puerto Rico Internal Revenue Code of 2011, as amended (the "2011 PR Code"), the Corporation and its subsidiaries are treated as separate taxable entities and are generally not entitled to file consolidated tax returns and, thus, the Corporation is generally not entitled to utilize losses from one subsidiary to offset gains in another subsidiary. Accordingly, in order to obtain a tax benefit from a net operating loss ("NOL"), a particular subsidiary must be able to demonstrate sufficient taxable income within the applicable NOL carry-forward period. The 2011 PR Code allows entities organized as limited liability companies to perform an election to become a non-taxable "pass-through" entity and utilize losses to offset income from other "pass-through" entities, subject to certain limitations, with the remaining net income passing-through its partner entities. The 2011 PR Code also provides a dividend received deduction of 100% on dividends received from "controlled" subsidiaries subject to taxation in Puerto Rico and 85% on dividends received from other taxable domestic corporations.

On March 1, 2017, the Corporation completed the applicable regulatory filings to change the tax status of its subsidiary, First Federal Finance, from a taxable corporation to a non-taxable "pass-through" entity. This election allows the Corporation to realize tax benefits of its deferred tax assets associated with pass-through ordinary net operating losses available at the banking subsidiary, FirstBank, which were subject to a full valuation allowance as of December 31, 2016, against now pass-through ordinary income from this profitable subsidiary.

On March 1, 2017, the Corporation also completed the applicable regulatory filings to change the tax status of its subsidiary, FirstBank Insurance, from a taxable corporation to a non-taxable "pass-through" entity. This election allows the Corporation to offset pass-through income earned by FirstBank Insurance with net operating losses available at the holding company (the "Holding Company") level.

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 by doing business through an International Banking Entity ("IBE") unit of the Bank, and through the Bank's subsidiary, FirstBank Overseas Corporation, whose interest income and gain on sales is exempt from Puerto Rico income taxation. The IBE 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 on the specific activities identified in the IBE Act. An IBE that operates as a unit of a bank pays income taxes at the corporate standard rates to the extent that the IBE's net income exceeds 20% of the bank's total net taxable income.

For the first quarter of 2018, the Corporation recorded an income tax expense of $7.8 million, compared to an income tax benefit of $8.1 million for the same period in 2017. The variance was mostly attributable to the $13.2 million tax benefit recorded in the first quarter of 2017 as a result of the above discussed change in tax status of certain subsidiaries from taxable corporations to limited liability companies that elected to be treated as partnerships for income tax purposes in Puerto Rico, higher pre-tax earnings in the first quarter of 2018, and a higher estimated effective tax rate for 2018.

For the quarter ended March 31, 2018, the Corporation calculated the provision for income taxes by applying the estimated annual effective tax rate for the full fiscal year to ordinary income or loss. In the computation of the consolidated worldwide annual estimated effective tax rate, ASC 740-270 requires the exclusion of legal entities with pre-tax losses from which a tax benefit cannot be recognized. The Corporation's estimated annual effective tax rate in the first quarter of 2018, excluding entities from which a tax benefit cannot be recognized and discrete items, was 27% compared to 24% for the first quarter of 2017. The estimated annual effective tax rate including all entities for 2018 was 19% (23% excluding discrete items), compared to 13% for the first quarter of 2017, (25% excluding discrete items, primarily the tax benefit resulting from the previously mentioned change in the tax status of two subsidiaries)

The Corporation's net deferred tax asset amounted to $289.3 million as of March 31, 2018, net of a valuation allowance of $186.1 million, and management concluded, based upon the assessment of all positive and negative evidence, that it is more likely than not that the Corporation will generate sufficient taxable income within the applicable NOL carry-forward periods to realize such amount. The net deferred tax asset of the Corporation's banking subsidiary, FirstBank, amounted to $289.2 million as of March 31, 2018, net of a valuation allowance of $150.0 million, compared to net deferred tax asset of $294.7 million, net of a valuation allowance of $150.7 million, as of December 31, 2017.

During the third quarter of 2017, the Corporation completed a formal ownership change analysis within the meaning of Section 382 of the U.S. Internal Revenue Code ("Section 382") covering a comprehensive period, and concluded that an ownership change occurred during such period. Section 382 limits the ability to utilize U.S. and USVI NOLs for income tax purposes at such jurisdictions following an event of an ownership change. The Section 382 limitation could result in higher U.S. and USVI liabilities in the future than we would incur in the absence of such limitation. As of March 31, 2018, and as a result of the Section 382 limitation, the Corporation incurred an income tax expense of approximately $1.6 million related to its U.S. operations. The limitation did not affect the USVI operations in the first quarter of 2018. Prospectively, the Corporation expects that it will be able to mitigate the adverse effects associated with the Section 382 limitation as any such tax paid in the U.S. or USVI could be creditable against Puerto Rico tax liabilities or taken as deduction against taxable income. However, our ability to reduce our Puerto Rico tax liability through such a credit or deduction depends on our tax profile at each annual taxable period, which is dependent on various factors.

On December 22, 2017, the United States president signed H.R.1, The Tax Cuts and Jobs Act, which includes an overhaul of individual, business and international taxes and has affected our branch operations in the U.S. and the

USVI. The bill includes measures reducing corporate taxes from 35% to 21%, a repeal of the corporate alternative minimum tax regime, changes to business deductions and NOLs, a 15.5% tax on mandatory repatriation of liquid assets, 10% tax on base erosion payments, and a minimum 10.5% tax on inclusion of global intangible low-tax income by U.S. shareholders, among other significant changes. The main provisions affecting our operations in the U.S. and the USVI in the first quarter for 2018 include: the change in tax rate to 21%, the limitation to the amount certain financial institutions may deduct for premiums paid to the FDIC, and changes in permanent differences such as the meals and entertainment deductions. Other significant provisions, such as the base erosion and anti-abuse tax, do not affect the Corporation's US and USVI branch operations since these operations' receipts do not exceed the annual threshold of US effectively connected gross receipts.

On April 16, 2018, the Puerto Rico House of Representatives introduced the house legislative project 1544 ("P de la C. 1544") including proposed changes to the Puerto Rico Income Tax Code. The P de la C. 1544 proposes changes effective January 1, 2019 including: a reduction in the maximum corporate tax rate to 31% from the current 39%, the NOL limitation will increase to 90% from the current 80%, and changes to the alternative minimum tax ("AMT") computation including a reduction in rate to 23%, from the current 30%, among others. The legislative project also eliminates the exemption on interest income of certain mortgage loans, and provides additional limitations to deductions related to meals and travel. Other proposed measures include a reduction of the business to business services sales tax for electronic payments to 2%, from the current 4%, effective July 1, 2018, and to 0% effective July 1, 2019. The P de la C. 1544 also includes preventive measures which condition the reductions in income tax rates and sales and taxes to the government reaching the budgeted revenue collections.

FINANCIAL CONDITION AND OPERATING DATA ANALYSIS

Assets

The Corporation's total assets were $12.2 billion as of March 31, 2018, a decrease of $60.9 million from December 31, 2017. The decrease, as further discussed below, was mainly due to a $96.2 million decrease in total loans, a $75.2 million decrease in total investment securities, and a $13.1 million decrease in accrued interest receivables on loans and investments.

The variances were partially offset by a $127.4 million increase in cash and cash equivalents, largely driven by the increase of $186.2 million in non-interest-bearing deposits during the first quarter of 2018 and proceeds from U.S. agency MBS and loan repayments, partially offset by liquidity used to pay off maturing brokered CDs and a $100 million short-term repurchase agreement, as well as for the repurchase of $23.8 million of trust preferred securities.

Loan Portfolio

The following table presents the composition of the Corporation's loan portfolio, including loans held for sale, as of the dates indicated:

(In thousands)		March 31, 2018		December 31, 2017
Residential mortgage loans	$	3,267,868	$	3,290,957
Commercial loans:				
Commercial mortgage loans (1)		1,552,503		1,614,972
Construction loans (1)		79,150		111,397
Commercial and Industrial loans		2,061,773		2,083,253
Total commercial loans		3,693,426		3,809,622
Finance leases		262,863		257,462
Consumer loans		1,471,733		1,492,435
Total loans held for investment		8,695,890		8,850,476
Less:				
Allowance for loan and lease losses		(225,856)		(231,843)
Total loans held for investment, net	$	8,470,034	$	8,618,633
Loans held for sale (1)		91,375		32,980
Total loans, net	$	8,561,409	$	8,651,613

(1) During the first quarter of 2018, the Corporation transferred $57.2 million in loans (net of fair value write-downs of $9.7 million at the time of the transfer) to held for

sale. Loans transferred to held for sale consisted of a $30.0 million non-performing construction loan in the Virgin Islands (net of a fair value write-down of $5.1 million at the time of the transfer) and two non-performing commercial mortgage loans totaling $27.2 million in Puerto Rico (net of fair value write-downs of $4.6 million at the time of the transfer).

As of March 31, 2018, the Corporation's total loan portfolio, before allowance, amounted to $8.8 billion, down $96.2 million when compared to December 31, 2017. The decline primarily reflects reductions of $83.8 million and $15.5 million in the Puerto Rico and Virgin Island regions, respectively. The decrease was mainly related to a $59.5 million decline in the commercial and construction loan portfolio driven by three large loans totaling $28.3 million that were paid off during the first quarter, two large loans totaling $14.8 million sold in the first quarter, and significant payments received in the first quarter, including payments that reduced the outstanding balance of three revolving commercial lines of credit in Puerto Rico by $24.2 million. The variances were partially offset by an increase of $3.1 million in the Florida region.

As shown in the table above, as of March 31, 2018, the loans held for investment portfolio was comprised of commercial and construction loans (42%), residential real estate loans (38%), and consumer and finance leases (20%). Of the total gross loan portfolio held for investment of $8.7 billion as of March 31, 2018, approximately 75% has credit risk concentration in Puerto Rico, 19% in the United States (mainly in the state of Florida) and 6% in the Virgin Islands, as shown in the following table:

As of March 31, 2018	**Puerto Rico**	**Virgin Islands**	**United States**	**Total**
(In thousands)				
Residential mortgage loans	$ 2,396,307	$ 273,557	$ 598,004	$ 3,267,868
Commercial mortgage loans	1,062,693	90,817	398,993	1,552,503
Construction loans	42,148	8,309	28,693	79,150
Commercial and Industrial loans	1,366,090	121,182	574,501	2,061,773
Total commercial loans	2,470,931	220,308	1,002,187	3,693,426
Finance leases	262,863	-	-	262,863
Consumer loans	1,368,759	45,215	57,759	1,471,733
Total loans held for investment, gross	$ 6,498,860	$ 539,080	$ 1,657,950	$ 8,695,890
Loans held for sale	50,814	30,000	10,561	91,375
Total loans, gross	$ 6,549,674	$ 569,080	$ 1,668,511	$ 8,787,265

As of December 31, 2017	**Puerto Rico**	**Virgin Islands**	**United States**	**Total**
(In thousands)				
Residential mortgage loans	$ 2,413,379	$ 282,738	$ 594,840	$ 3,290,957
Commercial mortgage loans	1,127,409	95,464	392,099	1,614,972
Construction loans	41,511	43,314	26,572	111,397
Commercial and Industrial loans	1,373,714	116,323	593,216	2,083,253

Total commercial loans	2,542,634	255,101	1,011,887	3,809,622
Finance leases	257,462	-	-	257,462
Consumer loans	1,389,560	46,412	56,463	1,492,435
Total loans held for investment, gross	$ 6,603,035	$ 584,251	$ 1,663,190	$ 8,850,476
Loans held for sale	30,397	325	2,258	32,980
Total loans, gross	$ 6,633,432	$ 584,576	$ 1,665,448	$ 8,883,456

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NOTE 24 – SEGMENT INFORMATION

Residential Real Estate Loans

As of March 31, 2018, the Corporation's residential mortgage loan portfolio held for investment decreased by $23.1 million as compared to the balance as of December 31, 2017, mainly resulting from activities in Puerto Rico as principal repayments, charge-offs and $12.9 million of foreclosures recorded in the first quarter of 2018, exceeded the volume of loans originated and held for investment purposes. The residential mortgage loan portfolio held for investment in the Puerto Rico and Virgin Island regions decreased during the first quarter of 2018 by $17.1 million and $9.2 million, respectively, partially offset by an increase of $3.2 million in the Florida region.

The majority of the Corporation's outstanding balance of residential mortgage loans in Puerto Rico and the Virgin Islands consists of fixed-rate loans that traditionally carried higher yields than residential mortgage loans in Florida. In the Florida region, approximately 57% of the residential mortgage loan portfolio consisted of adjustable rate mortgages. In accordance with the Corporation's underwriting guidelines, residential mortgage loans are mostly fully-documented loans, and the Corporation does not originate negative amortization loans. Refer to *Contractual Obligations and Commitments* below for additional information about outstanding commitments to sell mortgage loans.

Commercial and Construction Loans

As of March 31, 2018, the Corporation's commercial and construction loan portfolio held for investment decreased by $116.2 million to $3.7 billion, as compared to the balance as of December 31, 2017. The decrease in commercial and construction loans held for investment was mainly related to the aforementioned transfer of $57.2 million of non-performing loans to held for sale (net of fair value write-downs of $9.7 million recorded at the time of the transfer), three large loans totaling $28.3 million that were paid off during the first quarter, two large loans totaling $14.8 million sold in the first quarter, and significant payments received in the first quarter, including payments that reduced the outstanding balance of three revolving commercial lines of credit in Puerto Rico by $24.2 million.

The commercial and construction loan portfolio, including loans held for sale, decreased by $45.0 million in the Puerto Rico region driven by a $7.7 million commercial mortgage loan paid off during the first quarter, the aforementioned sale of a $5.6 million adversely classified loans, payments of $4.0 million that reduced the outstanding balance of loans that were previously guaranteed by the TDF, significant repayments that reduced the balance of certain commercial loans, including payments totaling $24.2 million that reduced the outstanding balance of three revolving commercial lines of credit, and charge-offs. In the Virgin Islands, commercial and construction loans decreased by $4.7 million, driven by the fair value write-down of $5.1 million recorded on the construction loan transferred to held for sale during the first quarter. In Florida, commercial and construction loans decreased by $9.7 million, mainly attributable to the sale of a $9.2 million commercial loan participation and two large loans paid off during the first quarter totaling $20.6 million, partially offset by new loan originations.

As of March 31, 2018, the Corporation had $54.8 million of outstanding loans extended to the Puerto Rico government, its municipalities and public corporations, compared to $55.9 million as of December 31, 2017. Approximately $33.1 million of the outstanding loans as of March 31, 2018 consisted of loans extended to municipalities in Puerto Rico, which in most cases are supported by assigned property tax revenues. The vast majority of revenues of the municipalities included in the Corporation's loan portfolio are independent of the Puerto Rico central government. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and notes. Late in 2015, the GDB and the Municipal Revenue Collection Center ("CRIM") signed and perfected a deed of trust. Through this deed, the GDB, as fiduciary, is required to keep the CRIM funds separate from any other deposits and must distribute the funds pursuant to applicable law. The CRIM funds are deposited at another commercial depository financial institution in Puerto Rico. Approximately $6.7 million of the outstanding loans as of March 31, 2018 consisted of a loan to a unit of the central government, and approximately $15.0 million consisted of a loan to an affiliate of PREPA.

Furthermore, as of March 31, 2018, the Corporation had three loans granted to the hotel industry in Puerto Rico that were previously guaranteed by the TDF with an outstanding principal balance of $116.2 million (book value $61.6 million), compared to $120.2 million outstanding (book value of $70.8 million) as of December 31, 2017. Historically, the borrower and the operations of the underlying collateral of these loans have been the primary sources of repayment and the TDF, which is a subsidiary of the GDB, provided a secondary guarantee for payment performance. As part of agreements executed in the second quarter of 2017 and first quarter of 2018, the TDF paid $7.6 million and $4.0 million, respectively, to honor a portion of its guarantee on these loans. As provided in the agreements, the cash payments received by the Corporation released the TDF from its liability as a guarantor of these loans. All three of the commercial mortgage loans previously guaranteed by the TDF have been classified as non-performing and impaired since the first quarter of 2016, and interest payments have been applied against principal since then. Approximately $5.2 million of interest payments received on loans previously guaranteed by the TDF since late March 2016 have been applied against principal. In addition, the GDB agreed to issue to the Bank a fixed income financial instrument pursuant to the GDB's Restructuring Support Agreement approved by the PROMESA oversight board. During the first quarter of 2018, two of these three commercial

mortgage loans, with an aggregate outstanding principal balance of $50.4 million (book value of $27.2 million) were transferred to held for sale.

The Corporation also has credit exposure to USVI government entities. As of March 31, 2018, the Corporation had $76.7 million in loans to USVI government instrumentalities and public corporations, compared to $70.4 million as of December 31, 2017. Of the amount outstanding as of March 31, 2018, public corporations of the USVI owed approximately $53.5 million and an independent instrumentality of the USVI government owed approximately $23.2 million. As of March 31, 2018, all loans were currently performing and up to date on principal and interest payments.

As of March 31, 2018, the Corporation's total exposure to shared national credit ("SNC") loans amounted to $730.1 million. As of March 31, 2018, approximately $269.0 million of the SNC exposure related to the portfolio in Puerto Rico and $461.1 million related to the portfolio in the Florida region.

The composition of the Corporation's construction loan portfolio held for investment as of March 31, 2018 by category and geographic location follows:

As of March 31, 2018

	Puerto Rico	Virgin Islands	United States	Total
(In thousands)				
Loans for residential housing projects:				
Mid-rise (1)	$ 587	$ -	$ -	$ 587
Single-family, detached	1,862	689	2,314	4,865
Total for residential housing projects	2,449	689	2,314	5,452
Construction loans to individuals secured by residential properties	426	595	-	1,021
Loans for commercial projects (2)	15,267	4,629	26,364	46,260
Land loans - residential	12,739	2,402	15	15,156
Land loans - commercial	11,305	-	-	11,305
Total before net deferred fees and allowance for loan losses	$ 42,186	$ 8,315	$ 28,693	$ 79,194
Net deferred fees	(38)	(6)	-	(44)
Total construction loan portfolio, gross	42,148	8,309	28,693	79,150
Allowance for loan losses	(3,369)	(738)	(15)	(4,122)
Total construction loan portfolio, net (2)	$ 38,779	$ 7,571	$ 28,678	$ 75,028

(1) Mid-rise relates to buildings of up to 7 stories.
(2) Excludes a construction-commercial loan held for sale of $30.0 million in the Virgin Islands.

The following table presents further information related to the Corporation's construction portfolio as of and for the quarter ended March 31, 2018:

(In thousands)		
Total undisbursed funds under existing commitments	$	70,433
Construction loans held for investment in non-accrual status	$	16,236
Construction loans held for sale in non-accrual status	$	37,732
Net charge offs - Construction loans (1)	$	5,164
Allowance for loan losses - Construction loans	$	4,122
Non-performing construction loans to total construction loans, including held for sale		46.17%
Allowance for loan losses for construction loans to total construction loans held for investments		5.21%
Net charge-offs (annualized) to total average construction loans (1)		17.37%

(1) Includes a charge-off of $5.1 million associated with the fair value write-down of a $30.0 million construction loan transferred to held for sale in the Virgin Islands.

The following summarizes the construction loans for residential housing projects in Puerto Rico segregated by the estimated selling price of the units:

		(In thousands)
Under $300k	$	1,787
Over $600k (1)		662
	$	2,449

(1) One residential housing project in Puerto Rico.

Consumer Loans and Finance Leases

As of March 31, 2018, the Corporation's consumer loan and finance lease portfolio decreased by $15.3 million to $1.7 billion, as compared to the portfolio balance as of December 31, 2017. The decrease was primarily reflected in credit card, auto loans, and boat loans, which decreased by $9.9 million, $5.8 million, and $2.5 million, respectively, partially offset by a $5.4 million increase in finance leases. The decrease was primarily associated with the result of charge-offs and repayments that exceeded the volume of new loan originations.

Loan Production

First BanCorp. relies primarily on its retail network of branches to originate residential and consumer loans. The Corporation supplements its residential mortgage originations with wholesale servicing released mortgage loan purchases from mortgage bankers. The Corporation manages its construction and commercial loan originations through centralized units and most of its originations come from existing customers as well as through referrals and direct solicitations.

The following table provides a breakdown of First BanCorp.'s loan production, including purchases, refinancings, renewals and draws from existing revolving and nonrevolving commitments, for the periods indicated:

	Quarter Ended March 31,	
	2018	2017
	(In thousands)	
Residential real estate	$ 120,774	$ 164,140
Commercial and industrial and commercial mortgage	335,075	524,695
Construction	10,684	25,615
Finance leases	27,478	24,388
Consumer	189,430	205,647
Total loan production	$ 683,441	$ 944,485

The Corporation is experiencing continued loan demand and has continued its targeted origination strategy. During the first quarter of 2018, total loan originations, including purchases, refinancing's and draws from existing revolving and non-revolving commitments, amounted to approximately $683.4 million, compared to $944.5 million for the comparable period in 2017.

Residential mortgage loan originations and purchases amounted to $120.8 million for the first quarter of 2018, compared to $164.1 million for the first quarter of 2017. These statistics include purchases from mortgage bankers of $14.5 million for the first quarter of 2018, compared to $14.8 million for the comparable period in 2017. The decrease

of $43.4 million in the first quarter of 2018, as compared to the same period of 2017, reflects declines of approximately $27.4 million in Puerto Rico, primarily in conforming loan originations and refinancings, and decreases of $14.4 million and $1.6 million in Florida and the Virgin Islands, respectively.

Commercial and construction loan originations (excluding government loans) amounted to $329.8 million for the first quarter of 2018, compared to $550.3 million for the first quarter of 2017. The decrease in the first quarter of 2018, compared to the same period in 2017, reflects a decrease of approximately $217.8 million in the Puerto Rico region, primarily due to the effect in the first quarter of 2017 of the refinancing and renewal of three large commercial loans in Puerto Rico totaling $176.4 million and reduced activity compared to pre-hurricane levels, and a decrease of $4.7 million in the Virgin Island region, partially offset by an increase of $2.1 million in the Florida region.

Government loan originations amounted to $16.0 million for the first quarter of 2018, mainly related to the utilization of an arranged overdraft line of credit of a government entity in the Virgin Islands region.

Originations of auto loans (including finance leases) for the first quarter of 2018 amounted to $101.4 million, a decrease of $4.0 million, compared to $105.4 million for the first quarter of 2017. The decrease was primarily reflected in the Puerto Rico and Florida regions with decreases of $3.6 million and $0.6 million, respectively, partially offset by a $0.2 million increase in the Virgin Islands. Personal loan originations for the first quarter 2018, other than credit cards, amounted to $38.4 million, compared to $47.7 million for the first quarter of 2017. Most of the decrease in personal loan originations for the first quarter of 2018, as compared with the same period in 2017, was reflected in the Puerto Rico region. The utilization activity on the outstanding credit card portfolio for the first quarter of 2018 amounted to $77.1 million, compared to $76.9 million for the first quarter of 2017.

Investment Activities

As part of its liquidity, revenue diversification and interest rate risk strategies, First BanCorp. maintains an investment portfolio that is classified as available for sale or held to maturity. The Corporation's total available-for-sale investment securities portfolio as of March 31, 2018 amounted to $1.8 billion, a decrease of $75.5 million from December 31, 2017. The decrease was mainly driven by U.S. agency MBS prepayments of $42.3 million and a $24.1 million decrease in the fair value of available-for-sale investment securities, primarily U.S. agency MBS, due to changes in market interest rates.

As of March 31, 2018, approximately 98% of the Corporation's available-for-sale securities portfolio was invested in U.S. Government and agency debentures and fixed-rate U.S. government sponsored-agency MBS (mainly GNMA, FNMA and FHLMC fixed-rate securities).

The Corporation owns bonds of the Puerto Rico Housing Finance Authority in the aggregate amount of $8.1 million that are carried on the Corporation's books at their aggregate fair value of $6.8 million and are current as to contractual payments as of March 31, 2018.

As of March 31, 2018, the Corporation's held-to-maturity investment securities portfolio amounted to $150.5 million, down $0.1 million from December 31, 2017. Held-to-maturity investment securities consist of financing arrangements with Puerto Rico municipalities issued in bond form, which are accounted for as securities, but are underwritten as loans with features that are typically found in commercial loans. These obligations typically are not issued in bearer form, are not registered with the SEC and are not rated by external credit agencies. These bonds have seniority to the payment of operating costs and expenses of the municipality and are supported by assigned property tax revenues. Approximately 70% of the Corporation's municipality bonds consist of obligations issued by three of the largest municipalities in Puerto Rico. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and loans.

Refer to *Exposure to Puerto Rico Government* below for information and details about the Corporation's total direct exposure to the Puerto Rico Government.

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

(In thousands)		**March 31, 2018**		**December 31, 2017**
Money market investments	$	100,415	$	10,415

Investment securities available for sale, at fair value:				
U.S. government and agencies obligations		603,571		609,188
Puerto Rico government obligations		6,808		6,813
Mortgage-backed securities		1,205,125		1,274,497
Other (1)		-		518
Total investment securities available for sale, at fair value		1,815,504		1,891,016
Investment securities held-to-maturity, at amortized cost:				
Puerto Rico Municipal Bonds		150,486		150,627
Other investment securities, including $40.9 million of FHLB stock				
as of March 31, 2018 and December 31, 2017 (1)		43,532		43,119
Total money market and investment securities	$	2,109,937	$	2,095,177

(1) As of January 1, 2018, the Corporation adopted ASU 2016-01, resulting in the reclassification of equity securities from available-for-sale investment securities to other investment securities.

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Mortgage-backed securities as of the indicated dates consisted of:

(In thousands)	March 31, 2018	December 31, 2017
Available for sale:		
FHLMC certificates	$ 296,299	$ 311,706
GNMA certificates	209,603	221,630
FNMA certificates	640,058	680,040
Collateralized mortgage obligations issued or guaranteed by FHLMC and GNMA	43,091	44,061
Other mortgage pass-through certificates	16,074	17,060
Total mortgage-backed securities	$ 1,205,125	$ 1,274,497

The carrying values of investment securities classified as available for sale and held to maturity as of March 31, 2018 by contractual maturity (excluding mortgage-backed securities) are shown below:

(Dollars in thousands)	Carrying Amount	Weighted Average Yield %
U.S. Government and agencies obligations		
Due within one year	$ 122,019	1.27
Due after one year through five years	311,855	1.42
Due after five years through ten years	130,761	2.74
Due after ten years	38,936	2.07
	603,571	1.72
Puerto Rico government and municipalities obligations		
Due after one year through five years	3,712	5.39
Due after five years through ten years	43,597	5.14
Due after ten years	109,985	5.27
	157,294	5.24
Total	760,865	2.44
Mortgage-backed securities	1,205,125	2.60
Total investment securities available for sale and held to maturity	$ 1,965,990	2.54

Net interest income of future periods could be affected by prepayments of mortgage-backed securities. Any acceleration in the prepayments of mortgage-backed securities would lower yields on these securities, as the amortization of premiums paid upon acquisition of these securities would accelerate. Conversely, acceleration of the prepayments of mortgage-backed securities would increase yields on securities purchased at a discount, as the amortization of the discount would accelerate. These risks are directly linked to future period market interest rate fluctuations. Also, net interest income in future periods might be affected by the Corporation's investment in callable securities. As of March 31, 2018, the Corporation had approximately $221.3 million in debt securities (U.S. agencies and Puerto Rico government securities) with embedded calls and with an average yield of 2.15%. Refer to *Risk Management* below for further analysis of the effects of changing interest rates on the Corporation's net interest income and of the interest rate risk management strategies followed by the Corporation. Also refer to Note 5 to the accompanying unaudited consolidated financial statements for additional information regarding the Corporation's investment portfolio.

RISK MANAGEMENT

Risks are inherent in virtually all aspects of the Corporation's business activities and operations. Consequently, effective risk management is fundamental to the success of the Corporation. The primary goals of risk management are to ensure that the Corporation's risk-taking activities are consistent with the Corporation's objectives and risk tolerance, and that there is an appropriate balance between risk and reward in order to maximize stockholder value.

The Corporation has in place a risk management framework to monitor, evaluate and manage the principal risks assumed in conducting its activities. First BanCorp.'s business is subject to eleven broad categories of risks: (1) liquidity risk; (2) interest rate risk; (3) market risk; (4) credit risk; (5) operational risk; (6) legal and compliance risk; (7) reputational risk; (8) model risk; (9) capital risk; (10) strategic risk; and (11) information technology risk. First BanCorp. has adopted policies and procedures designed to identify and manage the risks to which the Corporation is exposed.

The Corporation's risk management policies are described below as well as in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of First BanCorp.'s 2017 Annual Report on Form 10-K.

Liquidity Risk and Capital Adequacy

Liquidity is the ongoing ability to accommodate liability maturities and deposit withdrawals, fund asset growth and business operations, and meet contractual obligations through unconstrained access to funding at reasonable market

rates. Liquidity management involves forecasting funding requirements and maintaining sufficient capacity to meet liquidity needs and accommodate fluctuations in asset and liability levels due to changes in the Corporation's business operations or unanticipated events.

The Corporation manages liquidity at two levels. The first is the liquidity of the parent company, which is the holding company that owns the banking and non-banking subsidiaries. The second is the liquidity of the banking subsidiary. As of March 31, 2018, FirstBank could not pay any dividend to the holding company except upon receipt of required regulatory approvals. During the first quarter of 2018, the Corporation continued to pay quarterly interest payments on the subordinated debentures associated with its trust preferred securities and the monthly dividend income on its non-cumulative perpetual monthly income preferred stock pursuant to regulatory approvals.

The Asset and Liability Committee of the Board of Directors is responsible for establishing the Corporation's liquidity policy, as well as approving operating and contingency procedures and monitoring liquidity on an ongoing basis. The Management Investment and Asset Liability Committee (the "MIALCO"), using measures of liquidity developed by management that involve the use of several assumptions, reviews the Corporation's liquidity position on a monthly basis. The MIALCO oversees liquidity management, interest rate risk and other related matters.

The MIALCO, which reports to the Board of Directors' Asset and Liability Committee, is composed of senior management officers, including the Chief Executive Officer, the Chief Financial Officer, the Chief Risk Officer, the Retail Financial Services Director, the Risk Manager of the Treasury and Investments Division, the Financial Analysis and Asset/Liability Director and the Treasurer. The Treasury and Investments Division is responsible for planning and executing the Corporation's funding activities and strategy, monitoring liquidity availability on a daily basis, and reviewing liquidity measures on a weekly basis. The Treasury and Investments Accounting and Operations area of the Controller's Department is responsible for calculating the liquidity measurements used by the Treasury and Investment Division to review the Corporation's liquidity position on a monthly basis. The Financial Analysis and Asset/Liability Director estimates the liquidity gap for longer periods.

To ensure adequate liquidity through the full range of potential operating environments and market conditions, the Corporation conducts its liquidity management and business activities in a manner that will preserve and enhance funding stability, flexibility and diversity. Key components of this operating strategy include a strong focus on the continued development of customer-based funding, the maintenance of direct relationships with wholesale market funding providers, and the maintenance of the ability to liquidate certain assets when, and if, requirements warrant.

The Corporation develops and maintains contingency funding plans. These plans evaluate the Corporation's liquidity position under various operating circumstances and are designed to help ensure that the Corporation will be able to operate through periods of stress when access to normal sources of funds is constrained. The plans project funding requirements during a potential period of stress, specify and quantify sources of liquidity, outline actions and procedures for effectively managing through a difficult period, and define roles and responsibilities. Under the contingency funding plan, the Corporation stresses the balance sheet and the liquidity position to critical levels that imply difficulties in getting new funds or even maintaining the current funding position of the Corporation and the Bank and are designed to help ensure the ability of the Corporation and the Bank to honor its respective commitments, and establish liquidity triggers monitored by the MIALCO in order to maintain the ordinary funding of the banking business. Four different scenarios are defined in the contingency funding plan: local market event, credit rating downgrade, an economic cycle downturn event, and a concentration event. They are reviewed and approved annually by the Board of Directors' Asset and Liability Committee.

The Corporation manages its liquidity in a proactive manner and maintains a sound liquidity position. It uses multiple measures to monitor the liquidity position, including core liquidity, basic liquidity, and time-based reserve measures. As of March 31, 2018, the estimated core liquidity reserve (which includes cash and free liquid assets) was $2.0 billion or 16.2% of total assets, compared to $1.9 billion or 15.6% of total assets as of December 31, 2017. The basic liquidity ratio (which adds available secured lines of credit to the core liquidity) was approximately 21.9% of total assets, compared to 21.2% of total assets as of December 31, 2017. The increase in core liquidity levels was largely driven by the aforementioned deposit build-up experienced after the hurricanes. As of March 31, 2018, the Corporation had $689.5 million available for additional credit from the FHLB of New York. Unpledged liquid securities as of March 31, 2018, mainly fixed-rate MBS and U.S. agency debentures, amounted to approximately $1.0 billion. The Corporation does not rely on uncommitted inter-bank lines of credit (federal funds lines) to fund its operations and does not include them in the basic liquidity measure. As of March 31, 2018, the holding company had $23.0 million of cash and cash equivalents. Cash and cash equivalents at the Bank level as of March 31, 2018 were approximately $837.0 million. The Bank had $956.1 million in brokered CDs as of March 31, 2018, of which approximately $548.3 million mature over the next twelve months. Liquidity at the Bank level is highly dependent on bank deposits, which fund 75% of the Bank's assets (or 67% excluding brokered CDs).

Sources of Funding

The Corporation utilizes different sources of funding to help ensure that adequate levels of liquidity are available when needed. Diversification of funding sources is of great importance to protect the Corporation's liquidity from market disruptions. The principal sources of short-term funds are deposits, including brokered CDs, securities sold under agreements to repurchase, and lines of credit with the FHLB.

The Asset Liability Committee of the Board of Directors reviews credit availability on a regular basis. The Corporation has also sold mortgage loans as a supplementary source of funding. Long-term funding has also been obtained in the past through the issuance of notes and long-term brokered CDs. The cost of these different

alternatives, among other things, is taken into consideration.

The Corporation has continued reducing the amounts of its outstanding brokered CDs. As of March 31, 2018, the amount of brokered CDs had decreased $194.4 million to $956.1 million from brokered CDs of $1.2 billion as of December 31, 2017. At the same time as the Corporation focuses on reducing its reliance on brokered CDs, it is seeking to add core deposits. During the first quarter of 2018, the Corporation increased non-brokered deposits, excluding government deposits, by $194.6 million to $7.4 billion as further discussed below.

The Corporation continues to have the support of creditors, including counterparties to repurchase agreements, the FHLB, and other agents such as wholesale funding brokers. While liquidity is an ongoing challenge for all financial institutions, management believes that the Corporation’s available borrowing capacity and efforts to grow retail deposits will be adequate to provide the necessary funding for the Corporation’s business plans in the foreseeable future.

The Corporation’s principal sources of funding are:

Brokered CDs – A large portion of the Corporation’s funding has been brokered CDs issued by FirstBank. Total brokered CDs decreased during the first quarter of 2018 by $194.4 million to $956.1 million as of March 31, 2018.

The average remaining term to maturity of the retail brokered CDs outstanding as of March 31, 2018 was approximately 1.3 year.

The use of brokered CDs has historically been important for the growth of the Corporation. The Corporation encounters intense competition in attracting and retaining regular retail deposits in Puerto Rico. The brokered CD market is very competitive and liquid, and has enabled the Corporation to obtain substantial amounts of funding in short periods of time. This strategy has enhanced the Corporation’s liquidity position, since brokered CDs are insured by the FDIC up to regulatory limits and can be obtained faster than regular retail deposits.

The following table presents contractual maturities of time deposits with denominations of $100,000 or higher as of March 31, 2018:

		Total (In thousands)
Three months or less	$	412,728
Over three months to six months		420,571
Over six months to one year		641,050
Over one year		1,135,050
Total	$	2,609,399

Certificates of deposit in denominations of $100,000 or higher include brokered CDs of $956 million issued to deposit brokers in the form of large certificates of deposit that are generally participated out by brokers in amounts of less than the FDIC insurance limit.

Government deposits – As of March 31, 2018, the Corporation had $541.4 million of Puerto Rico public sector deposits ($443.0 million in transactional accounts and $98.4 million in time deposits) compared to $490.3 million as of December 31, 2017. Approximately 24% came from municipalities and municipal agencies in Puerto Rico and 76% came from public corporations and the central government and agencies. Most of the increase in 2018 was related to the increase in the balance of a Puerto Rico government-owned corporation's transactional deposit account.

In addition, as of March 31, 2018, the Corporation had $154.3 million of government deposits in the Virgin Islands, compared to $161.7 million as of December 31, 2017.

Retail deposits – The Corporation's deposit products also include regular saving accounts, demand deposit accounts, money market accounts and retail CDs. Total deposits, excluding brokered CDs and government deposits, increased by $194.6 million to $7.4 billion from the balance of $7.2 billion as of December 31, 2017. The higher balance reflects increases of $137.2 million and $72.5 million in Puerto Rico and the Virgin Islands, respectively, partially offset by a $15.2 million decrease in Florida. The Corporation experienced rapid accumulation of deposits after the hurricanes in the fourth quarter of 2017 and the first quarter of 2018. Total deposits as of March 31, 2018, excluding brokered CDs and government deposits, increased $194.6 million from December 31, 2017 and $571.6 million since September 30, 2017. The most significant increase was in noninterest-bearing demand deposits, which grew 10%, or $186.2 million, since December 31, 2017 and $433.6 million, or 27%, since September 30, 2017. Hurricane-related factors, such as the effect of payment deferral programs available to customers, disaster relief funds, and settlement of insurance claims, continue to contribute to this accumulation. Although management expects the balances accumulated by deposit customers in the hurricane-affected areas to reduce over time, it is difficult to predict when and to what degree, and there may be further growth as insurance claims are resolved and additional disaster-recovery funds are distributed. Refer to Note 15 in the accompanying unaudited consolidated financial statements for further details.

Refer to *Net Interest Income* above for information about average balances of interest-bearing deposits, and the average interest rate paid on deposits for the quarters ended March 31, 2018 and 2017.

Securities sold under agreements to repurchase - The Corporation's investment portfolio is funded in part with repurchase agreements. The Corporation's outstanding securities sold under repurchase agreements amounted to $400 million as of March 31, 2018, compared to $500 million as of December 31, 2017. The Corporation repaid at maturity a $100 million short-term repurchase agreement carried at a cost of 1.53%. One of the Corporation's strategies has been the use of structured repurchase agreements and long-term repurchase agreements to reduce liquidity risk and manage exposure to interest rate risk by lengthening the final maturities of its liabilities while keeping funding costs at reasonable levels. In addition to these repurchase agreements, the Corporation has been able to maintain access to credit by using cost-effective sources such as FHLB advances. Refer to Note 16 in the Corporation's unaudited consolidated financial statements for the quarter ended March 31, 2018 for further details about repurchase agreements outstanding by counterparty and maturities.

As of March 31, 2018, the Corporation had $200 million of reverse repurchase agreements with a counterparty under a master netting arrangement that provides for a right of setoff that meets the conditions of ASC 210-20-45-11 for a net presentation. These repurchase agreements and reverse repurchase agreements are presented net on the consolidated statement of financial condition.

Under the Corporation's repurchase agreements, as is the case with derivative contracts, the Corporation is required to pledge cash or qualifying securities to meet margin requirements. To the extent that the value of securities previously pledged as collateral declines due to changes in interest rates, a liquidity crisis or any other factor, the Corporation is required to deposit additional cash or securities to meet its margin requirements, thereby adversely affecting its liquidity.

Given the quality of the collateral pledged, the Corporation has not experienced margin calls from counterparties arising from credit-quality-related write-downs in valuations.

Advances from the FHLB – The Bank is a member of the FHLB system and obtains advances to fund its operations under a collateral agreement with the FHLB that requires the Bank to maintain qualifying mortgages and/or investments as collateral for advances taken. As of each March 31, 2018 and December 31, 2017, the outstanding balance of FHLB advances was $715.0 million. As of March 31, 2018, the Corporation had $689.5 million available for additional credit on FHLB lines of credit.

Trust-Preferred Securities – In 2004, FBP Statutory Trust I, a statutory trust that is wholly-owned by the Corporation and not consolidated in the Corporation's financial statements, sold to institutional investors $100 million of its variable-rate trust-preferred securities. FBP Statutory Trust I used the proceeds of the issuance, together with the proceeds of the purchase by the Corporation of $3.1 million of FBP Statutory Trust I variable-rate common securities to purchase $103.1 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures.

Also in 2004, FBP Statutory Trust II, a statutory trust that is wholly-owned by the Corporation and not consolidated in the Corporation's financial statements, sold to institutional investors $125 million of its variable-rate trust-preferred securities. FBP statutory Trust II used the proceeds of the issuance, together with the proceeds of the purchase by the Corporation of $3.9 million of FBP Statutory Trust II variable rate common securities to purchase $128.9 million aggregate principal amount of the Corporation's Junior Subordinated Deferrable Debentures.

The trust-preferred debentures are presented in the Corporation's consolidated statement of financial condition as Other Borrowings. The variable-rate trust-preferred securities are fully and unconditionally guaranteed by the Corporation. The $100 million Junior Subordinated Deferrable Debentures issued by the Corporation in April 2004 and the $125 million issued in September 2004 mature on June 17, 2034 and September 20, 2034, respectively; however, under certain circumstances, the maturity of the subordinated debentures may be shortened (such shortening would result in a mandatory redemption of the variable-rate trust-preferred securities). The Collins Amendment of the Dodd-Frank Act eliminated certain trust-preferred securities from Tier 1 Capital. Bank Holding Companies such as the Corporation were required to fully phase out these instruments from Tier I capital by January 1, 2016; however, they may remain in Tier 2 capital until the instruments are redeemed or mature.

As mentioned above, during the first quarter of 2018, the Corporation completed the repurchase of $23.8 million of trust preferred securities of FBP Statutory Trust I that were being auctioned in a public sale at which the Corporation was invited to participate. The Corporation repurchased and cancelled the repurchased trust preferred securities, resulting in a commensurate reduction in the related subordinated debenture. As of March 31, 2018, the Corporation still had subordinated debentures outstanding in the aggregate amount of $184.2 million.

During the second quarter of 2016, the Corporation received approval from the Federal Reserve and paid $31.2 million for all the accrued but deferred interest payments plus the interest for the 2016 second quarter on the Corporation's subordinated debentures associated with its trust-preferred securities. Subsequently, the Corporation received quarterly regulatory approvals and made scheduled quarterly interest payments. As of March 31, 2018, the Corporation was current on all interest payments due related to its subordinated debentures. On October 3, 2017, the New York FED terminated the Written Agreement entered into on June 3, 2010 between the Corporation and the Federal Reserve. However, the Corporation has agreed with its regulators to continue to obtain approval before paying dividends, receiving dividends from the Bank, making payments on subordinated debt or trust-preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock. The Corporation has received approval to make the subordinated debentures quarterly payment for June 30, 2018. The Corporation intends to request approval for future periods to continue regularly-scheduled quarterly payments.

Other Sources of Funds and Liquidity - The Corporation's principal uses of funds are for the origination of loans and the repayment of maturing deposits and borrowings. The ratio of residential real estate loans to total loans has increased over time. Commensurate with the increase in its mortgage banking activities, the Corporation has also invested in technology and personnel to enhance the Corporation's secondary mortgage market capabilities.

The enhanced capabilities improve the Corporation's liquidity profile as they allow the Corporation to derive liquidity, if needed, from the sale of mortgage loans in the secondary market. The U.S. (including Puerto Rico) secondary mortgage market is still highly liquid, in large part because of the sale of mortgages through guarantee programs of the FHA, VA, HUD, FNMA and FHLMC. During the first quarter of 2018, the Corporation sold approximately $54.4 million of FHA/VA mortgage loans to GNMA, which packages them into mortgage-backed securities. Any regulatory actions affecting GNMA, FNMA or FHLMC could adversely affect the secondary mortgage market.

Although currently not in use, other potential sources of short-term funding for the Corporation include commercial paper and federal funds purchased. Furthermore, in previous years, the Corporation entered into several financing transactions to diversify its funding sources, including the issuance of notes payable and, as noted above, junior subordinated debentures as part of its longer-term

liquidity and capital management activities. No assurance can be given that these sources of liquidity will be available in the future and, if available, will be on comparable terms.

Effect of Credit Ratings on Access to Liquidity

The Corporation's liquidity is contingent upon its ability to obtain external sources of funding to finance its operations. The Corporation's current credit ratings and any further downgrade in credit ratings can hinder the Corporation's access to new forms of external funding and/or cause external funding to be more expensive, which could in turn adversely affect results of operations. Also, changes in credit ratings may further affect the fair value of unsecured derivatives that consider the Corporation's own credit risk as part of the valuation.

The Corporation does not have any outstanding debt or derivative agreements that would be affected by credit downgrades. Furthermore, given the Corporation's non-reliance on corporate debt or other instruments directly linked in terms of pricing or volume to credit ratings, the liquidity of the Corporation so far has not been affected in any material way by downgrades. The Corporation's ability to access new non-deposit sources of funding, however, could be adversely affected by credit downgrades.

The Corporation's credit as a long-term issuer is currently rated B+ by S&P and B- by Fitch. At the FirstBank subsidiary level, long-term issuer ratings are currently Caa1 by Moody's, seven notches below their definition of investment grade, B+ by S&P, four notches below their definition of investment grade, and B- by Fitch, six notches below their definition of investment grade. The Corporation's credit ratings are dependent on a number of factors, both quantitative and qualitative, and are subject to change at any time. The disclosure of credit ratings is not a recommendation to buy, sell or hold the Corporation's securities. Each rating should be evaluated independently of any other rating

Cash Flows

Cash and cash equivalents were $843.8 million as of March 31, 2018, an increase of $127.4 million when compared to the balance as of December 31, 2017. The following discussion highlights the major activities and transactions that affected the Corporation's cash flows during the first quarters of 2018 and 2017.

Cash Flows from Operating Activities

First BanCorp.'s operating assets and liabilities vary significantly in the normal course of business due to the amount and timing of cash flows. Management believes cash flows from operations, available cash balances and the Corporation's ability to generate cash through short- and long-term borrowings will be sufficient to fund the Corporation's operating liquidity needs for the foreseeable future.

For the first quarters of 2018 and 2017, net cash provided by operating activities was $95.4 million and $84.8 million, respectively. Net cash generated from operating activities was higher than reported net income largely as a result of adjustments for items such as the provision for loan and lease losses, depreciation and amortization, and impairments, as well as the cash generated from sales of loans held for sale.

Cash Flows from Investing Activities

The Corporation's investing activities primarily relate to originating loans to be held for investment and purchasing, selling and repaying available-for-sale and held-to-maturity investment securities. For the quarter ended March 31, 2018, net cash provided by investing activities was $111.8 million, primarily reflecting U.S. agency MBS prepayments and proceeds from the aforementioned sale of a commercial loan participation in Florida and an adversely classified loan in Puerto Rico.

For the first quarter of 2017, net cash provided by investing activities was $82.1 million, primarily reflecting U.S. agency MBS prepayments and proceeds from the sale of the PREPA credit line.

Cash Flows from Financing Activities

The Corporation's financing activities primarily include the receipt of deposits and the issuance of brokered CDs, the issuance and payments of long-term debt, the issuance of equity instruments and activities related to its short-term funding. For the first quarter of 2018, net cash used in financing activities was $79.7 million, mainly reflecting the effect of repayments of maturing brokered CDs and a $100 million short-term repurchase agreement, as well as the repurchase of trust-preferred securities, partially offset by the increase in non-brokered deposits.

In the first quarter of 2017, net cash used in financing activities was $42.5 million, mainly reflecting the effect of repayments of maturing short-term FHLB advances and brokered CDs, partially offset by the increase in non-brokered deposits.

Capital

As of March 31, 2018, the Corporation's stockholders' equity was $1.9 billion, an increase of $8.0 million from December 31, 2017. The increase was mainly driven by the earnings generated in the first quarter, partially offset by a decrease in the fair value of available-for-sale investment securities recorded as part of other comprehensive loss. In December 31, 2016, for the first time since July 2009, the Corporation paid dividends on its non-cumulative perpetual monthly income preferred stock, after receiving regulatory approval. Since then, the Corporation has continued to pay monthly dividend payments on the non-cumulative perpetual monthly income preferred stock. As mentioned above, on October 3, 2017, the Federal Reserve terminated the Written Agreement entered into on June 3, 2010 between the Corporation and the Federal Reserve. However, the Corporation has agreed with its regulators to continue to obtain approval before paying dividends, receiving dividends from the Bank, making payments on subordinated debt or trust preferred securities, incurring or guaranteeing debt or purchasing or redeeming any corporate stock. The Corporation received regulatory approvals to pay the monthly dividends on the Corporation's Series A through E Preferred Stock through June 2018. The Corporation intends to request approval in future periods to continue to pay monthly dividend payments on the non-cumulative perpetual monthly income preferred stock.

Set forth below are First BanCorp.'s and FirstBank's regulatory capital ratios as of March 31, 2018 and December 31, 2017:

			Banking Subsidiary		
	First BanCorp.		FirstBank		To be well capitalized - General thresholds
As of March 31, 2018	**Actual**	**Fully Phased-in (1)**	**Actual**	**Fully Phased-in (1)**	
Total capital ratio (Total capital to risk-weighted assets)	22.98%	22.47%	22.52%	22.03%	10.00%
Common Equity Tier 1 capital ratio					
(Common equity Tier 1 capital to risk weighted assets)	19.24%	18.79%	17.70%	17.29%	6.50%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	19.66%	19.19%	21.26%	20.76%	8.00%
Leverage ratio	14.18%	14.18%	15.35%	15.35%	5.00%

			Banking Subsidiary		
	First BanCorp		FirstBank		To be well capitalized - General thresholds
As of December 31, 2017	**Actual**	**Fully Phased-in (1)**	**Actual**	**Fully Phased-in (1)**	

Total capital (Total capital to risk-weighted assets)	22.53%	21.99%	22.06%	21.53%	10.00%
Common Equity Tier 1 capital ratio					
(Common equity Tier 1 capital to risk weighted assets)	18.96%	18.09%	17.70%	16.86%	6.50%
Tier 1 capital ratio (Tier 1 capital to risk-weighted assets)	18.97%	18.49%	20.79%	20.26%	8.00%
Leverage ratio	14.03%	14.01%	15.39%	15.37%	5.00%

(1) Certain adjustments required under the Basel III rules will be phased-in through the end of 2018 although certain elements of the Basel III rules have recently been deferred by the federal banking agencies. The ratios shown in this column are calculated assuming a fully phased-in adjustments as if they were effective as of March 31, 2018 and December 31, 2017.

Although the Corporation and FirstBank became subject to the Basel III rules beginning on January 1, 2015, certain requirements of the Basel III rules are being phased-in over several years and, in general, will be fully effective as of January 1, 2019; however, the federal banking agencies have recently deferred certain elements of the Basel III rules. The Corporation and FirstBank compute risk-weighted assets using the Standardized Approach required by the Basel III rules.

The Basel III rules require the Corporation to maintain an additional capital conservation buffer of 2.5% to avoid limitations on both (i) capital distributions (e.g., repurchases of capital instruments, dividends and interest payments on capital instruments) and (ii) discretionary bonus payments to executive officers and heads of major business lines. The phase-in of the capital conservation buffer began on January 1, 2016 with a first year requirement of 0.625% of additional Common Equity Tier 1 capital ("CET1"), which is being progressively increased, by that same percentage amount on each subsequent January 1 until it reaches the fully phased-in 2.5% CET1 requirement on January 1, 2019.

Under the fully phased-in Basel III rules, in order to be considered adequately capitalized, the Corporation will be required to maintain: (i) a minimum CET1 capital to risk-weighted assets ratio of at least 4.5%, plus the 2.5% "capital conservation buffer," resulting in a required minimum CET1 ratio of at least 7%; (ii) a minimum ratio of total Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum Tier 1 capital ratio of 8.5%; (iii) a minimum ratio of total Tier 1 plus Tier 2 capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer, resulting in a required minimum total capital ratio of 10.5%; and (iv) a required minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average on-balance sheet (non-risk adjusted) assets.

In addition, as required under Basel III rules, the Corporation's trust-preferred securities ("TRuPs") were fully phased-out from Tier 1 capital on January 1, 2016. However, the Corporation's TRuPs may continue to be included in Tier 2 capital until the instruments are redeemed or mature.

On November 21, 2017, the Federal Reserve Board, the FDIC, and the Office of the Comptroller of the Currency finalized an extension of the phase-in of certain Basel III capita rules for banks not using the Basel advanced approaches capital rule. The extension, which was effective on January 1, 2018, pauses the full transition of the Basel III treatment of mortgage servicing assets, certain deferred tax assets, and investments in the capital of unconsolidated financial institutions and minority interests, pending the banking agencies' broader efforts, announced in September 2017, to simplify the regulatory capital rules that apply to banking organizations that are not subject to the advanced approaches capital rules. Because the advanced approaches capital rules apply to banking organizations with more than $250 billion in assets or foreign bank subsidiaries with more than $10 billion in assets, the extension relief applies broadly to community, midsize, and regional banks, including the Corporation and FirstBank.

The Corporation, as an institution with more than $10 billion but less than $50 billion of total consolidated assets, is subject to certain requirements established by the Dodd-Frank Act, including those related to capital stress testing. Consistent with these requirements, the Corporation submitted its third annual company-run stress test to regulators in

July 2017, which was made public in October 2017. The results show that even in a severely adverse economic environment, the Corporation's and the Bank's capital ratios exceed both the regulatory minimum required ratios mandated under Basel III and the generally required well-capitalized thresholds throughout the nine-quarter planning horizon.

The tangible common equity ratio and tangible book value per common share are non-GAAP financial measures generally used by the financial community to evaluate capital adequacy. Tangible common equity is total equity less preferred equity, goodwill, core deposit intangibles, purchased credit card relationship assets and insurance customer relationship intangible assets. Tangible assets are total assets less goodwill, core deposit intangibles, purchased credit card relationship and insurance customer assets relationship assets intangible assets. Refer to *Basis of Presentation* below for additional information.

The following table is a reconciliation of the Corporation's tangible common equity and tangible assets as of March 31, 2018 and December 31, 2017, respectively:

(In thousands, except ratios and per share information)		**March 31, 2018**		**December 31, 2017**
Total equity - GAAP	$	1,877,104	$	1,869,097
Preferred equity		(36,104)		(36,104)
Goodwill		(28,098)		(28,098)
Purchased credit card relationship intangible		(7,426)		(8,000)
Core deposit intangible		(5,084)		(5,478)
Insurance customer relationship intangible		(737)		(775)
Tangible common equity	**$**	**1,799,655**	**$**	**1,790,642**
Total assets - GAAP	$	12,200,386	$	12,261,268
Goodwill		(28,098)		(28,098)
Purchased credit card relationship intangible		(7,426)		(8,000)
Core deposit intangible		(5,084)		(5,478)
Insurance customer relationship intangible		(737)		(775)
Tangible assets	**$**	**12,159,041**	**$**	**12,218,917**
Common shares outstanding		**216,390**		**216,278**
Tangible common equity ratio		**14.80%**		**14.65%**
Tangible book value per common share	$	**8.32**	$	**8.28**

The Banking Law of the Commonwealth of Puerto Rico requires that a minimum of 10% of FirstBank's net income for the year be transferred to legal surplus until such surplus equals the total of paid-in-capital on common and preferred stock. Amounts transferred to the legal surplus account from the retained earnings account are not available for distribution to the Corporation, including for payment as dividends to the stockholders, without the prior consent of the Puerto Rico Commissioner of Financial Institutions. The Puerto Rico Banking Law provides that, when the expenditures of a Puerto Rico commercial bank are greater than receipts, the excess of the expenditures over receipts must be charged against the undistributed profits of the bank, and the balance, if any, must be charged against the legal surplus reserve, as a reduction thereof. If there is no legal surplus reserve sufficient to cover such balance, in whole or in part, the outstanding amount must be charged against the capital account and the Bank cannot pay dividends until it can replenish the legal surplus reserve to an amount of at least 20% of the original capital contributed. During the fourth quarter of 2017, $7.3 million was transferred to the legal surplus reserve. FirstBank's legal surplus reserve, included as part of retained earnings in the Corporation's consolidated statement of financial condition, amounted to $59.7 million as of March 31, 2018. There were no transfers to the legal surplus reserve during the quarter ended March 31, 2018.

Off -Balance Sheet Arrangements

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

As a provider of financial services, the Corporation routinely enters into commitments with off-balance-sheet risk to meet the financial needs of its customers. These financial instruments may include loan commitments and standby letters of credit. These commitments are subject to the same credit policies and approval processes used for on-balance-sheet instruments. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. As of March 31, 2018, commitments to extend credit amounted to approximately $1.2 billion, of which $650.5 million related to credit card loans. Commercial and financial standby letters of credit amounted to approximately $43.3 million. Commitments to extend credit are agreements to lend to customers as long as the conditions established in the contract are met.

Contractual Obligations and Commitments

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

	Contractual Obligations and Commitments As of March 31, 2018				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
			(In thousands)		
Contractual obligations:					
Certificates of deposit	$ 3,390,239	$ 1,905,798	$ 1,106,492	$ 371,183	$ 6,766
Securities sold under agreements to repurchase (1)	200,000	-	-	200,000	-
Advances from FHLB	715,000	95,000	300,000	320,000	-
Other borrowings	184,150	-	-	-	184,150
Total contractual obligations	$ 4,489,389	$ 2,000,798	$ 1,406,492	$ 891,183	$ 190,916
Commitments to sell mortgage loans	$ 59,335				
Standby letters of credit	$ 2,369				
Commitments to extend credit:					
Lines of credit	$ 1,103,190				
Letters of credit	40,959				
Construction undisbursed funds	70,433				
Total commercial commitments	$ 1,214,582				

(1) Reported net of reverse repurchase agreement by counterparty, when applicable, pursuant to ASC 210-20-45-11.

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The Corporation has obligations and commitments to make future payments under contracts, such as debt and lease agreements, and under other commitments to sell mortgage loans at fair value and to extend credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Other contractual obligations result mainly from contracts for the rental and maintenance of equipment. Since certain commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. For most of the commercial lines of credit, the Corporation has the option to reevaluate the agreement prior to additional disbursements. There have been no significant or unexpected draws on existing commitments. In the case of credit cards and personal lines of credit, the Corporation can cancel the unused credit facility at any time and without cause.

Interest Rate Risk Management

First BanCorp. manages its asset/liability position in order to limit the effects of changes in interest rates on net interest income and to maintain stability of profitability under varying interest rate scenarios. The MIALCO oversees interest rate risk, and the MIALCO's meetings focus on, among other things, current and expected conditions in world financial markets, competition and prevailing rates in the local deposit market, liquidity, the pipeline of loan originations, securities market values, recent or proposed changes to the investment portfolio, alternative funding sources and related costs, hedging and the possible purchase of derivatives such as swaps and caps, and any tax or regulatory issues that may be pertinent to these areas. The MIALCO approves funding decisions in light of the Corporation's overall strategies and objectives.

On a quarterly basis, the Corporation performs a consolidated net interest income simulation analysis to estimate the potential change in future earnings from projected changes in interest rates. These simulations are carried out over a one-to-five-year time horizon, assuming upward and downward yield curve shifts. The rate scenarios considered in these simulations reflect gradual upward and downward interest rate movements of 200 basis points during a twelve-month period. Simulations are carried out in two ways:

(1) Using a static balance sheet, as the Corporation had on the simulation date, and

(2) Using a dynamic balance sheet based on recent patterns and current strategies.

The balance sheet is divided into groups of assets and liabilities detailed by maturity or re-pricing structure and their corresponding interest yields and costs. As interest rates rise or fall, these simulations incorporate expected future lending rates, current and expected future funding sources and costs, the possible exercise of options, changes in prepayment rates, deposit decay and other factors, which may be important in projecting net interest income.

The Corporation uses a simulation model to project future movements in the Corporation's balance sheet and income statement. The starting point of the projections corresponds to the actual values on the balance sheet on the date of the simulations.

These simulations are highly complex, and are based on many assumptions that are intended to reflect the general behavior of the balance sheet components over the period in question. It is unlikely that actual events will match these assumptions in most cases. For this reason, the results of these forward-looking computations are only approximations of the true sensitivity of net interest income to changes in market interest rates. Several benchmark and market rate curves were used in the modeling process, primarily the LIBOR/SWAP curve, Prime, Treasury, FHLB rates, brokered CD rates, repurchase agreements rates and the mortgage commitment rate of 30 years.

The 12-month net interest income is forecasted assuming the March 31, 2018 interest rate curves remain constant. Then, net interest income is estimated under rising and falling rate scenarios. For the rising rate scenario, a gradual (ramp) parallel upward shift of the yield curve is assumed during the first 12 months (the "+200 ramp" scenario). Conversely, for the falling rate scenario, a gradual (ramp) parallel downward shift of the yield curve is assumed during the first 12 months (the "-200 ramp" scenario). However, given the current low levels of interest rates, a full downward shift of 200 basis points would represent an unrealistic scenario. Therefore, under the falling rate scenario, rates move downward up to 200 basis points, but without reaching zero. The resulting scenario shows interest rates close to zero in most cases, reflecting a flattening yield curve instead of a parallel downward scenario.

The Libor/Swap curve for March 2018, as compared to December 2017, reflected a 54 basis points increase in the short-term horizon, between 1 to 12 months, while market rates increased by 48 basis points in the medium term, that is, between 2 to 5 years. In the long-term, that is, over a 5-year-time horizon, market rates increased by 38 basis points, causing a more flattened yield curve. The U.S. Treasury curve in the short-term increased by 36 basis points and in the medium-term horizon increased by 39 basis points, as compared to the December 2017 end of month levels. The long-term horizon increased by 28 basis points as compared to December 2017 end-of-month levels.

The following table presents the results of the simulations as of March 31, 2018 and December 31, 2017. Consistent with prior years, these exclude non-cash changes in the fair value of derivatives:

	March 31, 2018 Net Interest Income Risk (Projected for the next 12 months)				**December 31, 2017 Net Interest Income Risk (Projected for the next 12 months)**			
	Static Simulation		**Growing Balance Sheet**		**Static Simulation**		**Growing Balance Sheet**	
(Dollars in millions)	**Change**	**% Change**	**Change**	**% Change**	**Change**	**% Change**	**Change**	**% Change**
+ 200 bps ramp	$ 18.2	3.54%	$ 18.1	3.41%	$ 18.0	3.55%	$ 17.5	3.42%
- 200 bps ramp	$ (16.7)	(3.24)%	$ (19.4)	(3.65)%	$ (14.6)	(2.89)%	$ (17.7)	(3.47)%

The Corporation continues to manage its balance sheet structure to control the overall interest rate risk. As of March 31, 2018, the simulations showed that the Corporation maintains an asset-sensitive position. The Corporation has continued repositioning the balance sheet and improving the funding mix, driven by an increase in the average balance of non-interest bearing deposits and reductions in brokered certificates of deposits, short-term repurchase agreements and other borrowings. The above-mentioned growth in non-interest bearing deposits, along with proceeds from US agency mortgage-backed securities and loan repayments, has helped the Corporation continue to maintain high liquidity levels.

Taking into consideration the above-mentioned facts for modeling purposes, the net interest income for the next 12 months under a non-static balance sheet scenario is estimated to increase by $18.1 million in the rising rate scenario when compared against the Corporation's flat or unchanged interest rate forecast scenario. Under the falling rate, non-static scenario, the net interest income is estimated to decrease by $19.4 million.

Derivatives

First BanCorp. uses derivative instruments and other strategies to manage its exposure to interest rate risk caused by changes in interest rates beyond management's control.

The following summarizes major strategies, including derivative activities, used by the Corporation in managing interest rate risk:

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 for protection from rising interest rates.

Forward contracts - Forward contracts are sales of TBAs MBS that will settle over the standard delivery date and do not qualify as "regular way" security trades. Regular-way security trades are contracts that have no net settlement provision and no market mechanism to facilitate net settlement and provide for delivery of a security within the timeframe generally established by regulations or conventions in the market-place or exchange in which the transaction is being executed. The forward sales are considered derivative instruments that need to be marked-to-market. These securities are used to hedge the FHA/VA residential mortgage loan securitizations of the mortgage-banking operations. Unrealized gains (losses) are recognized as part of mortgage banking activities in the consolidated statement of income.

For detailed information regarding the volume of derivative activities (e.g., notional amounts), location and fair values of derivative instruments in the consolidated statement of financial condition and the amount of gains and losses reported in the consolidated statement of income, refer to Note 11 in the accompanying unaudited consolidated financial statements.

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

(In thousands)	**Asset Derivatives Quarter Ended March 31, 2018**		**Liability Derivatives Quarter Ended March 31, 2018**	
Fair value of contracts outstanding at the beginning of the period	$	312	$	(324)
Changes in fair value during the period		359		(411)
Fair value of contracts outstanding as of March 31, 2018	$	671	$	(735)

Sources of Fair Value

	Payment Due by Period									
(In thousands)	**Maturity Less Than One Year**		**Maturity 1-3 Years**		**Maturity 3-5 Years**		**Maturity in Excess of 5 Years**		**Total Fair Value**	
As of March 31, 2018										
Pricing from observable market inputs - Asset Derivatives	$	3	$	668	$	-	$	-	$	671
Pricing from observable market inputs - Liability Derivatives		(67)		(668)		-		-		(735)
	$	(64)	$	-	$	-	$	-	$	(64)

Derivative instruments, such as interest rate caps, are subject to market risk. 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 level of interest rates, as well as expectations for rates in the future.

As of March 31, 2018 and December 31, 2017, all of the derivative instruments held by the Corporation were considered undesignated economic hedges.

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

Refer to Note 21 of the accompanying unaudited consolidated financial statements for additional information regarding the fair value determination of derivative instruments.

Credit Risk Management

First BanCorp. is subject to credit risk mainly with respect to its portfolio of loans receivable and off-balance-sheet instruments, mainly derivatives and loan commitments. Loans receivable represents loans that First BanCorp. holds for investment and, therefore, First BanCorp. is at risk for the term of the loan. Loan commitments represent commitments to extend credit, subject to specific conditions, for specific amounts and maturities. These commitments may expose the Corporation to credit risk and are subject to the same review and approval process as for loans made by the Bank. Refer to *Contractual Obligations and Commitments* above for further details. The credit risk of derivatives arises from the potential of the counterparty's default on its contractual obligations. To manage this credit risk, the Corporation deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. For further details and information on the Corporation's derivative credit risk exposure, refer to *Interest Rate Risk Management* above. The Corporation manages its credit risk through its credit policy, underwriting, independent loan review and quality control procedures, statistical analysis, comprehensive financial analysis, and established management committees. The Corporation also employs proactive collection and loss mitigation efforts. Furthermore, personnel performing structured loan workout functions are responsible for mitigating defaults and minimizing losses upon default within each region and for each business segment. In the case of the commercial and industrial ("C&I"), commercial mortgage and construction loan portfolios, the Special Asset Group ("SAG") focuses on strategies for the accelerated reduction of non-performing assets through

note sales, short sales, loss mitigation programs, and sales of OREO. In addition to the management of the resolution process for problem loans, the SAG oversees collection efforts for all loans to prevent migration to the non-performing and/or adversely classified status. The SAG utilizes relationship officers, collection specialists and attorneys. In the case of residential construction projects, the workout function monitors project specifics, such as project management and marketing, as deemed necessary.

The Corporation may also have risk of default in the securities portfolio. The securities held by the Corporation are principally fixed-rate U.S. agency mortgage-backed securities and U.S. Treasury and agency securities. Thus, a substantial portion of these instruments is backed by mortgages, a guarantee of a U.S. government-sponsored entity or the full faith and credit of the U.S. government.

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

Allowance for Loan and Lease Losses and Non-performing Assets

Allowance for Loan and Lease Losses

The allowance for loan and lease losses represents the estimate of the level of reserves appropriate to absorb inherent credit losses. The amount of the allowance is determined by empirical analysis and judgments regarding the quality of each individual loan portfolio. All known relevant internal and external factors that affect loan collectability are considered, including analyses of historical charge-off experience, migration patterns, changes in economic conditions, and changes in loan collateral values. For example, factors affecting the economies of Puerto Rico, Florida (USA), the United States Virgin Islands and the British Virgin Islands may contribute to delinquencies and defaults above the Corporation's historical loan and lease losses. Such factors are subject to regular review and may change to reflect updated performance trends and expectations, particularly in times of severe stress. The process includes judgments and quantitative elements that may be subject to significant change.

The allowance for loan and lease losses provides for probable losses that have been identified with specific valuation allowances for individually evaluated impaired loans and probable losses believed to be inherent in the loan portfolio that have not been specifically identified. An internal risk rating is assigned to each business loan at the time of approval and is subject to subsequent periodic reviews by the Corporation's senior management. The allowance for loan and lease losses is reviewed on a quarterly basis as part of the Corporation's continued evaluation of its asset quality.

Hurricanes Maria and Irma caused widespread property damage, flooding, power outages, and water and communication services interruptions, and severely disrupted normal economic activity in the affected areas. Damages associated with these hurricane-related events have had and will continue to have significant short-term economic repercussions, both positive and negative, for the Corporation's commercial and individual loan customers in the most severely affected parts of Puerto Rico and the Virgin Islands. While these events have affected certain quality metrics, including higher non-performing assets, the hurricanes' ultimate effect on loan collections is uncertain. The methodologies used by the Corporation to determine the hurricane-related qualitative estimate and for the review of individual large commercial credits are discussed in detail in Note 1, "Nature of Business and Summary of Significant Accounting Policies," in the audited consolidated financial statements for the year ended December 31, 2017, which are included in the Corporation's 2017 Annual Report on Form 10-K. With the ongoing collection of information on individual commercial customers and statistics on the consumer and residential loan portfolios, the loss estimate will be revised as needed.

The ratio of the allowance for loan and lease losses to total loans held for investment remained relatively flat at 2.60% as of March 31, 2018, compared to 2.62% as of December 31, 2017. The change for each portfolio follows:

- The allowance to total loans ratio for the residential mortgage portfolio decreased from 1.79% as of December 31, 2017 to 1.73% as of March 31, 2018, primarily due to lower delinquency levels reflecting the effect of clients that resumed their payments after the expiration of the three-month payment deferral program.

- The allowance to total loans ratio for the commercial mortgage portfolio increased from 3.00% as of December 31, 2017 to 3.25% as of March 31, 2018, driven by the effect of the downgrade of a $46.8 million loans in Florida.

- The allowance to total loans for the C&I portfolio decreased from 2.35% as of December 31, 2017 to 2.31% as of March 31, 2018, reflecting the effect of a $3.8 million net loan loss reserve release related to revised estimates of the reserve associated with the effects of Hurricanes Maria and Irma, primarily due to updated assessments about the performance and repayment prospects of certain individually assessed commercial loans.

- The allowance to total loans for the construction loan portfolio increased from 4.06% as of December 31, 2017 to 5.21% as of March 31, 2018, primarily due to the effect of the aforementioned transfer of loans to held for sale, including the transfer to held for sale of a $30.0 million construction loan in the Virgin Islands.

- The allowance to total loans for the consumer loan portfolio decreased from 4.06% as of December 31, 2017 to 3.88% as of March 31, 2018, reflecting the effect of a $2.0 million release of the hurricane-related qualitative reserve resulting from payments received during the first quarter that reduced the balance of the consumer loan portfolio outstanding on the dates of the hurricanes.

The ratio of the total allowance to non-performing loans held for investment was 54.82% as of March 31, 2018 compared to 47.36% as of December 31, 2017, reflecting the effect of the aforementioned transfer to held for sale of non-performing commercial and construction loans totaling $57.2 million.

Substantially all of the Corporation's loan portfolio is located within the boundaries of the U.S. economy. Whether the collateral is located in Puerto Rico, the U.S. and British Virgin Islands or the U.S. mainland (mainly in the state of Florida), the performance of the

Corporation's loan portfolio and the value of the collateral supporting the transactions are dependent upon the performance of and conditions within each specific area's real estate market. The real estate market in Puerto Rico experienced readjustments in value driven by the loss of income due to higher unemployment, reduced demand and general adverse economic conditions that were exacerbated by the effect of Hurricanes Maria and Irma. The Corporation sets adequate loan-to-value ratios following its regulatory and credit policy standards.

As shown in the following table, the allowance for loan and lease losses amounted to $225.9 million as of March 31, 2018, or 2.60% of total loans, compared with $231.8 million, or 2.62% of total loans, as of December 31, 2017. Refer to *Provision for Loan and Lease Losses* above for additional information.

	Quarter Ended March 31	
(Dollars in thousands)	**2018**	**201**
Allowance for loan and lease losses, beginning of period	$ 231,843	$ 205.
Provision (release) for loan and lease losses:		
Residential Mortgage (1)	447	9.
Commercial Mortgage (2)	8,661	12.
Commercial and Industrial (3)	656	(4,8
Construction (4)	4,764	
Consumer and Finance Leases (5)	6,016	7.
Total provision for loan and lease losses (6)	20,544	25.
Charge-offs		
Residential Mortgage	(3,371)	(8,2
Commercial Mortgage (7)	(6,810)	(1,3
Commercial and Industrial (8)	(1,930)	(12,0
Construction (9)	(5,177)	
Consumer and Finance Leases	(12,072)	(11,1
Total charge offs (10)	(29,360)	(32,8
Recoveries:		
Residential Mortgage	335	
Commercial Mortgage	49	
Commercial and Industrial	62	
Construction	13	
Consumer and Finance Leases	2,370	2.
Total recoveries	2,829	5.
Net Charge-Offs	(26,531)	(27,8
Allowance for loan and lease losses, end of period	$ 225,856	$ 203.
Allowance for loan and lease losses to period end total loans held for investment	2.60%	
Allowance for loan and lease losses, excluding the $62.1 million hurricane-related allowance, to period end total loans held for investment (11)	1.88%	
Net charge-offs (annualized) to average loans outstanding during the period	1.21%	
Net charge-offs (annualized), excluding charge-offs of $9.7 million related to loans transferred to held		

for sale in the first quarter of 2018 and the charge-off of $10.7 million related to the sale of the PREPA credit line in the first quarter of 2017, to average loans outstanding during the period (11)	0.77%
Provision for loan and lease losses to net charge-offs during the period	0.77x
Provision for loan and lease losses to net charge-offs during period, excluding the effect of the hurricane-related reserve release and loans transferred to held for sale in the first quarter of 2018, and the effect of the sale of the PREPA credit line in the first quarter of 2017 (11)	1.26x

(1) Net of a $0.1 million net loan loss reserve release for the first quarter of 2018 associated with the effects of Hurricanes Ma and Irma.

(2) Net of a $0.2 million net loan loss reserve release for the first quarter of 2018 associated with the revised estimates of the e of Hurricanes Maria and Irma. Includes a provision of $1.1 million associated with $27.2 million in non-performing comm mortgage loans transferred to held for sale in the first quarter of 2018.

(3) Net of a $3.8 million net loan loss reserve release for the first quarter of 2018 associated with revised estimates of the effec Hurricanes Maria and Irma. Includes a provision of $0.6 million associated with the sale of the PREPA credit line in the fir quarter of 2017.

(4) Net of a $0.2 million net loan loss reserve release for the first quarter of 2018 associated with the revised estimates of the e of Hurricanes Maria and Irma. Includes a provision of $4.5 million associated with a $30.0 million non-performing constru loan transferred to held for sale in the first quarter of 2018.

(5) Net of a $2.0 million net loan loss reserve release for the first quarter of 2018 associated with revised estimates of the effec of Hurricanes Maria and Irma.

(6) Net of a $6.4 million net loan loss reserve release for the first quarter of 2018 associated with revised estimates of the effec of Hurricanes Maria and Irma. Includes a provision of $5.6 million associated with $57.2 million in non-performing loans transferred to held for sale in the first quarter of 2018. Includes a provision of $0.6 million associated with the sale of the PREPA credit line in the first quarter of 2017.

(7) Includes charge-offs totaling $4.6 million associated with $27.2 million in non-performing commercial mortgage loans transferred to held for sale in the first quarter of 2018.

(8) Includes a charge-off of $10.7 million associated with the sale of the PREPA credit line in the first quarter of 2017.

(9) Includes a charge-off of $5.1 million associated with a $30.0 million non-performing construction loan transferred to held sale in the first quarter of 2018.

(10) Includes charge-offs totaling $9.7 million associated with $57.2 million in non-performing loans transferred to held for sal the first quarter of 2018. Includes a charge-off of $10.7 million associated with the sale of the PREPA credit line in the firs quarter of 2017.

(11) Non-GAAP financial measures, refer to *Basis of Presentation* below for a reconciliation of these measures.

The following table sets forth information concerning the allocation of the allowance for loan and lease losses by loan
category and the percentage of loan balances in each category to the total of such loans as of the dates indicated:

	As of March 31, 2018		As of December 31, 2017	
(In thousands)	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans
Residential mortgage loans	$ 56,386	37%	$ 58,975	37%
Commercial mortgage loans	50,393	18%	48,493	18%
Construction loans	4,122	1%	4,522	1%
Commercial and Industrial loans	47,659	24%	48,871	24%
Consumer loans and finance leases	67,296	20%	70,982	20%
	$ 225,856	100%	$ 231,843	100%

During the first quarter of 2018, the Corporation implemented enhancements to the methodology behind the calculation of the allowance for commercial loans, which includes, among others, the following: (i) a revised procedure to determine the historical loss rates applicable for each commercial loan regulatory-based credit risk categories (i.e., pass, special mention, substandard and doubtful) that changed the previous blending of loss rates for loans risk-rated special mention, substandard and doubtful with an aggregation methodology whereas historical losses and portfolio balances of special mention loans are allocated to pass or substandard categories based on the historical proportion of the loans in this risk category that ultimate cured or resulted uncollectible; (ii) a quarterly sensitivity analysis using actual historical loss rates for loans risk-rated pass, special mention and substandard to compare the results of such sensitivity to the calculated reserves under the revised procedure, and (iii) establishment of sensitivity thresholds that could trigger further reviews and/or adjustments prior to reaching a conclusion as to the adequacy of the allowance for loan and lease losses for the Corporation's commercial portfolios.

The comparison of the revised procedure with the sensitivity analysis resulted in an immaterial increase to the qualitative reserve for commercial mortgage loans that was recorded as of March 31, 2018. The Corporation engaged an independent third party to assess the allowance framework and the appropriateness of assumptions used in the analysis and expects such review to be completed during the second quarter of 2018.

The following table sets forth information concerning the composition of the Corporation's allowance for loan and lease loss as of March 31, 2018 and December 31, 2017 by loan category and by whether the allowance and related provisions were calculated individually or through a general valuation allowance.

As of March 31, 2018 (Dollars in thousands)	**Residential Mortgage Loans**	**Commercial Mortgage Loans**	**C&I Loans**	**Construction Loans**	**Consumer and Finance Leases**	**Total**
Impaired loans without specific reserves:						
Principal balance of loans, net of charge-offs	$ 94,817	$ 60,811	$ 24,712	$ -	$ 2,653	$ 182,9
Impaired loans with specific reserves:						
Principal balance of loans, net of charge-offs	322,793	101,315	95,066	12,067	32,046	563,2
Allowance for loan and lease losses	22,546	13,451	14,375	1,484	5,074	56,9
Allowance for loan and lease losses to principal balance	6.98%	13.28%	15.12%	12.30%	15.83%	10
PCI loans:						
Carrying value of PCI loans	151,067	4,214	-	-	-	155,2
Allowance for PCI loans	10,873	378	-	-	-	11,2
Allowance for PCI loans to carrying value	7.20%	8.97%	-	-	-	7
Loans with general allowance:						
Principal balance of loans	2,699,191	1,386,163	1,941,995	67,083	1,699,897	7,794,3
Allowance for loan and lease losses	22,967	36,564	33,284	2,638	62,222	157,6
Allowance for loan and lease losses to principal balance	0.85%	2.64%	1.71%	3.93%	3.66%	2
Total loans held for investment:						
Principal balance of loans	$ 3,267,868	$ 1,552,503	$ 2,061,773	$ 79,150	$ 1,734,596	$ 8,695,8
Allowance for loan and lease losses	56,386	50,393	47,659	4,122	67,296	225,8
Allowance for loan and lease losses to principal balance (1)	1.73%	3.25%	2.31%	5.21%	3.88%	2

(Dollars in thousands)	**Residential Mortgage Loans**	**Commercial Mortgage Loans**	**C&I Loans**	**Construction Loans**	**Consumer and Finance Leases**	**Total**
As of December 31, 2017						
Impaired loans without specific reserves:						
Principal balance of loans, net of charge-offs	$ 116,818	$ 65,100	$ 28,292	$ 48	$ 2,788	$ 213,046

Impaired loans with specific reserves:						
Principal balance of loans, net of charge-offs	316,616	87,814	90,008	47,218	35,606	577,262
Allowance for loan and lease losses	22,086	9,783	12,359	2,017	5,165	51,410
Allowance for loan and lease losses to principal balance	6.98%	11.14%	13.73%	4.27%	14.51%	8.91%
PCI loans:						
Carrying value of PCI loans	153,991	4,183	-	-	-	158,174
Allowance for PCI loans	10,873	378	-	-	-	11,251
Allowance for PCI loans to carrying value	7.06%	9.04%	-	-	-	7.11%
Loans with general allowance:						
Principal balance of loans	2,703,532	1,457,875	1,964,953	64,131	1,711,503	7,901,994
Allowance for loan and lease losses	26,016	38,332	36,512	2,505	65,817	169,182
Allowance for loan and lease losses to principal balance	0.96%	2.63%	1.86%	3.91%	3.85%	2.14%
Total loans held for investment:						
Principal balance of loans	$ 3,290,957	$ 1,614,972	$ 2,083,253	$ 111,397	$ 1,749,897	$ 8,850,476
Allowance for loan and lease losses	58,975	48,493	48,871	4,522	70,982	231,843
Allowance for loan and lease losses to principal balance (1)	1.79%	3.00%	2.35%	4.06%	4.06%	2.62%

(1) Loans used in the denominator include PCI loans of $155.3 million and $158.2 million as of March 31, 2018 and December 31, 2017, respectively. However, the Corporation separately tracks and reports PCI loans and

excludes these loans from the amounts of non-performing loans, impaired loans, TDRs and non-performing assets.

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The following tables show the activity for impaired loans held for investment and the related specific reserve during the first quarter of 2018 and 2017:

	Quarter Ended			
	March 31, 2018		March 31, 2017	
	(In thousands)			
Impaired Loans:				
Balance at beginning of period	$	790,308	$	887,905
Loans determined impaired during the period		61,408		19,628
Charge-offs (1) (2)		(17,213)		(17,404)
Loans sold, net of charge-offs		(4,121)		(53,245)
Increases to existing impaired loans		6,998		541
Foreclosures		(11,675)		(9,457)
Loans no longer considered impaired		(1,507)		(892)
Loans transferred to held for sale		(57,213)		-
Paid in full or partial payments		(20,705)		(19,878)
Balance at end of period	$	746,280	$	807,198

(1) The first quarter of 2018 includes charge-offs totaling $9.7 million associated with the $57.2 million in non-performing loans transferred to held for sale.

(2) The first quarter of 2017 includes a charge-off of $10.7 million related to the sale of the PREPA credit line.

	Quarter Ended			
	(In thousands)			
Specific Reserve:				
Balance at beginning of period	$	51,410	$	64,421
Provision for loan losses		22,702		19,294
Net charge-offs		(17,183)		(17,404)
Balance at end of period	$	56,929	$	66,311

In addition, as of March 31, 2018, the Corporation maintained a $0.6 million reserve for unfunded loan commitments, mainly related to outstanding commitments on floor plan revolving lines of credit. The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance sheet loan commitments to borrowers that are experiencing financial difficulties at the balance sheet date. The reserve for unfunded loan commitments is included as part of accounts payable and other liabilities in the consolidated statement of financial condition and any change to the reserve is included as part of other non-interest expenses in the consolidated statement of income.

Non-performing Loans and Non-performing Assets

Total non-performing assets consist of non-performing loans (generally loans held for investment or loans held for sale on which the recognition of interest income has been discontinued when the loan became 90 days past due or earlier if the full and timely collection of interest or principal is uncertain), foreclosed real estate and other repossessed properties, and non-performing investment securities. When a loan is placed in non-performing status, any interest previously recognized and not collected is reversed and charged against interest income.

Non-performing Loans Policy

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

Commercial and Construction Loans — The Corporation places commercial loans (including commercial real estate and construction loans) in non-performing status when interest and principal have not been received for a period of 90 days or more or when collection of all of the principal or interest is not expected due to deterioration in the financial condition of the borrower.

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

Consumer Loans — Consumer loans are classified in non-performing status when interest and principal have not been received for a period of 90 days or more. Credit card loans continue to accrue finance charges and fees until charged-off at 180 days delinquent.

Purchased Credit Impaired Loans — PCI loans were recorded at fair value at acquisition. Since the initial fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans, the subsequent accounting for PCI loans differs from the accounting for non-PCI loans. Therefore, the Corporation separately tracks and reports PCI loans and excludes these from the amounts of non-performing loans, impaired loans, TDR loans, and non-performing assets.

Cash payments received on certain loans that are impaired and collateral dependent are recognized when collected in accordance with the contractual terms of the loans. The principal portion of the payment is used to reduce the principal balance of the loan, whereas the interest portion is recognized on a cash basis (when collected). However, when management believes that the ultimate collectability of principal is in doubt, the interest portion is applied to the outstanding principal. The risk exposure of this portfolio is diversified as to individual borrowers and industries, among other factors. In addition, a large portion is secured with real estate collateral.

Other Real Estate Owned

OREO acquired in settlement of loans is carried at the lower of cost (the carrying value of the loan) or fair value less estimated costs to sell off the real estate. Appraisals are obtained periodically, but generally, on an annual basis.

Other Repossessed Property

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

Past-Due Loans 90 days and still accruing

These are accruing loans that are contractually delinquent 90 days or more. These past-due loans are either current as to interest but delinquent as to the payment of principal or are insured or guaranteed under applicable FHA and VA programs. Past due loans 90 days and still accruing also include PCI loans with individual delinquencies over 90 days, primarily related to mortgage loans acquired from Doral Bank in 2015 and from Doral Financial in 2014.

TDRs are classified as either accrual or nonaccrual loans. A loan on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loans being returned to accrual status

at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a nonaccrual loan.

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

(Dollars in thousands)		March 31, 2018		December 31, 2017
Non-performing loans held for investment:				
Residential mortgage	$	171,380	$	178,291
Commercial mortgage (1)		115,179		156,493
Commercial and Industrial		85,325		85,839
Construction (1)		16,236		52,113
Finance leases		1,801		1,237
Consumer		22,056		15,581
Total non-performing loans held for investment (1)	$	411,977	$	489,554
OREO		154,639		147,940
Other repossessed property		5,646		4,802
Total non-performing assets, excluding loans held for sale	$	572,262	$	642,296
Non-performing loans held for sale (1)		64,945		8,290
Total non-performing assets, including loans held for sale (2)(3)	$	637,207	$	650,586
Past due loans 90 days and still accruing (4)(5)	$	163,045	$	160,725
Non-performing assets to total assets		5.22%		5.31%
Non-performing loans held for investment to total loans held for investment		4.74%		5.53%
Allowance for loan and lease losses	$	225,856	$	231,843
Allowance to total non-performing loans held for investment (6)		54.82%		47.36%
Allowance to total non-performing loans held for investment, excluding residential real estate loans (7)		93.87%		74.48%

(1) During the first quarter of 2018, the Corporation transferred $57.2 million (net of fair value write-downs of $9.7 million) in non-performing loans to held for sale. Loans transferred to held for sale consisted of a $30.0 million non-performing construction loan (net of a $5.1 million fair value write-down) and two non-performing commercial mortgage loans totaling $27.2 million (net of fair value write-downs of $4.6 million).

(2) Purchased credit impaired loans accounted for under ASC 310-30 of $155.3 million and $158.2 million as of March 31, 2018 and December 31, 2017, respectively, are excluded and not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.

(3) Non-performing assets exclude $366.4 million and $374.7 million of TDR loans that were in compliance with the modified terms and in accrual status as of March 31, 2018 and December 31, 2017, respectively.

(4) It is the Corporation's policy to report delinquent residential mortgage loans insured by the FHA or guaranteed by the VA as past-due loans 90 days and still accruing as opposed to

non-performing loans since the principal repayment is insured. These balances include $30.6 million of residential mortgage loans insured by the FHA or guaranteed by the VA that are over 15 months delinquent, and are no longer accruing interest as of March 31, 2018.

(5) Amounts include purchased credit impaired loans with individual delinquencies over 90 days and still accruing with a carrying value as of March 31, 2018 and December 31, 2017 of approximately $30.3 million and $29.3 million, respectively, primarily related to loans acquired from Doral Bank in the first quarter of 2015 and from Doral Financial in the second quarter of 2014.

(6) The ratio of the allowance for loan and lease losses to non-performing loans held for investment, excluding the hurricane-related allowance, was 39.74% and 33.39% as of March 31, 2018 and December 31, 2017, respectively.

(7) The ratio of the allowance for loan and lease losses to non-performing loans held for investment, excluding the residential real estate and the hurricane-related allowance, was 68.05% and 52.52% as of March 31, 2018 and December 31, 2017, respectively.

The following table shows non-performing assets by geographic segment:

(Dollars in thousands)	March 31, 2018	December 31, 2017
Puerto Rico:		
Non-performing loans held for investment:		
Residential mortgage	$ 141,432	$ 147,852
Commercial mortgage (1)	89,575	128,232
Commercial and Industrial	78,913	79,809
Construction	14,458	14,506
Finance leases	1,801	1,237
Consumer	20,985	14,885
Total non-performing loans held for investment	347,164	386,521
OREO	146,128	140,063
Other repossessed property	5,501	4,723
Total non-performing assets, excluding loans held for sale	$ 498,793	$ 531,307
Non-performing loans held for sale (1)	34,945	8,290
Total non-performing assets, including loans held for sale (2)	$ 533,738	$ 539,597
Past due loans 90 days and still accruing (3)	$ 161,281	$ 151,724
Virgin Islands:		
Non-performing loans held for investment:		
Residential mortgage	$ 19,004	$ 22,110
Commercial mortgage	22,973	25,309
Commercial and Industrial	6,412	6,030
Construction (4)	1,778	37,607
Consumer	729	281
Total non-performing loans held for investment	50,896	91,337
OREO	7,015	6,306
Other repossessed property	32	26
Total non-performing assets, excluding loans held for sale	$ 57,943	$ 97,669
Non-performing loans held for sale (4)	30,000	-
Total non-performing assets, including loans held for sale	$ 87,943	$ 97,669
Past due loans 90 days and still accruing	$ 1,764	$ 9,001
United States:		
Non-performing loans held for investment:		
Residential mortgage	$ 10,944	$ 8,329
Commercial mortgage	2,631	2,952
Consumer	342	415
Total non-performing loans held for investment	13,917	11,696
OREO	1,496	1,571
Other repossessed property	113	53

Total non-performing assets	$	15,526	$	13,320
Past due loans 90 days and still accruing	$	-	$	-

(1) During the first quarter of 2018, the Corporation transferred two non-performing commercial mortgage loans totaling $27.2 million (net of fair value write-downs of $4.6 million) to held for sale.

(2) Purchased credit impaired loans accounted for under ASC 310-30 of $155.3 million and $158.2 million as of March 31, 2018 and December 31, 2017, respectively, are excluded and not considered non-performing due to the application of the accretion method, under which these loans will accrete interest income over the remaining life of the loans using estimated cash flow analysis.

(3) Amount includes purchased credit impaired loans with individual delinquencies over 90 days and still accruing with a carrying value as of March 31, 2018 and December 31, 2017 of approximately $30.3 million and $29.3 million, respectively, primarily related to loans acquired from Doral Bank in the first quarter of 2015 and from Doral Financial in the second quarter of 2014.

(4) During the first quarter of 2018, the Corporation transferred a $30.0 million non-performing construction loan (net of a $5.1 million fair value write-down) to held for sale.

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Total non-performing loans, including non-performing loans held for sale, were $476.9 million as of March 31, 2018. This represents a decrease of $20.9 million from $497.8 million as of December 31, 2017. The decrease in non-performing loans was primarily attributable to the charge-offs totaling $11.4 million taken on four commercial and construction loans, including $9.7 million associated with the aforementioned loans transferred to held-for-sale during the first quarter, and payments totaling $4.0 million received in the first quarter of 2018 that reduced the outstanding balance of non-performing commercial mortgage loans that were previously guaranteed by the TDF.

Non-performing commercial mortgage loans, including loans held for sale, decreased by $14.1 million to $142.4 million as of March 31, 2018 from $156.5 million as of December 31, 2017. The decrease was primarily related to charge-offs totaling $6.3 million taken on three commercial mortgage loans in Puerto Rico, including $4.6 million related to $27.2 million in loans transferred to held for sale in the first quarter of 2018, the aforementioned payments totaling $4.0 million received in the first quarter that reduced the outstanding balance of non-performing commercial mortgage loans that were previously guaranteed by the TDF, and a $1.6 million loan brought current and restored to accrual status in the Virgin Islands. Total inflows of non-performing commercial mortgage loans were $3.6 million during the first quarter of 2018 compared to $0.9 million for the same period in 2017.

Non-performing C&I loans decreased by $0.5 million to $85.3 million as of March 31, 2018 from $85.8 million as of December 31, 2017. Total inflows of non-performing C&I loans were $2.8 million for the quarter ended March 31, 2018, compared to $1.4 million for the same quarter in 2017.

Non-performing construction loans, including non-performing construction loans held for sale, decreased by $6.4 million to $54.0 million as of March 31, 2018 from $60.4 million as of December 31, 2017, mainly due to the $5.1 million charge-off taken on the $30.0 million non-performing construction loan transferred to held for sale in the Virgin Islands, and a $0.6 million write-down to the fair value of another construction loan held for sale in Puerto Rico. The inflows of non-performing construction loans during the first quarter of 2018 amounted to $0.2 million compared to inflows of $0.5 million for the same period in 2017.

The following tables present the activity of commercial and construction non-performing loans held for investment:

	Commercial Mortgage	Commercial & Industrial	Construction	Total
(In thousands)				
Quarter ended March 31, 2018				
Beginning balance	$ 156,493	$ 85,839	$ 52,113	294,445
Plus:				
Additions to non-performing	3,568	2,772	196	6,536
Less:				
Loans returned to accrual status	(3,151)	-	-	(3,151)
Non-performing loans transferred to OREO	(1,456)	(1,133)	(58)	(2,647)
	(6,810)	(531)	(5,177)	(12,518)

Non-performing loans charged-off				
Loan collections	(6,251)	(1,622)	(57)	(7,930)
Reclassification	-	-	(781)	(781)
Loans transferred to loans held for sale, net of charge-offs	(27,214)	-	(30,000)	(57,214)
Ending balance	$ 115,179	$ 85,325	$ 16,236	$ 216,740

(In thousands)	Commercial Mortgage	Commercial & Industrial	Construction	Total
Quarter ended March 31, 2017				
Beginning balance	$ 178,696	$ 146,599	$ 49,852	375,147
Plus:				
Additions to non-performing	905	1,389	457	2,751
Less:				
Loans returned to accrual status	(473)	(812)	-	(1,285)
Non-performing loans transferred to OREO	(531)	(457)	(162)	(1,150)
Non-performing loans charged-off	(1,107)	(11,975)	(60)	(13,142)
Loan collections	(2,829)	(3,527)	(1,619)	(7,975)
Reclassification	247	-	-	247
Non-performing loans sold, net of charge-off	-	(53,245)	-	(53,245)
Ending balance	$ 174,908	$ 77,972	$ 48,468	$ 301,348

The following tables present the activity of commercial and construction non-performing loans held for sale:

(In thousands)	Commercial Mortgage	Construction	Total
Quarter ended March 31, 2018			
Beginning balance	$ -	$ 8,079	$ 8,079
Plus:			
Loans transferred from held for investment	27,213	30,000	57,213
Less:			
Lower of cost or market adjustment	-	(558)	(558)
Ending balance	$ 27,213	$ 37,521	$ 64,734

Total non-performing commercial and construction loans, including non-performing loans held for sale, with a book value of $281.7 million as of March 31, 2018 are being carried (net of reserves and accumulated charge-offs) at 49.0% of unpaid principal balance.

Non-performing residential mortgage loans decreased by $6.9 million to $171.4 as of March 31, 2018 from $178.3 million as of December 31, 2017. The decrease was driven by loans transferred to the OREO portfolio, loans brought current, and charge-offs recorded during the first quarter, partially offset by inflows of loans that already had delinquent payments before the hurricanes and failed to resume their payments after the expiration of the three-month payments deferral programs.

The following table presents the activity of residential non-performing loans held for investment:

(In thousands)	Quarters Ended March 31, 2018		Quarters Ended March 31, 2017	
Beginning balance	$	178,291	$	160,867
Plus:				
Additions to non-performing		26,961		22,848
Less:				
Loans returned to accrual status		(19,121)		(12,150)
Non-performing loans transferred to OREO		(10,129)		(9,551)
Non-performing loans charged-off		(2,800)		(4,452)
Loan collections		(2,603)		(2,422)
Reclassification		781		(247)
Ending balance	$	171,380	$	154,893

The amount of non-performing consumer loans, including finance leases, increased by $7.0 million during the first quarter of 2018 to $23.9 million compared to $16.8 million as of December 31, 2017. The increase was mainly related to inflows of loans that already had delinquent payments before the hurricanes and failed to resume their payments after the expiration of the three-month payment deferral program. The inflows of non-performing consumer loans during the first quarter of 2018 were $16.3 million, an increase of $8.5 million, compared to inflows of $7.8 million for the same period in 2017.

As of March 31, 2018, approximately $83.3 million of the loans placed in non-accrual status, mainly commercial loans, were current, or had delinquencies of less than 90 days in their interest payments, including $53.2 million of TDRs maintained in nonaccrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and there is no doubt about full collectability. Collections on these loans are being recorded on a cash basis through earnings, or on a cost-recovery basis, as conditions warrant.

During the quarter ended March 31, 2018, interest income of approximately $1.5 million related to non-performing loans with a carrying value of $281.9 million as of March 31, 2018, mainly non-performing construction and commercial loans, was applied against the related principal balances under the cost-recovery method.

As of March 31, 2018, approximately $74.6 million, or 18.1% of total non-performing loans held for investment have been charged-off to their net realizable value and no specific reserve was allocated as shown in the following table:

(Dollars in thousands)	**Residential Mortgage Loans**	**Commercial Mortgage Loans**	**C&I Loans**	**Construction Loans**	**Consumer and Finance Leases**	**Total**
As of March 31, 2018						
Non-performing loans held for investment charged-off to realizable value	$ 56,696	$ 13,816	$ 3,305	$ -	$ 811	$ 74,628
Other non-performing loans held for investment	114,684	101,363	82,020	16,236	23,046	337,349
Total non-performing loans held for investment	$ 171,380	$ 115,179	$ 85,325	$ 16,236	$ 23,857	$ 411,977
Allowance to non-performing loans held for investments	32.90%	43.75%	55.86%	25.39%	282.08%	54.82%
Allowance to non-performing loans held for investments, excluding non-performing loans charged-off to realizable value	49.17%	49.72%	58.11%	25.39%	292.01%	66.95%
As of December 31, 2017						
Non-performing loans held for investment charged-off to realizable value	$ 76,668	$ 60,680	$ 6,872	$ 48	$ 843	$ 145,111
Other non-performing loans held for investment	101,623	95,813	78,967	52,065	15,975	344,443
Total non-performing loans held for investment	$ 178,291	$ 156,493	$ 85,839	$ 52,113	$ 16,818	$ 489,554
Allowance to non-performing loans held for investments	33.08%	30.99%	56.93%	8.68%	422.06%	47.36%
Allowance to non-performing loans held for investments, excluding non-performing loans charged-off to realizable value	58.03%	50.61%	61.89%	8.69%	444.33%	67.31%

Total loans in early delinquency (i.e., 30-89 days past due loans, as defined in regulatory report instructions) amounted to $202.5 million as of March 31, 2018, a decrease of $42.2 million compared to $244.7 million as of December 31, 2017. The variances by major portfolio categories follow:

- Consumer loans in early delinquency decreased in the first quarter by $44.5 million to $66.7 million as of March 31, 2018 from $111.2 million as of December 31, 2017, and residential mortgage loans in early delinquency decreased in the first quarter by $46.4 million to $69.5 million as of March 31, 2018 from $115.9 million as of December 31, 2017. These variances reflect a combination of clients that resumed their payments after the expiration of the three-month payment deferral programs and loans classified as non-performing during the first quarter. When compared to pre-hurricane levels, consumer loans in early delinquency decreased by $16.2 million to $66.7 million as of March 31, 2018 from $82.9 million as of June 30, 2017, and residential mortgage loans in early delinquency decreased by $35.2 million to $69.5 million as of March 31, 2018 from $104.7 million as of June 30, 2017.

- Commercial and construction loans in early delinquency increased in the first quarter by $48.7 million to $66.4 million as of March 31, 2018 from $17.7 million as of December 31, 2017, primarily related to the aforementioned $46.8 million commercial mortgage loan adversely classified in the Florida region during the first quarter of 2018. When compared to pre-hurricane levels, commercial and construction loans in early delinquency increased by $60.4 million to $66.4 million as of March 31, 2018 from $6.0 million as of June 30, 2017.

The Corporation provides homeownership preservation assistance to its customers through a loss mitigation program in Puerto Rico that is similar to the U.S. government's Home Affordable Modification Program guidelines. Depending upon the nature of borrowers' financial condition, restructurings or loan modifications through this program as well as other restructurings of individual commercial, commercial mortgage, construction, and residential mortgage loans fit the definition of a TDR. A restructuring of a debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Modifications involve changes in one or more of the loan terms that bring a defaulted loan current and provide sustainable affordability. Changes may include, among others, the extension of the maturity of the loan and modifications of the loan rate. Refer to Note 7, "Loans Held for Investment," to the accompanying consolidated financial statements for additional information and statistics about the Corporation's TDR loans.

TDR loans are classified as either accrual or nonaccrual loans. Loans in accrual status may remain in accrual status when their contractual terms have been modified in a TDR if the loans had demonstrated performance prior to the restructuring and payment in full under the restructured terms is expected. Otherwise, loans on nonaccrual and restructured as a TDR will remain on nonaccrual status until the borrower has proven the ability to perform under the modified structure, generally for a minimum of six months, and there is evidence that such payments can and are likely to continue as agreed. Performance prior to the restructuring, or significant events that coincide with the restructuring, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of the restructuring or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains classified as a non-accrual loan. Loan modifications increase the Corporation's interest income by returning a non-performing loan to performing status, if applicable, increase cash flows by providing for payments to be made by the borrower, and limit increases in foreclosure and OREO costs.

The following table provides a breakdown between the accrual and nonaccrual TDRs:

(In thousands)	As of March 31, 2018		
	Accrual	Non-accrual (1)(2)	Total TDRs
Non-FHA/VA Residential Mortgage loans	$ 272,659	$ 77,321	$ 349,980
Commercial Mortgage loans	24,010	61,824	85,834
Commercial and Industrial loans	43,251	53,014	96,265
Construction loans (2)	1,197	5,398	6,595
Consumer loans - Auto	14,082	6,729	20,811
Finance leases	1,653	223	1,876
Consumer loans - Other	9,570	1,445	11,015
Total Troubled Debt Restructurings	$ 366,422	$ 205,954	$ 572,376

(1) Included in non-accrual loans are $53.2 million in loans that were performing under the terms of the restructuring agreement but are reported in non-accrual status until the restructured loans meet the criteria of sustained payment performance under the revised terms for reinstatement to accrual status and are deemed fully collectible.

(2) Excludes a $30.0 million non-performing construction loans transferred to held for sale during the first quarter of 2018.

The OREO portfolio, which is part of non-performing assets, increased by $6.7 million to $154.7 million as of March 31, 2018 from $147.9 million as of December 31, 2017. The following tables show the composition of the OREO portfolio as of March 31, 2018 and December 31, 2017, as well as the activity during the quarter ended March 31, 2018 of the OREO portfolio by geographic region:

OREO Composition by Region

(In thousands)	As of March 31, 2018			
	Puerto Rico	Virgin Islands	Florida	Consolidated
Residential	$ 57,652	$ 1,223	$ 1,365	$ 60,240
Commercial	78,853	4,926	132	83,911
Construction	9,623	865	-	10,488
	$ 146,128	$ 7,014	$ 1,497	$ 154,639

(In thousands)	As of December 31, 2017			
	Puerto Rico	Virgin Islands	Florida	Consolidated
Residential	$ 52,427	$ 514	$ 1,440	$ 54,381
Commercial	77,812	4,927	132	82,871
Construction	9,823	865	-	10,688
	$ 140,062	$ 6,306	$ 1,572	$ 147,940

OREO Activity by Region

(In thousands)	As of March 31, 2018

	Puerto Rico	Virgin Islands	Florida	Consolidated
Beginning Balance	$ 140,062	$ 6,306	$ 1,572	$ 147,940
Additions	15,073	708	85	15,866
Sales	(8,103)	-	(160)	(8,263)
Fair value adjustments	(904)	-	-	(904)
Ending Balance	$ 146,128	$ 7,014	$ 1,497	$ 154,639

Net Charge-offs and Total Credit Losses

Net charge-offs totaled $26.5 million for the first quarter of 2018, or 1.21% of average loans on an annualized basis, compared to $27.8 million, or 1.26% of average loans for the same period in 2017. Net charge-offs for the first quarter of 2018 included charge-offs totaling $9.7 million associated with the $57.2 million in non-performing commercial and construction loans transferred to held for sale. For the first quarter of 2017, net charge-offs included a $10.7 million charge-off related to the sale of the PREPA credit line. Excluding the charge offs related to the loans transferred to held for sale in the first quarter of 2018 and the charge-off related to the sale of the PREPA credit line, total adjusted net charge-offs for the first quarter of 2018 were $16.9 million, or 0.77% of average loans on an annualized basis, compared to adjusted net charge-offs of $17.1 million, 0.78% of average loans for the first quarter of 2017.

Commercial mortgage loans net charge-offs in the first quarter of 2018 were $6.8 million, or an annualized 1.69% of average commercial mortgage loans, compared to $1.3 million, or an annualized 0.33% of average loans, for the first quarter of 2017. Commercial mortgage loans net charge-offs for the first quarter of 2018 included $4.6 million associated with $27.2 million in non-performing loans transferred to held for sale. Excluding the effect of the loans transferred to held for sale, adjusted commercial mortgage loans net charge-offs for the first quarter of 2018 were $2.2 million. The increase, as compared to the first quarter of 2017, was primarily related to a commercial relationship in Puerto Rico.

Construction loans net charge-offs in the first quarter of 2018 were $5.2 million, or an annualized 17.37% of related average loans, compared to net recoveries of $0.4 million for the first quarter of 2017. The variance was primarily related to the $5.1 million charge-off recorded on the $30.0 million non-performing loan transferred to held for sale in the Virgin Islands.

Commercial and industrial loans net charge-offs in the first quarter of 2018 totaled $1.9 million, or an annualized 0.36% of related average loans, compared to $11.2 million, or an annualized 2.07%, for the first quarter of 2017. For the first quarter of 2017, commercial and industrial net charge-offs included a $10.7 million charge-off related to the sale of the PREPA credit line.

Residential mortgage loans net charge-offs in the first quarter of 2018 were $3.0 million, or an annualized 0.38% of related average loans, compared to $7.5 million, or an annualized 0.92% of related average loans, for the first quarter of 2017. Approximately $2.4 million in charge-offs for the first quarter of 2018 resulted from valuations for impairment purposes of residential mortgage loans considered homogeneous given high delinquency and loan-to-value levels, compared to $3.7 million for the first quarter of 2017. Net charge-offs on residential mortgage loans also included $0.7 million related to foreclosures, compared to $3.0 million in the first quarter of 2017.

Net charge-offs of consumer loans and finance leases in the first quarter of 2018 were $9.7 million, or an annualized 2.22% of related average loans, compared to $8.2 million, or an annualized 1.92% of average loans, in the first quarter of 2017. The increase primarily reflects the effect of the loan loss recovery of $1.2 million recorded in the first quarter of 2017 on the sale of certain credit card loans that had been fully charged off in prior periods.

The following table presents annualized net charge-offs to average loans held-in-portfolio:

	Quarter Ended	
	March 31, 2018	**March 31, 2017**
Residential mortgage	0.38%	0.92%
Commercial mortgage (1)	1.69%	0.33%
Commercial and industrial (2)	0.36%	2.07%
Construction (3) (4)	17.37%	(1.17)%
Consumer and finance leases	2.22%	1.92%
Total loans (5) (6)	1.21%	1.26%

(1) Includes net charge-offs totaling $4.6 million associated with $27.2 million in non-performing commercial mortgage loans transferred to held for sale in the first quarter of 2018. The ratio of commercial mortgage net charge-offs to average loans, excluding the charge-offs associated with commercial mortgage loans transferred to held for sale, was 0.55% for the first quarter of 2018.

(2) Includes a charge-off of $10.7 million associated with the sale of the PREPA credit line in the first quarter of 2017. The ratio of commercial and industrial net charge-offs to average loans, excluding the charge-off associated with the sale of the PREPA credit line, was 0.08% for the first quarter of 2017.

(3) Includes a charge-off of $5.1 million associated with a $30.0 million non-performing construction loan transferred to held for sale in the first quarter of 2018. The ratio of construction net charge-offs to average loans, excluding the charge-off associated with the construction loan transferred to held for sale, was 0.22% for the first quarter of 2018.

(4) For the first quarter of 2017, recoveries in construction loans exceeded charge-offs.

(5) Includes net charge-offs totaling $9.7 million associated with $57.2 million in non-performing loans transferred to held for sale in the first quarter of 2018. The ratio of total loans net charge-offs to average loans, excluding charge-offs associated with loans transferred to held for sale, was 0.77% for the first quarter of 2018.

(6) Includes a charge-off of $10.7 million associated with the sale of the PREPA credit line in the first quarter of 2017. The ratio of total net charge-offs to average loans, excluding the charge-off associated with the sale of the PREPA credit line, was 0.78% in the first quarter of 2017.

The following table presents net charge-offs (or recoveries) to average loans held in various portfolios by geographic segment:

	Quarter Ended	
	March 31, 2018	March 31, 2017
PUERTO RICO:		
Residential mortgage	0.43%	1.19%
Commercial mortgage (1)	2.45%	0.46%
Commercial and Industrial (2)	0.52%	2.86%
Construction	0.62%	0.52%
Consumer and finance leases	2.25%	1.96%
Total loans (3)	1.25%	1.62%
VIRGIN ISLANDS:		
Residential mortgage	0.73%	0.10%
Commercial mortgage (4)	(0.15)%	(0.11)%
Commercial and Industrial (5)	(0.01)%	-%
Construction (6) (7)	46.90%	(3.90)%
Consumer and finance leases	2.55%	1.19%
Total loans (8) (9)	4.01%	(0.15)%
FLORIDA:		
Residential mortgage	-%	0.11%
Commercial mortgage (10)	(0.01)%	(0.01)%
Commercial and Industrial	0.05%	-%
Construction (11)	(0.20)%	(0.12)%
Consumer and finance leases	1.30%	1.43%
Total loans	0.06%	0.09%

(1) Includes charge-offs totaling $4.6 million associated with $27.2 million in non-performing commercial mortgage loans transferred to held for sale in the first quarter of 2018. The ratio of commercial mortgage net-charge offs to average loans in Puerto Rico, excluding the charge-offs associated with commercial mortgage loans transferred to held for sale was 0.80% for the first quarter of 2018.
(2) Includes the charge-off of $10.7 million associated with the sale of the PREPA credit line in the first quarter of 2017. The ratio of commercial and industrial net charge-offs to average loans in Puerto Rico, excluding the charge-off associated with the sale of the PREPA credit line, was 0.12%.
(3) Includes charge-offs totaling $4.6 million associated with $27.2 million in non-performing loans transferred to held for sale in the first quarter of 2018. The ratio of total loans net charge-offs to average loans in Puerto Rico, excluding charge-offs associated with loans transferred to held for sale, was 0.97% for the first quarter of 2018.
(4) For the first quarter of 2018 and 2017, recoveries in commercial mortgage loans in the Virgin Islands exceeded charge-offs.
(5) For the first quarter of 2018, recoveries in commercial and industrial loans in the Virgin Islands exceeded charge-offs.
(6) Includes a charge-off of $5.1 million associated with a $30.0 million non-performing construction loan transferred to held for sale in the first quarter of 2018. The ratio of construction net charge-offs to average loans in the Virgin Islands, excluding the charge-off associated with the construction loans transferred to held for sale, was 0.00% for the first quarter of 2018.
(7) For the first quarter of 2017, recoveries in construction loans in the Virgin Islands exceeded charge-offs.

(8) Includes the charge-off of $5.1 million associated with the $30.0 million non-performing loan transferred to held for sale in the Virgin Islands in the first quarter of 2018. The ratio of total loans net charge-offs to average loans in the Virgin Islands, excluding charge-offs associated with the loan transferred to held for sale, was 0.52% for the first quarter of 2018.
(9) For the first quarter of 2017, recoveries in total loans in the Virgin Islands exceeded charge-offs.
(10) For the first quarter of 2018 and 2017, recoveries in commercial mortgage loans in Florida exceeded charge-offs.
(11) For the first quarter of 2018 and 2017, recoveries in construction loans in Florida exceeded charge-offs.

The above ratios are based on annualized charge-offs and are not necessarily indicative of the results expected for the entire year or in subsequent periods.

Total credit losses (equal to net charge-offs plus losses on OREO operations) for the first quarter of 2018 amounted to $26.7 million, or a loss rate of 1.20% on an annualized basis to average loans and repossessed assets, compared to credit losses of $31.9 million, or a loss rate of 1.59% on an annualized basis, for the same period in 2017.

The following table presents information about of the OREO inventory and credit losses for the periods indicated:

	Quarter Ended March 31,			
(Dollars in thousands)	2018		2017	
OREO				
OREO balances, carrying value:				
Residential	$	60,240	$	50,683
Commercial		83,911		76,208
Construction		10,488		10,893
Total	$	154,639	$	137,784
OREO activity (number of properties):				
Beginning property inventory		708		626
Properties acquired		130		114
Properties disposed		(83)		(69)
Ending property inventory		755		671
Average holding period (in days)				
Residential		416		333
Commercial		1,092		881
Construction		1,473		1,150
		855		701
OREO operations gain (loss) :				
Market adjustments and gain (losses) on sale:				
Residential	$	179	$	(1,388)
Commercial		(175)		(3,383)
Construction		(163)		793
		(159)		(3,978)
Other OREO operations expenses		(31)		(97)
Net Loss on OREO operations	$	(190)	$	(4,075)
CHARGE-OFFS				
Residential charge offs, net		(3,036)		(7,476)
Commercial charge offs, net		(8,629)		(12,509)

Construction charge offs, net	(5,164)	382
Consumer and finance leases charge-offs, net	(9,702)	(8,211)
Total charge-offs, net	(26,531)	(27,814)
TOTAL CREDIT LOSSES (1)	$ (26,721)	$ (31,889)
LOSS RATIO PER CATEGORY (2):		
Residential	0.35%	1.07%
Commercial	0.93%	1.66%
Construction	16.31%	-3.28%
Consumer	2.22%	1.91%
TOTAL CREDIT LOSS RATIO (3)	**1.20%**	**1.59%**

(1) Equal to Net Loss on OREO operations plus charge-offs, net.

(2) Calculated as net charge-offs plus market adjustments and gains (losses) on sale of OREO divided by average loans and repossessed assets.

(3) Calculated as net charge-offs plus net loss on OREO operations divided by average loans and repossessed assets.

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Operational Risk

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

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

Legal and Compliance Risk

Legal and compliance risk includes the risk of noncompliance with applicable legal and regulatory requirements, the risk of adverse legal judgments against the Corporation, and the risk that a counterparty's performance obligations will be unenforceable. The Corporation is subject to extensive regulation in the different jurisdictions in which it conducts its business, and this regulatory scrutiny has been significantly increasing over the last several years. The Corporation has established and continues to enhance procedures based on legal and regulatory requirements that are designed to ensure compliance with all applicable statutory and regulatory requirements. The Corporation has a Compliance Director who reports to the Chief Risk Officer and is responsible for the oversight of regulatory compliance and implementation of an enterprise-wide compliance risk assessment process. The Compliance division has officer roles in each major business area with direct reporting relationships to the Corporate Compliance Group.

Concentration Risk

The Corporation conducts its operations in a geographically concentrated area, as its main market is Puerto Rico. However, the Corporation has diversified its geographical risk, as evidenced by its operations in the Virgin Islands and in Florida. Of the total gross loan portfolio held for investment of $8.7 billion as of March 31, 2018, credit risk concentration was approximately 75% in Puerto Rico, 19% in the United States (mainly in the state of Florida) and 6% in the Virgin Islands.

Update to the Puerto Rico Fiscal Situation

Economy Indicators and Projections

A significant portion of our financial activities and credit exposure is concentrated in the Commonwealth of Puerto Rico, which has been in an economic recession since 2006, that has been exacerbated by the effects of Hurricanes Irma and Maria in 2017. The New Fiscal Plan certified by the PROMESA oversight board, projects a contraction in the Puerto Rico's gross national product ("GNP") of 13.2% for fiscal year 2018, followed by projected growths of 5.9% and 1.6% for fiscal years 2019 and 2020, respectively. Such projected growth was based on an assumption that over $62 billion of disaster relief funding will enter the economy of Puerto Rico from federal and private sources. Of the total disaster relief funding of $62 billion, approximately $35 billion is estimated to be used for public assistance, $19 billion for individual assistance, and $8 billion will be used for private and business insurance pay outs. Meanwhile, the GDB Economic Activity Index (the "GDB-EAI") in December 2017 was 104.9, a 13.9% reduction compared to March 2017, and a decrease of 13.3% compared to August 2017. The GDB-EAI is a coincident index of economic activity for Puerto Rico made up of four indicators (non-farm payroll employment, electric power generation, cement sales and gasoline consumption). The New Fiscal Plan projects that the hurricanes will create a spike in inflation of 2.0% in fiscal year 2018, with subsequent average increases of about 1.8.

5% over the next six years, until fiscal year 2023. The seasonally adjusted unemployment rate in Puerto Rico was 10.9% in December 2017, compared to 12.4% in December 2016.

GDB liquidation plan

On July 14, 2017, the PROMESA oversight board authorized the GDB to pursue the restructuring of its debts under Title VI of PROMESA and conditionally certified the GDB's Restructuring Support Agreement ("RSA") under the relevant provisions of Title VI. The PROMESA oversight board's decision was in response to a request from Puerto Rico's Fiscal Agency and Financial Advisory Authority, dated June 30, 2017, in which the agency noted that the proposed restructuring, along with certain related settlements contemplated by the RSA, will result in an efficient wind down of GDB's operations and a comprehensive financial restructuring of GDB's obligations. The RSA provides for the organized and consensual restructuring of a substantial portion of the

GDB's liabilities, including the GDB public bonds, deposit claims by municipalities and certain non-public entities, and claims under certain GDB-issued letters of credit and guarantees ("Participating Bond Claims"). In exchange for releasing the GDB from liability relating to these claims, the claim-holders will receive new bonds to be issued by a new entity.

On April 20, 2018, the PROMESA oversight board approved the new GDB fiscal plan. The new GDB fiscal plan authorizes the recently amended terms of the GDB's Restructuring Support Agreement ("RSA"). It also paves the way for the GDB's operational wind-down, provides for a simplified transaction structure, and ensures equal treatment of creditors. It also offers municipalities offset rights against their deposit claims.

New Fiscal Plan

On April 19, 2018, the PROMESA oversight board's twelfth public meeting took place. In that meeting, the PROMESA oversight board approved the Commonwealth of Puerto Rico New Fiscal Plan (the "New Fiscal Plan"). The New Fiscal Plan uses a six-year horizon and projects a six-year cumulative decline in population of 12%. In addition, the New Fiscal Plan established an annual emergency reserve of $130 million for 10 years. As mentioned above, it also assumes $62 billion in disaster relief funding. The New Fiscal Plan include a series of structural reforms in areas, such as: (i) human capital and labor, (ii) ease of doing business, (iii) power sector reform, and (iv) infrastructure reform. The plan also proposes fiscal measures projected to drive $12.3 billion in increased revenues and reduced expenditures through fiscal year 2023, and up to $142 billion in fiscal benefits over a 30-year period. These fiscal measures include areas, such as: (i) tax compliance and incentives, (ii) governmental rightsizing, (iii) healthcare reform, (iv) reduction of appropriations, (v) comprehensive pension reform, and (vi) fiscal controls, budgeting, procurement practices and accountability.

Exposure to Puerto Rico Government

As of March 31, 2018, the Corporation had $213.4 million of direct exposure to the Puerto Rico government, its municipalities and public corporations, compared to $214.5 million as of December 31, 2017. As of March 31, 2018, approximately $183.5 million of the exposure consisted of loans and obligations of municipalities in Puerto Rico that are supported by assigned property tax revenues and for which, in most cases, the good faith, credit and unlimited taxing power of the applicable municipality have been pledged to their repayment, compared to $184.6 million as of December 31, 2017. Approximately 73% of the Corporation's municipality exposure consisted primarily of senior priority obligations concentrated in three of the largest municipalities in Puerto Rico. These municipalities are required by law to levy special property taxes in such amounts as are required for the payment of all of their respective general obligation bonds and notes. The PROMESA oversight board has not designated any of the Commonwealth's 78 municipalities as covered entities under PROMESA. However, while the recent fiscal plan approved by the PROMESA oversight board did not contemplate a restructuring of the debt of Puerto Rico's municipalities, the plan did call for the gradual elimination of budgetary subsidies provided to municipalities. Furthermore, municipalities are also likely to be affected by the negative economic and other effects resulting from expense, revenue or cash

management measures taken to address the Puerto Rico government's fiscal and liquidity shortfalls, as well as measures included in fiscal plans of other government entities. In addition to municipalities, the total direct exposure also included a $6.7 million loan to a unit of the central government, and a $15.0 million loan to an affiliate of PREPA. The Corporation's total direct exposure also included obligations of the Puerto Rico government, specifically bonds of the Puerto Rico Housing Finance Authority, at an amortized cost of $8.1 million as part of its available-for-sale investment securities portfolio recorded on its books at a fair value of $6.8 million as of March 31, 2018.

The following table details the Corporation's total direct exposure to the Puerto Rico Government according to their maturities:

	As of March 31, 2018		
	Investment Portfolio (Amortized cost)	**Loans**	**Total Exposure**
(In thousands)			
Central Government:			
After 1 to 5 years	$ -	$ 6,739	$ 6,739
Total Central Government	-	6,739	6,739
Puerto Rico Housing Finance Authority:			
After 5 to 10 years	4,052	-	4,052
After 10 years	4,035	-	4,035
Total Puerto Rico Housing Finance Authority	8,087	-	8,087
Public Corporations:			
Affiliate of the Puerto Rico Electric Power Authority:			
After 1 to 5 years	-	14,984	14,984
Total Public Corporations	-	14,984	14,984
Municipalities:			
After 1 to 5 years	3,712	33,056	36,768
After 5 to 10 years	39,523	-	39,523
After 10 years	107,251	-	107,251
Total Municipalities	150,486	33,056	183,542
Total Direct Government Exposure	$ 158,573	$ 54,779	$ 213,352

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Furthermore, as of March 31, 2018, the Corporation had three loans granted to the hotel industry in Puerto Rico that were previously guaranteed by the TDF with an outstanding principal balance of $116.2 million (book value $61.6 million), compared to $120.2 million outstanding (book value of $70.8 million) as of December 31, 2017. Historically, the borrower and the operations of the underlying collateral of these loans have been the primary sources of repayment and the TDF, which is a subsidiary of the GDB, provided a secondary guarantee for payment performance. As part of agreements executed in the second quarter of 2017 and first quarter of 2018, the TDF paid $7.6 million and $4.0 million, respectively, to honor a portion of its guarantee on these loans. As provided in the agreements, the cash payments received by the Corporation released the TDF from its liability as a guarantor of these loans. All three of the commercial mortgage loans previously guaranteed by the TDF have been classified as non-performing and impaired since the first quarter of 2016, and interest payments have been applied against principal since then. Approximately $5.2 million of interest payments received on loans previously guaranteed by the TDF since late March 2016 have been applied against principal. In addition, the GDB agreed to issue to the Bank a fixed income financial instrument pursuant to the GDB's Restructuring Support Agreement approved by the PROMESA oversight board. During the first quarter of 2018, two of these three commercial mortgage loans, with an aggregate outstanding principal balance of $50.4 million (book value of $27.2 million) were transferred to held for sale.

In addition, the Corporation had $115.9 million in exposure to residential mortgage loans that are guaranteed by the Puerto Rico Housing Finance Authority. Residential mortgage loans guaranteed by the Puerto Rico Housing Finance Authority are secured by the underlying properties and the guarantees serve to cover shortfalls in collateral in the event of a borrower default. The Puerto Rico government guarantees up to $75 million of the principal under the mortgage loan insurance program. According to the most recently released audited financial statements of the Puerto Rico Housing Finance Authority, as of June 30, 2015, the Puerto Rico Housing Finance Authority's mortgage loans insurance program covered loans in aggregate of approximately $552 million. The regulations adopted by the Puerto Rico Housing Finance Authority require the establishment of adequate reserves to guarantee the solvency of the mortgage loan insurance fund. As of June 30, 2015, the most recent date as to which information is available, the Puerto Rico Housing Finance Authority had a restricted net position for such purposes of approximately $77.4 million.

As of March 31, 2018, the Corporation had $541.4 million of public sector deposits in Puerto Rico, compared to $490.3 million as of December 31, 2017. Approximately 24% is from municipalities and municipal agencies in Puerto Rico and 76% is from public corporations and the central government and agencies in Puerto Rico.

Exposure to USVI Government

The Corporation has operations in the USVI and has credit exposure to USVI government entities.

The USVI is experiencing a number of fiscal and economic challenges, exacerbated by the impact of Hurricane Irma in the third quarter of 2017, that could adversely affect the ability of its public corporations and instrumentalities to service their outstanding debt obligations. PROMESA does not apply to the USVI and, as such, there is currently no federal legislation permitting the restructuring of the debts of the USVI and its public corporations and instrumentalities.

To the extent that the fiscal condition of the USVI government continues to deteriorate, the U.S. Congress or the government of the USVI may enact legislation allowing for the restructuring of the financial obligations of the USVI government entities or imposing a stay on creditor remedies, including by making PROMESA applicable to the USVI.

As of March 31, 2018, the Corporation had $76.7 million in loans to USVI government instrumentalities and public corporations, compared to $70.4 million as of December 31, 2017. Of the amount outstanding as of March 31, 2018, public corporations of the USVI owed approximately $53.5 million and an independent instrumentality of the USVI government owned approximately $23.2 million. As of March 31, 2018, all loans were currently performing and up to date on principal and interest payments.

Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in conformity with GAAP, which requires the measurement of the financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

Unlike most industrial companies, substantially all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a greater impact on a financial institution's performance than the effects of general levels of inflation. Interest rate movements are not necessarily correlated with changes in the prices of goods and services.

Basis of Presentation

The Corporation has included in this Form 10-Q the following financial measures that are not recognized under GAAP, which are referred to as non-GAAP financial measures:

1. Net interest income, interest rate spread, and net interest margin are reported excluding the changes in the fair value of derivative instruments and on a tax-equivalent basis in order to provide to investors additional information about the Corporation's net interest income that management uses and believes should facilitate comparability and analysis. The changes in the fair value of derivative instruments have no effect on interest due or interest earned on interest-bearing liabilities or interest-earning assets, respectively. The tax-equivalent adjustment to net interest income recognizes the income tax savings when comparing taxable and tax-exempt assets and assumes a marginal income tax rate. Income from tax-exempt earning assets is increased by an amount equivalent to the taxes that would have been paid if this income had been taxable at statutory rates. Management believes that it is a standard practice in the banking industry to present net interest income, interest rate spread, and net interest margin on a fully tax-equivalent basis. This adjustment puts all earning assets, most notably tax-exempt securities and tax-exempt loans, on a common basis that facilitates comparison of results to the results of peers. Refer to *Net Interest Income* above for the table that reconciles the non-GAAP financial measure "net interest income excluding fair value changes and on a tax-equivalent basis" with net interest income calculated and presented in accordance with GAAP. The table also reconciles the non-GAAP financial measures "net interest spread and margin excluding fair value changes and on a tax-equivalent basis" with net interest spread and margin calculated and presented in accordance with GAAP.

2. The tangible common equity ratio and tangible book value per common share are non-GAAP financial measures generally used by the financial community to evaluate capital adequacy. Tangible common equity is total equity less preferred equity, goodwill, core deposit intangibles, and other intangibles, such as the purchased credit card relationship intangible asset and the insurance customer relationship intangible asset. Tangible assets are total assets less goodwill, core deposit intangibles, and other intangibles, such as the purchased credit card relationship intangible asset and the insurance customer relationship intangible asset. Management and many stock analysts use the tangible common equity ratio and tangible book value per common share in conjunction with more traditional

bank capital ratios to compare the capital adequacy of banking organizations with significant amounts of goodwill or other intangible assets, typically stemming from the use of the purchase method of accounting for mergers and acquisitions. Accordingly, the Corporation believes that disclosures of these financial measures may be useful also to investors. Neither tangible common equity nor tangible assets, or the related measures, should be considered in isolation or as a substitute for stockholders' equity, total assets, or any other measure calculated in accordance with GAAP. Moreover, the manner in which the Corporation calculates its tangible common equity, tangible assets, and any other related measures may differ from that of other companies reporting measures with similar names. Refer to *Risk Management – Capital* above for a reconciliation of the Corporation's tangible common equity and tangible assets.

3. Adjusted provision for loan and lease losses, adjusted net charge-offs and the ratios of adjusted net charge-offs to average loans, adjusted provision for loan and lease losses to net charge-offs, and the adjusted allowance to total loans held for investment are non-GAAP financial measures that exclude the effects related to: (a) a $6.4 million net loan loss reserve release recorded in the first quarter of 2018 in connection with revised estimates of the reserve associated with the effects of Hurricanes Maria and Irma, (b) a $5.6 million charge to the provision associated with commercial and construction loans transferred to held for sale in the first quarter of 2018, and (c) the effect related to the sale of the Corporation's participation in the PREPA line of credit in the first quarter of 2017. Management believes that this information helps investors understand the adjusted measures without regard to items that are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts on reported results and facilitates comparisons with prior periods.

4. Adjusted non-interest income excludes the effect of the $2.3 million gain on the repurchase and cancellation of trust preferred securities in the first quarter of 2018 and the effect of $12.2 million in other-than-temporary impairment charges on debt securities recorded in the first quarter of 2017. Management believes that the exclusion from non-interest income of items that are not expected to reoccur with any regularity or may reoccur at uncertain times or in uncertain amounts facilitates comparisons with prior periods, and provides an alternate presentation of the Corporation's performance.

5. Adjusted non-interest expenses reflect the exclusion of hurricane-related expenses of $1.6 million associated with the effects of Hurricanes Irma and Maria in the first quarter of 2018, and the exclusion of costs of $0.3 million associated with a secondary offering of the Corporation's common stock by certain of the existing stockholders in the first quarter of 2017. Management believes that adjustments to non-interest expenses of items that are above normal or recurring levels, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts facilitate comparisons with prior periods, and provide an alternate presentation of the Corporation's performance.

6. Adjusted net income that reflects the effect of the $13.2 million tax benefit recorded in the first quarter of 2017 related to the change in tax status of certain subsidiaries from taxable corporations to limited liability companies, and the effect of all the items mentioned above and their tax related impacts as follows:

- Tax expense of $2.5 million in the first quarter of 2018 related to the net loan loss reserve release resulting from the revised estimates of the reserves associated with the effects of Hurricanes Maria and Irma (calculated based on the statutory tax rate of 39%).

- Tax benefit of $2.2 million in the first quarter of 2018 related to the charges to the provision for loan and lease losses recorded in connection with the $57.2 million in loans transferred to held for sale (calculated based on the statutory tax rate of 39%).

- Tax benefit of $0.6 million in the first quarter of 2018 related to hurricane-related costs (calculated based on the statutory tax rate of 39%).

- Tax benefit of $0.2 million in the first quarter of 2017 related to the charge to the provision for loan and lease losses in connection with the sale of the Corporation's participation in the PREPA credit line (calculated based on the statutory tax rate of 39%).

- No tax expense/benefit was recorded for the gain on repurchase and cancellation of trust preferred securities and for costs related to the secondary offering that was recorded at the holding company level in the first quarter of 2018 and the first quarter of 2017, respectively.

- No tax benefit was recognized for the OTTI charges recorded in the first quarter of 2017 on tax-exempt bonds of the GDB and the Puerto Rico Public Buildings Authority.

Management believes that adjustments to net income of items that are not reflective of core operating performance, are not expected to reoccur with any regularity or may reoccur at uncertain times and in uncertain amounts facilitate comparisons with prior periods, and provide an alternate presentation of the Corporation's performance.

The Corporation uses these non-GAAP financial measures, and believes that these non-GAAP financial measures enhance the ability of analysts and investors to analyze trends in the Corporation's business and understand the performance of the Corporation. In addition, the Corporation may utilize these non-GAAP financial measures as a guide in its budgeting and long-term planning process. Any analysis of these non-GAAP financial measures should be used only in conjunction with results presented in accordance with GAAP.

Refer to Overview of Results of Operations above for the reconciliation of the non-GAAP financial measure “adjusted net income,” to the GAAP financial measures. The following tables reconcile the non-GAAP financial measures “adjusted net charge-offs,” “adjusted net charge-offs to average loans ratio,” “adjusted provision for loan and lease losses,” “adjusted provision for loan and lease losses to adjusted net charge-offs,” “adjusted allowance for loan and lease losses to total loans held for investment,” “adjusted non-interest income,” and “adjusted non-interest expenses,” to the GAAP financial measures for the first quarter of 2018 and 2017:

2018 First Quarter	As reported (GAAP)	Loans Transferred to Held for Sale	Storm-related Allowance	Storm-rel Expenses Relate Adjustme
(Dollars in thousands)				
Total net-charge offs (1)	**$ 26,531**	**$ (9,673)**	**$ -**	**$**
Total net charge-offs to average loans	1.21%			
Commercial mortgage	6,761	(4,573)	-	
Commercial mortgage net charge-offs average loans	1.69%			
Construction	5,164	(5,100)	-	
Construction net charge-offs to average loans	17.37%			
Provision for loan and lease losses	**$ 20,544**	**$ (5,645)**	**$ 6,407**	**$**
Residential mortgage	447	-	136	
Commercial mortgage	8,661	(1,105)	245	
Commercial and industrial	656	-	3,822	
Construction	4,764	(4,540)	161	
Consumer	6,016	-	2,043	
Non-interest income	**$ 22,784**	**$ -**	**$ -**	**$**
Gain on early extinguishment of debt	2,316	**-**	**-**	
Non-interest expenses	**$ 86,027**	**$**	**$**	**$ (1,**
Employees' compensation and benefits	40,684	**-**	**-**	
Occupancy and equipment	15,105	**-**	**-**	(1,
Business promotion	2,576	**-**	**-**	

(1) Net charge-offs percentages annualized

2017 First Quarter	As reported (GAAP)	Sale of PREPA Credit Line	Secondary Offering Costs	OTTI o Debt Securiti
(Dollars in thousands)				
Total net-charge offs (1)	**$ 27,814**	**$ (10,734)**	**$ -**	**$**
Total net charge-offs to average loans	1.26%			
Commercial and Industrial	11,177	(10,734)	-	
Commercial and industrial net charge-offs average loans	2.07%			
Provision for loan and lease losses	**$ 25,442**	**$ (569)**	**$ -**	**$**
Commercial and industrial	(4,806)	(569)	-	

Non-interest income	**$**	**8,243$**	**-$**	**-$**	**12**
(Loss) gain on investments and impairments		(12,231)	**-**	**-**	12
Non-interest expenses	**$**	**87,882$**	**$**	**(274)$**	
Professional fees		10,956	**-**	**(254)**	
Business promotion		3,281	**-**	**(20)**	

(1) Net charge-offs percentages annualized

The following tables reconcile the ratios of provision for loan and lease losses to net charge-offs, net charge-offs to average loans, and allowance for loan and lease losses to total loans held for investment for the first quarter of 2018 and 2017 to the Non-GAAP financial measure "adjusted provision for loan and lease losses to net charge-offs," "adjusted net charge-offs to average loans," and "adjusted allowance for loan and lease losses to total loans held for investment" for the first quarter of 2018 and 2017:

	Provision for Loan and Lease Losses to Net Charge-Offs and Net Charge-Offs to Average Loans (GAAP to Non-GAAP reconciliation) Quarter Ended March 31, 2018	
(In thousands)	Provision for Loan and Lease Losses	Net Charge-Offs
Provision for loan and lease losses and net charge-offs (GAAP)	$ 20,544	$ 26,531
Less special items:		
Loans transferred to held for sale	(5,645)	(9,673)
Storm-related reserve release/(charge) to the provision for loan and lease losses	6,407	-
Provision for loan and lease losses and net charge-offs, excluding special items (Non-GAAP)	$ 21,306	$ 16,858
Average Loans	$ 8,778,968	
Provision for loan and lease losses to net charge-offs (GAAP)	77.43%	
Provision for loan and lease losses to net charge-offs, excluding special items (Non-GAAP)	126.39%	
Net charge-offs to average loans (GAAP)	1.21%	
Net charge-offs to average loans, excluding special items (Non-GAAP)	0.77%	

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(In thousands)	Provision for Loan and Lease Losses to Net Charge-Offs and Net Charge-Offs to Average Loans (GAAP to Non-GAAP reconciliation) Quarter Ended March 31, 2017 Provision for Loan and Lease Losses	Net Charge-Offs
Provision for loan and lease losses and net charge-offs (GAAP)	$ 25,442	$ 27,814
Less special items:		
Sale of the PREPA credit line	(569)	(10,734)
Provision for loan and lease losses and net charge-offs, excluding special items (Non-GAAP)	$ 24,873	$ 17,080
Average Loans	$ 8,862,271	
Provision for loan and lease losses to net charge-offs (GAAP)	91.47%	
Provision for loan and lease losses to net charge-offs, excluding special items (Non-GAAP)	145.63%	
Net charge-offs to average loans (GAAP)	1.26%	
Net charge-offs to average loans, excluding special items (Non-GAAP)	0.78%	

	Allowance for Loan and Lease Losses to Total Loans Held for Investment (GAAP to Non-GAAP reconciliation)		Allowance and Lease Total Loan Investment Non-(reconci
	As of March 31, 2018		As of Dece 20
(In thousands)	Allowance for Loan and Lease Losses	Total Loans Held for Investment	Allowance for Loan and Lease Losses
Allowance for Loan and Lease Losses and Total Loans Held for Investment (GAAP)	$225,856	$8,695,890	$231,843
Less Special items:			
Storm-related allowance for loan and lease losses	(62,136)	-	(68,543)
Allowance for Loan and Lease Losses and Total Loans Held for Investment,			

excluding special items (Non-GAAP)	$163,720	$8,695,890	$163,300
Allowance for Loan and Lease Losses to Total Loans Held for Investment (GAAP)	2.60%		2.62%
Allowance for Loan and Lease Losses to Total Loans Held for Investment, excluding special items (Non-GAAP)	1.88%		1.85%

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding market risk to which the Corporation is exposed, see the information contained in "Part I – Item 2 -"Management's Discussion and Analysis of Financial Condition and Results of Operations — Risk Management."

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Control and Procedures

First BanCorp.'s management evaluated the effectiveness of the design and operation of First BanCorp.'s disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of March 31, 2018. Disclosure controls and procedures are designed to ensure that information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to ensure timely decisions regarding required disclosures. During the evaluation of disclosure controls and procedures and our internal control over financial reporting as of December 31, 2017, which was conducted during the preparation of our financial statements that were included in our Annual Report on Form 10-K for the year ended December 31, 2017, management identified a material weakness in internal control over financial reporting relating to management's review and approval of the appropriateness of certain assumptions used to estimate the allowance for loan losses for commercial loans. As a result, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2017, our disclosure controls and procedures and our internal control over financial reporting were ineffective. Upon identification of the material weakness and under the direction of our Chief Executive Officer and Chief Financial Officer, we developed a plan to remediate the material weakness.

As of March 31, 2018, and as described under Status of Remediation of Material Weakness in Internal Control Over Financial Reporting below, the material weakness has not being fully remediated. As a result, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2018, our disclosure controls and procedures were not effective. Notwithstanding the aforementioned material weakness, management has taken additional steps to assure the accuracy of our allowance for loan losses for commercial loans as of March 31, 2018, and has concluded that the financial statements included in this report fairly present, in all material respects, our financial condition for the periods presented in conformity with generally accepted accounting principles.

Internal Control over Financial Reporting

There have been no changes to the Corporation's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting, other than as described below under the caption "Status of Remediation of Material Weakness in Internal Control Over Financial Reporting."

Status of Remediation of Material Weakness in Internal Control Over Financial Reporting

As previously described in Part II, Item 9A of our 2017 Form 10-K, we began implementing a remediation plan to address the control deficiency that led to the material weakness mentioned above. The remediation plan includes the following:

• Implementing a revised procedure to determine the historical loss rates to be applied to the different commercial loans regulatory-based credit risk categories (i.e., pass, special mention, substandard and doubtful).

• Implementing a quarterly sensitivity analysis using actual historical loss rates for loans risk-rated pass, special mention and substandard to compare the results of such sensitivity to the calculated reserves under the revised procedure, and establishing sensitivity thresholds that could trigger further reviews and/or adjustments prior to reaching a conclusion as to the adequacy of the allowance for loan losses for the Corporation's commercial portfolio.

• Engaging an independent third party to assess the allowance framework and the appropriateness of the assumptions used in the analysis.

The Corporation implemented enhancements to the methodology and internal controls behind the calculation of the allowance for commercial loans that were in place and operating during the first quarter of 2018, which includes, among others, the following: (i) a revised procedure to determine the historical loss rates applicable for each commercial loan regulatory-based credit risk category (i.e., pass, special mention, substandard and doubtful) that changed the previous blending of loss rates for loans risk-rated special mention, substandard and doubtful to an aggregation methodology under which historical losses and portfolio balances of special mention loans are allocated to pass or substandard categories based on the historical proportion of the loans in this risk category that are ultimately cured or resulted uncollectible; and (ii) the implementation of a quarterly sensitivity analysis and establishment of sensitivity thresholds as described in the Remediation Plan.

In addition, the Corporation engaged an independent third party to assess the allowance framework and the appropriateness of assumptions used in the analysis and expects such review to be completed during the second quarter of 2018.

Management believes that the new procedures and controls discussed above will appropriately remediate the material weakness; however, the effectiveness of the controls has not been fully tested by management. The Corporation expects to remediate the material weakness during 2018 subsequent to the completion of the independent third party assessment and when, in the opinion of our management, the revised control processes have been operating on a satisfactory basis for a sufficient period of time and have been independently validated by management.

The remediation and ultimate resolution of the material weakness will be reviewed with the Audit Committee of the Corporation's Board of Directors.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable.

ITEM 1A. RISK FACTORS

The Corporation's business, operating results and/or the market price of our common and preferred stock may be significantly affected by a number of factors. For a detailed discussion of certain risk factors that could affect the Corporation's future operations, financial condition or results for future periods see the risk factors in Item 1A, "Risk Factors," in the Corporation's 2017 Annual Report on Form 10-K. These factors could also cause actual results to differ materially from historical results or the results contemplated by the forward-looking statements contained in this report. Also refer to the discussion in "Part I – Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report for additional information that may supplement or update the discussion of risk factors in the Corporation's 2017 Form 10-K.

There have been no other material changes from those risk factors previously disclosed in Item 1A, "Risk Factors," of Part I of the Corporation's 2017 Form 10-K. Additional risks and uncertainties that are not currently known to the Corporation or are currently deemed by the Corporation to be immaterial also may materially adversely affect the Corporation's business, financial condition or results of operations.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

a) Not applicable.

b) Not applicable

c) Purchase of equity securities by the issuer and affiliated purchases. The following table provides information relating to the Corporation's purchases of shares of its common stock in the first quarter of 2018.

Period	Total number of shares purchased (1)		Average price paid	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet be Purchased Under These Plans or Programs
January 2018	26,346	$	5.48	-	-
February 2018	15,497		6.02	-	-
March 2018	341,244		6.44	-	-
Total	383,087	$	6.35	**-**	**-**

(1)	Reflects shares of common stock withheld from the common stock paid to certain senior officers as additional compensation which the Corporation calls salary stock, and upon vesting of restricted stock to cover minimum tax withholding obligations. The Corporation intends to continue to satisfy statutory tax withholding obligations in connection with shares paid as salary stock to certain senior officers and the vesting of outstanding restricted stock through the withholding of shares.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

See the Exhibit Index below:

Exhibit Index

10.1 – Form of First BanCorp Long-Term Incentive Award Agreement.

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

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

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

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

101.1- Interactive Data File (Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2018, furnished in XBRL (eXtensible Business Reporting Language)

SIGNATURES

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

	First BanCorp.
	Registrant

Date: May 10, 2018	By:	/s/ Aurelio Alemán
		Aurelio Alemán
		President and Chief Executive Officer

Date: May 10, 2018	By:	/s/ Orlando Berges
		Orlando Berges
		Executive Vice President and Chief Financial Officer