AVERY DENNISON CORPORATION
Form DEF 14A
March 14, 2003

SCHEDULE 14A INFORMATION

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

Filed by the Registrant x

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Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

x Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to sec.240.14a-11(c) or sec.240.14a-12

AVERY DENNISON CORPORATION

(Name of Registrant as Specified In Its Charter)

AVERY DENNISON CORPORATION

(Name of Person(s) Filing Proxy Statement)

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(1) Title of each class of securities to which transaction applies:

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Avery Dennison Corporation

150 North Orange Grove Boulevard

Pasadena, California 91103

Notice of Annual Meeting of Stockholders

To be held

April 24, 2003

To the Stockholders:

The Annual Meeting of Stockholders of Avery Dennison Corporation will be held at 150 North Orange Grove Boulevard, Pasadena, California, on Thursday, April 24, 2003, at 1:30 P.M. for the following purposes:

1. To elect three directors to hold office for a term of three years and until their successors are elected and have qualified; and

2. To ratify the appointment of PricewaterhouseCoopers LLP as the Company s independent auditors for the current fiscal year, which ends on December 27, 2003; and

3. To consider and vote upon a proposal to approve an amended and restated director equity plan; and

4. To consider and vote upon a proposal to approve an amended and restated employee stock option and incentive plan; and

5. To transact such other business as may properly come before the meeting and any adjournments thereof.

In accordance with the Bylaws, the Board of Directors has fixed the close of business on Monday, February 24, 2003, as the record date for the determination of stockholders entitled to vote at the Annual Meeting and to receive notice thereof.

All stockholders are cordially invited to attend the meeting.

BY ORDER OF THE BOARD OF DIRECTORS

Robert G. van Schoonenberg

Secretary

Pasadena, California

Dated: March 14, 2003

Whether or not you presently plan to attend the Annual Meeting, in order to ensure your representation please vote by telephone or by using the Internet as instructed on the enclosed proxy card, or complete, sign and date the enclosed proxy card as promptly as possible and return it in the enclosed envelope (which does not require postage if mailed in the United States). If you attend the meeting and wish to vote in person, your proxy will not be used.

AVERY DENNISON CORPORATION

150 North Orange Grove Boulevard

Pasadena, California 91103

PROXY STATEMENT

This proxy statement is furnished to the stockholders on behalf of the Board of Directors of Avery Dennison Corporation, a Delaware corporation (hereinafter called the Company), for solicitation of proxies for use at the Annual Meeting of Stockholders to be held on Thursday, April 24, 2003, at 1:30 P.M. and at any and all adjournments thereof. A stockholder giving a proxy pursuant to the present solicitation may revoke it at any time before it is exercised by giving a subsequent proxy or by delivering to the Secretary of the Company a written notice of revocation prior to the voting of the proxy at the Annual Meeting. If you attend the meeting and wish to vote your shares in person, your proxy will not be used. Votes cast by proxy or in person at the Annual Meeting will be tabulated by the election inspectors appointed for the meeting and will determine whether or not a quorum is present. Under the Company s Bylaws and Delaware law: (1) shares represented by proxies that reflect abstentions or broker non-votes (i.e., shares held by a broker or nominee which are represented at the meeting, but with respect to which such broker or nominee is not empowered to vote on a particular proposal) will be counted as shares that are present and entitled to vote for purposes of determining the presence of a quorum; (2) there is no cumulative voting and the director nominees receiving the highest number of votes, up to the number of directors to be elected, are elected and, accordingly, abstentions, broker non-votes and withholding of authority to vote will not affect the election of directors; and (3) proxies that reflect abstentions as to a particular proposal will be treated as voted for purposes of determining the approval of that proposal and will have the same effect as a vote against that proposal, while proxies that reflect broker non-votes will be treated as unvoted for purposes of determining approval of that proposal and will not be counted as votes for or against that proposal. The Company has retained D. F. King & Co., Inc. to assist in soliciting proxies for this meeting at a fee estimated at $10,000 plus out of pocket expenses. Expenses incident to the preparation and mailing of the notice of meeting, proxy statement and form of proxy are to be paid by the Company. This proxy statement is to be mailed to stockholders on or about March 14, 2003.

The purpose of the meeting and the matters to be acted upon are set forth in the foregoing attached Notice of Annual Meeting. In addition to the election of directors and ratification of the appointment of PricewaterhouseCoopers, LLP as independent auditors for the Company, two equity compensation plans will be submitted for approval by the Company s stockholders: an amended and restated director equity plan and an amended and restated employee stock option and incentive plan. As of the date of this statement, management knows of no other business that will be presented for consideration at the meeting. However, if any such other business shall properly come before the meeting, votes will be cast pursuant to said proxies in respect of any such other business in accordance with the best judgment of the persons acting under said proxies. See GENERAL Stockholder Proposals below.

ELECTION OF DIRECTORS (Proxy Item 1)

The Bylaws of the Company presently provide for twelve directors, divided into three classes. Three directors are to be elected at the 2003 Annual Meeting and will hold office until the Annual Meeting in 2006 and until their successors are elected and have qualified. It is intended that the persons so appointed in the enclosed proxy will, unless authority is withheld, vote for the election of the three nominees proposed by the Board of Directors, all of whom are presently directors of the Company. In voting for the election of directors, each share has one vote for each position to be filled. All of the nominees have consented to being named herein and to serve if elected. In the event that any of them should become unavailable prior to the Annual Meeting, the proxy may be voted for a substitute nominee or nominees designated by the Board of Directors, or the number of directors may be reduced accordingly.

The following information, which has been provided by the directors, shows for each of the nominees for election to the Board of Directors and for each director whose term continues, his or her name, age and principal occupation or employment during the past five years, the name of the corporation or other organization, if any, in which such occupation or employment is or was carried on, the period during which such person has served as a director of the Company and the year in which each continuing director s present term as director expires.

2003 NOMINEES

The Board of Directors recommends a vote **FOR** the nominees below.

David E. I. Pyott, age 49. Since April 2001, Mr. Pyott has been Chairman of the Board, President and Chief Executive Officer of Allergan, Inc., a global healthcare company. From January 1998 through March 2001, he was President and Chief Executive Officer of Allergan, Inc. Prior to 1998, Mr. Pyott was with Switzerland-based Novartis AG, a worldwide healthcare company, serving as head of the Novartis Nutrition Division. He is also a director of Advanced Medical Optics, Inc., a leader in the development, manufacturing and marketing of ophthalmic surgical and contact lens care products and Edwards Lifesciences Corporation, a cardiovascular disease treatment company. He has been a director of Avery Dennison Corporation since November 1999.

Dean A. Scarborough, age 47. Since May 2000, Mr. Scarborough has been President and Chief Operating Officer of Avery Dennison Corporation, a global leader in pressure-sensitive technology. From November 1999 through April 2000, Mr. Scarborough served the Company as Group Vice President, Fasson Roll Worldwide. From August 1997 through October 1999, Mr. Scarborough served as Group Vice President, Fasson Roll North America and Europe. Prior to August 1997, Mr. Scarborough held other executive positions with the Company. He has been a director of Avery Dennison Corporation since May 2000.

Julia A. Stewart, age 47. Since May 2002, Ms. Stewart has been Chief Executive Officer, President and Chief Operating Officer of IHOP, which owns, operates and franchises a restaurant chain. From December 2001 through April 2002, Ms. Stewart served as President and Chief Operating Officer of IHOP. Ms. Stewart was President of the Domestic Division of Applebee s International, Inc., a restaurant chain, from 1998 until August 2001. Ms. Stewart is a director of IHOP. She has been a director of Avery Dennison Corporation since January 2003.

CONTINUING DIRECTORS

Philip M. Neal, age 62. Since May 2000, Mr. Neal has served as Chairman of the Board and Chief Executive Officer of Avery Dennison Corporation, a global leader in pressure-sensitive technology. From May 1998 through April 2000, Mr. Neal served as President and Chief Executive Officer of Avery Dennison Corporation. From December 1990 through April 1998, Mr. Neal was President and Chief Operating Officer of Avery Dennison Corporation; prior to December 1990, he held various executive positions. He is also a director of Edwards Lifesciences Corporation, a cardiovascular disease treatment company. He has been a director of Avery Dennison Corporation since December 1990. His present term expires in 2004.

Frank V. Cahouet, age 70. Mr. Cahouet is a private investor. In December 1998, Mr. Cahouet retired as Chairman of the Board, President and Chief Executive Officer of Mellon Financial Corporation, a financial services company, a position that he had held since June 1987. From September 1986 through June 1987, Mr. Cahouet served as President of the Federal National Mortgage Association, a federally chartered, stockholder-owned corporation. He is also a director of Allegheny Technologies, Inc., a specialty materials company; Korn/Ferry International, an international executive search firm, Teledyne Technologies, Inc., an engineering and aerospace products company; and Saint-Gobain Corporation, a supplier of industrial materials. Mr. Cahouet has been a director of Avery Dennison Corporation since February 1983. His present term expires in 2004.

Peter W. Mullin, age 62. During the past five years, Mr. Mullin has been Chairman and Chief Executive Officer of Mullin Consulting, Inc., an executive compensation, benefit planning and corporate insurance consulting firm. He is also a director of Mrs. Fields Famous Brands, Inc., a leading provider of fresh-baked products company. He has been a director of Avery Dennison Corporation since January 1988. His present term expires in 2004.

Bruce E. Karatz, age 57. Since October 1993, Mr. Karatz has been Chairman of the Board, President and Chief Executive Officer of KB Home, a home construction and mortgage finance company. From 1985 to September 1993, Mr. Karatz served as President and Chief Executive Officer of KB Home. He is also a director of Edison International, an electric utility company, and Honeywell International, Inc., a technology and manufacturing company. He has been a director of Avery Dennison Corporation since November 2001. His present term expires in 2004.

Sidney R. Petersen, age 72. During the past five years, Mr. Petersen has been a private investor. In 1984, he retired as Chairman of the Board and Chief Executive Officer of Getty Oil Company, which was acquired by Texaco. He is also a director of Sypris Solutions, Inc., a provider of technology-based outsourced service and specialty products. He has been a director of Avery Dennison Corporation since December 1981. Mr. Petersen will retire from the board of Avery Dennison Corporation after the Annual Meeting of Stockholders in April.

Charles D. Miller, age 75. Since February 1998, he has been Chairman of the Board of Nationwide Health Properties, Inc., a real estate investment trust. In May 2000, Mr. Miller retired as Chairman of the Board of Avery Dennison Corporation, a position he had held since May 1998. From November 1983 through April 1998, Mr. Miller was Chairman and Chief Executive Officer of Avery Dennison Corporation. Prior to 1983, he served as President and Chief Executive Officer. He is also a director of Korn/Ferry International, an international executive search firm. He has been a director of Avery Dennison Corporation since January 1975. His present term expires in 2005.

Richard M. Ferry, age 65. Mr. Ferry is a private investor. Since July 2001, Mr. Ferry has been Founder Chairman of Korn/Ferry International, an international executive search firm. In July 2001, Mr. Ferry retired as Chairman of the Board of Korn/Ferry International, a position he had held since May 1997, and in September 2002, he left the board. From May 1991 through May 1997, Mr. Ferry was Chairman and Chief Executive Officer of Korn/Ferry International. He is also a director of Dole Food Company, a producer and marketer of fresh produce and packaged foods; Mrs. Fields Famous Brands, Inc., a fresh-baked products company; and Pacific Life Corporation, an insurance, annuities, group employee benefits and investment company. He has been a director of Avery Dennison Corporation since December 1985. His present term expires in 2005.

Kent Kresa, age 64. Since September 2001, Mr. Kresa has been Chairman of the Board and Chief Executive Officer of Northrop Grumman Corporation, an aeronautical and defense systems manufacturer. From September 1990 to September 2001, Mr. Kresa served as Chairman, President and Chief Executive Officer of Northrop Grumman Corporation. He has been a director of Avery Dennison Corporation since February 1999. His present term expires in 2005.

Peter K. Barker, age 54. Mr. Barker is a private investor. From November 1982 until November 1998, Mr. Barker was a partner in Goldman Sachs & Company, an investment banking, securities and investment management firm. He is also a director of Ameron International Corporation, a manufacturer of concrete, pipe, protective coatings and construction products, and Stone Energy Corporation, an independent oil and gas exploration and development company. He has been a director of Avery Dennison Corporation since January 2003. His present term expires in 2005.

SECURITY OWNERSHIP OF MANAGEMENT

The following table shows the number of shares of the Company s common stock beneficially owned by each director of the Company and each of the executive officers named in the table on page 9, and the aggregate number of such shares beneficially owned by all directors and executive officers as of December 31, 2002.

Name	Amount and Nature of Beneficial Ownership(1)	Percent of Class
Philip M. Neal	435,406(3)	(2)
Charles D. Miller	564,994(4)	(2)
Sidney R. Petersen	40,485(5)(6)	(2)
Frank V. Cahouet	74,338(7)	(2)
Richard M. Ferry	45,625(5)(8)	(2)
Peter W. Mullin	47,633(5)(9)	(2)
Kent Kresa	13,536(10)	(2)
David E. I. Pyott	13,584(11)	(2)
Dean A. Scarborough	161,902(12)	(2)
Bruce E. Karatz	4,706(13)	(2)
Julia A. Stewart	(14)	(2)
Peter K. Barker	1,000(15)	(2)
Robert G. van Schoonenberg	95,896(16)	(2)
Robert M. Malchione	4,278	(2)
Christian A. Simcic	30,878(17)	(2)
All Directors and Executive Officers as a Group (20 persons, including those named)	1,654,954(18)	1.5%

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(1) Except as otherwise indicated and subject to applicable community property and similar statutes, the persons listed as beneficial owners of the shares have sole voting and/or investment power with respect to such shares. Exercise prices for options on shares range from $15.28 to $68.31.

(2) Less than 1%.

(3) Includes 320,022 shares with respect to which Mr. Neal holds options exercisable within 60 days from December 31, 2002. Includes 110,619 shares held in trust in which Mr. Neal has sole voting and disposition power.

(4) Includes 465,925 shares with respect to which Mr. Miller holds options exercisable within 60 days from December 31, 2002. Also includes 75,323 shares held in the Miller Family Trust, as to which Mr. Miller has sole authority to vote and to dispose of the shares. Also includes 4,570 shares held in the Candyman Trust and 4,570 shares held in the Mandycan Trust, as to which Mr. Miller, as co-trustee, shares the authority to vote and to dispose of the shares. Also includes 5,079 shares held by Mrs. Miller, as to which Mr. Miller disclaims beneficial ownership. Also includes 500 shares held by each of Mr. Miller s two dependent daughters, as to which Mr. Miller disclaims beneficial ownership.

(5) Includes 25,000 shares with respect to which each of Messrs. Petersen, Ferry and Mullin holds options exercisable within 60 days from December 31, 2002.

(6) Includes 13,830 shares held in the Petersen Family Trust, as to which Mr. Petersen, as co-trustee, shares the authority to vote and to dispose of the shares. Also includes 1,655 stock units designated for Mr. Petersen under the director deferred equity compensation

program (DDECP), representing the right to receive Company shares upon retirement from the Board.

(7) Includes 29,000 shares with respect to which Mr. Cahouet holds options exercisable within 60 days from December 31, 2002. Includes 21,223 shares held in trust with respect to which Mr. Cahouet has sole voting and disposition power. Also includes 21,869 shares held in trust by Mrs. Cahouet, as to which Mr. Cahouet disclaims any beneficial ownership. Also includes 1,225 shares issuable under stock units designated for Mr. Cahouet under the Company s Capital Accumulation Plan (CAP) trust. Also includes 909 stock units designated for Mr. Cahouet under DDECP.

(8) Includes 1,266 shares issuable under stock units designated for Mr. Ferry under the CAP trust.

(9) Includes 633 shares issuable under stock units designated for Mr. Mullin under the CAP trust.

(10) Includes 10,000 shares with respect to which Mr. Kresa holds options exercisable within 60 days from December 31, 2002. Also includes 2,736 stock units designated for Mr. Kresa under DDECP.

(11) Includes 10,000 shares with respect to which Mr. Pyott holds options exercisable within 60 days from December 31, 2002. Also includes 2,984 stock units designated for Mr. Pyott under DDECP.

(12) Includes 135,255 shares with respect to which Mr. Scarborough holds options exercisable within 60 days from December 31, 2002. Also includes 116 shares held by Mrs. Scarborough, as to which Mr. Scarborough disclaims beneficial ownership, and 2,180 shares issuable under stock units designated for Mr. Scarborough under the CAP trust.

(13) Includes 3,500 shares with respect to which Mr. Karatz holds options exercisable within 60 days from December 31, 2002. Also includes 1,006 stock units designated for Mr. Karatz under DDECP.

(14) Ms. Stewart joined the Board of Directors in January 2003.

(15) Mr. Barker joined the Board of Directors in January 2003.

(16) Includes 71,200 shares with respect to which Mr. van Schoonenberg holds options exercisable within 60 days from December 31, 2002.

(17) Includes 24,625 shares with respect to which Mr. Simcic holds options exercisable within 60 days from December 31, 2002.

(18) Includes 1,236,472 shares with respect to which all executive officers and directors as a group hold options exercisable within 60 days from December 31, 2002.

BOARD OF DIRECTORS AND COMMITTEE MEETINGS

During 2002, there were seven meetings of the full Board of Directors and twelve meetings of committees of the Board. All directors of the Company attended at least 75% of the aggregate number of meetings of the Board and meetings of Board committees of which they were members held during the time they served on the Board or Committee. A substantial majority of the directors are independent.

Standing committees of the Board of Directors include the following:

The Audit Committee, which is composed of the following independent directors: Sidney R. Petersen (Chairman), Kent Kresa, David E.I. Pyott, Bruce E. Karatz and Peter K. Barker, met three times during 2002. Mr. Petersen also conducted four teleconference reviews prior to the Company s quarterly and annual earnings releases. The functions of the Audit Committee are to aid the directors in undertaking and fulfilling their monitoring and oversight responsibilities related to the financial reporting process; support and encourage efforts to improve the financial controls exercised by management and to monitor their adequacy for purposes of public reporting; and provide better avenues of communication between the Board of Directors, management and the external and internal auditors.

The Compensation and Executive Personnel Committee, which is composed of the following independent directors: Frank V. Cahouet (Chairman), Sidney R. Petersen and David E.I. Pyott, met four times during 2002. The functions of the Compensation and Executive Personnel Committee are to review new or modified programs in the areas of executive salary and incentive compensation, deferred compensation and stock plans; and review and make recommendations to the Board concerning executive s stock option grants, cash incentive awards and other direct and indirect compensation matters.

The Ethics and Conflict of Interest Committee, which is composed of the following directors: David E.I. Pyott (Chairman), Sidney R. Petersen, Kent Kresa, Dean A. Scarborough and Bruce E. Karatz, met once during 2002. The functions of the Ethics and Conflict of Interest Committee are to survey, monitor and provide counsel as to the business relationships, affiliations and financial transactions of directors, officers and key employees, as they may relate to possible conflicts of interest or to the Company s Legal and Ethical Conduct Policy; monitor the Company s compliance program; and report and make recommendations to the full Board in instances where it is believed that possible violations of Company policy could exist.

The Finance Committee, which is composed of the following directors: Frank V. Cahouet (Chairman), Charles D. Miller, Peter W. Mullin, Philip M. Neal, Sidney R. Petersen, Richard M. Ferry, Kent Kresa and Dean A. Scarborough, met once during 2002. The functions of the Finance Committee are to assist the Board in consideration of matters relating to the financial affairs and capital requirements of the Company; provide an overview of the financial planning and policies of the Company; and review proposed budgets, significant borrowings and changes in the financial structure of the Company.

The Nominating and Governance Committee, which is composed of the following independent directors: Richard M. Ferry (Chairman), Frank V. Cahouet and David E.I. Pyott met twice during 2002. The functions of the Nominating and Governance Committee are to oversee corporate governance matters and make recommendations to the Board of Directors, review the qualifications of candidates for board membership, review the status of a director when his or her principal position and/or primary affiliation changes, recommend to the Board of Directors candidates for election by stockholders at annual meetings, recommend candidates to fill vacancies in directorships, recommend to the Board of Directors the removal of a director, if in the Company s best interest, and make recommendations to the Board of Directors concerning selection, tenure, retirement, and composition of the Board of Directors. Stockholders desiring to make recommendations concerning new directors must submit the candidate s name, together with biographical information and the candidate s written consent to nomination, to: Secretary, Nominating and Governance Committee of the Board of Directors, Avery Dennison Corporation, 150 North Orange Grove Boulevard, Pasadena, California 91103. Stockholders wishing to nominate new directors for election at an annual meeting must comply with the requirements described under the heading GENERAL Stockholder Proposals on p. 35.

The Strategic Planning Committee, which is composed of all of the directors with Philip M. Neal as Chairman, met once during 2002. The functions of the Strategic Planning Committee are to review the

Company s long-term strategic plan, objectives, programs, and proposed acquisition candidates and divestitures; review steps being taken to improve shareholder value; and make recommendations to the Board of Directors on any of these matters.

The Executive Committee, which is composed of the following directors: Charles D. Miller (Chairman), Richard M. Ferry, Philip M. Neal, Frank V. Cahouet, and Peter Mullin, did not meet during 2002. The function of the Executive Committee is to act on an interim basis for the full Board and to report all such actions to the Board for ratification at its next meeting.

Each director who is not an officer of the Company is paid an annual retainer fee of $55,000 and attendance fees of $1,500 per Board meeting attended, and $1,600 per committee meeting attended as Chairman of the committee or $1,200 per committee meeting attended as a member of the committee. The Chairmen of the Audit and the Compensation and Executive Personnel Committees are each also paid an annual retainer fee of $5,500, and the Chairmen of the Finance, the Nominating and Governance and the Ethics and Conflict of Interest Committees are each paid an annual retainer fee of $3,000. Under the directors deferred compensation plans, fees, which are deferred either accrue interest at a fixed rate based on the 120-month rolling average of ten-year U.S. Treasury Notes (plus, if the director ceases to be a director by reason of death, disability or normal retirement, 25% of such rate per annum), or accrue at the actual rate of return (less an administrative fee) of one of eight investment funds managed by an insurance company. Benefits payable by the Company under this plan are secured with assets placed in an irrevocable trust. Under the directors deferred equity compensation program, directors have been able to defer fees into stock units, which will be paid out in shares of Company stock at retirement. The Company provided Mr. Miller, as retired Chairman, office space, administrative assistance, leased car and a part-time driver, and paid for financial counseling services and fees for two local clubs. The Company has a matching gift program under which the Company will match an amount of up to $5,000 that a director gives to charitable organizations, and the Company will also match an amount of up to $5,000 given to educational institutions. Each non-employee director received an award of 200 shares of the Company s common stock on April 25, 2002. Mrs. Joan Bok and Mr. Dwight Allison, who retired from the Board in April 2002, each received 2,200 shares of the Company s common stock at the time of their retirement.

Through November 2002, directors were eligible to receive service credit in a retirement plan for directors, under which individuals who served on the Company s Board of Directors and subsequently terminated their service as a director with at least five years tenure, are entitled to receive an annual benefit from the Company equal to the annual director retainer fee plus 12 times the regular meeting fee, as such fees were in effect as of November 30, 2002, payable to the director (or to the director s surviving spouse) for the number of full or partial years the director served on the Company s Board. Following the death of an eligible director s surviving spouse, or if there is no surviving spouse living at the time of the death of the director, any benefits will be paid to one or more secondary beneficiaries designated by the director prior to his or her death until the first to occur of: (i) the receipt of the maximum benefit to which the director would have been entitled had he or she survived; (ii) the death of the secondary beneficiaries, or (iii) benefits have been paid under the plan to the director, surviving spouse, and/or the secondary beneficiaries for a combined period of ten years. As of December 31, 2002, there will be no crediting of future service and the benefits under this plan have been frozen; directors, joining the Board after November 30, 2002, will not participate in the plan.

Non-employee directors participate in the 1988 Stock Option Plan for Non-Employee Directors (Director Equity Plan), which options to purchase a total of 16,000 shares (2,000 options for each non-employee director in December 2002) of Company common stock were granted in 2002 to the non-employee directors eligible to receive grants under such plan. The option price for each such option granted is 100% of the fair market value of Company common stock on the date of grant. All options granted have a term of ten years, and become exercisable in two cumulative installments of 50% of the number of shares with respect to which the option was initially granted on each of the first and second anniversaries of the grant date, except that all options held by a director, which are unexercisable on the date the director retires at or after age 72, will become fully exercisable on the date of such retirement. Under the CAP, eligible non-employee directors have the opportunity to defer until retirement the receipt of gain realized on exercise of stock options. This Plan provides for each non-employee director to receive an option grant with respect to 5,000 shares upon joining the Board of Directors, and automatic annual grants of 2,000 shares thereafter to each non-employee director.

EXECUTIVE COMPENSATION AND OTHER INFORMATION

Executive Compensation

The following table and accompanying notes show for the Chairman and Chief Executive Officer and the other four most highly compensated executive officers of the Company for 2002, the compensation paid by the Company to such persons for services in all capacities during 2002 and the preceding two fiscal years.

SUMMARY COMPENSATION TABLE

					Long-Term Compensation			
		Annual Compensation			Awards		Payouts	
Name and Principal Position	Year	Salary ($)(1)	Bonus ($)(1)	Other Annual Compensation ($)(2)	Restricted Stock Award(s) ($)	Securities Underlying Options (#)	LTIP Payouts ($)(3)	All Other Compensation ($)(4)
Philip M. Neal	2002	$ 935,000	$ 1,300,000			150,000		$ 68,418
Chairman and Chief	2001	871,667	500,000			220,000	$ 1,320,000	93,713
Executive Officer	2000	808,350	1,000,000			50,000		81,567
Dean A. Scarborough	2002	$ 563,333	$ 700,000	$ 97,222		55,000		$ 21,956
President and Chief	2001	526,667	200,000	118,732		85,000	$ 568,200	27,800
Operating Officer	2000	457,043	430,000	102,821		40,000		22,839
Robert G. van Schoonenberg	2002	$ 454,666	$ 475,000			35,000		$ 30,175
Executive Vice President,	2001	421,667	181,200			46,750	$ 616,000	22,306
General Counsel and	2000	376,675	337,800			11,750		33,120
Secretary								
Robert M. Malchione								
Senior Vice President,	2002	$ 385,333	$ 357,000			75,000		$ 14,32
Corporate Strategy and	2001	363,333	131,300	$ 55,955		44,150		13,4925
Technology	2000	145,833	116,400			68,300		3,933
Christian A. Simcic	2002	$ 382,500	$ 400,000					
Group Vice President,	2001	348,333	90,300			30,000	$ 292,500	
Roll Materials Worldwide	2000	287,500	233,600			50,000		

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(1) Amounts shown include amounts earned, but deferred at the election of these officers under the Company s deferred compensation plans and Employee Savings Plan, a qualified defined contribution plan under Section 401(k) of the Code.

(2) Amount paid to Mr. Scarborough includes $49,426 for mortgage differential payments related to relocation expenses.

(3) Amounts for 2001 consist of cash payments under the Company s Executive Long-Term Incentive Plan (LTIP) for the cycle, which was completed on December 31, 2000.

(4) Amounts consist of (i) Company contributions to deferred compensation plans and Company contributions to the Company s Employee Savings Plan, a 401(k) plan (Savings Plan); and (ii) interest earned on deferred compensation accounts above 120% of the applicable federal rate (above market interest) for Mr. Neal and Mr. van Schoonenberg. These amounts for 2002 are $42,044 and $26,374, respectively, for Mr. Neal; $21,956 for Mr. Scarborough; $18,424 and $11,751, respectively, for Mr. van Schoonenberg, $14,325 for Mr. Malchione; and $0 for Mr. Simcic.

Option Grants

The following table shows information regarding options granted in 2002 to each of the named executive officers under the 1990 Stock Option and Incentive Plan (the Employee Plan) or the 1996 Stock Incentive Plan (the Stock Incentive Plan).

OPTION GRANTS IN LAST FISCAL YEAR

	Individual Grants				
Name	Number of Securities Underlying Options Granted (#)(1)(2)	% of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price ($/Share)	Expiration Date	Grant Date Present Value ($)(3)
Philip M. Neal	150,000	10.8%	$ 62.87	12/5/2012	$ 2,026,500
Dean A. Scarborough	55,000	4.0	$ 62.87	12/5/2012	743,000
Robert G. van Schoonenberg	35,000	2.5	$ 62.87	12/5/2012	472,800
Robert M. Malchione	50,000	3.6	$ 61.74	8/1/2012	685,500
	25,000	1.8	$ 62.87	12/5/2012	337,800
Christian A. Simcic	30,000	2.2	$ 62.87	12/5/2012	405,300

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(1) Non-qualified stock options were granted at fair market value for a term of ten years under the Employee Plan or the Stock Incentive Plan. Except for the second grant for Mr. Malchione, which vest 50% in 3 years and 50% in 6 years, the options vest nine years and nine months from the date of grant, but are eligible for accelerated vesting, beginning three years from the date of grant, if the Company meets a return on total capital test, which measures the Company s return on total capital against that of a specified group of other companies approved by the Compensation and Executive Personnel Committee. Alternatively, options, granted to LTIP participants retiring under the Company s retirement plan, who have at least 10 years service and have a combination of age and service with the Company of 75 or more, will vest as the date of termination of employment, provided that the performance test (referred to above) has been met for the fiscal year ending prior to retirement.

(2) The Compensation and Executive Personnel Committee may accelerate the time at which an option becomes exercisable, and in the event of a change of control of the Company (as defined in the option agreement) options become immediately exercisable.

(3) Option grant date values were determined using a Black-Scholes option-pricing model adapted for use in valuing executive stock options. In determining the Black-Scholes value, the following underlying assumptions were used: (i) stock price volatility is measured as the standard deviation of the Company s stock price over the three years prior to grant (ranges from .2660 to .3032); (ii) dividend yield is measured as the cumulative dividends paid the last twelve months as a percentage of the twelve-month average of the month-end closing prices (for the month in which the dividend was declared) prior to grant of the option (ranges from 2.134% to 2.229%); (iii) the risk-free rate of return represents the weekly average of the ten-year Treasury bond rates for the 52 weeks immediately preceding the grant date of the options (ranges from 4.31% to 4.71%); (iv) average period from date of grant to exercise of options (7 years); and (v) vesting restrictions are reflected by reducing the value of the option determined by the Black-Scholes model by 5% for each full year of vesting restrictions, assuming that exercisability of the options were accelerated to the fifth anniversary of the option grant date as a result of meeting the performance condition described in footnote (1) as of that date (i.e., 25%). In the event that the performance condition described in footnote (1) is met later than the fifth anniversary of the grant date, or is not met during the term of the options, the grant date present value of the options would be lower. In the event that such performance condition is not met at all and the options become exercisable nine years and nine months after the options are granted, the grant date present value of the options would be $1,384,500, for Mr. Neal; $507,650, for Mr. Scarborough; $323,050, for Mr. van Schoonenberg, $230,750, for Mr. Malchione, and $276,900, for Mr. Simcic. The Black-Scholes option pricing model calculates a cash equivalent value for an option on the date of grant. The Company s use

of such model is not intended to forecast any future appreciation in the price of the Company s stock. In addition, no gain to the optionees is possible without appreciation in the price of the Company s common stock, which will benefit all stockholders. If the market price of the stock does not exceed the exercise price of the options at some time after the options become exercisable or if they terminate unvested or unexercised, the value of the options will ultimately be zero.

EQUITY COMPENSATION PLAN INFORMATION

as of December 31, 2002

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column) (a) (c)
Equity compensation plans approved by security holders (1)	200,000	$ 39.20	65,000
	1,349,813	$ 41.40	965,587
Equity compensation plans not approved by security holders (2)	5,361,990	$ 53.97	none
Total	6,911,803	$ 51.09	1,030,587

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(1) There are two plans: the Company s Director Equity Plan, and the Employee Plan respectively. Only stock options have been issued.

(2) The Stock Incentive Plan was amended and restated in December of 2002, to provide that no future stock options or other awards will be made after December 6, 2002, and options that have been granted may not be repriced (note that no previously granted options have ever been repriced).

(3) In general, the material feature of the Stock Incentive Plan are similar to those in the Employee Plan, which is proposed to be amended and restated in proxy item 4 as set forth on pages 28 to 34. The Stock Incentive Plan was adopted by the Board of Directors in December 1996 and provided for grants of stock options, stock payments and other awards; however, only stock options, and stock payments issued in exchange for cash compensation at fair market value, have been awarded. Options were granted at fair market value on the grant date. Of the 5,361,990 options outstanding, 2,048,930 were exercisable as of December 31, 2002. The shares available under this Plan upon exercise of stock options or issuance of stock payments, may be either previously unissued shares, issued shares which have been repurchased by the Company as treasury shares, or former treasury shares held in a grantor trust. This Plan provides for appropriate adjustments in the number and kind of shares subject to this Plan and to outstanding grants thereunder in the event of a stock split, stock dividend or certain other types of recapitalizations. The Stock Incentive Plan is administered by the Compensation and Executive Personnel Committee, which consists of at least three members of the Board, none of whom is an employee of the Company. The Committee was authorized to select directors, officers and other employees to whom options were to be granted and determined the number of shares to be subject thereto (annual option grants to an individual could not exceed 400,000) and the terms and conditions thereof and to adopt, amend and rescind rules relating to the administration of this Plan. The exercise or purchase price for all options to acquire Company common stock, together with any applicable tax required to be withheld, must be paid in full in cash at the time of exercise or purchase or may be paid in whole or in part in common stock of the Company owned by the optionee and having a fair market value on the date of exercise equal to the aggregate exercise price of the shares so to be purchased.

Options granted under the Stock Incentive Plan were nonqualified stock options (NQSO s) and provided for the right to purchase common stock at an exercise price equal to at least 100% of fair market value of common stock on the grant date and generally become exercisable in equal installments over four years after the grant date, or for officers, who participate in the LTIP, options vest in nine years and nine months subject to accelerated vesting after three years, if the Company meets certain performance requirements. NQSO s were granted for a term of ten years. Stock payments were authorized in the form of shares of common stock as part of a compensation or deferred compensation arrangement instead of receiving all or any part of compensation, including salary, fees or retainers, that would otherwise be payable to an employee or to a director in cash. Dividend equivalents may be credited to a participant in receipt of deferred stock payments. They represent the value of the dividends per share paid by the Company, calculated with reference to the number of stock payments or stock units held by the participant under a deferral arrangement.

Options and other rights granted under this Plan provide that in the event of a change of control of the Company (as defined in the award agreement) all previously unexercisable options and rights become immediately exercisable. This Plan provides that the period of exercisabilty, following retirement, for options is (i) the full term of the option for the Chief Executive Officer and Chief Operating Officer; (ii) the lesser of five years or the full term of the option for options granted to participants in the LTIP or any successor plan; and (iii) the lesser of three years or the full term of the option for all other optionees. No option or other award granted under the Stock Incentive Plan may be assigned or transferred by the awardee, except by will or the laws of intestate succession or to a properly designated beneficiary or transferee. During the lifetime of the holder of any option or right, the option or right may be exercised only by the holder, or his guardian or legal representative or properly designated transferee.

Option Exercises and Fiscal Year-End Values

The following table shows for each of the named executive officers the shares acquired on exercise of options during 2002, the difference between the option exercise price and the market value of the underlying shares on the date of such exercise, and (as to outstanding options at December 31, 2002) the number of unexercised options and the aggregate unrealized appreciation on in-the-money, unexercised options held at such date.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR

AND FISCAL YEAR-END OPTION VALUES

			Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)	Value of Unexercised In-the-Money Options at Fiscal Year-End ($)(2)
Name	Shares Acquired on Exercise (#)	Value Realized ($)(1)	Exercisable/ Unexercisable	Exercisable/ Unexercisable
Philip M. Neal	42,000	$ 1,978,775	320,022/499,266	$ 8,754,057/1,838,875
Dean A. Scarborough			135,255/236,600	3,201,034/1,372,747
Robert G. van Schoonenberg	32,000	1,030,470	71,200/110,100	1,379,035/403,583
Robert A. Malchione			0/178,300	0/1,095,926
Christian A. Simcic			24,625/111,875	365,915/459,708

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(1) Market value of the common stock at the exercise date minus the exercise price of the options exercised. Amounts in this column represent the value realized by the named executive upon the exercise of stock options granted in prior years. All options had exercise prices equal to the market price of the Company s stock on the date the options were granted, and vested on the basis of the executive s continued employment with the Company. Thus, the amount realized upon exercise of the options resulted directly from appreciation in the Company s stock price during the executives tenure with the Company.

(2) Market value of the common stock at December 31, 2002, minus the exercise price of in-the-money options.

Long-Term Incentive Plan Awards

Under the LTIP, key executives recommended by the Company s Chief Executive Officer and designated by the Compensation and Executive Personnel Committee of the Board of Directors (the Committee) are eligible to earn a deferred cash incentive award based on the financial performance of the Company and, in some cases, its business units. Participants in the LTIP are eligible to earn a deferred cash incentive award after the end of each performance cycle, which cycles generally begin every other year. The current three-year cycle commenced in 2002 (2002-2004), and future cycles will commence every other year (e.g., 2004 and 2006).

The following table shows, for each of the named executive officers, the estimated future payouts, if any, under the LTIP for the performance cycle which began in 2002. Threshold amounts are the minimum amounts which could be paid under the LTIP and assume that the minimum level of performance is achieved with respect to only one of the two pre-established performance objectives (earnings per share and cumulative economic value added) during the performance cycle. If such performance is not achieved, amounts would be zero. In addition, maximum awards would not be paid unless the Company achieved pre-established objectives substantially in excess of these objectives.

LONG-TERM INCENTIVE PLANS AWARDS IN LAST FISCAL YEAR(1)

			Estimated Future Payout Under Non-Stock Price Based Plans (3)(4)		
Name	**Number of Shares, Units or Other Rights (#)**	**Performance or Other Period Until Maturation or Payout (2)**	**Threshold ($)**	**Target ($)**	**Maximum ($)**
Philip M. Neal		3 years	$ 186,512	$ 802,200	$ 1,604,400
Dean A. Scarborough		3 years	112,298	483,000	966,000
Robert G. van Schoonenberg		3 years	90,229	388,080	776,160
Robert A. Malchione		3 years	76,753	330,120	660,240
Christian A. Simcic		3 years	78,120	336,000	672,000

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(1) Each listed executive officer has been designated by the Committee as a participant in the LTIP for the performance cycle which began in 2002 and is eligible to receive a deferred cash incentive award, after the end of that cycle, based on a percentage of the named executive s base salary in effect at the end of the performance cycle. The threshold (minimum), target and maximum awards are 18.6 percent, 80 percent and 160 percent of the executive s base salary, respectively. The amount of the executive s award will depend on the Company s actual performance during the performance cycle versus the pre-established performance objectives. See Report of Compensation and Executive Personnel Committee on Executive Compensation for a more detailed description of the LTIP.

(2) The performance cycle began on January 1, 2002, and ends on December 31, 2004.

(3) Estimated future payouts under the LTIP are calculated using projected salaries for the executive officers as of the end of the performance cycle.

(4) Upon a change of control (as defined in the LTIP) of the Company, each executive will be entitled to receive a cash payment equal to the named executive s target award based on his or her annual base salary rate in effect at the time of the change of control.

Retirement Plan

The Company provides retirement benefits for employees under the Retirement Plan for Employees of Avery Dennison Corporation (the Retirement Plan) and the Benefit Restoration Plan (the BRP) described below. Benefits under the Retirement Plan are based on compensation and are calculated separately for each year of service using the formula 1.25% times compensation up to the breakpoint (currently $37,212, which is the average of the Social Security wage bases for the preceding 35 years) plus 1.75% times compensation in excess of the breakpoint. The results of the calculation for each year of service are added together to determine the annual single life annuity Retirement Plan benefit for an employee at normal retirement (age 65). The benefit is not subject to reductions for Social Security payments or other offsets.

Amounts payable under the Retirement Plan may be reduced in accordance with certain Code provisions which, as applied to plan years beginning on or after December 1, 1994, limited the amount of compensation used to determine annual benefit accruals under the Retirement Plan to the first $170,000 of covered compensation and which limited the annual pension benefit payable under the Retirement Plan to $140,000. The Company established the BRP in December 1994 to provide for the payment of supplemental retirement benefits to eligible employees, including each of the individuals listed in the table on page 9, whose Retirement Plan benefits are limited under the foregoing Code provisions. The BRP is an unfunded excess benefit plan, which is administered by the Company. Benefits are payable under the BRP in amounts equal to the amount by which a participant s benefits otherwise payable under the Retirement Plan, with respect to periods from and after December 1, 1994, are reduced under the applicable provisions of the Code.

Compensation covered by the Retirement Plan includes both salary and bonus amounts, less amounts deferred at the election of employees under the Company s deferred compensation plans and the Company s Employee Savings Plan. However, the BRP covers compensation without deduction of amounts deferred under such plans. Hence the retirement benefits payable to each of the individuals listed in the table on page 9 under the Retirement Plan and the BRP, taken together, will be based (for each year of service from and after December 1, 1994) on the sum of the salary and bonus amounts (including all deferred amounts) earned in each such year. The estimated annual benefits payable to each of these individuals at normal retirement are $352,460 for Mr. Neal, $395,250 for Mr. Scarborough, $223,800 for Mr. van Schoonenberg, $218,530 for Mr. Malchione and $205,000 for Mr. Simcic, respectively. These estimated benefits do not include any assumption for annual increases in compensation.

The Supplemental Executive Retirement Plan (the SERP), adopted in 1983, is designed to provide its participants with additional incentives to further the Company s growth and development and as an inducement to remain in its service. Participants designated by the Committee of the Board of Directors are offered benefits under this plan to supplement those to which they may be entitled at the time of their retirement. The Committee has designated Mr. Neal as a participant in this plan. Mr. Neal s benefits will commence upon his retirement at a benefit level which, when added to the benefits to which he will be entitled from the Retirement Plan, the BRP and the SHARE Plan at the time of his retirement, Company contributions to the Employee Savings Plan and Social Security, will equal 62.5% of his final average compensation (average of his annual salary plus annual bonus for the last three years of employment). Assuming benefits commence in 2005, Mr. Neal s estimated annual retirement benefit under the SERP would be $606,000. Survivor and disability benefits are also payable under the SERP under certain circumstances. Benefits payable under the SERP are secured with assets placed in an irrevocable trust. The cost of benefits payable under the SERP will be recovered from the proceeds of life insurance purchased by the Company, if assumptions made as to life expectancy, policy dividends, and other factors are realized.

Other Information

On April 15, 1997, the Company entered into an agreement with Mr. Neal, which agreement was amended on May 1, 2000, to reflect his promotion to Chairman and Chief Executive Officer, providing that, if his employment is terminated for any reason other than for death, disability, cause or voluntary resignation without good reason (as such terms are defined in the agreement), he (i) will receive a payment equivalent to a pro-rated annual bonus for the year of termination; salary and bonus (based on his highest combined annual base salary plus bonus in any of the three previous years) for three years or until he reaches age 65 (the severance period); and additional retirement and supplemental retirement benefits which would have accrued during the severance period; (ii) will continue to participate in welfare benefit plans (such as medical, dental, and life insurance) for three years (but reduced to the extent such benefits are provided by another employer); (iii) will receive three additional years of age and service credit under the Company s deferred compensation plans; (iv) will receive payments under the LTIP for performance cycles which commence during the severance period; and (v) his unvested stock options will be accelerated. Upon any such termination, Mr. Neal will be entitled to purchase the Company automobile, if any, then being provided for his use at its depreciated book value, and to have assigned to him at no cost (although Mr. Neal must reimburse the Company for the cash value of the policy, if any) and with no apportionment of prepaid premiums, any assignable insurance policy then owned by the Company specifically relating to him. If such termination occurs after a change of control, the Company will pay for outplacement services not to exceed $50,000. Amounts to which Mr. Neal would be entitled under the agreement are reduced to the extent of any compensation which he earns from any new employment or services performed during the severance period. Mr. Neal will be reimbursed for any excise taxes that are imposed under Section 4999 of the Code.

On August 1, 1997, the Company entered into an agreement with Mr. Scarborough, which was amended on May 1, 2000, to reflect his promotion to President and Chief Operating Officer. On September 1, 2000, the Company entered into an agreement with Mr. Malchione. These agreements are substantially the same as Mr. Neal s described above, except (i) the severance period following termination is one year before a change of control and three years after a change of control; (ii) coverage under welfare benefit plans and additional age and service credit under the Company s deferred compensation plans following termination is one year before a change of control and three years (or the minimum age and service credit required for early retirement benefits and the retirement interest rate) after a change of control; and (iii) there are no comparable provisions relating to payments under the LTIP or assumption of insurance policies. On March 16, 1996, the Company entered into an agreement with Mr. van Schoonenberg providing that, if his employment with the Company is terminated for any reason other than for death, disability, cause, or voluntary resignation without good reason (as such terms are defined in the agreement), he will receive a payment equivalent to two years salary and bonus, continue to participate in benefit and incentive plans for a two-year period, his unvested options will be accelerated, and he will receive the minimum age and service credit required for early retirement eligibility and other purposes; in the event of such termination within two years of a change of control, he will receive a payment equal to three times salary and bonus, payment for LTIP and reimbursement for excise taxes.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the 1934 Act) requires the Company s executive officers and directors, and persons who own more than ten percent of a registered class of the Company s equity securities (collectively, Insiders), to file initial reports of ownership and reports of changes in ownership with the Securities and Exchange Commission (the SEC) and the New York Stock Exchange. Insiders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file. To the Company s knowledge, based solely on its review of the copies of such reports furnished to the Company and written representations from certain Insiders that no other reports were required for such Insiders, the Company believes that, during the 2002 fiscal year, Insiders complied with the Section 16(a) filing requirements applicable to Insiders.

REPORT OF COMPENSATION AND EXECUTIVE PERSONNEL COMMITTEE

ON EXECUTIVE COMPENSATION

The Committee has furnished the following report on executive compensation.

Overall Policy

The Company s executive compensation program is designed to be closely linked to Company performance and returns to stockholders. To this end, the Company developed several years ago overall compensation strategy and specific compensation plans that tie a significant portion of executive compensation to the Company s success in meeting specified performance goals and to appreciation in the Company s stock price. The overall objectives of this strategy are to attract and retain the best possible executive talent, to motivate these executives to achieve the goals inherent in the Company s business strategy, to link executive and stockholders interests through equity based plans and finally to provide a compensation package that recognizes individual contributions as well as overall business results.

Each year the Committee, which is comprised exclusively of non-employee directors, conducts a review of the Company s executive compensation program. This review includes an assessment of the effectiveness of the Company s compensation program and a comparison of the Company s executive compensation and performance to comparable public corporations, including companies within the Peer Group described under Stockholder Return Performance. The Company retains from time to time the services of executive compensation consultants to provide the Committee comparative data, benefit design advice and analysis of the cost of incentives provided.

The Committee determines the compensation of the Company s 10 executive officers, including the individuals whose compensation is detailed in this proxy statement, and sets policies for and reviews the compensation awarded to another approximately 65 highly compensated executives. This is designed to ensure consistency throughout the executive compensation program. In reviewing the individual performance of the 9 executive officers (other than Mr. Neal), the Committee takes into account the detailed performance reviews and recommendations of Mr. Neal.

The key elements of the Company s executive compensation program consist of base salary, annual bonus, stock options, and, for executive officers and certain other officers and employees recommended by the Chief Executive Officer and confirmed by the Committee, participation in the LTIP. The Committee s policies with respect to each of these elements, including the basis for the compensation paid and awarded to Mr. Neal, Chairman and Chief Executive Officer, are discussed below. In addition, while the elements of compensation described below are considered separately, the Committee takes into account the full compensation package afforded by the Company to the individual executive.

Under the 1993 Omnibus Budget Reconciliation Act (OBRA) and Section 162(m) of the Code, income tax deductions of publicly-traded companies may be limited to the extent total compensation for certain executive officers exceeds $1 million (less the amount of any excess parachute payments as defined in Section 280G of the Code) in any one year, except for compensation payments which qualify as performance-based. To qualify as performance-based, compensation payments must be based solely upon the achievement of objective performance goals and made under a plan that is administered by a committee of outside directors. In addition, the material terms of the plan must be disclosed to and approved by stockholders, and the Committee must certify that the performance goals were achieved before payments can be made. The Committee has designed certain of the Company s compensation programs to conform with the Section 162(m) of the Code and related regulations so that total compensation paid to any employee covered by the Section 162(m) should not exceed $1 million in any one year, except for compensation payments which qualify as performance-based. However, the Company may pay compensation, which is not deductible in certain circumstances, when sound management of the Company so requires.

Base Salaries

Base salaries for new executive officers are initially determined by evaluating the responsibilities of the position to be held and the experience of the individual, and by reference to the competitive marketplace for executive talent, including a comparison to base salaries for comparable positions at other companies. The Company participates each year in two nationwide salary surveys of between approximately 350 and 400 large public companies performed by nationally recognized compensation consulting firms. The Committee uses the data compiled from these surveys to assist it in establishing base salaries. In general, base salaries and total compensation for executives are targeted to a range that is within the third quartile (the fourth quartile being the highest) of the compensation paid by such other companies. Mr. Neal s base salary is also targeted in this range, and his total compensation is targeted to a range within the fourth quartile. In addition, in establishing salary levels within that range, the Committee considers the competitiveness of Mr. Neal s entire compensation package. For 2002, his salary level was below this range, based on competitive salary data compiled in 2001 and updated for use in 2002.

Annual salary adjustments are determined by evaluating the performance of the Company and of each executive officer, reviewing base salaries for comparable positions at other companies contained in the salary surveys described above, and, for selected senior executives, including Mr. Neal, comparing the total compensation packages of the executive, including base salary, with those of the companies in the Peer Group described under Stockholder Return Performance. In addition, the Committee takes into account any new responsibilities. In the case of executive officers with responsibility for a particular business unit, such unit s financial results are also considered. The Committee, where appropriate, also considers non-financial performance measures. These include increases in market share, sales, manufacturing efficiency gains, improvements in product quality, customer service, working capital management, employee safety, relations with employees and leadership development.

With respect to the base salary granted to Mr. Neal in 2002, the Committee took into account a comparison of base salaries of chief executive officers of the other companies contained in the salary surveys described above; the total compensation packages of the executives, including base salary, of the companies in the Peer Group described under Stockholder Return Performance; the Company s success in improving several financial measures in 2001, including increases in shareholder s equity and dividend payments; the performance of the Company s common stock against the Peer Group; and the assessment by the Committee of Mr. Neal s performance, including his individual leadership with respect to the development of long-term business strategies for the Company to improve its economic value, leadership development, succession planning and management continuity. The Committee also took into account Mr. Neal s considerable experience in both operating and corporate positions, which has enabled him to make significant contributions to the Company. Mr. Neal was granted a base salary of $955,000 in 2002 (effective May 2002), which was an increase of 6.7% over his $895,000 base salary for 2001.

Annual Bonus

The Company s executive officers, other than Mr. Neal, are eligible for an annual cash bonus under the Company s Executive Leadership Compensation Plan (the Executive Bonus Plan). Under the Executive Bonus Plan, individual and corporate performance objectives are established at the beginning of each year. Eligible executives are assigned threshold, target and maximum bonus levels. The Company performance measure for bonus payments is based on several financial goals, including, in 2002: return on total capital (ROTC) and earnings per share (EPS). In 2002, the Company exceeded the maximum of each of its targeted financial goals, each of which is given approximately equal weight for the senior executive officers. For other executive officers with responsibility for a particular group, each of which consists of several business units, the performance measure is based on the group s net income, economic value added and sales. The sales performance measure is weighted more heavily than the group s net income and economic value added for determining bonuses. The Committee weighs these financial goals very heavily. The Committee also considers individual non-financial performance measures described above under Base Salaries in determining bonuses under the Executive Bonus Plan, but to a much lesser extent than the financial goals described above.

Mr. Neal is eligible for an annual cash bonus under the Company s Senior Executive Leadership Compensation Plan (the Senior Executive Bonus Plan) which, along with the Executive Bonus Plan was approved by stockholders in 1999 as part of the Company s policy to design certain of the Company s compensation programs to conform with Section 162(m) of the Code and related regulations. Payments under the Senior Executive Bonus Plan are based solely on the achievement of one or more of the following pre-established objective performance goals: ROTC, EPS, return on sales (ROS), economic value added (EVA), return on equity (ROE), net income, cash flow, sales and total shareholder return (defined as cumulative shareholder return, including the reinvestment of dividends, on the Company s common stock), subject to the Committee s discretion to decrease awards which would otherwise be payable under the Senior Executive Bonus Plan. In addition, no bonuses are payable to the chief executive officer, chief operating officer or chief financial officer (who is currently a participant in the Executive Bonus Plan) unless the Company s pre-tax return on stockholders equity exceeds a minimum threshold and, in such event, the total of such executives bonuses may not exceed a specified percentage of the Company s pre-tax return on stockholders equity in excess of that minimum threshold. In 2002, the Company exceeded the maximum for each of its targeted performance goals (ROTC and EPS) under the Senior Executive Bonus Plan. Based on this performance, Mr. Neal was awarded a cash bonus of $1,300,000, which is 160% higher than the bonus paid for 2001.

Stock Options

Stock options were granted to the Company s executive officers, under the Employee Plan or the Stock Incentive Plan. The size of stock option awards is determined by the Committee using as a guideline a formula, which takes into account competitive compensation data. The formula does not take into account the amount of stock options previously awarded to the executive officers, although the Committee may do so. In the event of poor Company or individual performance, the Committee may elect not to award options or to grant options on fewer shares. In December 2002, the Committee recommended and the Board approved amendments to the Stock Incentive Plan, including provisions such that no further awards, including stock options, would be made after the annual grant of stock options, and the Board noted that no stock options have been or would be repriced.

Stock options are designed to align the interests of executives with those of the stockholders. The Committee believes that significant equity interests in the Company held by the Company s management align the interests of stockholders and management. The Company has adopted a stock ownership philosophy for officers and directors, which encourages each officer and director to achieve and maintain certain specified levels of stock ownership during his or her tenure with the Company.

Stock options are granted with an exercise price equal to the market price of the common stock on the date of grant and with a ten-year term. Options for the executive officers (including the individuals whose compensation is detailed in this proxy statement) vest nine years and nine months from the date of grant, subject to accelerated vesting beginning three years from the date of grant if the Company meets a return on total capital, which measures Company s return on total capital against that of a specified group of other companies approved by the Compensation and Executive Personnel Committee. Alternatively, options, granted to LTIP participants retiring under the Company s retirement plan, who have at least 10 years service and have a combination of age and service with the Company of 75 or more, will vest as the date of termination of employment; provided that the performance test (referred to above) has been met for the fiscal year ending prior to retirement. Options for executives who do not participate in the LTIP vest 25% per year over four years. This approach is designed to promote the creation of stockholder value over the long-term since the full benefit of the compensation package cannot be realized unless stock price appreciation occurs over a number of years.

In 2002, Mr. Neal received options to purchase 150,000 shares with an exercise price of $62.87 per share. As of December 31, 2002, Mr. Neal held in trust 110,619 shares of the Company s common stock and, with the 2002 grant, holds options to purchase an additional 819,288 shares, of which options to purchase 320,022 shares were exercisable at December 31, 2002.

LTIP

Under the LTIP, key executives recommended by the Company s Chief Executive Officer and designated by the Committee are eligible to earn a deferred cash incentive award based on the financial performance of the Company and, in some cases, its business units. Participants in the LTIP are eligible to earn a deferred cash incentive award after the end of each multi-year performance cycle, which cycles generally begin every other year (e.g., 2002 and 2004).

During 2002, the Committee designated each of the executive officers, whose compensation is detailed in this proxy statement, and certain other executive officers and other officers and employees recommended by the Chief Executive Officer and confirmed by the Committee, as participants in the LTIP for the performance cycle, which began in 2002.

Each of the most senior group of executives who is designated as a participant in the LTIP (including Mr. Neal and the other executives whose compensation is detailed in this proxy statement) (Senior Executives) will be eligible to receive (after the end of the performance cycle (2004)) a deferred cash incentive award of a percentage of the participant s base salary in effect at the end of the cycle. The threshold (i.e., minimum), target and maximum awards are 18.6 percent, 80 percent and 160 percent of the executive s base salary, respectively. The award is based on the Company s achievement of certain pre-established EPS and cumulative economic value added objectives, each of which is given equal weight. The threshold award of 18.6 percent of base salary will be earned if the Company meets at least 80 percent of the EPS or cumulative EVA objective. The target award of 80 percent of base salary will be earned if the Company achieves 100 percent of each of the EPS and cumulative economic value added objectives. The maximum award will be earned only if the Company achieves pre-established objectives well above the target objectives.

Participants other than Senior Executives (Other Participants) are divided into categories under the LTIP based on their positions with the Company. Target and threshold awards are based on the Company s achievement of certain pre-established EPS and cumulative economic value added objectives (each of which is given equal weight) or, for executives who are responsible for a business unit, the unit s achievement of pre-established sales, net income and cumulative business unit economic value added objectives (each of which is given equal weight). Threshold awards for Other Participants, ranging from 7 percent to 14 percent of base salary (depending on the category) will be earned if at least 80 percent of one of the applicable objectives is met. Target awards ranging from 30 percent to 60 percent of base salary will be earned if 100 percent of all objectives are achieved. Maximum awards ranging from 60 percent to 120 percent of base salary, depending on the category, will be earned only if the Company achieves pre-established objectives well above these objectives and, for executives who are responsible for a business unit, such business unit reaches certain levels of achievement of its sales, net income and cumulative business unit economic value added objectives. In addition, for Other Participants, the Committee may, in its discretion, provide for deferred cash incentive awards in excess of the awards that would be made based on the formulas contained in the LTIP.

Conclusion

Through the programs described above, a very significant portion of the Company s executive compensation is linked directly to individual and Company performance and stock price appreciation. In 2002, approximately 50% of the Company s executive compensation (approximately 70% for the individuals listed in the table on page 9) consisted of these performance-based variable elements. For Mr. Neal, approximately 80% of his 2002 compensation consisted of performance-based variable elements. The Committee intends to continue the policy of linking executive compensation to Company performance and returns to stockholders, recognizing that the ups and downs of the business cycle from time to time may result in an imbalance for a particular period.

February 27, 2003	Frank V. Cahouet, Chairman
	Sidney R. Petersen
	David E.I. Pyott

STOCKHOLDER RETURN PERFORMANCE

The graph on the next page compares the Company s cumulative stockholder return on its common stock, including the reinvestment of dividends, with the return on the Standard & Poor s 500 Stock Index (the S&P 500 Index) and the average return, weighted by market capitalization, of a peer group of companies (the Peer Group). In addition, the Company has included the median return of the Peer Group in the graph because, under the Company s LTIP, Company performance is measured against the performance of other companies using a percentile approach in which each company is given equal weight regardless of its size.

The Peer Group is comprised of Air Products & Chemicals Inc., ArvinMeritor, Inc., Baker-Hughes, Incorporated, Bemis Company, Incorporated, Black & Decker Corporation, Boise Cascade Corporation, Bowater Incorporated, Cabot Corporation, Crane Company, Crown Cork & Seal Company, Inc., Dana Corporation, Danaher Corporation, Dover Corporation, Eaton Corporation, Ecolab Incorporated, Engelhard Corporation, Ethyl Corporation, Ferro Corporation, FMC Corporation, H. B. Fuller Company, The B. F. Goodrich Company, W. R. Grace & Company, Great Lakes Chemical Corporation, Harris Corporation, Harsco Corporation, Hercules Incorporated, Illinois Tool Works Incorporated, Ingersoll-Rand Company, MASCO Corporation, Maytag Corporation, MeadWestvaco Corporation, Moore Corporation Limited, NACCO Industries, National Service Industries, Incorporated, Newell Rubbermaid Incorporated, Olin Corporation, P.P.G. Industries Incorporated, Parker-Hannifin Corporation, Pentair Incorporated, Pitney Bowes Incorporated, PolyOne Corporation, Sequa Corporation, The Sherwin-Williams Company, Snap-On Tools Corporation, Sonoco Products Company, Stanley Works, Tecumseh Products Company, Thermo Electron Corporation, Thomas & Betts Corporation, and Timken Company.

During 2002, four companies were removed from the Peer Group for all periods due to merger/acquisition/bankruptcy activity. Armstrong Industries Inc. filed bankruptcy, Federal-Mogul Corporation filed bankruptcy, The Mead Corporation and Westvaco Corporation merged. Bowater Incorporated, Crown Cork & Seal Company, Inc., Maytag Corporation and MeadWestvaco Corporation were added, and have been included for all periods.

COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN(1)

OF AVERY DENNISON, S&P 500 INDEX AND PEER GROUP,

WEIGHTED AVERAGE(2) AND MEDIAN

as of December 31, 2002

	12/97	12/98	12/99	12/00	12/01	12/02
Avery Dennison	$ 100	$ 102	$ 168	$ 129	$ 136	$ 151
S&P 500 Index	$ 100	$ 129	$ 156	$ 141	$ 125	$ 97
Peer Group (Wt. Avg.) (2)	$ 100	$ 105	$ 101	$ 102	$ 108	$ 105
Peer Group (Median)	$ 100	$ 96	$ 84	$ 89	$ 95	$ 84

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(1) Assumes $100 invested on December 31, 1997, and the reinvestment of dividends; chart reflects performance on a calendar year basis.

(2) Weighted average is weighted by market capitalization.

Stock price performance of the Company reflected in the above graph is not necessarily indicative of future price performance.

CERTAIN TRANSACTIONS

Peter W. Mullin is the chairman and chief executive officer and a director of MC Insurance Services, Inc. (MC), Mullin Insurance Services, Inc. (MINC) and PWM Insurance Services, Inc. (PWM), executive compensation and benefit consultants and insurance agents. Mr. Mullin is also the majority stockholder of MC, MINC and PWM. During 2002, the Company paid insurance companies premiums for life insurance placed by MC, MINC and PWM in 2002 and prior years in connection with various Company employee benefit plans. In 2002, MC, MINC and PWM earned commissions from such insurance companies in an aggregate amount of approximately $1,344,800 for the placement and renewal of this insurance, in which Mr. Mullin had direct and indirect interests of approximately $934,500, the majority of which was allocated to and used by MCP Insurance Services, LLC (an affiliate of MC) to administer benefit plans and provide benefit statements to participants under various Company employee benefit plans.

VOTING SHARES

Stockholders of record, at the close of business on February 24, 2003, are entitled to notice of, and to vote at, the Annual Meeting. There were 110,465,810 shares of common stock of the Company outstanding on February 24, 2003.

Principal Stockholders

Whenever in this proxy statement information is presented as to beneficial ownership, please note that such ownership indicates only that the person shown, directly or indirectly, has or shares with others the power to vote (or to direct the voting of) or the power to dispose of (or to direct the disposition of) such shares; such person may or may not have any economic interest in the shares. The reporting of information herein does not constitute an admission that any such person is, for the purpose of Section 13 or 16 of the 1934 Act, the beneficial owner of the shares shown herein.

To the knowledge of the Company, the following were the only persons who, as of December 31, 2002, owned beneficially 5% or more of the outstanding common stock of the Company.

Name and Address of Beneficial Owner	Number of Shares Beneficially Owned	Percent of Class
Avery Dennison Corporation Employee Stock Benefit Trust (ESBT) Wachovia Bank, N.A., Trustee Executive Services 100 Main Street Winston-Salem, NC 27150	11,163,451(1)	10.1%
FMR Corp. 82 Devonshire Street Boston, MA 02109	7,915,569(2)	7.2%
U.S. Trust Corporation Avery Dennison Master Defined Contribution Plan Trust 515 South Flower Street Suite 2800 Los Angeles, CA 90071 United States Trust Company of New York 114 West 47th Street New York, NY 10036	6,821,782(3)	6.2%

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(1) The ESBT and Wachovia Bank, N.A., as Trustee, disclaim beneficial ownership of these shares.

(2) Based on information contained in the Schedule 13G of FMR Corp. for the period ending December 31, 2002, FMR Corp is the parent holding company of a group of investment management companies (including Fidelity Management and Research Company) that hold investment power and, in some cases, voting power over the securities referred to herein. The investment management companies, which also include a bank as defined in Section 3(a)6 of the 1934 Act and several investment advisers registered under Section 203 of the Investment Advisers Act of 1940, provide investment advisory and management services for their respective clients, which include registered investment companies and institutional accounts.

(3)

Based on information contained in the Schedule 13G of U.S. Trust Corporation and United States Trust Company of New York for the period ending December 31, 2002. Both entities are direct subsidiaries of The Charles Schwab Corporation. Each entity files reports completely separate and independent from the other. Correspondingly, neither entity shares with the other any information and/or power with respect to either the voting and/or disposition of the securities reported by each. U.S. Trust Corporation is trustee for an employee benefit plan, in accordance with Section 240.13d-1(b)(1)(ii)(F) of the 1934 Act and a parent holding company or control person in accordance with Section 240.13d-1(b)(1)(ii)(G) of the 1934 Act.

The Company s Employee Savings Plan, SHARE Plan and Retirement Plan (the Plans) together owned a total of 8,103,456 shares of Company common stock on December 31, 2002, or 7.3% of the common stock then outstanding. Although the Company is the Administrator of the Plans, each plan was established and is administered to achieve the different purposes for which it was created for the exclusive benefit of its participants, and employees participating in the Plans are entitled to vote all shares allocated to their accounts. Accordingly, such plans do not constitute a group within the meaning of Section 13(d) of the 1934 Act.

RATIFICATION OF APPOINTMENT OF AUDITORS (Proxy Item 2)

The Audit Committee of the Board of Directors has selected PricewaterhouseCoopers LLP (PwC) as Avery Dennison s independent auditors for fiscal 2003, and the Board urges stockholders to vote to ratify PwC s appointment. Ratification of the selection of PwC by stockholders is not required by the Company s Bylaws. However, as a matter of good corporate practice, the Board is submitting the selection of PwC for stockholder ratification. PwC has audited the Company s financial statements since 1998. PwC has confirmed to Avery Dennison that PwC is in compliance with all rules, standards and policies of the Independence Standards Board and the Securities and Exchange Commission governing auditor independence. See Report of the Audit Committee on page 34.

Representatives of PwC will be present at the Annual Meeting and will have the opportunity to make a statement if they desire and will be available to respond to appropriate questions.

Relationship with Independent Auditors

PwC has served as Avery Dennison s independent auditors since 1998, and was our independent auditor for the fiscal year ended December 28, 2002. Prior to 1998, Coopers & Lybrand, LLP, a predecessor firm of PwC, served as the Company s independent auditor. As stated in Proxy Item 2, the Audit Committee of the Board has selected PwC to serve as our independent auditors for the fiscal year ending December 27, 2003.

Audit services performed by PwC for fiscal 2002 consisted of the examination of the Company s financial statements and services related to filings with the Securities and Exchange Commission (SEC) and certain other non-audit services.

Fiscal 2002 Audit Firm Fee Summary

During fiscal year 2002, we retained PwC to provide services in the following categories and amounts(1):

Audit Fees	$ 4.2 million
The aggregate fees billed by PwC for professional services rendered for the audit of the Company s financial statements for fiscal year 2002 were $4.2 million.	
All Other Fees	7.8 million
The aggregate fees billed by PwC for professional services (other than the services described above) for fiscal year 2002 were $7.8 million, and included various services of which $5.2 million related to tax support with the remaining $2.6 million related to services for mergers and acquisitions due diligence, research and SEC registration support and benefit plan audits.	

Total Fees	$12.0 million

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(1) Under the SEC s final rule issued on January 28, 2003, Strengthening the Commissions Requirements Regarding Auditor Independence, in accordance with Section 208(a) of the Sarbanes-Oxley Act of 2002, the categorization of PwC services for fiscal 2002 would be as follows:

Audit Fees	$ 5.0 million
Audit Related Fees	1.8 million
Tax Fees	5.2 million
Other Fees	none
Total Fees	$12.0 million

The Audit Committee considers at least annually whether the provision of non-audit services by PwC is compatible with maintaining auditor independence.

Required Vote for Approval and Recommendation of the Board of Directors

The affirmative vote of a majority of the shares present or represented and entitled to vote at the Annual Meeting is required to ratify the appointment of PricewaterhouseCoopers LLP as the Company s independent auditors for the current fiscal year, which ends on December 27, 2003.

Your Board of Directors recommends that you vote FOR approval for this proposal.

DIRECTOR EQUITY PLAN, amended and restated, (Director Plan) (Proxy Item 3)

Proposed Amendments

Upon the recommendation of the Committee, the Board of Directors has approved and adopted, subject to stockholder approval, the Director Plan, as amended and restated, which includes the following key amendments:

1. an increase of 250,000 in the number of shares of common stock authorized for issuance to non-employee directors under the Director Plan;
2. the ability to make stock awards to non-employee directors as part of their compensation;
3. the ability to issue stock units to non-employee directors, who elect to receive stock units instead of retainers and meeting fees; such stock units to be exchanged for shares of common stock at retirement; and
4. clarification that stock options may not be repriced (note that options previously granted have never been repriced); options may be exercised within five years of retirement after age seventy-two, but not later than the option s expiration date.

Description of the Director Plan

In January 1988, the Company s Board of Directors adopted the Director Plan and in March 1988 the stockholders approved it. In April 1995, the stockholders approved certain amendments to the Director Plan. The Director Plan is designed to assist the Company in attracting and retaining the services of experienced and knowledgeable independent directors for the benefit of the Company and its stockholders, and to provide additional incentive for such directors to continue to work for the best interests of the Company and its stockholders.

The principal features of the Director Plan, as amended and restated, are summarized below, but the summary is qualified in its entirety by reference to the Director Plan itself. Copies of the Director Plan will be available at the Annual Meeting, can also be obtained by making written request to the Company s Secretary, and the Director Plan will be filed with the SEC as an exhibit to the Company s Annual Report on Form 10-K, which will be filed by March 31, 2003.

Under the Director Plan, as of December 31, 2002, 265,000 shares of common stock were authorized for issuance upon exercise of options. There are no outstanding forms of award other than stock options. As of December 31, 2002, a total of 200,000 shares were subject to outstanding stock options held by non-employee directors of which 173,500 were exercisable. As of December 31, 2002, assuming that all outstanding options will be exercised, 65,000 shares remained available for the grant of new stock options. Subject to stockholder approval, as of April 24, 2003, the number of shares deliverable pursuant to awards shall be increased by 250,000 for an aggregate total of 515,000 under the Director Plan. On February 24, 2003, the closing price of a share of the Company s common stock on the New York Stock Exchange Composite Tape was $57.05.

Awards to Directors

Under the Director Plan, each non-employee director receives an initial option grant of 5,000 shares upon joining the Board of Directors, and each non-employee director automatically receives on the date of the regular meeting of the Board of Directors in December (or other month in which annual grants of options are made to employees) thereafter an option for 2,000 shares. Employee directors who retire as employees of the Company, but who remain on the Board, are not entitled to receive a 5,000 share option grant, but will receive annual option grants as described above commencing on the December next following their retirement from the Company. Appropriate adjustments in the number of shares subject to the Director Plan and to outstanding options will be made in the event of stock splits, stock dividends or certain other types of recapitalization. Only non-qualified stock options may be granted under the Director Plan. At present, ten non-employee directors are eligible to participate in the Director Plan. Upon approval of the Director Plan, as amended and restated, by the stockholders, all nine continuing non-employee directors will be eligible to participate in the Director Plan. (Mr. Petersen is retiring in April 2003). As described above, eight non-employee directors received 2,000 share option grants in 2002.

DIRECTOR PLAN(1)

Name and Position	Grant Date/Dollar Value ($)(2)	Number of Options in 2002
Non-Executive Director Group	$266,720	16,000

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(1) The value of options to be granted in the future under the Director Plan is not presently determinable.

(2) Option grant date values were determined using a Black-Scholes option pricing model as described in footnote (3) on page 10.

The option price for each option granted under the Director Plan is 100% of the fair market value of the common stock on the date of grant. Options granted under the Director Plan have a term of ten years and vest and become exercisable in two cumulative installments of 50% of the number of shares initially granted, on each of the first and second anniversaries of the grant date, except that all options held by a director, which are unexercisable on the date the director retires at or after the age of seventy-two, will become fully exercisable on the date of such retirement.

If an optionee ceases to be a director, other than by reason of death or retirement, the optionee may exercise an option (unless previously terminated) for a period of three months after such termination, but not after expiration of the option, to the extent the option was exercisable at the date of termination. An option will be exercisable for twelve or sixty months after death or retirement from the Board of Directors after age seventy-two, respectively, to the extent the option was exercisable on the date of death or retirement, as the case may be. However, options granted under the Director Plan provide that in the event of a change of control of the Company (as defined in the option) all previously unexercisable options become immediately exercisable.

Options granted under the Director Plan may be assigned or transferred by its holder by will or by the laws of intestate succession, or to a properly designated transferee. During the lifetime of the holder, an option may be exercised only by the holder, or his guardian or legal representative, or properly designated transferee.

Instead of receiving cash payments for meeting and retainer fees, directors are permitted to elect to receive stock units (each of which represents one share of common stock), which are credited to the director s account, to be paid to the director in the form of common stock at retirement, together with additional shares representing dividends and other distributions thereon. Stock units shall be settled with shares of common stock issued pursuant to this Plan. The Board or Committee may also approve awards of stock (stock payments) to directors, as a portion of the directors   compensation program.

Administration

The Board of Directors, or the Compensation and Executive Personnel Committee as designated by the Board, administers the Director Plan.

Amendment and Termination

The Director Plan may be terminated, modified or amended by the stockholders of the Company. The Board of Directors may also terminate the Director Plan or modify or amend it in certain respects as set forth in the Director Plan, unless such action would otherwise require stockholder approval as a matter of applicable law regulation or rule. Amendments to the Plan will not, without the consent of the participant, affect such person s rights under an award previously granted, unless the award itself otherwise expressly so provides.

Federal Income Tax Consequences

The tax consequences of the Director Plan under current federal law are summarized in the following discussion that deals with the general tax principles applicable to the Director Plan, and is intended for general information only. Alternative minimum tax and state and local income taxes are not discussed, and may vary depending on individual circumstances and from locality to locality.

For federal income tax purposes, the recipient of options granted under the Director Plan will not have taxable income upon the grant of the option, nor will the Company then be entitled to any deduction. Generally, upon exercise of an option, the optionee will realize ordinary income, and the Company will be entitled to a deduction, in an amount equal to the difference between the option exercise price and the fair market value of the stock on the date of exercise. An optionee s basis for the stock for purposes of determining his gain or loss on his subsequent disposition of the shares generally will be the fair market value of the stock on the date of exercise of the option. With respect to stock awards and stock issued in exchange for stock units (at retirement), the recipient will have taxable income at the time of receipt of the stock award or stock in exchange of stock units, and the Company will be entitled to a deduction equal to the value of the stock award, or the stock received in exchange for stock units.

Stock payments may be authorized by the Committee in the form of shares of common stock as part of a compensation or deferred compensation arrangement instead of receiving all or any part of compensation, including fees and retainers, that would otherwise be payable to a director in cash. Directors who receive stock at retirement in exchange for stock units will have taxable income at the time of such receipt.

Reasons for Amended and Restated Director Plan

After the grants of 5,000 stock options each to Ms. Stewart and Mr. Baker in January 2003, there were 55,000 shares available for future awards under the Directors Plan. The Company estimates that the Plan will need approximately 40,000 to 50,000 shares per year for stock options, stock awards and stock units that are to be provided under the Directors Plan. In addition to the 5,000 stock options that are granted to new non-employee directors and the 2,000 stock options that are granted each year to the Company s non-employee directors, the Company currently awards 200 shares of stock annually to these directors as part of their compensation program. Furthermore, the Company encourages these directors to increase their equity interest in the Company by electing to trade their cash compensation in the form of retainers and meeting fees for stock units at fair market value in the Company, which are exchanged for company stock at retirement, which further aligns the interests of directors with other shareholders. Currently, directors must exercise their stock options within twenty-four months following retirement; an amendment to the Directors Plan would permit a director to exercise options up to sixty months following retirement after age seventy-two (but no later than the option s termination date), thereby providing directors with additional incentive to work for the long-term best interests of the Company.

Required Vote for Approval and Recommendation of the Board of Directors

The affirmative vote of a majority of the shares present or represented and entitled to vote at the Annual Meeting is required to approve the Directors Plan, as amended and restated.

Your Board of Directors recommends that you vote FOR approval of this proposal.

EMPLOYEE STOCK OPTION AND INCENTIVE PLAN, amended and restated

(Employee Plan) (Proxy Item 4)

Proposed Amendments

Upon the recommendation of the Committee, the Board of Directors has approved and adopted, subject to stockholder approval, the Employee Plan, as amended and restated, which includes the following key amendments:

1. an increase of 3,500,000 in the number of shares of common stock authorized for issuance to employees under the Employee Plan;
2. the ability to make restricted stock unit awards;
3. an aggregate limit of 100,000 on the number of shares represented by restricted stock and restricted stock units that can be awarded; and
4. clarification that stock options may not be repriced (note that options previously granted have never been repriced).

Description of the Employee Plan

In January 1990, the Company s Board of Directors adopted the Employee Plan and in March 1990 the stockholders approved it. In February 1991, January 1994 and September 1995, the Board of Directors adopted certain amendments to the Employee Plan, which were approved by the stockholders in March 1991, April 1994 and April 1996, respectively.

The principal purpose of the Employee Plan is to provide incentives for officers and employees of the Company and its subsidiaries through granting of options and other awards, thereby stimulating their personal and active interest in the Company s development and financial success, and inducing them to remain in the Company s employ.

Under the Employee Plan, as of December 31, 2002, 2,315,400 shares of common stock were authorized for issuance upon exercise of options and other awards. There are no outstanding stock appreciation rights (SARs), restricted stock or forms of award other than stock options under this Plan. As of December 31, 2002, a total of 1,349,813 shares were subject to outstanding stock options, of which 709,213 were exercisable; and stock options were held by approximately 650 employees under the Employee Plan and the Stock Incentive Plan. As of December 31, 2002, assuming that all outstanding options are exercised, 965,587 shares remained available for the grant of new stock options and other awards under the Employee Plan. Subject to stockholder approval, as of April 24, 2003, the number of shares deliverable pursuant to awards shall be increased by 3,500,000 for an aggregate total of 5,815,400 under the Employee Plan. On February 24, 2003, the closing price of a share of the Company s common stock on the New York Stock Exchange Composite Tape was $57.05.

The shares available under the Employee Plan upon exercise of stock options, SAR s and other awards, and issuance as restricted stock, may be either previously unissued shares, issued shares which have been repurchased by the Company as treasury shares, or former treasury shares that are held in a grantor trust. The Employee Plan provides for appropriate adjustments in the number and kind of shares subject to this Plan and to outstanding grants thereunder in the event of a stock split, stock dividend or certain other types of recapitalizations.

If any portion of a stock option, SAR or other award terminates or lapses unexercised, or are canceled, the shares which were subject to the unexercised portion of such option, SAR or other award will continue to be available for issuance under the Employee Plan. The Company has not repriced and will not reprice any stock option under the Employee Plan. This Plan has been designed to meet the requirements of Section 162(m) of the Code regarding deductibility of executive compensation.

The principle features of the Employee Plan, as amended and restated, are summarized herein, but the summary is qualified in its entirety by reference to the Employee Plan itself. Copies of the Employee Plan will be available at the Annual Meeting of Stockholders and can also be obtained by making written request to the Company s Secretary; a copy of the Employee Plan will be filed with the SEC as an exhibit to the Company s Annual Report on Form 10-K, which will be filed by March 31, 2003.

Administration

The Employee Plan is administered by the Committee, which consists of at least three members of the Board, none of whom is an employee of the Company. The Committee is authorized to select from among the eligible employees the individuals to whom options, SAR s, restricted stock and other awards are to be granted and to determine the number of shares to be subject thereto and the terms and conditions thereof, consistent with the Employee Plan. The Committee is also authorized to adopt, amend and rescind rules relating to the administration of the Employee Plan.

The Employee Plan also authorizes the Committee to delegate all or specified administrative duties and authority, except the authority to make grants or awards, to the Chief Executive Officer or the Secretary of the Company, or both. In addition, the Committee may in its discretion grant to the Chief Executive Officer of the Company authority to make grants or awards under the Employee Plan to employees other than executive officers, subject to such limitations as the Committee may impose.

Payment for Shares

The exercise or purchase price for all options, SAR s, restricted stock and other rights to acquire Company common stock, together with any applicable tax required to be withheld, must be paid in full in cash at the time of exercise or purchase, or may be paid in whole or in part in common stock of the Company owned by the optionee and having a fair market value on the date of exercise equal to the aggregate exercise price of the shares so to be purchased. The Committee may also authorize other lawful consideration to be applied to the exercise or purchase price of an award. This may also include services rendered, or the difference between the exercise price of presently exercisable options and the fair market value of the common stock covered by such options on the date of exercise.

Amendment and Termination

Amendments of the Employee Plan to (i) increase the number of shares as to which options, SAR s, restricted stock and other awards may be granted (except for adjustments resulting from stock splits, etc.), (ii) change the class of persons eligible to participate, (iii) grant options at an exercise price below the fair market value of a share of common stock of the Company on the date of grant, or (iv) to reprice options require the approval of the Company s stockholders. In other respects, the Employee Plan can be amended, modified, suspended or terminated by the Board of Directors, unless such action would otherwise require stockholder approval as a matter of applicable law, regulation, or rule. Amendments of the Plan will not, without the consent of the participant, affect such person s rights under an award previously granted, unless the award itself otherwise expressly so provides. No termination date is specified for the Employee Plan.

Eligibility

As determined by the Committee, options, SAR s, restricted stock and other awards under the Employee Plan may be granted to individuals who are then officers or other employees of the Company or any of its present or future subsidiaries as determined by the Committee. Approximately 2,100 officers and other employees are eligible for consideration to participate in the Employee Plan. More than one option, SAR, restricted stock grant or other award may be granted to an employee, but the aggregate fair market value (determined at the time of grant) of shares with respect to which an Incentive Stock Option is first exercisable by an optionee during any calendar year cannot exceed $100,000, and the Committee may not grant options or restricted stock to any optionee during any calendar year covering more than 400,000 shares and 100,000 shares, respectively.

Awards to Employees

EMPLOYEE PLANS(1)

Name and Position	Grant Date/Dollar Value ($)(2)	Options Granted in 2002
Philip M. Neal Chairman and CEO	$2,026,500	150,000
Dean A. Scarborough President and CFO	743,000	55,000
Robert G. van Schoonenberg EVP, General Counsel and Secretary	472,800	35,000
Robert M. Malchione SVP, Corporate Strategy and Technology	1,023,300	75,000
Christian A. Simcic Group VP, Roll Materials Worldwide	405,300	30,000
Executive Group	5,927,330	438,000
Non-Executive Director Group	0	
Non-Executive Officer Employee Group	13,688,854	930,400
Total	$19,616,184	1,368,400

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(1) Values of options to be granted in the future are not presently determinable.

(2) Option grant date values (for grants under Employee Plan and Stock Incentive Plan) were determined using a Black-Scholes option pricing model as described in footnote (3) on page 10.

Although only stock options have been awarded, the Employee Plan provides that the Committee may award stock options, SAR s, restricted stock, restricted stock units, performance units, stock payments, dividend equivalents and other stock related benefits, or any combination thereof. Each award or issuance will be set forth in a separate agreement with the person receiving the award and will indicate the type, terms and conditions of the award.

Nonqualified stock options (NQSO s) will provide for the right to purchase common stock at an exercise price equal to at least 100% of fair market value of common stock on the grant date and generally will become exercisable in equal installments over four years after the grant date, or for officers, who participate in the LTIP, options will vest in nine years and nine months, subject to accelerated vesting after three years, if the Company meets certain performance requirements. NQSO s have been granted with a term of ten years, but may be granted for any reasonable term.

Incentive stock options (ISO s), if granted, will be designed to comply with the provisions of the Code and will be subject to restrictions contained in the Code, including exercise prices equal to at least 100% of fair market value of common stock on the grant date and a ten year restriction on their term, but may be subsequently modified to disqualify them from treatment as an incentive stock option.

Stock appreciation rights may be granted in connection with stock options or other awards, or separately. SAR s granted by the Committee in connection with stock options or other awards typically will provide for payments to the holder based upon increases in the price of the Company s common stock over the exercise price of the related option or other awards, subject to such restrictions and requirements as may be determined by the Committee. The Committee may elect to pay SAR s in cash or in common stock, or in a combination of cash and common stock.

Restricted stock and restricted stock units may be sold or granted to participants at various prices and made subject to such restrictions and requirements as may be determined by the Committee. Restricted stock, typically, may be repurchased by the Company at the original purchase price if the conditions or restrictions are not met. In general, restricted stock may not be sold, or otherwise transferred or pledged, until restrictions are removed or expire. Purchasers of restricted stock, unlike recipients of options, will have voting rights and will receive dividends prior to the time when the restrictions lapse. Restricted stock units represents the right to receive, at a specified time or times, either a specified number of shares of common stock, or a cash payment equal to the fair market value of a specified number of shares of common stock, as the Committee shall determine.

Performance units may be granted as determined by the Committee. Generally, these awards will be based upon attainment of specific performance goals, such as increases in earnings per share, net income, sales or unit volume, and may be paid in cash or in common stock or in a combination of cash and common stock. Performance awards may also include bonuses, which may be granted by the Committee on an individual or group basis and which may be payable in cash or in common stock or in a combination of cash and common stock.

Stock payments may be authorized by the Committee in the form of shares of common stock as part of a compensation or deferred compensation arrangement instead of receiving all or any part of compensation, including salary and bonuses, that would otherwise be payable to an employee in cash.

Dividend equivalents may be credited to a participant in the Employee Plan. They represent the value of the dividends per share paid by the Company, calculated with reference to the number of shares covered by options, SAR s, restricted stock, or other awards held by the participant.

Miscellaneous Provisions

In consideration of the granting of a stock option, SAR, dividend equivalent, performance award or right to purchase restricted stock, the employee agrees in the written agreement embodying such award to remain in the employ of the Company or a subsidiary of the Company generally for at least one year after the award is granted. Option agreements may also provide for immediate termination of options in the event the optionee terminates employment in violation of an employment agreement or is discharged for cause. Options and other rights granted under the Employee Plan currently provide that in the event of a change of control of the Company (as defined in the award agreement) all previously unexercisable options and rights become immediately exercisable.

The Employee Plan provides that the period of exercisability, following retirement, for options, granted on or after November 30, 1995, is (i) the full term of the option for the Chief Executive Officer and Chief Operating Officer; (ii) the lesser of five years or the full term of the option for options granted to participants in the LTIP or any successor plan; and (iii) the lesser of three years or the full term of the option for all other optionees.

No option, SAR or other award granted under the Employee Plan may be assigned or transferred by the awardee, except by will or the laws of intestate succession or to a properly designated beneficiary or transferee.

During the lifetime of the holder of any option or right, the option or right may be exercised only by the holder, his guardian or legal representative, or properly designated transferee.

The Company requires participants to discharge withholding tax obligations in connection with the exercise of any option or other right granted under the Employee Plan, or the lapse of restrictions on restricted stock, as a condition to the issuance or delivery of stock or payment of other compensation pursuant thereto. Shares held by or to be issued to a participant may also be used to discharge tax withholding obligations related to exercise of options or receipt of other awards, subject to the discretion of the Committee to disapprove such use.

Federal Income Tax Consequences

The tax consequences of the Employee Plan under current federal law are summarized in the following discussion which deals with the general tax principles applicable to the Employee Plan, and is intended for general information only. In addition, the tax consequences described below are subject to the limitation of OBRA. Under OBRA, which became law in August 1993, income tax deductions of publicly-traded companies may be limited to the extent total compensation (including base salary, annual bonus, stock option exercises and non-qualified benefits paid in 1994 and thereafter) for certain executive officers exceeds $1 million (less the amount of any excess parachute payments as defined in section 280G of the Code) in any one year. However, under OBRA, the deduction limit does not apply to qualified performance-based compensation established by an independent compensation committee, which is adequately disclosed to, and approved by, stockholders. In particular, stock options and stock appreciation rights will satisfy the performance-based exception if the awards are made by a qualifying compensation committee, the plan sets the maximum number of shares that can be granted to any particular employee within a specified period and the compensation is based solely on an increase in the stock price after the grant date (i.e., the option exercise price is equal to or greater than the fair market value of the stock subject to the award on the grant date). The Company believes that it has complied with the requirements of the performance-based compensation exclusion under OBRA, including option pricing requirements and requirements governing the administration of the Employee Plan so that deductibility of compensation paid to top executives thereunder is not expected to be disallowed. Alternative minimum tax and state and local income taxes are not discussed below, and may vary depending on individual circumstances and from locality to locality.

Nonqualified Stock Options. For federal income tax purposes, the recipient of NQSO s granted under the Employee Plan will not have taxable income upon the grant of the option, nor will the Company then be entitled to any deduction. Generally, upon exercise of NQSO s the optionee will realize ordinary income, and the Company will be entitled to a deduction, in an amount equal to the difference between the option exercise price and the fair market value of the stock on the date of exercise. An optionee s basis for the stock for the purpose of determining his gain or loss on his subsequent disposition of the shares generally will be the fair market value of the stock on the date of exercise of the NQSO.

Incentive Stock Options. There is no taxable income to an employee when an ISO is granted to him or when that option is exercised; however, the amount by which the fair market value of the shares at the time of exercise exceeds the option price will be an item of tax preference for the optionee. Gain realized by an optionee upon sale of stock issued on exercise of an ISO is taxable at capital gains rates, and no tax deduction is available to the Company, unless the optionee disposes of the shares within two years after the date of grant of the option or within one year of the date the shares were transferred to the optionee. In such event, the difference between the option exercise price and the fair market value of the shares on the date of the option s exercise will be taxed at ordinary income rates, and the Company will be entitled to a deduction to the extent the employee must recognize ordinary income. An ISO exercised more than three months after an optionee s retirement from employment, other than by reason of death or disability, will be taxed as an NQSO, with the optionee deemed to have received income upon such exercise taxable at ordinary income rates. The Company will be entitled to a tax deduction equal to the ordinary income, if any, realized by the optionee.

Stock Appreciation Rights. No taxable income is realized upon the receipt of a SAR, but upon exercise of the SAR the fair market value of the shares (or cash in lieu of shares) received must be treated as compensation taxable as ordinary income to the recipient in the year of such exercise. The Company will be entitled to a deduction for compensation paid in the same amount, which the recipient realized as ordinary income.

Restricted Stock. Unless an election is made under Section 83(b) of the Code, an employee to whom restricted stock is issued will not have taxable income upon issuance and the Company will not then be entitled to a deduction. However, when restrictions on shares of restricted stock lapse, such that the shares are no longer subject to repurchase by the Company, the employee will realize ordinary income and the Company will be entitled to a deduction in an amount equal to the fair market value of the shares at the date such restrictions lapse, less the purchase price therefor. If an election is made under Section 83(b), the employee will realize ordinary income at the date of issuance equal to the difference between the fair market value of the shares at that date less the purchase price therefor and the Company will be entitled to a deduction in the same amount.

Restricted Stock Unit. An employee, who has been granted a restricted stock unit award, will not realize taxable income until the employee receives stock or cash pursuant to the award, at which time such employee will realize ordinary income equal to the full fair market value of the shares delivered or the amount of cash paid. At that time, the Company generally will be allowed a corresponding tax deduction equal to the compensation taxable to the employee, subject to any other Code restrictions.

Performance Awards. A participant who has been granted a performance award will not realize taxable income at the time of grant, and the Company will not be entitled to a deduction at that time. When an award is paid, whether in cash or in common stock, the participant will have ordinary income, and the Company will be entitled to a corresponding deduction.

Stock Payments. A participant who receives a stock payment in lieu of a cash payment that would otherwise have been made will be taxed as if the cash payment has been received, and the Company will have a deduction in the same amount.

Dividend Equivalents. A recipient of a dividend equivalent award will not realize taxable income at the time of grant, and the Company will not be entitled to a deduction at that time. When a dividend equivalent is paid, the participant will recognize ordinary income, and the Company will be entitled to a corresponding deduction.

Deferred Compensation. Participants who defer compensation generally will recognize no income, gain or loss for federal income tax purposes when nonqualified stock options or other awards are granted in lieu of amounts otherwise payable, and the Company will not be entitled to a deduction at that time. When and to the extent options are exercised or awards are received, the ordinary rules regarding nonqualified stock options outlined above will apply. When and to the extent, stock or cash is received, the ordinary rules outlined above will apply.

Reasons for Amended and Restated Employee Plan

Under the Employee Plan, 2,315,000 shares of common stock are authorized for issuance. As of December 31, 2002, 965,587 shares remained available for future awards. Also as of that date, options held by officers and employees and covering 1,349,813 shares were outstanding under the Employee Plan. The Board of Directors has determined that it is advisable to continue to provide stock-based incentive compensation to the Company s key employees, thereby continuing to align the interests of such employees with those of the stockholders, and that awards under the

Employee Plan are an effective means of providing such compensation. On February 27, 2003, the Board of Directors approved and adopted the Employee Plan, as amended and restated, including an increase in the number of shares authorized for issuance, fixing the aggregate number of share of restricted stock or restricted stock units at 100,000 that may be issued, and clarified that, while no previously granted options have ever been repriced, the Employee Plan now expressly provides that, options may not be repriced without stockholder approval. In order to continue to grant stock-based incentive compensation in the future, it is necessary to increase the number of shares available for issuance under the Employee Plan. Therefore, the Board recommends that 3,500,000 additional shares of common stock be reserved under the Employee Plan for issuance on exercise of options and other awards.

Required Vote for Approval and Recommendation of the Board of Directors

The affirmative vote of a majority of the shares present or represented and entitled to vote at the Annual Meeting is required to approve the Employee Plan, as amended and restated.

Your Board of Directors recommends that you vote FOR approval of this proposal.

AUDIT COMMITTEE REPORT

The following Report of the Audit Committee of the Board of Directors does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Company filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates this Report by reference therein.

The Audit Committee of the Company s Board of Directors (the Audit Committee) is composed of independent directors set forth below, each of whom meets the independence standards of the New York Stock Exchange. The Audit Committee has a written charter adopted by the Board of Directors.

Management is responsible for the Company s internal controls and the financial reporting process. The independent auditors are responsible for performing an independent audit of the Company s consolidated financial statements in accordance with auditing standards generally accepted in the United States and to issue an opinion thereon. The Audit Committee s responsibility is to monitor and oversee these processes. The members of the Audit Committee are not professionally engaged in the practice of auditing or accounting. Members of the Audit Committee rely without independent verification on the information provided to them and the representations made by management and the independent auditors.

Management has represented to the Audit Committee that the Company s consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States. The Audit Committee has reviewed and discussed the consolidated financial statements for the year ended December 28, 2002, with management and the independent auditors. The Audit Committee has also discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61 (Communication with Audit Committees), as amended. The Company s independent auditors have also provided to the Audit Committee the written disclosures and the letter from the independent auditors required by Independence Standards Board No. 1 (Independence Discussions with Audit Committees). The Audit Committee has discussed independence matters with the independent auditors and management, and, based on its discussion and review, the Audit Committee is satisfied that the provision of non-audit services, described above, is compatible with maintaining PwC s independence.

Based on the Audit Committee s discussions with management and the independent auditors and on the Audit Committee s review of the representations of management and the report of the independent auditors, the Audit Committee has recommended that the Board of Directors include the audited consolidated financial statements in the Company s Annual Report on Form 10-K for the year ended December 28, 2002, filed with the Securities and Exchange Commission.

February 27, 2003	Sidney R. Petersen (Chairman)
	Kent Kresa
	David E.I. Pyott
	Bruce E. Karatz
	Peter K. Barker

GENERAL

Stockholder Proposals

Stockholder proposals for presentation at the annual meeting scheduled to be held on April 22, 2004, must be received at the Company s principal executive offices on or before November 14, 2003. The Company s Bylaws provide that stockholders desiring to nominate persons for election to the Board of Directors or to bring any other business before the stockholders at an annual meeting must notify the Secretary of the Company thereof in writing 60 to 90 days prior to the first anniversary of the preceding year s annual meeting (or, if the date of the annual meeting is more than 30 days before or more than 60 days after such anniversary date, 60 to 90 days prior to such annual meeting or within 10 days after the public announcement of the date of such meeting is first made by the Company; or, if the number of directors to be elected to the Board of Directors is increased and the Company does not make a public announcement naming all of the nominees for director or specifying the size of the increased Board of Directors at least 70 days prior to the first anniversary of the preceding year s annual meeting, within 10 days after such public announcement is first made by the Company (with respect to nominees for any newly created positions only)). Such notice must include (a) as to each person whom the stockholder proposes to nominate for election or reelection as a director, all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, in each case pursuant to Regulation 14A under the 1934 Act and Rule 14a-11 thereunder, (b) as to any other business that the stockholder proposes to bring before the meeting, a brief description of such business, the reasons for conducting such business at the meeting and any material interest in such business of such stockholder and the beneficial owner, if any, on whose behalf the proposal is made, and (c) the name and record address, and class and number of shares owned beneficially and of record, of such stockholder and any such beneficial owner.

Annual Report

The Company s 2002 Annual Report to Stockholders has recently been mailed to all stockholders of record.

ALL STOCKHOLDERS ARE URGED TO VOTE BY TELEPHONE OR ELECTRONICALLY THROUGH THE INTERNET BY FOLLOWING THE INSTRUCTIONS ON THE PROXY CARD, OR TO COMPLETE, SIGN, AND RETURN THE ACCOMPANYING PROXY SOLICITATION/VOTING INSTRUCTION CARD PROMPTLY IN THE ENCLOSED ENVELOPE.

Robert G. van Schoonenberg

Secretary

Dated: March 14, 2003

PROXY SOLICITATION/

VOTING INSTRUCTION CARD

ANNUAL MEETING APRIL 24, 2003

PASADENA, CALIFORNIA

Avery Dennison Corporation

150 North Orange Grove Boulevard

Pasadena, California 91103

The undersigned hereby appoints Frank V. Cahouet, Philip M. Neal and Peter W. Mullin, or each or any of them with power of substitution, proxies for the undersigned to act and vote at the 2003 Annual Meeting of Stockholders of Avery Dennison Corporation and at any adjournments thereof as indicated upon the matters referred to on the reverse side and described in the proxy statement for the meeting, and, in their discretion, upon any other matters which may properly come before the meeting. This card provides voting instructions, as applicable, to (i) the appointed proxies for shares held of record by the undersigned including those held under the Company s DirectSERVICE Investment Program, and (ii) the Trustee for shares held on behalf of the undersigned in the Company s Savings Plan and SHARE Plan.

1. Election of Directors

Nominees: (01) David E.I. Pyott, (02) Dean A. Scarborough and (03) Julia A. Stewart

2. Ratification of the appointment of PricewaterhouseCoopers LLP as the Company s independent auditors for the current fiscal year, which ends on December 27, 2003

3. Approval of the Director Equity Plan, as amended and restated

4. Approval of the Employee Stock Option and Incentive Plan, as amended and restated

IF NO OTHER INDICATION IS MADE, THE PROXIES SHALL VOTE FOR THE ELECTION

OF THE DIRECTOR NOMINEES, AND FOR PROPOSALS NOS. 2, 3 AND 4.

(OVER)

(continued and to be signed on other side)

PLEASE FOLD AND DETACH HERE

NOTICE

If you plan to attend the Annual Meeting of Stockholders, please so indicate by marking the appropriate box on this card. Space limitations make it necessary to limit attendance to stockholders. Registration for the Annual Meeting will begin at 12:30 p.m. on April 24, 2003.

☒ Please mark your
votes as indicated in
this example

A vote **FOR ALL** nominees is recommended by the Board of Directors.

1. Election of Directors (page 1)	**FOR ALL**	**WITHHELD FROM ALL**
	☐	☐

FOR ALL EXCEPT the following nominee(s):

____

A vote **FOR** the proposals below is recommended by the Board of Directors

	FOR	**AGAINST**	**ABSTAIN**
2. Ratification of appointment of PricewaterhouseCoopers LLP as the Company’s independent auditors for the current fiscal year, which ends on December 27, 2003 (page 24)	☐	☐	☐
3. Approval of Director Equity Plan, as amended and restated (page 25)	☐	☐	☐
4. Approval of Employee Stock Option and Incentive Plan, as amended and restated (page 28)	☐	☐	☐

PLEASE DO NOT FOLD OR PERFORATE THIS CARD

IMPORTANT PLEASE MARK, SIGN, DATE AND RETURN THIS CARD PROMPTLY

IN THE ENCLOSED ENVELOPE.

THANK YOU.

Send admission ticket for meeting ☐

Signature of Stockholder(s)/Plan Participant(s) ______________________________ Date ______ , 2003

NOTE: If acting as attorney, executor, trustee, or in other representative capacity, please sign name and title.

PLEASE FOLD AND DETACH HERE

Dear Stockholder/Plan Participant:

You may vote the shares held in this account in any one of the following three ways:

Vote by mail. Complete, sign, date and mail your proxy card (above) in the enclosed postage-paid envelope.

Vote by phone. Call toll-free **1-877-PRX-VOTE** (1-877-779-8683) 24 hours a day, 7 days a week from the U.S. and Canada.

Vote by Internet. Access the Web site at http://www.eproxyvote.com/avy 24 hours a day, 7 days a week.

If you vote by phone or via the Internet, please have your social security number and proxy card available. The sequence of numbers appearing in the box above, just below the perforation, and your social security number are necessary to verify your vote. A phone or Internet vote authorizes the named proxies in the same manner as if you marked, signed, dated and returned this proxy card.

U.S. Trust Company, N.A., as Trustee of the Avery Dennison Corporation Savings Plan and SHARE Plan, will vote shares of Company Stock that have not been allocated to the account of any participant in proportion to the manner in which allocated shares of Company Stock are voted by participants who timely furnish voting instructions. The card should be returned **no** later than April 17, 2003.

If you vote by phone or vote using the Internet, please do not mail back your proxy card.

YOUR VOTE IS IMPORTANT. THANK YOU FOR VOTING.

CONFIDENTIAL VOTING INSTRUCTIONS

Avery Dennison Corporation
150 North Orange Grove Boulevard
Pasadena, California 91103

TO: EQUISERVE TRUST COMPANY, N. A., AS TABULATING AGENT FOR THE TRUSTEE OF THE AVERY DENNISON CORPORATION EMPLOYEE STOCK BENEFIT TRUST

VOTING INSTRUCTIONS SOLICITED BY THE TRUSTEE ON BEHALF OF THE BOARD OF DIRECTORS OF AVERY DENNISON CORPORATION FOR THE ANNUAL MEETING OF STOCKHOLDERS, APRIL 24, 2003.

The undersigned hereby authorizes Wachovia Bank, N.A., as Trustee, to act and vote at the 2003 Annual Meeting of Stockholders of Avery Dennison Corporation and at any adjournments thereof as indicated upon the matters referred to on the reverse side and described in the proxy statement for the meeting, and, in its discretion, upon any other matters which may properly come before the meeting.

1. Election of Directors

Nominees: (01) David E.I. Pyott, (02) Dean A. Scarborough and (03) Julia A. Stewart

2. Ratification of the appointment of PricewaterhouseCoopers LLP as the Company s independent auditors for the current fiscal year, which ends on December 27, 2003

3. Approval of the Director Equity Plan, as amended and restated

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PART I – FINANCIAL INFORMATION

Item 1 – Financial Statements

MVB Financial Corp. and Subsidiaries

Consolidated Balance Sheets

(Unaudited) (Dollars in thousands except per share data)

	March 31, 2019 (Unaudited)		December 31, 2018 (Note 1)	
ASSETS				
Cash and cash equivalents:				
Cash and due from banks	$	15,185	$	14,747
Interest bearing balances with banks	2,773		7,474	
Total cash and cash equivalents	17,958		22,221	
Certificates of deposit with other banks	14,778		14,778	
Investment Securities:				
Securities available-for-sale, at fair value	224,741		221,614	
Equity securities	9,841		9,599	
Loans held for sale	65,955		75,807	
Loans:	1,341,218		1,304,366	
Less: Allowance for loan losses	(11,242)		(10,939)	
Net Loans	1,329,976		1,293,427	
Premises and equipment	25,922		26,545	
Bank owned life insurance	34,128		34,291	
Accrued interest receivable and other assets	48,129		34,207	
Goodwill	18,480		18,480	
TOTAL ASSETS	$	1,789,908	$	1,750,969
LIABILITIES AND STOCKHOLDERS' EQUITY				
Deposits:				
Noninterest bearing	$	236,086	$	213,597
Interest bearing	1,194,573		1,095,557	
Total deposits	1,430,659		1,309,154	
Accrued interest payable and other liabilities	33,416		17,706	
Repurchase agreements	12,553		14,925	
FHLB and other borrowings	114,884		214,887	

Subordinated debt	17,524		17,524	
Total liabilities	1,609,036		1,574,196	
STOCKHOLDERS' EQUITY				
Preferred stock, par value $1,000; 20,000 authorized; 783 issued in 2019 and 2018, respectively (See Footnote 7)	7,834		7,834	
Common stock, par value $1; 20,000,000 shares authorized; 11,665,870 shares issued and 11,614,793 shares outstanding in 2019 and 11,658,370 shares issued and 11,607,293 shares outstanding in 2018	11,666		11,658	
Additional paid-in capital	117,408		116,897	
Retained earnings	50,937		48,274	
Accumulated other comprehensive loss	(5,889)		(6,806)	
Treasury stock, 51,077 shares, at cost	(1,084)		(1,084)	
Total stockholders' equity	180,872		176,773	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	1,789,908	$	1,750,969

See accompanying notes to unaudited consolidated financial statements.

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MVB Financial Corp. and Subsidiaries

Consolidated Statements of Income

(Unaudited) (Dollars in thousands except per share data)

	Three Months Ended March 31	
	2019	**2018**
INTEREST INCOME		
Interest and fees on loans	$ 17,662	$ 13,291
Interest on deposits with other banks	122	90
Interest on investment securities - taxable	879	895
Interest on tax exempt loans and securities	960	778
Total interest income	19,623	15,054
INTEREST EXPENSE		
Interest on deposits	4,123	2,298
Interest on repurchase agreements	14	19
Interest on FHLB and other borrowings	1,229	714
Interest on subordinated debt	285	558
Total interest expense	5,651	3,589
NET INTEREST INCOME	13,972	11,465
Provision for loan losses	300	474
Net interest income after provision for loan losses	13,672	10,991
NONINTEREST INCOME		
Service charges on deposit accounts	315	185
Income on bank owned life insurance	525	218
Interchange and debit card transaction fees	141	150
Mortgage fee income	6,670	6,563
Gain on sale of portfolio loans	55	212

Insurance and investment services income	156	164
(Loss) gain on sale of available-for-sale securities, net	(118)	326
Gain on derivatives, net	450	584
Commercial swap fee income	80	413
Holding gain (loss) on equity securities	180	(30)
Other operating income	311	254
Total noninterest income	8,765	9,039
NONINTEREST EXPENSES		
Salary and employee benefits	11,734	10,473
Occupancy expense	1,185	1,049
Equipment depreciation and maintenance	854	784
Data processing and communications	988	835
Mortgage processing	809	892
Marketing, contributions, and sponsorships	214	347
Professional fees	828	745
Printing, postage, and supplies	135	165
Insurance, tax, and assessment expense	505	390
Travel, entertainment, dues, and subscriptions	690	648
Other operating expenses	506	411
Total noninterest expense	18,448	16,739
Income before income taxes	3,989	3,291
Income tax expense	797	697
Net income	$ 3,192	$ 2,594
Preferred dividends	121	121
Net income available to common shareholders	$ 3,071	$ 2,473

Earnings per share - basic	$	0.26	$	0.24
Earnings per share - diluted	$	0.26	$	0.23
Cash dividends declared	$	0.035	$	0.025
Weighted average shares outstanding - basic	11,607,543		10,474,138	
Weighted average shares outstanding - diluted	13,177,281		12,714,353	

See accompanying notes to unaudited consolidated financial statements.

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MVB Financial Corp. and Subsidiaries

Consolidated Statements of Comprehensive Income

(Unaudited) (Dollars in thousands)

	Three Months Ended March 31	
	2019	2018
Net Income	$ 3,192	$ 2,594
Other comprehensive income (loss):		
Unrealized holding gains (losses) on securities available-for-sale	1,859	(4,448)
Income tax effect	(502)	1,201
Reclassification adjustment for loss (gain) recognized in income	118	(326)
Income tax effect	(32)	88
Change in defined benefit pension plan	(263)	—
Income tax effect	71	—
Carrying Value Adjustment - Investment hedge	(458)	—
Income tax effect	124	—
Total other comprehensive income (loss)	917	(3,485)
Comprehensive income (loss)	$ 4,109	$ (891)

See accompanying notes to unaudited consolidated financial statements.

MVB Financial Corp. and Subsidiaries

Consolidated Statements of Changes in Stockholders’ Equity

(Unaudited) (Dollars in thousands except per share data)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)	Treasury Stock	Total Stockholders' Equity
January 1, 2018	$ 7,834	$ 10,496	$ 98,698	$ 37,236	$ (2,988)	$ (1,084)	$ 150,192
Net Income	—	—	—	2,594	—	—	2,594
Other comprehensive loss	—	—	—	—	(3,485)	—	(3,485)
Cash dividends paid ($0.025 per common share)	—	—	—	(263)	—	—	(263)
Dividends on preferred stock	—	—	—	(121)	—	—	(121)
Stock based compensation	—	—	244	—	—	—	244
Common stock options exercised	—	94	1,166	—	—	—	1,260
Stranded AOCI (See Note 2)	—	—	—	646	(646)	—	—
Mark to Market on equity positions held at December 31, 2017 (See Note 2)	—	—	—	98	(98)	—	—
Balance March 31, 2018	$ 7,834	$ 10,590	$ 100,108	$ 40,190	$ (7,217)	$ (1,084)	$ 150,421
January 1, 2019	$ 7,834	$ 11,658	$ 116,897	$ 48,274	$ (6,806)	$ (1,084)	$ 176,773
Net Income	—	—	—	3,192	—	—	3,192
Other comprehensive income	—	—	—	—	917	—	917
Cash dividends paid ($0.035 per common share)	—	—	—	(408)	—	—	(408)
Dividends on preferred	—	—	—	(121)	—	—	(121)

stock							
Stock based compensation	—	—	425	—	—	—	425
Common stock options exercised	—	8	86	—	—	—	94
Balance March 31, 2019	$ 7,834	$ 11,666	$ 117,408	$ 50,937	$ (5,889)	$ (1,084)	$ 180,872

See accompanying notes to unaudited consolidated financial statements.

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MVB Financial Corp. and Subsidiaries
Consolidated Statements of Cash Flows

(Unaudited) (Dollars in thousands)

	,Three Months Ended March 31	
	2019	**2018**
OPERATING ACTIVITIES		
Net Income	$ 3,192	$ 2,594
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization and accretion of investments	280	361
Net amortization of deferred loan costs	72	16
Provision for loan losses	300	474
Depreciation and amortization	759	741
Stock based compensation	425	244
Loans originated for sale	(239,160)	(238,935)
Proceeds of loans sold	255,682	261,012
Mortgage fee income	(6,670)	(6,563)
Gain on sale of securities	(33)	(326)
Loss on sale of securities	151	—
Gain on sale of portfolio loans	(55)	(212)
Income on bank owned life insurance	(525)	(218)
Deferred taxes	21	(51)
Amortization of operating lease right-of-use asset	20	—
Other, net	(1,534)	(3,924)
Net cash provided by operating activities	12,925	15,213
INVESTING ACTIVITIES		
Purchases of investment securities available-for-sale	(20,400)	(14,859)
Maturities/paydowns of investment securities available-for-sale	5,236	7,364
Sales of investment securities	13,694	680

available-for-sale		
Purchases of premises and equipment	(115)	(506)
Net increase in loans	(36,866)	(51,321)
Purchases of restricted bank stock	(6,119)	(5,901)
Redemptions of restricted bank stock	8,352	3,797
Proceeds from sale of other real estate owned	97	181
Proceeds from death benefit of bank owned life insurance policies	688	—
Purchase of equity securities	(450)	—
Net cash used in investing activities	(35,883)	(60,565)
FINANCING ACTIVITIES		
Net increase in deposits	121,505	(5,673)
Net decrease in repurchase agreements	(2,372)	(1,727)
Net change in short-term FHLB & other borrowings	(99,982)	67,421
Principal payments on FHLB & other borrowings	(21)	(12,220)
Common stock options exercised	94	1,260
Cash dividends paid on common stock	(408)	(263)
Cash dividends paid on preferred stock	(121)	(121)
Net cash provided by financing activities	18,695	48,677
(Decrease) increase in cash and cash equivalents	(4,263)	3,325
Cash and cash equivalents at beginning of period	22,221	20,305
Cash and cash equivalents at end of period	$ 17,958	$ 23,630
Supplemental disclosure of cash flow information:		
Loans transferred to other real estate owned	$ 63	$ 720

Initial recognition of operating lease right-of-use assets	12,935	—
Initial recognition of operating lease liabilities	15,659	—
Cash payments for:		
Interest on deposits, repurchase agreements and borrowings	$ 6,136	$ 3,635
Income taxes	—	87

See accompanying notes to unaudited consolidated financial statements.

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Notes to the Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies

Nature of Operations

MVB Financial Corp. ("the Company") is a financial holding company and was organized in 2003. MVB operates principally through its wholly-owned subsidiary, MVB Bank, Inc. ("MVB Bank"). MVB Bank's operating subsidiaries include Potomac Mortgage Group ("PMG" which began doing business under the registered trade name "MVB Mortgage"), MVB Insurance, LLC ("MVB Insurance"), and MVB Community Development Corporation ("CDC").

Principles of Consolidation and Basis of Presentation

These consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with instructions to Form 10-Q. Accordingly, they do not include all the information and footnotes required by GAAP for annual year-end financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. The consolidated balance sheet as of December 31, 2018 has been derived from audited financial statements included in the Company's 2018 filing on Form 10-K. Operating results for the three months ended March 31, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States and practices in the banking industry. The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Estimates, such as the allowance for loan losses, are based upon known facts and circumstances. Estimates are revised by management in the period such facts and circumstances change. Actual results could differ from those estimates. All significant inter-company accounts and transactions have been eliminated in consolidation.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the company's December 31, 2018, Form 10-K filed with the Securities and Exchange Commission (the "SEC").

In certain instances, amounts reported in prior periods' consolidated financial statements have been reclassified to conform to the current presentation.

Information is presented in these notes with dollars expressed in thousands, unless otherwise noted or specified.

Accounting Changes

On January 1, 2019, the Company adopted ASU 2016-02, *Leases (Topic 842)*. This pronouncement requires that lessees and lessors recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. ASU 2016-02 provides for a modified retrospective transition approach requiring lessees to recognize and measure leases on the balance sheet at the beginning of either the earliest period presented or as of the beginning of the period of adoption with the option to elect certain practical expedients. The Company has elected to apply ASU 2016-02 as of the beginning of the period (January 1, 2019) and has not restated comparative periods. Of the optional practical expedients available under ASU 2016-02, all have been adopted. Upon adoption, the Company recognized right-of-use assets and related lease liabilities totaling $12.9 million and $15.7 million, respectively.

Certain of the Company's leases contain options to renew the lease; however, some of these renewal options are not included in the calculation of the lease liabilities as they are not reasonably expected to be exercised. The Company's leases do not contain residual value guarantees or material variable lease payments, and the Company does not have any material restrictions or covenants imposed by leases that would impact the Company's ability to pay dividends or cause the Company to incur additional financial obligations.

The Company has made an accounting policy election to not apply the recognition requirements in Topic 842 to short-term leases. The Company has also elected to use the practical expedient to make an accounting policy election for property leases to include both lease and non-lease components as a single component and account for as a lease.

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The Company's leases are not complex; therefore, there were no significant assumptions or judgments made in applying the requirements of Topic 842, including the determination of whether the contracts contained a lease, the allocation of consideration in the contracts between lease and non-lease components, and the determination of the discount rates for the leases.

Note 2 – Recent Accounting Pronouncements

In February 2018, the Financial Accounting Standards Board ("FASB") issued ASU 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. This update requires a reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate in the Tax Reform Act, which was enacted on December 22, 2017. The Tax Reform Act included a reduction to the corporate income tax rate from 34 percent to 21 percent effective January 1, 2018. The amendments in the ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company elected to early adopt ASU 2018-02 during the first quarter of 2018 and elected to reclassify the income tax effects of the Tax Reform Act from AOCI to retained earnings. The amount of the reclassification is the difference between the historical corporate income tax rate and the newly enacted 21 percent corporate income tax rate, which amounted to $646 thousand.

In August 2017, the FASB issued ASU 2017-12, *Targeted Improvements to Accounting for Hedging Activities*, which amends the existing hedge accounting model and expands an entity's ability to hedge nonfinancial and financial risk components and reduce complexity in fair value hedges of interest-rate risk. The ASU eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. The ASU also changes certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. This ASU is effective for public business entities for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company adopted this ASU in accordance with paragraph ASC 815-20-65-3 subpart C. The adoption of this ASU did not have a significant impact on the Company's financial condition, results of operations and consolidated financial statements. The Company can now employ additional hedging strategies as described above, including the ability to apply fair value hedge accounting to a specified pool of assets by excluding the portion of the hedged items related to prepayments, defaults and other events. This allows the Company to better align its accounting and the financial reporting of its hedging activities with their economic objectives thereby reducing the earnings volatility resulting from these hedging activities.

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. This ASU amends guidance on the amortization period of premiums on certain purchased callable debt securities. Specifically, the amendments shorten the amortization period of premiums on certain purchased callable debt securities to the earliest call date. The amendments affect all entities that hold investments in callable debt securities that have an amortized cost basis in excess of the amount that is repayable by the issuer at the earliest call date (that is, at a premium). For public companies, this update is effective for fiscal years beginning after December 15, 2018, including all interim periods within those fiscal years. The adoption of this guidance was not material to the consolidated financial statements, as it is our current policy to amortize premiums of investment securities to the earliest call date.

In January 2017, the FASB issued ASU 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. Topic 350, Intangibles – Goodwill and Other (Topic 350), currently requires an entity that has not elected the private company alternative for goodwill to perform a two-step test to determine the amount, if any, of goodwill impairment. In Step 1, an entity compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the entity performs Step 2 and compares the implied fair value of goodwill with the carrying amount of that goodwill for that reporting unit. An impairment charge equal to the amount by which the carrying amount of goodwill for the reporting unit exceeds the implied fair value of that goodwill is recorded, limited to the amount of goodwill allocated to that reporting unit to address concerns over the cost and complexity of the two-step goodwill impairment test. The amendments in this Update remove the second step of the test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. For public companies, this update will be effective for fiscal years beginning after December 15, 2019, including all interim periods within those fiscal years. The adoption of this guidance will not have a material impact on the consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The new guidance replaces the incurred loss impairment methodology in current GAAP with an expected credit loss methodology and requires consideration of a broader range of information to determine credit loss estimates. Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses. Purchased credit impaired loans will receive an allowance account at the acquisition date that represents a component of the purchase price allocation. Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses, with such allowance limited to the amount by which fair value is below amortized cost. The guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. The Company has formed an implementation team led by the CFO, that also includes other lines of business and functions within the Company. The Company has also engaged a third party to assist with a data gap analysis and will utilize the data to determine the impact of the pronouncement. Additionally, the Company has researched and acquired software to assist in the development of models that can meet the requirements of the new guidance. While this standard may potentially have a material impact on the Company's consolidated financial statements, we are still in the process of completing our evaluation.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842).* Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date:(1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. ASU 2016-02 initially required transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842) - Targeted Improvements*, which, among other things, provides an additional transition method that would allow entities to not apply the guidance in ASU 2016-02 in the comparative periods presented in the financial statements and instead recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. In December 2018, the FASB also issued ASU 2018-20, *Leases (Topic 842) - Narrow Scope Improvements*, for Lessors which provides certain policy elections and changes lessor accounting for sales and similar taxes and certain lessor costs. Upon the adoption of ASU 2016-02, ASU 2018-11, and ASU 2018-20 on January 1, 2019, the Company recognized right-of-use assets and related lease liabilities totaling $12.9 million and $15.7 million, respectively. The initial balance sheet gross up upon adoption was primarily related to operating leases of certain real estate properties and financing leases of certain office equipment. The Company has no material subleases or leasing arrangements for which it is the lessor of property or equipment. The Company applied certain practical expedients provided under ASU 2016-02 whereby the Company did reassess (i) whether any expired or existing contracts are or contain leases, (ii) the lease classification for any expired or existing leases, and (iii) initial direct costs for any existing leases. The Company did not apply the recognition requirements of ASU 2016-02 to any short-term leases (as defined by related accounting guidance). The Company accounted for lease and non-lease components separately because such amounts are readily determinable under our lease contracts and because this election resulted in a lower impact on our balance sheet. The Company utilized the modified-retrospective transition approach prescribed by ASU 2018-11. See Note 5, "Premises and Equipment" of the Notes to the Consolidated Financial Statements, included in Item 1, Financial Statements, of this Quarterly Report on Form 10-Q.`

In January 2016, the FASB issued ASU 2016-01, *Accounting for Financial Instruments - Overall: Classification and Measurement (Subtopic 825-10).* Amendments within ASU 2016-01 that relate to non-public entities have been excluded from this presentation. The amendments in this ASU 2016-01 address the following: 1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; 2) simplify the impairment assessment of equity investments without readily-determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; 3) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; 4) require entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; 5) require separate presentation in other comprehensive income for the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; 6) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and 7) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company adopted this guidance in the first quarter of 2018. The adoption of ASU 2016-01 on January 1, 2018 did not have a material impact on the Company's Consolidated Financial Statements. In accordance with 4) above, the Company discloses the fair value of its loan portfolio on a quarterly basis using an exit price notion. See Note 7, "Fair Value of Financial Instruments" of the Notes to the Consolidated Financial Statements, included in Item 1, Financial Statements, of this Quarterly Report on Form 10-Q.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The new revenue pronouncement creates a single source of revenue guidance for all companies in all industries and is more principles-based than current revenue guidance. The pronouncement provides a five-step model for a company to recognize revenue when it transfers control of goods or services to customers at an amount that reflects the consideration to which it expects to be entitled in exchange for those goods or services. The five steps are: (1) identify the contract with the customer, (2) identify the separate performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the separate performance obligations and (5) recognize revenue when each performance obligation is satisfied. The Company evaluated the impact of this standard on individual customer contracts, while management evaluated the impact of this standard on the broad categories of its customer contracts and revenue streams. The Company determined that this standard did not have a material impact on its consolidated financial statements because revenue related to financial instruments, including loans and investment securities are not in scope of these updates. Loan interest income, investment interest income, insurance services revenue and BOLI are accounted for under other U.S. GAAP standards and out of scope of ASC 606 revenue standard. The Company also completed an evaluation of certain costs related to customer contracts and revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross versus net). Based on the evaluation, the Company determined that the classification of certain debit and credit card related costs should change (i.e., costs previously recorded as expense are now recorded as contra-revenue). This classification change resulted in immaterial changes to both revenue and expense. The Company adopted the revenue recognition standard and its related amendments as of January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Consistent with the modified retrospective approach, the Company did not adjust prior period amounts for the debit and credit card related cost reclassifications noted above.

Note 3 – Investment Securities

There were no held-to-maturity securities at March 31, 2019 or December 31, 2018.

Amortized cost and fair values of investment securities available-for-sale at March 31, 2019 are summarized as follows:

(Dollars in thousands)	**Amortized Cost**	**Unrealized Gain**	**Unrealized Loss**	**Fair Value**
U. S. Agency securities	$ 67,631	$ —	$ (1,043)	$ 66,588
U.S. Sponsored Mortgage-backed securities	49,223	1	(1,453)	47,771
Municipal securities	100,253	241	(487)	100,007
Total debt securities	217,107	242	(2,983)	214,366
Other securities	10,294	98	(17)	10,375
Total investment securities available-for-sale	$ 227,401	$ 340	$ (3,000)	$ 224,741

Amortized cost and fair values of investment securities available-for-sale at December 31, 2018 are summarized as follows:

(Dollars in thousands)	**Amortized Cost**	**Unrealized Gain**	**Unrealized Loss**	**Fair Value**
U. S. Agency securities	$ 79,041	$ 14	$ (1,625)	$ 77,430
U.S. Sponsored Mortgage-backed securities	52,154	—	(2,039)	50,115
Municipal securities	84,747	206	(1,192)	83,761
Total debt securities	215,942	220	(4,856)	211,306
Other securities	10,308	68	(68)	10,308
Total investment securities available-for-sale	$ 226,250	$ 288	$ (4,924)	$ 221,614

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The following table summarizes amortized cost and fair values of debt securities by maturity:

	March 31, 2019	
	Available for sale	
(Dollars in thousands)	Amortized Cost	Fair Value
Within one year	$ 11,085	$ 11,280
After one year, but within five	31,156	30,716
After five years, but within ten	23,163	22,725
After ten years	151,703	149,645
Total	$ 217,107	$ 214,366

Investment securities with a carrying value of $58.3 million at March 31, 2019, were pledged to secure public funds, repurchase agreements, and potential borrowings at the Federal Reserve discount window.

The Company’s investment portfolio includes securities that are in an unrealized loss position as of March 31, 2019, the details of which are included in the following table. Although these securities, if sold at March 31, 2019 would result in a pretax loss of $3.0 million, the Company has no intent to sell the applicable securities at such fair values, and maintains the Company has the ability to hold these securities until all principal has been recovered. Management does not intend to sell these securities and it is unlikely that the Company will be required to sell these securities before recovery of their amortized cost basis. Declines in the fair values of these securities can be traced to general market conditions which reflect the prospect for the economy as a whole. When determining other-than-temporary impairment on securities, the Company considers such factors as adverse conditions specifically related to a certain security or to specific conditions in an industry or geographic area, the time frame securities have been in an unrealized loss position, the Company’s ability to hold the security for a period of time sufficient to allow for anticipated recovery in value, whether or not the security has been downgraded by a rating agency, and whether or not the financial condition of the security issuer has severely deteriorated. As of March 31, 2019, the Company considers all securities with unrealized loss positions to be temporarily impaired, and consequently, does not believe the Company will sustain any material realized losses as a result of the current temporary decline in fair value.

The following table discloses investments in an unrealized loss position at March 31, 2019:

(Dollars in thousands)	Less than 12 months		12 months or more	
Description and number of positions	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Agency securities (51)	$ 6,898	$ (70)	$ 59,690	$ (973)
U.S. Sponsored Mortgage-backed securities (39)	—	—	45,326	(1,453)
Municipal securities (55)	523	(7)	29,130	(480)
Other securities (2)	—	—	1,018	(17)
	$ 7,421	$ (77)	$ 135,164	$ (2,923)

The following table discloses investments in an unrealized loss position at December 31, 2018:

(Dollars in thousands)	**Less than 12 months**		**12 months or more**	
Description and number of positions	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. Agency securities (54)	$ 9,762	$ (123)	$ 63,740	$ (1,502)
U.S. Sponsored Mortgage-backed securities (42)	2,360	(32)	47,755	(2,007)
Municipal securities (78)	5,936	(46)	35,955	(1,146)
Other securities (2)	2,452	(48)	1,018	(20)
	$ 20,510	$ (249)	$ 148,468	$ (4,675)

For the three-month periods ended March 31, 2019 and 2018, the Company sold investments available-for-sale of $13.7 million and $680 thousand, respectively. These sales resulted in gross gains of $33 thousand and $326 thousand and gross losses of $151 thousand and $0 thousand, respectively.

For the three months ended March 31, 2019, the Company recognized an unrealized holding gain of $180 thousand on equity securities held as of March 31, 2019, which was recorded in noninterest income in the consolidated statements of income.

For the three months ended March 31, 2018, the Company recognized an unrealized holding loss of $30 thousand on equity securities held as of March 31, 2018, which was recorded in noninterest income in the consolidated statements of income.

Note 4 – Loans and Allowance for Loan Losses

The components of loans in the Consolidated Balance Sheets at March 31, 2019 and December 31, 2018, were as follows:

(Dollars in thousands)	March 31, 2019		December 31, 2018	
Commercial and Non-Residential Real Estate	$	962,064	$	941,033
Residential Real Estate	310,713		294,929	
Home Equity	58,675		59,015	
Consumer	9,469		9,605	
Total Loans	$	1,340,921	$	1,304,582
Deferred loan origination fees and costs, net	297		(216)	
Loans receivable	$	1,341,218	$	1,304,366

All loan origination fees and direct loan origination costs are deferred and recognized over the life of the loan.

An allowance for loan losses ("ALL") is maintained to absorb losses from the loan portfolio. The ALL is based on management's continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

The Bank's methodology for determining the ALL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (discussed above) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Bank's ALL. The Bank's methodology allows for the analysis of certain impaired loans in homogeneous pools, rather than on an individual basis, when those loans are below specific thresholds based on outstanding principal balance. More specifically, residential mortgage loans, home equity lines of credit, and consumer loans, when considered impaired, are evaluated collectively for impairment by applying allocation rates derived from the Bank's historical losses specific to impaired loans. Total collectively evaluated impaired loans were $1.8 million and $1.7 million, while the related reserves were $187 thousand and $218 thousand as of March 31, 2019 and December 31, 2018.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by qualified factors.

The segments described below in the impaired loans by class table, which are based on the federal call code assigned to each loan, provide the starting point for the ALL analysis. Company and bank management tracks the historical net charge-off activity at the call code level. A historical charge-off factor is calculated utilizing a defined number of consecutive historical quarters. All pools currently utilize a rolling 12 quarters.

“Pass” rated credits are segregated from “Criticized” credits for the application of qualitative factors. Loans in the criticized pools, which possess certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by management and subject to additional qualitative factors.

Company and Bank management have identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: lending policies and procedures, nature and volume of the portfolio, experience and ability of lending management and staff, volume and severity of problem credits, conclusion of loan reviews, audits, and exams, changes in the value of underlying collateral, effect of concentrations of credit from a loan type, industry and/or geographic standpoint, changes in economic and business conditions consumer sentiment, and other external factors. The combination of historical charge-off and qualitative factors are then weighted for each risk grade. These weightings are determined internally based upon the likelihood of loss as a loan risk grading deteriorates.

To estimate the liability for off-balance sheet credit exposures, Bank management analyzed the portfolios of letters of credit, non-revolving lines of credit, and revolving lines of credit, and based its calculation on the expectation of future advances of each loan category. Letters of credit were determined to be highly unlikely to advance since they are generally in place only to ensure various forms of performance of the borrowers. In the Bank's history, there have been no letters of credit drawn upon. In addition, many of the letters of credit are cash secured and do not warrant an allocation. Non-revolving lines of credit were determined to be highly likely to advance as these are typically construction lines. Meanwhile, the likelihood of revolving lines of credit advancing varies with each individual borrower. Therefore, the future usage of each line was estimated based on the average line utilization of the revolving line of credit portfolio as a whole.

Once the estimated future advances were calculated, an allocation rate, which was derived from the Bank's historical losses and qualitative environmental factors, was applied in the similar manner as those used for the allowance for loan loss calculation. The resulting estimated loss allocations were totaled to determine the liability for unfunded commitments related to these loans, which Management considers necessary to anticipate potential losses on those commitments that have a reasonable probability of funding. As of March 31, 2019 and December 31, 2018, the liability for unfunded commitments related to loans held for investment was $284 thousand.

Bank management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

The ALL is based on estimates, and actual losses will vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

The following tables summarize the primary segments of the ALL, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of March 31, 2019:

(Dollars in thousands)	**Commercial**		**Residential**		**Home Equity**		**Consumer**		**Total**	
January 1, 2019	$	8,605	$	1,405	$	684	$	245	$	10,939
Charge-offs	—		—		—		—		—	
Recoveries	—		1		1		1		3	
Provision (recovery)	259		11		19		11		300	
ALL balance at March 31, 2019	$	8,864	$	1,417	$	704	$	257	$	11,242
Individually evaluated for impairment	$	1,123	$	—	$	—	$	—	$	1,123
Collectively evaluated for impairment	$	7,741	$	1,417	$	704	$	257	$	10,119

The following table summarizes the primary segments of the Company loan portfolio as of March 31, 2019:

(Dollars in thousands)	**Commercial**		**Residential**		**Home Equity**		**Consumer**		**Total**	
	$	9,914	$	2,890	$	121	$	36	$	12,961

Individually evaluated for impairment					
Collectively evaluated for impairment	952,150	307,823	58,554	9,433	1,327,960
Total Loans	962,064	310,713	58,675	9,469	1,340,921

The following tables summarize the primary segments of the ALL, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of March 31, 2018:

(Dollars in thousands)	**Commercial**		**Residential**		**Home Equity**		**Consumer**		**Total**	
January 1, 2018	$	7,804	$	1,119	$	705	$	250	$	9,878
Charge-offs	(324)		(11)		—		(21)		(356)	
Recoveries	2		9		56		4		71	
Provision	516		60		(68)		(34)		474	
ALL balance at March 31, 2018	$	7,998	$	1,177	$	693	$	199	$	10,067
Individually evaluated for impairment	$	915	$	—	$	—	$	—	$	915
Collectively evaluated for impairment	$	7,083	$	1,177	$	693	$	199	$	9,152

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The following table summarizes the primary segments of the Company loan portfolio as of March 31, 2018:

(Dollars in thousands)	**Commercial**		**Residential**		**Home Equity**		**Consumer**		**Total**	
Individually evaluated for impairment	$	12,957	$	1,707	$	44	$	43	$	14,751
Collectively evaluated for impairment	811,668		258,806		59,482		11,866		1,141,822	
Total Loans	$	824,625	$	260,513	$	59,526	$	11,909	$	1,156,573

Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Company evaluates residential mortgage loans, home equity lines of credit, and consumer loans in homogeneous pools, rather than on an individual basis, when each of those loans are below specific thresholds based on outstanding principal balance. Such loans that individually exceed these thresholds are evaluated individually for impairment. The Chief Credit Officer identifies these loans individually by monitoring the delinquency status of the Bank’s portfolio. Once identified, the Bank’s ongoing communications with the borrower allow Management to evaluate the significance of the payment delays and the circumstances surrounding the loan and the borrower.

Once the determination has been made that a loan is impaired, the amount of the impairment is measured using one of 3 valuation methods: (a) the present value of expected future cash flows discounted at the loan’s effective interest rate; (b) the loan’s observable market price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by-loan basis, with management primarily utilizing the fair value of collateral method. The evaluation of the need and amount of a specific allocation of the allowance and whether a loan can be removed from impairment status is made on a quarterly basis.

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of March 31, 2019 and December 31, 2018:

	Impaired Loans with Specific Allowance			**Impaired Loans with No Specific Allowance**	**Total Impaired Loans**
(Dollars in thousands)	**Recorded Investment**	**Related Allowance**	**Recorded Investment**	**Recorded Investment**	**Unpaid Principal Balance**
March 31, 2019					
Commercial					
Commercial Business	$ 4,925	$ 744	$ 616	$ 5,541	$ 5,566
Commercial Real Estate	1,826	374	343	2,169	2,227
Acquisition & Development	1,787	5	417	2,204	3,583
Total Commercial	8,538	1,123	1,376	9,914	11,376
Residential	—	—	2,890	2,890	2,915
Home Equity	—	—	121	121	126
Consumer	—	—	36	36	36
Total Impaired Loans	$ 8,538	$ 1,123	$ 4,423	$ 12,961	$ 14,453
December 31, 2018					
Commercial					
Commercial Business	$ 4,885	$ 668	$ 387	$ 5,272	$ 5,292
Commercial Real Estate	1,842	375	396	2,238	2,300
Acquisition & Development	—	—	2,224	2,224	3,601
Total Commercial	6,727	1,043	3,007	9,734	11,193
Residential	—	—	2,831	2,831	2,882
Home Equity	—	—	123	123	123
Consumer	—	—	90	90	316
Total Impaired Loans	$ 6,727	$ 1,043	$ 6,051	$ 12,778	$ 14,514

Impaired loans have increased by $183 thousand, or 1.4%, during the three months ended March 31, 2019. This change is the net effect of multiple factors, including the identification of $328 thousand of impaired loans, the foreclosure of a commercial development loan which required the reclassification of $63 thousand to other real estate owned, the classification of $50 thousand to performing loans based on improved repayment performance, and normal loan amortization.

The following table presents the average recorded investment in impaired loans and related interest income recognized for the periods indicated:

	Three Months Ended March 31, 2019	**Three Months Ended March 31, 2018**

(Dollars in thousands)	**Average Investment in Impaired Loans**	**Interest Income Recognized on Accrual Basis**	**Interest Income Recognized on Cash Basis**	**Average Investment in Impaired Loans**	**Interest Income Recognized on Accrual Basis**	**Interest Income Recognized on Cash Basis**
Commercial						
Commercial Business	$ 3,608	$ —	$ —	$ 4,525	$ 38	$ 53
Commercial Real Estate	4,038	40	39	7,431	21	23
Acquisition & Development	2,215	31	29	1,837	—	—
Total Commercial	9,861	71	68	13,793	59	76
Residential	2,858	3	3	1,747	5	48
Home Equity	122	1	1	65	—	—
Consumer	79	—	—	132	—	—
Total	$ 12,920	$ 75	$ 72	$ 15,737	$ 64	$ 124

As of March 31, 2019, the Bank's other real estate owned balance totaled $2.1 million. The Bank held twelve foreclosed residential real estate properties representing $877 thousand, or 42%, of the total balance of other real estate owned. These properties are held as a result of the foreclosures of primarily two commercial loan relationships, one of which included two properties for a total of $294 thousand, while the other included seven properties for a total of $174 thousand. The three remaining residential real estate properties, totaling $409 thousand, were result of the foreclosure of three unrelated borrowers. The remaining $1.2 million, or 58%, of other real estate owned is the result of the foreclosure of three unrelated commercial development loans. There are three additional consumer mortgage loans collateralized by residential real estate properties in the process of foreclosure. The total recorded investment in these loans was $270 thousand as of March 31, 2019. These loans are included in the table above and have no specific allowance allocated to them.

Bank management uses a nine-point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. Any portion of a loan that has been or is expected to be charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as past due status, bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank’s Chief Credit Officer is responsible for the timely and accurate risk rating of the loans in the portfolio at origination and on an ongoing basis. The Credit Department ensures that a review of all commercial relationships of one million dollars or greater is performed annually.

Review of the appropriate risk grade is included in both the internal and external loan review process, and on an ongoing basis. The Bank has an experienced Credit Department that continually reviews and assesses loans within the portfolio. The Bank engages an external consultant to conduct independent loan reviews on at least an annual basis. Generally, the external consultant reviews larger commercial relationships or criticized relationships. The Bank’s Credit Department compiles detailed reviews, including plans for resolution, on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table represents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system as of March 31, 2019 and December 31, 2018:

(Dollars in thousands)	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
March 31, 2019					
Commercial					
Commercial Business	$ 463,995	$ 6,238	$ 6,318	$ —	$ 476,551
Commercial Real Estate	382,037	4,985	2,513	—	389,535
Acquisition & Development	92,822	177	2,854	125	95,978
Total Commercial	938,854	11,400	11,685	125	962,064
Residential	306,347	2,573	1,675	118	310,713
Home Equity	57,767	870	38	—	58,675
Consumer	9,287	164	18	—	9,469
Total Loans	$ 1,312,255	$ 15,007	$ 13,416	$ 243	$ 1,340,921
December 31, 2018					
Commercial					
Commercial Business	$ 432,589	$ 5,290	$ 5,652	$ —	$ 443,531
Commercial Real Estate	371,309	2,071	2,181	—	375,561
Acquisition & Development	118,754	179	2,879	129	121,941
Total Commercial	922,652	7,540	10,712	129	941,033
Residential	290,602	2,608	1,600	119	294,929
Home Equity	58,100	876	39	—	59,015
Consumer	9,359	164	19	63	9,605
Total Loans	$ 1,280,713	$ 11,188	$ 12,370	$ 311	$ 1,304,582

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due.

A loan that has deteriorated and requires additional collection efforts by the Bank could warrant non-accrual status. A thorough review is presented to the Chief Credit Officer and/or the MLC, as required with respect to any loan which is in a collection process and to make a determination as to whether the loan should be placed on non-accrual status. The placement of loans on non-accrual status is subject to applicable regulatory restrictions and guidelines. Generally, loans should be placed in non-accrual status when the loan reaches 90 days past due, when it becomes likely the borrower cannot or will not make scheduled principal or interest payments, when full repayment of principal and interest is not expected, or when the loan displays potential loss characteristics. Normally, all accrued interest is charged off when a loan is placed in non-accrual status, unless Management believes it is likely the accrued interest will be collected. Any payments subsequently received are applied to principal. To remove a loan from non-accrual status, all principal and interest due must be paid up to date and the Bank is reasonably sure of future satisfactory payment performance. Usually, this requires a six-month recent history of payments due. Removal of a loan from non-accrual status will require the approval of the Chief Credit Officer and/or MLC.

The following table presents the classes of the loan portfolio summarized by aging categories of performing loans and non-accrual loans as of March 31, 2019 and December 31, 2018:

(Dollars in thousands)	Current	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Total Loans	Non-Accrual	90+ Days Still Accruing
March 31, 2019								
Commercial								
Commercial Business	$ 472,847	$ 165	$ 130	$ 3,409	$ 3,704	$ 476,551	$ 3,707	$ —
Commercial Real Estate	389,336	199	—	—	199	389,535	333	—
Acquisition & Development	95,686	—	—	292	292	95,978	417	—
Total Commercial	957,869	364	130	3,701	4,195	962,064	4,457	—
Residential	307,936	2,384	50	343	2,777	310,713	2,506	—
Home Equity	58,457	193	25	—	218	58,675	83	—
Consumer	9,435	5	—	29	34	9,469	29	—
Total Loans	$ 1,333,697	$ 2,946	$ 205	$ 4,073	$ 7,224	$ 1,340,921	$ 7,075	$ —
December 31, 2018								
Commercial								
Commercial Business	$ 432,097	$ 6,380	$ 1,746	$ 3,308	$ 11,434	$ 443,531	$ 3,684	$ —
Commercial Real Estate	374,880	681	—	—	681	375,561	385	—
Acquisition & Development	121,644	—	—	297	297	121,941	426	—
Total Commercial	928,621	7,061	1,746	3,605	12,412	941,033	4,495	—
Residential	291,665	1,000	760	1,504	3,264	294,929	2,442	—
Home Equity	58,575	400	40	—	440	59,015	84	—
Consumer	9,485	28	10	82	120	9,605	82	—
Total Loans	$ 1,288,346	$ 8,489	$ 2,556	$ 5,191	$ 16,236	$ 1,304,582	$ 7,103	$ —

Troubled Debt Restructurings

The restructuring of a loan is considered a troubled debt restructuring (“TDR”) if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. At March 31, 2019 and December 31, 2018, the Bank had specific reserve allocations for TDR’s of $484 thousand and $439 thousand, respectively.

Loans considered to be troubled debt restructured loans totaled $8.2 million and $8.0 million as of March 31, 2019 and December 31, 2018, respectively. Of these totals, $4.5 million and $4.2 million, respectively, represent accruing troubled debt restructured loans and represent 35% and 27%, respectively of total impaired loans. Meanwhile, as of March 31, 2019, $3.7 million represents three loans to two borrowers that have defaulted under the restructured terms. Two of the three loans, totaling $417 thousand, are commercial acquisition and development loans that were considered TDR's due to extended interest only periods and/or unsatisfactory repayment structures once transitioned to principal and interest payments. The third loan, to an unrelated borrower, is a $3.3 million commercial term loan which was previously considered a TDR due to multiple interest only periods being provided. This loan defaulted during the three months ended September 30, 2018. The default is due to delayed payments stemming from ongoing negotiations with respect to a third-party operator that is expected to provide a new source of reliable cash flow to service the required payments of this loan. These negotiations are expected to conclude in the second quarter of 2019. These borrowers have experienced continued financial difficulty and are considered non-performing loans as of March 31, 2019 and December 31, 2018.

A commercial loan in the amount of $128 thousand was classified as impaired and as a TDR in the first quarter of 2018. Upon the identification of financial difficulties on the part of the borrower, this loan was modified to interest-only payments for a twelve-month period with the balance due at maturity. A commercial loan in the amount of $268 thousand was classified as a TDR during the three months ended March 31, 2019. Upon the identification of financial difficulties on the part of the borrower, this loan was modified to a lower loan payment by lengthening the amortization period beyond what is typical for a commercial loan of this type. These loans have paid as agreed since they were renewed under modified terms.

(Dollars in thousands)	Three Months Ended March 31, 2019			Three Months Ended March 31, 2018		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial						
Commercial Business	1	$ 268	$ 267	1	$ 128	$ 128
Commercial Real Estate	—	—	—	—	—	—
Acquisition & Development	—	—	—	—	—	—
Total Commercial	1	268	267	1	128	128
Residential	—	—	—	—	—	—
Home Equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total	1	$ 268	$ 267	1	$ 128	$ 128

[1] The pre-modification and post-modification balances represent the balances outstanding immediately before and after modification of the loan.

Note 5 – Premises and Equipment

The Company leases certain premises and equipment under operating and finance leases. At March 31, 2019, the Company had lease liabilities totaling $15.7 million and right-of-use assets totaling $12.9 million related to these leases. Lease liabilities and right-of-use assets are reflected in other liabilities and other assets, respectively. For the three months ended March 31, 2019, the weighted average remaining lease term for finance leases was 3.4 years and the weighted average discount rate used in the measurement of finance lease liabilities was 2.86%. For the three months ended March 31, 2019, the weighted average remaining lease term for operating leases was 12.3 years and the weighted average discount rate used in the measurement of operating lease liabilities was 3.52%.

Lease costs were as follows:

(Dollars in thousands)	Three Months Ended March 31, 2019
Amortization of right-of-use assets, finance leases	$ 20
Interest on lease liabilities, finance leases	2
Operating lease cost	530
Short-term lease cost	25
Variable lease cost	10

Total lease cost	$	587

Rent expense for the three months ended March 31, 2018, prior to the adoption of ASU 2016-02, was $512 thousand.

There were no sale and leaseback transactions, leveraged leases, or lease transactions with related parties during the three months ended March 31, 2019. At March 31, 2019, the Company had leases that had not commenced, but will create approximately $2.4 million and $4.1 million of additional lease liabilities and right-of-use assets, respectively, for the Company.

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Future minimum payments for finance leases and operating leases with initial or remaining terms of one year or more are as follows:

	March 31, 2019	
(Dollars in thousands)	Finance Leases	Operating Leases
2019	$ 69	$ 1,851
2020	66	1,753
2021	66	1,783
2022	27	1,655
2023	—	1,425
2024 and thereafter	—	11,050
Total future minimum lease payments	$ 228	$ 19,517
Less: Amounts representing interest	(10)	(4,048)
Present value of net future minimum lease payments	$ 218	$ 15,469

Note 6 – Borrowed Funds

Short-term borrowings

Along with traditional deposits, the Bank has access to short-term borrowings from the FHLB, Federal Reserve discount window borrowings, and Fed Funds purchased from correspondent banks to fund its operations and investments. Short-term borrowings totaled $112.4 million at March 31, 2019, compared to $212.4 million at December 31, 2018.

Information related to short-term borrowings is summarized as follows:

(Dollars in thousands)	March 31, 2019	December 31, 2018
Balance at end of period	$ 112,412	$ 212,395
Average balance during the period	176,428	171,117
Maximum month-end balance	177,164	264,297
Weighted-average rate during the year	2.63 %	2.27 %
Weighted-average rate at end of period	2.70 %	2.62 %

Repurchase agreements

Along with traditional deposits, the Bank has access to securities sold under agreements to repurchase “repurchase agreements” with customers representing funds deposited by customers, on an overnight basis, that are collateralized by investment securities owned by the Company. Repurchase agreements with customers are included in borrowings section on the consolidated balance sheets. All repurchase agreements are subject to terms and conditions of repurchase/security agreements between the Company and the client and are accounted for as secured borrowings. The Company’s repurchase agreements reflected in liabilities consist of customer accounts and securities which are pledged on an individual security basis.

The Company monitors the fair value of the underlying securities on a monthly basis. Repurchase agreements are reflected at the amount of cash received in connection with the transaction and included in Securities sold under agreements to repurchase on the consolidated balance sheets. The primary risk with the Company’s repurchase agreements is market risk associated with the investments securing the transactions, as we may be required to provide additional collateral based on fair value changes of the underlying investments. Securities pledged as collateral under repurchase agreements are maintained with our safekeeping agents.

All of the Company’s repurchase agreements were overnight agreements at March 31, 2019 and December 31, 2018. These borrowings were collateralized with investment securities with a carrying value of $13.0 million and $15.4 million at March 31, 2019 and December 31, 2018, respectively, and were comprised of U.S. Government Agencies and Mortgage backed securities. Declines in the value of the collateral would require the Company to increase the amounts of securities pledged.

Repurchase agreements totaled $12.6 million at March 31, 2019, compared to $14.9 million at December 31, 2018.

Information related to repurchase agreements is summarized as follows:

(Dollars in thousands)	March 31, 2019	December 31, 2018
Balance at end of period	$ 12,553	$ 14,925
Average balance during the period	14,206	18,536
Maximum month-end balance	14,655	20,903
Weighted-average rate during the year	0.38 %	0.30 %
Weighted-average rate at end of period	0.52 %	0.16 %

Long-term notes from the FHLB were as follows:

(Dollars in thousands)	March 31, 2019	December 31, 2018
Fixed interest rate notes, originating between October 2006 and April 2007, due between October 2021 and April 2022, interest of between 5.18% and 5.20% payable monthly	$ 1,727	$ 1,741
Amortizing fixed interest rate note, originating February 2007, due February 2022, payable in monthly installments of $5 thousand, including interest of 5.22%	745	751
	$ 2,472	$ 2,492

Subordinated Debt

Information related to subordinated debt is summarized as follows:

(Dollars in thousands)	March 31, 2019	December 31, 2018
Balance at end of period	$ 17,524	$ 17,524
Average balance during the period	17,524	25,774
Maximum month-end balance	17,524	33,524
Weighted-average rate during the year	6.51 %	6.81 %
Weighted-average rate at end of period	6.53 %	6.57 %

In March 2007, the Company completed the private placement of $4 million Floating Rate, Trust Preferred Securities through its MVB Financial Statutory Trust I subsidiary (the "Trust"). The Company established the Trust for the sole purpose of issuing the Trust Preferred Securities pursuant to an Amended and Restated Declaration of Trust. The proceeds from the sale of the Trust Preferred Securities will be loaned to the Company under subordinated Debentures (the “Debentures”) issued to the Trust pursuant to an Indenture. The Debentures are the only asset of the Trust. The Trust Preferred Securities have been issued to a pooling vehicle that will use the distributions on the Trust Preferred Securities to securitize note obligations. The securities issued by the Trust are includable for regulatory purposes as a component of the Company’s Tier 1 capital.

The Trust Preferred Securities and the Debentures mature in 2037 and have been redeemable by the Company since 2012. Interest payments are due in March, June, September, and December and are adjusted at the interest due dates at a rate of 1.62% over the three-month LIBOR Rate. The obligations of the Company with respect to the issuance of the trust preferred securities constitute a full and unconditional guarantee by the Company of the Trust’s obligations with respect to the trust preferred securities to the extent set forth in the related guarantees.

On June 30, 2014, the Company issued its Convertible Subordinated Promissory Notes Due 2024 (the “Notes”) to various investors in the aggregate principal amount of $29,400,000. The Notes were issued in $100,000 increments per Note subject to a minimum investment of $1,000,000. The Notes expire 10 years after the initial issuance date of the Notes (the “Maturity Date”).

Interest on the Notes accrues on the unpaid principal amount of each Note (paid quarterly in arrears on January 1, April 1, July 1, and October 1 of each year) which rate shall be dependent upon the principal invested in the Notes and the holder’s ownership of common stock in the Company. For investments of less than $3,000,000 in Notes, an ownership of Company common stock representing at least 30% of the principal of the Notes acquired, the interest rate on the Notes is 7% per annum. For investments of $3,000,000 or greater in Notes and ownership of the Company’s common stock representing at least 30% of the principal of the Notes acquired, the interest rate on the Notes is 7.5% per annum. For investments of $10,000,000 or greater, the interest rate on the Notes is 7% per annum, regardless of whether the holder owns or acquires MVB common stock. The principal on the Notes shall be paid in full at the Maturity Date. On the fifth anniversary of the issuance of the Notes, a holder may elect to continue to receive the stated fixed rate on the Notes or a floating rate determined by LIBOR plus 5% up to a maximum rate of 9%, adjusted quarterly.

The Notes are unsecured and subject to the terms and conditions of any senior debt and after consultation with the Board of Governors of the Federal Reserve System, the Company may, after the Notes have been outstanding for 5 years, and without premium or penalty, prepay all or a portion of the unpaid principal amount of any Note together with the unpaid interest accrued on such portion of the principal amount of such Note. All such prepayments shall be made pro rata among the holders of all outstanding Notes.

At the election of a holder, any or all of the Notes may be converted into shares of common stock during the 5-day period after the first, second, third, fourth, and fifth anniversaries of the issuance of the Notes or upon a notice to prepay by the Company. On December 28, 2017, the Company distributed notices to the holders of the Notes that provide that the Company has elected to waive the timing requirements associated with when a conversion may occur and, instead, the Company will accept notices of conversion at any time prior to July 1, 2019, which is the final conversion date for the Notes. The Notes will convert into common stock based on $16 per share of the Company's common stock. The conversion price will be subject to anti-dilution adjustments for certain events such as stock splits, reclassifications, non-cash distributions, extraordinary cash dividends, pro rata repurchases of common stock, and business combination transactions. The Company must give 20 days' notice to the holders of the Company's intent to prepay the Notes, so that holders may execute the conversion right set forth above if a holder so desires.

Repayment of the Notes is subordinated to the Company's outstanding senior debt including (if any) without limitation, senior secured loans. No payment will be made by the Company, directly or indirectly, on the Notes, unless and until all of the senior debt then due has been paid in full. Notwithstanding the foregoing, so long as there exists no event of default under any senior debt, the Company would make, and a holder would receive and retain for the holder's account, regularly scheduled payments of accrued interest and principal pursuant to the terms of the Notes.

The Company must obtain a consent of the holders of the Notes prior to issuing any new senior debt in excess of $15,000,000 after the date of issuance of the Notes and prior to the Maturity Date.

An event of default will occur upon the Company's bankruptcy or any failure to pay interest, principal, or other amounts owing on the Notes when due. Upon the occurrence and during the continuance of an event of default (but subject to the subordination provisions of the Notes) the holders of a majority of the outstanding principal amount of the Notes may declare all or any portion of the outstanding principal amount of the Notes due and payable and demand immediate payment of such amount.

The Notes are redeemable, in whole or in part, at a redemption price equal to 100% of the principal amount of the Notes to be redeemed on any interest payment date after a date five years from the original issue date.

The Company reflects subordinated debt in the amount of $17.5 million as of March 31, 2019 and December 31, 2018 and interest expense of $285 thousand and $558 thousand for the three months ended March 31, 2019 and 2018. In 2018, $16.0 million of subordinated debt was converted into common stock, which resulted in the issuance of 1,000,000 new shares and provided an annual interest expense savings of $1.1 million.

A summary of maturities of borrowings and subordinated debt over the next five years is as follows (dollars in thousands):

Year	**Amount**	
2019	$	112,477
2020	90	
2021	886	

2022	1,431	
2023	—	
Thereafter	17,524	
	$	132,408

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Note 7 – Fair Value of Financial Instruments

Accounting standards require that the Company adopt fair value measurement for financial assets and financial liabilities. This enhanced guidance for using fair value to measure assets and liabilities applies whenever other standards require or permit assets or liabilities to be measured at fair value. This guidance does not expand the use of fair value in any new circumstances.

Accounting standards establish a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined by these standards are as follows:

Level I:	Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
Level II:	Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities include items for which quoted prices are available but traded less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.
Level III:	Assets and liabilities that

have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The methods of determining the fair value of assets and liabilities presented in this footnote are consistent with our methodologies disclosed in Note 17, "Fair Value of Financial Instruments" and Note 18, "Fair Value Measurement" of the Notes to the Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data, of the Company's 2018 Annual Report on Form 10-K, except for the valuation of loans held for investment which was impacted by the adoption of ASU 2016-01. In accordance with ASU 2016-01, the fair value of loans held for investment is estimated using a discounted cash flow analysis. The discount rates used to determine fair value use interest rate spreads that reflect factors such as liquidity, credit, and nonperformance risk of the loans. Loans are considered a Level III classification.

Assets Measured on a Recurring Basis

As required by accounting standards, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company classified investments in government securities as Level II instruments and valued them using the market approach. The following measurements are made on a recurring basis.

•**Available-for-sale investment and equity securities**~~-~~Available-for-sale investment securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level I securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level II securities include mortgage-backed securities issued by government sponsored entities and private label entities, municipal bonds, and corporate debt securities. There have been no changes in valuation techniques for the three months ended March 31, 2019. Valuation techniques are consistent with techniques used in prior periods. Certain local municipal securities related to tax increment financing ("TIF") are independently valued and classified as Level III instruments.

- **Loans held for sale**—The fair value of mortgage loans held for sale is determined, when possible, using quoted secondary-market prices or investor commitments. If no such quoted price exists, the fair value of a loan is determined using quoted prices for a similar asset or assets, adjusted for the specific attributes of that loan, which would be used by other market participants.

- **Interest rate lock commitment**—The Company estimates the fair value of interest rate lock commitments based on the value of the underlying mortgage loan, quoted mortgage-backed security prices, and estimates of the fair value of the mortgage servicing rights and the probability that the mortgage loan will fund within the terms of the interest rate lock commitments.

- **Mortgage-backed security hedges**—MBS hedges are considered derivatives and are recorded at fair value based on observable market data of the individual mortgage-backed security.

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- **Interest rate cap –** The fair value of the interest rate cap is determined at the end of each quarter by using Bloomberg Finance which values the interest rate cap using observable inputs from forward and futures yield curves as well as standard market volatility.

- **Interest rate swap –** Interest rate swaps are recorded at fair value based on third party vendors who compile prices from various sources and may determine fair value of identical or similar instruments by using pricing models that consider observable market data.

- **Fair value hedge –** Treated like an interest rate swap, fair value hedges are recorded at fair value based on third party vendors who compile prices from various sources and may determine fair value of identical or similar instruments by using pricing models that consider observable market data.

The following tables present the assets reported on the consolidated statements of financial condition at their fair value on a recurring basis as of March 31, 2019 and December 31, 2018 by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	March 31, 2019			
(Dollars in thousands)	**Level I**	**Level II**	**Level III**	**Total**
Assets:				
U.S. Government Agency securities	$ —	$ 66,588	$ —	$ 66,588
U.S. Sponsored Mortgage backed securities	—	47,771	—	47,771
Municipal securities	—	63,206	36,801	100,007
Other securities	—	10,375	—	10,375
Equity securities	5,819	3,272	750	9,841
Loans held for sale	—	65,955	—	65,955
Interest rate lock commitment	—	—	2,256	2,256
Interest rate swap	—	2,666	—	2,666
Interest rate cap	—	—	—	—
Fair value hedge	—	630	—	630
Liabilities:				
Interest rate swap	—	2,666	—	2,666
Fair value hedge	—	630	—	630
Mortgage-backed security hedges	—	687	—	687

	December 31, 2018			
(Dollars in thousands)	**Level I**	**Level II**	**Level III**	**Total**
Assets:				
U.S. Government Agency securities	$ —	$ 77,430	$ —	$ 77,430
U.S. Sponsored Mortgage backed securities	—	50,115	—	50,115
Municipal securities	—	50,639	33,122	83,761
Other securities	—	10,308	—	10,308
Equity securities	6,027	3,272	300	9,599
Loans held for sale	—	75,807	—	75,807
Interest rate lock commitment	—	—	1,750	1,750
Interest rate swap	—	1,375	—	1,375
Interest rate cap	—	8	—	8
Fair value hedge	—	343	—	343
Liabilities:				
Interest rate swap	—	1,375	—	1,375

Fair value hedge	—	343	—	343
Mortgage-backed security hedges	—	853	—	853

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The following table represents recurring level III assets:

(Dollars in thousands)	Interest Rate Lock Commitments		Municipal Securities		Equity Securities		Total	
Balance at January 1, 2019	$	1,750	$	33,122	$	300	$	35,172
Realized and unrealized gains included in earnings	506		—		—		506	
Purchase of securities	—		—		450		450	
Unrealized gain included in other comprehensive income (loss)	—		5,012		—		5,012	
Unrealized loss included in other comprehensive income (loss)	—		(1,333)		—		(1,333)	
Balance at Balance at March 31, 2019	$	2,256	$	36,801	$	750	$	39,807
Balance at January 1, 2018	$	1,426	$	22,909	$	900	$	25,235
Realized and unrealized gains included in earnings	886		—		—		886	
Unrealized loss included in other comprehensive income (loss)	—		(338)		—		(338)	
Balance at Balance at March 31, 2018	$	2,312	$	22,571	$	900	$	25,783

Assets Measured on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain financial assets, financial liabilities, non-financial assets, and non-financial liabilities at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market value that were recognized at fair value below cost at the end of the period. Certain non-financial assets measured at fair value on a nonrecurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. Non-financial assets measured at fair value on a nonrecurring basis during 2019 and 2018 include certain foreclosed assets which, upon initial recognition, were remeasured and reported at fair value through a charge-off to the allowance for possible loan losses and certain foreclosed assets which, subsequent to their initial recognition, were remeasured at fair value through a write-down included in other noninterest expense.

- **Impaired loans**–Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Collateral values are estimated using Level II inputs based on observable market data or Level III inputs based on customized discounting criteria. For a majority of impaired real estate related loans, the Company obtains a current external appraisal. Other valuation techniques are used as well, including internal valuations, comparable property analysis and contractual sales information.

- **Other real estate owned**–Other real estate owned, which is obtained through the Bank's foreclosure process is valued utilizing the appraised collateral value. Collateral values are estimated using Level II inputs based on observable market data or Level III inputs based on customized discounting criteria. At the time, the foreclosure is completed, the Company obtains a current external appraisal.

Assets measured at fair value on a nonrecurring basis as of March 31, 2019 and December 31, 2018 are included in the table below:

	March 31, 2019			
(Dollars in thousands)	**Level I**	**Level II**	**Level III**	**Total**
Impaired loans	$ —	$ —	$ 11,838	$ 11,838
Other real estate owned	—	—	2,108	2,108

	December 31, 2018			
(Dollars in thousands)	**Level I**	**Level II**	**Level III**	**Total**
Impaired loans	$ —	$ —	$ 11,735	$ 11,735
Other real estate owned	—	—	2,145	2,145

The following tables presents quantitative information about the Level III significant unobservable inputs for assets and liabilities measured at fair value at March 31, 2019 and December 31, 2018.

	Quantitative Information about Level III Fair Value Measurements				
(Dollars in thousands)	**Fair Value**		**Valuation Technique**	**Unobservable Input**	Range
March 31, 2019					
Nonrecurring measurements:					
Impaired loans	$	11,838	Appraisal of collateral [1]	Appraisal adjustments [2]	20% - 62%
				Liquidation expense [2]	5% - 10%
Other real estate owned	$	2,108	Appraisal of collateral [1]	Appraisal adjustments [2]	20% - 30%
				Liquidation expense [2]	5% - 10%
Recurring measurements:					
Municipal securities	$	36,801	Appraisal of bond [3]	Bond appraisal adjustment [4]	5% - 15%
Equity securities	$	750	Net asset value	Cost minus impairment	0%
Interest rate lock commitments	$	2,256	Pricing model	Pull through rates	77% - 82%

	Quantitative Information about Level III Fair Value Measurements				
(Dollars in thousands)	**Fair Value**		**Valuation Technique**	**Unobservable Input**	Range
December 31, 2018					
Nonrecurring measurements:					
Impaired loans	$	11,735	Appraisal of collateral [1]	Appraisal adjustments [2]	20% - 62%
				Liquidation expense [2]	5% - 10%
Other real estate owned	$	2,145	Appraisal of	Appraisal adjustments [2]	20% - 30%

			collateral [1]		
				Liquidation expense [2]	5% - 10%
Recurring measurements:					
Municipal securities	$	33,122	Appraisal of bond [3]	Bond appraisal adjustment [4]	5% - 15%
Equity securities	$	300	Net asset value	Cost minus impairment	0%
Interest rate lock commitments	$	1,750	Pricing model	Pull through rates	80% - 88%

[1] Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level III inputs which are not identifiable.

[2] Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

[3] Fair value determined through independent analysis of liquidity, rating, yield and duration.

[4] Appraisals may be adjusted for qualitative factors such as local economic conditions.

Estimated fair value of financial instruments have been determined by the Company using historical data, as generally provided in the Company’s regulatory reports, and an estimation methodology suitable for each category of financial instruments.

The carrying values and estimated fair values of the Company’s financial instruments are summarized as follows:

Fair Value Measurements at:

(Dollars in thousands)	Carrying Value	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
March 31, 2019					
Financial assets:					
Cash and cash equivalents	$ 17,958	$ 17,958	$ 17,958	$ —	$ —
Certificates of deposits with other banks	14,778	14,498	—	14,498	—
Securities available-for-sale	224,741	224,741	—	187,940	36,801
Equity securities	9,841	9,841	5,819	3,272	750
Loans held for sale	65,955	65,955	—	65,955	—
Loans, net	1,329,976	1,322,042	—	—	1,322,042
Mortgage servicing rights	171	171	—	—	171
Interest rate lock commitment	2,256	2,256	—	—	2,256
Interest rate swap	2,666	2,666	—	2,666	—
Fair value hedge	630	630	—	630	—
Accrued interest receivable	7,205	7,205	—	1,789	5,416
Financial liabilities:					
Deposits	$ 1,430,659	$ 1,376,015	$ —	$ 1,376,015	$ —
Repurchase agreements	12,553	12,553	—	12,553	—
FHLB and other borrowings	114,884	114,886	—	114,886	—
Mortgage-backed security hedges	687	687	—	687	—
Interest rate swap	2,666	2,666	—	2,666	—
Fair value hedge	630	630	—	630	—
Accrued interest payable	959	959	—	959	—
Subordinated debt	17,524	18,250	—	18,250	—
December 31, 2018					
Financial assets:					
Cash and cash equivalents	$ 22,221	$ 22,221	$ 22,221	$ —	$ —
Certificates of deposits with other banks	14,778	14,300	—	14,300	—
Securities available-for-sale	221,614	221,614	—	188,492	33,122
Equity securities	9,599	9,599	6,027	3,272	300
Loans held for sale	75,807	75,807	—	75,807	—
Loans, net	1,293,427	1,276,065	—	—	1,276,065
Mortgage servicing rights	173	173	—	—	173

Interest rate lock commitment	1,750	1,750	—	—	1,750
Interest rate swap	1,375	1,375	—	1,375	—
Interest rate cap	8	8	—	8	—
Fair value hedge	343	343	—	343	—
Accrued interest receivable	7,710	7,710	—	1,368	6,342
Financial liabilities:					
Deposits	$ 1,309,154	$ 1,249,164	$ —	$ 1,249,164	$ —
Repurchase agreements	14,925	14,925	—	14,925	—
FHLB and other borrowings	214,887	214,969	—	214,969	—
Mortgage-backed security hedges	853	853	—	853	—
Interest rate swap	1,375	1,375	—	1,375	—
Fair value hedge	343	343	—	343	—
Accrued interest payable	1,064	1,064	—	1,064	—
Subordinated debt	17,524	18,250	—	18,250	—

Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates. Fair value estimates are based on existing on-and-off balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments.

Note 8 – Stock Offerings

On March 13, 2017, the Company entered into an Investment Agreement (the "Investment Agreement") with its Chief Executive Officer, Larry F. Mazza ("Mazza"). Pursuant to the Investment Agreement, Mazza committed to subscribe for and purchase, at the Subscription Price, upon expiration of the Rights Offering, the number of shares of the Company's common stock, if any, equal to the amount by which 100,000 exceeds the number of shares purchased by Mazza in the Rights Offering. Pursuant to the Investment Agreement, Mazza agreed not to sell or otherwise transfer any shares acquired in connection with the Investment Agreement for a period of six months following the closing of the Rights Offering.

Larry F. Mazza purchased 100,000 shares of the Company's common stock: 90,999 under the rights offering and 9,001 shares under the Investment Agreement.

On March 13, 2017, the Company filed with the SEC a prospectus supplement and accompanying base prospectus (collectively, the "Prospectus") relating to the commencement of the Company's rights offering (the "Rights Offering"), pursuant to which the Company distributed, at no charge, non-transferable subscription rights to the holders of its common stock as of 5:00 p.m., Eastern time, on March 10, 2017. The subscription rights were exercisable for up to a total of 434,783 shares of the Company's common stock, subject to such terms and conditions as further described in the Prospectus.

On April 20, 2017, the Company announced the completion of the rights offering, which expired at 5:00 p.m. Eastern time on April 14, 2017. All 434,783 shares offered in the rights offering were subscribed for, resulting in new capital of approximately $5.0 million. Computershare, who served as subscription agent, completed its review and tabulation of subscriptions on April 19, 2017. Computershare issued the shares acquired in the rights offering by book entry in the Company's stock ownership records, which are maintained by Computershare, as transfer agent, on or about April 20, 2017.

On June 30, 2014, the Company filed Certificates of Designations for its Convertible Noncumulative Perpetual Preferred Stock, Series B ("Class B Preferred") and its Convertible Noncumulative Perpetual Preferred Stock, Series C ("Class C Preferred"). The Class B Preferred Certificate designated 400 shares of preferred stock as Class B Preferred shares. The Class B Preferred shares carry an annual dividend rate of 6% and are convertible into shares of Company common stock within 30 days after the first, second, third, fourth and fifth anniversaries of the original issue date, based on a common stock price of $16 per share, as adjusted for future corporate activities. On December 28, 2017, the Company distributed a notice to each of the holders of the Class B Preferred Stock regarding the Company's agreement to waive the timing requirements associated with when a conversion may occur and, instead, the Company will accept notices of conversion at any time prior to July 30, 2019, which is the final conversion date for the Preferred Stock. The Class B Preferred shares are redeemable by the Company on or after the fifth anniversary of the original issue date for Liquidation Amount, as defined therein, plus declared and unpaid dividends. Redemption is subject to any necessary regulatory approvals. In the event of liquidation of the Company, shares of Class B Preferred stock shall be junior to creditors of the Company and to the shares of Senior Noncumulative Perpetual Preferred

Stock, Series A. Holders of Class B Preferred shares shall have no voting rights, except for authorization of senior shares of stock, amendment to the Class B Preferred shares, share exchanges, reclassifications or changes of control, or as required by law.

The Class C Preferred Certificate designated 383.4 shares of preferred stock as Class C Preferred shares. The Class C Preferred shares carry an annual dividend rate of 6.5% and are convertible into shares of Company common stock within 30 days after the first, second, third, fourth and fifth anniversaries of the original issue date, based on a common stock price of $16 per share, as adjusted for future corporate activities. On December 28, 2017, the Company distributed a notice to each of the holders of the Class C Preferred Stock regarding the Company's agreement to waive the timing requirements associated with when a conversion may occur and, instead, the Company will accept notices of conversion at any time prior to July 30, 2019, which is the final conversion date for the Preferred Stock. The Class C Preferred shares are redeemable by the Company on or after the fifth anniversary of the original issue date for Liquidation Amount, as defined therein, plus declared and unpaid dividends. Redemption is subject to any necessary regulatory approvals. In the event of liquidation of the Company, shares of Class C Preferred stock

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shall be junior to creditors of the Company and to the shares of Senior Noncumulative Perpetual Preferred Stock, Series A, and the Class B Preferred shares. Holders of Class C Preferred shares shall have no voting rights, except for authorization of senior shares of stock, amendment to the Class C Preferred shares, share exchanges, reclassifications, or changes of control, or as required by law. The proceeds of these preferred stock offerings will be used to support continued growth of the Company and its subsidiaries.

Note 9 – Net Income Per Common Share

The Company determines basic earnings per share by dividing net income less preferred stock dividends by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by dividing net income less dividends on convertible preferred stock plus interest on convertible subordinated debt by the weighted average number of shares outstanding increased by both the number of shares that would be issued assuming the exercise of stock options or restricted stock unit awards under the Company's 2003 and 2013 Stock Incentive Plans and the conversion of preferred stock and subordinated debt if dilutive.

	Three Months Ended March 31	
(Dollars in thousands except shares and per share data)	**2019**	**2018**
Numerator for basic earnings per share:		
Net income	$ 3,192	$ 2,594
Less: Dividends on preferred stock	121	121
Net income available to common shareholders - basic	$ 3,071	$ 2,473
Numerator for diluted earnings per share:		
Net income available to common shareholders - basic	$ 3,071	$ 2,473
Add: Dividends on convertible preferred stock	121	—
Add: Interest on subordinated debt (tax effected)	184	404
Net income available to common shareholders - diluted	$ 3,376	$ 2,877
Denominator:		
Total average shares outstanding	11,607,543	10,474,138
Effect of dilutive convertible preferred stock	489,625	—
Effect of dilutive convertible subordinated debt	837,500	1,837,500
Effect of dilutive stock options and restricted stock units	242,613	402,715
Total diluted average shares outstanding	13,177,281	12,714,353
Earnings per share - basic	$ 0.26	$ 0.24
Earnings per share - diluted	$ 0.26	$ 0.23

For the three months ended March 31, 2019 and 2018, approximately 0 and 490 thousand, respectively, of options to purchase shares of common stock were not included in the computation of diluted earnings per share because the effect would be antidilutive.

For the three months ended March 31, 2019 and 2018, approximately 0 and 3 thousand shares, respectively, of restricted stock units were not included in the computation of diluted earnings per share because the effect would be antidilutive.

Note 10 – Segment Reporting

The Company has identified three reportable segments: commercial and retail banking; mortgage banking; and financial holding company. Revenue from commercial and retail banking activities consists primarily of interest earned on loans and investment securities and service charges on deposit accounts. Revenue from financial holding company activities is mainly comprised of intercompany service income and dividends.

Revenue from the mortgage banking activities is comprised of interest earned on loans and fees received as a result of the mortgage origination process. The mortgage banking services are conducted by MVB Mortgage.

Information about the reportable segments and reconciliation to the consolidated financial statements for the three month periods ended March 31, 2019 and March 31, 2018 are as follows:

Three Months Ended March 31, 2019 **(Dollars in thousands)**	**Commercial & Retail Banking**		**Mortgage Banking**		**Financial Holding Company**		**Intercompany Eliminations**		**Consolidated**	
Interest income	$	18,327	$	1,538	$	1	$	(243)	$	19,623
Interest expense	4,754		993		285		(381)		5,651	
Net interest income	13,573		545		(284)		138		13,972	
Provision for loan losses	247		53		—		—		300	
Net interest income after provision for loan losses	13,326		492		(284)		138		13,672	
Noninterest Income:										
Mortgage fee income	109		6,697		—		(136)		6,670	
Other income	1,566		476		1,779		(1,726)		2,095	
Total noninterest income	1,675		7,173		1,779		(1,862)		8,765	
Noninterest Expenses:										
Salaries and employee benefits	4,395		5,159		2,180		—		11,734	
Other expense	5,352		2,025		1,061		(1,724)		6,714	
Total noninterest expenses	9,747		7,184		3,241		(1,724)		18,448	
Income (loss) before income taxes	5,254		481		(1,746)		—		3,989	
Income tax expense (benefit)	1,054		146		(403)		—		797	
Net income (loss)	$	4,200	$	335	$	(1,343)	$	—	$	3,192
Preferred stock dividends	—		—		121		—		121	
Net income (loss) available to common shareholders	$	4,200	$	335	$	(1,464)	$	—	$	3,071

Capital Expenditures for the three month period ended March 31, 2019	$ 89	$ 4	$ 22	$ —	$ 115
Total Assets as of March 31, 2019	1,790,725	175,218	197,191	(373,226)	1,789,908
Total Assets as of December 31, 2018	1,753,932	165,430	196,537	(364,930)	1,750,969
Goodwill as of March 31, 2019	1,598	16,882	—	—	18,480
Goodwill as of December 31, 2018	1,598	16,882	—	—	18,480

Three Months Ended March 31, 2018 **(Dollars in thousands)**	**Commercial & Retail Banking**		**Mortgage Banking**		**Financial Holding Company**		**Intercompany Eliminations**		**Consolidated**	
Interest income	$	13,838	$	1,335	$	1	$	(120)	$	15,054
Interest expense	2,674		727		558		(370)		3,589	
Net interest income	11,164		608		(557)		250		11,465	
Provision for loan losses	417		57		—		—		474	
Net interest income after provision for loan losses	10,747		551		(557)		250		10,991	
Noninterest income:										
Mortgage fee income	140		6,673		—		(250)		6,563	
Other income	1,780		517		1,553		(1,374)		2,476	
Total noninterest income	1,920		7,190		1,553		(1,624)		9,039	
Noninterest Expense:										
Salaries and employee benefits	3,569		5,416		1,488		—		10,473	
Other expense	4,559		2,122		959		(1,374)		6,266	
Total noninterest expenses	8,128		7,538		2,447		(1,374)		16,739	
Income (loss) before income taxes	4,539		203		(1,451)		—		3,291	
Income tax expense (benefit)	978		53		(334)		—		697	
Net income (loss)	$	3,561	$	150	$	(1,117)	$	—	$	2,594
Preferred stock dividends	—		—		121		—		121	
Net income (loss) available to common shareholders	$	3,561	$	150	$	(1,238)	$	—	$	2,473
Capital Expenditures for the three month period	$	403	$	78	$	25	$	—	$	506

ended March 31, 2018					
Total Assets as of March 31, 2018	1,581,673	148,789	185,012	(333,956)	1,581,518
Total Assets as of December 31, 2017	1,533,497	149,323	184,600	(333,118)	1,534,302
Goodwill as of March 31, 2018	1,598	16,882	—	—	18,480
Goodwill as of December 31, 2017	1,598	16,882	—	—	18,480

Commercial & Retail Banking

For the three months ended March 31, 2019, the Commercial & Retail Banking segment earned $4.2 million compared to $3.6 million in 2018. Net interest income increased by $2.4 million, primarily the result of an increase of $4.3 million in interest and fees on loans, which was partially offset by an increase of $1.8 million in interest on deposits. Noninterest income decreased by $245 thousand which was the result of a decrease of $260 thousand in gain on sale of securities. Noninterest expense increased by $1.6 million, primarily the result of an increase of $826 thousand in salaries and employee benefits expense, an increase of $347 thousand in other operating expenses, an increase of $210 thousand in occupancy and equipment expense, and an increase of $150 thousand in data processing and communications. In addition, provision expense decreased by $170 thousand due to decreased loan volume in the first quarter of 2019 versus the same quarter in 2018, fluctuating historical loan loss rates, increased specific loan loss allocations, and a lower level of charge-offs in the first quarter of 2019 versus 2018.

Mortgage Banking

For the three months ended March 31, 2019, the Mortgage Banking segment earned $335 thousand compared to $150 thousand in 2018. Net interest income decreased $63 thousand, which was the result of an increase of $266 thousand in interest on FHLB and other borrowings, which was partially offset by an increase of $203 thousand in interest and fees on loans. The increase in interest on FHLB and other borrowings was due to an increase of $5.6 million in average borrowings and an increase in short-term borrowing rates. Noninterest income decreased by $17 thousand, primarily the result of a decrease $56 thousand in the gain on derivative, which was partially offset by an increase of $24 thousand in mortgage fee income. The decrease in the gain on derivatives was largely the result of a $26.9 million decrease in the derivative asset, as the locked pipeline related to the derivative asset increased 42.7% in the first quarter of 2019 compared to an increase of 67.6% in the first quarter of 2018. Noninterest expense decreased by $354 thousand, which was the result of a decrease of $257 thousand in salaries and employee benefits expense and a decrease of $83 thousand in mortgage processing expense. The decrease in salaries and employee benefits expense was primarily the result of a decrease in the overall contractual commissions to loan officers and management.

Financial Holding Company

For the three months ended March 31, 2019, the Financial Holding Company segment lost $1.3 million compared to a loss of $1.1 million in 2018. Interest expense decreased $273 thousand, noninterest income increased $226 thousand, and noninterest expense increased $794 thousand. In addition, the income tax benefit increased $69 thousand. The decrease in interest expense was due to a $273 thousand decrease in interest on subordinated debt. The increase in noninterest income was primarily the result of an increase of $350 thousand in intercompany services income related to Regulation W, which was partially offset by a decrease of $184 thousand in the gain on sale of securities. The increase in noninterest expense was primarily the result of an increase of $692 thousand in salaries and employee benefits expense and an increase of $60 thousand in professional fees.

Note 11 – Pension and Supplemental Executive Retirement Plans

The Company participates in a trusteed pension plan known as the Allegheny Group Retirement Plan covering virtually all full-time employees. Benefits are based on years of service and the employee's compensation. Accruals under the Plan were frozen as of May 31, 2014. Freezing the plan resulted in a re-measurement of the pension obligations and plan assets as of the freeze date. The pension obligation was re-measured using the discount rate based on the Citigroup Above Median Pension Discount Curve in effect on May 31, 2014 of 4.46%.

Information pertaining to the activity in the Company's defined benefit plan, using the latest available actuarial valuations with a measurement date of March 31, 2019 and 2018 is as follows:

(Dollars in thousands)	**Three Months Ended March 31, 2019**	**Three Months Ended March 31, 2018**
Service cost	$ —	$ —
Interest cost	98	88
Expected Return on Plan Assets	(102)	(93)
Amortization of Net Actuarial Loss	68	77
Amortization of Prior Service Cost	—	—
Net Periodic Benefit Cost	$ 64	$ 72
Contributions Paid	$ 90	$ 79

On June 19, 2017, the Company and MVB Mortgage approved a Supplemental Executive Retirement Plan ("SERP"), pursuant to which the Chief Executive Officer of MVB Mortgage is entitled to receive certain supplemental nonqualified retirement benefits. The SERP took effect on December 31, 2017. If executive completes three years of continuous employment with MVB Mortgage prior to retirement date (which shall be no earlier than the date he attains age 55) he will, upon retirement, be entitled to receive $1.8 million payable in 180 equal consecutive monthly installments of $10 thousand. The liability is calculated by discounting the anticipated future cash flows at 4.0%. The liability accrued for this obligation was $478 thousand and $377 thousand as of March 31, 2019 and December 31, 2018, respectively. Service cost was $102 thousand and $94 thousand for the three-month periods ended March 31, 2019 and 2018, respectively.

Note 12 – Comprehensive Income

The following tables present the components of accumulated other comprehensive income ("AOCI") three months ended March 31, 2019 and 2018:

(Dollars in thousands)	**Three Months Ended March 31, 2019**	**Three Months Ended March 31, 2018**	
Details about AOCI Components	**Amount Reclassified from AOCI**	**Amount Reclassified from AOCI**	**Affected line item in the Statement where Net Income is presented**
Available-for-sale securities			
Unrealized holding gains (losses)	$ (118)	$ 326	Gain (loss) on sale of securities
	(118)	326	Total before tax
	32	(88)	Income tax expense
	(86)	238	Net of tax
Defined benefit pension plan items			
Amortization of net actuarial loss	(68)	(77)	Salaries and benefits
	(68)	(77)	Total before tax
	18	31	Income tax expense
	(50)	(46)	Net of tax
Investment hedge			
Carrying value adjustment	458	—	Interest on investment securities - taxable
	458	—	Total before tax
	(124)	—	Income tax expense
	334	—	Net of tax
Total reclassifications	$ 198	$ 192	

(Dollars in thousands)	**Unrealized gains (losses) on available for-sale securities**	**Defined benefit pension plan items**	**Investment Hedge**	**Total**
Balance at January 1, 2019	$ (3,384)	$ (3,422)	$ —	$ (6,806)
Other comprehensive loss before reclassification	1,357	(242)	—	1,115
Amounts reclassified from AOCI	86	50	(334)	(198)
Net current period OCI	1,443	(192)	(334)	917
Balance at March 31, 2019	$ (1,941)	$ (3,614)	$ (334)	$ (5,889)
Balance at January 1, 2018	$ (5)	$ (2,983)		$ (2,988)

Other comprehensive loss before reclassification	(3,247)	(46)	(3,293)
Amounts reclassified from AOCI	(238)	46	(192)
Net current period OCI	(3,485)	—	(3,485)
Stranded AOCI	—	(646)	(646)
Mark to Market on equity positions held at December 31, 2017	(98)	—	(98)
Balance at March 31, 2018	$ (3,588)	$ (3,629)	$ (7,217)

Note 13 – Revenue Recognition

The Company records revenue from contracts with customers in accordance with Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers (Topic 606). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation.

Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

The Company’s primary sources of revenue are derived from interest and fees earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers.

The Company also completed its evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contract-revenue (i.e. gross versus net). Based on the evaluation, the Company determined that the classification of certain debit and credit card processing related costs should change (i.e. costs previously recorded as expense in now recorded as contract-revenue). These classification changes resulted in immaterial changes to both revenue and expense. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to beginning retained earnings was not deemed necessary. Consistent with the modified retrospective approach, the Company did not adjust prior period amounts related to the debit and credit card related cost reclassifications discussed above.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees, monthly service fees, check orders, and other deposit account related fees. The Company’s performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Company’s performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers’ accounts.

Visa Debit Card and Interchange Income

Visa debit card and interchange income is primarily comprised of interchange fees earned whenever the Bank’s debit and credit cards are processed through card payment networks, such as Visa. The Bank’s performance obligation for debit card and interchange income is generally satisfied, and the related revenue recognized, on a transactional basis. Payment is typically received immediately or in the following month.

Other Operating Income

Other operating income is primarily comprised of ATM fees, wire transfer fees, travelers check fees, revenue streams such as safe deposit box rental fees, and other miscellaneous service charges. ATM fees, wire transfer fees and travelers check fees are primarily generated when a Bank’s cardholder uses a non-Bank ATM or a non-Bank cardholder uses a Bank ATM. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Bank determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation. Other service charges include revenue from processing wire transfers, bill pay service, cashier’s checks, and other services. The Bank’s performance obligations for fees and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month. The Bank’s performance obligation for the gains and losses on sales of other real estate owned is satisfied, and the related revenue recognized, after each sale of other real estate owned is closed.

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The following presents noninterest income, segregated by revenue streams in scope and out of scope of Topic 606, for the periods indicated:

(Dollars in thousands)	**Three Months Ended March 31, 2019**		**Three Months Ended March 31, 2018**	
Service charges on deposit accounts	$	315	$	185
Visa debit card and interchange income	141		150	
Other	113		46	
Noninterest income in scope of Topic 606	569		381	
Noninterest income out of scope of Topic 606	8,196		8,658	
Total noninterest income	$	8,765	$	9,039

Note 14 – Subsequent Event

MVB continues to carve a niche in the fintech industry by making strategic investments in fintech companies. As of the date of this filing, MVB has invested a total of $3.1 million in various fintech companies. After a recent valuation of MVB's fintech investment portfolio, MVB intends to recognize a pre-tax gain on its equity investment of $13.5 million that will be recognized in the second quarter of 2019. MVB's fintech investment portfolio is now valued at approximately $17.3 million.

Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations

The following presents management's discussion and analysis of our consolidated financial condition at March 31, 2019 and December 31, 2018 and the results of our operations for the three months ended March 31, 2019 and 2018. This discussion should be read in conjunction with our unaudited consolidated financial statements and the notes thereto appearing elsewhere in this report and the audited consolidated financial statements and the notes to consolidated financial statements included in our Annual Report to Shareholders on Form 10-K for the year ended December 31, 2018.

Forward-Looking Statements:

Statements in this Quarterly Report on Form 10-Q that are based on other than historical data are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements provide current expectations or forecasts of future events and include, among others:

- statements with respect to the beliefs, plans, objectives, goals, guidelines, expectations, anticipations, and future financial condition, results of operations and performance of the Company and its subsidiary (collectively "we," "our," or "us"), including the Bank; and
- statements preceded by, followed by or that include the words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "projects," "outlook," or similar expressions.

These forward-looking statements are not guarantees of future performance, nor should they be relied upon as representing the Company's or the Bank management's views as of any subsequent date. Forward-looking statements involve significant risks and uncertainties (both known and unknown) and actual results may differ materially from those presented, either expressed or implied, including, but not limited to, those presented in this Management's Discussion and Analysis section. Factors that might cause such differences include, but are not limited to:

- the ability of the Company, the Bank, and MVB Mortgage to successfully execute business plans, manage risks, and achieve objectives;
- changes in local, national and international political and economic conditions, including without limitation changes in the political and economic climate, economic conditions and fiscal imbalances in the United States and other countries, potential or actual downgrades in rating of sovereign debt issued by the United States and other countries, and other major developments, including wars, natural disasters, military actions, and terrorist attacks;
- changes in financial market conditions, either internationally, nationally, or locally in areas in which the Company, the Bank, and MVB Mortgage conduct operations, including without limitation, reduced rates of business formation and growth, commercial and residential real estate development, and real estate prices;
- fluctuations in markets for equity, fixed-income, commercial paper, and other securities, including availability, market liquidity levels, and pricing; changes in interest rates, the quality and composition of the loan and securities portfolios, demand for loan products, deposit flows and competition;
- the ability of the Company, the Bank, and MVB Mortgage to successfully conduct acquisitions and integrate acquired businesses;
- potential difficulties in expanding the businesses of the Company, the Bank, and MVB Mortgage in existing and new markets;
- increases in the levels of losses, customer bankruptcies, bank failures, claims, and assessments;
- changes in fiscal, monetary, regulatory, trade and tax policies and laws, including the recently enacted Tax Reform Act, and regulatory assessments and fees, including policies of the U.S. Department of Treasury, the (Federal Reserve, and the FDIC);
- the impact of executive compensation rules under the Dodd-Frank Act and banking regulations which may impact the ability of the Company and its subsidiaries, and other American financial institutions to retain and recruit executives and other personnel necessary for their businesses and competitiveness;

- the impact of the Dodd-Frank Act and of new international standards known as Basel III, and rules and regulations thereunder, many of which have not yet been promulgated, on our required regulatory capital and liquidity levels, governmental assessments on us, the scope of business activities in which we may engage, the manner in which the Company, the Bank, and MVB Mortgage engage in such activities, the fees that the Company’s subsidiaries may charge for certain products and services, and other matters affected by the Dodd-Frank Act and these international standards;
- continuing consolidation in the financial services industry; new legal claims against the Company, the Bank, and MVB Mortgage, including litigation, arbitration and proceedings brought by governmental or self-regulatory agencies, or changes in existing legal matters;
- success in gaining regulatory approvals, when required, including for proposed mergers or acquisitions;

- changes in consumer spending and savings habits;
- increased competitive challenges and expanding product and pricing pressures among financial institutions;
- inflation and deflation;
- technological changes and the implementation of new technologies by the Company and its subsidiaries;
- the ability of the Company, the Bank, and MVB Mortgage to develop and maintain secure and reliable information technology systems;
- legislation or regulatory changes which adversely affect the operations or business of the Company, the Bank, and MVB Mortgage;
- the ability of the Company, the Bank, and MVB Mortgage to comply with applicable laws and regulations; changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or regulatory agencies;
- costs of deposit insurance and changes with respect to FDIC insurance coverage levels; and
- other risks and uncertainties detailed in Part I, Item 1A, Risk Factors in the Annual Report to Shareholders on Form 10-K for the year ended December 31, 2018.

Except to the extent required by law, the Company specifically disclaims any obligation to update any factors or to publicly announce the result of revisions to any of the forward-looking statements included herein to reflect future events or developments.

Summary of Results of Operations

As of March 31, 2019 and 2018 and for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31	
(Dollars in thousands, except per share data)	**2019**	**2018**
Earnings and Per Share Data:		
Net income	$ 3,192	$ 2,594
Net income available to common shareholders	$ 3,071	$ 2,473
Earnings per share - basic	$ 0.26	$ 0.24
Earnings per share - diluted	$ 0.26	$ 0.23
Cash dividends paid per common share	$ 0.035	$ 0.025
Book value per common share	$ 14.90	$ 13.53
Weighted average shares outstanding - basic	11,607,543	10,474,138
Weighted average shares outstanding - diluted	13,177,281	12,714,353
Performance Ratios:		
Return on average assets [1]	0.73%	0.68 %
Return on average equity [1]	7.18%	6.94 %
Net interest margin [2]	3.45%	3.29 %
Efficiency ratio [3]	81.14%	81.64 %
Overhead ratio [1] [4]	4.19%	4.40 %
Asset Quality Data and Ratios:		
Charge-offs	$ —	$ 356
Recoveries	$ 3	$ 71
Net loan charge-offs to total loans [1] [5]	— %	0.10 %

Allowance for loan losses	$ 11,242	$ 10,067
Allowance for loan losses to total loans [6]	0.84%	0.87 %
Nonperforming loans	$ 7,075	$ 9,102
Nonperforming loans to total loans	0.53%	0.79 %
Capital Ratios:		
Equity to assets	10.11%	9.51 %
Bank Leverage ratio	10.32%	10.92 %
Bank Common equity Tier 1 capital ratio	12.55%	13.26 %
Bank Tier 1 risk-based capital ratio	12.55%	13.26 %
Bank Total risk-based capital ratio	13.37%	14.11 %

[1] Annualized for the quarterly periods presented

[2] Net interest income as a percentage of average interest earning assets

[3] Noninterest expense as a percentage of net interest income and noninterest income

[4] Noninterest expense as a percentage of average assets

[5] Charge-offs less recoveries

[6] Excludes loans held for sale

Introduction

Corporate Overview

MVB Financial Corp. is a financial holding company and was organized in 2003. MVB operates principally through its wholly-owned subsidiary, MVB Bank, Inc. MVB Bank's operating subsidiaries include MVB Mortgage, MVB Insurance, and MVB CDC.

MVB Bank was chartered in 1997 and commenced operations in 1999.

In 2012, MVB Bank acquired Potomac Mortgage Group, Inc. ("PMG" which began doing business under the registered trade name "MVB Mortgage"), a mortgage company in the northern Virginia area, and fifty percent (50%) interest in a mortgage services company, Lender Service Provider, LLC ("LSP"). In 2013, this fifty percent interest (50%) in LSP was reduced to a twenty-five percent (25%) interest. In 2017, a forfeiture of a partial interest occurred, which increased the interest owned to thirty-three percent (33%). At this time, LSP began doing business as Lenderworks.

MVB CDC was formed in 2017 and was created as a means to provide opportunities for loans and investments that help to increase access to equity capital in under-served urban and rural areas of West Virginia and our market areas in Virginia. MVB CDC promotes specific bank-driven economic development strategies, provides for effective support for its CRA compliance strategy, and helps to support positive local reputation of the Bank through marketing and visible activities in the communities where we live and work.

Business Overview

The Company's primary business activities, through its subsidiaries, are primarily community banking and mortgage banking. The Bank offers its customers a full range of products and services including:

- Various demand deposit accounts, savings accounts, money market accounts, and certificates of deposit;
- Commercial, consumer, and real estate mortgage loans and lines of credit;
- Debit and credit cards;
- Cashier's checks and money orders;
- Safe deposit rental facilities; and
- Non-deposit investment services.

The Company is also involved in new innovative strategies to provide independent banking to corporate clients throughout the United States by leveraging recent investments in Fintech.

The Bank's financial products and services are offered through its financial service locations and automated teller machines ("ATMs") in West Virginia and Virginia, as well as telephone and internet-based banking through both personal computers and mobile devices. Non-deposit investment services are offered through an association with a broker-dealer. The Bank has deployed Automated Interactive Teller machines ("AITs") in several branch locations. AITs provide services by featuring video interaction with a bank employee upon request. A customer can deposit cash and checks and withdraw cash, as well as a variety of other services typically occurring in a traditional branch location.

Since its opening in 1999, the Bank has experienced significant growth in assets, loans, and deposits due to strong community and customer support in Marion and Harrison counties in West Virginia, expansion into Jefferson, Berkeley, Monongalia, and Kanawha counties in West Virginia and, most recently, into Fairfax and Loudoun counties in Virginia. Since the acquisition of PMG, mortgage banking is now a much more significant focus, which has opened increased market opportunities in the Washington, DC metropolitan region and added enough volume to further diversify the Company’s revenue stream.

This discussion and analysis should be read in conjunction with the prior year-end audited consolidated financial statements and footnotes thereto included in the Company’s 2018 filing on Form 10-K and the unaudited financial statements, ratios, statistics, and discussions contained elsewhere in this Form 10-Q.

At March 31, 2019, the Company had 389 full-time equivalent employees.

The Company’s principal office is located at 301 Virginia Avenue, Fairmont, West Virginia 26554, and its telephone number is (304) 363-4800. The Company’s Internet web site is www.mvbbanking.com.

Application of Critical Accounting Policies

The Company’s consolidated financial statements are prepared in accordance with U. S. generally accepted accounting principles and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements; accordingly, as this information changes, the consolidated financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a 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 originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the consolidated financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When third-party information is not available, valuation adjustments are estimated in good faith by management primarily through the use of internal forecasting techniques.

The most significant accounting policies followed by the Company are presented in Note 1, “Summary of Significant Accounting Policies” of the Notes to the Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data, of the Company’s 2018 Annual Report on Form 10-K. These policies, along with the disclosures presented in the other financial statement notes and in management’s discussion and analysis of operations, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for loan losses to be the accounting area that requires the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

The allowance for loan losses represents management’s estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of losses inherent in classifications of homogeneous loans based on the Bank’s historical loss experience and consideration of current economic trends and conditions, all of which may be susceptible to significant change. Non-homogeneous loans are specifically evaluated due to the increased risks inherent in those loans. The loan portfolio also represents the largest asset type in the consolidated balance sheet. Note 1, “Summary of Significant Accounting Policies” of the Notes to the Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data, of the Company’s 2018 Annual Report on Form 10-K, describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the “Allowance for Loan Losses” section of Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations, of this Quarterly Report on Form 10-Q.

Results of Operations

Overview of the Statements of Income

For the three months ended March 31, 2019, the Company earned $3.2 million compared to $2.6 million in the first quarter of 2018. Net interest income increased by $2.5 million, noninterest income decreased by $274 thousand, and noninterest expenses increased by $1.7 million. The increase in net interest income was driven by an increase of $4.6 million in interest income. The increase in interest income was partially offset by an increase of $2.1 million in interest expense. The increase in interest income was due to average loan growth of $223.9 million with the yield on loans and loans held for sale increasing by 52 basis points, primarily due to an increase in commercial loan yield of 69 basis points and a 28-basis point increase in yield on investment securities. The $115.1 million increase in average interest-bearing liabilities generated the increase in interest expense of $2.1 million. The increase in interest expense was mainly driven by a $1.3 million increase in certificates of deposit, through short-term brokered certificates of deposit, and an increase in the rates of certificates of deposit. Certificates of deposit increased by $159.3 million, of which $156.9 million are brokered certificates of deposit, while the cost of funds on certificates of deposit increased by 63 basis points compared to the three months ended March 31, 2018. The increase in interest expense was also driven by borrowing growth of $15.0 million, which increased interest expense by $515 thousand, while the cost of funds on FHLB and other borrowings increased by 103 basis points due to multiple interest rate increases since March 31, 2018.

The provision for loan losses, which is a product of management’s formal quarterly analysis, is recorded in response to inherent losses in the loan portfolio. Loan loss provisions of $300 thousand and $474 thousand were made for the three months ended

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March 31, 2019 and 2018, respectively. The decrease in loan loss provision is most attributable to decreased loan volume in the first quarter of 2019 versus the same time period in 2018. Most notably, the commercial loan portfolio increased by $22 million for the three months ended March 31, 2019, in comparison to $41 million for the three months ended March 31, 2018. The residential mortgage loan portfolio increased by $16 million and $14 million, respectively, during these same time periods. Additionally, total charge offs of $0 in the first quarter of 2019 were $355 thousand less versus the same time period in 2018. Meanwhile, overall provision was impacted by an $80 thousand increase in the specific loan loss allocations in the first quarter of 2019, relative to a $273 thousand decrease in the first quarter of 2018. Also, the various historical loss rates fluctuated somewhat in the first quarter of 2019 versus the same time period in 2018, which resulted in a need for relatively less provision per dollar of new loan growth in the first quarter of 2019 versus the first quarter of 2018.

Interest Income and Expense

Net interest income is the amount by which interest income on earning assets exceeds interest expense on interest-bearing liabilities. Interest-earning assets include loans, investment securities, and certificates of deposits in other banks. Interest-bearing liabilities include interest-bearing deposits and repurchase agreements, subordinated debt, and Federal Home Loan Bank (“FHLB”) and other borrowings. Net interest income is a primary source of revenue for the bank. Changes in market interest rates, as well as changes in the mix and volume of interest-earning assets and interest-bearing liabilities impact net interest income.

Net interest margin is calculated by dividing net interest income by average interest-earning assets. This ratio serves as a performance measurement of the net interest revenue stream generated by the Company’s balance sheet. The net interest margin continues to face considerable pressure due to rising interest rates and competitive pricing of loans and deposits in the Bank’s markets. In December 2018, the Federal Reserve raised its key interest rate from a range of 2.00% to 2.25% to a range of 2.25% to 2.50%.

For the three months ended March 31, 2019 versus 2018, the Company was able to grow average investment securities by $2.1 million to $232.1 million and average loans and loans held for sale balances by $223.9 million to $1.4 billion. Average interest-bearing liabilities increased by $115.1 million, primarily the result of a $159.3 million increase in average certificates of deposit balances, a $56.1 million increase in money market checking, and a $15.0 million increase in average FHLB and other borrowing balances. An increase in the Company’s average non-interest balances of $85.2 million helped to grow a 30-basis point favorable spread on net interest margin in 2019 compared to a 15-basis point in 2018.

The net interest margin for the three months ended March 31, 2019 and 2018 was $3.45% and $3.29%, respectively. The 16-basis point increase in the net interest margin for the three months ended March 31, 2019 was the result of a 53-basis point increase in yield on average earning assets, primarily the result of a 52-basis point increase in yield on loans and loans held for sale. More specifically, the increase was due to an increase in commercial loan yield of 69 basis points and a 28-basis point increase in yield on investment securities. Cost of interest-bearing liabilities for the three months ended March 31, 2019 versus 2018 increased by 52 basis points. The cost of interest-bearing liabilities increase was mainly the result of a 103-basis point increase in FHLB and other borrowings and a 56-basis point increase in interest-bearing deposits. More specifically, the increase in interest-bearing deposits was as follows: a 63-basis point increase in certificates of deposit, a 37-basis point increase in IRAs, an 13-basis point increase in NOW, an 68-basis point increase in money market checking, which was offset by a 16-basis point decrease in savings.

Company and Bank management continuously monitor the effects of net interest margin on the performance of the Bank and, thus, the Company. Growth and mix of the balance sheet will continue to impact net interest margin in future periods.

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MVB Financial Corp. and Subsidiaries

Average Balances and Interest Rates

(Unaudited) (Dollars in thousands)

	Three Months Ended March 31, 2019			Three Months Ended March 31, 2018		
(Dollars in thousands)	**Average Balance**	**Interest Income/Expense**	**Yield/Cost**	**Average Balance**	**Interest Income/Expense**	**Yield/Cost**
Assets						
Interest-bearing deposits in banks	$ 7,546	$ 49	2.63 %	$ 3,883	$ 18	1.83 %
CDs with other banks	14,778	73	2.00	14,778	72	1.97
Investment securities:						
Taxable	139,692	879	2.55	154,430	895	2.35
Tax-exempt	92,417	837	3.67	75,556	655	3.51
Loans and loans held for sale: [1]						
Commercial	951,836	12,594	5.37	775,764	8,943	4.68
Tax exempt	14,251	123	3.50	14,464	123	3.46
Real estate	411,639	4,941	4.87	360,744	4,190	4.71
Consumer	9,654	127	5.34	12,517	158	5.11
Total loans	1,387,380	17,785	5.20	1,163,489	13,414	4.68
Total earning assets	1,641,813	19,623	4.85	1,412,136	15,054	4.32
Less: Allowance for loan losses	(11,071)			(9,987)		
Cash and due from banks	16,088			15,966		
Other assets	112,301			102,645		
Total assets	$ 1,759,131			$ 1,520,760		
Liabilities						
Deposits:						
NOW	$ 357,005	$ 729	0.83	$ 443,784	$ 762	0.70
Money market checking	297,607	1,044	1.42	241,472	443	0.74
Savings	40,235	1	0.01	46,544	20	0.17
IRAs	17,826	79	1.80	17,691	62	1.43
CDs	428,610	2,270	2.15	269,286	1,011	1.52
Repurchase agreements and federal funds sold	14,206	14	0.40	20,605	19	0.37
FHLB and other borrowings	175,222	1,229	2.84	160,205	714	1.81
Subordinated debt	17,524	285	6.60	33,524	558	6.75
Total interest-bearing	1,348,235	5,651	1.70	1,233,111	3,589	1.18

liabilities						
Noninterest bearing demand deposits	214,541			129,385		
Other liabilities	18,450			8,673		
Total liabilities	1,581,226			1,371,169		
Stockholders' equity						
Preferred stock	7,834			7,834		
Common stock	11,659			10,525		
Paid-in capital	116,925			99,110		
Treasury stock	(1,084)			(1,084)		
Retained earnings	49,161			38,004		
Accumulated other comprehensive (loss)	(6,590)			(4,798)		
Total stockholders' equity	177,905			149,591		
Total liabilities and stockholders' equity	$ 1,759,131			$ 1,520,760		
Net interest spread			3.15			3.14
Net interest income-margin		$ 13,972	3.45%		$ 11,465	3.29%

[1] Non-accrual loans are included in total loan balances, lowering the effective yield for the portfolio in the aggregate.

Noninterest Income

Mortgage fee income, gain (loss) on derivatives, interchange income, security sale gains, income on bank owned life insurance and portfolio loan sales generate the core of the Company's noninterest income. Also, service charges on deposit accounts continue to be part of the core of the Company's noninterest income and include mainly non-sufficient funds and returned check fees, allowable overdraft fees and service charges on commercial accounts.

For the three months ended March 31, 2019, noninterest income totaled $8.8 million compared to $9.0 million for the same time period in 2018. The $274 thousand decrease in noninterest income was primarily the result of a decrease in gain on sale of securities of $444 thousand, a decrease in commercial swap fee income of $333 thousand, a decrease in gain on the sale of portfolio loans of $157 thousand, and a decrease in gain on derivatives of $134 thousand. These decreases were partially offset by an increase of $307 thousand in income on bank owned life insurance, an increase of $210 thousand in the holding gain on equity securities, and an increase of $130 thousand in service charges on deposit accounts. The decrease in gain on derivatives of $134 thousand was largely the result of an increase of 42.72% in the locked pipeline during the three months ended March 31, 2019 compared to an increase of 67.64% in the locked pipeline during the three months ended March 31, 2018.

Noninterest Expense

The Company had 389 full-time equivalent personnel at March 31, 2019, as noted, compared to 393 full-time equivalent personnel as of March 31, 2018. Company and Bank management will continue to strive to find new ways of increasing efficiencies and leveraging its resources, while effectively optimizing customer service.

Salaries and employee benefits, occupancy and equipment, data processing and communications, mortgage processing and professional fees generate the core of the Company's noninterest expense. The Company's efficiency ratio was 81.14% for the first quarter of 2019 compared to 81.64% for the first quarter of 2018. This ratio measures the efficiency of noninterest expenses incurred in relationship to net interest income plus noninterest income. The decreased efficiency ratio is the result of net interest income and noninterest income outpacing the growth in noninterest expense.

For the three months ended March 31, 2019, noninterest expense totaled $18.4 million compared to $16.7 million for the same time period in 2018. The $1.7 million increase in noninterest expense was primarily the result of the following:

Salaries and employee benefits expense increased by $1.3 million. The increase was largely driven by the addition of senior management, lenders, a treasury team, and the opening of one new branch in 2018.

Data processing and communication expense increased $153 thousand. This increase was primarily related to data processing costs of our core system due to growth in clients and transactions.

Occupancy expense increased by $136 thousand. Rent & lease expense has increased $75 thousand due to the new branch opening and relocation of the Reston branch.

Insurance, tax, and assessment expense increased by $115 thousand. This increase was largely driven by the increase in the FDIC assessment expense, which increased by $87 thousand in 2019 compared to the FDIC assessment expense in 2018.

Marketing, contributions, & sponsorships expense decreased by $133 thousand. This decrease was primarily driven by a continued focus on identifying the avenues with the highest return on marketing investment.

Return on Average Assets (Annualized)

The Company’s return on average assets was 0.73% for the first quarter of 2019, compared to 0.68% for the first quarter of 2018. The increased return for the first quarter of 2019 is a direct result of a $598 thousand increase in earnings, while average total assets increased by $238.4 million, primarily the result of a $223.9 million increase in average total loans and loans held for sale and a $2.1 million increase in average investment securities.

Return on Average Equity (Annualized)

The Company’s return on average stockholders’ equity was 7.18% for the first quarter of 2019, compared to 6.94% for the first quarter of 2018. The increased return for the first quarter of 2019 is a direct result of a $598 thousand increase in earnings, while average stockholders’ equity increased by $28.3 million. The increase in average stockholders’ equity was primarily due to a

$17.8 million increase in paid-in capital, primarily due to the subordinated debt conversions, and an $11.2 million increase in retained earnings.

Overview of the Statement of Condition

The greatest balance changes since December 31, 2018 were as follows: total assets increased by $38.9 million, to $1.8 billion, loans increased $36.9 million, to $1.3 billion, investment securities increased $3.4 million, to $234.6 million, deposits increased $121.5 million, to $1.4 billion, borrowings decreased $100.0 million, to $114.9 million, and stockholders' equity increased by $4.1 million, to $180.9 million.

Cash and Cash Equivalents

Cash and cash equivalents totaled $18.0 million at March 31, 2019, compared to $22.2 million at December 31, 2018.

Management believes the current balance of cash and cash equivalents adequately serves the Company's liquidity and performance needs. Total cash and cash equivalents fluctuate on a daily basis due to transactions in process and other liquidity demands. Management believes liquidity needs are satisfied by the current balance of cash and cash equivalents, readily available access to traditional and non-traditional funding sources, and the portions of the investment and loan portfolios that mature within one year. These sources of funds should enable the Company to meet cash obligations as they come due.

Investment Securities

Investment securities totaled $234.6 million at March 31, 2019, compared to $231.2 million at December 31, 2018. As of March 31, 2019, the investment portfolio is comprised of the following mix of securities:

- 42.6% – Municipal securities
- 28.4% – U.S. Agency securities
- 20.4% – U.S. Sponsored Mortgage-backed securities
- 4.4% – Other securities
- 4.2% – Equity securities

The Company and Bank management monitor the earnings performance and liquidity of the investment portfolio on a regular basis through Asset and Liability Committee ("ALCO") meetings. The ALCO also monitors net interest income and assists in the management of interest rate risk for the Company. Through active balance sheet management and analysis of the investment securities portfolio, sufficient liquidity is maintained to satisfy depositor requirements and the various credit needs of its customers. The Company and Bank management believe the risk characteristics inherent in the investment portfolio are acceptable based on these parameters.

Loans

The Company's loan portfolio totaled $1.3 billion as of March 31, 2019 and December 31, 2018. The Bank's lending is primarily focused in the Marion, Harrison, Jefferson, Berkeley, Monongalia, and Kanawha counties of West Virginia, and Fairfax and Loudoun counties of Virginia, with a secondary focus on the adjacent counties. Its extended market is in the adjacent counties. The portfolio consists principally of commercial lending, retail lending, which includes single-family residential mortgages, and consumer lending. The growth in loans is primarily attributable to organic growth within the Bank's primary lending areas and Northern Virginia.

Loan Concentration

At March 31, 2019 and December 31, 2018, $962.1 million, or 71.7 and $941.0 million, or 72.1%, respectively, of our loan portfolio consisted of commercial loans. A significant portion of the nonresidential real estate loan portfolio is secured by commercial real estate. The majority of nonresidential real estate loans that are not secured by real estate are lines of credit secured by accounts receivable and equipment and obligations of states and political subdivisions. While the loan concentration is in nonresidential real estate loans, the nonresidential real estate portfolio is comprised of loans to many different borrowers, in numerous different industries but primarily located in our market areas.

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Allowance for Loan Losses

The allowance for loan losses was $11.2 million or 0.84% of total loans at March 31, 2019 compared to $10.9 million or 0.84% of total loans at December 31, 2018. The nominal decrease in this ratio was the direct result of the net effect of loan loss provision; in conjunction with growth in outstanding loan balances in the commercial loan and residential real estate loan portfolios since December 31, 2018. The Bank management continually monitors the risk in the loan portfolio through review of the monthly delinquency reports and the Loan Review Committee. The Loan Review Committee is responsible for the determination of the adequacy of the allowance for loan losses. This analysis involves both experience of the portfolio to date and the makeup of the overall portfolio. Specific loss estimates are derived for individual loans based on specific criteria such as current delinquent status, related deposit account activity, where applicable, and changes in the local and national economy. When appropriate, Management also considers public knowledge and/or verifiable information from the local market to assess risks to specific loans and the loan portfolios as a whole.

Capital Resources

The Bank considers a number of alternatives, including but not limited to deposits, short-term borrowings, and long-term borrowings when evaluating funding sources. Traditional deposits continue to be the most significant source of funds, totaling $1.4 billion at March 31, 2019.

Noninterest-bearing deposits remain a core funding source for the Bank and thus, the Company. At March 31, 2019, noninterest-bearing balances totaled $236.1 million compared to $213.6 million at December 31, 2018. Of the $236.1 million, noninterest-bearing balances of $62.9 million are related to Fintech opportunities and noninterest-bearing balances of $33.4 million are related to title business funds. The Company and Bank management intend to continue to focus on finding ways to increase the base of noninterest-bearing sources of the Bank and its subsidiaries.

Interest-bearing deposits totaled $1.2 billion at March 31, 2019 compared to $1.1 billion at December 31, 2018.

At March 31, 2019, the Bank had brokered deposits of $153.7 million and CDs with other banks of $79.7 million.

Average interest-bearing deposits totaled $1.1 billion during the first quarter of 2019 compared to $1.0 billion during the first quarter of 2018, an increase of $122.5 million. Average noninterest bearing deposits totaled $214.5 million during the first quarter of 2019 compared to $129.4 million during the first quarter of 2018, an increase of $85.2 million. Management will continue to emphasize deposit growth opportunities from the network of current customers and Fintech partners. The Company and Bank management will also concentrate on balancing deposit growth with adequate net interest margin to meet the Company’s strategic goals.

Along with traditional deposits, the Bank has access to both repurchase agreements, which are corporate deposits secured by pledging securities from the investment portfolio, and FHLB and other borrowings to fund its operations and investments. At March 31, 2019, repurchase agreements totaled $12.6 million compared to $14.9 million at December 31, 2018. In addition to the aforementioned funds alternatives, the Bank has access to more than $243.4 million through additional advances from the FHLB of Pittsburgh and the ability to readily sell jumbo certificates of deposits to other banks as well as brokered deposit markets.

Liquidity

Maintenance of a sufficient level of liquidity is a primary objective of the Asset and Liability Committee (“ALCO”). Liquidity, as defined by the ALCO, is the ability to meet anticipated operating cash needs, loan demand, and deposit withdrawals, without incurring a sustained negative impact on net interest income. It is MVB’s policy to manage liquidity so that there is no need to make unplanned sales of assets or to borrow funds under emergency conditions.

The main source of liquidity for the Bank comes through deposit growth. Liquidity is also provided from cash generated from investment maturities, principal payments from loans, and income from loans and investment securities. During the three months ended March 31, 2019, cash provided by financing activities totaled $18.7 million, while outflows from investing activity totaled $35.9 million. When appropriate, the Bank has the ability to take advantage of external sources of funds such as advances from the FHLB, national market certificate of deposit issuance programs, the Federal Reserve discount window, brokered deposits and CDARS. These external sources often provide attractive interest rates and flexible maturity dates that enable the Bank to match funding with contractual maturity dates of assets. Securities in the investment portfolio are primarily classified as available-for-sale and can be utilized as an additional source of liquidity.

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The Company has an effective shelf registration covering $75 million of debt and equity securities, of which approximately $75 million remains available, subject to Board authorization and market conditions, to issue equity or debt securities at our discretion. While we seek to preserve flexibility with respect to cash requirements, there can be no assurance that market conditions would permit us to sell securities on acceptable terms at any given time or at all.

Current Economic Conditions

The Company considers its primary market area to be comprised of those counties where it has a physical branch presence and their contiguous counties. This includes Marion, Harrison, Jefferson, Berkeley, Monongalia, and Kanawha counties of West Virginia and Fairfax and Loudoun counties of Virginia. In addition, MVB Mortgage has mortgage-only offices located in Virginia, Washington, DC, North Carolina, and South Carolina. The Bank currently operates a total of fifteen full-service banking branches: twelve in West Virginia and three in Virginia. MVB Mortgage operates eleven mortgage-only offices, located in Virginia, within the Washington, DC metropolitan area, Maryland, North Carolina, and South Carolina. In addition, MVB Mortgage has mortgage loan originators located at select Bank locations throughout West Virginia.

The Company originates various types of loans, including commercial and commercial real estate loans, residential real estate loans, home equity lines of credit, real estate construction loans, and consumer loans (loans to individuals). In general, the Company retains most of its originated loans (exclusive of long-term, fixed rate residential mortgages that are sold). However, loans originated in excess of the Bank's legal lending limit are participated to other banking institutions and the servicing of those loans is retained by the Bank.

The current economic climate in the Company's primary market areas reflect economic climates that are consistent with the general national climate. Unemployment in the United States was 3.9% and 4.1% in March 2019 and 2018, respectively. The unemployment levels in the Company's primary market areas were as follows for the periods indicated:

	February 2019	**February 2018**
Berkeley County, WV	4.4%	4.9%
Harrison County, WV	5.4	5.7
Jefferson County, WV	3.6	4.0
Marion County, WV	6.1	6.8
Monongalia County, WV	4.4	4.7
Kanawha County, WV	5.7	6.2
Fairfax County, VA	2.6	2.7
Loudoun County, VA	2.6	2.7

Capital/Stockholders' Equity

For the three months ended March 31, 2019, stockholders' equity increased approximately $4.1 million to $180.9 million. This increase consists of net income for the year-to-date of $3.2 million, a decrease in other comprehensive loss of $917 thousand, stock based compensation of $425 thousand, and common stock options exercised totaling $94 thousand, offset by dividends paid totaling $529 thousand. As stockholders' equity increased, the equity to assets ratio increased 0.01% to 10.11%. The Company paid dividends to common shareholders of $408 thousand in the three months ended March 31, 2019 and $263 thousand in the three months ended March 31, 2018, and earned $3.2 million in the three months ended March 31, 2019 versus $2.6 million in the three months ended March 31, 2018, resulting in the dividend payout ratio decreasing from 10.63% in the three months ended March 31, 2018 to 12.78% in the three months ended March 31, 2019.

The Company and the Bank have financed operations and growth over the years through the sale of equity. These equity sales have resulted in an effective source of capital. For more information related to equity sales, see Note 8, “Stock Offerings” of the Notes to the Consolidated Financial Statements, included in Item 1, Financial Statements, of this Quarterly Report on Form 10-Q.

At March 31, 2019, accumulated other comprehensive loss totaled $5.9 million, an decrease in the loss of $917 thousand from December 31, 2018. Total securities available-for-sale in an unrealized loss position decreased by $1.9 million to $3.0 million at March 31, 2019. The Company considers all securities with unrealized loss positions to be temporarily impaired, and consequently, does not believe the Company will sustain any material realized losses as a result of the current temporary decline in fair value.

Treasury stock totaled 51,077 shares.

The primary source of funds for dividends to be paid by the Company are dividends received by the Company from the Bank. Dividends paid by the Bank are subject to restrictions by banking regulations. The most restrictive provision requires regulatory approval if dividends declared in any year exceeds that years retained net profits, as defined, plus the retained net profits, as defined, of the two preceding years.

Capital Requirements

The Bank's total risk-based capital ratio increased from 13.29% at December 31, 2018 to 13.37% at March 31, 2019. The increase in this ratio was largely due to an increase of $29.1 million in risk-weighted assets outpacing the increase in total capital of $5.0 million.

The Bank is required to comply with applicable capital adequacy standards established by the FDIC ("Capital Rules"). The Company is exempt from the Federal Reserve Board's capital adequacy standards as it believes it meets the requirements of the Small Bank Holding Company Policy Statement. State chartered banks, such as the Bank, are subject to similar capital requirements adopted by the West Virginia Division of Financial Institutions.

The Capital Rules, among other things, (i) include a "Common Equity Tier 1" ("CET1") measure, (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting certain revised requirements, (iii) define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and (iv) expand the scope of the deductions/adjustments to capital as compared to existing regulations.

Under the Capital Rules, the minimum capital ratios effective as of January 1, 2015 are:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets;
- 8.0% Total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets; and
- 4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the leverage ratio").

The Capital Rules also include a "capital conservation buffer," composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will increase by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019. The Capital Rules also provide for a "countercyclical capital buffer" that is only applicable to certain covered institutions and does not have any current applicability to the Company or the Bank. The capital conservation buffer is designed to absorb losses during periods of economic stress and effectively increases the minimum required risk-weighted capital ratios. Banking institutions with a ratio of CET1 to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer and, if applicable, the countercyclical capital buffer) will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

Since fully phased in on January 1, 2019, the Capital Rules require the Bank to maintain an additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, (iii) a minimum ratio of Total capital to risk-weighted assets of at least 10.5%; and (iv) a minimum leverage ratio of 4%. The Capital Rules also provide for a number of deductions from and adjustments to CET1.

The Capital Rules prescribe a standardized approach for risk weightings that expanded the risk-weighting categories from the general risk-based capital rules to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories.

In September 2017, the Federal Reserve Board, along with other bank regulatory agencies, proposed amendments to its capital requirements to simplify certain aspects of the capital rules for community banks, including the Bank, in an attempt to reduce the regulatory burden for such smaller financial institutions. Because the amendments were proposed with a request for comments and have not been finalized, we do not yet know what effect the final rules will have on the Bank's capital calculations. In November 2017, the federal banking agencies extended for community banks the existing capital requirements for certain items, including mortgage servicing assets, certain deferred tax assets, investments in the capital instruments of unconsolidated financial institutions, and minority interest, which were scheduled to change effective January 1, 2018, in light of the simplification amendments being considered.

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In June 2016, the Financial Accounting Standards Board issued an update to the accounting standards for credit losses that included the Current Expected Credit Losses ("CECL") methodology, which replaces the existing incurred loss methodology for certain financial assets. CECL becomes effective January 1, 2020. In December 2018, the federal bank regulatory agencies approved a final rule providing an option to phase-in, over a period of three years, the day-one regulatory capital effects resulting from the implementation of CECL.

Notwithstanding the foregoing, the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 (the "EGRRCPA"), which was enacted on May 24, 2018, simplifies capital calculations by requiring regulators to establish for insured depository institutions under $10 billion in assets a community bank leverage ratio (tangible equity to average consolidated assets) at a percentage not less than 8% and not greater than 10% that such institutions may elect to replace the general applicable risk-based capital requirements under the Capital Rules. Such institutions that meet the community bank leverage ratio will automatically be deemed to be well-capitalized, although the regulators retain the flexibility to determine that the institution may not qualify for the community bank leverage ratio test based on the institution's risk profile. The federal banking agencies have proposed a community bank leverage ratio of 9% with additional parameters, including limited amounts of off-balanced sheet exposure. That proposal has not been finalized, and until such time, the Capital Rules as described above remain in effect. The effective date and specific requirements for the community bank leverage ratio are unknown.

With respect to the Bank, the Capital Rules also revise the "prompt corrective action" regulations pursuant to Section 38 of the Federal Deposit Insurance Act, as discussed below under "Prompt Corrective Action."

Prompt Corrective Action

The Federal Deposit Insurance Act ("FDIA") requires among other things, the federal banking agencies to take "prompt corrective action" in respect of depository institutions that do not meet minimum capital requirements. The FDIA includes the following five capital tiers: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." A depository institution's capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation. The relevant capital measures, which reflect changes under the Capital Rules that became effective on January 1, 2015, are the total capital ratio, the CET1 capital ratio, the Tier 1 capital ratio, and the leverage ratio.

A bank will be (i) "well capitalized" if the institution has a total risk-based capital ratio of 10.0% or greater, a CET1 capital ratio of 6.5% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure; (ii) "adequately capitalized" if the institution has a total risk-based capital ratio of 8.0% or greater, a CET1 capital ratio of 4.5% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, and a leverage ratio of 4.0% or greater and is not "well capitalized"; (iii) "undercapitalized" if the institution has a total risk-based capital ratio that is less than 8.0%, a CET1 capital ratio less than 4.5%, a Tier 1 risk-based capital ratio of less than 6.0% or a leverage ratio of less than 4.0%; (iv) "significantly undercapitalized" if the institution has a total risk-based capital ratio of less than 6.0%, a CET1 capital ratio less than 3.0%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 3.0%; and (v) "critically undercapitalized" if the institution's tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank's capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes.

As noted above, the EGRRCPA will eliminate these requirements for banks with less than $10.0 billion in assets who elect to follow the community bank leverage ratio once regulators finalize the regulation.

The FDIA generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be “undercapitalized.” “Undercapitalized” institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution’s capital. In addition, for a capital restoration plan to be acceptable, the depository institution’s parent holding company must guarantee that the institution will comply with such capital restoration plan. The bank holding company must also provide appropriate assurances of performance. The aggregate liability of the parent holding company is limited to the lesser of (i) an amount equal to 5.0% of the depository institution’s total assets at the time it became undercapitalized and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized."

"Significantly undercapitalized" depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

The appropriate federal banking agency may, under certain circumstances, reclassify a well-capitalized insured depository institution as adequately capitalized. The FDIA provides that an institution may be reclassified if the appropriate federal banking agency determines (after notice and opportunity for hearing) that the institution is in an unsafe or unsound condition or deems the institution to be engaging in an unsafe or unsound practice. The appropriate agency is also permitted to require an adequately capitalized or undercapitalized institution to comply with the supervisory provisions as if the institution were in the next lower category (but not treat a significantly undercapitalized institution as critically undercapitalized) based on supervisory information other than the capital levels of the institution.

In addition to the "prompt corrective action" directives, failure to meet capital guidelines may subject a banking organization to a variety of other enforcement remedies, including additional substantial restrictions on its operations and activities, termination of deposit insurance by the FDIC and, under certain conditions, the appointment of a conservator or receiver.

At March 31, 2019, the Company is considered to be well-capitalized.

For further information regarding the capital ratios and leverage ratio of the Company and the Bank see the discussion under the section captioned "Capital/Stockholders' Equity" included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 14, "Regulatory Capital Requirements" of the Notes to the Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data, of the Company's December 31, 2018 Annual Report on Form 10-K.

Commitments and Contingent Liabilities

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the statements of financial condition.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount and type of collateral obtained, if deemed necessary by the Company upon extension of credit, varies and is based on management's credit evaluation of the customer.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Company's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit.

Concentration of Credit Risk

The Company grants a majority of its commercial, financial, agricultural, real estate and installment loans to customers throughout the Marion, Harrison, Monongalia, Kanawha, Jefferson, and Berkeley County areas of West Virginia, as well as the Northern Virginia area and adjacent counties. Collateral for loans is primarily residential and commercial real estate, personal property, and business equipment. The Company evaluates the credit worthiness of each of its customers on a case-by-case basis, and the amount of collateral it obtains is based upon management’s credit evaluation.

Regulatory

The Company is required to maintain certain reserve balances on hand in accordance with the Federal Reserve Board requirements. The average balance maintained in accordance with such requirements was $0 on March 31, 2019 and December 31, 2018. During 2016, a deposit reclassification program was implemented and allowed the Company to reduce its requirement of reserve balances on hand in accordance with the Federal Reserve Board's daily Federal Reserve Requirement.

Contingent Liability

The subsidiary bank is involved in various legal actions arising in the ordinary course of business. In the opinion of management and counsel, the outcome of these matters will not have a significant adverse effect on the consolidated financial statements.

Off-Balance Sheet Commitments

The Bank has entered into certain agreements that represent off-balance sheet arrangements that could have a significant impact on the consolidated financial statements and could have a significant impact in future periods. Specifically, the Bank has entered into agreements to extend credit or provide conditional payments pursuant to standby and commercial letters of credit.

Commitments to extend credit, including loan commitments, standby letters of credit, and commercial letters of credit do not necessarily represent future cash requirements, in that these commitments often expire without being drawn upon.

Market Risk

There have been no material changes in market risks faced by the Company since December 31, 2018. For information regarding the Company’s market risk, refer to the company’s December 31, 2018, Form 10-K filed with the SEC.

Effects of Inflation and Changing Prices

Substantially all of the Company’s assets relate to banking and are monetary in nature. Therefore, they are not impacted by inflation to the same degree as companies in capital-intensive industries in a replacement cost environment. During a period of rising prices, a net monetary asset position results in loss in purchasing power and conversely a net monetary liability position results in an increase in purchasing power. In the banking industry, typically monetary assets exceed monetary liabilities. Therefore, as prices increase, financial institutions experience a decline in the purchasing power of their net assets.

Future Outlook

The Company has invested in the infrastructure to support anticipated future growth in each key area, including personnel, technology, and processes to meet the growing compliance requirements in the industry. The Company believes it is well positioned in some of the finest markets in the State of West Virginia and the Commonwealth of Virginia and will continue to focus on the following: margin improvement; leveraging capital; organic portfolio loan growth; and operating efficiency. The key challenge for the Company in the future is to attract core deposits to fund growth in the new markets through continued delivery of outstanding customer service coupled with the highest quality products and technology. The Company is expanding the treasury services function to support the banking needs of financial and emerging technology companies, which will further enhance core deposits.

Item 3 – Quantitative and Qualitative Disclosures About Market Risk

The Company's market risk is composed primarily of interest rate risk. The Asset and Liability Committee ("ALCO") is responsible for reviewing the interest rate sensitivity position and establishes policies to monitor and coordinate the Company's sources, uses, and pricing of funds.

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Interest Rate Sensitivity Management

The Company uses a simulation model to analyze, manage and formulate operating strategies that address net interest income sensitivity to movements in interest rates. The simulation model projects net interest income based on various interest rate scenarios over a twenty-four-month period. The model is based on the actual maturity and re-pricing characteristics of rate sensitive assets and liabilities. The model incorporates certain assumptions which management believes to be reasonable regarding the impact of changing interest rates and the prepayment assumption of certain assets and liabilities as of December 31, 2018. The model assumes changes in interest rates without any management intervention to change the composition of the balance sheet. According to the model run for the period ended December 31, 2018, over a twelve-month period, an immediate 100-basis point increase in interest rates would result in a decrease in net interest income by 0.7%. An immediate 200-basis point increase in interest rates would result in a decrease in net interest income by 0.7%. A 100-basis point decrease in interest rates would result in a decrease in net interest income of 2.9%. While management carefully monitors the exposure to changes in interest rates and takes actions as warranted to decrease any adverse impact, there can be no assurance about the actual effect of interest rate changes on net interest income.

The Company's net interest income and the fair value of its financial instruments are influenced by changes in the level of interest rates. The Company manages its exposure to fluctuations in interest rates through policies established by its ALCO. The ALCO meets quarterly and has responsibility for formulating and implementing strategies to improve balance sheet positioning and reviewing interest rate sensitivity.

The Company has counter-party risk which may arise from the possible inability of third-party investors to meet the terms of their forward sales contracts. The Company works with third-party investors that are generally well-capitalized, are investment grade, and exhibit strong financial performance to mitigate this risk. The Company monitors the financial condition of these third parties on an annual basis and the Company does not expect these third parties to fail to meet their obligations.

Item 4 – Controls and Procedures

The Company, under the supervision and with the participation of the Company's management, including the Company's President and Chief Executive Officer, along with the Company's Chief Financial Officer (the Principal Financial Officer), has evaluated the effectiveness as of March 31, 2019, of the design and operation of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based upon that evaluation, the Company's President and Chief Executive Officer, along with the Company's Principal Accounting Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2019.

There have been no material changes in the Company's internal control over financial reporting during the first quarter of 2019 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1 – Legal Proceedings

From time to time in the ordinary course of business, the Company and its subsidiaries are subject to claims, asserted or unasserted, or named as a party to lawsuits or investigations. Litigation, in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of legal proceedings cannot be predicted with any certainty and in the case of more complex legal proceedings, the results are difficult to predict at all. The Company is not aware of any asserted or unasserted legal proceedings or claims that the Company believes would have a material adverse effect on the Company’s financial condition or results of the Company’s operations.

Item 1A – Risk Factors

Our operations are subject to many risks that could adversely affect our future financial condition and performance and, therefore, the market value of our securities, including the risk factors that are described in our Annual Report to Shareholders on Form 10-K for the year ended December 31, 2018. There have been no material changes in our risk factors from those disclosed.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3 – Defaults Upon Senior Securities

None.

Item 4 – Mine Safety Disclosures

Not applicable.

Item 5 – Other Information

None.

Item 6 – Exhibits

The following exhibits are filed herewith:

Exhibit 31.1	Certificate of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certificate of principal financial officer

	pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certificate of principal executive officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	Certificate of principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101.INS	XBRL Instance Document
Exhibit 101.SCH	XBRL Taxonomy Extension Schema
Exhibit 101.CAL	XBRL Taxonomy Extension Calculation Linkbase
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase
Exhibit 101.LAB	XBRL Taxonomy Extension Label Linkbase
Exhibit 101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MVB Financial Corp.

Date:	May 1, 2019	By:	/s/ Larry F. Mazza	
				Larry F. Mazza President, CEO and Director (Principal Executive Officer)
Date:	May 1, 2019	By:	/s/ Donald T. Robinson Donald T. Robinson Executive Vice President and CFO (Principal Financial and Accounting Officer)	