KBR, INC.
Form 10-K
February 27, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ý Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2014
OR
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to
Commission File Number: 1-33146

KBR, Inc.
(Exact name of registrant as specified in its charter)

Delaware	20-4536774
(State of incorporation or organization)	(I.R.S. Employer Identification No.)
601 Jefferson Street, Suite 3400, Houston, Texas	77002
(Address of principal executive offices)	(Zip Code)

(713) 753-3011
(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock par value $0.001 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No ý

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý

The aggregate market value of the voting stock held by non-affiliates on June 30, 2014 was approximately $3.5 billion, determined using the closing price of shares of the registrant's common stock on the New York Stock Exchange on that date of $23.85.

As of January 31, 2015, there were 144,821,140 shares of KBR, Inc. Common Stock, par value $0.001 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for its 2015 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.

TABLE OF CONTENTS

	Page
PART I	
Item 1. Business	4
Item 1A. Risk Factors	11
Item 1B. Unresolved Staff Comments	20
Item 2. Properties	21
Item 3. Legal Proceedings	21
Item 4. Mine Safety Disclosures	21
PART II	
Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	22
Item 6. Selected Financial Data	25
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations	26
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	43
Item 8. Financial Statements and Supplementary Data	44
Report of Independent Registered Public Accounting Firm	45
FINANCIAL STATEMENTS	
Consolidated Statements of Operations	46
Consolidated Statements of Comprehensive Income (Loss)	47
Consolidated Balance Sheets	48
Consolidated Statements of Shareholders’ Equity	49
Consolidated Statements of Cash Flows	50
Notes to Consolidated Financial Statements	52
Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure	105
Item 9A. Controls and Procedures	105
Item 9B. Other Information	108
PART III	
Item 10. Directors, Executive Officers and Corporate Governance	108
Item 11. Executive Compensation	108
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	108
Item 13. Certain Relationships and Related Transactions, and Director Independence	108
Item 14. Principal Accounting Fees and Services	108
PART IV	
Item 15. Exhibits and Financial Statement Schedules	108
SIGNATURES	114

Forward-Looking and Cautionary Statements

This report contains certain statements that are, or may be deemed to be, "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Private Securities Litigation Reform Act of 1995 provides safe harbor provisions for forward-looking information. Some of the statements contained in this annual report are forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. The words "believe," "may," "estimate," "continue," "anticipate," "intend," "plan," "expect" and similar expressions are intended t forward-looking statements. Forward-looking statements include information concerning our possible or assumed future financial performance and results of operations.

We have based these statements on our assumptions and analyses in light of our experience and perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly affect expected results, and actual future results could differ materially from those described in such statements. While it is not possible to identify all factors, factors that could cause actual future results to differ materially include the risks and uncertainties described under "Risk Factors" contained in Part I of this Annual Report on Form 10-K.

Many of these factors are beyond our ability to control or predict. Any of these factors, or a combination of these factors, could materially and adversely affect our future financial condition or results of operations and the ultimate accuracy of the forward-looking statements. These forward-looking statements are not guarantees of our future performance, and our actual results and future developments may differ materially and adversely from those projected in the forward-looking statements. We caution against putting undue reliance on forward-looking statements or projecting any future results based on such statements or on present or prior earnings levels. In addition, each forward-looking statement speaks only as of the date of the particular statement, and we undertake no obligation to publicly update or revise any forward-looking statement.

PART I

Item 1. Business

General

KBR, Inc. and its subsidiaries (collectively, "KBR") is an engineering, construction and services company supporting the global hydrocarbons and international government services market segments. We offer an extensive portfolio of proprietary technology and consulting services; engineering, construction, procurement and asset maintenance services; and base operational, logistics, life support and asset management services, through our Technology & Consulting, Engineering & Construction and Government Services business segments. Information regarding business segment disclosures is incorporated by reference in Note 2 to our consolidated financial statements and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

KBR, Inc. was incorporated in Delaware on March 21, 2006 prior to an exchange offer transaction that separated us from our former parent, Halliburton Company, which was completed on April 5, 2007. We trace our history and culture to two businesses, The M.W. Kellogg Company ("Kellogg") and Brown & Root, Inc. ("Brown & Root"). Kellogg dates back to a pipe fabrication business that was founded in New York in 1901 and evolved into a technology and service provider for petroleum refining and petrochemicals processing. Brown & Root was founded in Houston, Texas in 1919 and built the world's first offshore platform in 1947. Brown & Root was acquired by Halliburton in 1962 and Kellogg was acquired by Halliburton in 1998 through its merger with Dresser Industries.

Our Business Segments

Business Reorganization

On December 11, 2014, we announced our reorganization into the following three business segments:

- Technology & Consulting
- Engineering & Construction
- Government Services

Our corporate expenses and other operations that do not individually meet the criteria for group presentation continue to be reported in our Other business segment. In addition, we combined certain operations in the markets we have decided to exit into a new, Non-strategic Business segment. We have revised our business segment reporting to reflect our current management approach and recast prior periods to conform to the current business segment presentation. Our business segments are described below.

Technology & Consulting ("T&C"). Our T&C business segment combines proprietary KBR technologies, knowledge-based services and our three specialty consulting brands, Granherne, Energo and GVA, under a single customer-facing global business. This segment provides licensed technologies and consulting services to the oil and gas value chain, from wellhead to crude refining and through to specialty chemicals production. In addition to sharing many of the same customers, these brands share the approach of early and continuous customer involvement to deliver an optimal solution to meet the customer's objectives through early planning and scope definition, advanced technologies and project lifecycle support.

Engineering & Construction ("E&C"). Our E&C business segment leverages our operational and technical excellence as a global provider of engineering, procurement, construction ("EPC"), commissioning and maintenance services for oil and gas, refining, petrochemicals and chemicals customers. E&C is managed on a geographic basis in order to facilitate close proximity to our customers and our people, while utilizing a consistent global execution strategy.

Government Services ("GS"). Our GS business segment focuses on long-term service contracts with annuity streams particularly for the United Kingdom ("U.K."), Australian and United States ("U.S.") governments.
Non-strategic Business. On December 11, 2014, we also announced that we would exit businesses that are no longer a part of our future strategic focus. Our Non-strategic Business segment represents these operations or activities which we intend to either sell to third parties or exit upon completion of existing contracts and runoff activities.

Other. Our Other business segment includes our corporate expenses and general and administrative expenses not allocated to the business segments above and any future activities that do not individually meet the criteria for segment presentation.

Our Business Strategy

Our business strategy is to provide our customers with differentiated and superior capital project delivery and services offerings across the entire engineering, construction and operations project lifecycle. We aim to create enhanced customer satisfaction leading to repeat business through a best-in-class delivery platform. Our projects are generally long-term in nature and an essential feature of our global strategy is to establish local operations in locations where services demand growth is expected. Our core skills are conceptual design, front-end engineering design ("FEED"), engineering, project management, procurement, construction, construction management, logistics, commissioning, operations and maintenance. When necessary, we complement organic growth by pursuing targeted acquisitions that focus on expanding our capabilities and market coverage or accelerating business growth strategies.

In addition, we provide superior technology offerings in focused markets through our broad portfolio of proprietary technology and niche consulting skills. These proven and innovative options provide customers with tailored solutions to their market challenges.

As a part of the strategic announcement on December 11, 2014, we performed a critical evaluation of our business portfolio and identified the businesses where we believe we have a competitive edge. We are moving into a project delivery and accountability focused structure that aligns with the needs of our customers, recognizes diverse business models and employs a more targeted approach that will enable us to realize revenue and cost synergies. Our strategic priorities will focus on differentiated offerings in two core markets: global hydrocarbons and international government services. Key features of our business segment strategies are discussed below.

The Technology & Consulting business segment offers a broad spectrum of services and solutions, including licensing, basic engineering and design ("BED"), proprietary equipment ("PEQ"), plant automation, catalysts and related consulting services to hydrocarbons, chemicals and fertilizer markets. Services provided by the oil and gas consulting portion of this business include field development and planning, technology selection and optimization of capital spending, offshore integrity management and structural analysis for production platforms in various locations. Services provided by the downstream consulting portion of this business include feasibility and revamp studies as well as planning activities related to the development and construction of refining, petrochemical, chemical and fertilizer complexes.

Our upstream technology solutions include the provision of technology related to semi-submersible hull design and monohull vessels capable of working in the ultra-deep and harsh environments, as well as Drillship and Floating Production, Storage and Offshore ("FPSO") vessels. Downstream technology offerings include technologies for conversion of heavy hydrocarbon streams to fuels in the refining markets as well as technologies for the conversion and production of high value olefins from a variety of feedstocks. Additionally, the technology portfolio includes market leading ammonia process technology solutions for the ammonia and fertilizer markets as well as clean coal gasification technology, a promising alternative to meet global energy demand.

The Engineering & Construction business segment, our project delivery business, offers a scope of services covering the entire spectrum of project development activities from the earliest conceptual engineering, through FEED and execution planning phases to full EPC delivery and asset services. E&C provides engineering and EPC services for the development, construction and commissioning of projects in the offshore, onshore and liquefied natural gas ("LNG") and gas-to-liquids ("GTL") markets. Offshore offerings focus on fixed and floating platforms and facilities, hulls, moorings, risers ("HMR") and subsea umbilicals, risers and flowlines ("SURF"). Our services in the onshore markets include projects in oil & gas, refining, petrochemicals, chemicals, ammonia, fertilizers, syngas and gasification units. Our service offerings in the LNG and GTL markets include liquefaction, regasification, floating

LNG ("FLNG") and floating storage and regasification units ("FSRU"). Our asset services include maintenance, modification, asset integrity and small capital expenditure ("CAPEX") projects. With these service offerings, we continue to leverage our proud history of delivering some of the most complex projects throughout the world and in some of the most remote and challenging locations.

The Government Services business segment focuses on providing a wide range of base and remote life support services, logistics, program management and capability risk management, resilience planning and execution services and training to government agencies from the U.K., Australia, the U.S. and other parts of the world. Our service offerings range from construction, refurbishment, operations and maintenance of housing and other facilities for military personnel to home base and overseas operations support, embassy and other life support programs, heavy equipment transportation and police facilities management integration around the world. Our objective is to capitalize on new opportunities resulting from the industry’s demands for increased efficiencies in response to tight government budgets and governments' requirements to deal with new threats.

The Non-strategic business segment focuses on the completion of three power projects and other run-off activities in the markets we are exiting, and the eventual sale of a product line.

Competition and Scope of Global Operations

We operate in highly competitive markets throughout the world and believe the following are the areas where we have a competitive advantage:

- market-leading health, safety and environmental standards and sustainable practices;
- customer relationships;
- successful prior execution of large projects in difficult locations;
- technical excellence and differentiation;
- high value in delivered projects and services measured by performance, quality, operability and cost;
- service delivery, including the ability to deliver personnel, processes, systems and technology on an "as needed, where needed and when needed" basis with the required local content and presence;
- consistent superior service quality;
- financial strength through liquidity, capital capacity and the ability to support warranties;
- breadth of proprietary technology, know-how and technical solutions; and
- robust risk awareness and management processes.

We conduct business in over 70 countries. Based on the location of projects executed, our operations in countries other than the U.S. accounted for 63% of our consolidated revenues during 2014, 66% of our consolidated revenues during 2013 and 73% of our consolidated revenues during 2012. See Note 2 to our consolidated financial statements for selected geographic information.

We have summarized our revenues by geographic location as a percentage of total revenues below:

	Years ended December 31,					
	2014		2013		2012	
Revenues:						
United States	37	%	34	%	27	%
Australia	22	%	25	%	23	%
Canada	12	%	10	%	6	%
Middle East	11	%	13	%	13	%
Europe	10	%	8	%	7	%
Africa	4	%	8	%	21	%
Other countries	4	%	2	%	3	%
Total	100	%	100	%	100	%

We market substantially all of our project and service offerings through our business segments. The markets we serve are highly competitive and for the most part require substantial resources and highly skilled and experienced technical personnel. A large number of companies are competing in the markets served by our business, including U.S.-based companies such as Bechtel Corporation, Fluor Corporation, Jacobs Engineering, AECOM, and international-based companies such as AMEC Foster Wheeler, Chicago Bridge and Iron, Chiyoda Corporation ("Chiyoda"), JGC Corporation ("JGC"), McDermott International, Petrofac, Saipem, Technip, Wood Group/PSN and Worley Parsons. Since the markets for our services are vast and extend across multiple geographic regions, we cannot make a definitive estimate of the total number of our competitors.

Our operations in some countries may be adversely affected by unsettled political conditions, acts of terrorism, civil unrest, force majeure, war or other armed conflict, expropriation or other governmental actions, inflation and foreign currency exchange controls and fluctuations. We strive to manage or mitigate these risks through a variety of means including contract provisions, contingency planning, insurance schemes, hedging and other risk management activities. See "Item 1A. Risk Factors," "Item 7A. Quantitative and Qualitative Discussion about Market Risk" and Note 20 to our consolidated financial statements for information regarding our exposures to foreign currency fluctuations, risk concentration and financial instruments used to manage our risks.

Acquisitions and Other Transactions

In November 2013, we closed on the sale of a portion of a subsidiary, Allstates Technical Services, for $10 million in cash. The sale resulted in a $3 million pre-tax gain and is recorded in "gain on disposition of assets" in our consolidated statements of operations.

In November 2012, a joint venture in which we hold a 50% interest sold the office building in which we lease office space for our corporate headquarters and business segment offices in Houston, Texas for $175 million. Since we continue to lease the office building from the new owner under essentially the same lease terms, the $44 million pre-tax gain on the sale was deferred and is being amortized using the straight-line method over the remaining term of the lease, which expires in 2030.

In November 2012, we closed on the sale of our former headquarters campus located at 4100 Clinton Drive in Houston, Texas for $42 million in cash. The sale resulted in a $27 million pre-tax gain on disposal of assets in "gain on disposition of assets" in our consolidated statements of operations.

Joint Ventures and Alliances

We enter into joint ventures and alliances with other industry participants in order to reduce exposure and diversify risk, increase the number of opportunities that can be pursued, capitalize on the strengths of each party and provide greater flexibility in delivering our services based on cost and geographical efficiency. Clients of our E&C business segment frequently require EPC contractors to work in teams given the size and complexity of global projects that may cost billions of dollars to complete. Our significant joint ventures and alliances are described below. All joint venture ownership percentages presented are stated as of December 31, 2014.

We are working with JGC and Chiyoda for the purpose of design, procurement, fabrication, construction, commissioning and testing of the Ichthys Onshore LNG export facility in Darwin, Australia. The project is being executed using two joint ventures and we own a 30% equity interest in each joint venture. The investments are accounted for using the equity method of accounting and reported in our E&C business segment.

KJVG is a joint venture consisting of JGC, Hatch Associates, Clough Projects Australia and KBR for the purpose of design, procurement, fabrication, construction, commissioning and testing of the Gorgon onshore LNG project located on Barrow Island off the northwest coast of Western Australia. We hold a 30% interest in the joint venture which is consolidated for financial accounting purposes and reported in our E&C business segment.

Aspire Defence Holdings Limited ("Aspire Defence") is a joint venture currently owned by KBR and two financial investors to upgrade and provide a range of services to the British Army’s garrisons at Aldershot and around the Salisbury Plain in the U.K. We own a 45% interest in Aspire Defence and we own a 50% interest in each of the two joint ventures that provide the construction and related support services to Aspire Defence. The investments are accounted for using the equity method of accounting and reported in our GS business segment.

Mantenimiento Marino de Mexico (“MMM”) is a joint venture formed under a Partners Agreement with Grupo R affiliated entities. The principal Grupo R entity is Corporative Grupo R, S.A. de C.V. and Discoverer ASA, Ltd., a Cayman Islands company. The Partners Agreement covers five joint venture entities executing Mexican contracts with Petróleos Mexicanos ("PEMEX"). MMM was set up under Mexican maritime law in order to hold navigation permits to operate in Mexican waters. The scope of the business is to render maintenance, repair and restoration services of offshore oil and gas platforms and provisions of quartering in the territorial waters of Mexico. We own a 50% interest in MMM and in each of the four other joint ventures. We account for our investment in these entities using the equity method of accounting and report them in our E&C business segment.

Backlog of Unfulfilled Orders

Backlog is our estimate of the dollar amount of revenues we expect to realize in the future as a result of executing awarded contracts. For our projects related to unconsolidated joint ventures, we have included our percentage ownership of the joint venture's estimated revenues in backlog to provide an indication of future work to be performed. Our backlog was $10.9 billion and $14.1 billion at December 31, 2014 and 2013, respectively. We estimate that, as of December 31, 2014, 51% of our backlog will be recognized as revenues within one year. All backlog is attributable to firm orders at December 31, 2014 and 2013. For additional information regarding backlog see our discussion within "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Contracts

Our contracts are broadly categorized as cost-reimbursable, fixed price or “hybrid” contracts containing both cost-reimbursable and fixed-price scopes. Our fixed price contracts often include cost escalation and other features that allow for increases in price should certain events occur or conditions change. Change orders on fixed-priced contracts are routinely approved as work scope changes resulting in adjustments to our fixed price.

Fixed-price contracts, which include our unit-rate contracts (essentially a fixed-price contract with the only variable being units of work performed) where we are paid fixed amounts based on the final number of units of work performed, are for a fixed sum to cover all costs and any profit element for a defined scope of work. Fixed-price contracts entail more risk to us because they require us to predetermine the work to be performed, the project execution schedule and the costs associated with the work. Although fixed-price contracts involve greater risk than cost-reimbursable contracts, they also are potentially more profitable since the owner/customer pays a premium to transfer project risks to us.

Cost-reimbursable contracts include contracts where the price is variable based upon our actual costs incurred for time and materials and for reimbursable labor hour contracts. Profit on cost-reimbursable contracts may be a fixed amount, a mark-up applied to costs incurred or a combination of the two. Cost-reimbursable contracts are generally less risky than fixed-price contracts because the owner/customer retains many of the project risks.

Our GS business segment performs work under cost-reimbursable contracts with the U.K. Ministry of Defence ("MoD"), the U.S. Department of Defense (“DoD”) and other governmental agencies that are generally subject to applicable statutes and regulations. If the government concludes costs charged to a contract are not reimbursable under the terms of the contract or applicable procurement regulations, these costs are disallowed or, if already reimbursed, we may be required to refund the costs to the customer. Such conditions may also include interest and other financial penalties. If performance issues arise under any of our government contracts, the government retains the right to pursue remedies, which could include termination under any affected contract. Furthermore, the government has the contractual right to terminate or reduce the amount of work under our contracts at any time. See “Item 1A. Risk Factors” for more information.

Significant Customers

We provide services to a diverse customer base, including:

- international oil companies ("IOC"s) and national oil companies ("NOC"s);
- independent refiners;
- petrochemical, fertilizer and chemical producers;
- manufacturers;
- domestic and foreign governments; and
- regulated electric utilities.

A considerable percentage of revenues is generated from transactions with the Chevron Corporation ("Chevron") primarily within our E&C segment. No other customers represented 10% or more of consolidated revenues in any of the periods presented. The information in the following table has summarized data related to our revenues from Chevron.

Revenue and percent of consolidated revenues attributable to major customers by year:

Years ended December 31,					
2014		2013		2012	
$	%	$	%	$	%

Dollars in millions, except percentage amounts								
Chevron revenue	1,069	17	%	1,859	26	%	2,302	30	%

8

Raw Materials and Suppliers

Equipment and materials essential to our business are obtained from a variety of sources throughout the world. The principal equipment and materials we use in our business are subject to availability and price fluctuations due to customer demand, producer capacity and market conditions. We monitor the availability and price of equipment and materials on a regular basis. Our procurement department seeks to leverage our size and buying power to ensure that we have access to key equipment and materials at the best possible prices and delivery schedules. While we do not currently foresee any significant lack of availability of equipment and materials in the near term, the availability of these items may vary significantly from year to year and any prolonged unavailability or significant price increases for equipment and materials necessary to our projects and services could have a material adverse effect on our business. See “Item 1A. Risk Factors” for more information.

Intellectual Property

We have developed or otherwise have the right to license leading technologies, including technologies held under license from third parties, used for the production of a variety of petrochemicals and chemicals and in the areas of olefins, refining, fertilizers, coal gasification and semi-submersible technology. We also license a variety of technologies for the transformation of raw materials into commodity chemicals such as phenol and aniline used in the production of consumer-end products. In addition, we are a licensor of ammonia process technologies used in the conversion of synthetic gas to ammonia. We believe our technology portfolio and experience in the commercial application of these technologies and related know-how differentiates us, enhances our margins and encourages customers to utilize our broad range of EPC and construction services.

Our rights to make use of technologies licensed to us are governed by written agreements of varying durations, including some with fixed terms that are subject to renewal based on mutual agreement. Generally, each agreement may be further extended and we have historically been able to renew existing agreements before they expire. We expect these and other similar agreements to be extended so long as it is mutually advantageous to both parties at the time of renewal. However, the majority of our license fees tend to result in a one-time payment per agreement rather than ongoing royalty-type payments. For technologies we own, we protect our rights, know-how and trade secrets through patents and confidentiality agreements. Our expenditures for research and development activities were immaterial in each of the past three fiscal years.

Seasonality

Our operations are not generally affected by seasonality. Weather and natural phenomena can temporarily affect the performance of our services.

Employees

As of December 31, 2014, we had approximately 25,000 employees, of which approximately 10% were subject to collective bargaining agreements. Based upon the geographic diversification of our employees, we believe any risk of loss from employee strikes or other collective actions would not be material to the conduct of our operations taken as a whole.

Health and Safety

We are subject to numerous health and safety laws and regulations. In the United States, these laws and regulations include the Federal Occupational Safety and Health Act and comparable state legislation, the Mine Safety and Health Administration laws, and safety requirements of the Departments of State, Defense, Energy and Transportation of the

U.S. government. We are also subject to similar requirements in other countries in which we have extensive operations, including the U.K. where we are subject to the various regulations enacted by the Health and Safety Act of 1974.

These laws and regulations are frequently changing and it is impossible to predict the effect of such laws and regulations on us in the future. We actively seek to maintain a safe, healthy and environmentally friendly work place for all of our employees and those who work with us. However, we provide some of our services in high-risk locations and, as a result; we may incur substantial costs to maintain the safety and security of our personnel.

During the fourth quarter of 2014, we embarked on a global Zero Harm initiative in order to reinforce health, safety, security and environment as key components of the KBR culture and lifestyle. This initiative incorporates three dynamic components, Zero Harm, 24/7 and courage to care which empowers individuals to take responsibility for their health and safety, as well as that of their colleagues.

Environmental Regulation

We are subject to numerous environmental, legal and regulatory requirements related to our operations worldwide. In the U.S., these laws and regulations include, among others: the Comprehensive Environmental Response, Compensation and Liability Act; the Resources Conservation and Recovery Act; the Clean Air Act; the Clean Water Act; and the Toxic Substances Control Act. In addition to federal and state laws and regulations, other countries where we do business often have numerous environmental regulatory requirements by which we must abide in the normal course of our operations. These requirements apply to our business segments where we perform construction and industrial maintenance services or operate and maintain facilities.

We continue to monitor conditions at sites owned or previously owned, and until further information is available, we are only able to estimate a possible range of remediation costs. These locations were primarily utilized for manufacturing or fabrication work and are no longer in operation. The use of these facilities created various environmental issues including deposits of metals, volatile and semi-volatile compounds and hydrocarbons impacting surface and subsurface soils and groundwater. The range of remediation costs could change depending on our ongoing site analysis and the timing and techniques used to implement remediation activities. We do not expect that costs related to environmental matters will have a material adverse effect on our consolidated financial position or results of operations. Based on the information presently available to us, as of December 31, 2014, we have accrued approximately $1 million for the assessment and remediation costs associated with all environmental matters and we do not anticipate incurring additional costs. See Note 15 to our consolidated financial statements for more information on environmental matters.

We have been named as a potentially responsible party in various clean-up actions taken by federal and state agencies in the U.S. At this time, we are unable to determine whether we will ultimately be deemed responsible for any costs associated with these actions.

Existing or pending climate change legislation, regulations, international treaties or accords are not expected to have a short-term material direct effect on our business, the markets that we serve or on our results of operations or financial position. However, climate change legislation could have a direct effect on our customers or suppliers, which could impact our business. For example, our commodity-based markets depend on the level of activity of mineral and oil and gas companies and existing or future laws, regulations, treaties or international agreements related to climate change, including incentives to conserve energy or use alternative energy sources, which could impact our business if such laws, regulations, treaties or international agreements reduce the worldwide demand for minerals, oil and natural gas. We will continue to monitor developments in this area.

Compliance

Conducting our business with ethics and integrity is a key priority for KBR. We are subject to numerous compliance-related laws and regulations, including the U.S. Foreign Corrupt Practices Act (the "FCPA"), the U.K. Bribery Act, other applicable anti-bribery legislation and laws and regulations regarding trade and exports. We are also governed by our own Code of Business Conduct and other compliance-related corporate policies and procedures that mandate compliance with these laws. Our Code of Business Conduct is a guide for every employee in applying legal and ethical practices to our everyday work. The Code of Business Conduct describes not only our standards of integrity but also some of the specific principles and areas of the law that are most likely to affect our business. We regularly train our employees regarding anti-bribery issues and our Code of Business Conduct.

Website Access

Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are made available free of charge on our Internet website at www.kbr.com as soon as reasonably practicable after we have electronically filed the material with, or furnished it to, the U.S. Securities and Exchange Commission ("SEC"). The public may read and copy any materials we have filed with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet website that contains our reports, proxy and information statements and our other SEC filings. The address of that website is www.sec.gov. We have posted on our website our Code of Business Conduct, which applies to all of our employees and Directors and serves as a code of ethics for our principal executive officer, principal financial officer, principal accounting officer and other persons performing similar functions. Any amendments to our Code of Business Conduct or any waivers from provisions of our Code of Business Conduct granted to the specified officers above are disclosed on our website within four business days after the date of any amendment or waiver pertaining to these officers. No such waivers were granted during 2014.

Item 1A. Risk Factors

Risks Related to Operations of our Business

Our results of operations depend on the award of new contracts and the timing of the performance of these contracts.

A substantial portion of our revenues is directly or indirectly derived from new contract awards. Delays in the timing of the awards or potential cancellations of such prospects as a result of economic conditions, material and equipment pricing and availability or other factors could impact our long-term projected results. It is particularly difficult to predict whether or when we will receive large-scale international and domestic projects as these contracts frequently involve a lengthy and complex bidding and selection process, which is affected by a number of factors, such as market conditions, governmental and environmental approvals. Since a significant portion of our revenues is generated from such projects, our results of operations and cash flows can fluctuate significantly from quarter to quarter depending on the timing of our contract awards and the commencement or progress of work under awarded contracts. In addition, many of these contracts are subject to financing contingencies and as a result, we are subject to the risk that the customer will not be able to secure the necessary financing for the project.

The uncertainty of our contract award timing can also present difficulties in matching workforce size with contract needs. In some cases, we maintain and bear the cost of a ready workforce that is larger than necessary under existing contracts in anticipation of future workforce needs for expected contract awards. If an expected contract award is delayed or not received, we may incur additional costs resulting from reductions in staff or redundancy of facilities which could have a material adverse effect on our business, financial condition and results of operations.

The nature of our contracts, particularly those that are fixed-price, subjects us to risks associated with cost over-runs, operating cost inflation and potential claims for liquidated damages.

We conduct our business under various types of contracts where costs must be estimated in advance of our performance. Approximately 40% of the value of our backlog is attributable to fixed-price contracts, which include our unit-rate contracts where we bear a significant portion of the risk of cost over-runs. These types of contracts are priced based in part on cost and scheduling estimates that are based on assumptions including prices and availability of labor, equipment and materials as well as productivity, performance and future economic conditions. If these estimates prove inaccurate, there are errors or ambiguities as to contract specifications or if circumstances change due to, among other things, unanticipated technical problems, difficulties in obtaining permits or approvals, changes in local laws or labor conditions, weather delays, changes in the costs of equipment and materials or our suppliers' or subcontractors' inability to perform, then cost overruns may occur. We may not be able to obtain compensation for additional work performed or expenses incurred. Additionally, we may be required to pay liquidated damages upon our failure to meet schedule or performance requirements of our contracts. Our failure to accurately estimate the resources and time required for fixed-price contracts or our failure to complete our contractual obligations within the time frame and costs committed could result in reduced profits or, in certain cases, a loss for that contract. If the contract is significant, or we encounter issues that impact multiple contracts, cost overruns could have a material adverse effect on our business, financial condition and results of operations.

If we are unable to attract and retain a sufficient number of affordable trained engineers, craft labor, and other skilled workers, our ability to pursue projects may be adversely affected and our costs may increase.

Our rate of growth and the success of our business depend upon our ability to attract, develop and retain a sufficient number of affordable trained engineers, craft labor and other skilled workers either through direct hire or acquisition of other firms employing such professionals. The market for these professionals is competitive. If we are unable to attract and retain a sufficient number of skilled personnel, our ability to pursue projects may be adversely affected, the

costs of executing our existing and future projects may increase and our financial performance may decline.

We conduct a portion of our engineering and construction operations through joint ventures and partnerships exposing us to risks and uncertainties, many of which are outside of our control.

We conduct a portion of our EPC operations through large project-specific joint ventures where control may be shared with unaffiliated third parties. As with any joint venture arrangement, differences in views among the joint venture participants may result in delayed decisions or in failures to agree on major issues. We also cannot control the actions of our joint venture partners, including any nonperformance, default or bankruptcy of our joint venture partners, and we typically share liabilities on a joint and several basis with our joint venture partners under these arrangements. If our partners do not meet their contractual obligations, the joint venture may be unable to adequately perform and deliver its contracted services, requiring us to make additional investments or perform additional services to ensure the adequate performance and delivery of services to our customer. We could be liable for both our obligations and those of our partners, which may result in reduced profits or, in some cases, significant losses on the

project. Additionally, these factors could have a material adverse effect on the business operations of the joint venture and, in turn, our business operations and reputation.

Operating through joint ventures in which we have a minority interest could result in us having limited control over many decisions made with respect to projects and internal controls relating to projects. These joint ventures may not be subject to the same requirements regarding internal controls and internal control reporting that we follow. As a result, internal control issues may arise, which could have a material adverse effect on our financial condition and results of operations. Additionally, in order to establish or preserve relationships with our joint venture partners, we may agree to risks and contributions of resources that are proportionately greater than the returns we could receive, which could reduce our income and returns on these investments compared to what we may have received if the risks and resources we contributed were always proportionate to our returns.

The nature of our engineering and construction business exposes us to potential liability claims and contract disputes which may exceed or be excluded from existing insurance coverage.

We engage in engineering and construction activities for large facilities where design, construction or systems failures can result in substantial injury or damage to employees or other third parties or delays in completion or commencement of commercial operations, exposing us to legal proceedings, investigations and disputes. The nature of our business results in clients, subcontractors and vendors occasionally presenting claims against us for recovery of costs they incurred in excess of what they expected to incur or for which they believe they are not contractually liable. When it is determined that we have liability, we may not be covered by insurance or, if covered, the dollar amount of these liabilities may exceed our policy limits. Our professional liability coverage is on a “claims-made” basis covering only claims actually made during the policy period currently in effect. In addition, even where insurance is maintained for such exposures, the policies have deductibles, which result in our assumption of exposure for a layer of coverage with respect to any such claims. Any liability not covered by our insurance, in excess of our insurance limits or if covered by insurance but subject to a high deductible could result in a significant loss for us, which may reduce our profits and cash available for operations.

We occasionally bring claims against project owners for additional costs exceeding the contract price or for amounts not included in the original contract price. These types of claims occur due to matters such as owner-caused delays or changes from the initial project scope which may result in additional direct and indirect costs. Often these claims can be the subject of lengthy arbitration or litigation proceedings, and it is difficult to accurately predict when these claims will be fully resolved. When these types of events occur and unresolved claims are pending, we may invest significant working capital in projects to cover cost overruns pending the resolution of the relevant claims. A failure to promptly recover on these types of claims could have a material adverse impact on our liquidity and financial results.

International and political events may adversely affect our operations.

A significant portion of our revenues is derived from foreign operations, which exposes us to risks inherent in doing business in each of the countries where we transact business. The occurrence of any of the risks described below could have a material adverse effect on our business operations and financial performance. With respect to any particular country, these risks may include, but not be limited to:

- expropriation and nationalization of our assets in that country;
- political and economic instability;
- civil unrest, acts of terrorism, force majeure, war or other armed conflict;
- currency fluctuations, devaluations and conversion restrictions;
- confiscatory taxation or other adverse tax policies; or
-

governmental activities or judicial actions that limit or disrupt markets, restrict payments, limit the movement of funds, result in the deprivation of contract rights or result in the inability for us to obtain or retain licenses required for operation.

Due to the unsettled political conditions in many oil-producing countries and other countries where we provide governmental logistical support, our financial performance is subject to the adverse consequences of war, the effects of terrorism, civil unrest, strikes, currency controls and governmental actions. Our operations are conducted in areas that have significant political risk. In addition, military action or unrest in such locations as the Middle East could restrict the supply of oil and gas, disrupt our operations in the region and elsewhere and increase our costs related to security worldwide.

We may have additional tax liabilities associated with our domestic and international operations.

We are subject to income taxes in the United States and numerous foreign jurisdictions, many of which are developing countries. Significant judgment is required in determining our worldwide provision for income taxes due to lack of clear and concise tax laws and regulations in certain jurisdictions. It is not unlikely that laws may be changed or clarified and such changes may require material changes to our tax provisions. We are audited by various U.S. and foreign tax authorities and in the ordinary course of our business there are many transactions and calculations where the ultimate tax determination may be uncertain. Although we believe that our tax estimates are reasonable, the final outcome of tax audits and related litigation could be materially different from that which is reflected in our financial statements. In addition, because of the changing nature of our projects, geographic locations, etc. our effective tax rates in future years may differ materially from previous years.

We work in international locations where there are high security risks, which could result in harm to our employees and contractors or substantial costs.

Some of our services are performed in high-risk locations, such as Iraq, Afghanistan, certain parts of Africa and the Middle East, where the country or surrounding area is suffering from political, social or economic issues, war or civil unrest. In those locations where we have employees or operations, we have and may continue to incur substantial costs to maintain the safety of our personnel. Despite these precautions, we have suffered the loss of employees and contractors that has resulted in claims and litigation. In the future, the safety of our personnel in these and other locations may continue to be at risk, exposing us to the potential loss of additional employees and contractors that could lead to future claims and litigation.

We ship a significant amount of cargo using seagoing vessels exposing us to certain maritime risks.

We execute different projects in remote locations around the world. Depending on the type of contract, location and the nature of the work, we may charter seagoing vessels under time and bareboat charter arrangements and assume certain risks typical of those agreements. Such risks may include damage to the ship, liability for cargo and liability which charterers and vessel operators have to third parties “at law.” In addition, we ship a significant amount of cargo and are subject to hazards of the shipping and transportation industry.

Demand for our services depends on demand and capital spending by customers in their target markets, many of which are cyclical in nature.

Demand for many of our services in our commodity-based markets depends on capital spending by oil and natural gas companies, including national and international oil companies, and by industrial companies, which is directly affected by trends in oil, natural gas and commodities prices. Capital expenditures for refining and distribution facilities by large oil and gas companies have a significant impact on the activity levels of our businesses. Demand for LNG facilities for which we provide services could decrease in the event of a sustained reduction in the price and demand for crude oil or natural gas. Perceptions of longer-term lower oil and natural gas prices by oil and gas companies or longer-term higher material and contractor prices impacting facility costs can similarly reduce or defer major expenditures given the long-term nature of many large-scale projects. Prices of oil, natural gas and commodities are subject to large fluctuations in response to relatively minor changes in supply and demand, market uncertainty and a variety of other factors that are beyond our control. Factors affecting the prices of oil, natural gas and other commodities include, but are not limited to:

- worldwide or regional political, social or civil unrest, military action and economic conditions;
- the level of demand for oil, natural gas, industrial services and power generation;
-

governmental regulations or policies, including the policies of governments regarding the use of energy and the exploration for and production and development of their oil and natural gas reserves;

- a reduction in energy demand as a result of energy taxation or a change in consumer spending patterns;
- global economic growth or decline;
- the level of oil production by non-OPEC countries and the available excess production capacity from OPEC countries;
- global weather conditions and natural disasters;
- oil refining capacity;
- shifts in end-customer preferences toward fuel efficiency and the use of natural gas;
- potential acceleration of the development and expanded use of alternative fuels;
- environmental regulation, including limitations on fossil fuel consumption based on concerns about its relationship to climate change; and
- reduction in demand for the commodity-based markets in which we operate.

Historically, the markets for oil and natural gas have been volatile and are likely to continue to be volatile in the future.

Crude oil and natural gas prices are extremely volatile. A substantial or extended decline in the price of oil and natural gas could adversely affect our results of operations.

Our business segment revenues are highly dependent on capital expenditures for LNG, refining and distribution facilities and other investments by large oil and gas companies. The demand for these facilities and the ability of our customers to borrow and obtain additional capital on attractive terms is also substantially dependent upon crude oil and natural gas prices. As seen in the recent decline in crude prices, prices of oil and natural gas are subject to large fluctuations in response to relatively minor changes in supply and demand, market uncertainty and a variety of other factors that are beyond our control. Demand for the services we provide could decrease in the event of a sustained reduction in demand for crude oil or natural gas, while perceptions of long-term decline in crude oil and natural gas prices by oil and gas companies (our customers) can similarly reduce or defer major expenditures given the long-term nature of many large-scale projects.

Our backlog is subject to unexpected adjustments and cancellations and, therefore, may not be a reliable indicator of our future revenues or earnings.

As of December 31, 2014, our backlog was approximately $10.9 billion. We cannot guarantee that the revenues projected in our backlog will be realized or that the projects will be profitable. Many of our contracts are subject to cancellation, termination or suspension at the discretion of the customer. From time to time, changes in project scope may occur with respect to contracts reflected in our backlog and could reduce the dollar amount of our backlog and the timing of the revenues and profits that we actually earn. Projects may remain in our backlog for an extended period of time because of the nature of the project and the timing of the particular services or equipment required by the project. Delays, suspensions, cancellations, payment defaults, scope changes and poor project execution could materially reduce or eliminate profits that we actually realize from projects in backlog. We cannot predict the impact that future economic conditions may have on our backlog, which could include a diminished ability to replace backlog once projects are completed or could result in the termination, modification or suspension of projects currently in our backlog. Such developments could have a material adverse effect on our financial condition, results of operations and cash flows.

Intense competition in the engineering and construction industry could reduce our market share and profits.

We serve markets that are highly competitive and in which a large number of multinational companies compete. These highly competitive markets require substantial resources and capital investment in equipment, technology and skilled personnel. Our projects are frequently awarded through a competitive bidding process, which is standard in our industry. We are constantly competing for project awards based on pricing and the breadth and technical sophistication of our services. Any increase in competition or reduction in our competitive capabilities could have a material adverse effect on the margins we generate from our projects as well as our ability to maintain or increase market share.

A portion of our revenues is generated by large, recurring business from certain significant customers. A loss, cancellation or delay in projects by our significant customers in the future could negatively affect our revenues.

We provide services to a diverse customer base, including IOCs, NOCs, independent refiners, petrochemical producers, fertilizer producers, chemical producers, manufacturers, domestic and foreign governments and regulated electric utilities. A considerable percentage of revenues is generated from transactions with Chevron primarily from our E&C business segment. Revenues from Chevron in 2014 represented 17% of our total consolidated revenues.

Dependence on craft labor, subcontractors and equipment manufacturers could adversely affect our profits.

We rely on local craft labor, third party subcontractors as well as third party equipment manufacturers to complete our projects. To the extent that we cannot engage craft labor, subcontractors or acquire equipment or materials, our ability to complete a project in a timely fashion or at a profit may be impaired. If the amount we are required to pay for these goods and services exceeds the amount we have estimated in bidding for fixed price contracts, we could experience losses in the performance of these contracts. In addition, if a subcontractor or a manufacturer is unable to deliver its services, equipment or materials according to the negotiated terms for any reason, including the deterioration of its financial condition, we may be required to purchase the services, equipment or materials from another source at a higher price. This may reduce the profit we expect to realize or result in a loss on a project for which the services, equipment or materials were needed.

If we are unable to enforce our intellectual property rights, or if our intellectual property rights become obsolete, our competitive position could be adversely impacted.

We utilize a variety of intellectual property rights in the provisioning of services to our customers. We view our portfolio of process and design technologies as one of our competitive strengths and we use it as part of our efforts to differentiate our service offerings. We may not be able to successfully preserve these intellectual property rights in the future, and these rights could be invalidated, circumvented, challenged or infringed upon. In addition, the laws of some foreign countries in which our services may be sold do not protect intellectual property rights to the same extent as the laws of the United States. Since we license technologies from third parties, there is a risk that our relationships with licensors may terminate, expire or be interrupted or harmed. In some, but not all cases, we may be able to obtain the necessary intellectual property rights from alternative sources. If we are unable to protect and maintain our intellectual property rights, or if there are any successful intellectual property challenges or infringement proceedings against us, our ability to differentiate our service offerings could diminish. In addition, if our intellectual property rights or work processes become obsolete, we may not be able to differentiate our service offerings and some of our competitors may be able to offer more attractive services to our customers. As a result, our business and financial performance could be materially and adversely affected.

Our current business strategy includes the possibility of acquisitions, which may present certain risks and uncertainties.

We may seek business acquisitions as a means of broadening our offerings and capturing additional market opportunities by our business segments and we may be exposed to certain additional risks resulting from these activities. These risks include, but are not limited to the following:

- Valuation methodologies may not accurately capture the value proposition;
- Future completed acquisitions may not be integrated within our operations with the efficiency and effectiveness initially expected, resulting in a potentially significant detriment to the associated product/service line financial results and posing additional risks to our operations as a whole;
- We may have difficulty managing our growth from acquisition activities;
- Key personnel within an acquired organization may resign from their related positions resulting in a significant loss to our strategic and operational efficiency associated with the acquired company;
- The effectiveness of our daily operations may be reduced by the redirection of employees and other resources to acquisition activities;
- We may assume liabilities of an acquired business (e.g. litigation, tax liabilities, contingent liabilities, environmental issues), including liabilities that were unknown at the time of the acquisition, that pose future risks to our working capital needs, cash flows and the profitability of related operations;
- We may assume unprofitable projects that pose future risks to our working capital needs, cash flows and the profitability of related operations;
- Business acquisitions may include substantial transactional costs to complete the acquisition that exceed the estimated financial and operational benefits; or
- Future acquisitions may require us to obtain additional equity or debt financing, which may not be available on attractive terms, if at all. Moreover, to the extent an acquisition transaction results in additional goodwill, it will reduce our tangible net worth, which might have an adverse effect on our credit capacity.

We rely on information technology ("IT") systems to conduct our business, and disruption, failure or security breaches of these systems could adversely affect our business and results of operations.

We rely heavily on IT systems in order to achieve our business objectives. We also rely upon industry accepted security measures and technology to securely maintain confidential and proprietary information maintained on our IT systems. However, our portfolio of hardware and software products, solutions and services and our enterprise IT systems may be vulnerable to damage or disruption caused by circumstances beyond our control such as catastrophic events, power outages, natural disasters, computer system or network failures, computer viruses, cyber-attacks or other malicious software programs. The failure of our IT systems to perform as anticipated for any reason could disrupt our business and result in decreased performance, significant remediation costs, transaction errors, loss of data, processing inefficiencies, downtime, litigation and the loss of suppliers or customers. We have experienced security threats, none of which we considered to be significant to our business or results of operations, but significant disruption or failure could have a material adverse effect on our business operations, financial performance and financial condition.

An impairment of all or part of our goodwill and/or our intangible assets could have a material adverse impact on our net earnings and net worth.

As of December 31, 2014, we had $324 million of goodwill and $41 million of intangible assets recorded on our consolidated balance sheets. Goodwill represents the excess of cost over the fair market value of net assets acquired in business combinations. If our market capitalization drops significantly below the amount of net equity recorded on our balance sheets, it might indicate a decline in our fair value and would require us to further evaluate whether our goodwill has been impaired. We perform an annual and an interim analysis, if appropriate, of our goodwill to determine if it has become impaired. The analysis requires us to make assumptions in estimates of fair value of our reporting units. If actual results are significantly different from the estimates, we might be required to write down the impaired portion of goodwill. An impairment of all or a part of our goodwill and/or intangible assets could have a material adverse effect on our net earnings and net worth.

Our use of the percentage-of-completion method of revenue recognition could result in a reduction or reversal of previously recorded revenues and profits.

A substantial portion of our revenues and profits are measured and recognized using the percentage-of-completion method of revenue recognition. Our use of this accounting method results in recognition of revenues and profits over the life of a contract, based generally on the proportion of costs incurred to date to total costs expected to be incurred for the entire project, the ratio of hours performed to date to our estimate of total expected hours at completion, or the physical progress methodology. The effects of revisions to estimated revenues and estimated costs are recorded when the amounts are known or can be reasonably estimated. Such revisions could occur in any period and their effects could be material. Although we have historically made reasonably reliable estimates of the progress towards completion of long-term engineering, program management, construction management or construction contracts, the uncertainties inherent in the estimating process make it possible for actual costs to vary materially from estimates, including reductions or reversals of previously recorded revenues and profits.

Risks Related to Government Operations of our Business

The U.S. government awards its contracts through a rigorous competitive process and our efforts to obtain future contracts from the U.S. government may be unsuccessful.

The U.S. government conducts a rigorous competitive process for awarding most contracts. In the services arena, the U.S. government uses multiple contracting approaches. Historically, omnibus contract vehicles have been used for work that is done on a contingency or as-needed basis. In more predictable “sustainment” environments, contracts may include both fixed-price and cost-reimbursable elements. The U.S. government has also favored multiple award task order contracts in which several contractors are selected as eligible bidders for future work. Such processes require successful contractors to continually anticipate customer requirements and develop rapid-response bid and proposal teams as well as have supplier relationships and delivery systems in place to react to emerging needs. We will face rigorous competition and pricing pressures for any additional contract awards from the U.S. government, and we may be required to qualify or continue to qualify under the various multiple award task order contract criteria. It may be more difficult for us to win future awards from the U.S. government and we may have other contractors sharing in any U.S. government awards that we win. In addition, negative publicity regarding findings stemming from audits by the Defense Contract Audit Agency (the "DCAA"), congressional investigations and litigation may adversely affect our ability to obtain future awards. See "Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Analysis - U.S. Government Matters."

Demand for our services provided under government contracts are directly affected by spending by our customers.

We derive a portion of our revenues from contracts with agencies and departments of the U.K., Australia and U.S. governments, which is directly affected by changes in government spending and availability of adequate funding. Additionally, U.S. government regulations generally include the right for government agencies to modify, delay, curtail, renegotiate or terminate contracts at their convenience any time prior to their completion. As a defense contractor, our financial performance is affected by the allocation and prioritization of defense spending. Factors that could affect current and future government spending include:

- policy and/or spending changes implemented by the current administration, DoD or other government agencies;
- changes, delays or cancellations of government programs or requirements;
- adoption of new laws or regulations that affect companies providing services to the governments;
- curtailment of the governments' outsourcing of services to private contractors; or
- level of political instability due to war, conflict or natural disasters.

We face uncertainty with respect to our government contracts due to the fiscal and economic challenges facing our customers, including sequestration and issues surrounding the U.S. national debt ceiling. Potential contract cancellations, modifications or terminations may arise from resolution of these issues and could cause our revenues, profits and cash flows to be lower than our current projections. The loss of work we perform for the governments or decreases in governmental spending and outsourcing could have a material adverse effect on our business, results of operations and cash flows.

Our U.S. government contract work is regularly reviewed and audited by our customer, U.S. government auditors and others, and these reviews can lead to withholding or delay of payments to us, non-receipt of award fees, legal actions, fines, penalties and liabilities and other remedies against us.

U.S. government contracts are subject to specific regulations such as the Federal Acquisition Regulation ("FAR"), the Truth in Negotiations Act, the Cost Accounting Standards ("CAS"), the Service Contract Act and DoD security regulations. Failure to comply with any of these regulations, requirements or statutes may result in contract price adjustments, financial penalties or contract termination. Our U.S. government contracts are subject to audits, cost reviews and investigations by U.S. government contracting oversight agencies such as the DCAA. The DCAA reviews the adequacy of, and our compliance with, our internal control systems and policies, including our labor, billing, accounting, purchasing, property, estimating, compensation and management information systems. The DCAA has the authority to conduct audits and reviews to determine if KBR is complying with the requirements under FAR and CAS, pertaining to the allocation, period assignment and allowability of costs assigned to U.S. government contracts. The DCAA presents its report findings to the Defense Contract Management Agency ("DCMA"). Should the DCMA determine that we have not complied with the terms of our contract and applicable statutes and regulations, payments to us may be disallowed, which could result in adjustments to previously reported revenues and refunding of previously collected cash proceeds. Additionally, we may be subject to qui tam litigation brought by private individuals on behalf of the U.S. government under the Federal False Claims Act, which could include claims for treble damages.

Given the demands of working for the U.S. government, we may have disagreements or experience performance issues. When performance issues arise under any of our U.S. government contracts, the U.S. government retains the right to pursue remedies, which could include termination under any affected contract. If any contract were so terminated, our ability to secure future contracts could be adversely affected, although we would receive payment for amounts owed for our allowable costs under cost-reimbursable contracts. Other remedies that could be sought by our government customers for any improper activities or performance issues include sanctions such as forfeiture of profits, suspension of payments, fines and suspensions or debarment from doing business with the government. Further, the negative publicity that could arise from disagreements with our customers or sanctions as a result thereof could have an adverse effect on our reputation in the industry, reduce our ability to compete for new contracts and may also have a material adverse effect on our business, financial condition, results of operations and cash flows.

Some of our U.S. government work requires KBR and certain of its employees to qualify for and retain a government-issued security clearance.

A KBR subsidiary currently holds a U.S. government-issued facility security clearance and certain of its employees have qualified for and hold U.S. government-issued personal security clearances. These clearances are necessary in order to qualify for and ultimately perform certain of our U.S. government contracts. Should we no longer qualify for such clearances, our ability to pursue and perform U.S. government contracts would be negatively impacted.

Risks Related to Governmental Regulations and Law

We could be adversely impacted if we fail to comply with domestic and international export laws, which are the subject of rigorous enforcement by the U.S. government.

To the extent that we export products, technical data and services outside of the United States, we are subject to laws and regulations governing trade and exports, including, but not limited to, the International Traffic in Arms Regulations, the Export Administration Regulations and trade sanctions against embargoed countries, which are administered by the Office of Foreign Asset Control within the Department of the Treasury. A failure to comply with these laws and regulations could result in civil and/or criminal sanctions, including the imposition of fines upon us as well as the denial of export privileges and debarment from participation in U.S. government contracts. U.S. government contract violations could result in the imposition of civil and criminal penalties or sanctions, contract termination, forfeiture of profit and/or suspension of payment, any of which could make us lose our status as an eligible U.S. government contractor and cause us to suffer serious harm to our reputation. Any suspension or termination of our U.S. government contractor status could have a material adverse effect on our business, financial condition or results of operations.

We are subject to anti-bribery laws in the U.S. and other jurisdictions, violations of which could include suspension or debarment of our ability to contract with the U.S. state or local governments, U.S. government agencies or the U.K. MoD, third-party claims, loss of customers, adverse financial impact, damage to reputation and adverse consequences on financing for current or future projects.

The FCPA, the U.K. Bribery Act and similar anti-bribery laws in other jurisdictions generally prohibit companies and their intermediaries from making improper payments to non-U.S. officials for the purpose of obtaining or retaining business. Our policies mandate compliance with these anti-bribery laws. We operate in many parts of the world that have experienced governmental corruption to some degree and, in certain circumstances; strict compliance with anti-bribery laws may conflict with local customs and practices. We train our staff concerning FCPA issues, and we also inform our partners, subcontractors, agents and other third parties who work for us or on our behalf that they must comply with the requirements of the FCPA and other anti-corruption laws. We also have procedures and controls in place to monitor internal and external compliance. We cannot provide complete assurance that our internal controls and procedures will always protect us from the reckless or criminal acts committed by our employees or third parties working on our behalf. If we are found to be liable for violations of these laws (either due to our own acts or our inadvertence, or due to the acts or inadvertence of others), we could suffer from criminal or civil penalties or other sanctions, which could have a material adverse effect on our business.

We are subject to various environmental, health and safety laws and regulations. If we fail to comply with these laws and regulations, we may incur significant costs and penalties that could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our operations are subject to a variety of environmental, health and safety laws and regulations governing the generation, management and use of regulated materials, the discharge of materials into the environment, the remediation of environmental contamination associated with the release of hazardous substances and human health and safety. Violations of these laws and regulations can cause significant delays and add significant cost to a project.

Various U.S. federal, state, local, and foreign environmental laws and regulations may impose liability for property damage and costs of investigation and cleanup of hazardous or toxic substances on property currently or previously owned by us or arising out of our waste management or environmental remediation activities. These laws may impose responsibility and liability without regard to knowledge or causation of the presence of contaminants. The liability under these laws is joint and several. The ongoing costs of complying with existing environmental laws and regulations could be substantial and have a material adverse impact on our financial condition, results of operations and cash flows.

When we perform our services, our personnel and equipment may be exposed to radioactive and hazardous materials and conditions. We may be subject to claims alleging personal injury, property damage or natural resource damages by employees, customers and third parties as a result of alleged exposure to or contamination by hazardous substances. In addition, we may be subject to fines, penalties or other liabilities arising under environmental safety laws. A claim, if not covered by insurance at all or only partially, could have a material adverse impact on our financial condition, results of operations and cash flows.

Changes in the environmental laws and regulations, remediation obligations, enforcement actions, stricter interpretations of existing requirements, future discovery of contamination or claims for damages to persons, property, natural resources or the environment could result in material costs and liabilities that we currently do not anticipate.

Risks Related to Financial Conditions and Markets

Current or future economic conditions in the credit markets may negatively affect the ability to operate our or our customers' businesses, finance working capital, implement our acquisition strategy and access our cash and short-term investments.

We finance our business using cash provided by operations, but also depend on the availability of credit for growth. Our ability to obtain capital or financing on satisfactory terms will depend in part upon prevailing market conditions as well as our operating results. If adequate credit or funding is not available, or is not available on terms satisfactory to us, there could be a material adverse effect on our business and financial performance.

Disruptions of the credit markets could also adversely affect our clients' borrowing capacity, which supports the continuation and expansion of projects worldwide, and could result in contract cancellations or suspensions, project delays and payment delays or defaults by our clients. In addition, clients may choose to make fewer capital expenditures or otherwise slow their spending on our services or to seek contract terms more favorable to them. Our government clients may face budget deficits that prohibit them from funding proposed and existing projects or that cause them to exercise their right to terminate our contracts with little

or no prior notice. Furthermore, any financial difficulties suffered by our subcontractors or suppliers could increase our cost or adversely impact project schedules. These disruptions could materially impact our backlog and financial performance.

In addition, we are subject to the risk that the counterparties to our Credit Agreement may be unable to meet their contractual obligations to us if they suffer catastrophic demands on their liquidity. We also routinely enter into contracts with counterparties, including vendors, suppliers and subcontractors that may be negatively affected by events in the credit markets. If those counterparties are unable to perform their obligations to us or our clients, we may be required to provide additional services or make alternate arrangements on less favorable terms with other parties to ensure adequate performance and delivery of service to our clients. These circumstances could also lead to disputes and litigation with our partners or clients, which could have a material adverse effect on our reputation, business, financial condition and results of operations.

Furthermore, our cash balances and short-term investments are maintained in accounts held at major banks and financial institutions located primarily in North America, the United Kingdom and Australia. Deposits are in amounts that exceed available insurance. Although none of the financial institutions in which we hold our cash and investments have gone into bankruptcy, been forced into receivership or have been seized by their governments, there is a risk that this may occur in the future. If this were to occur, we would be at risk of not being able to access our cash and investments which may result in a temporary liquidity crisis that could impede our ability to fund operations.

We may be unable to obtain new contract awards if we are unable to provide our customers with letters of credit, surety bonds or other credit enhancements.

Customers may require us to provide credit enhancements, including letters of credit, bank guarantees or surety bonds. We are often required to provide performance guarantees to customers to indemnify the customer should we fail to perform our obligations under the contract. Failure to provide the required credit enhancements on terms required by a customer may result in an inability to bid, win or comply with the contract. Historically, we have had adequate letters of credit capacity but such capacity beyond our Credit Agreement is generally at the provider’s sole discretion. Due to events that affect the banking and insurance markets generally, letters of credit and/or surety bonds may be difficult to obtain or may only be available at significant cost. Moreover, many projects are often very large and complex, which often necessitates the use of a joint venture, often with a market competitor, to bid on and perform the contract. However, entering into joint ventures or partnerships exposes us to the credit and performance risk of third parties, many of whom may not be financially strong. If our joint ventures or partners fail to perform, we could suffer negative results. In addition, future projects may require us to obtain letters of credit that extend beyond the term of our current Credit Agreement. Any inability to bid for or win new contracts due to the failure of obtaining adequate letters of credit, surety bonding and/or other customary credit enhancements could have a material adverse effect on our business prospects and future revenues.

Our Credit Agreement imposes restrictions that limit our operating flexibility and may result in additional expenses, and this credit agreement may not be available if financial covenants are violated or if an event of default occurs.

Our Credit Agreement provides a credit line of $1 billion and expires in December 2016. It contains a number of covenants restricting, among other things, our ability to incur liens and indebtedness, sell assets, repurchase our equity shares and make certain types of investments. We are also subject to certain financial covenants, including maintenance of a maximum ratio of consolidated debt to consolidated EBITDA and a minimum consolidated net worth.

A breach of any covenant or our inability to comply with the required financial ratios could result in a default under our Credit Agreement, and we can provide no assurance that we will be able to obtain the necessary waivers or

amendments from our lenders to remedy a default. In the event of any default not cured or waived, the lenders are not obligated to provide funding or issue letters of credit and could elect to require us to apply available cash to collateralize any outstanding letters of credit and declare any outstanding borrowings, together with accrued interest and other fees, to be immediately due and payable, thus requiring us to apply available cash to repay any borrowings then outstanding. If we are unable to cash collateralize our letters of credit or repay borrowings with respect to our Credit Agreement when due, our lenders could proceed against the guarantees of our major domestic subsidiaries. If any future indebtedness under our Credit Agreement is accelerated, we can provide no assurance that our assets would be sufficient to repay such indebtedness in full.

Provisions in our charter documents, Delaware law and our Credit Agreement may inhibit a takeover or impact operational control which could adversely affect the value of our common stock.

Our certificate of incorporation and bylaws, as well as Delaware corporate law, contain provisions that could delay or prevent a change of control or changes in our management that a stockholder might consider favorable. These provisions include, among others, prohibiting stockholder action by written consent, advance notice for making nominations at meetings of

stockholders, providing for the State of Delaware as the exclusive forum for lawsuits concerning certain corporate matters and the issuance of preferred stock with rights that may be senior to those of our common stock without stockholder approval. These provisions would apply even if a takeover offer may be considered beneficial by some of our stockholders. If a change of control or change in management is delayed or prevented, the market price of our common stock could decline. Additionally, our Credit Agreement contains a default provision that is triggered upon a change in control of at least 25%.

We are subject to significant foreign exchange and currency risks that could adversely affect our operations and our ability to reinvest earnings from operations. Our ability to mitigate our foreign exchange risk through hedging transactions may be limited.

We generally attempt to denominate our contracts in U.S. Dollars or in the currencies of our costs. However, we do enter into contracts that subject us to currency risk exposure, primarily when our contract revenues are denominated in a currency different from the contract costs. A significant portion of our consolidated revenues and consolidated operating expenses are in foreign currencies. As a result, we are subject to significant foreign currency risks, including risks resulting from changes in currency exchange rates and limitations on our ability to reinvest earnings from operations in one country to fund the financing requirements of our operations in other countries.

The governments of certain countries have or may in the future impose restrictive exchange controls on local currencies and it may not be possible for us to engage in effective hedging transactions to mitigate the risks associated with fluctuations of a particular currency. We are often required to pay all or a portion of our costs associated with a project in the local currency. As a result, we generally attempt to negotiate contract terms with our customer, who is often affiliated with the local government, or has a significant local presence, to provide that we are only paid in the local currency for amounts that match our local expenses. If we are unable to match our local currency costs with revenues in the local currency, we would be exposed to the risk of adverse changes in currency exchange rates.

If we need to sell or issue additional common shares to finance future acquisitions, our existing shareholder ownership could be diluted.

Part of our business strategy is to expand into new markets and enhance our position in existing markets, both domestically and internationally, which may include the acquiring and merging of complementary businesses. To successfully fund and complete such potential acquisitions, we may issue additional equity securities that may result in dilution of our existing shareholder ownership's earnings per share.

We make equity investments in privately financed projects in which we could sustain significant losses.

We participate in privately financed projects that enable governments and other customers to finance large-scale projects, such as the acquisition and maintenance of major military equipment, capital projects and service purchases. These projects typically include the facilitation of nonrecourse financing, the design and construction of facilities and the provision of operation and maintenance services for an agreed-upon period after the facilities have been completed. We may incur contractually reimbursable costs and typically make investments prior to an entity achieving operational status or receiving project financing. If a project is unable to obtain financing, we could incur losses on our investments and any related contractual receivables. After completion of these projects, the return on our investments can be dependent on the operational success of the project and market factors which may not be under our control. As a result, we could sustain a loss on our equity investment in these projects.

Item 1B. Unresolved Staff Comments

None.

Item 2.Properties

We own or lease properties in domestic and foreign locations. The following locations represent our major facilities.

Location	Owned/Leased	Description	Business Segment
Greenford, United Kingdom	Owned	Office facilities	Engineering & Construction
Leatherhead, United Kingdom	Owned	Office facilities	Engineering & Construction and Government Services
Birmingham, Alabama	Owned	Office facilities	Non-strategic Business
North America:			
Arlington, Virginia	Leased	Office facilities	Government Services
Edmonton, Alberta, Canada	Leased	Office and Project facilities	Engineering & Construction and Other
Houston, Texas	Leased	Office facilities	All and Other
Monterrey, Nuevo Leon, Mexico	Leased	Office facilities	Engineering & Construction
Newark, Delaware	Leased	Office facilities	Engineering & Construction
Europe, Middle East and Africa:			
Al Khobar, Saudi Arabia	Leased	Office facilities	Engineering & Construction
Gothenburg, Sweden	Leased	Office facilities	Technology & Consulting
Asia-Pacific:			
Singapore	Leased	Office facilities	Technology & Consulting and Engineering & Construction
Sydney, Australia	Leased	Office facilities	Engineering & Construction
Perth, Australia	Leased	Office and project facilities	Engineering & Construction
Melbourne, Australia	Leased	Office facilities	Engineering & Construction

We also own or lease numerous small facilities that include sales offices and project offices throughout the world and lease office space in other buildings owned by unrelated parties. All of our owned properties are unencumbered and we believe all properties that we currently occupy are suitable for their intended use.

Item 3.Legal Proceedings

Information relating to various commitments and contingencies is described in “Item 1A. Risk Factors” and in Notes 14 and 15 to our consolidated financial statements, and the information discussed therein is incorporated by reference into this Item 3.

Item 4.Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is traded on the New York Stock Exchange under the symbol "KBR." The following table sets forth, on a per share basis for the periods indicated, the high and low sales prices per share for our common stock as reported by the New York Stock Exchange and dividends declared. In the fourth quarter of 2014, we declared a dividend of $0.08 per share on October 2, 2014.

	Common Stock Price Range		Dividends
	High	Low	Declared Per Share
Fiscal Year 2014			
First quarter ended March 31, 2014	$34.77	$26.34	$0.08
Second quarter ended June 30, 2014	$28.29	$22.48	$0.08
Third quarter ended September 30, 2014	$24.44	$18.77	$0.08
Fourth quarter ended December 31, 2014	$20.48	$14.65	$0.08
Fiscal Year 2013			
First quarter ended March 31, 2013	$32.65	$28.24	$—
Second quarter ended June 30, 2013	$36.69	$27.60	$0.08
Third quarter ended September 30, 2013	$34.01	$29.42	$0.08
Fourth quarter ended December 31, 2013	$36.70	$29.32	$0.08

At January 31, 2015, there were 110 shareholders of record. In calculating the number of shareholders, we consider clearing agencies and security position listings as one shareholder for each agency or listing.

Share Repurchases

On February 25, 2014, our Board of Directors authorized a new $350 million share repurchase program, which replaces and terminates the August 26, 2011 share repurchase program. The authorization does not specify an expiration date for the share repurchase program.

We also have a share maintenance program to repurchase shares based on vesting and other activity under our equity compensation plans. In a given fiscal year, we allocate repurchased shares first to our maintenance program and next to our Board-authorized repurchase program. In the months in which we have not repurchased but have had to cover vesting on our equity compensation plans we reduce previous repurchases under the Board-authorized repurchase program.

Under our Credit Agreement, we are permitted to repurchase our common stock provided that no such repurchases shall be made from the proceeds borrowed under the Credit Agreement and that the aggregate purchase price and dividends paid after December 2, 2013 does not exceed the Distribution Cap. At December 31, 2014, the remaining availability under the Distribution Cap was approximately $468 million. The declaration, payment or increase of any future dividends will be at the discretion of our Board of Directors and will depend upon, among other things, future earnings, general financial condition and liquidity, success in business activities, capital requirements and general business conditions. Since January 2007, we have repurchased $731 million of our outstanding common stock.

The following is a summary of share repurchases of our common stock settled during the three months ended December 31, 2014.

Purchase Period	Total Number of Shares Purchased [(1)]	Average Price Paid per Share [(3)]	Total Number of Shares Purchased as Part of Publicly Announced Plan [(2)]	Dollar Value of Maximum Number of Shares that May Yet Be Purchased Under the Plan
October 1 – 31, 2014	—	$—	—	$265,330,176
November 3 – 28, 2014	—	$20.78	(2,880)	$265,390,024
December 1 – 31, 2014	230,400	$15.59	228,208	$261,832,261
Total	230,400	$15.52	225,328	$261,832,261

(1) Does not include shares withheld for tax purpose or forfeitures under our equity plans. Shares are acquired from employees in connection with the settlement of income tax and related benefit-withholding obligations arising from the vesting of restricted stock units. For the three month period ended December 31, 2014, 507 shares were acquired to cover employee transactions at an average price of $18.23.

(2) Represents the number of shares applied to the share repurchase program authorized and announced on February 25, 2014 less shares allocated to our maintenance program. Repurchases applied to cover our share maintenance plan for the three month period ended December 31, 2014, were 5,072 shares at an average price of $18.54 per share.

(3) We did not repurchase shares in October and November of 2014. The average price paid per share of $20.78 reflects the average price paid on the previous repurchases in August 2014.

Performance Graph

The chart below compares the cumulative total shareholder return on shares of our common stock for the five-year period ended December 31, 2014, with the cumulative total return on the Dow Jones Heavy Construction Industry Index and the Russell 1000 Index for the same period. The comparison assumes the investment of $100 on December 31, 2009 and reinvestment of all dividends. The shareholder return is not necessarily indicative of future performance.

	12/31/2009	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014
KBR	$ 100.00	$ 161.70	$ 148.90	$ 160.95	$ 171.54	$ 91.18
Dow Jones Heavy Construction	100.00	127.89	105.04	126.90	165.86	122.89
Russell 1000	100.00	113.87	113.29	129.07	168.36	186.99

Item 6.Selected Financial Data

The following table presents selected financial data for the last five years. You should read the following information in conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements and the related notes to the consolidated financial statements.

	Years Ended December 31,				
	2014	2013	2012	2011	2010
Dollars in millions, except per share amounts					
Statement of Operations Data:					
Revenues	$6,366	$7,214	$7,770	$9,103	$9,962
Gross profit (loss)	(65)	417	518	640	689
Equity in earnings of unconsolidated affiliates	163	137	151	158	137
Impairment of goodwill, asset impairments and restructuring charges (a)	(660)	—	(180)	—	(5)
Operating income (loss)	(794)	308	299	587	609
Income (loss) from continuing operations, net of tax (b)	(1,198)	171	202	540	395
Net income attributable to noncontrolling interests	(64)	(96)	(58)	(60)	(68)
Net income (loss) attributable to KBR	(1,262)	75	144	480	327
Basic net income (loss) attributable to KBR per share	$(8.66)	$0.50	$0.97	$3.18	$2.08
Diluted net income (loss) attributable to KBR per share	$(8.66)	$0.50	$0.97	$3.16	$2.07
Cash dividends declared per share (c)	$0.32	$0.24	$0.28	$0.20	$0.15
Balance Sheet Data (as of the end of period):					
Total assets	$4,199	$5,438	$5,767	$5,666	$5,417
Long-term nonrecourse project-finance debt	63	78	84	88	92
Total shareholders’ equity	$935	$2,439	$2,511	$2,442	$2,204
Other Financial Data (as of the end of period):					
Backlog of unfulfilled orders	$10,859	$14,118	$14,931	$10,931	$12,041

(a) Included in 2014 is a goodwill impairment charge of $446 million related to three of our previous reporting units. Included in 2012 is a goodwill impairment charge of $178 million related to one of our previous reporting units. Included in 2014, 2012 and 2010 are impairment of long-lived asset charges of $171 million, $2 million and $5 million, respectively, primarily related to equipment, land and buildings. Also included in 2014 are restructuring charges of $43 million.

(b) Included in 2014 is a $421 million of tax expense primarily related to valuation allowance on U.S. federal, foreign and state net operating loss carryforwards, foreign tax credit carryforwards, other deferred tax assets and foreign tax expense.

(c) In 2012, we declared five dividends totaling $0.28 per share. In each quarter during 2012, we declared a dividend of $0.05 per share. In the fourth quarter of 2012, we declared an additional dividend of $0.08 per share on December 18, 2012. Consequently, in 2013 we declared only three dividends totaling 0.24 per share.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

Management's discussion and analysis ("MD&A") should be read in conjunction with Part I of this Form 10-K as well as the consolidated financial statements and related notes included in Item 8 of this Form 10-K.

Executive Overview

Business Reorganization

Following the June 2014 appointment of Mr. Stuart Bradie as CEO, we announced plans to undertake a global strategic review of our business. The outcome of this review was a reorganization of our business into three new segments, T&C, E&C and GS to focus on core strengths in global hydrocarbons and international government services. Our corporate expenses and other operations that do not individually meet the criteria for group presentation continue to be reported in our Other business segment, while operations we intend to sell or exit upon completion of our existing contracts are presented separately in the Non-strategic Business segment. Each business segment excluding "Other" reflects a reportable segment led by a separate business segment president who reports directly to our chief operating decision maker ("CODM"). See "Item 1. Business" for a description of the new business segments. We have revised our business segment reporting to reflect our current management approach and recast prior periods to conform to the current business segment presentation.

Business Environment

Demand for our services depends primarily on the level of capital expenditure in our market sectors, which is driven generally by global and regional economic growth (primarily GDP growth) and more specifically by the demand for energy and derivative products and government services. While the recent decline in oil prices may have a near term adverse impact on our business, we see long-term growth in energy projects such as low cost production, shallow water, onshore production, subsea tiebacks and brownfields revamping. Low energy prices reflected in the current oil price provide opportunities in brownfield LNG and new petrochemicals, chemicals and fertilizer markets. We believe KBR has a balanced portfolio of upstream, midstream and downstream and recurring revenues in outsourced government services, which provides us with less exposure to the oil price declines than some of our peers.
We expect LNG demand to grow annually mainly in Asia and demand in Europe to rebound. We expect global capacity coming online in the next 15 years to translate to the letting of two LNG plants per year, which is consistent with the last five years. Growth regions include U.S. Gulf Coast and the Asia-Pacific region; Canada, due to new tax rules; and East Africa, due to successful appraisals.

Overview of Financial Results

2014 was a transitional year for KBR with the arrival of a new CEO and the launch of a major strategic business review. This review was completed in December 2014 and we intend to focus future efforts on the global hydrocarbons and international government services markets. As a result of this decision, we decided to divest or exit the following businesses upon completion of existing projects:

- Fixed priced EPC power projects
- Fixed priced U.S. infrastructure and mining business
- Building Group
- Fixed price construction-only projects

The 2014 financial results include significant restructuring charges, impairments of goodwill and other assets, and tax valuation allowances from the strategic review that total approximately $1.1 billion. Our results for the year ended December 31, 2014 were also impacted by the following:

- Reduced revenues and gross profit due to lower activity or the completion of several mega LNG and GTL projects
- Reduced gross profit due to increases in estimates of costs to complete certain projects, including recognition of additional losses on our Canadian pipe fabrication and module assembly projects.

Our financial results continue to be driven by our E&C business segment, which is where we execute large EPC projects. This segment generated revenues of $4.6 billion and gross profit of $141 million during 2014. While we continue to successfully execute close-out activities on some of our major LNG/GTL projects, our E&C business segment remains focused on actively pursuing new prospects in the LNG/GTL markets and in the petrochemical markets. We do not expect the next major LNG EPC award until early 2016 and beyond. During 2014, our E&C business segment also experienced an increase in EPC activity on refining, petrochemical and chemicals projects driven in large part by the abundant supply and low natural gas prices in North America. Although we incurred losses during the first two quarters of 2014 on our Canadian pipe fabrication and module assembly projects, the losses were less than 2013 and five of the seven projects are now complete. During the fourth quarter we generated modest profit from claims recovery on several of these completed projects. One of the Canadian pipe fabrication and module assembly contracts that is in a loss position is a master services-type agreement that provides our client with the right, but not the obligation, to place new pipe fabrication and module assembly orders until 2017. During 2014, we did not execute any new orders under this agreement.

Our GS business continues to be impacted by declines in our government logistics and support business, the slow-down in government investments and by ongoing close-out costs associated with litigation and commercial disputes on legacy U.S. government contracts that supported the U.S. military in Iraq (LogCAP III and RIO projects).

Our results were also impacted by a decline in building projects and increased costs to complete our power projects, which resulted in the recognition of loss on two projects, all of which are reported within our Non-strategic Business segment.
Our backlog of unfilled orders declined in 2014 as we completed two mega EPC (i.e. LNG and GTL) projects and continue to execute two additional mega LNG projects.

Revenues

			2014 vs. 2013			2013 vs. 2012	
Dollars in millions	2014	2013	$	%	2012	$	%
Revenues	$6,366	$7,214	$(848)	(12)%	$7,770	$(556)	(7)%

Consolidated revenues decreased in 2014 compared to 2013. This decrease was primarily driven by reduced volumes within our E&C business segment resulting from the completion or near completion of EPC projects in our LNG/GTL markets, partially offset by new awards of refining, petrochemicals and chemicals projects. Lower overall volumes associated with our GS business segment's support and logistics activities in Iraq and Afghanistan for the U.S. and U.K. governments, respectively, also contributed to the decline. Additionally, the reduction in revenues was due to completion of several building projects within our Non-strategic Business segment.

Consolidated revenues decreased in 2013 compared to 2012. This decline was primarily driven by the reduced volume as we entered the early completion phases of the EPC projects previously noted, partially offset by activities on large new awards within our E&C business segment. The decrease was also attributable to reduced volumes driven by base closures and headcount reductions under the contract supporting the U.S. Military and the U.S. Department of State in Iraq. There was also a reduction of commercial support and other services for the U.K. MoD in Afghanistan and other locations. These declines were partially offset by activities on new projects within our Non-strategic Business segment.

Gross Profit (Loss)

Dollars in millions	2014	2013	2014 vs. 2013 $	2014 vs. 2013 %	2012	2013 vs. 2012 $	2013 vs. 2012 %
Gross profit (loss)	$(65)	$417	$(482)	(116)%	$518	$(101)	(19)%

Consolidated gross profit decreased in 2014 compared to 2013. This decrease was primarily attributable to an increase in estimated costs to complete projects within our Non-strategic Business segment and reduced volumes resulting from completion of our GS contracts discussed above. Within our E&C business segment, reduced volume as we reached peak activity in 2013 on certain EPC projects, higher estimated costs to complete certain projects and the positive impact of a fee negotiation in 2013, which did not recur in 2014, contributed to the reduction in gross profit. The impact of these decreases was partially offset by the reduction in losses on our Canadian pipe fabrication and module assembly projects in 2014 compared to 2013.

Consolidated gross profit decreased in 2013 compared to 2012. This decline was driven by reduced activity on the EPC projects, cost savings realized in 2012, which did not recur in 2013, the impact of a foreign currency adjustment on an EPC project as well as increased estimated costs to complete certain Canadian pipe fabrication and module assembly projects all within our E&C business segment. This decrease was partially offset by activity on new awards within our Non-strategic Business segment.

Equity in Earnings of Unconsolidated Affiliates

Dollars in millions	2014	2013	2014 vs. 2013 $	2014 vs. 2013 %	2012	2013 vs. 2012 $	2013 vs. 2012 %
Equity in earnings of unconsolidated affiliates	$163	$137	$26	19%	$151	$(14)	(9)%

Equity in earnings of unconsolidated affiliates increased in 2014 compared to 2013. This change was primarily due to increased activity and progress on an LNG project joint venture within our E&C business segment and by an insurance recovery and reduced costs on a joint venture project in our GS business segment, offset by a reduction in volume as we near completion of construction activities on this project.

Equity in earnings of unconsolidated affiliates decreased in 2013 compared to 2012. This change was primarily due to extended dry docking and lower utilization of marine vessels in our MMM joint venture, interruptions in natural gas feedstock in our ammonia plant joint venture in Egypt, partially offset by increased activity and progress on an LNG project joint venture within our E&C business segment. The decline was also due to reduced construction activity on the GS joint venture discussed above.

General and Administrative Expenses

Dollars in millions	2014	2013	2014 vs. 2013 $	2014 vs. 2013 %	2012	2013 vs. 2012 $	2013 vs. 2012 %
General and administrative expenses	$(239)	$(248)	$(9)	(4)%	$(222)	$26	12%

General and administrative expenses decreased in 2014 compared to 2013. The decrease was primarily due to lower information technology support costs and reduced overhead costs resulting from headcount reductions and cost savings initiatives implemented at the end of 2013 and during 2014. Our general and administrative expenses for 2014 and 2013 included $35 million each related to our ERP project. Amortization on the completed phase of the project was $15 million and $7 million for 2014 and 2013, respectively. General and administrative expenses in 2014 included $174 million related to corporate and $66 million related to the business segments.

General and administrative expenses increased in 2013 compared to 2012. The increase was primarily due to higher ERP project expenses, consulting and legal expenses related to tax items, including arbitration with our former parent and changes in our risk and benefit programs. These increases were partially offset by lower incentive compensation costs in 2013. Our general and administrative expenses for 2013 and 2012 included $35 million and $20 million, respectively, related to our ERP project. Amortization on the completed phase of the project was $7 million and less than $1 million for 2013 and 2012, respectively. General and administrative expenses in 2013 included $179 million related to corporate and $72 million related to the business segments.

Impairment and Restructuring Charges

Dollars in millions	2014	2013	2014 vs. 2013 $	2014 vs. 2013 %	2012	2013 vs. 2012 $	2013 vs. 2012 %
Impairment of goodwill	$(446)	$—	$446	100%	$(178)	$(178)	(100)%
Asset impairment and restructuring charges	$(214)	$—	$214	100%	$(2)	$(2)	(100)%

As a result of our December 11, 2014 strategic reorganization announcement, including our decisions to exit certain businesses, and continued business decline in certain markets, we recognized an impairment charge of $446 million related to the remaining goodwill on our Roberts and Schaefer (R&S) acquisition and the goodwill on our BE&K acquisition. We also recognized a $31 million impairment of R&S intangible assets.

On December 11, 2014, we also announced that we were discontinuing the implementation of our ERP project. This resulted in a $135 million impairment charge for the portion of the ERP project we do not expect will provide us any future benefits.

As part of our reorganization of our business and associated restructuring, we have started the process of reducing headcount and and recognized a severance charge of $29 million. Additionally, we terminated leases in several locations, resulting in lease termination charges of $14 million. We also recognized a $5 million impairment charge related to leasehold improvements on the terminated leases and other property.

See Note 8 and 9 to our consolidated financial statements for further discussion on our goodwill and asset impairment and restructuring charges.

In the third quarter of 2012 in connection with our interim impairment review, we recognized a noncash goodwill impairment charge of $178 million related to one of our previous reporting units (see Note 8 to our consolidated financial statements for further discussion).

Non-operating Income (Expenses)

Dollars in millions	2014	2013	2014 vs. 2013 $	2014 vs. 2013 %	2012	2013 vs. 2012 $	2013 vs. 2012 %
Non-operating income (expenses)	$17	$(8)	$25	313%	$(11)	$(3)	(27)%

We had non-operating income in 2014 compared to non-operating expense in 2013. The change was primarily attributable to a $24 million gain related to a negotiated dispute settlement with our former parent.

Non-operating expenses decreased in 2013 compared to 2012. This decrease was primarily attributable to a reduction in interest expense due to higher interest income on our treasury-managed time deposits.

Provision for Income Taxes

Dollars in millions	2014	2013	2014 vs. 2013 $	2014 vs. 2013 %	2012	2013 vs. 2012 $	2013 vs. 2012 %
Income (loss) before provision for income taxes	$(777)	$300	$(1,077)	n/m	$288	$12	4%
Provision for income taxes	$(421)	$(129)	$292	n/m	$(86)	$43	50%

n/m - not meaningful

Provision for income taxes increased in 2014 compared to 2013. We recognized income tax expense of $421 million in 2014 on our loss before provision for income taxes instead of recognizing a tax benefit primarily as a result of the nondeductible goodwill impairment loss, an increase in our valuation allowance for deferred tax assets and recognition of taxes on undistributed earnings.

Provision for income taxes increased in 2013 compared to 2012 . Income tax expense in 2013 increased primarily as a result of an increase of $47 million in valuation allowance for the year ended December 31, 2013 as a result of losses recognized in our Canada pipe fabrication and module assembly business and certain state net operating losses.

A reconciliation of our effective tax rates for 2014, 2013 and 2012 to the U.S. statutory federal rate is presented in Note 13 to our consolidated financial statements.

Net Income Attributable to Noncontrolling Interests

			2014 vs. 2013			2013 vs. 2012	
Dollars in millions	2014	2013	$	%	2012	$	%
Net income attributable to noncontrolling interests	$(64)	$(96)	$(32)	(33)%	$(58)	$38	66 %

Net income attributable to noncontrolling interests decreased in 2014 compared to 2013. This decrease is primarily due to earnings from the renegotiation of fees and cost recoveries on a joint venture project which were recognized in our E&C business segment in 2013 but did not recur in 2014.

Net income attributable to noncontrolling interests increased in 2013 compared to 2012. This increase is primarily due to the renegotiation of fees and cost recoveries on a joint venture project that were recognized in our E&C business segment.

Results of Operations by Business Segment

We analyze the financial results for each of our five business segments. The business segments presented are consistent with our reportable segments discussed in Note 2 to our consolidated financial statements.

	Years Ended December 31,						
			2014 vs. 2013			2013 vs. 2012	
Dollars in millions	2014	2013	$	%	2012	$	%
Revenues							
Technology & Consulting	$353	$330	$23	7 %	$296	$34	11 %
Engineering & Construction	4,584	4,956	(372)	(8)%	5,616	(660)	(12)%
Government Services	638	931	(293)	(31)%	1,105	(174)	(16)%
Other	—	—	—	— %	—	—	— %
Subtotal	$5,575	$6,217	$(642)	(10)%	$7,017	$(800)	(11)%
Non-strategic Business	791	997	(206)	(21)%	753	244	32 %
Total	$6,366	$7,214	$(848)	(12)%	$7,770	$(556)	(7)%
Gross profit							
Technology & Consulting	$53	$69	$(16)	(23)%	$80	$(11)	(14)%
Engineering & Construction	141	263	(122)	(46)%	450	(187)	(42)%
Government Services	(32)	90	(122)	(136)%	83	7	8 %
Other	—	—	—	— %	—	—	— %
Subtotal	$162	$422	$(260)	(62)%	$613	$(191)	(31)%
Non-strategic Business	(227)	(5)	(222)	n/m	(95)	90	95 %
Total	$(65)	$417	$(482)	(116)%	$518	$(101)	(19)%
Equity in earnings of unconsolidated affiliates							
Technology & Consulting	$—	$—	$—	— %	$—	$—	— %
Engineering & Construction	90	76	14	18 %	79	(3)	(4)%
Government Services	73	61	12	20 %	67	(6)	(9)%
Other	—	—	—	— %	—	—	— %
Subtotal	$163	$137	$26	19 %	$146	$(9)	(6)%
Non-strategic Business	—	—	—	— %	5	(5)	(100)%
Total	$163	$137	$26	19 %	$151	$(14)	(9)%
Total general and administrative expense	$(239)	$(248)	$(9)	(4)%	$(222)	$26	12 %
Impairment of goodwill	$(446)	$—	$446	— %	$(178)	$(178)	(100)%
Asset impairment and restructuring charges	$(214)	$—	$214	— %	$(2)	$(2)	(100)%
Gain on disposition of assets	$7	$2	$5	250 %	$32	$(30)	n/m
Total operating income	$(794)	$308	$(1,102)	(358)%	$299	$9	3 %

n/m - not meaningful

31

Technology & Consulting

T&C revenues increased by $23 million, or 7%, to $353 million in 2014 compared to $330 million in 2013 driven largely by an increase in proprietary equipment supply on several ammonia plants and an increase in the number of consulting projects. This improvement was partially offset by a reduction in volume attributable to delays in project awards and a decline in BED activities on several projects.

T&C gross profit decreased by $16 million, or 23%, to $53 million in 2014 compared to $69 million in 2013 due primarily to the project delays and decline in BED activities discussed above, offset by the impact to gross profit of the increased revenues from proprietary equipment supply and consulting projects.

T&C revenues increased by $34 million, or 11%, to $330 million in 2013 compared to $296 million in 2012 primarily due to an increase in the delivery of PEQ and license and basic engineering design ("LBED") on several ammonia projects offset by slight decreases in consulting activities resulting from low volume of new awards in our Australia market.

T&C gross profit decreased by $11 million, or 14%, to $69 million in 2013 compared to $80 million in 2012 due to a decline in licensing activities and increased proposal costs in 2013.

Engineering & Construction

E&C revenue decreased by $372 million, or 8%, to $4.6 billion in 2014 compared to $5.0 billion in 2013. This decrease was primarily due to lower activity on EPC projects in our LNG/GTL markets, as they neared completion in 2014, and reduced construction projects in the U.S. market. These decreases were partially offset by increased activity on EPC contracts for downstream projects in North America, increased activity on several Canadian pipe fabrication and module assembly and construction projects, increased activity on an upstream project in Azerbaijan and an increase in KBR services on an LNG project joint venture in Australia.

E&C gross profit decreased by $122 million, or 46%, to $141 million in 2014 compared to $263 million in 2013 due to higher activity and incentive fees on an LNG project in Australia in 2013 that did not recur in 2014 and a reduction in gross profit resulting from an increase in estimated costs to complete certain projects. These decreases were partially offset by reduced losses of $60 million on our Canadian pipe fabrication and module assembly projects, start-up work on an ammonia plant in North America and $45 million in charges taken on LNG projects in 2013 that did not recur in 2014.

E&C equity in earnings in unconsolidated affiliates increased by $14 million, or 18%, to $90 million in 2014 compared to $76 million in 2013 due primarily to increased progress on an LNG project in Australia. This increase was partially offset by reduced earnings on the MMM joint venture in Mexico, because the vessels were out of contract for a significant portion of 2014.

E&C revenue decreased by $660 million, or 12%, to $5.0 billion in 2013 compared to $5.6 billion in 2012 as a result of reduced volume on a GTL project in Nigeria and an LNG project in Algeria as these projects were completed or neared completion. This decrease was partially offset by revenue recorded in the third quarter of 2013 resulting from a change order on an LNG project in Australia, increased activity on EPC contracts for chemicals projects in North America and scope growth on a base oil project in North America.

E&C gross profit decreased by $187 million, or 42%, to $263 million in 2013 compared to $450 million in 2012 as a result of reduced activity on an LNG project in Algeria as it neared completion in 2013, $97 million in losses on Canadian pipe fabrication and module assembly projects and increased overheads. These decreases were partially

offset by increased activity on an LNG project in Australia and losses on several U.S. construction projects in 2012 that did not reoccur in 2013.

E&C equity in earnings in unconsolidated affiliates decreased by $3 million, or 4%, to $76 million in 2013 compared to $79 million in 2012 due to extended dry dock and out of contract periods for vessels in our MMM joint venture. This decline is also due to reduced earnings on our ammonia plant joint venture in Egypt, arising from lower ammonia production brought about by curtailments in the supply of natural gas feedstock and is partially offset by earnings from increased activities and overall project growth on an LNG project joint venture in Australia.

Government Services

GS revenues decreased by $293 million, or 31% to $638 million in 2014 compared to $931 million in 2013. This decline was driven primarily by a $246 million reduction in revenues following the March 31, 2014 completion of activities supporting the U.S. military and U.S. Department of State for the war in Iraq and a $45 million decrease from reduction in troop numbers on U.K. MoD and NATO contracts in Afghanistan. Settlement of outstanding items on LogCAP III and adjustments to reserves for questioned costs on the RIO contract (GS Legacy Contracts), resulted in a $94 million reduction in revenues. These decreases were partially offset by new awards of U.S. government construction and base support contracts in Europe and Africa as well as the award of a long term contract with the U.K. Metropolitan Police.

GS gross profit decreased by $122 million, or 136% to a loss of $32 million in 2014 compared to gross profit of $90 million in 2013. This decline was primarily driven by the completion of the U.S. military and U.S. Department of State support contract as well as the U.K. MoD support activities discussed above. The settlement and reserves for questioned costs on the GS Legacy Contracts discussed above also reduced gross profit by $66 million. Additionally, the reduction in gross profit was attributable to an increase in our estimate of costs to complete the roads project in Qatar and a construction management contract with the U.S. government in Europe.

GS equity in earnings in unconsolidated affiliates increased by $12 million, or 20% to $73 million in 2014 compared to $61 million in 2013. This increase was primarily due to an insurance recovery and reduced costs on a joint venture for a U.K. MoD project, offset by a reduction in volume as we near completion of construction activities on this joint venture project.

GS revenue decreased by $174 million, or 16% to $931 million in 2013 compared to $1.1 billion in 2012. The decrease was driven by base closures and headcount reductions under the contract supporting the U.S. Military and the U.S. Department of State in Iraq as well as reduced activity on contracts for the U.K. MoD including completion of a portion of a support services contract in Afghanistan. As the U.S. government continued its withdrawal from Iraq, the volume of support services also continued to decline. There was also reduced activity related to commercial support services in Africa, reduced activity on a major contract for the U.K. MoD, and completion of a portion of U.K. MoD contracts in Afghanistan. Our offerings in the Asia-Pacific region were affected by the continuing slow market conditions and also from reduced government and private sector investments.

GS gross profit increased by $7 million, or 8% to $90 million in 2013 compared to $83 million in 2012. This increase was due to project charges of $28 million related to the unfavorable U.S. government ruling associated with dining facility services in Iraq in 2012 that did not recur. Gross profit in 2013 includes the reversal of $25 million of reserves due to the progress of audits, offset by declines due to reduced activity in the Middle East under the contract supporting the U.S. Military and the U.S. Department of State in Iraq.

GS equity in earnings in unconsolidated affiliates decreased by $6 million, or 9% to $61 million in 2013 compared to $67 million in 2012. This decrease was due to the existing U.K. MoD construction project slowly nearing completion.

Non-strategic Business

Non-strategic Business revenue decreased by $206 million, or 21%, to $791 million in 2014 compared to $1 billion in 2013. This was largely due to the completion or near completion of several building construction projects. The decline was partially offset by higher revenues from increased activity on two power projects.

Non-strategic Business gross loss increased by $222 million to $227 million in 2014 compared to $5 million in 2013. This increase in gross loss was primarily due to a $173 million impact from an increase in the estimate of costs to

complete three power projects, resulting in losses or reduced margins on these projects, a settlement on a minerals project and increased legal reserves on an infrastructure project.

Non-strategic Business revenue increased by $244 million, or 32%, to $1 billion in 2013 compared to $753 million in 2012. This was primarily due to increased activity on several building and power projects. These increases were partially offset by minerals projects completed in 2013.

Non-strategic Business gross loss decreased by $90 million, or 95%, $5 million in 2013 compared to $95 million in 2012. This decrease was primarily due to losses incurred on minerals projects in 2012 that did not recur in 2013. In addition, several new projects were added in the building, minerals and power sectors during 2013.

Changes in Estimates

Information relating to our changes in estimates is discussed in Note 2 to our consolidated financial statements and the information discussed therein is incorporated by reference into this Item 7.

Acquisitions and Other Transactions

Information relating to various acquisitions and other transactions is described in "Item 1. Business" and the information discussed therein is incorporated by reference into this Item 7.

Backlog of Unfilled Orders

Backlog generally represents the dollar amount of revenues we expect to realize in the future as a result of performing work on contracts and our pro-rata share of work to be performed by unconsolidated joint ventures. We generally include total expected revenues in backlog when a contract is awarded under a legally binding commitment. In many instances, arrangements included in backlog are complex, nonrepetitive in nature and may fluctuate depending on estimated revenues and contract duration. Where contract duration is indefinite, projects included in backlog are limited to the estimated amount of expected revenues within the following twelve months. Certain contracts provide maximum dollar limits, with actual authorization to perform work under the contract agreed upon on a periodic basis with the customer. In these arrangements, only the amounts authorized are included in backlog. For projects where we act solely in a project management capacity, we only include the value of our services of each project in backlog. For certain long-term service contracts with a defined contract term, such as those associated with privately financed projects, the amount included in backlog is limited to five years.

We have included in the table below our proportionate share of unconsolidated joint ventures' estimated revenues. However, because these projects are accounted for under the equity method, only our share of future earnings from these projects will be recorded in our results of operations. Our backlog for projects related to unconsolidated joint ventures totaled $4.3 billion at December 31, 2014 and $5.5 billion at December 31, 2013. We consolidate joint ventures which are majority-owned and controlled or are variable interest entities in which we are the primary beneficiary. Our backlog included in the table below for projects related to consolidated joint ventures with noncontrolling interests includes 100% of the backlog associated with those joint ventures and totaled $928 million at December 31, 2014 and $1.5 billion at December 31, 2013. All backlog is attributable to firm orders as of December 31, 2014 and 2013. Backlog attributable to unfunded government orders was $36 million at December 31, 2014 and $166 million at December 31, 2013. The following table summarizes our backlog by business segment.

Dollars in millions	December 31, 2013	New Awards	Changes in scope on existing contracts (a)	Net Workoff (b)	December 31, 2014
Technology & Consulting	$458	$182	$130	$(370)	$400
Engineering & Construction	10,712	1,571	239	(4,734)	7,788
Government Services	2,175	216	83	(711)	1,763
Subtotal	13,345	1,969	452	(5,815)	9,951
Non-strategic Business	773	803	46	(714)	908
Total backlog	$14,118	$2,772	$498	$(6,529)	$10,859

(a) In addition to changes in scope, these amounts reflect the elimination of our proportionate share of non-partner costs related to our unconsolidated joint ventures.

(b) These amounts include the net workoff of our projects as well as our proportionate share of the net workoff of our unconsolidated joint ventures projects.

We estimate that as of December 31, 2014, 51% of our backlog will be executed within one year. As of December 31, 2014, 40% of our backlog was attributable to fixed-price contracts and 60% of our backlog was attributable to cost-reimbursable contracts. For contracts that contain both fixed-price and cost-reimbursable components, we classify the components as either fixed-price or cost-reimbursable according to the composition of the contract; however, except for smaller contracts, we characterize the entire contract based on the predominant component.

Liquidity and Capital Resources

Cash and equivalents totaled $970 million at December 31, 2014 and $1.1 billion December 31, 2013 and consisted of the following:

Dollars in millions	December 31, 2014	2013
Domestic U.S. cash	$200	$355
International cash	690	675
Joint venture cash	80	76
Total	$970	$1,106

Domestic cash relates to cash balances held by U.S. entities and is largely used to support obligations of those businesses as well as general corporate needs such as the payment of dividends to shareholders and potential repurchases of our outstanding common stock.

The international cash balances may be available for general corporate purposes but are subject to local restrictions such as capital adequacy requirements and local obligations such as maintaining sufficient cash balances to support our underfunded U.K. pension plan and other obligations incurred in the normal course of business by those foreign entities. Repatriated foreign cash may become subject to U.S. income taxes.

Joint venture cash balances reflect the amounts held by joint venture entities that we consolidate for financial reporting purposes. Such amounts are limited to joint venture activities and are not readily available for general corporate purposes but portions of such amounts may become available to us in the future should there be distribution of dividends to the joint venture partners. We expect that the majority of the joint venture cash balances will be utilized for the corresponding joint venture projects.

Cash generated from operations is our primary source of operating liquidity. Our cash balances are held in numerous locations throughout the world. We believe that existing cash balances and internally generated cash flows are sufficient to support our day-to-day domestic and foreign business operations for at least the next 12 months.

In December 2014, we implemented a foreign cash repatriation strategy for which we have provided cumulative income taxes of $98 million on certain foreign earnings which provide us, if necessary, the ability to repatriate approximately an additional $370 million of international cash without recognizing additional tax expense. In determining our foreign cash repatriation strategy and in determining whether earnings would continue to be considered permanently invested, we considered our future U.S. and non-U.S. cash needs such as 1) our anticipated foreign working capital requirements, including funding of our U.K. pension plan; 2) the expected growth opportunities across all geographical markets; and 3) our plans to invest in strategic growth opportunities that may include acquisitions around the world. The remaining international cash balances associated with past foreign earnings which we currently intend to permanently reinvest in our foreign entities are not available for domestic use. The company has not recognized an estimated deferred tax liability of approximately $320 million for undistributed earnings it continues to consider to be permanently reinvested in the foreseeable future. These undistributed earnings could be subject to additional tax if remitted, or deemed remitted, as a dividend.

Our operating cash flow can vary significantly from year to year and is affected by the mix, terms and percentage of completion of our engineering and construction projects. We sometimes receive cash through billings to our customers on our larger engineering and construction projects and those of our consolidated joint ventures in advance of incurring the related costs. In other projects our net investment in the project costs may be greater than available

project cash and we may utilize other cash on hand or availability under our Credit Agreement to satisfy any periodic operating cash requirements.

Engineering and construction projects generally require us to provide credit support to our customers in the form of letters of credit, surety bonds or guarantees. Our ability to obtain new project awards in the future may be dependent on our ability to maintain or increase our letter of credit and surety bonding capacity, which may be further dependent on the timely release of existing letters of credit and surety bonds. As the need for credit support arises, letters of credit will be issued under our Credit Agreement or arranged with our banks on a bilateral, syndicated or other basis. We believe we have adequate letter of credit capacity under our existing Credit Agreement and bilateral lines, as well as adequate surety bond capacity under our existing lines to support our operations and current backlog for the next twelve months.

As of December 31, 2014, substantially all of our excess cash was held in commercial bank time deposits with the primary objectives of preserving capital and maintaining liquidity.

Cash flows activities summary

	December 31,		
Dollars in millions	2014	2013	2012
Cash flows provided by operating activities	$170	$297	$142
Cash flows provided by (used in) investing activities	(44)	(62)	52
Cash flows used in financing activities	(210)	(148)	(116)
Effect of exchange rate changes on cash	(52)	(34)	9
Increase (decrease) in cash and equivalents	$(136)	$53	$87

Operating activities. Cash provided by operations totaled $170 million in 2014 and was primarily attributable to distributions of earnings received from unconsolidated affiliates of $249 million and fluctuations in our working capital accounts. This increase was partially offset by contributions of approximately $48 million to our pension funds.

Cash provided by operations totaled $297 million in 2013 and resulted from our earnings, working capital and distributions of earnings received from unconsolidated affiliates of $180 million, partially offset by our payment of $108 million in outstanding performance bonds to PEMEX Exploration and Production ("PEP"), other uses driven by taxes and contributions of approximately $54 million to our pension funds. See Note 15 to our consolidated financial statements for further discussion of the performance bonds.

Cash provided by operations totaled $142 million in 2012 and resulted from our earnings, adjusted for items to reconcile to net income, of $317 million, distributions of earnings received from unconsolidated affiliates, including repayment of advances to unconsolidated affiliates, of $102 million and subcontractor advances of $131 million. These increases were partially offset by working capital uses related to the E&C business segment and our business with the U.S. government in our Government Services business segment.

Investing activities. Cash used in investing activities totaled $44 million in 2014, which was primarily due to purchases of property, plant and equipment associated with information technology projects which have now largely been stopped.

Cash used in investing activities totaled $62 million in 2013 which was primarily due to purchases of property, plant and equipment associated with information technology projects.

Cash provided by investing activities totaled $52 million in 2012 which was primarily due to proceeds of $127 million from the sale of our interest in the 601 Jefferson building and the Clinton Drive campus facility. These proceeds were offset by capital expenditures of $75 million associated with information technology projects and leasehold and facility improvements.

Financing activities. Cash used in financing activities totaled $210 million in 2014 and included $106 million for the purchase of treasury stock, $47 million for dividend payments to common shareholders, $61 million for distributions to noncontrolling interests and $11 million for principal payments on short- and long-term borrowings consisting primarily of nonrecourse debt of our Fasttrax variable interest entity ("VIE"). The uses of cash were partially offset by $10 million of investments from noncontrolling interests and $4 million of proceeds from the exercise of stock options.

Cash used in financing activities totaled $148 million in 2013 and included $7 million for the purchase of treasury stock, $36 million for dividend payments to common shareholders, $109 million for distributions to noncontrolling interests and $14 million for principal payments on short- and long-term borrowings consisting primarily of nonrecourse debt of our Fasttrax VIE and computer software purchases financed in 2010. The uses of cash were partially offset by $9 million of investments from noncontrolling interests and $6 million of proceeds from the exercise of stock options.

Cash used in financing activities totaled $116 million in 2012 and included $40 million for the purchase of treasury stock, $37 million for dividend payments to common shareholders, $36 million for distributions to noncontrolling interests and $14 million for principal payments on short- and long-term borrowings consisting primarily of nonrecourse debt of our Fasttrax VIE

and computer software purchases financed in 2010. The uses of cash were partially offset by $11 million of tax benefits associated with stock exercises and proceeds from the exercise of stock options.

Future sources of cash. Future sources of cash include cash flows from operations, including cash advances from our clients, cash derived from working capital management and cash borrowings under our Credit Agreement as well as potential litigation proceeds.

Future uses of cash. Future uses of cash will primarily relate to working capital requirements, including payments to our former parent as a result of a settlement, capital expenditures, dividends, share repurchases and strategic investments. In addition, we will use cash to fund pension obligations, payments under operating leases and various other obligations, including potential litigation payments, as they arise. Our capital expenditures will be focused primarily on information technology, real estate, facilities and equipment. See “Off-Balance Sheet Arrangements” below for a schedule of contractual obligations and other long-term liabilities that will require the use of cash.

Other factors potentially affecting liquidity

Canada project losses. Our reserve for estimated losses on uncompleted contracts included in "other current liabilities" on our consolidated balance sheets consists of $53 million related to our Canadian pipe fabrication and module assembly projects at December 31, 2014. These accrued losses will result in future cash expenditures in excess of customer receipts. Based on current contracts and work authorizations, we anticipate completion of these projects in 2015.

Power project losses. Our reserve for estimated losses on uncompleted contracts included in "other current liabilities" on our consolidated balance sheets consists of $80 million related to two power projects at December 31, 2014. These accrued losses will result in future cash expenditures in excess of customer receipts. Based on current contracts and work authorizations, we anticipate completion of these projects in 2017.

Credit Agreement

On December 2, 2011, we entered into a $1 billion, five-year unsecured revolving credit agreement (the “Credit Agreement”) with a syndicate of international banks. The Credit Agreement is available for cash borrowings and the issuance of letters of credit related to general corporate needs. The Credit Agreement expires in December 2016; however, given that projects generally require letters of credit that extend beyond one year in length, we will likely need to enter into a new or amended credit agreement no later than 2015. Amounts drawn under the Credit Agreement bear interest at variable rates, per annum, based either on (1) the London interbank offered rate (“LIBOR”) plus an applicable margin of 1.50% to 1.75%, or (2) a base rate plus an applicable margin of 0.50% to 0.75%, with the base rate equal to the highest of (a) reference bank’s publicly announced base rate, (b) the Federal Funds Rate plus 0.5%, or (c) LIBOR plus 1%. The amount of the applicable margin to be applied will be determined by our ratio of consolidated debt to consolidated EBITDA for the prior four fiscal quarters, as defined in the Credit Agreement. The Credit Agreement provides for fees on letters of credit issued under the Credit Agreement at a rate equal to the applicable margin for LIBOR-based loans, except for performance letters of credit, which are priced at 50% of such applicable margin. We pay an issuance fee of 0.15% of the face amount of a letter of credit. We also pay a commitment fee of 0.25% per annum on any unused portion of the commitment under the Credit Agreement. As of December 31, 2014, there were $174 million in letters of credit and no cash borrowings outstanding.

The Credit Agreement contains customary covenants which include financial covenants requiring maintenance of a ratio of consolidated debt to consolidated EBITDA not greater than 3.5 to 1 and a minimum consolidated net worth, as defined in the Credit Agreement as amended. In anticipation of our reorganization and the expected impairment and restructuring charges, in December 2014 we obtained an amendment to the Credit Agreement which reset the

minimum consolidated net worth to $1.5 billion plus 50% of consolidated net income for each quarter beginning December 31, 2014 and 100% of any increase in shareholders' equity attributable to the sale of equity interests. At December 31, 2014, we were in compliance with our financial covenants. However, due to actual recorded impairments, tax valuation allowances and restructuring charges, our consolidated net worth and consolidated EBITDA have been reduced. At December 31, 2014, the consolidated net worth and consolidated debt to consolidated EBITDA covenants were both in compliance by approximately $10 million to $25 million.

The Credit Agreement contains a number of other covenants restricting, among other things, our ability to incur additional liens and indebtedness, enter into asset sales, repurchase our equity shares and make certain types of investments. Our subsidiaries are restricted from incurring indebtedness, except if such indebtedness relates to purchase money obligations, capitalized leases, refinancing or renewals secured by liens upon or in property acquired, constructed or improved in an aggregate principal amount not to exceed $200 million at any time outstanding. Additionally, our subsidiaries may incur unsecured indebtedness not to exceed $200 million in aggregate outstanding principal amount at any time. We are also permitted to repurchase our equity shares,

provided that no such repurchases shall be made from proceeds borrowed under the Credit Agreement, and that the aggregate purchase price and dividends paid after December 2, 2011, does not exceed the Distribution Cap (equal to the sum of $750 million plus the lesser of (1) $400 million and (2) the amount received by us in connection with the arbitration and subsequent litigation of the PEP contracts as discussed in Note 15 to our consolidated financial statements). At December 31, 2014, the remaining availability under the Distribution Cap was approximately $468 million.

Nonrecourse Project Finance Debt

Information relating to our nonrecourse project debt is described in Note 12 to our consolidated financial statements and the information discussed therein is incorporated by reference into this Item 7.

Off-Balance Sheet Arrangements

Letters of credit, surety bonds and guarantees. In connection with certain projects, we are required to provide letters of credit, surety bonds or guarantees to our customers. Letters of credit are provided to certain customers and counterparties in the ordinary course of business as credit support for contractual performance guarantees, advanced payments received from customers and future funding commitments. We have approximately $2.1 billion in committed and uncommitted lines of credit to support the issuance of letters of credit and as of December 31, 2014, we have utilized $628 million of our present capacity under lines of credit. Surety bonds are also posted under the terms of certain contracts to guarantee our performance. The letters of credit outstanding included $174 million issued under our Credit Agreement and $454 million issued under uncommitted bank lines as of December 31, 2014. Of the letters of credit outstanding under our Credit Agreement, approximately $3 million letters of credit have expiry dates beyond the maturity date of the Credit Agreement. Of the total letters of credit outstanding, $246 million relate to our joint venture operations where the letters of credit are posted using our capacity to support our pro-rata share of obligations under various contracts executed by joint ventures of which we are a member. As the need arises, future projects will be supported by letters of credit issued under our Credit Agreement or other lines of credit arranged on a bilateral, syndicated or other basis. We believe we have adequate letter of credit capacity under our Credit Agreement and bilateral lines of credit to support our operations for the next twelve months.

Commitments and other contractual obligations. The following table summarizes our significant contractual obligations and other long-term liabilities as of December 31, 2014:

	Payments Due						
Dollars in millions	2015	2016	2017	2018	2019	Thereafter	Total
Operating leases (a)	$99	$85	$71	$62	$53	$383	$753
Purchase obligations (b)	8	4	1	1	1	2	17
Pension funding obligation (c)	48	44	44	44	44	173	397
Nonrecourse project finance debt	10	10	11	12	12	18	73
Total (d)	$165	$143	$127	$119	$110	$576	$1,240

(a) Amounts presented are net of subleases.

(b) In the ordinary course of business, we enter into commitments for the purchase or lease of software, materials, supplies and similar items. The purchase obligations can span several years depending on the duration of the projects. In general, the costs associated with those purchase obligations are expensed to correspond with the revenues earned on the related projects. The purchase obligations disclosed above do not include purchase obligations that we enter into with vendors in the normal course of business that support existing contracting arrangements with our customers.

(c) Included in our pension obligations are payments related to our agreement with the trustees of our international plan. The agreement calls for minimum contributions of £28 million in 2014 through 2023. The foreign funding

obligations were converted to U.S. dollars using the conversion rate as of December 31, 2014. KBR, Inc. has provided a guarantee for up to £125 million in support of Kellogg Brown & Root (U.K.) Limited's obligation to make payments to the plan in respect of its liability under the U.K. Pensions Act 1995.

(d) Not included in the total are uncertain tax positions recorded pursuant to ASC 740 - Income Taxes, which totaled $228 million as of December 31, 2014. The ultimate timing of when these obligations will be settled cannot be determined with reasonable assurance and have been excluded from the table above. See Note 13 to our consolidated financial statements for further discussion on income taxes.

Transactions with Joint Ventures

We perform many of our projects through incorporated and unincorporated joint ventures. In addition to participating as a joint venture partner, we often provide engineering, procurement, construction, operations or maintenance services to the joint venture as a subcontractor. Where we provide services to a joint venture that we control and therefore consolidate for financial reporting purposes, we eliminate intercompany revenues and expenses on such transactions. In situations where we account for our interest in the joint venture under the equity method of accounting, we do not eliminate any portion of our revenues or expenses. We recognize the profit on our services provided to joint ventures that we consolidate and joint ventures that we record under the equity method of accounting primarily using the percentage-of-completion method.

Recent Accounting Pronouncements

Information relating to recent accounting pronouncements is described in Note 21 to our consolidated financial statements and the information discussed therein is incorporated by reference into this Item 7.

U.S. Government Matters

Information relating to U.S. government matters commitments and contingencies is described in Note 14 to our consolidated financial statements and the information discussed therein is incorporated by reference into this Item 7.

Legal Proceedings

Information relating to various commitments and contingencies is described in Note 15 to our consolidated financial statements and the information discussed therein is incorporated by reference into this Item 7.

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and judgments that affect the determination of financial positions, cash flows and results of operations. Our critical accounting policies are described below to provide a better understanding of our estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Significant accounting estimates are important to the representation of our financial position and results of operations and require our most difficult, subjective or complex judgments. We base our estimates on historical experience and on various other assumptions we believe to be reasonable according to the current facts and circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

We believe the following are the critical accounting policies used in the preparation of our consolidated financial statements in accordance with accounting principles generally accepted in the United States, as well as the significant estimates and assumptions affecting the application of these policies. Our accounting policies are more fully described in Note 1 to our consolidated financial statements.

Engineering and Construction Contracts. Revenues from the performance of contracts for which specifications are provided by the customer for the construction of facilities, the production of goods or the provision of related services is accounted for using the percentage-of-completion method. These contracts include services essential to the construction or production of tangible property, such as design, EPC and EPC management.

At the outset of each contract, we prepare a detailed analysis of our estimated cost to complete the project. Risks relating to service delivery, usage, productivity and other factors are considered in the estimation process. Our project personnel regularly evaluate the estimated costs, revenues and progress and adjust the estimates accordingly.

We measure the progress towards completion of the project to determine the amount of revenues and profit to be recognized in each reporting period. Profits are recorded based upon the product of estimated contract profit at completion times the current percentage-complete for the contract. Our progress estimates are based upon estimates of the total cost to complete the project, which considers, among other things, the current project schedule and anticipated completion date, as well as estimates of the extent of progress toward completion. While progress is generally based upon costs incurred in relation to total estimated costs at completion, we also use alternative methods including physical progress, labor hours incurred to total estimated labor hours at completion or others depending on the type of project.

Our estimate of total revenues includes estimates of probable liquidated damages and certain probable claims and unapproved change orders. When estimating the amount of total gross profit or loss on a contract, we include certain unapproved change orders or claims to our clients as adjustments to revenues and claims to vendors, subcontractors and others as adjustments to total estimated costs. Claims against others are recorded up to the extent of the lesser of the amounts management expects to recover or to costs incurred and include no profit until such time as they are finalized and approved. See Note 5 to our consolidated financial statements for our discussion on unapproved change orders and claims.

At least quarterly, significant projects are reviewed by management. We have a long history of working with multiple types of projects and in preparing cost estimates. However, there are many factors that impact future costs, including but not limited to weather, inflation, labor and community disruptions, timely availability of materials, productivity and other factors as outlined in “Item 1A. Risk Factors”. These factors can affect the accuracy of our estimates and materially impact our future reported earnings.

For contracts containing multiple deliverables we analyze each activity within the contract to ensure that we adhere to the separation guidelines of ASC 605 - Revenue Recognition and ASC 605-25 - Multiple-Element Arrangements.

Estimated Losses on Uncompleted Contracts and Changes in Contract Estimates. We record provisions for total estimated losses on uncompleted contracts in the period in which such losses are identified. The cumulative effects of revisions to contract revenues and estimated completion costs are recorded in the accounting period in which the amounts become evident and can be reasonably estimated. These revisions can include such items as the effects of change orders and claims, warranty claims, liquidated damages or other contractual penalties, adjustments for audit findings on U.S. government contracts and contract closeout settlements. Information relating to our changes in estimates is discussed in Note 2 to our consolidated financial statements and the information discussed therein is incorporated by reference into this Item 7.

Accounting for Government Contracts. Some of the services provided to the U.S. government are performed on cost-reimbursable contracts. Generally, these contracts may contain base fees (a fixed profit percentage applied to our actual costs to complete the work).

Revenues are recognized at the time services are performed, and such revenues include base fees, actual direct project costs incurred and an allocation of indirect costs. Indirect costs are applied using rates approved by our government customers. The general, administrative and overhead cost reimbursement rates are estimated periodically in accordance with government contract accounting regulations and may change based on actual costs incurred or based upon the volume of work performed. Revenues are reduced for our estimate of costs that either are in dispute with our customer or have been identified as potentially unallowable pursuant to the terms of the contract or the federal acquisition regulations.

Similar to many cost-reimbursable contracts, these government contracts are typically subject to audit and adjustment by our customer. Each contract is unique; therefore, the level of confidence in our estimates for audit adjustments varies depending on how much historical data we have with a particular contract. KBR excludes from billings to the U.S. government costs that are expressly unallowable, or mutually agreed to be unallowable, or not allocable to government contracts based on the applicable regulations. Revenues recorded for government contract work are reduced for our estimate of potentially unallowable costs related to issues that may be categorized as disputed or unallowable as a result of cost overruns or the audit process. Our estimates of potentially unallowable costs are based upon, among other things, our internal analysis of the facts and circumstances, terms of the contracts and the applicable provisions of the FAR, quality of supporting documentation for costs incurred and subcontract terms, as applicable. From time to time, we engage outside counsel to advise us in determining whether certain costs are allowable. We also review our analysis and findings with the administrative contracting officer (“ACO”) as appropriate.

In some cases, we may not reach agreement with the DCAA or the ACO regarding potentially unallowable costs which may result in our filing of claims in various courts such as the Armed Services Board of Contract Appeals (“ASBCA”) or the COFC. We only include amounts in revenues related to disputed and potentially unallowable costs when we determine it is probable that such costs will result in revenue. We generally do not recognize additional revenues for disputed or potentially unallowable costs for which revenues have been previously reduced until we reach agreement with the DCAA and/or the ACO that such costs are allowable.

Goodwill Impairment Testing. Our October 1, 2014, annual impairment test for goodwill was a quantitative analysis using a two-step process that involves comparing the estimated fair value of each reporting unit to its carrying value, including goodwill. The fair values of reporting units were determined using a combination of two methods, one utilizing market earnings multiples (the market approach) and the other derived from discounted cash flow models with estimated cash flows based on internal forecasts of revenues and expenses over a specified period plus a terminal value (the income approach).

Under the market approach, we estimate fair value by applying earnings and revenue market multiples to a reporting unit’s operating performance for the trailing twelve-month period. The earnings multiples for the market approach ranged from 4.3 to 12.54 times the earnings for each of our reporting units. The income approach estimates fair value by discounting each reporting

unit’s estimated future cash flows using a weighted-average cost of capital that reflects current market conditions and the risk profile of the reporting unit. To arrive at our future cash flows, we use estimates of economic and market assumptions, including growth rates in revenues, costs, estimates of future expected changes in operating margins, tax rates and cash expenditures. Future revenues are also adjusted to match changes in our business strategy. The risk-adjusted discount rates applied to our future cash flows under the income approach ranged from 11.4% to 15.4%. We believe these two approaches are appropriate valuation techniques and we generally weight the two resulting values equally as an estimate of a reporting unit's fair value for the purposes of our impairment testing. However, we may weigh one value more heavily than the other when conditions merit doing so. Other significant estimates and assumptions include terminal value growth rates, future estimates of capital expenditures and changes in future working capital requirements. The fair value derived from the weighting of these two methods provides appropriate valuations that, in the aggregate, reasonably reconcile to our market capitalization, taking into account observable control premiums.

In addition to the earnings multiples and the discount rates disclosed above, certain other judgments and estimates are used in our goodwill impairment test. Given this, if market conditions change compared to those used in our market approach, or if actual future results of operations fall below the projections used in the income approach, our goodwill could become impaired in the future.

At the annual testing date of October 1, 2014, our market capitalization exceeded the carrying value of our consolidated net assets by $1.5 billion and, except for three of our previous reporting units; the fair value of all our reporting units substantially exceeded their respective carrying amounts as of that date.

In connection with preparing for our reorganization on December 11, 2014, we decided we would no longer bid on certain types of work and we would also exit certain non-strategic businesses. As a result, our forecasts of future cash flows for three of our previous reporting units were significantly reduced. The carrying value of three of our previous reporting units exceeded their fair value by approximately 54%, 106% and 811%, respectively, thus failing Step 1. We then performed Step 2 of the goodwill impairment test which compares the implied fair value of goodwill to the carrying value of that goodwill. The carrying value of each of the reporting units' goodwill exceeded the implied fair value of that goodwill, respectively. As a result, we recorded a noncash goodwill impairment charge of $446 million.

On December 31, 2014, we reorganized our reporting units in conjunction with our business segment reorganization. As a result, we performed an additional impairment test immediately before and after this change in reporting units, utilizing the same methodology as our October 1st test and no indication of impairment was identified. At the testing date of December 31, 2014, our market capitalization exceeded the carrying value of our consolidated net assets by $1.6 billion and the fair value of all our reporting units substantially exceeded their respective carrying amounts as of that date. The fair value for one reporting unit in our E&C business segment with goodwill of $75 million exceeded its carrying value by 20% based on projected growth rates and other market inputs that are more sensitive to the risk of future variances due to competitive market conditions and reporting unit project execution. If future variances for these assumptions are negative and significant, the fair value of this reporting unit may not substantially exceed its carrying value in future periods.

In the third quarter of 2012, we recognized a noncash goodwill impairment charge of $178 million related to one of our previous reporting units, now included in the Non-strategic Business segment, in connection with our interim impairment review. The charge was primarily the result of the determination that both the actual and expected income and cash flows were substantially lower than previous forecasts due to losses from ongoing projects acquired as part of the acquisition of Roberts & Schaefer Company. We also identified a deterioration in economic conditions in the minerals markets and less than expected actual and projected income and cash flows for the previous reporting unit, which reduced forecasts of the sales, operating income and cash flows expected in 2013 and beyond.

Deferred taxes and tax contingencies. See Note 1 to our consolidated financial statements for discussion on income taxes.

Legal and Investigation Matters. As discussed in Notes 14 and 15 to our consolidated financial statements, as of December 31, 2014 and 2013, we have accrued an estimate of the probable and estimable costs for the resolution of some of our legal and investigation matters. For other matters for which the liability is not probable and reasonably estimable, we have not accrued any amounts. Attorneys in our legal department monitor and manage all claims filed against us and review all pending investigations. Generally, the estimate of probable costs related to these matters is developed in consultation with internal and external legal counsel representing us. Our estimates are based upon an analysis of potential results, assuming a combination of litigation and settlement strategies. The precision of these estimates and the likelihood of future changes depend on a number of underlying variables and a range of possible outcomes. We attempt to resolve these matters through settlements, mediation and arbitration proceedings when possible. If the actual settlement costs, final judgments or fines, differ from our estimates after appeals, our future financial results may be materially and adversely affected. We record adjustments to our initial estimates of these types of contingencies in the periods when the change in estimate is identified.

Pensions. Our pension benefit obligations and expenses are calculated using actuarial models and methods. Two of the more critical assumptions and estimates used in the actuarial calculations are the discount rate for determining the current value of benefit obligations and the expected rate of return on plan assets. Other assumptions and estimates used in determining benefit obligations and plan expenses include inflation rates and demographic factors such as retirement age, mortality and turnover. These assumptions and estimates are evaluated periodically and are updated accordingly to reflect our actual experience and expectations.

The discount rate used to determine the benefit obligations was computed using a yield curve approach that matches plan specific cash flows to a spot rate yield curve based on high quality corporate bonds. The expected long-term rate of return on assets was determined by a stochastic projection that takes into account asset allocation strategies, historical long-term performance of individual asset classes, an analysis of additional return (net of fees) generated by active management, risks using standard deviations and correlations of returns among the asset classes that comprise the plans' asset mix. Plan assets are comprised primarily of equity securities, fixed income funds and securities, hedge funds, real estate and other funds. As we have both domestic and international plans, these assumptions differ based on varying factors specific to each particular country or economic environment.

The discount rate utilized to calculate the projected benefit obligation at the measurement date for our U.S. pension plan decreased to 2.89% at December 31, 2014 from 3.38% at December 31, 2013. The discount rate utilized to determine the projected benefit obligation at the measurement date for our U.K. pension plan, which constitutes all of our international plans and 96% of all plans, decreased to 3.65% at December 31, 2014 from 4.45% at December 31, 2013. Our expected long-term rates of return on plan assets utilized at the measurement date decreased to 5.28% from 7.00% for our U.S. pension plans and increased to 6.45% from 6.15% for our U.K. pension plans.

The following table illustrates the sensitivity to changes in certain assumptions, holding all other assumptions constant, for our pension plans:

	Effect on Pretax Pension Cost in 2015 U.S.
Dollars in millions	
25-basis-point decrease in discount rate	$8.1 million, noninterest income increased $8.3 million and noninterest expenses increased by $11.4 million dur The Company's yield on earning assets in 2016 was 4.05% compared to 3.88% in 2015. Total loans increased to 2016, from $1.0 billion at December 31, 2015.

Deposits increased $52.6 million to $1.2 billion at December 31, 2017, from $1.1 billion at December 31, 2016.
uncomplicated product design accompanied by a simple fee structure that is attractive to customers. The overall
liabilities for the Company was 1.04% in 2017 compared to 0.93% in 2016. This cost of interest-bearing liabiliti
asset yield, resulted in a net interest margin of 3.27% in 2017 compared to 3.22% in 2016.

Deposits increased $94.7 million to $1.1 billion at December 31, 2016, from $1.0 billion at December 31, 2015.
interest-bearing liabilities for the Company was 0.93% in 2016 compared to 0.90% in 2015. Increasing the asset
cost of interest-bearing liabilities resulted in a net interest margin of 3.22% in 2016 compared to 3.07% in 2015.

Interest Income and Expense

Net interest income is the amount by which interest income on earning assets exceeds interest expense incurred c
Interest-earning assets include loans, investment securities and certificates of deposit in other banks. Interest-bea
interest-bearing deposits and borrowed funds such as sweep accounts and repurchase agreements. Net interest in
source of revenue for the Bank. Net interest income is also impacted by changes in market interest rates, as well
assets and interest-bearing liabilities. Net interest income is also impacted favorably by increases in noninterest b
equity.

Net interest margin is calculated by dividing net interest income by average interest-earning assets and serves as
revenue stream generated by the Bank's balance sheet. Net interest margin was 3.27% in 2017 compared to 3.22
2015, respectively. The net interest margin continues to face considerable pressure due rising interest rates and c
and deposits in the Bank's markets. During 2017, the Federal Reserve raised its key interest rate from a range of
1.25% to 1.50%. Management's estimate of the impact of future changes in market interest rates is shown in the
Rate Risk."

Company management continues to analyze methods to deploy assets into an earning asset mix which will result
margin. Loan growth continues to be strong and management anticipates that loan activity will remain strong in

During 2017, net interest income increased by $1.3 million or 3.0% to $44.3 million from $43.0 million in 2016.
to the growth in average earning assets, primarily $49.3 million in taxable investment securities and $16.6 millio
Average total earning assets were $1.36 billion in 2017 compared to $1.34 billion in 2016. Average total loans a
declined to $1.15 billion in 2017 from $1.17 billion in 2016, primarily the result of a $24.0 million decrease in a
for sale. As a result of the increase in average total earning assets, total interest income increased by $2.5 million
2017 from $54.1 million in 2016. Average investment securities increased $44.0 million, the result of a $49.3 mi
investments and partially offset by a $5.3 million average decrease in tax-exempt investments. Yield on tax-exem
basis points and taxable securities yield increased 32 basis points. Average interest-bearing liabilities decreased i
primarily the result of a $52.1 million decrease in the average balance of certificates of deposit, a $17.6 million c
balance of borrowings, and a $16.2 million decrease in the average balance of NOW accounts, partially offset by
the average balance of money market checking accounts. Average interest-bearing deposits grew to $1.0 billion i
in 2016. Total interest expense increased by $1.2 million, caused primarily by a $546 thousand increase in depos
thousand increase in interest on FHLB and other borrowings. The result was a 11 basis point increase in the cost
from 2016 to 2017.

During 2016, net interest income increased by $8.1 million or 23.3% to $43.0 million from $34.9 million in 2015
to the growth in average earning assets, primarily $179.0 million in loans and loans held for sale. Average total e
billion in 2016 compared to $1.14 billion in 2015. Average total loans and loans held for sale grew to $1.2 billion
million in 2015. Primarily as a result of this growth, total interest income increased by $10.0 million, or 22.7%, t
$44.1 million in 2015. Average investment securities increased $21.1 million, mainly the result of a $10.7 millio
tax-exempt investments and a $10.4 million increase in taxable investments. Yield on tax-exempt

Table of Contents

securities remained flat, increasing only 1 basis point, while taxable securities increased 34 basis points. Average
mainly deposits and borrowings, likewise increased in 2016 by $165.8 million. Average interest-bearing deposits
2016 from $842.3 million in 2015. Total interest expense increased by $1.9 million, caused primarily by a $1.5 m
interest and a $394 thousand increase in interest on FHLB and other borrowings. The result was a 3 basis point in
2015 to 2016.

The Company's average earning assets increased $21.2 million and net interest income increased by $1.3 million
margin continues to be pressured by rising rate, increased competition for high quality loan growth and the depo
the growth.

The Bank's yield on earning assets changed during 2017 as follows: The loan portfolio yield increased by 15 bas
portfolio yield increased by 16 basis points while the cost of interest bearing liabilities increased by 11 basis poi

The cost of interest-bearing liabilities increased to 1.04% in 2017 from 0.93% in 2016. This increase is primarily
increase in the cost of borrowings and a 22 basis point increase on deposits. Further discussion on borrowings is
"Borrowed Funds" of the Notes to the Consolidated Financial Statements included in Item 8, Financial Statemen
of this Annual Report on Form 10-K.

Table of Contents

Statistical Financial Information Regarding MVB Financial Corp.
The following tables provide further information about interest income and expense:
Average Balances and Analysis of Net Interest Income:

(Dollars in thousands)	2017 Average Balance	Interest Income/Expense	Yield/Cost	2016 Average Balance	Interest Income/Expense	Yield/Cost	2015 Avera Balan
Assets							
Interest-bearing deposits in banks	$3,790	$ 52	1.37 %	$16,347	$ 94	0.58 %	$16,0
CDs with other banks	14,619	288	1.97	11,694	228	1.95	12,26
Investment securities:							
Taxable	125,797	2,658	2.11	76,525	1,366	1.79	66,11
Tax-exempt	58,786	1,863	3.17	64,108	1,853	2.89	53,37
Loans and loans held for sale: [1]							
Commercial	751,444	33,896	4.51	734,829	32,620	4.44	616,0
Tax exempt	15,064	520	3.45	16,326	564	3.45	19,67
Real estate	373,360	16,612	4.45	398,766	16,594	4.16	334,5
Consumer	13,660	709	5.19	16,762	804	4.80	17,38
Total loans	1,153,528	51,737	4.49	1,166,683	50,582	4.34	987,6
Total earning assets	1,356,520	56,598	4.17	1,335,357	54,123	4.05	1,135
Less: Allowance for loan losses	(9,626)			(8,939)			(7,01
Cash and due from banks	16,287			13,765			14,46
Other assets	90,585			87,815			83,52
Total assets	$1,453,766			$1,427,998			$1,22
Liabilities							
Deposits:							
NOW	$438,123	$ 2,608	0.60	$454,320	$ 2,413	0.53	$446,
Money market checking	239,632	1,781	0.74	163,630	1,282	0.78	65,30
Savings	47,034	78	0.17	43,870	88	0.20	39,76
IRAs	16,678	217	1.30	16,319	208	1.27	12,03
CDs	262,417	3,610	1.38	314,542	3,757	1.19	278,4
Repurchase agreements and federal funds sold	23,559	75	0.32	27,066	72	0.27	26,88
FHLB and other borrowings	122,144	1,690	1.38	139,736	1,086	0.78	124,4
Subordinated debt	33,524	2,242	6.69	33,524	2,226	6.64	33,52
Total interest-bearing liabilities	1,183,111	12,301	1.04	1,193,007	11,132	0.93	1,027
Noninterest bearing demand deposits	117,696			99,826			79,61
Other liabilities	8,006			12,220			7,486
Total liabilities	1,308,813			1,305,053			1,114
Stockholders' equity							
Preferred stock	7,927			16,334			16,33
Common stock	10,355			8,263			8,065
Paid-in capital	96,987			75,799			74,33
Treasury stock	(1,084)			(1,084)			(1,08
Retained earnings	34,155			25,943			16,94

Accumulated other comprehensive income	(3,387)			(2,310)			(2,46
Total stockholders' equity	144,953			122,945			112,1
Total liabilities and stockholders' equity	$1,453,766			$1,427,998			$1,22
Net interest spread			3.13			3.12	
Net interest income-margin		$ 44,297	3.27 %		$ 42,991	3.22 %	

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

Table of Contents

Rate Volume Calculation: 2017 vs. 2016

(Dollars in thousands)	Change in Volume	Change in Rate	Change in both Rate & Volume	Total Change
Earning Assets				
Loans				
Commercial	738	526	12	1,276
Tax exempt	(44)	—	—	(44)
Real estate	(1,057)	1,148	(73)	18
Consumer	(149)	66	(12)	(95)
Investment securities:				
Taxable	880	250	162	1,292
Tax-exempt	(154)	179	(15)	10
Interest-bearing deposits in banks	(73)	130	(99)	(42)
CDs with other banks	57	2	1	60
Total earning assets	198	2,301	(24)	2,475
Interest bearing liabilities				
NOW	(86)	291	(10)	195
Money market checking	595	(65)	(31)	499
Savings	6	(15)	(1)	(10)
IRAs	5	4	—	9
CDs	(623)	570	(94)	(147)
Repurchase agreements and federal funds sold	(9)	14	(2)	3
FHLB and other borrowings	(137)	847	(106)	604
Subordinated debt	—	16	—	16
Total interest bearing liabilities	(249)	1,662	(244)	1,169
Total	447	639	220	1,306

Table of Contents

Rate Volume Calculation: 2016 vs. 2015

(Dollars in thousands)	Change in Volume	Change in Rate	Change in both Rate & Volume	Total Change
Earning Assets				
Loans				
Commercial	5,064	1,083	209	6,356
Tax exempt	(117)	(10)	2	(125)
Real estate	2,608	336	64	3,008
Consumer	(28)	41	(1)	12
Investment securities:				
Taxable	151	222	35	408
Tax-exempt	309	6	1	316
Interest-bearing deposits in banks	1	49	1	51
CDs with other banks	(11)	8	—	(3)
Total earning assets	7,977	1,735	311	10,023
Interest bearing liabilities				
NOW	46	(340)	(6)	(300)
Money market checking	596	116	174	886
Savings	11	(31)	(3)	(23)
IRAs	52	7	3	62
CDs	373	446	58	877
Repurchase agreements and federal funds sold	1	(12)	—	(11)
FHLB and other borrowings	85	275	34	394
Subordinated debt	—	22	—	22
Total interest bearing liabilities	1,164	483	260	1,907
Total	6,813	1,252	51	8,116

Provision for Loan Losses

The Company's provision for loan losses for 2017, 2016, and 2015 was $2.2 million, $3.6 million and $2.5 milli

Provision for loan losses of $2.2 million and $3.6 million were made for the year ended December 31, 2017 and
decrease in loan loss provision is most attributable to average historical loss rates that have declined substantially
charge-offs were $1.1 million, or 45.0%, less in 2017 versus the prior year. The total decrease in provision would
increased loan volume, and a greater level of ASC 310-10 specific loan loss allocations for impaired loans requi
2016. More specifically, total loan portfolio growth was 5.0% in 2017 versus 2.0% in 2016, while total specific l
impaired loans increased by $645 thousand in 2017, versus a decrease of $470 thousand in 2016. The provision f
product of management's formal quarterly analysis, is recorded in response to inherent losses in the loan portfoli

Provision for loan losses of $3.6 million and $2.5 million were made for the year ended December 31, 2016 and
increase in loan loss provision is most attributable to a significantly higher level of net charge-offs recognized in
increased by $1.8 million or 257.3%. The total increase in provision would have been greater if not for decrease
decreased ASC 310-10 specific loan loss allocations for impaired loans. More specifically, total loan portfolio gr
versus 29.3% in 2015, while total specific loan loss allocations decreased by $470 thousand in 2016, versus an i
2015. The provision for loan losses, which is a product of management's formal quarterly analysis, is recorded i
the loan portfolio.

Determining the appropriate level of the allowance for loan losses requires considerable management judgment.
management considers numerous internal and external factors including, but not limited to, portfolio growth, nat
conditions, trends in the markets served and guidance from the Bank’s primary regulators. Management seeks to

44

Table of Contents

maintain an allowance for loan losses that is appropriate in the circumstances and that complies with applicable a
standards. Further discussion can be found earlier in this discussion under "Allowance for Loan Losses."

Noninterest Income

Mortgage fee income, gain (loss) on derivatives, interchange income, security sale gains, income on bank owned
loan sales generate the core of the Company's noninterest income. Also, service charges on deposit accounts con
the Company's noninterest income and include mainly non-sufficient funds and returned check fees, allowable o
charges on commercial accounts. The total of noninterest income for 2017, 2016 and 2015 was $40.7 million, $4
million, respectively.

The decrease in noninterest income for 2017 compared to 2016 was primarily the result of a $4.2 million decreas
to a 39.0% decrease in the locked mortgage pipeline during 2017 compared to a 31.6% increase in the locked mo
addition, mortgage production volume decreased $102.2 million or 6.2% in 2017 and increased $303.6 million o
the decrease in gain on derivatives, noninterest income for 2017 increased $1.7 million and was primarily attribu
fee income, commercial swap fee income and other operating income. Gain on sale of securities and gain on sale
$351 thousand and $504 thousand respectively, in 2017 compared to 2016.

In 2017 and 2016, mortgage fee income increased $1.5 million and $6.2 million, respectively. Production volum
or 6.2% in 2017 and increased $303.6 million or 22.7% in 2016. The greatest decrease in 2017 was due to the de
$199.4 million, which was a result of increasing interest rates in 2017. This decrease was partially offset by a $6
construction loans, a $13.5 million increase in purchase loans, and a $13.2 million increase in bridge loans. The i
all sectors: a $166.7 million increase in construction, a $124.7 million increase in refinance, a $37.7 million incre
million increase in bridge. The production volume increase in 2016 was related to expansion into new market are

Commercial swap fee income increased $419 thousand from $84 thousand in 2016 to $503 thousand in 2017. Th
an increase in swap volume from $4.5 million in 2016 to $17.2 million in 2017.

Other operating income increased $425 thousand from $850 thousand in 2016 to $1.3 million in 2017. This incre
gain on sale of fixed assets of $344 thousand related to the closure and sale of the land, building, and certain furn
from a branch located at 704 Foxcroft Avenue, Martinsburg, WV.

During the ordinary course of business in 2017, 2016 and 2015 the Company sold several investment securities a
$1.1 million and $130 thousand, respectively. All investments that were sold were classified as available-for-sale
held-to-maturity investment that was sold during 2015 due to a credit downgrade. The Company is always lookin
while maintaining a high quality short-term investment portfolio.

Gain on sale of portfolio loans decreased $504 thousand from $1.0 million in 2016 to $538 thousand in 2017 and
from $1.4 million in 2015 to $1.0 million in 2016. The total volume of portfolio loans sold in 2017, 2016 and 20
million, and $75.0 million, respectively.

The Company is continually searching for ways to increase noninterest income.

Noninterest Expense

Noninterest expense was $70.5 million, $69.2 million and $57.8 million in 2017, 2016 and 2015, respectively. A
62% of noninterest expense for 2017, 2016 and 2015, respectively, related to personnel costs. Personnel are a cri
service organization, which is why personnel costs are such a significant part of the expenditure mix. Salaries an
million in 2017 and increased $9.2 million in 2016. The 2017 decrease is primarily the result of decreased comm

decrease in mortgage loan origination volume, a $1.2 million decrease in the earn out paid to management of the
the 2012 acquisition, and due to operational efficiency gains during the year. The 2016 increase related to the fol
related to organic growth, increased commissions due to a 26.4% increase in origination volume and increases fo
million increase in the earn out paid to management of the mortgage company related to the 2012 acquisition, an

45

Table of Contents

Equipment and occupancy expense increased by $951 thousand in 2017 and $735 thousand in 2016. The 2017 in
of the two new full-service branches opened in 2017 and increased equipment expense related to depreciation an
property and software. Two branches in Martinsburg, WV were consolidated in December 2017. The 2016 incre
expense related to the branch acquisitions during late August 2015, three new full-service branches opened in 20
expense related to depreciation and continued maintenance of property and software.

Travel, entertainment, dues, and subscriptions expense increased by $496 thousand in 2017 and $146 thousand in
2017 increase was a result of a $144 increase in publications and subscriptions, a $121 thousand increase in mea
thousand increase in travel expense, a $60 thousand increase in dues and memberships, and a $30 thousand incre
The 2016 increase was a result of a $100 thousand increase in meals and entertainment and a $44 thousand incre
subscriptions.

Professional fees increased by $423 thousand in 2017 and decreased by $512 thousand in 2016. The 2017 increa
management, core conversion and other efficiency implementations, and the Nasdaq listing and subsequent appr
related to not having merger and acquisition related activity and $150 thousand related to a commercial lending r

Data processing increased by $152 thousand in 2017 and $1.0 million in 2016. Both increases were largely drive
completed in April 2017, along with overall growth in terms of personnel and office space company-wide and th
products, services, and providers to better serve the client base.

Income Taxes

The Company incurred income tax expense of $4.8 million, $6.8 million, and $3.0 million in 2017, 2016, and 20

The Company's effective tax rate was 39%, 34%, and 31% in 2017, 2016 and 2015, respectively. This increase i
2017 was primarily the result of the Tax Reform Act, signed into law on December 22, 2017, in which the Comp
re-measure its net deferred tax asset and resulted in a income tax charge of $646 thousand. Among other things,
new, flat corporate federal statutory income tax rate of 21%, (ii) eliminates the corporate alternative minimum ta
such carryforwards to offset regular tax liability for any taxable year, (iii) limits the deduction for net interest ex
corporations, (iv) allows businesses to immediately expense, for tax purposes, the cost of new investments in cer
assets, (v) eliminates or reduces certain deductions related to meals and entertainment expenses, (vi) modifies th
employee remuneration to eliminate the exception for performance-based compensation and clarifies the definiti
(vii) limits the deductibility of deposit insurance premiums. If not for having to re-measure the net deferred tax a
tax rate for 2017 would have been 33%. The Company's effective tax rate is affected by certain permanent tax di
requirements in the tax code. The largest permanent difference relates to tax-exempt interest income related to m
loans held by the Company. Other, smaller permanent differences arise from income derived from life insurance
employees and directors and meals and entertainment expenses. The Company expects that the effective tax rate
new tax law than would have been the case prior to enactment; however, there can be no assurance as to the actu
because it will be dependent upon the nature and amount of future income and expenses as well as transactions v

Return on Assets

Excluding discontinued operations, the Company's return on average assets from continuing operations was 0.52
0.63% in 2016 and 0.54% in 2015. The decreased return in 2017 is a direct result of a $1.4 million decrease in ea
operations, while average total assets increased by $25.8 million, mainly the result of a $44.0 million increase in
increased return in 2016 is a direct result of a $2.4 million increase in earnings from continuing operations, while
increased by $201.6 million, mainly the result of a $179.0 million increase in average total loans.

Return on Equity

Excluding discontinued operations, the Company's return on average stockholders' equity from continuing opera
compared to 7.30% in 2016 and 5.89% in 2015. The decreased return in 2017 is a direct result of a $1.4 million c
continuing operations, while average equity increased by $22.0 million. The increased return in 2016 is a direct r
increase in earnings from continuing operations, while average equity increased by $10.8 million.

Table of Contents

Overview of the Statement of Condition

The greatest balance sheet changes from 2016 to 2017 were as follows: total assets increased by $115.5 million t
December 31, 2017, loans increased by $53.3 million to $1.1 billion, investment securities increased by $69.1 m
$52.6 million, increased borrowings of $61.2 million, and stockholders' equity increased $4.6 million.

Cash and Cash Equivalents

Cash and cash equivalents totaled $20.3 million at December 31, 2017, compared to $17.3 million at December
deposit reclassification program was implemented and allowed the Company to reduce its requirement of reserve
accordance with the Federal Reserve Board the daily Federal Reserve Requirement.

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

Investment Securities

Prior to the final determination of Basel III, investments were recorded as held-to-maturity due to the uncertainty
available-for-sale investments. Upon the issuance of the final ruling, the Company opted out of the Other Compr
available-for-sale investments permitted under Basel III. Due to the change in capital treatment under the final ru
Company's purpose of recording investments as held-to-maturity changed; therefore, during the period ended M
reclassified $52.4 million of the remaining held-to-maturity investments into available-for-sale investments.

Investment securities totaled $231.5 million at December 31, 2017, compared to $162.4 million at December 31,

The following table sets forth a summary of the investment securities portfolio as of the dates indicated. Available for sale securities are reported at estimated fair value:

December 31, (Dollars in thousands)	2017	2016	2015
Available-for-sale securities:			
U. S. Agency securities	$80,945	$28,816	$29,351
U.S. Sponsored Mortgage-backed securities	58,154	54,732	33,714
Municipal securities	75,842	70,796	1,798
Equity and other securities	16,566	8,024	5,393
Total investment securities available-for-sale	$231,507	$162,368	$70,256
Held-to-maturity securities:			
Municipal securities	$—	$—	$52,859

At December 31, 2017, investment securities are all available-for-sale. Management believes the available-for-sa
flexibility in terms of managing the portfolio for liquidity, yield enhancement and interest rate risk management
December 31, 2017, the amortized cost of investment securities totaled $231.5 million, resulting in unrealized lo
of $7 thousand. Although these investments show an unrealized loss, management has the intent and ability to ho
maturity and they are all high quality investments with no other than temporary impairment. The municipal secu
company the ability to pledge and to better the effective tax rate.

Table of Contents

The following table shows the maturities for the investment securities portfolio at December 31, 2017:

(Dollars in thousands)	Within one year			After one year, but within five			After five years, but within ten			After ten ye
	Amortized Cost	Weighted Avg. Yield		Amortized Cost	Weighted Avg. Yield		Amortized Cost	Weighted Avg. Yield		Amortized Cost
U. S. Agency securities	$—	—	%	$24,345	1.90	%	$20,940	2.13	%	$36,420
U.S. Sponsored Mortgage-backed securities	—	—		—	—		7,251	1.64		52,136
Equity and other securities	—	—		1,910	5.53		8,493	2.72		5,537
Municipal securities	300	2.10		11,142	4.06		2,760	5.94		60,280
Total	$300	2.10	%	$37,397	2.73	%	$39,444	2.44	%	$154,373

Management monitors the earnings performance and liquidity of the investment portfolio on a regular basis throu
Committee ("ALCO") meetings. The ALCO also monitors net interest income and assists in the management of
Company. Through active balance sheet management and analysis of the investment securities portfolio, sufficie
satisfy depositor requirements and the various credit needs of its customers. Management believes the risk chara
investment portfolio are acceptable based on these parameters.

Loans

The Company's primary market areas are the Marion, Harrison, Jefferson, Berkeley, Monongalia, and Kanawha
Fairfax and Loudoun counties of Virginia, with a secondary focus on the adjacent counties. The portfolio consist
lending, retail lending, which includes single-family residential mortgages and consumer lending. Loans totaled
December 31, 2017 and December 31, 2016.

During 2017, the Bank experienced loan growth of $53.1 million. The growth primarily came from the commerc
estate area, which grew approximately $27.3 million, and from the residential real estate area, which grew $27.8

Major classification of loans held for investment at December 31, are as follows:

(Dollars in thousands)	2017	2016	2015	2014	2013
Commercial and non-residential real estate	$783,909	$756,619	$728,202	$559,387	$455,926
Residential real estate and home equity	308,614	280,838	285,490	220,442	146,001
Consumer and other	12,783	14,511	17,361	17,103	18,916
Total Loans	$1,105,306	$1,051,968	$1,031,053	$796,932	$620,843
Deferred loan origination fees and costs, net	$635	$897	$1,117	$1,365	$1,462
Loans receivable	$1,105,941	$1,052,865	$1,032,170	$798,297	$622,305

At December 31, 2017, commercial loans represented the largest portion of the portfolio approximating 70.9% o
Commercial loans totaled $783.9 million at December 31, 2017, compared to $756.6 million at December 31, 20
continue to focus on the enhancement and growth of the commercial loan portfolio while maintaining appropriat
risk/price balance.

Residential real estate loans to retail customers (including home equity lines of credit) account for the second lar
portfolio, comprising 27.9% of the total loan portfolio. Residential real estate and home equity loans totaled $30
2017, compared to $280.8 million at December 31, 2016. Included in residential real estate loans are home equit
million at December 31, 2017, compared to $65.4 million at December 31, 2016. Management believes the hom
products with an acceptable return on investment after risk considerations. Residential real estate lending continu

focus due to the lower risk factors associated with this type of loan and the opportunity to provide service to thos
Berkeley, Jefferson, Kanawha and Monongalia county markets of West Virginia and Fairfax and Loudoun count
the Tax Cuts and Jobs Act signed into law on December 22, 2017,

48

Table of Contents

interest on home equity loans and lines of credit is no longer deductible. This change could adversely impact the
outstanding volumes of home equity loans and lines of credit in the future.

At December 31, 2017, consumer loan balances totaled $12.8 million compared to $14.5 million at December 31
consumer loans are in the direct lending area. Management is pleased with the performance and quality of the co
can be attributed to the many years of experience of its consumer lenders. This is another important product nece
areas.

At December 31, 2017, loans identified by management as potential problem loans amounted to $3.6 million, wh
relationships comprised of two loans in total. One of the two loans, with an outstanding balance of $3.2 million,
loan that has begun to pay slowly and is being monitored for improvement. These are loans where known inform
possible credit problems causes management to have doubts as to the borrowers' ability to comply with the loan
these loans are sufficiently collateralized and are not believed to present significant risk of loss.

The following table provides additional information about loans:

Loan maturities at December 31, 2017:

(Dollars in thousands)	One Year or Less	One Through Five Years	Due After Five Years	Total
Commercial and non-residential real estate	$151,938	$ 307,994	$323,977	$783,909
Residential real estate and home equity	149,877	20,644	138,093	308,614
Consumer and other	1,464	3,910	7,409	12,783
Total Loans	$303,279	$ 332,548	$469,479	$1,105,306

The preceding data has been compiled based upon the earlier of either contractual maturity or next repricing date

The following table reflects the sensitivity of loans to changes in interest rates as of December 31, 2017 that mat

(Dollars in thousands)	Commercial and Non-Residential Real Estate	Residential Real Estate and Home Equity	Consumer and Other	Total
Predetermined fixed interest rate	$ 358,961	$ 98,061	$ 4,981	$462,003
Floating or adjustable interest rate	273,010	60,676	6,338	340,024
Total as of December 31, 2017	$ 631,971	$ 158,737	$ 11,319	$802,027

Loan Concentration

At December 31, 2017, commercial loans comprised the largest component of the loan portfolio. A large portion
estate secured however, they are geographically and industry diverse. Loans that are non-real estate secured are t
receivable, mortgages or equipment. While the loan concentration is in commercial loans, the commercial portfo
many different borrowers, in numerous different industries but primarily located in our market areas.

Allowance for Loan Losses

Management continually monitors the risk in the loan portfolio through review of the monthly delinquency repor
Committee. The Loan Review Committee is responsible for the determination of the adequacy of the allowance
involves both experience of the portfolio to date and the makeup of the overall portfolio. Specific loss estimates

loans based on specific criteria such as current delinquent status, related deposit account activity, where applicab
and national economy. When appropriate, Management also considers public knowledge and/or verifiable inform
to assess risks to specific loans and the loan portfolios as a whole.

The result of the evaluation of the adequacy at each period presented herein indicated that the allowance for loan
adequate to absorb losses inherent in the loan portfolio.

49

Table of Contents

At December 31, 2017 and 2016, impaired loans totaled $15.6 million and $12.2 million respectively. A portion
losses of $1.2 million and $543 thousand was allocated to cover any loss in these loans at December 31, 2017 an
past due more than 30 days were $9.8 million and $7.7 million, respectively, at December 31, 2017 and 2016.

	December 31,		
	2017	2016	2015
Loans past due more than 30 days to gross loans	0.89%	0.73%	1.83%
Loans past due more than 90 days to gross loans	0.25%	0.39%	0.97%

Net charge-offs of $1.4 million in 2017, $2.5 million in 2016, and $710 thousand in 2015 were incurred. The pro
$2.2 million in 2017, $3.6 million in 2016, and $2.5 million in 2015. Net charge-offs represented 0.13%, 0.24%,
2017, 2016, 2015, 2014 and 2013, respectively, compared to gross loans for the indicated period.

The following tables reflect the allocation of the allowance for loan losses as of December 31, 2017, 2016, 2015,

(Dollars in thousands)	Commercial and Non-Residential Real Estate	Residential Real Estate and Home Equity	Consumer and Other	Total
ALL balance at December 31, 2016	$ 7,181	$ 1,718	$ 202	$9,101
Charge-offs	(1,138)	(250)	(109)	(1,497)
Recoveries	39	44	18	101
Provision	1,722	312	139	2,173
ALL balance at December 31, 2017	$ 7,804	$ 1,824	$ 250	$9,878

(Dollars in thousands)	Commercial and Non-Residential Real Estate	Residential Real Estate and Home Equity	Consumer and Other	Total
ALL balance at December 31, 2015	$ 6,066	$ 1,810	$ 130	$8,006
Charge-offs	(1,995)	(224)	(338)	(2,557)
Recoveries	8	11	1	20
Provision	3,102	121	409	3,632
ALL balance at December 31, 2016	$ 7,181	$ 1,718	$ 202	$9,101

(Dollars in thousands)	Commercial and Non-Residential Real Estate	Residential Real Estate and Home Equity	Consumer and Other	Total
ALL balance at December 31, 2014	$ 4,363	$ 1,653	$ 207	$6,223
Charge-offs	(708)	(33)	(6)	(747)
Recoveries	20	6	11	37
Provision	2,391	184	(82)	2,493
ALL balance at December 31, 2015	$ 6,066	$ 1,810	$ 130	$8,006

(Dollars in thousands)	Commercial and Non-Residential	Residential Real	Consumer and Other	Total

	Real Estate	Estate and Home Equity		
ALL balance at December 31, 2013	$ 3,609	$ 1,073	$ 253	$4,935
Charge-offs	(1,110)	(130)	(68)	(1,308)
Recoveries	7	3	4	14
Provision	1,857	707	18	2,582
ALL balance at December 31, 2014	$ 4,363	$ 1,653	$ 207	$6,223

Table of Contents

(Dollars in thousands)	Commercial and Non-Residential Real Estate	Residential Real Estate and Home Equity	Consumer and Other	Total
ALL balance at December 31, 2012	$ 3,107	$ 756	$ 213	$4,076
Charge-offs	(1,458)	(38)	(33)	(1,529)
Recoveries	57	70	1	128
Provision	1,903	285	72	2,260
ALL balance at December 31, 2013	$ 3,609	$ 1,073	$ 253	$4,935

(Dollars in thousands)	2017		2016		2015		2014	
December 31,	Amount	% of loans in each category to total loans	Amount	% of loans in each category to total loans	Amount	% of loans in each category to total loans	Amount	% o loan each cate to to loan
Commercial and non-residential real estate	$7,804	71 %	$7,181	72 %	$6,066	70 %	$4,363	70
Residential real estate and home equity	1,824	28	1,718	27	1,810	28	1,653	28
Consumer and other	250	1	202	1	130	2	207	2
Total	$9,878	100 %	$9,101	100 %	$8,006	100 %	$6,223	100

Non-performing assets consist of loans that are no longer accruing interest, loans that have been renegotiated to l upon financial difficulties of the borrower, and real estate acquired through foreclosure. When interest accruals a interest income is reversed with current year accruals charged to earnings and prior year amounts generally charg in management's judgment, the borrower's ability to make periodic interest and principal payments resumes and doubt, which is evident by the receipt of six consecutive months of regular, on-time payments, the loan is eligibl status. For 2017, interest income on loans would have increased by approximately $423 thousand if loans had pe their terms.

Non-performing assets and past due loans:

(Dollars in thousands)	2017	2016	2015	2014	2013
Non-accrual loans					
Commercial	$8,350	$4,975	$8,195	$3,462	$284
Real estate and home equity	1,170	1,176	839	487	29
Consumer and other	179	78	371	—	76
Total non-accrual loans	9,699	6,229	9,405	3,949	389
Accruing loan past due 90 days or more	—	—	848	5,306	460
Total non-performing loans	9,699	6,229	10,253	9,255	849
Other real estate, net	1,346	414	239	575	375
Total non-performing assets	$11,045	$6,643	$10,492	$9,830	$1,224
Allowance for loan losses	$9,878	$9,101	$8,006	$6,223	$4,935
Non-performing loans to gross loans	0.88 %	0.59 %	0.99 %	1.16 %	0.14 %
Allowance for loan losses to non-performing loans	101.85 %	146.11 %	78.08 %	67.24 %	581.27 %
Non-performing assets to total assets	0.72 %	0.47 %	0.76 %	0.89 %	0.12 %

Impaired loans have increased by $3.4 million, or 28%, during 2017. This change is the net effect of multiple fac
identification of $7.6 million of recently impaired loans, principal curtailments of $2.1 million, partial charge-of
foreclosure and reclassification to other real estate owned of $1.3 million, reclassification of $150 thousand of pr
loans to performing loans, and normal loan amortization of $213 thousand.

51

Table of Contents

The $7.6 million total of recently identified impaired loans includes $6.7 million, or 88.2%, of commercial loans
residential mortgage loans, and $129 thousand, or 1.5%, of consumer loans. The commercial loans are primarily
relationships, including a $3.4 million purchased participation note secured by a senior healthcare facility, a $1.2
estate loan, net of a $579 thousand sold participation, secured by a retail strip center, and a $810 thousand develo
developed commercial pad site. These three loans represent 80.0% of the recently impaired commercial loans, w
million represent fifteen additional commercial loans ranging from $6 thousand to $457 thousand in outstanding

Funding Sources

The Bank considers a number of alternatives, including but not limited to deposits, short-term borrowings, and lo
evaluating funding sources. Traditional deposits continue to be the most significant source of funds, totaling $1.2
sources at December 31, 2017. This same information at December 31, 2016 reflected $1.1 billion in deposits rep
funding sources. Repurchase agreements, which are available to large corporate customers, represented 1.6% and
December 31, 2017 and 2016, respectively. FHLB and other borrowings and subordinated debt represented the r
sources.

Management continues to emphasize the development of additional noninterest-bearing deposits as a core fundin
December 31, 2017, noninterest-bearing balances totaled $126.0 million compared to $115.7 million at Decembe
10.5% of total deposits respectively. Interest-bearing deposits totaled $1.0 billion at December 31, 2017, compar
December 31, 2016 or 89.1% and 89.5% of total deposits respectively.

(Dollars in thousands)	2017	2016	2015
Demand deposits of individuals, partnerships, and corporations			
Noninterest bearing demand	$125,963	$115,692	$80,423
Interest bearing demand	436,303	414,031	473,459
Savings and money markets	284,795	280,533	128,622
Time deposits including CDs and IRAs	312,519	296,761	329,810
Total deposits	$1,159,580	$1,107,017	$1,012,314
Time deposits that meet or exceed the FDIC insurance limit	$18,832	$18,727	$21,690

The following table sets forth the average balance and average rate paid on each of the deposit categories for the
2017, 2016 and 2015:

(Dollars in thousands)	2017 Average Balance	Average Rate	2016 Average Balance	Average Rate	2015 Average Balance	Average Rate
Noninterest bearing demand deposits	$117,696		$99,826		$79,611	
Interest-bearing demand deposits:						
NOW	438,123	0.60 %	454,320	0.53 %	446,704	0.61 %
Money market checking	239,632	0.74 %	163,630	0.78 %	65,306	0.61 %
Savings	47,034	0.17 %	43,870	0.20 %	39,766	0.28 %
IRAs	16,678	1.30 %	16,319	1.27 %	12,038	1.21 %
CDs	262,417	1.38 %	314,542	1.19 %	278,499	1.03 %
Total interest-bearing deposits	1,003,884	0.83 %	992,681	0.78 %	842,313	0.74 %
Total deposits	$1,121,580		$1,092,507		$921,924	

Average interest-bearing deposits totaled $1.0 billion during 2017 compared to $992.7 million during 2016. Ave
deposits totaled $117.7 million during 2017 compared to $99.8 million during 2016.

52

Table of Contents

Maturities of time deposits that meet or exceed the FDIC insurance limit:

(Dollars in thousands)	2017
Under 3 months	$1,327
Over 3-12 months	8,878
Over 1 to 3 years	7,155
Over 3 years	1,472
Total	$18,832

Along with traditional deposits, the Bank has access to both short-term borrowings from FHLB and overnight re
its operations and investments.
Short-term borrowings:

(Dollars in thousands)	2017	2016	2015
Balance at end of year	$149,596	$87,733	$179,917
Average balance during the year	100,969	137,822	121,425
Maximum month-end balance	220,097	210,600	179,917
Weighted-average rate during the year	1.16 %	0.51 %	0.34 %
Weighted-average rate at December 31	1.61 %	0.74 %	0.44 %

Repurchase agreements:

(Dollars in thousands)	2017	2016	2015
Balance at end of year	$22,403	$25,160	$27,437
Average balance during the year	25,160	27,066	26,884
Maximum month-end balance	25,972	29,561	32,470
Weighted-average rate during the year	0.30 %	0.27 %	0.31 %
Weighted-average rate at December 31	0.34 %	0.28 %	0.30 %

In addition, the Company holds subordinated debt as follows:

(Dollars in thousands)	2017	2016	2015
Balance at end of year	$33,524	$33,524	$33,524
Average balance during the year	33,524	33,524	33,524
Maximum month-end balance	33,524	33,524	33,524
Weighted-average rate during the year	6.69 %	6.64 %	6.57 %
Weighted-average rate at December 31	6.70 %	6.63 %	6.57 %

Capital/Stockholders' Equity

During the year ended December 31, 2017, stockholders' equity increased approximately $4.6 million to $150.2
of net income for the year of $7.6 million, along with dividends paid totaling $1.5 million, net proceeds from a c
totaling $4.9 million, and an increase in equity due to a change in accumulated other comprehensive income of $
million decrease related to the redemption of SBLF preferred stock. Although stockholders' equity increased as r
assets ratio decreased 0.47% to 9.79% due to the $115.5 million increase in total assets during 2017. The Compa
shareholders of $1.0 million in 2017 and $646 thousand in 2016 and earned $7.6 million in 2017 versus $12.9 m

dividend payout ratio increasing from 5.00% in 2016 to 13.64% in 2017.

Table of Contents

At December 31, 2017, accumulated other comprehensive loss totaled $3.0 million, a decrease in the loss of $1.3
2016. This change is primarily the result of the increase in the market value of the investment portfolio from 201
area of local municipal bonds.

The Company and the Bank are also subject to various regulatory capital requirements administered by the feder
to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actio
undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capita
Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabi
sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classificatio
qualitative judgments by the regulators about components, risk weightings, and other factors. Bank regulators ha
capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks of v
in their portfolios. A weight category of 0% (lowest risk assets), 20%, 50%, 100% or 150% (highest risk assets)
the balance sheet. Detailed information concerning the Company's risk-based capital ratios can be found in Note
Requirements" of the Notes to the Consolidated Financial Statements included in Item 8, Financial Statements ar
this Annual Report on Form 10-K; and see also "Supervision and Regulation" in Item 1, Business, of this Annua

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain mir
Total capital, Tier 1 capital and Tier 1 common equity to risk-weighted assets, and of Tier 1 capital to average as
December 31, 2017 and 2016, the Company meets all capital adequacy requirements to which it is subject.

At December 31, 2017, the Company's consolidated risk-based capital ratios were above the minimum standards
institution. The total risk-based capital ratio of 14.9% at December 31, 2017, is above the well capitalized standa
risk-based capital ratio of 11.5% also exceeded the well capitalized minimum of 8%. The common equity tier 1 c
above the well capitalized standard of 6.5%. The leverage ratio at December 31, 2017, was 9.3% and was also ab
standard of 5%. Management believes that capital continues to provide a strong base for profitable growth.

Liquidity and Interest Rate Sensitivity

The objective of the asset/liability management function is to structure the balance sheet in ways that maintain co
interest income and minimize exposure to market risks within its policy guidelines. This objective is accomplishe
balance sheet liquidity and interest rate risk exposure based on changes in economic conditions, interest rate leve
The Company manages balance sheet liquidity through the investment portfolio, sales of commercial and residen
through the utilization of diversified funding sources, including retail deposits, a variety of wholesale funding so
the FHLB. Interest rate risk is managed through the use of interest rate caps, commercial loan swap transactions
commitments on mortgage loans held for sale, as well as the structuring of loan terms that provide cash flows to
along the rate cycle.

Interest Rate Risk

Our primary market risk is interest rate fluctuation. Interest rate risk results from the traditional banking activitie
such as gathering deposits and extending loans. Many factors, including economic conditions, financial conditio
rates, and consumer preferences affect the difference between interest earned on our assets and interest paid on o
interest rate risk represents the levels of exposure our income and market values have to fluctuations in interest r
measured as the change in earnings and the theoretical market value of equity that results from changes in interes
Committee (ALCO) oversees the management of interest rate risk. ALCO's objective is to maximize stockholde
and increase capital, serve customer and community needs, and protect the Company from any material financia
with changes in interest rates.

Interest rate risk arises from differences between the timing of rate changes and the timing of cash flows (repricin
relationships across yield curves that affect bank activities (basis risk); from changing rate relationships across th
(yield curve risk); and from interest rate related options embedded in certain bank products (option risk). Change
affect a bank's underlying economic value. The values of a bank's assets, liabilities, and interest-rate related, off
affected by changes in rates because the present values of future cash flows, and in some cases the cash flows the
discounting by different rates.

The Company believes that accepting some level of interest rate risk is necessary in order to achieve realistic pro
the Board have chosen an interest rate risk profile that is consistent with our strategic business plan.

Table of Contents

The Company's Board of Directors has established a comprehensive interest rate risk management policy, which
ALCO. The policy establishes limits on risk, which are quantitative measures of the percentage change in net int
net interest income at risk) and the fair value of equity capital (a measure of economic value of equity or "EVE"
hypothetical change in interest rates. The Company measures the potential adverse impacts that changing interes
short-term earnings, long-term value, and liquidity by employing simulation analysis through the use of compute
model captures optionality factors such as call features and interest rate caps and floors embedded in investment
As with any method of gauging interest rate risk, there are certain shortcomings inherent in the interest rate mod
employ. When interest rates change, actual movements in different categories of interest-earning assets and inter
prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in th
methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan customer
or the impact of rate changes on demand for loan and deposit products.

A base case forecast is prepared using Global Insight's Most Likely rate forecast and alternative simulations refl
behavior of rates each quarter. The analysis gets presented to the ALCO and the Board of Directors. In addition,
produced when interest rates are particularly uncertain, when other business conditions so dictate, or when neces
balance sheet changes.

The balance sheet is subject to quarterly testing for interest rate shock possibilities to indicate the inherent intere
rates are shocked by +/ - 100, 200, 300, and 400 basis points ("bp"). The goal is to structure the balance sheet so
over a twelve-month period and the economic value of equity at risk do not exceed policy guidelines at the vario

At December 31, 2017, the Company is shown in a liability sensitive position for the first year after rate shocks.
strives to reduce higher costing fixed rate funding instruments, while increasing assets that are more fluid in thei
position, theoretically, is more favorable in a rising rate environment since more assets than liabilities will repric
interest rates rise. Similarly, a liability sensitive position, theoretically, is favorable in a declining interest rate en
liabilities than assets will reprice in a given time frame as interest rates decline. Management works to maintain
yields on assets and costs of deposits and borrowings, regardless of the direction of interest rates.

Estimated Changes in Net Interest Income

Change in interest rates	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp	-300 bp	-400 bp
Policy Limit	25.0 %	20.0 %	15.0 %	10.0 %	10.0 %	15.0 %	20.0 %	25.0 %
December 31, 2017	(4.3)%	(3.9)%	(3.2)%	(1.6)%	(0.3)%	(11.6)%	(19.2)%	(22.8)%
December 31, 2016	16.0 %	11.2 %	6.5 %	3.8 %	(5.8)%	(12.8)%	(15.4)%	(15.9)%

As shown above, measures of net interest income at risk in a rising rate environment were less favorable at Dece
December 31, 2016 at all interest rate shock levels and less favorable in a falling rate environment for the same t
remained well within prescribed policy limits. This reflects rising liability costs in an environment in which we e
to rise faster than long-term rates.

The measures of equity value at risk indicate the ongoing economic value of the Company by considering the eff
rates on all of the Company's cash flows, and by discounting the cash flows to estimate the present value of asse
difference between these discounted values of the assets and liabilities is the economic value of equity, which, in
value of the Company's net assets.

Estimated Changes in Economic Value of Equity (EVE)

Change in interest rates	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp	-300 bp	-400 bp
Policy Limit	35.0 %	25.0 %	17.0 %	12.0 %	12.0 %	17.0 %	25.0 %	35.0 %

December 31, 2017	(6.3)%	(4.7)%	(3.2)%	(1.7)%	(1.9)%	(16.1)%	(29.7)%	(29.7)%
December 31, 2016	6.3 %	5.7 %	4.7 %	3.2 %	(10.4)%	(24.9)%	(36.4)%	(30.5)%

The EVE at risk in down rate scenarios decreased at December 31, 2017, when compared to December 31, 2016
value of equity to decline during rising rate environments. This is due to operating in an environment expecting a
curve.

55

Table of Contents

Impact of Inflation and Changing Prices

The consolidated financial statements and related notes have been prepared in accordance with GAAP, which ge
measurement of financial position and operating results in terms of historical dollars without consideration for cl
purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost c
industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market ir
impact on performance than the effects of inflation.

Liquidity

Maintenance of a sufficient level of liquidity is a primary objective of the ALCO. Liquidity, as defined by the Al
anticipated operating cash needs, loan demand, and deposit withdrawals, without incurring a sustained negative i
It is MVB's policy to manage liquidity so that there is no need to make unplanned sales of assets or to borrow fu
conditions.

The main source of liquidity for the Bank comes through deposit growth. Liquidity is also provided from cash ge
maturities, principal payments from loans, and income from loans and investment securities. During the year enc
provided by financing activities totaled $105.9 million, while outflows from investing activity totaled $136.1 mi
Bank has the ability to take advantage of external sources of funds such as advances from the Federal Home Loa
market certificate of deposit issuance programs, the Federal Reserve discount window, brokered deposits and CI
often provide attractive interest rates and flexible maturity dates that enable the Bank to match funding with cont
assets. Securities in the investment portfolio are classified as available-for-sale and can be utilized as an addition

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

Contractual Obligations

The following table reflects the contractual maturities of our term liabilities as of December 31, 2017. The amou
contractual interest, early withdrawal or prepayment assumptions.

(Dollars in thousands)	Less than one year	One to three years	Three to five years	More than five years	Total
Certificates of deposit and individual retirement accounts [1]	$169,220	$98,012	$45,287	$—	$312,519
Securities sold under agreement to repurchase	22,403	—	—	—	22,403
Operating leases	1,822	2,543	2,469	5,185	12,019
FHLB short-term advances	149,596	—	—	—	149,596
FHLB long-term advances	81	175	2,317	—	2,573
Total	$343,122	$100,730	$50,073	$5,185	$499,110

[1] Certificates of deposit give customers rights to early withdrawal. Early withdrawals may be subject to penalties
depends on the remaining time to maturity at the time of early withdrawal.

Table of Contents

Off-Balance Sheet Commitments

The Bank has entered into certain agreements that represent off-balance sheet arrangements that could have a sig
consolidated financial statements and could have a significant impact in future periods. Specifically, the Bank ha
extend credit or provide conditional payments pursuant to standby and commercial letters of credit. In addition, t
credit issued by the FHLB to collateralize certain public funds deposits. Further discussion of these agreements,
outstanding at December 31, 2017, is included in Note 7, "Commitments and Contingent Liabilities" of the Note
Financial Statements included in Item 8, Financial Statements and Supplementary Data, of this Annual Report or

Commitments to extend credit, including loan commitments, standby letters of credit, and commercial letters of c
represent future cash requirements, in that these commitments often expire without being drawn upon.

Fourth Quarter

Fourth quarter 2017 net income was $1.4 million compared to $2.3 million in the fourth quarter of 2016. This eq
share, on a quarterly basis, of $0.12 in 2017 and $0.23 in 2016. Diluted earnings per share for the fourth quarter c
and $0.22, respectively. Net interest income increased during the fourth quarter and was $11.7 million in the fou
to $10.8 million in 2016. Noninterest income was $10.2 million in the fourth quarter of 2017 compared to $10.1
expense increased to $17.7 million for the fourth quarter of 2017 from $16.8 million in 2016. Loan loss provision
fourth quarter of 2017, an increase of $379 thousand over the fourth quarter of 2016.

The commercial and retail banking segment of the Company showed a decrease in earnings in the fourth quarter
from the same period one year prior due to an increase in noninterest expenses. Net interest margin increased $5
Company's strong balance sheet growth, namely loan growth of $27.4 million and deposit growth of $51.1 millio
increased $576 thousand, primarily the result of a $225 thousand increase in mortgage fee income, a $181 thousa
operating income, a $58 thousand increase in Visa debit card and interchange income, and a $50 thousand increa
investment services income. Noninterest expenses increased by $959 thousand, mostly the result of a $366 thous
operating expenses, a $298 thousand increase in salaries and employee benefits, a $137 thousand increase in data
communications expense, and $135 thousand increase in occupancy and equipment expense.

Additionally, fourth quarter 2017 income tax expense increased by $570 thousand to $1.9 million versus the four
in tax expense was primarily the result of tax reform in which the Company was required to re-measure its net de
in a income tax charge of $646 thousand.

The mortgage segment of the Company showed an increase in fourth quarter earnings of $115 thousand as a resu
Mortgage fee income decreased by $452 thousand and gain on derivative decreased by $371 thousand. Salaries a
thousand as a result of decreased commission expense. In addition, there was an income tax expense increased o
larger fourth quarter 2017 earnings versus the prior year.

The financial holding company segment of the company showed an earnings decrease of $286 thousand in the fo
compared to the same period in 2016. The earnings decrease was primarily related to a $498 thousand increase in
thousand increase in salaries and employee benefits. Additionally, the fourth quarter income tax benefit increased
decrease in earnings.

Future Outlook

Three significant factors contributed to the Company's 2017 performance results compared to 2016. These were
on the asset sale of a wholly-owned subsidiary, MVB Insurance, in 2016; the $1.5 million decrease in net income
created by the continued market pressure within the mortgage industry; and a $646 thousand charge associated w

passed in late 2017. The Company has invested in infrastructure to support anticipated future growth in each key technology and processes to meet the growing compliance requirements in the industry. The Company believes i of the finest markets in the State of West Virginia and the Commonwealth of Virginia and will continue to focus improvement; leveraging capital; organic portfolio loan growth; and operating efficiency. The key challenge for to attract core deposits to fund growth in the new markets through continued delivery of outstanding customer se quality products and technology.

Table of Contents

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risk is composed primarily of interest rate risk. The Asset and Liability Committee ("AL
reviewing the interest rate sensitivity position and establishes policies to monitor and coordinate the Company's
funds.

Interest Rate Sensitivity Management

The Company uses a simulation model to analyze, manage and formulate operating strategies that address net int
movements in interest rates. The simulation model projects net interest income based on various interest rate sce
month period. The model is based on the actual maturity and re-pricing characteristics of rate sensitive assets and
incorporates certain assumptions which management believes to be reasonable regarding the impact of changing
prepayment assumption of certain assets and liabilities as of December 31, 2017. The model assumes changes in
management intervention to change the composition of the balance sheet. According to the model run for the per
2017, over a twelve-month period, an immediate 100 basis point increase in interest rates would result in a decre
1.6%. An immediate 200 basis point increase in interest rates would result in a decrease in net interest income by
decrease in interest rates would result in a decrease in net interest income of 0.3%. While management carefully
changes in interest rates and takes actions as warranted to decrease any adverse impact, there can be no assuranc
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 th
Company manages its exposure to fluctuations in interest rates through policies established by its ALCO. The A
responsibility for formulating and implementing strategies to improve balance sheet positioning and reviewing in

We have counter-party risk which may arise from the possible inability of the Company's third-party investors to
forward sales contracts. The Company works with third-party investors that are generally well capitalized, are in
strong financial performance to mitigate this risk. We do not expect any third-party investor to fail to meet its ob
financial condition of these third parties on an annual basis. We do not expect these third parties to fail to meet th

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
MVB Financial Corp. and Subsidiary
Consolidated Balance Sheets
(Dollars in thousands except per share data)
December 31, 2017 and 2016

ASSETS
Cash and cash equivalents:
Cash and due from banks
Interest bearing balances with banks
Total cash and cash equivalents
Certificates of deposit with other banks
Investment Securities:
Securities available-for-sale
Loans held for sale
Loans receivable:
Less: Allowance for loan losses
Net Loans
Premises and equipment
Bank owned life insurance
Accrued interest receivable and other assets
Goodwill
TOTAL ASSETS

LIABILITIES AND STOCKHOLDERS' EQUITY
Deposits:
Noninterest bearing
Interest bearing
Total deposits

Accrued interest payable and other liabilities
Repurchase agreements
FHLB and other borrowings
Subordinated debt
Total liabilities

STOCKHOLDERS' EQUITY
Preferred stock, par value $1,000; 20,000 authorized; 783 and 9,283 issued in 2017 and 2016, respectively (See Footnote 12)
Common stock, par value $1; 20,000,000 shares authorized; 10,495,704 issued and 10,444,627 shares outstandin
in 2017; 10,047,621 shares issued and 9,996,544 shares outstanding in 2016
Additional paid-in capital
Retained earnings
Accumulated other comprehensive loss
Treasury Stock, 51,077 shares, at cost
Total stockholders' equity
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

See Notes to Consolidated Financial Statements

Table of Contents

MVB Financial Corp. and Subsidiary
Consolidated Statements of Income
(Dollars in thousands except per share data)
Years ended December 31, 2017, 2016 and 2015

	2017	2016	2015
INTEREST INCOME			
Interest and fees on loans	$51,217	$50,018	$40,642
Interest on deposits with other banks	340	322	274
Interest on investment securities - taxable	2,658	1,366	958
Interest on tax exempt loans and securities	2,383	2,417	2,226
Total interest income	56,598	54,123	44,100
INTEREST EXPENSE			
Interest on deposits	8,294	7,748	6,246
Interest on repurchase agreements	75	72	83
Interest on FHLB and other borrowings	1,690	1,086	692
Interest on subordinated debt	2,242	2,226	2,204
Total interest expense	12,301	11,132	9,225
NET INTEREST INCOME	44,297	42,991	34,875
Provision for loan losses	2,173	3,632	2,493
Net interest income after provision for loan losses	42,124	39,359	32,382
NONINTEREST INCOME			
Service charges on deposit accounts	765	764	646
Income on bank owned life insurance	646	638	653
Visa debit card and interchange income	1,258	1,185	987
Mortgage fee income	37,149	35,673	29,472
Gain on sale of portfolio loans	538	1,042	1,413
Insurance and investment services income	563	420	338
Gain on sale of securities	731	1,082	130
Gain (loss) on derivatives	(2,722)	1,467	675
Commercial swap fee income	503	84	382
Other operating income	1,275	850	259
Total noninterest income	40,706	43,205	34,955
NONINTEREST EXPENSES			
Salary and employee benefits	44,108	45,225	36,073
Occupancy expense	4,084	3,686	3,390
Equipment depreciation and maintenance	3,005	2,452	2,013
Data processing and communications	5,116	4,964	4,010
Mortgage processing	3,207	3,355	3,158
Marketing, contributions and sponsorships	1,179	1,253	1,352
Professional fees	3,143	2,720	3,232
Printing, postage and supplies	988	767	762
Insurance, tax and assessment expense	1,797	1,528	1,394
Travel, entertainment, dues and subscriptions	2,221	1,725	1,579
Other operating expenses	1,652	1,534	885
Total noninterest expense	70,500	69,209	57,848

Income from continuing operations, before income taxes	12,330	13,355	9,489
Income tax expense - continuing operations	4,755	4,378	2,886
Net Income from continuing operations	7,575	8,977	6,603
Income from discontinued operations, before income taxes	—	6,346	353
Income tax expense - discontinued operations	—	2,411	140
Net Income from discontinued operations	—	3,935	213
Net Income	$7,575	$12,912	$6,816
Preferred dividends	498	1,128	575
Net Income available to common shareholders	$7,077	$11,784	$6,241

Table of Contents

Earnings per share from continuing operations - basic	$ 0.69	$ 0.96	$ 0.75
Earnings per share from discontinued operations - basic	$ —	$ 0.48	$ 0.03
Earnings per common shareholder - basic	$ 0.69	$ 1.44	$ 0.78
Earnings per share from continuing operations - diluted	$ 0.68	$ 0.92	$ 0.74
Earnings per share from discontinued operations - diluted	$ —	$ 0.39	$ 0.03
Earnings per common shareholder - diluted	$ 0.68	$ 1.31	$ 0.77
Cash dividends declared	$ 0.10	$ 0.08	$ 0.08
Weighted average shares outstanding - basic	10,308,738	8,212,021	8,014,316
Weighted average shares outstanding - diluted	10,440,228	10,068,733	8,140,116

See Notes to Consolidated Financial Statements

Table of Contents

MVB Financial Corp. and Subsidiary
Consolidated Statements of Comprehensive Income
(Dollars in thousands)
Years ended December 31, 2017, 2016 and 2015

Net Income

Other comprehensive income (loss):

Unrealized holding gains (losses) on securities available-for-sale

Unrealized holding gains during the year related to reclassified held-to-maturity securities

Income tax effect

Reclassification adjustment for gain recognized in income

Reclassification adjustment for gain recognized in income related to reclassified held-to-maturity securities

Income tax effect

Change in defined benefit pension plan

Income tax effect

Total other comprehensive income (loss)

Comprehensive income

See Notes to Consolidated Financial Statements

Table of Contents

MVB Financial Corp. and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity
(Dollars in thousands except per share data)
Years ended December 31, 2017, 2016 and 2015

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)	Trea Stoc
Balance December 31, 2014	$16,334	$8,034	$74,342	$14,454	$ (2,642)	$(1,(
Net Income	—	—	—	6,816	—	—
Other comprehensive loss	—	—	—	—	(291)	—
Cash dividends paid ($0.08 per share)	—	—	—	(641)	—	—
Dividends on preferred stock	—	—	—	(575)	—	—
Stock based compensation	—	—	413	—	—	—
Common stock options exercised	—	79	(527)	—	—	—
Balance December 31, 2015	16,334	8,113	74,228	20,054	(2,933)	(1,08
Net Income	—	—	—	12,912	—	—
Other comprehensive loss	—	—	—	—	(1,344)	—
Cash dividends paid ($0.08 per share)	—	—	—	(646)	—	—
Dividends on preferred stock	—	—	—	(1,128)	—	—
Common stock issuance, net of issuance costs	—	1,913	18,606	—	—	—
Stock based compensation	—	—	568	—	—	—
Common stock options exercised	—	22	10	—	—	—
Balance December 31, 2016	16,334	10,048	93,412	31,192	(4,277)	(1,08
Net Income	—	—	—	7,575	—	—
Other comprehensive income	—	—	—	—	1,289	—
Cash dividends paid ($0.10 per share)	—	—	—	(1,033)	—	—
Dividends on preferred stock	—	—	—	(498)	—	—
Redemption of preferred stock	(8,500)	—	—	—	—	—
Common stock issuance, net of issuance costs	—	444	4,487	—	—	—
Stock based compensation	—	—	813	—	—	—
Common stock options exercised	—	4	(14)	—	—	—
Balance December 31, 2017	$7,834	$10,496	98,698	37,236	$ (2,988)	$(1,(

See Notes to Consolidated Financial Statements

Table of Contents

MVB Financial Corp. and Subsidiary
Consolidated Statements of Cash Flows
(Dollars in thousands)
Years ended December 31, 2017, 2016 and 2015

	2017	2016
OPERATING ACTIVITIES		
Net Income	$ 7,575	$ 12,91
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net amortization and accretion of investments	1,166	1,001
Net amortization of deferred loan fees	26	55
Provision for loan losses	2,173	3,632
Depreciation and amortization	2,691	3,407
Stock based compensation	813	568
Loans originated for sale	(1,367,531)	(1,643,
Proceeds of loans sold	1,428,060	1,691,5
Mortgage fee income	(37,149)	(35,67
Gain on sale of securities	(1,103)	(1,084
Loss on sale of securities	372	2
Gain on sale of portfolio loans	(538)	(1,042
Gain on sale of subsidiary	—	(6,926
Income on bank owned life insurance	(646)	(638
Deferred taxes	1,349	707
Other, net	(4,137)	221
Net cash (used in) / provided by operating activities	33,121	25,264
INVESTING ACTIVITIES		
Purchases of investment securities available-for-sale	(139,127)	(114,6
Purchases of investment securities held-to-maturity	—	—
Maturities/paydowns of investment securities available-for-sale	19,011	17,790
Maturities/paydowns of investment securities held-to-maturity	—	400
Sales of investment securities available-for-sale	53,198	55,191
Sales of investment securities held-to-maturity	—	—
Purchases of premises and equipment	(4,496)	(1,668
Disposals of premises and equipment	307	—
Disposals of premises and equipment from sale of subsidiary	—	581
Net increase in loans	(53,960)	(22,24
Purchases of restricted bank stock	(20,712)	(23,93
Redemptions of restricted bank stock	18,980	26,684
Proceeds from sale of certificates of deposit with banks	1,978	6,717
Purchases of certificates of deposit with banks	(2,229)	(8,094
Proceeds from sale of other real estate owned	—	159
Proceeds from sale of subsidiary	—	7,047
Branch acquisition, net cash acquired	—	—
Purchase of bank owned life insurance	(9,050)	—
Net cash (used in) investing activities	(136,100)	(55,98
FINANCING ACTIVITIES		
Net increase in deposits	52,563	94,703
Net (decrease) in repurchase agreements	(2,757)	(2,277
Net change in short-term FHLB borrowings	49,663	(92,18
Principal payments on FHLB borrowings	(15,097)	(93

Proceeds from new FHLB borrowings	26,682	—
Proceeds from stock offering, net of issuance costs	4,931	20,519
Preferred stock redemption	(8,500)	—
Common stock options exercised	(10)	32
Cash dividends paid on common stock	(1,033)	(646
Cash dividends paid on preferred stock	(498)	(1,128
Net cash provided by financing activities	105,944	18,926
Increase (decrease) in cash and cash equivalents	2,965	(11,79
Cash and cash equivalents at beginning of period	17,340	29,133
Cash and cash equivalents at end of period	$ 20,305	$ 17,34
Supplemental disclosure of cash flow information:		
Loans transferred to other real estate owned	$ 1,164	$ 332
Cashless stock options exercised	$ 4	$ 16
Cash payments for:		
Interest on deposits, repurchase agreements and borrowings	$ 12,399	$ 10,89
Income taxes	$ 6,026	$ 6,922

See Notes to Consolidated Financial Statements

Table of Contents

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business and Organization

MVB Financial Corp. (“the Company”) is a financial holding company and was organized in 2003. MVB operat
wholly-owned subsidiary, MVB Bank, Inc. (“MVB Bank”). MVB Bank’s operating subsidiaries include MVB M
(“MVB Insurance”), and MVB Community Development Corporation (“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 reg
Mortgage”), a mortgage company in the northern Virginia area, and fifty percent (50%) interest in a mortgage se
Service Provider, LLC (“LSP”). In 2013, this fifty percent interest (50%) in LSP was reduced to a twenty-five pe
2017, a forfeiture of a partial interest occurred, which increased the interest owned to thirty-three percent (33%).
doing business as Lenderworks.

MVB Insurance was originally formed in 2000. In 2013, MVB Insurance became a direct subsidiary of the Comp
entered into an Asset Purchase Agreement with USI Insurance Services (“USI”), in which USI purchased substa
assumed certain liabilities of MVB Insurance, which resulted in a pre-tax gain of $6.9 million and was reported i
MVB Insurance retained the assets related to, and continues to operate, its title insurance business, which is imm
The Company reorganized MVB Insurance as a subsidiary of the Bank in 2016.

MVB Community Development Corporation was formed in 2017 to house significant CRA investments that the
the communities it serves.

A summary of significant accounting and reporting policies applied in the presentation of the accompanying con
follows:

Basis of Presentation

The financial statements are consolidated to include the accounts of the Company, its subsidiary, MVB Bank, an
subsidiaries, MVB Mortgage and MVB Insurance. These statements have been prepared in accordance with U.S
accounting principles. All significant inter-company accounts and transactions have been eliminated in the conso

In preparing the consolidated financial statements, management makes estimates and assumptions that affect the
and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statemen
of revenues and expenses for the period. Actual results could differ significantly from those estimates. Material e
susceptible to significant change relate to determination of the allowance for loan losses, derivative instruments,
assets and liabilities.

Operating Segments

An operating segment is defined as a component of an enterprise that engages in business activities that generate
and the operating results of which are reviewed by the chief operating decision maker in the determination of res
performance. While the Company’s chief decision makers monitor the revenue streams of the various Company’
operations are managed and financial performance is evaluated on a Company-wide basis. The Company has ide
segments: commercial and retail banking; mortgage banking; and financial holding company. Insurance services
a reportable segment until entering into an Asset Purchase Agreement, as discussed below and in Note 23, "Disc
Notes to the Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Dat

Form 10-K.

Cash and Cash Equivalents

Cash equivalents include cash on hand, deposits in banks and interest-earning deposits. Interest-earning deposits
days or less are considered cash equivalents. Net cash flows are reported for loans, deposits and short term borro

65

Table of Contents

Management Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting prin
to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the con
and the reported amounts of revenues and expenses during the reporting period. Estimates, such as the allowance
upon known facts and circumstances. Estimates are revised by management in the period such facts and circums
could differ from these estimates.

Investment Securities

Investment securities at the time of purchase are classified as one of the following:

Held-to-Maturity Securities - Includes securities that the Company has the positive intent and ability to hold to m
reported at amortized cost.

Available-for-Sale Securities - Includes debt and equity securities not classified as held-to-maturity that will be h
time. These securities may be sold in response to changes in market interest or prepayment rates, needs for liquid
availability of and yield of alternative investments. Such securities are reported at fair value, with unrealized hol
excluded from earnings and reported as a separate component of stockholders' equity, net of estimated income ta

The amortized cost of investment in debt securities is adjusted for amortization of premiums and accretion of dis
method that results in a level yield. Gains and losses on the sale of investment securities are computed on the bas
the adjusted cost of each security.

Securities are periodically reviewed for other-than-temporary impairment. For debt securities, management cons
value of future cash flows expected to be collected are less than the security's amortized cost basis (the differenc
the magnitude and duration of the decline, the reasons underlying the decline and the Company's intent to sell th
more likely than not that the Company would be required to sell the security before its anticipated recovery in m
whether the loss in value is other than temporary. Once a decline in value is determined to be other than tempora
intend to sell the security, and it is more-likely-than-not that it will not be required to sell the security, before rec
amortized cost basis, the charge to earnings is limited to the amount of credit loss. Any remaining difference betw
cost (the difference defined as the non-credit portion) is recognized in other comprehensive income, net of applic
securities where the fair value has been significantly below cost for one year, the Company's policy is to recogni
sufficient evidence is available that the decline is not other than temporary and a recovery period can be predicte
considered to be other-than-temporary is recorded as a loss within noninterest income in the consolidated statem

Common stock of the Federal Home Loan Bank represents ownership in an institution which is wholly owned by
These equity securities are accounted for at cost and are classified as other assets.

Loans Held for Sale

Through multiple secondary market investors, MVB Mortgage has the ability to offer customers long-term fixed
mortgage products without holding these instruments in the Bank's loan portfolio. MVB Mortgage elected the fa
records loans held for sale at fair value. Occasionally the Bank will sell portfolio loans and have them classified
loans are recorded at lower of cost or market.

The Company has a loan indemnification reserve for loans sold that may be subject to repurchase in the event of
borrower or subsequent discovery that underwriting standards were not met. The reserve amount was $200 thous
and 2016.

Loans and Allowance for Loan Losses

Loans are stated at the amount of unpaid principal reduced by an allowance for loan losses. Loans are considered
principal or interest payments are 90 days past due. Interest income on loans is recognized on an accrual basis. T
is maintained at a level deemed adequate to absorb probable losses inherent in the loan portfolio. The Company
quarterly loan review process to continually evaluate loans for changes in credit risk. This process

66

Table of Contents

serves as the primary means by which the Company evaluates the adequacy of the allowance for loan losses, and
review of the collectability of loans in light of historical experience, the nature and volume of the loan portfolio,
affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic cond
inherently subjective as it requires estimates that are susceptible to significant revision as more information beco

The allowance consists of specific and general components. The specific component relates to loans that are imp
covers all loans that are not impaired, and is based upon historical loss experience adjusted for qualitative factors

The Company allocates the allowance based on the factors described below, which conform to the Company's lo
reviewing risk within the Bank and Mortgage Company's loan portfolio, management has determined there to be
categories within the loan portfolio. The allowance for loan losses consists of amounts applicable to: (i) residenti
commercial and commercial real estate secured loans; (iii) home equity loans; (iv) consumer and other loans. Fa
process include general loan terms, collateral, and availability of historical data to support the analysis. Historica
loan category are calculated and used as the basis for calculating allowance allocations. Certain qualitative factor
additional inherent risks in the loan portfolio, which are not necessarily reflected in the historical loss percentage
added to the historical allocation percentages to get the adjusted factor to be applied to non-classified loans on a
The following qualitative factors are analyzed:

- Lending policies and procedures
- Nature and volume of the portfolio
- Experience and ability of lending management and staff
- Volume and severity of problem credits
- Conclusions of loan reviews, audits and exams
- National, state, regional and local economic trends and business conditions
  - General economic conditions
  - Unemployment rates
  - Inflation / CPI
- Value of underlying collateral
- Existence and effect of any credit concentrations
- Consumer sentiment
- Other external factors

The Company analyzes its loan portfolio each quarter to determine the appropriateness of its allowance for loan

A loan that has deteriorated and requires additional collection efforts by the Bank could warrant non-accrual stat
presented to the Chief Credit Officer and or the Management Loan Committee ("MLC"), as required with respec
collection process and to make a determination as to whether the loan should be placed on non-accrual status. Th
non-accrual status is subject to applicable regulatory restrictions and guidelines. Generally, loans should be place
the loan reaches 90 days past due, when it becomes likely the borrower cannot or will not make scheduled princi
when full repayment of principal and interest is not expected, or when the loan displays potential loss characteris
interest is charged off when a loan is placed in non-accrual status, unless Management believes it is likely the ac
collected. Any payments subsequently received are applied to principal. To remove a loan from non-accrual statu
due must be paid up to date and the Bank is reasonably sure of future satisfactory payment performance. Usually
recent history of payments due. Removal of a loan from non-accrual status requires the approval of the Chief Cre

A loan is considered impaired when, based upon current information and events, it is probable that the Company
scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. F
management in determining impairment include payment status, collateral value, and the probability of collectin
interest payments when due. Loans that experience insignificant payment delays and shortages generally are not

Generally, the Company considers impaired loans to include loans classified as non-accrual loans, loans past due
troubled debt restructurings.

The Company defers loan origination and commitment fees and direct loan origination costs and the net amount
of the related loan's yield.

67

Table of Contents

Troubled Debt Restructurings (TDRs)

A restructuring of debt constitutes a TDR if the creditor for economic or legal reasons related to the debtor's fina
concession to the debtor that it would not otherwise consider. The determination of whether a concession has bee
evaluation of the debtor's ability to access funds at a market rate for debt with similar risk characteristics and am
significance of the modification relative to unpaid principal or collateral value of the debt, and/or the significance
payments relative to the frequency of payments, original maturity date or the expected duration of the loan. The
granted generally include one or more modifications to the terms of the debt such as a reduction in the interest ra
the debt, an extension of the maturity date at an interest rate lower than the current market rate for new debt with
the unpaid principal or interest. All TDRs are considered impaired loans.

Derivative Instruments

Interest Rate Lock Commitments and Hedges

The Company enters into commitments to originate mortgage loans whereby the interest rate on the loan is deter
lock commitments). Rate lock commitments on mortgage loans that are intended to be sold are considered to be
time between issuance of a loan commitment and closing and sale of the loan generally ranges from 30 days to 1
protects itself from changes in interest rates through the use of best efforts forward delivery commitments, where
sell a loan at the time the borrower commits to an interest rate with the intent that the buyer has assumed interest
correlation between the rate lock commitments and hedges is very high due to their similarity. As a result of thes
limits the exposure of losses with these arrangements and will not realize significant gains related to its rate lock
in interest rates. For loans not originated on a best effort basis, the Company also uses mortgage-backed security
mitigate interest rate risk by entering securities and mortgage-backed securities trades with brokers.

The fair value of rate lock commitments and hedges is not readily ascertainable with precision because rate lock
not actively traded in stand-alone-markets. The Company determines the fair value of rate lock commitments an
change in the value of the underlying asset while taking into consideration the probability that the rate lock com
value changes are recorded in noninterest income in the Company's consolidated statement of income. At Decem
balance of interest rate lock commitments was $1.4 million and $1.5 million, respectively. There were no forwar
December 31, 2017 and 2016.

Interest Rate Cap

The Company has entered into a rate protection transaction through SMBC Capital Markets, Inc. covering the pe
through December 1, 2019. The notional amount is $100 million and 3 month LIBOR is the underlying rate and
year coverage is broken into 20 quarterly caps. The Company's fixed cost in the interest rate cap was $1.5 millio
must maintain a long-term senior unsecured debt rating of A or better by S&P and A2 or better by Moody's. The
a free-standing derivative and is recorded at fair value on the Company's consolidated balance sheet. Fair value
noninterest income in the Company's consolidated net income statement. At December 31, 2017 and 2016, the f
cap was $33 thousand and $268 thousand, respectively.

Interest Rate Swap

Beginning in 2015, the Company entered into interest rate swap agreements to facilitate the risk management str
commercial banking clients. The Company mitigates this risk by entering into equal and offsetting interest rate s
rated third-party financial institutions. The interest rate swap agreements are free-standing derivatives and are re
Company's consolidated balance sheet. Fair value changes are recorded in noninterest income in the Company's
statement. At December 31, 2017 and 2016, the fair value of interest rate swap agreements was $268 thousand a

respectively.

Mortgage Servicing Rights

Mortgage servicing rights (MSRs) are recorded when the Bank sells mortgage loans and retains the servicing on
basis, MVB tracks the amount of mortgage loans that are sold with servicing retained. A valuation is done to det
which is then recorded as an asset and amortized over the period of estimated net servicing revenues. The balanc
impairment quarterly, and was determined not to be impaired at December 31, 2017 or 2016. Servicing loans

68

Table of Contents

for others generally consists of collecting mortgage payments from borrowers, maintaining escrow accounts, ren
investors and when necessary, foreclosure processing. Serviced loans are not included in the Consolidated Balan
2017 and 2016, the MSR's value was $182 thousand and $190 thousand, respectively.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation. Depreciation expense is computed for
straight-line-method based on the estimated useful lives of assets, which range from 7 to 40 years on buildings a
and 3 to 10 years on furniture, fixtures and equipment.

Intangible Assets and Goodwill

Goodwill is reviewed for potential impairment at least annually at the reporting unit level. In addition to the annu
Company evaluates for impairment when events or circumstances indicate that it is more likely than not an impa
Company performs its annual impairment test during the fourth quarter. The Company first assesses qualitative f
it is necessary to perform the two-step goodwill impairment test discussed below. The Company assesses qualita
whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including
qualitative factors include: economic conditions; industry and market considerations; increases in raw materials,
financial performance such as negative or declining cash flows; relevant entity-specific events such as changes i
personnel, strategy, or customers; and regulatory or political developments.

If, based on its assessment of the qualitative factors, the Company determines that it is not more likely than not t
reporting unit is less than its carrying amount, then the first and second steps of the goodwill impairment test are
to be necessary, a two-step impairment test is performed to identify potential goodwill impairment and measure t
impairment loss to be recognized (if any). The first step requires the estimation of the reporting unit's fair value.
reporting unit exceeds the carrying value, including goodwill, no further testing is required. If the carrying value
second step is performed to determine whether an impairment charge must be recorded, and if so, the amount of

It was decided that the Company would early adopt ASU 2017-04, Intangibles–Goodwill and Other (Topic 350):
Goodwill Impairment. Topic 350, Intangibles—Goodwill and Other (Topic 350) and did so for the period ended
the Company began using the one-step process for the annual impairment evaluation.

The Company's assessment of qualitative factors determined that it is not more likely than not that the fair value
than its carrying amount and therefore, goodwill is not impaired as of December 31, 2017 and 2016. As of Decer
Company had goodwill of $18.5 million, respectively.

Intangible Assets include core deposit intangibles which are amortized over their useful life of ten years using th
method. Net core deposit intangibles are included in accrued interest receivable and other assets on the consolida
$646 thousand and $744 thousand as of December 31, 2017 and 2016, respectively.

Restricted Bank Stock

The Bank is a member of the FHLB of Pittsburgh and as such, is required to maintain a minimum investment in
with the level of advances outstanding with the FHLB. As of December 31, 2017 and 2016, the Bank holds $7.6
respectively. The stock is bought from and sold to the FHLB based upon its $100 par value. The stock does not h
fair value and as such is classified as restricted stock, carried at cost and evaluated by management. The stock's v
ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whe
ultimately be recovered is influenced by criteria such as the following: (a) A significant decline in net assets of th
capital stock amount and the length of time this situation has persisted (b) commitments by the FHLB to make pa

regulation and the level of such payments in relation to the operating performance (c) the impact of legislative ar
customer base of the FHLB and (d) the liquidity position of the FHLB. Management evaluated the stock and con
impaired for the periods presented herein.

Management considered that the FHLB's regulatory capital ratios have improved in the most recent quarters, liq
shares of FHLB stock continue to exchange hands at the $100 par value and the FHLB has repurchased shares of
members during 2017 and 2016.

Table of Contents

Foreclosed Assets Held for Resale

Foreclosed assets held for resale acquired in satisfaction of mortgage obligations and in foreclosure proceedings
estimated selling costs at the time of foreclosure, with any valuation adjustments charged to the allowance for lo
periods, foreclosed assets are recorded at the lower of cost or fair value less any costs to sell. Any gains or losses
other noninterest expense. At December 31, 2017 and 2016, the Company held other real estate of $1.3 million a

Bank-Owned Life Insurance

Bank-owned life insurance (“BOLI”) represents life insurance on the lives of certain Company employees who h
allowing the Company to be the beneficiary of such policies. These policies are recorded at their cash surrender
be realized upon surrender of the policy. Income from these policies is not subject to income taxes and is recorde

Income Taxes

The Company and the Bank file a consolidated federal income tax return. Deferred tax assets and liabilities are c
difference between the financial statement basis and income tax basis of assets and liabilities using the enacted n
income tax expenses or benefits are based on the changes in the net deferred tax asset or liability from period to

Stock Based Compensation

Compensation cost is recognized for stock options issued to employees, based on the fair value of these awards a
Black-Scholes model is utilized to estimate the fair value of stock options. Compensation cost is recognized over
generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a st
requisite service period for the entire award.

Earnings Per Share

The Company determines basic earnings per share by dividing net income less preferred stock dividends by the
common shares outstanding during the period. Diluted earnings per share is determined by dividing net income l
preferred stock plus interest on convertible subordinated debt by the weighted average number of shares outstanc
number of shares that would be issued assuming the exercise of stock options under the Company’s 2003 and 20
the conversion of preferred stock and subordinated debt if dilutive.

The 2015 dilutive earnings per share has been modified with the calculation of continuing and discontinued oper
of shares from continuing operations for continuing, discontinuing, and total earnings per share. The subordinate
anti-dilutive for continuing operations and excluded from the calculation for year ending December 31, 2015. Th
earnings per share.

Table of Contents

(Dollars in thousands except shares and per share data)	For the years December 31 2017	2016
Numerator for basic earnings per share:		
Net Income from continuing operations	$7,575	$ 8,9
Less: Dividends on preferred stock	498	1,128
Net Income from continuing operations available to common shareholders - basic	7,077	7,849
Net Income from discontinued operations available to common shareholders - basic and diluted	—	3,935
Net Income available to common shareholders	$7,077	$ 11,
Numerator for diluted earnings per share:		
Net Income from continuing operations available to common shareholders - basic	$7,077	$ 7,8
Add: Dividends on preferred stock	—	—
Add: Interest on subordinated debt (tax effected)	—	1,390
Net Income available to common shareholders from continuing operations - diluted	$7,077	$ 9,2
Denominator:		
Total average shares outstanding	10,308,7[illegible]	[illegible]812
Effect of dilutive convertible preferred stock	—	—
Effect of dilutive convertible subordinated debt	—	1,837
Effect of dilutive stock options	131,490	19,21
Total diluted average shares outstanding	10,440,2[illegible]	[illegible]06
Earnings per share from continuing operations - basic	$0.69	$ 0.9
Earnings per share from discontinued operations - basic	$—	$ 0.4
Earnings per common shareholder - basic	$0.69	$ 1.4
Earnings per share from continuing operations - diluted	$0.68	$ 0.9
Earnings per share from discontinued operations - diluted	$—	$ 0.3
Earnings per common shareholder - diluted	$0.68	$ 1.3

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net in changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and minimum reported as a separate component of the equity section of the Consolidated Balance Sheet, such items, along with of comprehensive income.

In 2018, the Company will be required to perform a reclassification from AOCI to retained earnings for stranded newly enacted federal corporate income tax rate in the Tax Reform Act, which was enacted on December 22, 20 the Tax Reform Act included a reduction to the corporate income tax rate from 34 percent to 21 percent effective amount of the reclassification is the difference between the historical corporate income tax rate and the newly en income tax rate, which resulted in a decrease of $646 thousand.

Marketing Costs

Marketing costs are expensed as incurred. Marketing expense was $1.2 million, $1.3 million and $1.4 million for respectively.

Table of Contents

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Contro
deemed to be surrendered when (i) the assets have been isolated from the company, (ii) the transferee obtains the
constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (iii) the Compa
effective control over the transferred assets through an agreement to repurchase them before their maturity.

Reclassifications

Certain amounts in the 2016 and 2015 consolidated financial statements have been reclassified to conform to the
presentation.

Recent Accounting Pronouncements

In February 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("A
Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accum
Income. This update requires a reclassification from accumulated other comprehensive income ("AOCI") to retai
effects resulting from the newly enacted federal corporate income tax rate in the Tax Reform Act, which was ena
The Tax Reform Act included a reduction to the corporate income tax rate from 34 percent to 21 percent effectiv
amount of the reclassification is the difference between the historical corporate income tax rate and the newly en
income tax rate, which resulted in a decrease of $646 thousand. The amendments in the ASU are effective for fis
December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted and the Com

In March 2017, the FASB issued ASU 2017-08, Receivables–Nonrefundable Fees and Other Costs (Subtopic 31
on Purchased Callable Debt Securities. This ASU amends guidance on the amortization period of premiums on c
debt securities. Specifically, the amendments shorten the amortization period of premiums on certain purchased
earliest call date. The amendments affect all entities that hold investments in callable debt securities that have an
excess of the amount that is repayable by the issuer at the earliest call date (that is, at a premium). For public co
effective for fiscal years effective for fiscal years beginning after December 15, 2018, including all interim perio
The adoption of this guidance is not expected to be material to the consolidated financial statements, as it is our
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
Topic 350, Intangibles—Goodwill and Other (Topic 350), currently requires an entity that has not elected the pri
goodwill to perform a two-step test to determine the amount, if any, of goodwill impairment. In Step 1, an entity
reporting unit with its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds
performs Step 2 and compares the implied fair value of goodwill with the carrying amount of that goodwill for th
impairment charge equal to the amount by which the carrying amount of goodwill for the reporting unit exceeds
goodwill is recorded, limited to the amount of goodwill allocated to that reporting unit To address concerns over
the two-step goodwill impairment test, the amendments in this Update remove the second step of the test. An ent
quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amou
exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the option
goodwill impairment. For public companies, this update will be effective for fiscal years effective for fiscal year
15, 2019, including all interim periods within those fiscal years. The adoption of this guidance did not have a ma
consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement o
Instruments. The new guidance replaces the incurred loss impairment methodology in current GAAP with an exp
methodology and requires consideration of a broader range of information to determine credit loss estimates. Fin

amortized cost will be presented at the net amount expected to be collected by using an allowance for credit loss
loans will receive an allowance account at the acquisition date that represents a component of the purchase price
relating to available-for-sale debt securities will be recorded through an allowance for credit losses, with such all
by which fair value is below amortized cost. The guidance is effective for fiscal years beginning after December
within those fiscal years. The Company's project management team and Management Loan Committee ("MLC")
assist with a data gap analysis and will utilize the data to determine the impact of the pronouncement. Additional
researched and acquired software to assist with implementation that will be tested throughout 2018.

Table of Contents

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). Among other things, in the amendments
be required to recognize the following for all leases (with the exception of short-term leases) at the commenceme
which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and
is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Unde
accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor acc
accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are eff
beginning after December 15, 2018, including interim periods within those fiscal years. Early application is perm
(for capital and operating leases) and lessors (for sales-type, direct financing and operating leases) must apply a
transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period p
statements. The modified retrospective approach would not require any transition accounting for leases that expi
comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Co
management team, which is currently evaluating the impact of the new standard, and expects an increase to the C
for right-of-use assets and associated lease liabilities, as well as resulting depreciation expense of the right-of-us
of the lease liabilities in the Consolidated Statements of Income, for arrangements previously accounted for as o

In January 2016, the FASB issued ASU 2016-01, Accounting for Financial Instruments - Overall: Classification
825-10). Amendments within ASU 2016-01 that relate to non-public entities have been excluded from this prese
this ASU 2016-01 address the following: 1) require equity investments to be measured at fair value with change
net income; 2) simplify the impairment assessment of equity investments without readily-determinable fair value
assessment to identify impairment; 3) eliminate the requirement to disclose the method(s) and significant assump
value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet;
exit price notion when measuring the fair value of financial instruments for disclosure purposes; 5) require separ
comprehensive income for the portion of the total change in the fair value of a liability resulting from a change i
credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value optio
6) require separate presentation of financial assets and financial liabilities by measurement category and form of
securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; a
should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities
entity's other deferred tax assets. The amendments are effective for public business entities for fiscal years begin
2017, and interim periods within those fiscal years. The Company has performed a preliminary evaluation of the
evaluation, the Company has determined that this new standard is not expected to have a material impact on the
financial statements as it relates to accounting for financial instruments, as the effect of this pronouncement wou
$219 thousand from accumulated other comprehensive income to retained earnings upon adoption.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The new re
a single source of revenue guidance for all companies in all industries and is more principles-based than current
pronouncement provides a five-step model for a company to recognize revenue when it transfers control of good
an amount that reflects the consideration to which it expects to be entitled in exchange for those goods or service
(1) identify the contract with the customer, (2) identify the separate performance obligations in the contract, (3)
price, (4) allocate the transaction price to the separate performance obligations and (5) recognize revenue when
is satisfied. On July 9, 2015, the FASB approved a one-year deferral of the effective date of the update. The upd
annual reporting periods in fiscal years beginning after December 15, 2017. Early adoption is now permitted as
for interim and annual reporting periods in fiscal years beginning after December 15, 2016. In March 2016, the
ASU 2016-08, which amends the principal versus agent guidance in the revenue standard. In April 2016, the FA
ASU 2016-10, which clarifies when promised goods or services are separately identifiable in the revenue standa
issued ASU 2016-12, which provides narrow-scope improvements and practical expedients to the revenue standa
the impact of this standard on individual customer contracts, while management evaluated the impact of this sta
of its customer contracts and revenue streams. The Company determined that this standard will not have a mater
financial statements because revenue related to financial instruments, including loans and investment securities

updates. Loan interest income, investment interest income, insurance services revenue and BOLI are accounted f
standards and out of scope of ASC 606 revenue standard. The Company completed its evaluation and review of t
that this guidance will not have a material effect on the consolidated financial statements, and as such, adopted th
standard as of January 1, 2018.

Table of Contents

NOTE 2. INVESTMENT SECURITIES

Prior to the final determination of Basel III, investments were recorded as held-to-maturity due to the uncertainty
available-for-sale investments. Upon the issuance of the final ruling, the Company opted out of the Other Compr
available-for-sale investments permitted under Basel III. Due to the change in capital treatment under the final ru
Company's purpose of recording investments as held-to-maturity changed; therefore, during the period ended M
reclassified $52.4 million, with unrealized holding gains of $1.8 million, of the remaining held-to-maturity inves
investments.

There were no held-to-maturity securities at December 31, 2017 or December 31, 2016.

Amortized cost and fair values of investment securities available-for-sale at December 31, 2017 are summarized

(Dollars in thousands)	Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value
U. S. Agency securities	$81,705	$ 81	$ (841)	$80,945
U.S. Sponsored Mortgage-backed securities	59,387	31	(1,264)	58,154
Municipal securities	74,482	1,733	(373)	75,842
Total debt securities	215,574	1,845	(2,478)	214,941
Equity and other securities	15,940	644	(18)	16,566
Total investment securities available-for-sale	$231,514	$ 2,489	$ (2,496)	$231,507

Amortized cost and fair values of investment securities available-for-sale at December 31, 2016 are summarized

(Dollars in thousands)	Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value
U. S. Agency securities	$29,234	$ 7	$ (425)	$28,816
U.S. Sponsored Mortgage-backed securities	56,080	14	(1,362)	54,732
Municipal securities	72,075	744	(2,023)	70,796
Total debt securities	157,389	765	(3,810)	154,344
Equity and other securities	7,643	381	—	8,024
Total investment securities available-for-sale	$165,032	$ 1,146	$ (3,810)	$162,368

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

(Dollars in thousands)	December 31, 2017 Available for sale Amortized Cost	Fair Value
Within one year	$300	$302
After one year, but within five	37,208	37,210
After five years, but within ten	31,768	31,258
After ten years	146,298	146,171
Total	$215,574	$214,941

Investment securities with a carrying value of $113.3 million and $82.7 million at December 31, 2017 and 2016,
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 December 3
are included in the following table. Although these securities, if sold at December 31, 2017 would result in a pre

Company has no intent to sell the applicable securities at such fair values, and maintains the Company has the ab
until all principal has been recovered. It is more likely than not that the Company will not sell any securities at a
Declines in the fair values of these securities can be traced to general market conditions which reflect the prospe
whole. When determining other-than-temporary impairment on securities, the Company considers such factors a
specifically related to a certain security or to specific conditions in an industry

74

Table of Contents

or geographic area, the time frame securities have been in an unrealized loss position, the Company's ability to h
time sufficient to allow for anticipated recovery in value, whether or not the security has been downgraded by a r
not the financial condition of the security issuer has severely deteriorated. As of December 31, 2017, the Compa
with unrealized loss positions to be temporarily impaired, and consequently, does not believe the Company will
losses as a result of the current temporary decline in fair value.

The following table discloses investments in an unrealized loss position at December 31, 2017:

(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 (45)	$ 61,834	$ (659)	$ 7,709	$ (182)
U.S. Sponsored Mortgage-backed securities (39)	16,825	(159)	37,427	(1,105)
Municipal securities (47)	8,826	(48)	16,781	(325)
Equity and other securities (2)	$ 1,034	$ (18)	$—	$—
	$ 88,519	$ (884)	$ 61,917	$ (1,612)

The following table discloses investments in an unrealized loss position at December 31, 2016:

(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 (16)	$ 28,814	$ (425)	$—	$ —
U.S. Sponsored Mortgage-backed securities (29)	33,209	(1,040)	13,919	(322)
Municipal securities (86)	42,727	(2,023)	—	—
	$ 104,750	$ (3,488)	$ 13,919	$ (322)

The Company sold investments available-for-sale of $53.2 million, $55.2 million and $12.9 million in 2017, 201
These sales resulted in gross gains of $1.1 million, $1.1 million and $125 thousand and gross losses of $372 thou
2017, 2016 and 2015, respectively.

During 2015, the Company sold held-to-maturity investments of $421 thousand, resulting in gross gains of $5 th
investments were sold due to a credit downgrade, indicating significant deterioration of the issuer's creditworthi
held-to-maturity investments in during the years of 2017 or 2016.

NOTE 3. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Company routinely generates 1-4 family mortgages for sale into the secondary market. During 2017, 2016 a
recognized sales proceeds of $1.4 billion, $1.7 billion and $1.3 billion, resulting in mortgage fee income of $37.
$29.5 million, respectively.

The components of loans in the Consolidated Balance Sheet at December 31, were as follows:

(Dollars in thousands)	2017	2016
Commercial and Non-Residential Real Estate	$ 783,909	$ 756,619
Residential Real Estate	246,214	215,452
Home Equity	62,400	65,386
Consumer	12,783	14,511
Total Loans	1,105,306	1,051,968
Deferred loan origination fees and costs, net	635	897
Loans receivable	$ 1,105,941	$ 1,052,865

Table of Contents

The following table summarizes the primary segments of the loan portfolio as of December 31, 2017 and 2016:

(Dollars in thousands)	Commercial	Residential	Home Equity	Consumer	Total
December 31, 2017					
Individually evaluated for impairment	$ 13,796	$ 1,569	$ 13	$ 178	$ 15,556
Collectively evaluated for impairment	770,113	244,645	62,387	12,605	1,089,750
Total Loans	$ 783,909	$ 246,214	$ 62,400	$ 12,783	$ 1,105,306
December 31, 2016					
Individually evaluated for impairment	$ 10,781	$ 1,161	$ 132	$ 78	$ 12,152
Collectively evaluated for impairment	745,838	214,291	65,254	14,433	1,039,816
Total Loans	$ 756,619	$ 215,452	$ 65,386	$ 14,511	$ 1,051,968

Loans are considered to be impaired when, based on current information and events, it is probable that the Comp
the scheduled payments of principal or interest when due according to the contractual terms of the loan agreeme
management in evaluating impairment include payment status, collateral value, and the probability of collecting
interest payments when due. Management determines the significance of payment delays and payment shortfalls
taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of
delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and intere
separately evaluates individual consumer loans for impairment. The Chief Credit Officer identifies these loans in
delinquency status of the Bank's portfolio. Once identified, the Bank's ongoing communications with the borrov
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 o
methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) th
price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by-loan basis, with
utilizing the fair value of collateral method. The evaluation of the need and amount of a specific allocation of the
loan can be removed from impairment status is made on a quarterly basis.

Table of Contents

The following table presents impaired loans by class, segregated by those for which a specific allowance was req
specific allowance was not necessary as of December 31, 2017 and 2016:

(Dollars in thousands)	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
December 31, 2017					
Commercial					
Commercial Business	$ 3,283	$ 22	$ 979	$ 4,262	$ 4,275
Commercial Real Estate	4,603	1,150	2,814	7,417	7,921
Acquisition & Development	—	—	2,117	2,117	4,090
Total Commercial	7,886	1,172	5,910	13,796	16,286
Residential	—	—	1,569	1,569	1,601
Home Equity	—	—	13	13	13
Consumer	69	16	109	178	475
Total Impaired Loans	$ 7,955	$ 1,188	$ 7,601	$ 15,556	$ 18,375
December 31, 2016					
Commercial					
Commercial Business	$ —	$ —	$ 3,342	$ 3,342	$ 4,102
Commercial Real Estate	2,757	302	892	3,649	3,676
Acquisition & Development	264	74	3,526	3,790	6,059
Total Commercial	3,021	376	7,760	10,781	13,837
Residential	783	122	378	1,161	1,166
Home Equity	62	36	70	132	135
Consumer	16	9	62	78	285
Total Impaired Loans	$ 3,882	$ 543	$ 8,270	$ 12,152	$ 15,423

Impaired loans have increased by $3.4 million, or 28%, during 2017, primarily the result of the net impact of mu
increases due to the identification of $7.6 million of recently impaired loans less, principal curtailments of $2.1 r
$360 thousand, foreclosure and reclassification to other real estate owned of $1.3 million, reclassification of $15
reported impaired loans to performing loans, and normal loan amortization of $213 thousand.

The $7.6 million total of recently identified impaired loans includes $6.7 million, or 88.2%, of commercial loans
residential mortgage loans, and $129 thousand, or 1.5%, of consumer loans. The commercial loans are primarily
relationships, including a $3.4 million purchased participation note secured by a senior healthcare facility, a $1.2
estate loan, net of a $579 thousand sold participation, secured by a retail strip center, and a $810 thousand develo
developed commercial pad site. These three loans represent 80.0% of the recently impaired commercial loans, w
million represent fifteen additional commercial loans ranging from $6 thousand to $457 thousand in outstanding

Table of Contents

The following table presents the average recorded investment in impaired loans and related interest income reco

(Dollars in thousands)	December 31, 2017 Average Investment in Impaired Loans	Interest Income Recognized on Accrual Basis	Interest Income Recognized on Cash Basis	December 31, 2016 Average Investment in Impaired Loans	Interest Income Recognized on Accrual Basis	Interest Income Recognized on Cash Basis	Decemb Average Investme in Impaired Loans
Commercial							
Commercial Business	$3,718	$ 155	$ 113	$4,027	$ 155	$ 104	$3,153
Commercial Real Estate	3,199	100	98	3,590	100	75	6,618
Acquisition & Development	3,429	9	13	3,983	9	112	2,408
Total Commercial	10,346	264	224	11,600	264	291	12,179
Residential	1,424	13	53	928	20	28	920
Home Equity	538	1	1	50	1	1	28
Consumer	187	—	—	245	—	—	1
Total	$12,495	$ 278	$ 278	$12,823	$ 285	$ 320	$13,128

As of December 31, 2017, the Bank held sixteen foreclosed residential real estate properties representing $1.0 m
balance of other real estate owned. These properties are held as a result of the foreclosures of primarily two com
one of which included six properties for a total of $538 thousand, while the other included seven properties for a
three remaining properties, totaling $329 thousand, were result of the foreclosure of three unrelated borrowers. T
consumer mortgage loan collateralized by residential real estate property in the process of foreclosure. The total
loan was $132 thousand as of December 31, 2017. This loan is included in the table above and has a total of $0 i
to it.

Bank management uses a nine point internal risk rating system to monitor the credit quality of the overall loan po
categories are considered not criticized, and are aggregated as "Pass" rated. The criticized rating categories utiliz
follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but
resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. I
category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility
sustained if the weaknesses are not corrected. Any portion of a loan that has been or is expected to be charged of
category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a lo
structured loan rating process with several layers of internal and external oversight. Generally, consumer and res
included in the Pass categories unless a specific action, such as past due status, bankruptcy, repossession, or deat
of a possible credit event. The Bank's Chief Credit Officer is responsible for the timely and accurate risk rating o
origination and on an ongoing basis. The Credit Department ensures that a review of all commercial relationship
greater is performed annually.

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

Table of Contents

The following table represents the classes of the loan portfolio summarized by the aggregate Pass and the criticiz
Mention, Substandard and Doubtful within the internal risk rating system as of December 31, 2017 and 2016:

(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2017					
Commercial					
Commercial Business	$371,041	$4,816	$ 4,506	$ —	$380,363
Commercial Real Estate	271,751	22,995	5,961	1,149	301,856
Acquisition & Development	96,712	931	2,230	1,817	101,690
Total Commercial	739,504	28,742	12,697	2,966	783,909
Residential	242,823	3,036	223	132	246,214
Home Equity	61,037	1,311	52	—	62,400
Consumer	12,453	174	25	131	12,783
Total Loans	$1,055,817	$33,263	$ 12,997	$ 3,229	$1,105,306
December 31, 2016					
Commercial					
Commercial Business	$376,734	$2,933	$ 6,833	$ 69	$386,569
Commercial Real Estate	240,851	26,340	3,532	737	271,460
Acquisition & Development	90,875	1,905	2,584	3,226	98,590
Total Commercial	708,460	31,178	12,949	4,032	756,619
Residential	212,869	1,664	787	132	215,452
Home Equity	64,706	582	98	—	65,386
Consumer	14,134	302	13	62	14,511
Total Loans	$1,000,169	$33,726	$ 13,847	$ 4,226	$1,051,968

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of th
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 stat
presented to the Chief Credit Officer and or the Management Loan Committee ("MLC"), as required with respec
collection process and to make a determination as to whether the loan should be placed on non-accrual status. Th
non-accrual status is subject to applicable regulatory restrictions and guidelines. Generally, loans should be plac
the loan reaches 90 days past due, when it becomes likely the borrower cannot or will not make scheduled princi
when full repayment of principal and interest is not expected, or when the loan displays potential loss characteris
interest is charged off when a loan is placed in non-accrual status, unless Management believes it is likely the ac
collected. Any payments subsequently received are applied to principal. To remove a loan from non-accrual statu
due must be paid up to date and the Bank is reasonably sure of future satisfactory payment performance. Usually
recent history of payments due. Removal of a loan from non-accrual status will require the approval of the Chief

Table of Contents

The following table presents the classes of the loan portfolio summarized by aging categories of performing loan
December 31, 2017 and 2016:

(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+ Da Still Accrui
December 31, 2017								
Commercial								
Commercial Business	$377,901	$512	$1,368	$582	$2,462	$380,363	$ 1,027	$
Commercial Real Estate	300,282	45	1,149	380	1,574	301,856	5,206	—
Acquisition & Development	99,573	—	874	1,243	2,117	101,690	2,117	—
Total Commercial	777,756	557	3,391	2,205	6,153	783,909	8,350	—
Residential	243,177	1,879	707	451	3,037	246,214	1,157	—
Home Equity	61,907	240	240	13	493	62,400	13	—
Consumer	12,634	11	—	138	149	12,783	179	—
Total Loans	$1,095,474	$2,687	$4,338	$2,807	$9,832	$1,105,306	$ 9,699	$
December 31, 2016								
Commercial								
Commercial Business	$386,311	$15	$169	$74	$258	$386,569	$ 74	$
Commercial Real Estate	270,339	229	—	892	1,121	271,460	1,375	—
Acquisition & Development	96,014	—	—	2,576	2,576	98,590	3,526	—
Total Commercial	752,664	244	169	3,542	3,955	756,619	4,975	—
Residential	212,502	2,067	419	464	2,950	215,452	1,072	—
Home Equity	64,791	525	—	70	595	65,386	104	—
Consumer	14,354	55	34	68	157	14,511	78	—
Total Loans	$1,044,311	$2,891	$622	$4,144	$7,657	$1,051,968	$ 6,229	$

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL is based o
evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic con
size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-perform

Interest income on loans would have increased by approximately $423 thousand, $396 thousand and $639 thous
respectively, if loans had performed in accordance with their terms.

The Bank’s methodology for determining the ALL is based on the requirements of ASC Section 310-10-35 for l
impairment (discussed above) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well
Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the tw
Bank’s ALL. As of the quarter ended September 30, 2017, the Bank adjusted its methodology to allow for the an
loans in homogeneous pools, rather than on an individual basis, when those loans are below specific thresholds b
balance. More specifically, residential mortgage loans, home equity lines of credit, and consumer loans, when co
evaluated collectively for impairment by applying allocation rates derived from the Bank’s historical losses spec
reserve totaled $1.3 million and $0 as of December 31, 2017 and 2016.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as approp
historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts ar
factors.

The segments described above, which are based on the Federal call code assigned to each loan, provide the starti
analysis. Company and bank management tracks the historical net charge-off activity at the call code level. A his
calculated utilizing a defined number of consecutive historical quarters. All pools currently utilize a rolling 12 qu

"Pass" rated credits are segregated from "Criticized" credits for the application of qualitative factors. Loans in th
certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by managem
qualitative factors.

Table of Contents

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

To estimate the liability for off-balance sheet credit exposures, Bank management analyzed the portfolios of lette
lines of credit, and revolving lines of credit, and based its calculation on the expectation of future advances of ea
credit were determined to be highly unlikely to advance since they are generally in place only to ensure various f
borrowers. In the Bank's history, there have been no letters of credit drawn upon. In addition, many of the letters
do not warrant an allocation. Non-revolving lines of credit were determined to be highly likely to advance as the
lines. Meanwhile, the likelihood of revolving lines of credit advancing varies with each individual borrower. The
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 histo
environmental factors, was applied in the similar manner as those used for the allowance for loan loss calculatio
allocations were totaled to determine the liability for unfunded commitments related to these loans, which Manag
anticipate potential losses on those commitments that have a reasonable probability of funding. The liability for u
$284 thousand as of December 31, 2017 and 2016.

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

The following tables summarize the primary segments of the ALL, segregated into the amount required for loans
impairment and the amount required for loans collectively evaluated for impairment as of December 31, 2017, 2
allowance is presented for the periods indicated:

(Dollars in thousands)	Commercial	Residential	Home Equity	Consumer	Total
ALL balance at December 31, 2016	$ 7,181	$ 990	$ 728	$ 202	$ 9,101
Charge-offs	(1,138)	(141)	(109)	(109)	(1,497)
Recoveries	39	40	4	18	101
Provision	1,722	230	82	139	2,173
ALL balance at December 31, 2017	$ 7,804	$ 1,119	$ 705	$ 250	$ 9,878
Individually evaluated for impairment	$ 1,172	$ —	$ —	$ 16	$ 1,188
Collectively evaluated for impairment	$ 6,632	$ 1,119	$ 705	$ 234	$ 8,690

(Dollars in thousands)	Commercial	Residential	Home Equity	Consumer	Total
ALL balance at December 31, 2015	$ 6,066	$ 1,095	$ 715	$ 130	$ 8,006
Charge-offs	(1,995)	(124)	(100)	(338)	(2,557)
Recoveries	8	2	9	1	20
Provision	3,102	17	104	409	3,632
ALL balance at December 31, 2016	$ 7,181	$ 990	$ 728	$ 202	$ 9,101
Individually evaluated for impairment	$ 376	$ 122	$ 36	$ 9	$ 543
Collectively evaluated for impairment	$ 6,805	$ 868	$ 692	$ 193	$ 8,558

81

(Dollars in thousands)	Commercial	Residential	Home Equity	Consumer	Total
ALL balance at December 31, 2014	$ 4,363	$ 962	$ 691	$ 207	$ 6,223
Charge-offs	(708)	(28)	(5)	(6)	(747)
Recoveries	20	2	4	11	37
Provision	2,391	159	25	(82)	2,493
ALL balance at December 31, 2015	$ 6,066	$ 1,095	$ 715	$ 130	$ 8,006
Individually evaluated for impairment	$ 708	$ 276	$ 28	$ 1	$ 1,013
Collectively evaluated for impairment	$ 5,358	$ 819	$ 687	$ 129	$ 6,993

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Managen
granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well a
application of assumptions, result in an ALL that is representative of the risk found in the components of the por

Troubled Debt Restructurings

The restructuring of a loan is considered a troubled debt restructuring (“TDR”) if both (i) the borrower is experie
(ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market inter
forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. At Dec
the Bank had specific reserve allocations for TDR’s of $439 thousand and $348 thousand, respectively.

Loans considered to be troubled debt restructured loans totaled $6.4 million and $8.8 million as of December 31,
2016, respectively. Of these totals, $5.9 million and $5.9 million, respectively, represent accruing troubled debt r
represent 38% and 49%, respectively of total impaired loans. Meanwhile, as of December 31, 2017, $432 thousa
borrower that have defaulted under the restructured terms. Both loans are commercial acquisition and developme
TDR's due to extended interest only periods and/or unsatisfactory repayment structures once transitioned to princ
These borrowers have experienced continued financial difficulty and are considered non-performing loans as of
two loans, in addition to a third loan to a second borrower that defaulted under the restructured terms, totaled $2.
2016. All three loans are commercial acquisition and development loans that were considered TDR's due to exte
and/or unsatisfactory repayment structures once transitioned to principal and interest payments. These borrowers
financial difficulty and are considered non-performing loans as of December 31, 2016. Two additional restructur
commercial real estate loan and a $348 thousand mortgage loan, were considered non-performing as of Decembe
were also considered TDR's due to interest only periods and/or unsatisfactory repayment structures.

Table of Contents

The following table presents details related to loans identified as Troubled Debt Restructurings during the years
and 2016.

(Dollars in thousands)	New TDR's [1] December 31, 2017 Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	December 31, 2016 Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial						
Commercial Business	1	$ 147	$ 147	—	$ —	$ —
Commercial Real Estate	—	—	—	—	—	—
Acquisition & Development	—	—	—	—	—	—
Total Commercial	1	147	147	—	—	—
Residential	—	—	—	—	—	—
Home Equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total	1	$ 147	$ 147	—	$ —	$ —

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

NOTE 4. PREMISES AND EQUIPMENT

Premises and equipment at December 31, were as follows:

(Dollars in thousands)	2017	2016
Land	$3,901	$3,965
Buildings and improvements	17,358	16,906
Furniture, fixtures and equipment	14,864	12,127
Construction in progress	855	608
Leasehold improvements	1,530	1,345
	38,508	34,951
Accumulated depreciation	(11,822)	(9,870)
Net premises and equipment	$26,686	$25,081

In December 2017, the Bank closed and sold the land, building and certain furniture and equipment items from a
Foxcroft Avenue, Martinsburg, WV for a gain on sale of fixed assets of $343 thousand, which is included in othe
Consolidated Statements of Income.

Depreciation expense amounted to $2.6 million, $2.0 million and $2.0 million for 2017, 2016 and 2015, respecti

Table of Contents

NOTE 5. DEPOSITS

Deposits at December 31, were as follows:

(Dollars in thousands)	2017	2016
Demand deposits of individuals, partnerships, and corporations		
Noninterest bearing demand	$125,963	$115,692
Interest bearing demand	436,303	414,031
Savings and money markets	284,795	280,533
Time deposits including CDs and IRAs	312,519	296,761
Total deposits	$1,159,580	$1,107,017
Time deposits that meet or exceed the FDIC insurance limit	$18,832	$18,727

Maturities of time deposits at December 31, 2017 were as follows (Dollars in thousands):

2018	$169,220
2019	61,254
2020	36,758
2021	12,268
2022	33,019
Total	$312,519

NOTE 6. BORROWED FUNDS

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Pittsburgh, Pennsylvania. The remaining m
with the FHLB at December 31, 2017 was approximately $199.8 million. At December 31, 2017 and 2016 the B
million and $90.9 million. As of December 31, 2017, our maximum borrowing capacity with the FHLB was $43

Short-term borrowings

Along with traditional deposits, the Bank has access to short-term borrowings from FHLB to fund its operations
borrowings from FHLB totaled $149.6 million at December 31, 2017, compared to $87.7 million at year-end 20

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

(Dollars in thousands)	2017	2016	2015
Balance at end of year	$149,596	$87,733	$179,917
Average balance during the year	100,969	137,822	121,425
Maximum month-end balance	220,097	210,600	179,917
Weighted-average rate during the year	1.16 %	0.51 %	0.34 %
Weighted-average rate at December 31	1.61 %	0.74 %	0.44 %

Table of Contents

Repurchase agreements

Along with traditional deposits, the Bank has access to securities sold under agreements to repurchase "repurcha
represent funds deposited by customers, on an overnight basis, that are collateralized by investment securities ow
Repurchase agreements with customers are included in borrowings section on the consolidated balance sheets. A
subject to terms and conditions of repurchase/security agreements between the Company and the client and are a
borrowings. The Company's repurchase agreements reflected in liabilities consist of customer accounts and secu
individual security basis.

The Company monitors the fair value of the underlying securities on a monthly basis. Repurchase agreements ar
cash received in connection with the transaction and included in Securities sold under agreements to repurchase
sheets. The primary risk with our repurchase agreements is market risk associated with the investments securing
be required to provide additional collateral based on fair value changes of the underlying investments. Securities
repurchase agreements are maintained with our safekeeping agents.

All of the Company's repurchase agreements were overnight agreements at December 31, 2017 and December 3
were collateralized with investment securities with a carrying value of $23.1 million and $26.0 million at Decem
December 31, 2016, respectively, and were comprised of U.S. Government Agencies and Mortgage backed secu
the collateral would require the Company to increase the amounts of securities pledged.

Repurchase agreements totaled $22.4 million at December 31, 2017, compared to $25.2 million in 2016.
Information related to repurchase agreements is summarized as follows:

(Dollars in thousands)	2017	2016	2015
Balance at end of year	$22,403	$25,160	$27,437
Average balance during the year	25,160	27,066	26,884
Maximum month-end balance	25,972	29,561	32,470
Weighted-average rate during the year	0.30 %	0.27 %	0.31 %
Weighted-average rate at December 31	0.34 %	0.28 %	0.30 %

Long-term notes from the FHLB as of December 31, were as follows:

(Dollars in thousands)	2017		2016
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	$	1,798	$
Amortizing fixed interest rate note, originating February 2007, due February 2022, payable in monthly installments of $5 thousand, including interest of 5.22%	775		798
	$	2,573	$

Subordinated Debt
Information related to subordinated debt is summarized as follows:

(Dollars in thousands)	2017		2016		2015	
Balance at end of year	$33,524		$33,524		$33,524	
Average balance during the year	33,524		33,524		33,524	
Maximum month-end balance	33,524		33,524		33,524	
Weighted-average rate during the year	6.69	%	6.64	%	6.57	%
Weighted-average rate at December 31	6.70	%	6.63	%	6.57	%

In March 2007, the Company completed the private placement of $4 million Floating Rate, Trust Preferred Secu
Financial Statutory Trust I subsidiary (the “Trust”). The Company established the Trust for the sole purpose of is
Securities pursuant to an Amended and Restated Declaration of Trust. The proceeds from the sale of the Trust Pr

Table of Contents

Securities will be loaned to the Company under subordinated Debentures (the “Debentures”) issued to the Trust
Debentures are the only asset of the Trust. The Trust Preferred Securities have been issued to a pooling vehicle t
on the Trust Preferred Securities to securitize note obligations. The securities issued by the Trust are includable f
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 si
are due in March, June, September and December and are adjusted at the interest due dates at a rate of 1.62% ov
Rate. The obligations of the Company with respect to the issuance of the trust preferred securities constitute a fu
guarantee by the Company of the Trust's obligations with respect to the trust preferred securities to the extent set
guarantees.

On June 30, 2014, the Company issued its Convertible Subordinated Promissory Notes Due 2024 (the “Notes”) t
aggregate principal amount of $29,400,000. The Notes were issued in $100,000 increments per Note subject to a
$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
1 of each year) which rate shall be dependent upon the principal invested in the Notes and the holder’s ownershi
Company. For investments of less than $3,000,000 in Notes, an ownership of Company common stock represent
principal of the Notes acquired, the interest rate on the Notes is 7% per annum. For investments of $3,000,000 or
ownership of the Company’s common stock representing at least 30% of the principal of the Notes acquired, the
7.5% per annum. For investments of $10,000,000 or greater, the interest rate on the Notes is 7% per annum, rega
owns or acquires MVB common stock. The principal on the Notes shall be paid in full at the Maturity Date. On t
issuance of the Notes, a holder may elect to continue to receive the stated fixed rate on the Notes or a floating rat
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 th
Federal Reserve System, the Company may, after the Notes have been outstanding for five years, and without pr
or a portion of the unpaid principal amount of any Note together with the unpaid interest accrued on such portion
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 30 d
second, third, fourth, and fifth anniversaries of the issuance of the Notes or upon a notice to prepay by the Comp
the Company distributed notices to the holders of the Notes that provide that the Company has elected to waive t
associated with when a conversion may occur and, instead, the Company will accept notices of conversion at any
which is the final conversion date for the Notes. The Notes will convert into common stock based on $16 per sha
stock. The conversion price will be subject to anti-dilution adjustments for certain events such as stock splits, rec
distributions, extraordinary cash dividends, pro rata repurchases of common stock, and business combination tra
must give 20 days’ notice to the holders of the Company’s intent to prepay the Notes, so that holders may execut
above if a holder so desires.

Repayment of the Notes is subordinated to the Company’s outstanding senior debt including (if any) without lim
No payment will be made by the Company, directly or indirectly, on the Notes, unless and until all of the senior
in full. Notwithstanding the foregoing, so long as there exists no event of default under any senior debt, the Com
holder would receive and retain for the holder’s account, regularly scheduled payments of accrued interest and p
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
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 a
when due. Upon the occurrence and during the continuance of an event of default (but subject to the subordinatio
the holders of a majority of the outstanding principal amount of the Notes may declare all or any portion of the o
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 th
any interest payment date after a date five years from the original issue date.

Table of Contents

The Company reflects subordinated debt in the amount of $33.5 million as of December 31, 2017 and December
expense of $2.2 million for each of the years ended December 31, 2017, 2016 and 2015.

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

Year	Amount
2018	149,677
2019	85
2020	90
2021	886
2022	1,431
Thereafter	33,524
	$185,693

NOTE 7. COMMITMENTS AND CONTINGENT LIABILITIES

Commitments

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

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrum
extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Co
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 condit
contract. Commitments generally have fixed expiration dates or other termination clauses and may require paym
the commitments are expected to expire without being drawn upon, the total commitment amounts do not necess
requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount an
if deemed necessary by the Company upon extension of credit, varies and is based on management's credit evalu

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a
Standby letters of credit generally have fixed expiration dates or other termination clauses and may require paym
involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The C
obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitm

Specifically, the Bank has entered into agreements to extend credit or provide conditional payments pursuant to s
letters of credit. In addition, the Bank utilizes letters of credit issued by the FHLB to collateralize certain public f

Total contractual amounts of the commitments as of December 31, were as follows:

(Dollars in thousands)	2017	2016
Available on lines of credit	$327,647	$255,469
Stand-by letters of credit	12,297	13,387
Other loan commitments	1,396	1,819
	$341,340	$270,675

Table of Contents

Concentration of Credit Risk

The Company grants a majority of its commercial, financial, agricultural, real estate and installment loans to cus
Marion, Harrison, Monongalia, Kanawha, Jefferson and Berkeley County areas of West Virginia as well as the N
adjacent counties. Collateral for loans is primarily residential and commercial real estate, personal property, and
Company evaluates the credit worthiness of each of its customers on a case-by-case basis, and the amount of col
upon management's credit evaluation.

Regulatory

The Company is required to maintain certain reserve balances on hand in accordance with the Federal Reserve B
average balance maintained in accordance with such requirements was $0 on December 31, 2017 and 2016. Duri
reclassification program was implemented and allowed the Company to reduce its requirement of reserve balanc
with the Federal Reserve Board the 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
the outcome of these matters will not have a significant adverse effect on the consolidated financial statements.

NOTE 8. INCOME TAXES

The amount reflected as income taxes represents federal and state income taxes on financial statement income. C
expense, primarily the provision for possible loan losses, allowance for losses on foreclosed assets held for resal
of discounts on investment securities are reported in different accounting periods for income tax purposes.

The provisions for income taxes for the years ended December 31, were as follows:

(Dollars in thousands)	2017	2016	2015
Current:			
Federal	$2,635	$4,885	$2,830
State	771	1,197	591
	$3,406	$6,082	$3,421
Deferred expense (benefit)			
Federal	$1,268	$665	$(371)
State	81	42	(24)
	1,349	707	(395)
Income tax expense (benefit)	$4,755	$6,789	$3,026

Income tax expense for 2017 was impacted by the adjustment of the Company's deferred tax asset related to the r
statutory income tax rate to 21% under the Tax Reform Act, which was signed into law on December 22, 2017. T
revalue its net deferred tax asset to this lower rate, resulting in a income tax charge of $646 thousand.

Following is a reconciliation of income taxes at federal statutory rates to recorded income taxes for the year ende

	2017		2016		2015	
(Dollars in thousands)	Amount	%	Amount	%	Amount	%
Tax at Federal tax rate	$4,369	34 %	$6,689	34 %	$3,346	34 %
Tax effect of:						
State income tax	771	6.0 %	1,197	6.0 %	246	2.5 %
Tax exempt earnings	(1,031)	(6.4)%	(1,097)	(5.5)%	(566)	(5.8)%

Impact of deferred tax rate change	$646	5.0 %	$—	— %	$—	— %
	$4,755	38.6 %	$6,789	34.5 %	$3,026	30.7 %

Table of Contents

Deferred tax assets and liabilities are the result of timing differences in recognition of revenue and expense for in
statement purposes. As a result of the Tax Reform Act signed into law on December 22, 2017, deferred taxes as
based on the newly enacted U.S. statutory federal income tax rate of 21%. Deferred taxes as of December 31, 20
previously enacted U.S. statutory federal income tax rate of 34%.

Deferred income tax assets and (liabilities) were comprised of the following at December 31:

(Dollars in thousands)	2017	2016
Allowance for loan losses	$2,798	$2,641
Minimum pension liability	1,342	1,786
Unrealized loss on securities available-for-sale	2	1,066
Gross deferred tax assets	4,142	5,493
Depreciation	(1,137)	(1,352)
Pension	(21)	(6)
Goodwill	(1,523)	(465)
Gross deferred tax liabilities	(2,681)	(1,823)
Net deferred tax asset	$1,461	$3,670

No deferred income tax valuation allowance is provided since it is more likely than not that realization of the def
occur in future years.

Among other things, the new tax law (i) establishes a new, flat corporate federal statutory income tax rate of 21%
alternative minimum tax and allows the use of any such carryforwards to offset regular tax liability for any taxab
deduction for net interest expense incurred by U.S. corporations, (iv) allows businesses to immediately expense,
new investments in certain qualified depreciable assets, (v) eliminates or reduces certain deductions related to me
expenses, (vi) modifies the limitation on excessive employee remuneration to eliminate the exception for perform
and clarifies the definition of a covered employee and (vii) limits the deductibility of deposit insurance premium

As stated above, as a result of the enactment of the Tax Reform Act on December 22, 2017, the Company remea
asset based upon the newly enacted U.S. statutory federal income tax rate of 21%, which is the tax rate at which
reverse in the future. Notwithstanding the foregoing, the Company is still analyzing certain aspects of the new la
calculations, which could affect the measurement of these assets and liabilities or give rise to new deferred tax an
Company recognized an income tax charge of $646 thousand in 2017. The remeasurement of the deferred tax ass
charged or credited directly to AOCI was a component of 2017 income tax expense and recognized in continuing
ASC Topic 740.

The Company prescribes a recognition threshold and a measurement attribute for the financial statement recogni
tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the
when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing
full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition thresho
amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions
the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting pe
is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold sh
first subsequent financial reporting period in which that threshold is no longer met. There is currently no liability
and no known unrecognized tax benefits. With limited exception, the Company's federal and state income tax re
2014 have been closed for purposes of examination by the federal and state taxing jurisdictions.

NOTE 9. RELATED PARTY TRANSACTIONS

The Company has granted loans to officers and directors of the Company and to their associates as well as loans
related party loans are made on substantially the same terms, including interest rates and collateral, as those prev

89

Table of Contents

time for comparable transactions with unrelated parties and do not involve more than normal risk of collectabilit
summary of the related loan activity.

(Dollars in thousands)	Balance at Beginning of Year	Borrowings	Executive Officer and Director Retirements	Repayments	Balance at End of Year
December 31, 2017	$ 28,536	$ 129,947	$ (525)	$ (139,300)	$ 18,658
December 31, 2016	$ 42,840	$ 251,708	$ (7,194)	$ (258,818)	$ 28,536

The Company held related party deposits of $17.1 million and $17.8 million at December 31, 2017 and Decemb

The Company held no related party repurchase agreements at December 31, 2017 and December 31, 2016.

NOTE 10. PENSION PLAN

The Company participates in a trusteed pension plan known as the Allegheny Group Retirement Plan covering v
employees. Benefits are based on years of service and the employee's compensation. Accruals under the Plan we
Freezing the plan resulted in a re-measurement of the pension obligations and plan assets as of the freeze date. T
re-measured using the discount rate based on the Citigroup Above Median Pension Discount Curve in effect on N

On June 19, 2017, the Company and MVB Mortgage approved a Supplemental Executive Retirement Plan ("SE
Chief Executive Office of MVB Mortgage is entitled to receive certain supplemental nonqualified retirement ben
effect on December 31, 2017.

Pension expense was $256 thousand, $273 thousand and $256 thousand in 2017, 2016 and 2015, respectively.

Table of Contents

Information pertaining to the activity in the Company's defined benefit plan, using the latest available actuarial v
date of December 31, 2017 and 2016 is as follows:

(Dollars in thousands)	2017	2016
Change in benefit obligation		
Benefit obligation at beginning of year	$9,021	$8,662
Service cost	—	—
Interest cost	360	367
Actuarial loss	95	4
Assumption changes	775	179
Curtailment impact	—	—
Benefits paid	(193)	(191)
Benefit obligation at end of year	$10,058	$9,021
Change in plan assets:		
Fair value of plan assets at beginning of year	$4,573	$4,486
Actual return on plan assets	467	96
Employer contribution	319	182
Benefits paid	(193)	(191)
Fair value of plan assets at end of year	$5,166	$4,573
Funded status	$(4,892)	$(4,448)
Unrecognized net actuarial loss	4,972	4,464
Unrecognized prior service cost	—	—
Prepaid pension cost recognized	$80	$16
Accumulated benefit obligation	$10,058	$9,021

At December 31, 2017, 2016 and 2015, the weighted average assumptions used to determine the benefit obligati

	2017	2016	2015
Discount rate	3.55%	4.05%	4.30%
Rate of compensation increase	n/a	n/a	n/a

The components of net periodic pension cost are as
follows:

(Dollars in thousands)	2017	2016	2015
Service cost	$—	$—	$—
Interest cost	360	367	315
Expected return on plan assets	(345)	(330)	(316)
Amortization of prior service costs	—	—	—
Amortization of net actuarial loss	241	236	257
Net periodic pension cost	$256	$273	$256

For the years December 31, 2017, 2016 and 2015, the weighted average assumptions used to determine net perio
follows:

	2017	2016	2015
Discount rate	4.05%	4.30%	3.90%
Expected long-term rate of return on plan assets	6.75%	6.75%	6.75%
Rate of compensation increase	n/a	n/a	n/a

91

Table of Contents

The Company’s pension plan asset allocations at December 31, 2017 and 2016, as well as target allocations for 2

	12/31/2017		12/31/2016	
Plan Assets				
Cash	9	%	16	%
Fixed income	23	%	28	%
Alternative investments	13	%	9	%
Domestic equities	32	%	28	%
Foreign equities	23	%	19	%
Total	100	%	100	%

The estimated net loss (gain) for the plan that are expected to be amortized from accumulated other comprehensi benefit cost over the next fiscal year is $306 thousand.

The following table sets forth by level, within the fair value hierarchy, as defined in Note 18, "Fair Value Measu Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data, of this An the Plan’s assets at fair value as of December 31, 2017.

(Dollars in thousands)	Level I	Level II	Level III	Total
Assets:				
Cash	$465	$ —	$—	$465
Fixed income	1,188	—	—	1,188
Alternative investments	—	—	672	672
Domestic equities	1,653	—	—	1,653
Foreign equities	1,188	—	—	1,188
Total assets at fair value	$4,494	$ —	$672	$5,166

The following table sets forth by level, within the fair value hierarchy, as defined in Note 18, "Fair Value Measu Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data, of this An the Plan’s assets at fair value as of December 31, 2016.

(Dollars in thousands)	Level I	Level II	Level III	Total
Assets:				
Cash	$732	$ —	$ —	$732
Fixed income	1,280	—	—	1,280
Alternative investments	—	—	412	412
Domestic equities	1,280	—	—	1,280
Foreign equities	869	—	—	869
Total assets at fair value	$4,161	$ —	$ 412	$4,573

Investment in government securities and short-term investments are valued at the closing price reported on the a individual securities are traded. Alternative investments and investment in debt securities are valued at quoted pr traded less frequently, and items that are fair valued using other financial instruments, the parameters of which c methods described above may produce a fair value calculation that may not be indicative of net realizable value values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other mar different methodologies or assumptions to determine the fair value of certain financial instruments could result i measurement at the reporting date.

Table of Contents

Below we show the best estimate of the plan contribution for next fiscal year. We also show the benefits expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter.

(Dollars in thousands)	Cash Flow
Contributions for the period of 01/01/18 through 12/31/18	$ 416
Estimated future benefit payments reflecting expected future service	
2018	$ 251
2019	$ 259
2020	$ 283
2021	$ 299
2022	$ 308
2023 through 2027	$ 2,129

NOTE 11. GOODWILL AND OTHER INTANGIBLE ASSETS

The table below summarizes the changes in carrying amounts of goodwill and other intangibles (core deposit intangibles) for the periods presented:

		Core Deposit Intangible		
(Dollars in thousands)	Goodwill	Gross	Accumulated Depreciation	Net
Balance at January 1, 2017	$ 18,480	$ 1,006	$ (262)	$ 744
Amortization expense	—	—	(98)	(98
Balance at December 31, 2017	$ 18,480	$ 1,006	$ (360)	$ 646
Balance at January 1, 2016	$ 18,480	$ 1,006	$ (161)	$ 845
Amortization expense	—	—	(101)	(101
Balance at December 31, 2016	$ 18,480	$ 1,006	$ (262)	$ 744
Balance at January 1, 2015	$ 17,779	$ 128	$ (127)	$ 1
Goodwill and core deposit intangible resulting from branch acquisition	701	878	—	878
Amortization expense	—	—	(34)	(34
Balance at December 31, 2015	$ 18,480	$ 1,006	$ (161)	$ 845

Goodwill represents the excess of the purchase price over the fair value of acquired net assets under the acquisiti
The value of the acquired core deposit relationships was determined using the present value of the difference bet
cost of obtaining alternative funds and the cost to maintain the acquired deposit base. The core deposit intangible
ten-year period using an accelerated method. Goodwill in the amount of $701 thousand and core deposit intangib
thousand resulted from the branch acquisitions as discussed in Note 22, "Mergers and Acquisitions" of the Notes
Financial Statements included in Item 8, Financial Statements and Supplementary Data, of this Annual Report o

Table of Contents

The table below presents estimated amortization expense for the Company’s other intangible assets (dollars in thousands):

2018	$96
2019	93
2020	90
2021	87
2022	83
Thereafter	197
	$646

The Company’s assessment of qualitative factors determined that it is not more likely than not that the fair value
than its carrying amount and therefore, goodwill is not impaired as of December 31, 2017 and 2016. The Compa
triggering events since the impairment evaluation that would indicate potential impairment.

Core deposit intangibles are evaluated for impairment if events and circumstances indicate a potential for impair
other intangible assets is based on undiscounted cash flow projections. No impairment charges were recorded fo
any of the periods presented.

NOTE 12. STOCK OFFERING

On March 13, 2017, the Company entered into an Investment Agreement (the “Investment Agreement”) with its
F. Mazza (“Mazza”). Pursuant to the Investment Agreement, Mazza committed to subscribe for and purchase, at
expiration of the Rights Offering, the number of shares of the Company’s common stock, if any, equal to the am
which 100,000 exceeds the number of shares purchased by Mazza in the Rights Offering. Pursuant to the Investr
agreed not to sell or otherwise transfer any shares acquired in connection with the Investment Agreement for a p
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
Investment Agreement.

On March 13, 2017, the Company filed with the SEC a prospectus supplement and accompanying base prospect
“Prospectus”) relating to the commencement of the Company’s rights offering (the “Rights Offering”), pursuant
at no charge, non-transferable subscription rights to the holders of its common stock as of 5:00 p.m., Eastern tim
subscription rights were exercisable for up to a total of 434,783 shares of the Company’s common stock, subject
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. Ea
All 434,783 shares offered in the rights offering were subscribed for, resulting in new capital of approximately $
who served as subscription agent, completed its review and tabulation of subscriptions on April 19, 2017. Comp
acquired in the rights offering by book entry in the Company's stock ownership records, which are maintained by
agent, on or about April 20, 2017.

On December 5, 2016, the Company entered into Securities Purchase Agreements with certain accredited investo
Agreements, the Investors agreed to purchase an aggregate of 1,913,044 shares of the Company's common stock
a price of $11.50 per share, as part of a private placement (the "Private Placement"). The Private Placement clos
gross proceeds to the Company from the Private Placement were approximately $22 million or $20.5 million aft
proceeds from the Private Placement were used by the Company to pay related transaction fees and expenses an
purposes. A portion of the proceeds were used for the redemption of the preferred stock issued to the United Sta
connection with the Company's participation in the Small Business Lending Fund.

The Purchase Agreements contain representations and warranties and covenants of the Company and the Investo
private placement transactions. The provisions of the Purchase Agreements also include an agreement by the Co
Investors against certain liabilities.

Table of Contents

The Purchase Agreements required the Company to file a registration statement with the Securities and Exchang
register for resale the 1,913,044 shares of common stock issued to the Investors in the Private Placement. The reg
declared effective by the SEC on December 27, 2016.

On June 30, 2014, the Company filed Certificates of Designations for its Convertible Noncumulative Perpetual P
("Class B Preferred") and its Convertible Noncumulative Perpetual Preferred Stock, Series C ("Class C Preferred
Certificate designated 400 shares of preferred stock as Class B Preferred shares. The Class B Preferred shares ca
6% and are convertible into shares of Company common stock within thirty days after the first, second, third, fou
the original issue date, based on a common stock price of $16 per share, as adjusted for future corporate activitie
Company distributed a notice to each of the holders of the Class B Preferred Stock regarding the Company's agre
requirements associated with when a conversion may occur and, instead, the Company will accept notices of con
July 30, 2019, which is the final conversion date for the Preferred Stock. The Class B Preferred shares are redeem
after the fifth anniversary of the original issue date for Liquidation Amount, as defined therein, plus declared and
Redemption is subject to any necessary regulatory approvals. In the event of liquidation of the Company, shares
shall be junior to creditors of the Company and to the shares of Senior Noncumulative Perpetual Preferred Stock
Preferred shares shall have no voting rights, except for authorization of senior shares of stock, amendment to the
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 Cla
an annual dividend rate of 6.5% and are convertible into shares of Company common stock within 30 days after
and fifth anniversaries of the original issue date, based on a common stock price of $16 per share, as adjusted for
On December 28, 2017, the Company distributed a notice to each of the holders of the Class C Preferred Stock re
agreement to waive the timing requirements associated with when a conversion may occur and, instead, the Com
conversion at any time prior to July 30, 2019, which is the final conversion date for the Preferred Stock. The Cla
redeemable by the Company on or after the fifth anniversary of the original issue date for Liquidation Amount, a
declared and unpaid dividends. Redemption is subject to any necessary regulatory approvals. In the event of liqu
shares of Class C Preferred stock shall be junior to creditors of the Company and to the shares of Senior Noncum
Stock, Series A and the Class B Preferred shares. Holders of Class C Preferred shares shall have no voting rights
senior shares of stock, amendment to the Class C Preferred shares, share exchanges, reclassifications or changes
law. The proceeds of these preferred stock offerings will be used to support continued growth of the Company ar

On September 8, 2011 MVB received $8.5 million in Small Business Lending Fund (SBLF) capital. MVB issued
share preferred stock with dividends payable in arrears on January 1, April 1, July 1 and October 1 each year. MV
qualified for the lowest dividend rate possible of 1%. MVB may continue to utilize the SBLF capital through Ma
the 1% dividend rate. After that time, if the SBLF is not retired, the dividend rate increases to 9%. On January 5,
redeemed all of the 8,500 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series A, liquidation a
("Series A Preferred Stock"). The aggregate redemption price of the Series A Preferred Stock was $8,508,500, in
unpaid through, but not including the redemption date. The Series A Preferred Stock was redeemed from the Com
approved by the Company's primary federal regulator. The redemption terminates the Company's participation i
redemption, the Company's capital ratios remained well in excess of those required for well capitalized status.

NOTE 13. STOCK OPTIONS

The MVB Financial Corp. Incentive Stock Plan (the "Plan") provides for the issuance of stock options to selecte
Under the provisions of the plan, the option price per share shall not be less than the fair market value of the com
grant. During 2017, the companies shareholders amended the Plan to increase the total number of shares of stock
by 1.0 million. As of December 31, 2017, the Plan had 3.2 million shares authorized and 1,173,575 shares remai
issuance.These options also expire 10 years from the date of the grant. With the exception of 22,000 shares grant
years and expire 10 years from the date of grant, and 125,000 shares granted in 2017 that vest in 4 years and exp

granted vest in 5 years and expire 10 years from the date of the grant.

Total compensation expense recorded on stock options during 2017, 2016 and 2015 was $813 thousand, $568 th
respectively. Proceeds from stock options exercised were $(10) thousand, $32 thousand and $(448) thousand dur
respectively. During 2017, 2016 and 2015, certain options were exercised in cashless transactions. Shares were

95

Table of Contents

forfeited related to exercise price and tax withholdings and the Company paid tax authorities amounts due resulti

The following summarizes MVB's stock options as of and for the year ended December 31, 2017, and the chang

	2017		2016	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,499,795	$ 13.11	1,190,295	$ 13.15
Granted	321,750	15.12	432,000	12.72
Exercised	(49,400)	12.24	(55,000)	9.02
Forfeited/expired	(94,500)	8.41	(67,500)	14.59
Outstanding at end of year	1,677,645	$ 13.46	1,499,795	$ 13.11
Exercisable at end of year	910,647	$ 13.00	768,598	$ 12.75
Weighted-average fair value of options granted during 2017		$ 4.05		
Weighted-average fair value of options granted during 2016		$ 2.98		
Weighted-average fair value of options granted during 2015		$ 2.72		

The intrinsic value of options exercised during 2017, 2016 and 2015 was $8 thousand, $108 thousand and $1.6 m

The fair value for the options was estimated at the date of grant using a Black-Scholes option-pricing model with rates of 2.29%, 1.31% and 2.16% for 2017, 2016 and 2015, respectively, and a weighted average expected life of three years. The expected volatility of MVB's stock price used for 2017 options was 22.76%, while for the 2016 2015 options it was 13.90%. The expected dividend yield used was 0.60% for 2017, 0.43% for 2016 and 0.51% f

The following summarizes information related to the total outstanding and exercisable options at December 31, 2

Options Outstanding				Options Exercisable			
Total Options	Weighted-Average Exercise Price	Intrinsic Value	Weighted-Average Remaining Life	Total Options	Weighted-Average Exercise Price	Intrinsic Value	W L
1,677,645	$ 13.46	11,145,745	6.63	910,647	$ 13.00	6,465,272	5

NOTE 14. REGULATORY CAPITAL REQUIREMENTS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal ba meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capita Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabi sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classificati qualitative judgments by the regulators about components, risk weightings, and other factors.

Capital adequacy guidelines have recently changed as a result of the Dodd-Frank Act and a separate, internationa "Basel III." Regulators have issued rules implementing these requirements ("Revised Capital Rules"). Among ot Rules raise the minimum thresholds for required capital and revise certain aspects of the definitions and element used to satisfy these required minimum thresholds. While the rules became effective on January 1, 2014 for certa organizations, most banking organizations, including MVB Financial Corp and the Bank, were required to begin requirements on January 1, 2015.

Table of Contents

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain mir
Total capital, Tier 1 capital and Tier 1 common equity to risk-weighted assets, and of Tier 1 capital to average as
December 31, 2017 and 2016, the Company meets all capital adequacy requirements to which it is subject.

The most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, Tier 1 common equity risk-based and Tier 1 leverage ratios as set forth in the table below. Both the Company's and the Bank's actual capital amounts and ratios are presented in the table below.

	Actual		Minimum to be Well Capitalized		Minimum for Capital Adequacy Purposes	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017						
Total Capital (to risk-weighted assets)						
Consolidated	$178,147	14.9%	n/a	n/a	$95,948	8.0%
Subsidiary Bank	$169,536	14.2%	$119,231	10.0%	$95,385	8.0%
Tier 1 Capital (to risk-weighted assets)						
Consolidated	$138,308	11.5%	n/a	n/a	$71,886	6.0%
Subsidiary Bank	$159,097	13.3%	$95,385	8.0 %	$71,539	6.0%
Common Equity Tier 1 Capital (to risk-weighted assets)						
Consolidated	$126,350	10.6%	n/a	n/a	$53,915	4.5%
Subsidiary Bank	$159,097	13.3%	$77,500	6.5 %	$53,654	4.5%
Tier 1 Capital (to average assets)						
Consolidated	$138,308	9.3 %	n/a	n/a	$58,667	4.0%
Subsidiary Bank	$159,097	10.7%	$73,119	5.0 %	$58,495	4.0%
As of December 31, 2016						
Total Capital (to risk-weighted assets)						
Consolidated	$174,093	15.4%	n/a	n/a	$90,699	8.0%
Subsidiary Bank	$163,394	14.5%	$113,027	10.0%	$90,422	8.0%
Tier 1 Capital (to risk-weighted assets)						
Consolidated	$135,100	11.9%	n/a	n/a	$68,025	6.0%
Subsidiary Bank	$153,737	13.6%	$90,422	8.0 %	$67,816	6.0%
Common Equity Tier 1 Capital (to risk-weighted assets)						
Consolidated	$114,642	10.1%	n/a	n/a	$51,018	4.5%
Subsidiary Bank	$153,737	13.6%	$73,468	6.5 %	$50,862	4.5%

Tier 1 Capital (to average assets)						
Consolidated	$135,100	9.5 %	n/a	n/a	$56,655	4.0%
Subsidiary Bank	$153,737	10.9%	$70,651	5.0 %	$56,521	4.0%

NOTE 15. REGULATORY RESTRICTION ON DIVIDEND

The approval of the regulatory agencies is required if the total of all dividends declared by the Bank in any calen
net profits, as defined, for that year combined with its retained net profits for the preceding two calendar years.

Table of Contents

NOTE 16. LEASES

The Company leases land and building space for the operation of some banking offices. All such leases qualify a
is a schedule by year of future minimum lease payments required under operating leases that have initial or rema
terms in excess of one year as of December 31, 2017:

(Dollars in thousands)	
Years ended December 31:	
2018	$1,822
2019	1,299
2020	1,244
2021	1,268
2022	1,201
Thereafter	5,185
Total minimum payments required:	$12,019

Total rent expense for the years ended December 31, 2017, 2016 and 2015 was $2.0 million, $1.7 million and $1

NOTE 17. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following summarizes the methods and significant assumptions used by the Company in estimating its fair v
instruments.

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 observ The nature of these assets and liabilities include items for which quoted prices are available but traded les 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 are measured using management's best estimate of fair value, where the inputs into the determination of f management judgment or estimation.

Estimated fair values have been determined by the Company using historical data, as generally provided in the C
and an estimation methodology suitable for each category of financial instruments. The Company's fair value es
assumptions are set forth below for the Company's other financial instruments.

Cash and cash equivalents: The carrying amounts for cash and cash equivalents approximate fair value because t
of 90 days or less and do not present unanticipated credit concerns.

Certificates of deposits: The fair values for certificates of deposits are computed based on scheduled future cash
interest, discounted at interest rates currently offered for certificates of deposits with similar terms of investors. N
are assumed.

Securities: U.S. treasury, government agency, mortgage-backed securities, certain municipal securities and corpo
measured at fair value using a third-party pricing service or recent comparable market transactions in similar or i
classified as Level II instruments. Equity securities are measured at fair value using observable closing prices an
instruments if they are traded on a heavily active market and as Level II instruments if the observable closing pri
market. Certain local municipal securities related to tax increment financing ("TIF") are independently valued an
instruments.

Loans held for sale: Loans held for sale are reported at fair value. These loans currently consist of one-to-four-fa
originated for sale in the secondary market. Fair value is based on committed market rates or the price secondary
offering for similar loans using observable market data. (Level II)

Table of Contents

Loans: The fair values for loans are computed based on scheduled future cash flows of principal and interest, dis
currently offered for loans with similar terms of borrowers of similar credit quality. No prepayments of principal

Mortgage servicing rights: The carrying value of mortgage servicing rights approximates their fair value due to t
balance.

Interest rate lock commitment: For mortgage interest rate locks, the fair value is based on either (i) the price of th
from an investor for loans that will be delivered on a best efforts basis or (ii) the observable price for individual l
market for loans that will be delivered on a mandatory basis less (iii) expected costs to deliver the interest rate lo
through rate" is multiplied by this calculation to estimate the derivative value.

Mortgage-backed security hedges: MBS hedges are used to mitigate interest rate risk for residential mortgage loa
rate locks and manage expected funding percentages. These instruments are considered derivatives and are recor
observable market data of the individual mortgage-backed securities.

Interest rate cap: The fair value of the interest rate cap is determined at the end of each quarter by using Bloombe
interest rate cap using observable inputs from forward and futures yield curves as well as standard market volatil

Interest rate swap: Interest rate swaps are recorded at fair value based on third party vendors who compile prices
may determine fair value of identical or similar instruments by using pricing models that consider observable ma

Accrued interest receivable and payable and repurchase agreements: The carrying values of accrued interest rece
approximate their fair values.

Deposits: The fair values of demand deposits (i.e., noninterest bearing checking, NOW and money market), savi
variable rate deposits approximate their carrying values. Fair values of fixed maturity deposits are estimated usin
methodology at rates currently offered for deposits with similar remaining maturities. Any intangible value of lo
depositors is not considered in estimating the fair values disclosed.

FHLB and other borrowings: The fair values for loans are computed based on scheduled future cash flows of pri
discounted at interest rates currently offered for loans with similar terms of borrowers of similar credit quality. N
are assumed.

Subordinated debt: The fair values for debt are computed based on scheduled future cash flows of principal and i
rates currently offered for debt with similar terms of borrowers of similar credit quality. No prepayments of prin

Off-balance sheet instruments: The fair values of commitments to extend credit and standby letters of credit are e
currently charged to enter into similar agreements, taking into account the remaining terms of agreements and th
the counterparties. The amounts of fees currently charged on commitments and standby letters of credit are deem
therefore, the estimated fair values and carrying values are not shown.

Table of Contents

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)
December 31, 2017					
Financial assets:					
Cash and cash equivalents	$20,305	$20,305	$20,305	$—	$ —
Certificates of deposits with other banks	14,778	14,695	—	14,695	—
Securities available-for-sale	231,507	231,507	1,607	206,991	22,909
Loans held for sale	66,794	66,794	—	66,794	—
Loans, net	1,096,063	1,093,824	—	—	1,093,824
Mortgage servicing rights	182	182	—	—	182
Interest rate lock commitment	1,426	1,426	—	—	1,426
Interest rate swap	268	268	—	268	—
Interest rate cap	33	33	—	33	—
Accrued interest receivable	5,296	5,296	—	1,241	4,055
Financial liabilities:					
Deposits	$1,159,580	$1,126,615	$—	$1,126,615	$ —
Repurchase agreements	22,403	22,403	—	22,403	—
FHLB and other borrowings	152,169	152,190	—	152,190	—
Mortgage-backed security hedges	78	78	—	78	—
Interest rate swap	268	268	—	268	—
Accrued interest payable	643	643	—	643	—
Subordinated debt	33,524	35,117	—	35,117	—
December 31, 2016					
Financial assets:					
Cash and cash equivalents	$17,340	$17,340	$17,340	$—	$ —
Certificates of deposits with other banks	14,527	14,985	—	14,985	—
Securities available-for-sale	162,368	162,368	897	161,471	—
Loans held for sale	90,174	90,174	—	90,174	—
Loans, net	1,043,764	1,035,437	—	—	1,035,437
Mortgage servicing rights	190	190	—	—	190
Interest rate lock commitment	1,546	1,546	—	—	1,546
Mortgage-backed security hedges	372	372	—	372	—
Interest rate swap	250	250	—	250	—
Interest rate cap	268	268	—	268	—
Accrued interest receivable	3,951	3,951	—	1,002	2,949
Financial liabilities:					
Deposits	$1,107,017	$1,116,174	$—	$1,116,174	$ —
Repurchase agreements	25,160	25,160	—	25,160	—

FHLB and other borrowings	90,921	90,919	—	90,919	—
Interest rate swap	250	250	—	250	—
Accrued interest payable	741	741	—	741	—
Subordinated debt	33,524	32,275	—	32,275	—

Table of Contents

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

NOTE 18. FAIR VALUE MEASUREMENTS

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

Assets Measured on a Recurring Basis

As required by accounting standards, financial assets and liabilities are classified in their entirety based on the lo
significant to the fair value measurement. The Company classified investments in government securities as Leve
them using the market approach. The following measurements are made on a recurring basis.

- Available-for-sale investment securities — Available-for-sale investment securities are recorded at fair value on
measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measure
models or other model-based valuation techniques such as the present value of future cash flows, adjusted for th
prepayment assumptions and other factors such as credit loss assumptions. Level I securities include those trade
as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-th
market funds. Level II securities include mortgage-backed securities issued by government sponsored entities an
municipal bonds and corporate debt securities. There have been no changes in valuation techniques for the year
Valuation techniques are consistent with techniques used in prior periods.

- Loans held for sale — The fair value of mortgage loans held for sale is determined, when possible, using quoted
investor commitments. If no such quoted price exists, the fair value of a loan is determined using quoted prices f
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
mortgage loan, quoted mortgage-backed security prices and estimates of the fair value of the mortgage servicing
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 base
the individual mortgage-backed security.

- Interest rate cap — The fair value of the interest rate cap is determined at the end of each quarter by using Bloon
interest rate cap using observable inputs from forward and futures yield curves as well as standard market volati

- Interest rate swap — Interest rate swaps are recorded at fair value based on third party vendors who compile pric
may determine fair value of identical or similar instruments by using pricing models that consider observable ma

Table of Contents

The following tables present the assets reported on the consolidated statements of financial condition at their fair of December 31, 2017 and 2016 by level within the fair value hierarchy. Financial assets and liabilities are classi the lowest level of input that is significant to the fair value measurement.

	December 31, 2017			
(Dollars in thousands)	Level I	Level II	Level III	Total
Assets:				
U.S. Government Agency securities	$ —	$ 80,945	$ —	$ 80,945
U.S. Sponsored Mortgage backed securities	—	58,154	—	58,154
Municipal securities	—	52,933	22,909	75,842
Equity and other securities	1,607	16,566	—	16,566
Loans held for sale	—	66,794	—	66,794
Interest rate lock commitment	—	—	1,426	1,426
Interest rate swap	—	268	—	268
Interest rate cap	—	33	—	33
Liabilities:				
Interest rate swap	—	268	—	268
Mortgage-backed security hedges	—	78	—	78

	December 31, 2016			
(Dollars in thousands)	Level I	Level II	Level III	Total
Assets:				
U.S. Government Agency securities	$ —	$ 28,816	$ —	$ 28,816
U.S. Sponsored Mortgage backed securities	—	54,732	—	54,732
Municipal securities	—	70,796	—	70,796
Equity and other securities	897	8,024	—	8,024
Loans held for sale	—	90,174	—	90,174
Interest rate lock commitment	—	—	1,546	1,546
Mortgage-backed security hedges	—	372	—	372
Interest rate swap	—	250	—	250
Interest rate cap	—	268	—	268
Liabilities:				
Interest rate swap	—	250	—	250

The following table represents recurring level III assets:

Interest Rate Lock Commitments	December 31, 2017	December 31, 2016
(Dollars in thousands)		
Balance, beginning of period	$ 1,546	$ 1,537
Realized and unrealized gains included in earnings	(120)	9
Balance, end of period	$ 1,426	$ 1,546

Table of Contents

Assets Measured on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain financial assets, financial liabilities, non-fi
non-financial liabilities at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounti
assets that are measured at the lower of cost or market value that were recognized at fair value below cost at the
non-financial assets measured at fair value on a non-recurring basis include foreclosed assets (upon initial recogn
impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a good
intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. Nor
fair value on a nonrecurring basis during 2017 and 2016 include certain foreclosed assets which, upon initial reco
and reported at fair value through a charge-off to the allowance for possible loan losses and certain foreclosed as
their initial recognition, were remeasured at fair value through a write-down included in other noninterest expens

Impaired Loans — Loans for which it is probable that payment of interest and principal will not be made in acco
terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, manage
using one of several methods, including collateral value, liquidation value and discounted cash flows. Those imp
allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded i
Collateral values are estimated using Level II inputs based on observable market data or Level III inputs based o
criteria. For a majority of impaired real estate related loans, the Company obtains a current external appraisal. O
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 i
collateral value. Collateral values are estimated using Level II inputs based on observable market data or Level I
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 December 31, 2017 and 2016 are included in the tabl

	December 31, 2017			
(Dollars in thousands)	Level I	Level II	Level III	Total
Impaired loans	$—	$—	$14,368	$14,368
Other real estate owned	—	—	1,346	1,346
	December 31, 2016			
(Dollars in thousands)	Level I	Level II	Level III	Total
Impaired loans	$—	$—	$11,609	$11,609
Other real estate owned	—	—	414	414

Table of Contents

The following tables presents quantitative information about the Level III significant unobservable inputs for ass
fair value at December 31, 2017 and 2016.

	Quantitative Information about Level III Fair Value Measurements			
(Dollars in thousands)	Fair Value	Valuation Technique	Unobservable Input	Range
December 31, 2017				
Nonrecurring measurements:				
Impaired loans	$14,368	Appraisal of collateral [1]	Appraisal adjustments [2]	20% - 62%
			Liquidation expense [2]	5% - 10%
Other real estate owned	$1,346	Appraisal of collateral [1]	Appraisal adjustments [2]	20% - 30%
			Liquidation expense [2]	5% - 10%
Recurring measurements:				
Interest rate lock commitments	$1,426	Pricing model	Pull through rates	73% - 85%

	Quantitative Information about Level III Fair Value Measurements			
(Dollars in thousands)	Fair Value	Valuation Technique	Unobservable Input	Range
December 31, 2016				
Nonrecurring measurements:				
Impaired loans	$11,609	Appraisal of collateral [1]	Appraisal adjustments [2]	20% - 62%
			Liquidation expense [2]	5% - 10%
Other real estate owned	$414	Appraisal of collateral [1]	Appraisal adjustments [2]	20% - 30%
			Liquidation expense [2]	5% - 10%
Recurring measurements:				
Interest rate lock commitments	$1,546	Pricing model	Pull through rates	73% - 85%

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

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

104

Table of Contents

NOTE 19. COMPREHENSIVE INCOME

The following tables present the components of accumulated other comprehensive income ("AOCI") for the yea

(Dollars in thousands)	2017	2016	2015	
Details about AOCI Components	Amount Reclassified from AOCI	Amount Reclassified from AOCI	Amount Reclassified from AOCI	Affected line item in the Statement Income is presented
Available-for-sale securities				
Unrealized holding gains	$ 731	$ 1,082	$ 130	Gain on sale of securities
	731	1,082	130	Total before tax
	(292)	(433)	(52)	Income tax expense
	439	649	78	Net of tax
Defined benefit pension plan items				
Amortization of net actuarial loss	(241)	(236)	(257)	Salaries and benefits
	(241)	(236)	(257)	Total before tax
	96	94	103	Income tax expense
	(145)	(142)	(154)	Net of tax
Total reclassifications	$ 294	$ 507	$ (76)	

(Dollars in thousands)	Unrealized gains (losses) on available for-sale securities	Defined benefit pension plan items	Total
Balance at January 1, 2017	$ (1,598)	$ (2,679)	$ (4,277)
Other comprehensive loss before reclassification	2,032	(449)	1,583
Amounts reclassified from AOCI	(439)	145	(294)
Net current period OCI	1,593	(304)	1,289
Balance at December 31, 2017	$ (5)	$ (2,983)	$ (2,988)
Balance at January 1, 2016	$ (363)	$ (2,570)	$ (2,933)
Other comprehensive loss before reclassification	(586)	(251)	(837)
Amounts reclassified from AOCI	(649)	142	(507)
Net current period OCI	(1,235)	(109)	(1,344)
Balance at December 31, 2016	$ (1,598)	$ (2,679)	$ (4,277)

Table of Contents

NOTE 20. CONDENSED FINANCIAL STATEMENTS OF PARENT COMPANY

Information relative to the parent company's condensed balance sheets at December 31, 2017 and 2016, and the of income and cash flows for the years ended December 31, 2017, 2016 and 2015 are presented below:

Condensed Balance Sheets

	December 31,	
(Dollars in thousands)	2017	2016
Assets		
Cash	$3,904	$7,699
Investment in subsidiaries	175,027	168,325
Other assets	5,743	4,316
Total assets	$184,674	$180,340
Liabilities and stockholders' equity		
Other liabilities	$958	$1,191
Long-term debt	33,524	33,524
Total liabilities	34,482	34,715
Total stockholders' equity	150,192	145,625
Total liabilities and stockholders' equity	$184,674	$180,340

Condensed Statements of Income

	Year ended December 3		
(Dollars in thousands)	2017	2016	20
Income - dividends from bank subsidiary	$13,724	$9,241	$7
Expenses - operating	11,974	11,307	8,9
Income (loss) before income taxes and undistributed earnings - continuing operations	1,750	(2,066)	(1,
Income tax (benefit) - continuing operations	(2,147)	(2,072)	(1,
Income after tax from continuing operations	3,897	6	35
Income before income taxes and undistributed earnings - discontinued operations	—	6,926	—
Income tax - discontinued operations	—	2,629	—
Income after tax from discontinued operations	—	4,297	—
Equity in undistributed income earnings of subsidiaries	3,678	8,609	6,4
Net Income	$7,575	$12,912	$6
Preferred dividends	$498	$1,128	$5
Net Income available to common shareholders	$7,077	$11,784	$6

Table of Contents

Condensed Statements of Cash Flows			
(Dollars in thousands)	2017	2016	2015
OPERATING ACTIVITIES			
Net Income	$7,575	$12,912	$6,816
Equity in undistributed earnings of subsidiaries	(3,678)	(8,609)	(6,463)
(Decrease) in other assets	(2,214)	(612)	(529)
Decrease (increase) in other liabilities	(234)	920	(261)
Stock option expense	813	568	413
Net cash provided by (used in) operating activities	2,262	5,179	(24)
INVESTING ACTIVITIES			
Investment in subsidiary	(947)	(19,697)	(400)
Net cash used in investing activities	(947)	(19,697)	(400)
FINANCING ACTIVITIES			
Proceeds of stock offering	4,931	20,519	—
Dividend reinvestment plan	—	—	—
Proceeds from subordinated debt	—	—	—
Preferred stock issuance	—	—	—
Preferred stock redemption	(8,500)	—	—
Common stock options exercised	(10)	32	(448)
Cash dividends paid on common stock	(1,033)	(646)	(641)
Cash dividends paid on preferred stock	(498)	(1,128)	(575)
Net cash (used in) provided by financing activities	(5,110)	18,777	(1,664)
(Decrease) increase in cash	(3,795)	4,259	(2,088)
Cash at beginning of period	7,699	3,440	5,528
Cash at end of period	$3,904	$7,699	$3,440

NOTE 21. SEGMENT REPORTING

The Company has identified three reportable segments: commercial and retail banking; mortgage banking; and f
Insurance services was previously identified as a reportable segment until entering into an Asset Purchase Agree
in Note 23, "Discontinued Operations" of the Notes to the Consolidated Financial Statements included in Item 8,
Supplementary Data, of this Annual Report on Form 10-K. Revenue from commercial and retail banking activiti
interest earned on loans and investment securities and service charges on deposit accounts. Revenue from financ
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 res
origination process. The mortgage banking services are conducted by MVB Mortgage. Revenue from insurance s
of commissions on the sale of insurance products.

On June 30, 2016, the Company entered into an Asset Purchase Agreement with USI Insurance Services ("USI")
substantially all of the assets and assumed certain liabilities of MVB Insurance, which resulted in a pre-tax gain o

in Note 23, "Discontinued Operations" of the Notes to the Consolidated Financial Statements included in Item 8,
Supplementary Data, of this Annual Report on Form 10-K. MVB Insurance retained the assets related

---

Table of Contents

to, and continues to operate, its title insurance business. The title insurance business is immaterial in terms of rev
reorganized MVB Insurance as a subsidiary of the Bank.

Information about the reportable segments and reconciliation to the consolidated financial statements for the yea
2016, and 2015 are as follows:

(Dollars in thousands)	2017 Commercial & Retail Banking	Mortgage Banking	Financial Holding Company	Intercompany Eliminations	C
Revenues:					
Interest income	$52,423	$4,698	$4	$ (527)	$
Mortgage fee income	736	37,262	—	(849)	3
Insurance and investment services income	563	—	—	—	5
Other income	5,303	(2,372)	5,466	(5,403)	2
Total operating income	59,025	39,588	5,470	(6,779)	9
Expenses:					
Interest expense	9,118	2,317	2,241	(1,375)	1
Salaries and employee benefits	12,266	26,196	5,646	—	4
Provision for loan losses	1,967	206	—	—	2
Other expense	19,523	8,188	4,085	(5,404)	2
Total operating expenses	42,874	36,907	11,972	(6,779)	8
Income (loss) from continuing operations, before income taxes	16,151	2,681	(6,502)	—	1
Income tax expense (benefit) - continuing operations	5,820	1,082	(2,147)	—	4
Net income (loss) from continuing operations	10,331	1,599	(4,355)	—	7
Income (loss) from discontinued operations	—	—	—	—	–
Income tax expense (benefit) - discontinued operations	—	—	—	—	–
Net income (loss) from discontinued operations	—	—	—	—	–
Net income (loss)	$10,331	$1,599	$(4,355)	$ —	$
Preferred stock dividends	—	—	498	—	4
Net income (loss) available to common shareholders	$10,331	$1,599	$(4,853)	$ —	$
Capital Expenditures for the year ended December 31, 2017	$3,226	$1,187	$83	$ —	$
Total Assets as of December 31, 2017	1,533,497	149,323	184,600	(333,118)	1
Goodwill as of December 31, 2017	1,598	16,882	—	—	1

Table of Contents

(Dollars in thousands)	2016 Commercial & Retail Banking	Mortgage Banking	Financial Holding Company	Insurance	Inte Elin
Revenues:					
Interest income	$50,413	$ 4,285	$ 3	$ —	$ (
Mortgage fee income	(252)	36,960	—	—	(1,0
Insurance and investment services income	420	—	—	—	—
Other income	5,485	1,674	5,247	—	(5,2
Total operating income	56,066	42,919	5,250	—	(6,9
Expenses:					
Interest expense	8,437	2,082	2,226	—	(1,6
Salaries and employee benefits	11,592	27,696	5,937	—	—
Provision for loan losses	3,632	—	—	—	—
Other expense	18,009	8,125	3,144	—	(5,2
Total operating expenses	41,670	37,903	11,307	—	(6,9
Income (loss) from continuing operations, before income taxes	14,396	5,016	(6,057)	—	—
Income tax expense (benefit) - continuing operations	4,496	1,954	(2,072)	—	—
Net income (loss) from continuing operations	9,900	3,062	(3,985)	—	—
Income (loss) from discontinued operations	—	—	6,926	(580)	—
Income tax expense (benefit) - discontinued operations	—	—	2,629	(218)	—
Net income (loss) from discontinued operations	—	—	4,297	(362)	—
Net income (loss)	$9,900	$ 3,062	$ 312	$ (362)	$ –
Preferred stock dividends	—	—	1,128	—	—
Net income (loss) available to common shareholders	$9,900	$ 3,062	$ (816)	$ (362)	$ –
Capital Expenditures for the year ended December 31, 2016	$1,145	$ 220	$ 303	$ —	$ –
Total Assets as of December 31, 2016	1,415,735	122,242	180,340	—	(299
Goodwill as of December 31, 2016	1,598	16,882	—	—	—

109

Table of Contents

(Dollars in thousands)	2015 Commercial & Retail Banking	Mortgage Banking	Financial Holding Company	Insurance	Inter Elim
Revenues:					
Interest income	$40,524	$ 3,882	$ 2	$ —	$ (3
Mortgage fee income	7	30,560	—	—	(1,09
Insurance and investment services income	338		—	—	—
Other income	3,721	1,673	4,331	—	(4,58
Total operating income	44,590	36,115	4,333	—	(5,98
Expenses:					
Interest expense	6,776	1,647	2,204	—	(1,40
Salaries and employee benefits	11,049	20,774	4,250	—	—
Provision for loan losses	2,493	—	—	—	—
Other expense	16,132	7,471	2,534	—	(4,36
Total operating expenses	36,450	29,892	8,988	—	(5,76
Income (loss) from continuing operations, before income taxes	8,140	6,223	(4,655)	—	(219
Income tax expense (benefit) - continuing operations	2,176	2,394	(1,597)	—	(87
Net income (loss) from continuing operations	5,964	3,829	(3,058)	—	(132
Income (loss) from discontinued operations	—	—	—	134	219
Income tax expense (benefit) - discontinued operations	—	—	—	53	87
Net income (loss) from discontinued operations	—	—	—	81	132
Net income (loss)	$5,964	$ 3,829	$ (3,058)	$ 81	$ —
Preferred stock dividends	—	—	575	—	—
Net income (loss) available to common shareholders	$5,964	$ 3,829	$ (3,633)	$ 81	$ —
Capital Expenditures for the year ended December 31, 2015	$1,174	$ 354	$ 616	$ 9	$ —
Total Assets as of December 31, 2015	1,378,988	125,227	148,509	5,017	(273
Goodwill as of December 31, 2015	1,598	16,882	—	—	—

110

Table of Contents

Commercial & Retail Banking

For the year ended December 31, 2017, the Commercial & Retail Banking segment earned $10.3 million compar
Net interest income increased by $1.3 million, primarily the result of a $1.3 million increase in interest on taxabl
$734 thousand increase in interest and fees on loans which was offset by a $546 thousand increase in interest on
increase in interest on FHLB and other borrowings. Noninterest income increased by $949 thousand, primarily t
increase in mortgage fee income, a $419 thousand increase on commercial swap fee income, a $447 thousand inc
income, offset by a $557 thousand decrease in gain on sale of securities and a $504 thousand decrease in gain on
Noninterest expense increased by $2.2 million, primarily the result of the following: $674 thousand increase in s
expense, $599 thousand increase in occupancy and equipment expense, and $227 thousand increase in data proc
expense, which was offset by a $209 thousand decrease in professional fees. The $599 thousand increase in occu
expense was primarily the result of two new full-service branches opened in 2017 and increased equipment expe
and continued maintenance of property and software. The $227 thousand increase in data processing and commu
result of the core conversion completed in April 2017, along with overall growth in terms of personnel and offic
the usage of additional products, services, and providers to better serve the client base. In addition, provision exp
million. Also, income tax expense increased $1.3 million as a result of both increased net income before income
reform in which the Company was required to re-measure its net deferred tax asset and resulted in an income tax

Mortgage Banking

For the year ended December 31, 2017, the Mortgage Banking segment earned $1.6 million compared to $3.1 m
income increased $178 thousand, noninterest income decreased by $3.7 million, and noninterest expense decreas
decrease in noninterest income was primarily the result of a $4.1 million decrease in the gain on derivative. The
derivatives was largely the result of a 39.0% decrease in the locked mortgage pipeline for 2017 compared to a 31
mortgage pipeline for 2016. The decrease in noninterest expense was primarily the result of the following: $1.5
and employee benefits expense, which was primarily due to a 15.6% decrease in origination volume and a $1.2
out paid to management of the mortgage company related to the 2012 acquisition. Other items that impacted non
follows: a $242 thousand increase in occupancy and equipment expense and a $146 thousand increase in travel,
subscriptions expense, which were offset by a $159 thousand decrease in marketing expense and a $148 thousan
processing expense.

Financial Holding Company

Excluding discontinued operations, for the year ended December 31, 2017, the Financial Holding Company segr
compared to a loss of $4.0 million in 2016. Interest expense increased $15 thousand, noninterest income increase
noninterest expense increased $650 thousand. In addition, the income tax benefit increased $75 thousand. The in
was primarily due to a $604 thousand increase in professional fees, a $169 thousand increase in travel, entertainm
expense, a $125 thousand increase in occupancy and equipment expense, and a $100 thousand increase in other

Insurance

In June 2016, primarily all the assets of the Insurance segment were sold and the segment was reorganized as a s
was no insurance segment in 2017. The discontinued insurance segment lost $362 thousand in 2016.

NOTE 22. MERGERS AND ACQUISITIONS

On May 1, 2015, MVB Bank, Inc. (MVB Bank), a wholly-owned subsidiary of MVB Financial Corp. (MVB Fin
issued a joint news release with BB&T Corporation (BB&T) and Susquehanna Bancshares, Inc. (Susquehanna) a
definitive agreement, subject to customary closing conditions including regulatory approvals, through which MV

branch locations of Susquehanna Bank in Berkeley County, West Virginia and will assume approximately $69 m
million of loans. The two Susquehanna Bank branch locations are slated for divestiture under BB&T's agreemen
Department of Justice and commitments to the Board of Governors of the Federal Reserve System in connection
acquisition of Susquehanna. On July 22, 2015, regulatory approvals for the acquisition of the two Susquehanna B
received and the acquisition closed August 28, 2015.

Table of Contents

The acquisition was accounted for under the acquisition method of accounting in accordance with ASC 805. The
recorded at their estimated fair values as of the August 28, 2015 acquisition date.

The following is a summary of net liabilities assumed:

(Dollars in thousands)	
Net assets acquired:	
Cash received in transaction	$47,962
Cash on hand	330
Loans	18,200
Bank premises, furniture and equipment	609
Accrued interest receivable and other assets	62
Core deposit intangible	878
	68,041
Deposits	68,697
Accrued interest payable and other liabilities	45
	68,742
Net liabilities assumed	(701)
Goodwill	701
	$—

A valuation of the acquired loans and core deposit intangible was performed with the assistance of a third-party v
unpaid principal balance and fair value of performing loans was $18.7 million and $18.2 million, respectively. T
will be accreted through interest income over the life of the loans in accordance with Accounting Standards Codi
No nonperforming loans were acquired in this transaction. The core deposit intangible will be amortized over 10
declining balance amortization method.

Merger costs related to the branch acquisitions were $722 thousand, consisting primarily of legal, consulting and
Goodwill was recorded in the amount of $701 thousand which is the difference between the total purchase price
assumed and is not deductible for income tax purposes.

The following acquisition related costs are included in the consolidated statements of income for the periods indicated:

(Dollars in thousands)	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
Professional fees	$ —	$ —	$ 471
Marketing	—	—	29
Printing, postage and supplies	—	—	71
Equipment depreciation and maintenance	—	—	—
Travel and entertainment	—	—	50
Data processing and communications	—	—	76
Other operating expense	—	—	25
Total	$ —	$ —	$ 722

The following pro forma financial information combines the historical results of MVB and two branches acquire
pro forma results exclude the impact of branch acquisition costs of $722 thousand.

If the branch acquisition had been completed on January 1, 2014 total revenue, net of interest expense, would ha
$76.0 million for the years ended December 31, 2014 and 2015, respectively. Net income would have been $1.7

112

Table of Contents

$6.4 million for the same periods. Basic and diluted earnings per share would have been $0.17 and $0.17 and $0.
for the years ended December 31, 2014 and 2015.

NOTE 23. DISCONTINUED OPERATIONS

On June 30, 2016, the Company entered into an Asset Purchase Agreement with USI, in which USI purchased su
and assumed certain liabilities of MVB Insurance, which resulted in a pre-tax gain of $6.9 million. MVB Insurar
to, and continues to operate, its title insurance business. The title insurance business is immaterial in terms of rev
reorganized MVB Insurance as a subsidiary of the Bank. The Company retained approximately $424 thousand in
proceeds totaling $7.0 million related to this transaction.

There were no assets and liabilities of discontinued operations as of December 31, 2017 or 2016.

Net income (losses) from discontinued operations, net of tax, for the years ended December 31, 2017, 2016, and

(Dollars in thousands)	2017	2016	2015
NONINTEREST INCOME			
Insurance and investment services income	$ —	$1,887	$4,733
Gain on sale of subsidiary	—	6,926	—
Other operating income	—	2	6
Total noninterest income	—	8,815	4,739
NONINTEREST EXPENSES			
Salary and employee benefits	—	1,937	3,603
Occupancy expense	—	124	281
Equipment depreciation and maintenance	—	29	57
Data processing and communications	—	79	105
Marketing, contributions and sponsorships	—	7	25
Professional fees	—	2	23
Printing, postage and supplies	—	12	19
Insurance, tax and assessment expense	—	58	136
Travel, entertainment, dues and subscriptions	—	67	119
Other operating expenses	—	154	18
Total noninterest expense	—	2,469	4,386
Income from discontinued operations, before income taxes	—	6,346	353
Income tax expense - discontinued operations	—	2,411	140
Net Income from discontinued operations	$ —	$3,935	$213

NOTE 24. QUARTERLY FINANCIAL DATA (UNAUDITED)

					Earnings Per Share	
(Dollars in thousands)	Interest Income	Net Interest Income	Income Before Taxes	Net Income	Basic	Diluted
2017						
First quarter	$13,068	$10,306	$2,295	$1,574	$0.14	$0.14
Second quarter	13,814	10,894	3,435	2,260	0.21	0.20
Third quarter	14,630	11,414	3,510	2,318	0.21	0.21
Fourth quarter	15,086	11,683	3,090	1,423	0.12	0.12

113

Table of Contents

(Dollars in thousands)	Interest Income	Net Interest Income	Income Before Taxes	Net Income	Earnings Per Share	
					Basic	Diluted
2016						
First quarter	$13,382	$10,695	$2,612	$1,796	$0.20	$0.20
Second quarter	13,580	10,742	10,228	6,499	0.77	0.63
Third quarter	13,523	10,729	3,441	2,310	0.25	0.24
Fourth quarter	13,638	10,825	3,420	2,307	0.23	0.22

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Stockholders and the Board of Directors of MVB Financial Corp.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of MVB Financial Corp. and subsidiary (the "C
2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in stockhold
each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as t
our opinion, the financial statements present fairly, in all material respects, the financial position of the Company
and 2016, and the results of their operations and their cash flows for each of the three years in the period ended D
conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (Ur
Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Int
Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our
expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express
financial statements based on our audits. We are a public accounting firm registered with the Public Company A
(United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with
and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan a
obtain reasonable assurance about whether the financial statements are free of material misstatement whether du

Our audits included performing procedures to assess the risks of material misstatement of the financial statement
fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basi
amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principle
estimates made by management, as well as evaluating the overall presentation of the financial statements. We be
reasonable basis for our opinion.

/s/ Dixon Hughes Goodman LLP

We have served as the Company's auditor since 2014.

Gaithersburg, Maryland
March 8, 2018

Table of Contents

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINA

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company, under the supervision and with the participation of the Company's management, including the Co
Executive Officer, along with the Company's Chief Financial Officer (the Principal Financial Officer), has evalu
December 31, 2017, of the design and operation of the Company's disclosure controls and procedures, as such te
13a-15(e) promulgated under the Exchange Act. Based upon that evaluation, the Company's President and Chief
the Company's Principal Accounting Officer concluded that the Company's disclosure controls and procedures w
December 31, 2017.

There have been no material changes in the Company's internal control over financial reporting during the fourth
materially affected, or are reasonably likely to materially affect, the Company's internal control over financial re

Management's Annual Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over finan
Company's internal control over financial reporting is designed to provide reasonable assurance regarding the re
and the preparation of the consolidated financial statements for external purposes in accordance with generally a
principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstateme
evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because
that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency (as defined in Public Company Accounting Oversight Board Aud
combination of significant deficiencies, that results in there being more than a remote likelihood that a material r
interim financial statements will not be prevented or detected on a timely basis by management or employees in
performing their assigned functions.

Management assessed the effectiveness of the Company's internal control over financial reporting as of Decemb
assessment did not identify any material weaknesses in the Company's internal control over financial reporting.

In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organization
Commission (COSO) in Internal Control-Integrated Framework in 2013. Because there were no material weakne
believes that, as of December 31, 2017, the Company's internal control over financial reporting was effective.

Dixon Hughes Goodman LLP, an independent registered public accounting firm, has audited the consolidated fin
this Annual Report and has issued a report on the effectiveness of our internal control over financial reporting, w
"Item 9A – Controls and Procedures" of this Annual Report on Form 10-K.

Date: 3/8/2018 /s/ Larry F. Mazza
Larry F. Mazza
President, CEO and Director
(Principal Executive Officer)

Date:	3/8/2018	/s/ Donald T. Robinson
		Donald T. Robinson
		Executive Vice President and CFO
		(Principal Financial and Accounting Officer)

Table of Contents

Changes in Internal Control over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that materially affected, o
materially affect, our internal control over financial reporting.

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of MVB Financial Corp.

Opinion on Internal Controls Over Financial Reporting

We have audited MVB Financial Corp. and Subsidiary's (the "Company") internal control over financial reportin
based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Spor
Treadway Commission. In our opinion, MVB Financial Corp. and Subsidiary maintained, in all material aspects,
over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated F
the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (Un
consolidated financial statements of MVB Financial Corp. and Subsidiary as of December 31, 2017 and 2016, an
in the period ended December 31, 2017, and our report dated March 8, 2018, expressed an unqualified opinion o
statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting an
effectiveness of internal control over financial reporting, included in the accompanying Management's Annual R
Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over fina
audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respe
accordance with the U.S. federal securities laws and applicable rules and regulations of the Securities and Excha
PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan an
reasonable assurance about whether effective internal control over financial reporting was maintained in all mate
included obtaining an understanding of internal control over financial reporting, assessing the risk that a material
and evaluating the design and operating effectiveness of internal control based on the assessed risk and performi
we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opin

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance rega
financial reporting and the preparation of financial statements for external purposes in accordance with generally
principles. A company's internal control over financial reporting includes those policies and procedures that (1) p
records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of th
reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in a
accepted accounting principles, and that receipts and expenditures of the company are being made only in accord
management and

Table of Contents

directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unau
disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstateme
evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because
that the degree of compliance with the policies or procedures may deteriorate.

/s/ Dixon Hughes Goodman LLP

Gaithersburg, Maryland
March 8, 2018

Table of Contents

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

This information is omitted from this report pursuant to General Instruction G.(3) of Form 10-K as the Company
definitive Proxy Statement pursuant to Regulation 14A of the Exchange Act for the 2018 annual meeting of shar
Statement") not later than 120 days after December 31, 2017. The applicable information appearing in the Proxy
reference.

ITEM 11. EXECUTIVE COMPENSATION

This information is omitted from this report pursuant to General Instruction G.(3) of Form 10-K as the Company
definitive Proxy Statement not later than 120 days after December 31, 2017. The applicable information appeari
incorporated by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND R
MATTERS

This information is omitted from this report (with the exception of the equity compensation plan information, wh
this report and is incorporated herein by reference) pursuant to General Instruction G.(3) of Form 10-K as the Co
its definitive Proxy Statement not later than 120 days after December 31, 2017. The applicable information appe
is incorporated by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDE

This information is omitted from this report pursuant to General Instruction G.(3) of Form 10-K as the Company
definitive Proxy Statement not later than 120 days after December 31, 2017. The applicable information appeari
incorporated by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

This information is omitted from this report pursuant to General Instruction G.(3) of Form 10-K as the Company
definitive Proxy Statement not later than 120 days after December 31, 2017. The applicable information appeari
incorporated by reference.

Table of Contents

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements

Management's Annual Report on Internal Control over Financial Reporting
Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting
Report of Independent Registered Public Accounting Firm - Dixon Hughes Goodman LLP
Consolidated Balance Sheets at December 31, 2017 and 2016
Consolidated Statements of Income for the years ended December 31, 2017, 2016, and 2015
Consolidated Statements of Comprehensive Income for the years ended December 31, 2017, 2016, and 20
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2017, 201
Consolidated Statements of Cash Flows for the years ended December 31, 2017, 2016, and 2015
Notes to Consolidated Financial Statements

(b) Exhibits

Exhibits filed with this Annual Report on Form 10-K are attached hereto. For a list of such exhibits, see "E
Exhibit Index specifically identifies each management contract or compensatory plan required to be filed a
Form 10-K.

Table of Contents

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: 3/8/2018 By: /s/ Larry F. Mazza
Larry F. Mazza
President, CEO and Director
(Principal Executive Officer)

POWER OF ATTORNEY AND SIGNATURES

Know all persons by the presents, that each person whose signature appears below constitutes and appoints Larry F. Mazza or Donald T. Robinson or either of them, as attorney-in-fact, with each having the power of substitution, for him or her in any and all capacities, to sign any amendment to this Form 10-K and to file the same, with exhibits thereto, and other documents in connection therewith, with the Federal Deposit Insurance Corporation hereby ratifying and confirming all that each of said attorneys-in-fact or his substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities and Exchange Act of 1934, this Form 10-K has been signed below by the following person on behalf of the registrant in the capacities and on the dates indicated.

/s/ Larry F. Mazza — Date: 3/8/2018
Larry F. Mazza, President, CEO and Director
(Principal Executive Officer)

/s/ Donald T. Robinson — Date: 3/8/2018
Donald T. Robinson, Executive Vice President and CFO
(Principal Financial and Accounting Officer)

/s/ Stephen R. Brooks — Date: 3/8/2018
Stephen R. Brooks, Chairman

/s/ David B. Alvarez — Date: 3/8/2018
David B. Alvarez, Vice Chairman

/s/ James J. Cava, Jr. — Date: 3/8/2018
James J. Cava, Jr., Director

/s/ Harry E. Dean III — Date: 3/8/2018
Harry E. Dean III, Director

/s/ John W. Ebert John W. Ebert, Director	Date: 3/8/2018
/s/ Daniel W. Holt Daniel W. Holt, Director	Date: 3/8/2018
/s/ Gary A. LeDonne Gary A. LeDonne, Director	Date: 3/8/2018
/s/ Kelly R. Nelson Kelly R. Nelson, Director	Date: 3/8/2018
/s/ J. Christopher Pallotta J. Christopher Pallotta, Director	Date: 3/8/2018

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description	Exh
3.1	Articles of Incorporation, as amended	Ann No. 201 refe
3.2	Amended and Restated Bylaws	Forr filec inco
4.1	Specimen of stock certificate representing MVB Financial Corp. common stock.	Forr File Janu inco
4.2	Form of Certificate for the SBLF Preferred Stock	Forr filec inco
4.3	Form of Subscription Rights Certificate	Forr filec inco
10.1†	MVB Financial Corp. 2003 Stock Incentive Plan	Forr Stat filec inco
10.2†	MVB Financial Corp. 2013 Stock Incentive Plan, as amended	File
10.3†	MVB Financial Corp. 2018 Annual Senior Executive Performance Incentive Plan	Forr filec inco
10.4	Lease Agreement with Essex Properties, LLC for land occupied by Bridgeport Branch	Forr Stat filec inco
10.5†	Employment Agreement of Larry F. Mazza	Forr filec inco
10.6†	Employment Agreement of Donald T. Robinson	Forr filec inco
10.7†	Offer Letter for Donald T. Robinson	Forr filec inco
10.8	Asset Purchase Agreement by and among MVB Insurance, LLC, MVB Financial Corp., and USI Insurance Services LLC	Qua File Nov inco
10.9	Severance Agreement and Release of Claims by and between MVB Financial Corp. and Bret S. Price	Qua File Nov inco

10.10	Form of Securities Purchase Agreement	Forn filed inco
10.11	Investment Agreement between MVB Financial Corp. and Larry F. Mazza	Forn filed inco
10.12	Third Addendum to the Employment Agreement with MVB Financial Corp. and MVB Bank, Inc. and H. Edward Dean, III, President and Chief Executive Officer of Potomac Mortgage Group, Inc., doing business as MVB Mortgage	Qua File 201 refe
10.13	Fourth Addendum to the Employment Agreement with MVB Financial Corp. and MVB Bank, Inc. and H. Edward Dean, III, President and Chief Executive Officer of Potomac Mortgage Group, Inc., doing business as MVB Mortgage	Qua File 201 refe
11	Statement Regarding Computation of Earnings per Share	File
14	Code of Ethics	File
21	Subsidiary of Registrant	File
23.1	Consent of Independent Registered Public Accounting Firm	File
24	Power of Attorney	Con this
31.1	Certificate of Principal Executive Officer pursuant to Section 302 of Sarbanes Oxley Act of 2002	File

123

Table of Contents

EXHIBIT INDEX

31.2	Certificate of Principal Financial Officer pursuant to Section 302 of Sarbanes Oxley Act of 2002
32.1*	Certificate of Principal Executive Officer & Principal Financial Officer pursuant to Section 906 of Sarban of 2002
101	Interactive data files pursuant to Rule 405 of Regulation S-T

(*) In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release Nos. 33-8238 and 34-47986, Fin Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic I furnished in Exhibits 32.1 hereto are deemed to accompany this Form 10-K and will not be deemed "filed" for pu Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the S Act, except to the extent that the registrant specifically incorporates it by reference.

(†) Management contract or compensatory plan