MSC INDUSTRIAL DIRECT CO INC
Form DEF 14A
December 05, 2003

QuickLinks -- Click here to rapidly navigate through this document

Schedule 14A
(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION

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

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

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

ý Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12

MSC INDUSTRIAL DIRECT CO., INC.

(Name of Registrant as Specified in its Charter)

Payment of Filing Fee (Check the appropriate box):

ý No fee required.

o Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

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

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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

(3) Filing Party:

(4) Date Filed:

---

75 Maxess Road
Melville, New York 11747

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

To the Shareholders of MSC Industrial Direct Co., Inc.:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Shareholders of MSC Industrial Direct Co., Inc. (the "Company"), a New York corporation, will be held on January 6, 2004 at 9:00 a.m., local time, at the lower level atrium of Fleet Bank at 300 Broad Hollow Road, Melville, New York 11747, for the following purposes:

1. To elect seven directors of the Company to serve for one-year terms;

2. To consider and act upon a proposal to approve an amendment to the Company's 1995 Restricted Stock Plan;

3. To consider and act upon a proposal to approve an amendment to the Company's 1995 Stock Option Plan;

4. To consider and act upon a proposal to approve an amendment to the Company's 1998 Stock Option Plan;

5. To consider and act upon a proposal to approve an amendment to the Company's 2001 Stock Option Plan;

6. To consider and act upon a proposal to approve an amendment to the Company's Associate Stock Purchase Plan;

7. To consider and act upon a proposal to ratify the appointment of Ernst & Young LLP as independent certified public accountants of the Company for the fiscal year 2004;

8.

To consider and act upon such other matters as may properly come before the meeting or any adjournment thereof.

Only shareholders of record at the close of business on December 1, 2003 are entitled to notice of and to vote at the meeting and any adjournments thereof.

All shareholders are cordially invited to attend the meeting. However, to assure your representation at the meeting, you are urged to complete, sign and date the enclosed proxy card as promptly as possible and return it in the postage-paid envelope provided. Any shareholder attending the meeting may vote in person even if he or she has already returned a proxy.

By Order of the Board of Directors,

Thomas Eccleston
Secretary

Melville, New York
December 5, 2003

IMPORTANT:

The prompt return of proxies will ensure that your shares will be voted. A self-addressed envelope is enclosed for your convenience. No postage is required if mailed within the United States.

---

75 Maxess Road
Melville, New York 11747

PROXY STATEMENT FOR

Annual Meeting of Shareholders to be held on January 6, 2004

This proxy statement is furnished in connection with the solicitation of proxies by the Board of Directors of MSC Industrial Direct Co., Inc. (the "Company"), a New York corporation, to be used at the Annual Meeting of Shareholders of the Company (the "Meeting") to be held at the lower level atrium of Fleet Bank at 300 Broad Hollow Road, Melville, New York 11747, on January 6, 2004 at 9:00 a.m., local time, and at any adjournment or postponement thereof. The approximate date on which this proxy statement, the foregoing notice and the enclosed proxy were first mailed or given to shareholders was December 5, 2003.

Shareholders who execute proxies retain the right to revoke them at any time by notice in writing to the Secretary of the Company, by revocation in person at the Meeting or by presenting a later dated proxy. Unless so revoked, shares represented by proxies received by the Company, where the shareholder has specified a choice with respect to the election of directors or the other proposals described in this proxy statement, will be voted in accordance with the specification(s) so made. In the absence of such specification(s), the shares will be voted FOR the election of all seven nominees for the Board of Directors, FOR the proposal to approve an amendment to the Company's 1995 Restricted Stock Plan, FOR the proposal to approve an amendment to the Company's 1995 Stock Option Plan, FOR the proposal to approve an amendment to the Company's 1998 Stock Option Plan, FOR the proposal to approve an amendment to the Company's 2001 Stock Option Plan, FOR the proposal to approve an amendment to the Company's Associate Stock Purchase Plan, and FOR the ratification of the selection by the Board of Directors of Ernst & Young LLP as the Company's independent certified public accountants for the current fiscal year.

The expenses of solicitation of proxies for the Meeting will be paid by the Company. Such solicitation may be made in person or by telephone by officers and associates of the Company. Upon request, the Company will reimburse brokers, dealers, banks and trustees, or their nominees, for reasonable expenses incurred by them in forwarding material to beneficial owners of shares of the Company's Class A common stock, par value $.001 per share (the "Class A Common Stock").

VOTING

Only holders of record of the Class A Common Stock and the Company's Class B common stock, par value $.001 per share (the "Class B Common Stock"), at the close of business on December 1, 2003 are entitled to notice of and to vote at the Meeting. On that date, the Company had outstanding 34,721,057 shares of Class A Common Stock and 31,937,294 shares of Class B Common Stock.

Under New York law and the Company's By-Laws, the presence in person or by proxy of the holders of a majority of the shares of the Class A Common Stock and the Class B Common Stock entitled to vote is necessary to constitute a quorum at the Meeting. For these purposes, shares which are present or represented by proxy at the Meeting will be counted regardless of whether the holder of the shares or the proxy fails to vote on a proposal ("abstentions") or whether a broker with authority fails to exercise its authority with respect thereto (a "broker non-vote"). Abstentions and broker non-votes will not be included, however, in the tabulation of votes cast on proposals presented to shareholders. If a broker is not given instructions by the beneficial owner of shares for which the

broker holds a proxy, such shares will count for quorum purposes but the broker may not vote such shares with respect to non-routine matters, including the proposed amendments to the 1995 Restricted Stock Plan, 1995 Stock Option Plan, 1998 Stock Option Plan, 2001 Stock Option Plan, and Associate Stock Purchase Plan. The Company urges all beneficial owners to provide instructions to their brokers on how to vote their shares. Failure to provide such instructions will have the same effect as voting against the proposed amendments to the 1995 Restricted Stock Plan, 1995 Stock Option Plan, 1998 Stock Option Plan, 2001 Stock Option Plan, and Associate Stock Purchase Plan. With regard to the election of directors, votes may be cast in favor of or withheld from each nominee; votes that are withheld (*e.g*., abstentions and broker non-votes) will have no effect, as directors are elected by a plurality of votes cast. On all matters to be voted upon at the Meeting and any adjournment or postponement thereof, the holders of the Class A Common Stock and the Class B Common Stock vote together as a single class, with each record holder of Class A Common Stock entitled to one vote per share of Class A Common Stock and each record holder of Class B Common Stock entitled to 10 votes per share of Class B Common Stock.

The Board of Directors does not intend to bring any matter before the Meeting, except as specifically indicated in the foregoing notice, nor does the Board of Directors know of any matters which anyone else proposes to present for action at the Meeting. If any other matters properly come before the Meeting, however, the persons named in the enclosed proxy, or their duly constituted substitutes acting at the Meeting, will be authorized to vote or otherwise act thereon in accordance with their judgment on such matters.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

The information set forth on the following table is furnished as of November 24, 2003 (except as otherwise noted), with respect to any person (including any "group" as that term is used in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) who is known to the Company to be the beneficial owner of more than 5% of any class of the Company's voting securities. Except as otherwise indicated, the persons listed below have advised the Company that they have sole voting and investment power with respect to the shares listed as owned by them.

	Class A Common Stock(1)		Class B Common Stock			
	Amount & Nature of Beneficial Ownership	**Percent of Class**	**Amount & Nature of Beneficial Ownership**	**Percent of Class(2)**	**% Ownership of Common Stock(3)**	**% Voting Power(2)(4)**
T. Rowe Price Associates, Inc.(5)	2,523,100	7.3			3.8	*

	Class A Common Stock(1)		**Class B Common Stock**			
Lord Abbett & Co.(6)	1,859,873	5.4			2.8	*
Reich & Tang Asset Management(7)	3,351,000	9.7			5.0	*
Waddell & Reed Financial, Inc.(8)	4,058,975	11.7			6.1	1.2
Delaware Holdings Management(9)	1,892,855	5.5			2.8	*
Mitchell Jacobson(10)	1,133,111(11)	3.3	18,643,357(12)	58.4	29.6	53.0
Marjorie Gershwind(10)	1,025,766(13)	3.0	11,621,932(14)	36.4	19.0	33.1
Sidney Jacobson(10)	200	*	2,992,652(15)	9.4	4.5	8.5
Erik Gershwind(10)	56,000(16)	*	1,409,345(17)	4.4	2.2	4.0

*
Less than 1%

(1)
Does not include shares of Class A Common Stock issuable upon conversion of shares of Class B Common Stock. Shares of Class B Common Stock are convertible at any time into shares of Class A Common Stock on a share-for-share basis.

(2)
Percentages total more than 100% because of shared beneficial ownership of certain shares of Class B Common Stock described in footnotes 12 and 14.

(3)
Indicates percentage ownership of the aggregate number of outstanding shares of Class A Common Stock and Class B Common Stock. See footnote 1.

(4)
Indicates percentage of aggregate number of votes which can be cast. On all matters to be voted upon at the Meeting and any adjournment or postponement thereof, the holders of the Class A Common Stock and the Class B Common Stock vote together as a single class, with each record holder of Class A Common Stock entitled to one vote per share of Class A Common Stock and each record holder of Class B Common Stock entitled to 10 votes per share of Class B Common Stock.

(5)
Information as to shares owned by T. Rowe Price Associates, Inc. is as of February 6, 2003, as set forth in an Amendment to Schedule 13G filed with the Securities and Exchange Commission. The address of T. Rowe Price Associates, Inc. is 100 E. Pratt Street, Baltimore, Maryland 21202.

(6)
Information as to shares owned by Lord Abbett & Co. is as of January 31, 2003, as set forth in an Amendment to Schedule 13G filed with the Securities and Exchange Commission. The address of Lord Abbett & Co. is 90 Hudson Street, Jersey City, New Jersey 07302-3973.

(7)
Information as to shares owned by Reich & Tang Asset Management is as of February 6, 2003, as set forth in an Amendment to Schedule 13G filed with the Securities and Exchange Commission. The address of Reich & Tang Asset Management is 600 Fifth Avenue, 8th Floor, New York, New York 10020.

(8)
Information as to shares owned by Waddell & Reed Financial, Inc. is as of February 14, 2003, as set forth in an Amendment to Schedule 13G filed with the Securities and Exchange Commission. The address of Waddell & Reed Financial, Inc. is 6300 Lamar Avenue, P.O. Box 29217, Shawnee Mission, Kansas 66201-9217.

(9)
Information as to shares owned by Delaware Management Holdings is as of February 7, 2003, as set forth in a Schedule 13G filed with the Securities and Exchange Commission. The address of Delaware Management Holdings is 2005 Market Street, Philadelphia, PA 19103.

(Footnotes continued on next page)

(Footnotes continued from previous page)

(10)
The address of each person is c/o MSC Industrial Direct Co., Inc., 75 Maxess Road, Melville, New York 11747.

(11)

Includes (a) 169,669 shares of Class A Common Stock owned directly by Mr. Jacobson, (b) 709,100 shares of Class A Common Stock which may be deemed to be beneficially owned by Mr. Jacobson as a member of Platinum Investment Management, L.L.C., a Delaware limited liability company, the owner of such shares, (c) 154,342 shares of Class A Common Stock which may be deemed to be beneficially owned by Mr. Jacobson as a director of The Jacobson Family Foundation, the owner of such shares, and (d) 100,000 shares of Class A Common Stock issuable upon the exercise by Mr. Jacobson of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement. Mr. Jacobson disclaims beneficial ownership of 354,550 of the shares of Class A Common Stock owned by Platinum Investment Management, L.L.C. and disclaims beneficial ownership of all the shares of Class A Common Stock held by The Jacobson Family Foundation.

(12)

Includes (a) 10,850,814 shares of Class B Common Stock owned directly by Mr. Jacobson, (b) 7,032,000 shares of Class B Common Stock which may be deemed to be beneficially owned by Mr. Jacobson as a member of JF-MSC, L.L.C., a Delaware limited liability company, (c) 386,142 shares of Class B Common Stock which may be deemed to be beneficially owned by Mr. Jacobson as Settlor of the Mitchell Jacobson 1998 Qualified Seven Year Annuity Trust and (d) 374,401 shares of Class B Common Stock owned by Marjorie Diane Gershwind as Settlor of the Marjorie Diane Gershwind 1998 Qualified Seven Year Annuity Trust of which trust Mr. Jacobson is the sole trustee and over which shares he may be deemed to have beneficial ownership. Mr. Jacobson disclaims beneficial ownership of 3,352,800 of the shares of Class B Common Stock owned by JF-MSC, L.L.C. and disclaims beneficial ownership of all shares of Class B Common Stock owned by the Marjorie Diane Gershwind 1998 Qualified Seven Year Annuity Trust and the Mitchell Jacobson 1998 Qualified Seven Year Annuity Trust.

(13)

Includes (a) 190,680 shares of Class A Common Stock owned directly by Ms. Gershwind, (b) 709,100 shares of Class A Common Stock which may be deemed to be beneficially owned by Ms. Gershwind as a member of Platinum Investment Management, L.L.C., a Delaware limited liability company, the owner of such shares and (c) 125,986 shares of Class A Common Stock which may be deemed to be beneficially owned by Ms. Gershwind as a director of The Gershwind Family Foundation, the owner of such shares. Ms. Gershwind disclaims beneficial ownership of 354,550 of the shares of Class A Common Stock owned by Platinum Investment Management, L.L.C. and disclaims beneficial ownership of all the shares of Class A Common Stock held by The Gershwind Family Foundation.

(14)

Includes (a) 4,601,285 shares of Class B Common Stock owned directly by Ms. Gershwind, (b) 5,700,000 shares of Class B Common Stock which may be deemed to be beneficially owned by Ms. Gershwind as a member of GF-MSC, L.L.C., a Delaware limited liability company, (c) 946,246 shares of Class B Common Stock which may be deemed to be beneficially owned by Ms. Gershwind as Settlor of the Marjorie Diane Gershwind 1994 Qualified Fifteen Year Annuity Trust and (d) 374,401 shares of Class B Common Stock which may be deemed to be beneficially owned by Ms. Gershwind as Settlor of the Marjorie Diane Gershwind 1998 Qualified Seven Year Annuity Trust. Ms. Gershwind disclaims beneficial ownership of 3,652,000 of the shares of Class B Common Stock owned by GF-MSC, L.L.C. and disclaims beneficial ownership of the shares of Class B Common Stock owned by the Marjorie Diane Gershwind 1994 Qualified Fifteen Year Annuity Trust and the Marjorie Diane Gershwind 1998 Qualified Seven Year Annuity Trust.

(15)

Includes (a) 1,023,203 shares of Class B Common Stock as co-trustee for the Erik Gershwind 1995 Trust; (b) 1,023,203 shares of Class B Common Stock as co-trustee for the Stacey Gershwind 1995 Trust and (c) 946,246 shares of Class B Common Stock as the sole trustee of the Marjorie Diane Gershwind 1994 Qualified Fifteen Year Annuity Trust. Mr. Jacobson disclaims beneficial ownership of all such shares.

(16)

Includes 56,000 shares of Class A Common Stock issuable upon the exercise by Mr. Gershwind of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement.

(17)

Includes (a) 386,142 shares of Class B Common Stock owned by the Mitchell Jacobson 1998 Qualified Seven Year Annuity Trust of which trust Mr. Gershwind is the sole trustee and over which shares he may be deemed to have beneficial ownership, and (b) 1,023,203 shares of Class B Common Stock as Settlor of the Erik Gershwind 1995 Trust. Mr. Gershwind disclaims beneficial ownership of the shares of the Class B Common Stock owned by the Mitchell Jacobson 1998 Qualified Seven Year Annuity Trust.

Security Ownership of Management

The following table sets forth certain information regarding the Class A Common Stock and Class B Common Stock beneficially owned by each director and nominee for director of the Company, by the Company's Chief Executive Officer, by each of the Company's four most highly compensated executive officers and by all directors, nominees for director and executive officers as a group, at the close of business on November 24, 2003. Except as otherwise indicated, the persons listed below have advised the Company that they have sole voting and investment power with respect to the shares listed as owned by them.

	Class A Common Stock(1)	Class B Common Stock

	Class A Common Stock(1)					
	Amount & Nature of Beneficial Ownership	**Percent of Class**	**Amount & Nature of Beneficial Ownership**	**Percent of Class**	**% Ownership of Common Stock(2)**	**% Voting Power(3)**
Shelley Boxer	127,800 (4)	*			*	*
Charles Boehlke	130,000(5)	*			*	*
Roger Fradin	62,000(6)	*			*	*
Mitchell Jacobson	1,133,111(7)	3.3	18,643,357(8)	58.4	29.6	53.0
Sidney Jacobson	200	*	2,992,652(9)	9.4	4.5	8.5
Denis Kelly	88,814(10)	*			*	*
Raymond Langton	26,250(11)	*			*	*
Philip Peller	16,084(12)	*			*	*
David Sandler	288,359(13)	*			*	*
James Schroeder	522,712(14)	1.5			*	*
Ross Anker	197,177(15)	*			*	*
All directors, nominees for director and executive officers as a group (thirteen persons)	2,753,422	7.6%	21,636,009	67.7%	35.7%	61.9%

* Less than 1%

(1) Does not include shares of Class A Common Stock issuable upon conversion of shares of Class B Common Stock. Shares of Class B Common Stock are convertible at any time into shares of Class A Common Stock on a share-for-share basis.

(2) Indicates percentage ownership of the aggregate number of outstanding shares of Class A Common Stock and Class B Common Stock. See footnote 1.

(3) Indicates percentage of aggregate number of votes which can be cast. On all matters to be voted upon at the Meeting and any adjournment or postponement thereof, the holders of the Class A Common Stock and the Class B Common Stock vote together as a single class, with each record holder of Class A Common Stock entitled to one vote per share of Class A Common Stock and each record holder of Class B Common Stock entitled to 10 votes per share of Class B Common Stock.

(4) Includes 4,000 shares of Class A Common Stock owned directly by Mr. Boxer and 123,800 shares of Class A Common Stock issuable upon the exercise by Mr. Boxer of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement.

(5) Includes 130,000 shares of Class A Common Stock issuable upon the exercise by Mr. Boehlke of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement.

(6) Includes 42,000 shares of Class A Common Stock jointly owned by Mr. Fradin and his wife and 20,000 shares of Class A Common Stock issuable upon the exercise by Mr. Fradin of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement.

(Footnotes continued on next page)

(Footnotes continued from previous page)

(7) Includes (a) 169,669 shares of Class A Common Stock owned directly by Mr. Jacobson, (b) 709,100 shares of Class A Common Stock which may be deemed to be beneficially owned by Mr. Jacobson as a member of Platinum Investment Management, L.L.C., a Delaware limited liability company, the owner of such shares, (c) 154,342 shares of Class A Common Stock which may be deemed to be beneficially owned by Mr. Jacobson as a director of The Jacobson Family Foundation, the owner of such shares, and (d) 100,000 shares of Class A Common Stock issuable upon the exercise by Mr. Jacobson of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement. Mr. Jacobson disclaims

beneficial ownership of 354,550 of the shares of Class A Common Stock owned by Platinum Investment Management, L.L.C. and disclaims beneficial ownership of all the shares of Class A Common Stock held by The Jacobson Family Foundation.

(8) Includes (a) 10,850,814 shares of Class B Common Stock owned directly by Mr. Jacobson, (b) 7,032,000 shares of Class B Common Stock which may be deemed to be beneficially owned by Mr. Jacobson as a member of JF-MSC, L.L.C., a Delaware limited liability company, (c) 386,142 shares of Class B Common Stock which may be deemed to be beneficially owned by Mr. Jacobson as Settlor of the Mitchell Jacobson 1998 Qualified Seven Year Annuity Trust and (d) 374,401 shares of Class B Common Stock owned by Marjorie Diane Gershwind as Settlor of the Marjorie Diane Gershwind 1998 Qualified Seven Year Annuity Trust of which trust Mr. Jacobson is the sole trustee and over which shares he may be deemed to have beneficial ownership. Mr. Jacobson disclaims beneficial ownership of 3,352,800 of the shares of Class B Common Stock owned by JF-MSC, L.L.C. and disclaims beneficial ownership of all shares of Class B Common Stock owned by the Marjorie Diane Gershwind 1998 Qualified Seven Year Annuity Trust and the Mitchell Jacobson 1998 Qualified Seven Year Annuity Trust.

(9) Includes (a) 1,023,203 shares of Class B Common Stock as co-trustee for the Erik Gershwind 1995 Trust; (b) 1,023,203 shares of Class B Common Stock as co-trustee for the Stacey Gershwind 1995 Trust and (c) 946,246 shares of Class B Common Stock as the sole trustee of the Marjorie Diane Gershwind 1994 Qualified Fifteen Year Annuity Trust. Mr. Jacobson disclaims beneficial ownership of all such shares.

(10) Includes 35,000 shares of Class A Common Stock owned directly by Mr. Kelly and 53,814 shares of Class A Common Stock issuable upon the exercise by Mr. Kelly of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement.

(11) Includes 1,250 shares of Class A Common Stock owned directly by Mr. Langton and 25,000 shares of Class A Common Stock issuable upon the exercise by Mr. Langton of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement.

(12) Includes 4,000 shares of Class A Common Stock owned directly by Mr. Peller and 12,084 shares of Class A Common Stock issuable upon the exercise by Mr. Peller of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement.

(13) Includes 10,302 shares of Class A Common Stock owned directly by Mr. Sandler, 2,000 shares of Class A Common Stock held in trust by Mr. Sandler for the benefit of his children and 276,057 shares of Class A Common Stock issuable upon the exercise by Mr. Sandler of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement.

(14) Includes 12,000 shares of Class A Common Stock owned directly by Mr. Schroeder and 510,712 shares of Class A Common Stock issuable upon the exercise by Mr. Schroeder of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement.

(15) Includes 11,578 shares of Class A Common Stock owned directly by Mr. Anker and 186,199 shares of Class A Common Stock issuable upon the exercise by Mr. Anker of options that are presently exercisable or exercisable within 60 days of the date of this proxy statement.

6

ELECTION OF DIRECTORS
(ITEM 1)

Seven directors will be elected at the Meeting for a term of one year expiring at the annual meeting of shareholders to be held in 2005 and until their respective successors shall have been elected and shall qualify. Each of the nominees for director was previously elected a director of the Company by the shareholders.

The election of directors requires the affirmative vote of a plurality of the votes cast in person or by proxy at the Meeting. Each proxy received will be cast FOR the election of the nominees named below unless otherwise specified in the proxy.

Each nominee has indicated that he is willing to serve as a director of the Company, if elected, and the Board of Directors of the Company has no reason to believe that any nominee may become unable or unwilling to serve. In the event that a nominee should become unavailable for election for any reason, the shares represented by a properly executed and returned proxy will be voted for any substitute nominee who shall be designated by the current Board of Directors. There are no arrangements or understandings between any director or nominee for director and any other person pursuant to which such person was selected as a director or nominee for director of the Company.

Name of Nominee	Principal Occupation	Age	Director Since

Name of Nominee	Principal Occupation	Age	Director Since
Mitchell Jacobson	Chairman of the Board of Directors and Chief Executive Officer of the Company	52	October 1995
David Sandler	President and Chief Operating Officer of the Company	46	June 1999
Charles Boehlke	Executive Vice President and Chief Financial Officer of the Company	47	January 2001
Roger Fradin	President and Chief Executive Officer Automation and Control Products of Honeywell International	50	July 1998
Denis Kelly	Partner of Scura, Rise & Partners LLC	54	April 1996
Raymond Langton	Co-founder and Chief Executive Officer of SKM Applied Tech Products	58	July 1997
Philip Peller	Business Consultant; Retired Partner of Arthur Andersen LLP	63	April 2000

Mitchell Jacobson was appointed Chairman of the Board of Directors of the Company in January 1998. Mr. Jacobson was appointed Chief Executive Officer of the Company upon its formation in October 1995 and also served as President from its formation until November 3, 2003. Mr. Jacobson has also been Chief Executive Officer of Sid Tool Co., Inc., a wholly-owned and the principal operating subsidiary of the Company (the "Operating Subsidiary") since June 1982 and President from June 1982 to November 2003.

David Sandler was promoted to Executive Vice President of the Company in June 1999, appointed Chief Operating Officer of the Company in November 2000, and appointed President of the Company in November 2003. From September 1998 to June 1999, he served as Senior Vice President of Administration of the Company. From September 1997 to September 1998, Mr. Sandler was the Senior Vice President of Information Systems and Human Resources of the Company. From September 1996 to September 1997, Mr. Sandler served as the Vice President of Information Systems and Business

Development of the Company. From 1995 to 1996, Mr. Sandler was the Director of Business Development of the Company. From 1993 to 1995, Mr. Sandler was the Director of Product Management and Purchasing of the Operating Subsidiary.

Charles Boehlke was appointed Chief Financial Officer and Senior Vice President of the Company in June 2000 and was promoted to Executive Vice President of the Company in January 2003. From April 1996 to April 2000, Mr. Boehlke was the Vice President of Finance for North America operations at Arrow Electronics, Inc. From January 1994 to April 1996, Mr. Boehlke was the Chief Financial Officer of Black & Decker Mexico.

Roger Fradin is the President and Chief Executive Officer of Automation and Control Products division of Honeywell International, as of June 2002. From 2000 until June 2002, Mr. Fradin was President of the Security and Fire Solutions Division at Honeywell, Inc. From 1987 until 2000, Mr. Fradin was the President of the ADEMCO Group.

Denis Kelly is a Partner of Scura, Rise & Partners LLC (a private investment banking firm), a position he has held since 2001. From July 1993 until 2001, Mr. Kelly was a Managing Director of Prudential Securities Incorporated. Before July 1993, Mr. Kelly was President of Denbrook Capital Corporation. Mr. Kelly is also a director and member of the audit committee of Kenneth Cole Productions, Inc.

Raymond Langton is the Co-founder and Chief Executive Officer of SKM Applied Tech Products, a leveraged buy-out firm. From 1995 to February 1997, Mr. Langton was the President and Chief Executive Officer of Chicago Rawhide Worldwide, a manufacturer of sealing devices and subsidiary of SKF USA Inc. (itself a subsidiary of AB SKF of Sweden, a manufacturer of sealing devices and ball bearings). From 1991 to 1995, Mr. Langton was President and Chief Executive Officer of SKF North America, a manufacturer of ball bearings and subsidiary of SKF USA, Inc. Mr. Langton is also a director of Berwind Corp. and the Superior Group, both of which are privately held companies.

Philip Peller is a business consultant. Mr. Peller was a partner of Andersen Worldwide S.C. and Arthur Andersen LLP from 1970 until his retirement in 1999. Mr. Peller served as Managing Partner of Practice Protection and Partner Affairs for Andersen Worldwide S.C. from 1998 to 1999, and as Managing Partner of Practice Protection from 1996 to 1998. Mr. Peller also served as the Managing Director Quality, Risk Management and Professional Competence for Arthur Andersen's global audit practice.

Sidney Jacobson and Mitchell Jacobson are father and son. There are no family relationships among any of the other directors or executive officers of the Company.

Roger Fradin, Denis Kelly, Raymond Langton and Philip Peller are independent in accordance with Section 303(A)(1) of the New York Stock Exchange listing standards.

Committees, Meetings and Compensation of the Board of Directors

The Board of Directors held four meetings during the last fiscal year and acted by unanimous written consent on no occasion. Each of the directors attended at least 75% of the meetings of the Board of Directors and committees of the Board on which they served except for Sidney Jacobson who attended 50% of the meetings of the Board of Directors.

The Board of Directors has a standing Audit Committee currently comprised of Roger Fradin, Denis Kelly, Raymond Langton and Philip Peller. Mr. Peller is the chairman of the Audit Committee. The Board of Directors has determined that Mr. Peller qualifies as an "audit committee financial expert" as defined in Item 401(h) of Regulation S-K of the Exchange Act. All members of the Audit Committee are independent, in accordance with Section 303(A)(2) of the New York Stock Exchange listing standards and Rule 10A-3 promulgated under the Exchange Act. The purpose of the Audit

Committee is to (i) assist board oversight of the preparation and integrity of the Company's financial statements, the Company's compliance with its ethics policies and legal and regulatory requirements, the independent auditor's qualifications, performance and independence, and the performance of the Company's internal audit function and independent auditors; and (ii) to prepare an annual audit committee report to be included in the Company's proxy statement. The Audit Committee adopted a written charter during fiscal 2000 and amended the charter during fiscal 2003. The Audit Committee has the responsibilities and functions mandated by Section 303(A)(6) of the New York Stock Exchange listing standards and Rule 10A-3 promulgated under the Exchange Act, as set forth in its current charter, a copy of which is attached as Annex A. The Audit Committee has the authority to engage independent counsel and other advisors as it determines is necessary to carry out its duties, and the Company must provide appropriate funding for the Audit Committee. The Audit Committee must also undertake an annual performance evaluation of its performance. The Audit Committee met four times in the fiscal year ended August 30, 2003.

The Board of Directors has a standing Compensation Committee currently comprised of Roger Fradin, Denis Kelly, Raymond Langton and Philip Peller. All members of the Compensation Committee are independent, in accordance with Section 303(A)(2) of the New York Stock Exchange listing standards. Mr. Langton is the chairman of the Compensation Committee. The Compensation Committee is responsible for reviewing and approving corporate goals and objectives relevant to the compensation of the Chief Executive Officer; evaluating the Chief Executive Officer's performance in light of those goals and objectives; determining and approving, either as a committee or together with other independent directors (as directed by the Board of Directors) the Chief Executive Officer's compensation level based on their evaluation of his performance; making recommendations to the Board of Directors with respect to compensation other than the Chief Executive Officer's compensation, including with respect to incentive compensation plans and equity based plans of the Company; and producing a compensation committee report on executive compensation to be included in the Company's annual proxy statement. The Compensation Committee also administers the Company's 1995 Restricted Stock Plan, 1995 Stock Option Plan (the "1995 Option Plan"), 1998 Stock Option Plan (the "1998 Option Plan"), and 2001 Stock Option Plan (the "2001 Option Plan"). Pursuant to the 1995 Option Plan, the 1998 Option Plan and the 2001 Option Plan, the Compensation Committee has the authority to determine the persons to whom and the times at which options are to be granted, the number of option shares to be granted and the price and other terms of options and to designate whether options granted are intended to qualify as incentive stock options or are to be non-qualified stock options. The Compensation Committee must also undertake an annual evaluation of its performance. The Compensation Committee has adopted a written charter, a copy of which is available on the Company's website at www.mscdirect.com. The Compensation Committee met four times in the fiscal year ended August 30, 2003.

The Board of Directors created a standing Nominating/Corporate Governance Committee in November 2003. The Nominating/Corporate Governance Committee is comprised of Roger Fradin, Denis Kelly, Raymond Langton and Philip Peller. All members of the Nominating/Corporate Governance Committee are independent, in accordance with Section 303(A)(2) of the New York Stock Exchange listing standards. The chairman of the Nominating/Corporate Governance Committee will be selected at the first meeting of the Nominating/Corporate Governance Committee, which will be held immediately after the Meeting. The Nominating/Corporate Governance Committee is responsible for identifying individuals qualified to become members of the Board of Directors of the Company consistent with criteria approved by the Board of Directors; selecting or recommending that the Board of Directors select nominees for the Board of Directors; developing and recommending to the Board of Directors corporate governance principles applicable to the Company; and overseeing the evaluation of the Board of Directors and management of the Company. Only those candidates nominated by the Nominating/Corporate Governance Committee will be considered as nominees. Only those candidates nominated by the Nominating/Corporate Governance Committee will be considered as nominees for

the Board of Directors; recent regulations promulgated by the Securities and Exchange Commission which apply to future meetings of the Company's shareholders will require additional information to be provided to shareholders regarding the Company's future procedures for considering candidates for director, including those recommended by shareholders. The Nominating/Corporate Governance Committee must also undertake an annual evaluation of its performance. The Nominating/Corporate Governance Committee has adopted a written charter, a copy of which is available on the Company's website at www.mscdirect.com.

The Company's policy is not to pay compensation to directors who are also associates of the Company. The Company grants options to purchase 5,000 shares of Class A Common Stock to non-employee directors upon their election and reelection to the Board of Directors. Directors elected other than at an annual meeting of shareholders receive a pro rata number of options. The Company also pays each non-employee director compensation of $20,000 per annum and $1,500 per board meeting attended, and pays an annual fee of $5,000 to the chairman of each of the Audit and Compensation committees with respect to their duties in such capacity in addition to the standard non-employee director compensation. The annual fee which will be paid to the chairman of the Nominating/Corporate Governance Committee will be determined at the first meeting of the Nominating/Corporate Governance Committee, which will be held immediately after the Meeting.

Executive Officers

The following individuals are the executive officers of the Company.

Name of Officer	Position	Age	Executive Officer Since
Mitchell Jacobson	Chairman of the Board of Directors and Chief Executive Officer of the Company	52	October 1995
David Sandler	President and Chief Operating Officer of the Company	46	January 1998
Charles Boehlke	Executive Vice President and Chief Financial Officer of the Company	47	June 2000
James Schroeder	Senior Vice President of Logistics of the Company	63	October 1995
Shelley Boxer	Vice President of Finance of the Company	56	October 1995
Thomas Eccleston	Vice President of Plant and Equipment and Secretary	55	October 1995
Thomas Cox	Senior Vice President of Sales	42	June 2000
Ross Anker	Senior Vice President of Product Management and Information Systems	40	September 2001

James Schroeder, a director of the Company since inception, was appointed Senior Vice President of Logistics of the Company in August 1997. From October 1995 to August 1997, Mr. Schroeder served as Vice President of Logistics of the Company. From 1995 to January 1998, Mr. Schroeder also served as Chief Operating Officer of the Company. Mr. Schroeder has also been Vice President of Logistics of the Operating Subsidiary since 1986.

Shelley Boxer, a director of the Company since inception, was appointed Vice President of Finance of the Company in June 2000. Mr. Boxer was the Vice President and Chief Financial Officer of the Company from its formation in October 1995 until June 2000. From

June 1993 to October 1995, Mr. Boxer also served as Chief Financial Officer of the Operating Subsidiary. Mr. Boxer was the Vice

President and Chief Financial Officer of Joyce International, Inc., a distribution and manufacturing company, from 1992 to 1993. From 1987 to 1992, Mr. Boxer was the Executive Vice President and Chief Financial Officer of Kinney Systems, Inc., an automobile parking facility and real estate company.

Thomas Eccleston was appointed Vice President of Plant and Equipment and Secretary of the Company upon its formation in October 1995. Mr. Eccleston has also served as the Vice President of Plant and Equipment of the Operating Subsidiary since 1986.

Thomas Cox was appointed Senior Vice President of Sales of the Company in April 2000. From September 1999 to April 2000, Mr. Cox was Vice President of Sales for the North Region of the Company. From January 1998 to September 1999, Mr. Cox served as Regional Manager for the Midwest Region of the Company. From September 1997 to January 1998, Mr. Cox served as Director of Business Development for the Company. From 1995 to 1997, Mr. Cox was President of Mailnet Inc., an international delivery company.

Ross Anker was appointed Senior Vice President of Product Management and Information Systems in September 2001. From November of 1996 to September 2001, Mr. Anker was Chief Information Officer of the Company. Prior to joining the Company, Mr. Anker was President and founder of a consulting company based in Cleveland, Ohio.

Each executive officer serves until his successor is appointed and qualified or until earlier resignation, death or removal. There are no arrangements or understandings between any executive officer and any other person pursuant to which he was or is to be selected as an officer of the Company. The Operating Subsidiary, however, has entered into employment agreements with each of Mitchell Jacobson, the Chairman of the Board and Chief Executive Officer of the Company and Sidney Jacobson, Chairman Emeritus of the Company, which are described on pages 14 and 15 of this proxy statement. In addition, the Company has entered into employment agreements with David Sandler, President and Chief Operating Officer of the Company, Charles Boehlke, Chief Financial Officer and Executive Vice President of the Company, and James Schroeder, Senior Vice President of Logistics of the Company, as described on pages 15 and 16 of this proxy statement.

Sidney Jacobson was appointed Chairman Emeritus of the Company in November, 2003. Mr. Jacobson served as Vice Chairman of the Board of Directors of the Company from January 1998 to November 2003. Mr. Jacobson served as the Chairman of the Board of Directors from the Company's formation in October 1995 to January 1998. Mr. Jacobson is a co-founder of the Operating Subsidiary and has been the Chairman of the Operating Subsidiary since June 1982.

James Schroeder, Shelley Boxer and Sidney Jacobson have agreed not to stand for re-election as directors of the Company so that the Company will have a majority of independent directors under New York Stock Exchange corporate governance listing standards.

Code of Ethics

The Company has adopted a code of ethics that applies to its chief executive officer and senior financial officers, a copy of which was filed with the Company's 2003 Annual Report on Form 10-K with the Securities and Exchange Commission on November 6, 2003 and is incorporated by reference herein.

Section 16(a) Beneficial Ownership Reporting Compliance

Based solely upon a review of the filings furnished to the Company pursuant to Rule 16a-3(e) promulgated under the Exchange Act and written representations from its executive officers, directors and persons who own beneficially more than 10% of either the Class A Common Stock or the Class B Common Stock, all filing requirements of Section 16(a) of the Exchange Act were complied with during the fiscal year ended August 30, 2003 except that Philip Peller, Roger Fradin, Denis Kelly and Raymond Langton each failed to timely file a Statement of Changes in Beneficial Ownership on Form 4 with respect to options granted on January 8, 2003. Such transactions have since been reported on Annual Statements of Changes in Beneficial Ownership on Form 5.

EXECUTIVE COMPENSATION

The following table sets forth, for the Company's last three fiscal years, the aggregate compensation awarded to, earned by or paid to the Company's Chief Executive Officer, and to each of the Company's other four most highly compensated executive officers who were serving as executive officers at the end of the Company's last fiscal year (collectively, the "Named Executive Officers"), for services rendered in all capacities to the Company and its subsidiaries. All compensation noted below, other than stock options, was paid by the Operating Subsidiary.

Summary Compensation Table

		Annual Compensation			Long-Term Compensation Awards	
Name and Principal Position	**Fiscal Year**	**Salary**	**Bonus(1)**	**Other Annual Compensation(2)**	**Securities Underlying Options(1)**	**All Other Compensation**
Mitchell Jacobson	2003	$ 408,400	$ 275,000		0	$ 2,103(4)
Chief Executive Officer	2002	408,400	135,000		250,000	267,991(4)
	2001	408,400	250,000	$ 51,448(3)	0	207,398(4)
David Sandler	2003	$ 391,764	$ 225,000	$ 59,229(5)	0	$ 3,691(6)
President and Chief	2002	370,457	115,830		175,000	3,642(6)
Operating Officer	2001	351,000	214,500		125,000	3,587(6)
James Schroeder	2003	$ 330,501	$ 100,000		0	$ 87,105(7)
Senior Vice President,	2002	328,270	50,000		50,000	80,297(7)
Logistics	2001	315,000	135,000		40,000	69,415(7)
Ross Anker	2003	$ 316,808	$ 140,000		0	$ 1,932(8)
Senior Vice President of	2002	293,746	75,600		100,000	1,739(8)
Product Management and	2001	280,448	140,000		60,000	1,685(8)
Information Systems						
Charles Boehlke	2003	$ 302,229	$ 150,000		0	$ 3,670(9)
Executive Vice President and	2002	278,861	75,600		100,000	3,662(9)
Chief Financial Officer	2001	274,992	100,000		25,000	3,649(9)

No restricted stock, stock appreciation rights or long-term incentive plan payments, as defined in the regulations of the Exchange Act governing the solicitation of proxies, were awarded to, earned by or paid to any of the Named Executive Officers during any of the last three fiscal years.

(1) Amounts shown are for the year in which bonuses are paid or stock options granted; all such awards relate to prior fiscal year performance.

(2) Includes perquisites and other annual benefits where such perquisites and benefits exceed the lesser of $50,000 or 10% of the officer's annual salary and bonus for the year. Of the amounts reported, items that exceeded 25% of the total perquisites and benefits reported for the officer are described below.

(3) Includes club dues and expenses of approximately $30,875 paid by the Company in fiscal 2001, automobile allowances of $7,698 in fiscal 2001, and the use of subscription concert seats valued at $12,875 in fiscal 2001.

(Footnotes continued on next page)

(Footnotes continued from previous page)

(4)

Includes group term life insurance benefits of approximately $423, $414 and $380 paid by the Company in fiscal 2003, fiscal 2002 and fiscal 2001, respectively, and split dollar life insurance premiums of approximately $266,006 and $205,447 paid by the Company in fiscal 2002 and fiscal 2001, respectively. Under the terms of such policies, a portion of the premiums paid by the Company in fiscal 2002 and fiscal 2001 have been reimbursed. Also includes matching contributions to the Operating Subsidiary's 401(k) Plan of approximately $1,680, $1,571 and $1,571 paid by the Company in fiscal 2003, fiscal 2002 and fiscal 2001, respectively.

(5)

Includes rental payments of approximately $39,106 on an apartment maintained by the Company for Mr. Sandler's use in fiscal 2003.

(6)

Includes group term life insurance benefits of approximately $291, $242 and $187 paid by the Company in fiscal 2003, fiscal 2002 and fiscal 2001, respectively, and matching contributions to the Operating Subsidiary's 401(k) Plan of approximately $3,400 by the Company in fiscal 2003, fiscal 2002 and fiscal 2001.

(7)

Includes group term life insurance benefits of approximately $1,142, $1,188 and $1,234 paid by the Company in fiscal 2003, fiscal 2002 and fiscal 2001, respectively, and matching contributions to the Operating Subsidiary's 401(k) Plan of approximately $2,436, $2,285 and $2,181 paid by the Company in fiscal 2003, fiscal 2002 and fiscal 2001, respectively. Also includes approximately $83,527, $76,824 and $66,000 accrued by the Company in fiscal 2003, fiscal 2002 and fiscal 2001, respectively, in respect of annual post-retirement payments to be made to Mr. Schroeder pursuant to the terms and provisions of a written agreement between Mr. Schroeder and the Company which was terminated by the Company on September 1, 1997.

(8)

Includes group term life insurance benefits of $174, $162 and $214 paid by the Company in fiscal 2003, fiscal 2002 and fiscal 2001, respectively, and matching contributions to the Operating Subsidiary's 401(k) Plan of approximately $1,758, $1,577 and $1,471 paid by the Company in fiscal 2003, fiscal 2002 and fiscal 2001, respectively.

(9)

Includes group term life insurance benefits of $270, $270 and $249 paid by the Company in fiscal 2003, fiscal 2002 and fiscal 2001, respectively and matching contributions to the Operating Subsidiary's 401(k) Plan of approximately $3,400, $3,392 and $3,400 paid by the Company in fiscal 2003, fiscal 2002and fiscal 2001 respectively.

Option Grants in Last Fiscal Year

The following table sets forth information with respect to the grant of stock options under the 2001 Stock Option Plan by the Company during the fiscal year ended August 30, 2003 to the Named Executive Officers listed on the Summary Compensation Table.

	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
Name	**Number of Securities Underlying Options Granted (#)**	**Percentage of Total Options Granted to Associates in Fiscal Year (%)**	**Exercise Price ($/Sh)**	**Expiration Date**	**5% ($)**	**10% ($)**
Mitchell Jacobson						
Ross Anker						
David Sandler						
James Schroeder						
Charles Boehlke						

Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

The following table sets forth information with respect to the exercise of stock options during the fiscal year ending August 30, 2003 and the value at August 30, 2003 of unexercised stock options held by the Named Executive Officers listed on the Summary Compensation Table.

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at FYE Exercisable/Unexercisable	Value of Unexercised In-the-Money Options at FYE Exercisable/Unexercisable(1)
Mitchell Jacobson			100,000/250,000	$728,000/1,092,000
Ross Anker			244,000/112,000	$2,187,688/$943,610
David Sandler			401,057/219,190	$3,367,666/$1,902,423
James Schroeder	1,040	$ 11,128	502,712/65,778	$2,925,907/$518,885
Charles Boehlke			125,000/125,000	$601,563/$809,055

(1) Fair market value of securities underlying the options at fiscal year end minus the exercise price of the options.

Employment Arrangements and Compensation Plans

Sidney Jacobson was employed as Chairman of the Board of Directors of the Operating Subsidiary pursuant to an employment agreement, dated as of January 2, 1994 and amended as of October 30, 1995, which expires in January 2004. The employment agreement provides that Mr. Jacobson is required to devote his full working time to the affairs of the Operating Subsidiary. Under Mr. Jacobson's employment agreement, he receives an annual base salary of $250,000 and is entitled to participate in employee benefit and other fringe plans made available to the executives of the Operating Subsidiary. If the cost of living increases by more than 6% per annum, Mr. Jacobson's annual base salary is subject to a percentage increase equal to the 3 percentage cost of living increase. The employment agreement also provides for a benefit of $200,000 per year until January 2, 2004 payable to Mr. Jacobson's wife in the event of his death. Under the employment agreement, if Mr. Jacobson's employment is terminated because he becomes incapacitated due to physical or mental illness, he would continue to receive his salary for a six month period following such termination and, thereafter, would receive $200,000 per year for the balance of his employment term. Mr. Jacobson would also continue to be carried on the Operating Subsidiary's health and other insurance plans. The

employment agreement provides that Mr. Jacobson may, at his option, elect to become a consultant and advisor to the Operating Subsidiary at an annual fee of $300,000, in which event Mr. Jacobson will be required to be available to the Company for up to 10 hours per week, not to exceed 40 hours in any given month. Mr. Jacobson does not have any current intention to make such election, and any such election would not be expected to have a material impact on the Operating Subsidiary. The Company paid club dues and expenses on Mr. Jacobson's behalf of $483, and $20,839 in fiscal 2002 and 2001, respectively. The Company also provided Mr. Jacobson with a part-time driver whose services, and the corresponding use of a company car, were valued at $41,622, $52,695, and $52,386 in fiscal 2003, 2002 and 2001, respectively.

Mitchell Jacobson, Chief Executive Officer and Chairman of the Company, is employed as Chief Executive Officer of the Operating Subsidiary pursuant to an employment agreement, dated as of August 1, 1994 and amended on November 3, 2003, which expires on the earlier of August 1, 2004 or 90 days after Mr. Jacobson's written election to terminate his employment. Mr. Jacobson is required to devote his full working time to the affairs of the Operating Subsidiary. Under his employment agreement, Mr. Jacobson receives an annual base salary (currently set at $408,400). Mr. Jacobson is also entitled to participate in employee benefit and other fringe benefit plans made available to the executives of the Operating Subsidiary. Under the employment agreement, Mr. Jacobson's annual base salary is subject to an annual cost of living adjustment equal to the percentage increase, if any, in a specified Consumer Price Index. The employment agreement also provides that in the event Mr. Jacobson's employment is terminated because he becomes incapacitated due to physical or mental illness, Mr. Jacobson will receive payment of salary for a six-month period following such termination and $200,000 per year for the balance of his employment term. In the event of Mr. Jacobson's death, the agreement provides that his wife will receive $400,000 per year for a period of three years.

Charles Boehlke is employed as Executive Vice President and Chief Financial Officer of the Company pursuant to an agreement, dated as of June 19, 2000. Mr. Boehlke was promoted to Executive Vice President in January 2003. Mr. Boehlke is required to devote his full working time to the affairs of the Company. Under his agreement, Mr. Boehlke receives an annual base salary (currently set at $317,624) and is also entitled to participate in employee benefit and other fringe benefit plans made available to the executives of the Company. The agreement provides that if within two years after (i) a sale by the Company of all or substantially all of its assets, (ii) the consolidation of the Company, (iii) the merger of the Company with any entity as a result of which the Company is not the surviving entity as a public company or (iv) the sale of the Company's voting securities to one or more persons (other than Mitchell Jacobson and Marjorie Gershwind) as a result of which any such person shall possess more than 50% of the combined voting power of the Company's then outstanding securities (each such event, a "Change in Control"), there is a change in the circumstances of Mr. Boehlke's employment, such as (i) a material reduction or change in his employment duties or reporting responsibilities, (ii) a reduction in the annual base salary from the annual base salary received prior to a Change in Control or (iii) a material diminution in his status, working conditions or other economic benefits from those in effect immediately prior to a Change in Control (each such event, a "Changed Circumstance"), Mr. Boehlke may terminate his employment with the Company. Upon such termination, or if within two years after a Change in Control the Company terminates Mr. Boehlke's employment other than for cause, the Company will pay Mr. Boehlke an amount equal to his annual base salary at the time of such termination plus the amount of any bonus paid to him in the fiscal year ending immediately prior to such termination. The agreement provides that in the event of the termination of Mr. Boehlke's employment other than for cause, he is entitled to a severance payment in an amount equal only to the highest annual base salary he received at any time during the period of his employment. Mr. Boehlke's agreement provides that no amount shall be paid to him if such payment would restrict the ability of the Company to utilize the "pooling of interests" method of accounting. This method of accounting is no longer permitted under generally accepted accounting principles. In addition, upon the termination of Mr. Boehlke's employment other than for cause, the

Company is to retain Mr. Boehlke to provide financial consulting services for a one-year period commencing on the date of such termination, for not more than ten (10) hours in any calendar quarter. For such financial consulting services, the Company is to pay Mr. Boehlke $2,500 per annum.

In January 1999, the Company entered into written agreements with each of James Schroeder and David Sandler (each, an "Executive"). Each agreement provides that in the event of a Change in Control, the Company shall pay to James Schroeder and David Sandler, $2,000,000 and $1,200,000, respectively. Each agreement further provides that if within five years after a Change in Control, there is a Changed Circumstance, the Executive may terminate his employment with the Company. Upon such termination, or if within five years after a Change in Control the Company terminates the Executive's employment other than for cause, the Company will pay the Executive a lump sum equal to the difference between (i) the sum of (a) five times the Executive's annual base salary prior to a change in the circumstances of the Executive's employment or termination other than for cause and (b) five times the largest annual bonus paid to the Executive during the three fiscal years prior to the Executive's termination and (ii) the aggregate of all base salary and bonus amounts paid to the Executive from the Change in Control to the Executive's termination. Each agreement provides that no amount shall be paid to the Executives if such payment would restrict the ability of the Company to utilize the "pooling of interests" method of accounting. This method is no longer permitted under generally accepted accounting principles. The Company has also agreed to indemnify each of Mr. Schroeder and Mr. Sandler on an after tax basis (giving effect to the indemnity payments) for certain taxes that they may become liable for on account of the payments described above.

James Schroeder is employed as Senior Vice President of Logistics of the Company. Mr. Schroeder and the Company are parties to a written agreement which provides for annual benefit payments to Mr. Schroeder for seven years upon his retirement, or his termination by the Company without cause or, in the event of his death, to his designated beneficiary. The benefit is based upon the growth in the Company's earnings before interest and taxes over a certain base amount. The Company may terminate the agreement at any time and elect to prepay Mr. Schroeder any benefits accrued by the Company up to the date of such termination. The Company exercised its right to terminate the agreement with Mr. Schroeder as of September 1, 1997. Under the terms of the agreement, the Company is obligated to accrue to Mr. Schroeder's benefit the total amount that would be due as if September 1, 1997 were Mr. Schroeder's normal retirement date. Accordingly, the total amount due to Mr. Schroeder is approximately $1,434,654 of which approximately $83,527 represents interest accrued in fiscal 2003. This amount will accrue interest until Mr. Schroeder's normal retirement date and may be prepaid, at the Company's election, at any time, without penalty.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION IN COMPENSATION DECISIONS

During fiscal 2003, the Compensation Committee consisted of Roger Fradin, Denis Kelly, Raymond Langton and Philip Peller. None of the members of the Compensation Committee was, during such year, an officer of the Company or any of its subsidiaries or had any relationship with the Company other than serving as a director of the Company. In addition, no executive officer of the Company served as a director or a member of the compensation committee of any other entity one of whose executive officers served as a director or on the Compensation Committee of the Company.

REPORT OF COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION

During fiscal 2003, the Compensation Committee (the "Compensation Committee") was comprised of Roger Fradin, Denis Kelly, Raymond Langton and Philip Peller.

The Compensation Committee is responsible for reviewing and recommending to the Board of Directors the overall direction for the executive compensation strategy of the Company and for the

ongoing monitoring of the strategy. In addition to the matters described on page 10 of this proxy statement, the Compensation Committee is responsible for recommending and reviewing the compensation of the executive officers, recommending new incentive compensation plans and recommending changes and improvements to existing compensation plans, all subject to approval by the Board of Directors. The Compensation Committee makes its compensation determinations based upon its own analysis of information it compiles and the business experience of the members. In addition, the views of Mitchell Jacobson, as Chairman of the Board and Chief Executive Officer of the Company, are, and will continue to be, considered by the members of the Compensation Committee in their review of the performance and compensation of individual executives. The Company will engage an outside compensation consultant to assist the Compensation Committee if its members so request. An outside consultant was not used in fiscal 2003.

Overall Policy

The Compensation Committee believes that the Company's executive officers constitute a highly qualified management team and are largely responsible for the Company's success. The Compensation Committee further believes that the stability of the management team is a contributing factor to the Company's success. In order to promote stability, the Company's strategy is to (i) compensate its executive officers principally through a competitive base salary set at a sufficiently high level to retain and motivate these officers, (ii) link a portion of the executive officers' compensation to their performance and the Company's profitability for each fiscal year, and (iii) align the financial interests of the Company's executive officers with those of the Company's shareholders. The compensation objectives of the Compensation Committee and the Board of Directors are designed to provide competitive levels of compensation consistent with the Company's annual and long-term performance goals, recognize individual initiative and achievements and assist the Company in attracting and retaining qualified executives.

The major elements of the executive compensation program are base salary, annual incentive bonuses and long-term incentive compensation in the form of stock options, restricted stock grants and other equity based instruments. Executive officers are also entitled to customary benefits generally available to all associates of the Company, including group medical and life insurance and a 401(k) plan. Overall compensation is intended to be consistent with companies of similar characteristics (size, profitability, business lines, growth, etc.) (the "peer group"). The peer group for purposes of determining compensation of executive officers is not the same group of companies which are included in the industry index which appears on the performance graph contained in this proxy statement. The purpose of the industry index is to compare the performance of the Class A Common Stock to the performance of the stock of companies with similar businesses to the Company. The peer group for purposes of compensation matters is based upon companies with characteristics similar to the Company, including, but not limited to, type of business, in order to provide a more accurate measure of the compensation paid to executives of comparable companies. In any particular year, the Company's executives may be paid more or less than the executives of competitors, depending upon the Company's overall financial performance and other factors. For the fiscal year ended August 30, 2003, the Compensation Committee believes that the Company's senior executives were paid competitively as compared to comparable executives in the peer group.

Federal Income Tax Deductibility of Executive Compensation

Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code") limits the amount of compensation a publicly held corporation may deduct as a business expense for Federal income tax purposes. The limit, which applies to a company's chief executive officer and the four other most highly compensated executive officers, is $1 million, subject to certain exceptions (including the exclusion from the cap generally of performance-based compensation). The Compensation Committee

has determined that compensation payable to the executive officers should generally meet the conditions required for full deductibility under Internal Revenue Code Section 162(m). While the Company does not expect to pay its executive officers compensation in excess of the Section 162(m) deductibility limit, the Compensation Committee also recognizes that in certain instances it may be in the best interest of the Company to provide compensation that is not fully deductible.

Base Salary

Base salaries for the Company's senior executives are influenced by a variety of objective and subjective factors. Particular consideration is given to a comparison of the salaries at companies in the peer group and the executive's level of responsibility, tenure with the Company, prior year's compensation and effectiveness of management. The Compensation Committee has also relied heavily on the recommendations of Mitchell Jacobson, Chairman of the Board and Chief Executive Officer of the Company, in setting the compensation of the executive officers. A description of the employment agreement between the Operating Subsidiary and Mitchell Jacobson, Chairman of the Board and Chief Executive Officer of the Company, appears on page 15 of this proxy statement.

Annual Incentive Bonuses

Each fiscal year, the Company establishes a bonus pool based on financial and non-financial goals. The award of bonuses are at the Compensation Committee's sole discretion. Factors considered in awarding a bonus are the Company's core execution of key initiative performance goals, and the associate's level of responsibility, exhibited individual initiative, and effectiveness of management.

Long-Term Incentive Compensation

The Company reinforces the importance of producing satisfactory returns to shareholders over the long term through the operation of the 1995 Option Plan, the 1998 Option Plan, the 2001 Option Plan and the 1995 Restricted Stock Plan. Stock option grants provide executives with the opportunity to acquire an equity interest in the Company and the Restricted Stock grants confer an immediate equity interest in the Company. Both of these types of grants align the executive's interest with that of the shareholders to create shareholder value as reflected in the growth in the price of the Class A Common Stock.

1995, 1998 and 2001 Option Plans. The 1995 Option Plan, 1998 Option Plan, and 2001 Option Plan (collectively, the "Option Plans") are administered by the Compensation Committee, which may designate granted options as incentive stock options, non-qualified stock options or a combination thereof. The Compensation Committee has the discretion, subject to certain limitations, to determine the participants under the Option Plans, the time and price at which options will be granted, the period during which options will be exercisable and the number of shares subject to each option. Under the Option Plans, the per share exercise price of any option which is a non-incentive stock option may not be less than 85% of the fair market value of a share of Class A Common Stock on the date of grant (except for non-incentive stock options granted to any person who is or may reasonably be expected to become a "covered employee" under section 162(m)(3) of the Code, in which case the per share exercise price of such options may not be less than 100% of such fair market value). The aggregate fair market value of the shares of Class A Common Stock for which a participant may be granted incentive stock options which are exercisable for the first time in any calendar year may not exceed $100,000. No participant may be granted options to purchase more than 1,000,000 shares of the Class A Common Stock under the 1995 Option Plan and 400,000 shares of Class A Common Stock under the 1998 Option Plan and 2001 Option Plan. This approach provides an incentive to the executive officers to increase shareholder value over the long term, since the full benefit of the options granted cannot be realized unless stock price appreciation occurs over a number of years.

18

Chief Executive Officer's Fiscal 2003 Compensation

The compensation paid to the Company's Chief Executive Officer, Mitchell Jacobson, in fiscal 2003 consisted of base salary established pursuant to his employment agreement with the Operating Subsidiary, an annual incentive bonus. The terms of the agreement are described on page 15 of this proxy statement. Under the terms of his employment agreement, Mr. Jacobson received an annual base salary of $408,400. Mr. Jacobson received a $275,000 bonus in fiscal 2003. This bonus was awarded based on fiscal 2002 performance.

COMPENSATION COMMITTEE

Roger Fradin
Denis Kelly
Raymond Langton
Philip Peller

19

REPORT OF AUDIT COMMITTEE

During fiscal 2003, the Audit Committee (the "Committee") was comprised of Roger Fradin, Denis Kelly, Raymond Langton and Philip Peller. The Committee adopted a written charter during fiscal 2000 and amended the charter during fiscal 2003, a copy of which is attached as Annex A.

The Committee oversees the Company's financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and the reporting process including the systems of internal controls. In fulfilling its oversight responsibilities, the Committee reviewed the audited financial statements in the Company's Annual Report on Form 10-K with management and discussed the quality and acceptability of the Company's accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the Company's financial statements.

The Committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgments as to the quality and acceptability of the Company's accounting principles and such other matters as are required to be discussed with the Committee under generally accepted auditing standards, including the Statement on Auditing Standards No. 61 (Communications with Audit Committees). In addition, the Committee has discussed with the independent auditors the auditors' independence from management and the Company, including the matters in the written disclosures required by Independence Standards Board Standard No. 1 (Independent Discussions with Audit Committees), which were submitted to the Company, and considered the compatibility of non-audit services with the auditors' independence.

The Committee discussed with the Company's internal and independent auditors the overall scope and plans for their respective audits. The Committee meets with the internal and independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the Company's internal controls, and the overall quality of the Company's financial reporting.

In reliance on the reviews and discussions referred to above, the Committee recommended to the Board of Directors (and the Board has approved) that the audited financial statements be included in the Annual Report on Form 10-K for the year ended August 30, 2003 for filing with the Securities and Exchange Commission.

AUDIT COMMITTEE

Roger Fradin
Denis Kelly
Raymond Langton
Philip Peller

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

AMONG MSC INDUSTRIAL DIRECT CO., INC., THE S & P MIDCAP 400 INDEX
AND THE DOW JONES US INDUSTRIAL SERVICES INDEX

*
$100 invested on 8/28/98 in stock or on 8/31/98 in index-including reinvestment of dividends.

21

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Erik Gershwind, the nephew of Mitchell Jacobson, Chairman of the Board and Chief Executive Officer of the Company, and the son of Marjorie Gershwind, Mr. Jacobson's sister, is employed by the Company as the Director of Product Management. Mr. Gershwind is currently compensated at the rate of $165,000 per annum. Mr. Gershwind is also entitled to participate in all of the employee benefit plans available to all of the Company's associates.

An entity owned and controlled by Mitchell Jacobson, the Chairman of the Board and Chief Executive Officer of the Company, and Marjorie Gershwind, Mr. Jacobson's sister, leases a distribution center, located in Atlanta, Georgia, to the Operating Subsidiary. As part of a planned expansion project, the Company increased the square footage of the Atlanta, Georgia distribution center by 148,000 square feet to total approximately 525,000 square feet. Concurrently with the completion of the expansion project, the Company received an extension of the lease term to 2023. The terms of the lease agreement have been independently determined to be at fair market value. The rent paid by the Operating Subsidiary was approximately $1,316,000 in fiscal 2003 and is anticipated to be approximately $1,664,000 in fiscal 2004. The rent to be paid by the Operating Subsidiary under the remaining lease term, which expires or is subject to renewal in fiscal 2023, for the Atlanta, Georgia distribution center is approximately $34,478,000.

Additionally, four other entities owned or controlled by Mitchell Jacobson and Marjorie Gershwind lease certain branch offices to the Operating Subsidiary. The aggregate square footage of such branch offices is approximately 40,000 square feet as of August 30, 2003. The aggregate rent paid by the Operating Subsidiary to lease these branch offices was approximately $320,000 in fiscal 2003 and is anticipated to be approximately $192,000 in fiscal 2004. The aggregate rent to be paid by the Operating Subsidiary under the remaining lease terms, the last of which expires in fiscal 2010, is approximately $557,000. The Company believes that the terms of the foregoing arrangements are at least as favorable to the Company as could have been obtained from unaffiliated third parties.

See "Compensation Committee Interlocks and Insider Participation in Compensation Decisions" for certain relationships and related party transactions involving certain of the Company's directors.

**APPROVAL OF AMENDMENT TO MSC INDUSTRIAL DIRECT CO., INC.
1995 RESTRICTED STOCK PLAN**

On October 29, 2003, the Board of Directors adopted an amendment to the 1995 Restricted Stock Plan which will become effective, subject to shareholder approval, on January 6, 2004. The amendment adds provisions (consistent with, and in order to conform the 1995 Restricted Stock Plan to the Company's existing 2001 Stock Option Plan) that amends the Company's ability to effect amendments to the 1995 Restricted Stock Plan and terminates the Stock Restrictions on the sale, assignment or transfer of Restricted Shares allocated to Participants in the event of a Change in Control (as defined in the amendment to the 1995 Restricted Plan) of the Company, provides that Restricted Shares granted and allocated on or after January 6, 2004, shall be at and for no purchase price (rather than $.01 per share) and provides that the Stock Restrictions on such Restricted Shares on the sale, assignment or transfer of such shares shall terminate as to one-half of such Restricted Shares on the third anniversary of the allocation date and as to the remaining one-half of such Restricted Shares in annual equal installments over the ensuing four years. There are presently 86,000 shares available for issuance under the 1995 Restricted Stock Plan. If the amendment, a copy of which is attached hereto as Annex B, is not approved by the shareholders of the Company, the 1995 Restricted Stock Plan will remain as presently in effect.

To effectuate this amendment:

(i) Effective with respect to Restricted Shares granted and allocated on or after January 6, 2004, Section 8 of the MSC Industrial Direct Co., Inc. 1995 Restricted Stock Plan is hereby amended to add the following language after the first sentence thereof:

> "Notwithstanding the foregoing, effective with respect to Restricted Shares granted and allocated on or after January 6, 2004, Participants to whom Restricted Shares are allocated shall be granted such Restricted Shares by the Company at and for no purchase price."

(ii) Effective with respect to Restricted Shares granted and allocated on or after January 6, 2004, Paragraph A of Section 9 of the MSC Industrial Direct Co., Inc. 1995 Restricted Stock Plan is hereby amended to add the following language at the end thereof:

> "Except as otherwise provided in this Section and notwithstanding the foregoing, effective with respect to Restricted Shares granted and allocated on or after January 6, 2004, such Restricted Shares allocated to a Participant may not be sold, assigned, transferred or otherwise disposed of, and may not be pledged or hypothecated. Such Stock Restrictions shall terminate as follows:
>
> i) as to one-half ($^1/_2$) of such Restricted Shares owned by the Participant on the day immediately preceding the third anniversary of the date of his or her Restricted Stock Agreement (as such term is defined in paragraph E. of this Section 9);
>
> ii) as to an additional one-eighth ($^1/_8$) of such Restricted Shares owned by the Participant on the day immediately preceding the fourth anniversary of the date of his or her Restricted Stock Agreement;
>
> iii) as to an additional one-eighth ($^1/_8$) of such Restricted Shares owned by the Participant on the day immediately preceding the fifth anniversary of the date of his or her Restricted Stock Agreement;

iv) as to an additional one-eighth (1/8) of such Restricted Shares owned by the Participant on the day immediately preceding the sixth anniversary of the date of his or her Restricted Stock Agreement;

v) as to the remaining one-eighth (1/8) of such Restricted Shares owned by the Participant on the day immediately preceding the seventh anniversary of the date of his or her Restricted Stock Agreement."

(iii) Paragraph B of Section 9 of the MSC Industrial Direct Co., Inc. 1995 Restricted Stock Plan is hereby amended and restated in its entirety as follows:

"In addition, if the Participant to whom Restricted Shares have been allocated as of any Allocation Date leaves the employ of the Company and its Subsidiaries for any reason (other than death or Permanent Disability, his or her Termination Without Cause or his or her retirement from the Company at or after age 65) prior to the termination of the restriction provided for in paragraph A of this Section 9 with respect to the Restricted Shares allocated to such Participant as of such Allocation Date, he or she shall be obligated to redeliver such Restricted Shares to the Company immediately and the Company shall pay to him or her, in redemption of such shares, an amount equal to the price paid by the Participant for such Restricted Shares."

(iv) Section 9F is hereby added to the MSC Industrial Direct Co., Inc. 1995 Restricted Stock Plan to read as follows:

"F. Notwithstanding the provisions of Section 9A, in the event that a Change of Control of the Company shall occur, then, the Stock Restrictions with respect to each Restricted Share theretofore allocated to any Participant shall immediately terminate in full. For purposes hereof a "Change in Control" of the Company shall occur or be deemed to have occurred only if any of the following events occurs: (i) any "person," as such term is used in Sections 13(d) and 14(d) of the Exchange Act (other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any corporation owned directly or indirectly by the shareholders of the Company in substantially the same proportion as the ownership of stock of the Company) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing more than 50% of the combined voting power of the Company's then outstanding securities; (ii) individuals who, as of the Allocation Date of the Restricted Shares, constitute the Board (as of the Allocation Date, the "Incumbent Board") cease for any reason to constitute at least a majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of the Company, as such terms are used in Rule 14a-11 of Regulation 14A under the Exchange Act) shall be, for purposes of this Plan, considered as though such person were a member of the Incumbent Board; or (iii) the shareholders of the Company approve a merger or consolidation of the Company with any other corporation, other than (x) a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than 60% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation or (y) a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no "person" (as hereinabove defined) acquires more than 50% of the combined voting power of the Company's then outstanding securities; or (iv) the shareholders of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets. In the event that a Change in Control shall occur, then, from and after the time of such event,

neither the provisions of this Section 9F nor any of the rights of any Participant thereunder shall be modified or amended in any way."

(v) Section 15 of the MSC Industrial Direct Co., Inc. 1995 Restricted Stock Plan is hereby amended and restated in its entirety as follows:

"*Amendment of Plan.* The Board may at any time terminate the Plan or make such modifications of the Plan as it shall deem advisable; provided, however, that to the extent required by applicable laws or the rules of the New York Stock Exchange or such other exchange on which the Company's securities shall be listed or traded, any such modification or termination shall be subject to the approval of the shareholders of the Company. Except as otherwise provided in Section 10, no termination or amendment of the Plan may, without the consent of the Participant to whom any Restricted Shares shall theretofore have been allocated, adversely affect the rights of such Participant with respect to such Restricted Shares."

Set forth below is a summary of the 1995 Restricted Stock Plan, a copy of which is on file with the Securities and Exchange Commission. All capitalized terms used but not defined herein have the respective meanings ascribed to them in the 1995 Restricted Stock Plan.

There are 400,000 shares reserved under the 1995 Restricted Stock Plan, of which 86,000 shares are presently available for issuance.

The affirmative vote of holders of a majority of the shares of Class A Common Stock and Class B Common Stock present in person or by proxy at the Meeting is required for approval of the amendment to the 1995 Restricted Stock Plan.

The Board of Directors recommends a vote FOR the approval of the amendment to the 1995 Restricted Stock Plan. Each proxy received in response to this solicitation will be voted FOR the proposal to approve the amendment to the 1995 Restricted Stock Plan, unless otherwise specified in the proxy.

Nature and Purpose of the 1995 Restricted Stock Plan

The purpose of the 1995 Restricted Stock Plan is to induce certain employees to remain in the employ of the Company and its present and future subsidiaries, to encourage ownership of shares in the Company by such employees and to provide additional incentive for such employees to promote the success of the Company's business.

Duration and Modification

If the proposed amendment to the 1995 Restricted Stock Plan is approved by the shareholders of the Company, the Board of Directors may, at any time and from time to time, by a resolution and subject to the restrictions provided under the 1995 Restricted Stock Plan, make such modifications of the 1995 Restricted Stock Plan as it shall deem advisable, except that to the extent required by applicable laws or the rules of the New York Stock Exchange or such other exchange on which the Company's securities shall be listed or traded, any such modification or termination shall be subject to the approval of the shareholders of the Company. Further, subject to limited exceptions, no termination or amendment of the 1995 Restricted Stock Plan may, without the consent of the Participant to whom any Restricted Shares shall theretofore have been allocated, adversely affect the rights of such Participant with respect to such Restricted Shares.

Administration

The 1995 Restricted Stock Plan is administered by a Committee consisting of two or more members of the Board of Directors both or all of whom shall be "disinterested persons" within the meaning of Rule 16(b)-3(c)(i) promulgated under the Securities Exchange Act of 1934. The Compensation Committee currently administers the 1995 Restricted Stock Plan. The members of the Compensation Committee do not receive additional compensation for serving on the Compensation Committee, other than the Chairman of the Compensation Committee who receives an annual fee of $5,000 for serving as Chairman of the Compensation Committee. In the event that no Committee shall have been appointed, the Board of Directors shall act as the Committee.

The members of the Committee are appointed annually by, and serve at the pleasure of the Board. The present members of Committee are Messrs. Fradin, Kelly, Peller, and Langton. The Committee has discretion to determine the Participants under the 1995 Restricted Stock Plan, and the time and number of Restricted Shares allocated to each Participant. The Committee shall have the authority to interpret the 1995 Restricted Stock Plan and to prescribe, amend and rescind rules and regulations relating to it.

Eligibility and Extent of Participation

The 1995 Restricted Stock Plan provides for allocations of restricted stock to Participants. Participants must be employees of the Company or a Subsidiary. As of November 24, 2003 approximately 2,690 persons were eligible to receive Restricted Stock pursuant to the 1995 Restricted Stock Plan. In making any determination as to the Participants to whom and the number of allocations of Restricted Shares shall be made, the

Committee shall take into account the duties of the respective Participants, their past, present and potential contribution to the success of the Company and its Subsidiaries and any other factors the Committee shall deem relevant in connection with accomplishing the purpose of the 1995 Restricted Stock Plan.

If the proposed amendment to the 1995 Restricted Stock Plan is approved by the shareholders of the Company, effective with respect to Restricted Shares granted and allocated on or after January 6, 2004, participants to whom Restricted Shares are allocated shall be granted such Restricted Shares by the Company at and for no purchase price.

Termination of Stock Restrictions

If the proposed amendment to the 1995 Restricted Stock Plan is approved by the shareholders of the Company, except as otherwise provided in Section 9 of the Plan, effective with respect to Restricted Shares granted and allocated on or after January 6, 2004, such Restricted Shares allocated to a Participant may not be sold, assigned, transferred or otherwise disposed of, and may not be pledged or hypothecated. Such Stock Restrictions on such Restricted Shares shall terminate as follows (i) as to one-half ($^1/_2$) of the Restricted Shares owned by the Participant on the day immediately preceding the third anniversary of the date of his or her Restricted Stock Agreement (as such term is defined in paragraph E. of this Section 9); (ii) as to an additional one-eighth ($^1/_8$) of the Restricted Shares owned by the Participant on the day immediately preceding the fourth anniversary of the date of his or her Restricted Stock Agreement; (iii) as to an additional one-eighth ($^1/_8$) of the Restricted Shares owned by the Participant on the day immediately preceding the fifth anniversary of the date of his or her Restricted Stock Agreement; (iv) as to an additional one-eighth ($^1/_8$) of the Restricted Shares owned by the Participant on the day immediately preceding the sixth anniversary of the date of his or her Restricted Stock Agreement; (v) as to the remaining one-eighth ($^1/_8$) of the Restricted Shares owned by the Participant on the day immediately preceding the seventh anniversary of the date of his or her Restricted Stock Agreement. Stock Restrictions on Restricted Shares granted prior to January 6, 2004 will, whether or not the proposed amendments are adopted by the shareholders, continue to terminate

in equal installments over the five years following the grant; as of November 24, 2003, the Stock Restrictions on all previously granted Restricted Shares had terminated.

If the proposed amendment to the 1995 Restricted Stock Plan is approved by the shareholders of the Company, notwithstanding the provisions of Section 9A thereof, in the event that a Change of Control of the Company shall occur, then, the Stock Restrictions with respect to each Restricted Share theretofore allocated to any Participant shall immediately terminate in full. For purposes of the 1995 Restricted Stock Plan a "Change in Control" of the Company shall occur or be deemed to have occurred only if any of the following events occurs: (i) any "person," as such term is used in Sections 13(d) and 14(d) of the Exchange Act (other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any corporation owned directly or indirectly by the shareholders of the Company in substantially the same proportion as the ownership of stock of the Company) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing more than 50% of the combined voting power of the Company's then outstanding securities; (ii) individuals who, as of the Allocation Date of the Restricted Shares, constitute the Board (as of the Allocation Date, the "Incumbent Board") cease for any reason to constitute at least a majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of the Company, as such terms are used in Rule 14a-11 of Regulation 14A under the Exchange Act) shall be, for purposes of this Plan, considered as though such person were a member of the Incumbent Board; or (iii) the shareholders of the Company approve a merger or consolidation of the Company with any other corporation, other than (x) a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than 60% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation or (y) a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no "person" (as hereinabove defined) acquires more than 50% of the combined voting power of the Company's then outstanding securities; or (iv) the shareholders of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets. In the event that a Change in Control shall occur, then, from and after the time of such event, neither the provisions of Section 9F nor any of the rights of any Participant thereunder shall be modified or amended in any way.

If a Participant to whom Restricted Shares have been allocated leaves the employ of the Company and its Subsidiaries for any reason, other than death or Permanent Disability, his or her Termination Without Cause or his or her retirement from the Company at or after age 65, prior to termination of the Stock Restrictions with respect to any such Restricted Shares as provided in Section 9 of the Plan, he or she shall be obligated to redeliver such Restricted Shares to the Company immediately and the Company shall pay him or her an amount equal to the priced paid by the Participant, if any.

If a Participant's employment or service with the Company and its Subsidiaries shall terminate by reason of his or her death or Permanent Disability, his or her Termination Without Cause or his or her retirement from the Company at or after age 65 prior to the termination of the Stock Restrictions with respect to his or her Restricted Shares, then, such Stock Restrictions shall terminate.

The market value of the Class A Common Stock as reflected in the closing price of a share of the Class A Common Stock on the New York Stock Exchange on November 24, 2003, was $26.14.

Each Participant receiving Restricted Shares shall (a) agree that such Restricted Shares shall be held subject to the provisions of the 1995 Restricted Stock Plan, (b) represent and warrant to the Company that he or she is acquiring such Restricted Shares for investment in his or her account and will not sell or otherwise dispose of said shares except in compliance with the Securities Act of 1933, (c) agree that the Company may place an appropriate legend on the certificates representing the Restricted Shares and may place a stop transfer order to such Restricted Shares with the Transfer Agent(s) for the Class A Common Stock, and (d) at his or her option (i) be entitled to make an election under section 83(b) of the Internal Revenue Code of 1986, as amended, to include in gross income in the taxable year in which the Restricted Shares are transferred to him or her, the fair market value of such shares at the of transfer, notwithstanding that such shares are subject to a substantial risk of forfeiture within the meaning of the Code, or (ii) he or she may elect to include in gross income the fair market value of the Restricted Shares as of the date or date on which such restrictions lapse. The foregoing agreement, representation and warranty shall be contained in an agreement in writing. The Committee shall adopt such rules with respect to the return of executed Restricted Stock Agreements as it deems appropriate and failure by a Participant to comply with such rules shall terminate the allocation of such Restricted Shares.

The number of shares available for grant under the 1995 Restricted Stock Plan and covered by each Restricted Share allocated and granted thereunder will be adjusted in the event of a stock dividend, reorganization, recapitalization, stock split-up, combination of shares, sale of assets, merger or consolidation in which the Company is the surviving corporation or, as may be determined by the Committee, in the event of any other change affecting the number or kind of the Company's outstanding Class A Common Stock.

A Participant may, in the discretion of the Committee and subject to rules adopted by the Committee, elect to satisfy his or her withholding obligation as a result of the release of Stock Restrictions with respect to any Restricted Shares, in whole or in part, by electing (an "Election") to deliver to the Company shares of the Class A Common Stock having a fair market value, determined as of the date that the amount to be withheld is determined, equal to the amount required to be so withheld, provided however, that no Election shall become effective with respect to any Restricted Shares after the expiration of two years from the Allocation Date. The Participant shall pay the Company in cash for any fractional share that would otherwise be required to be delivered.

Each Election shall be subject to the following restrictions: (i) the Election must be made on or prior to the Tax Date, (ii) the Election shall be irrevocable, (iii) the Election is subject to the approval of the Committee, (iv) if the Participant's transactions in shares of the Class A Common Stock are subject to the provisions of section 16(b) of the Exchange Act, an Election may not be made within six months of the date of the execution and delivery of the Restricted Stock Agreement governing such Restricted Shares, (v) if the Participant's transactions in shares of the Class A Common Stock are subject to the provisions of section 16(b) of the Exchange Act, the Election must be made (A) six months or more prior to the Tax Date or (B) during the period beginning on the third business date following the date of the release of the Company's quarterly or annual statement of sales and earnings and ending on the twelfth business day following such date.

Benefits Under the 1995 Restricted Stock Plan

The amount of Restricted Shares received by the indicated persons and groups under the 1995 Restricted Stock Plan since its inception is as follows:

Name	**Number of Shares**
Mitchell Jacobson	0
Ross Anker	0
Shelley Boxer	0

Name	Number of Shares
Charles Boehlke	0
Roger Fradin	0
Sidney Jacobson	0
Denis Kelly	0
Raymond Langton	0
Philip Peller	0
David Sandler	6,316
James Schroeder	0
Current Executive Officers as a Group	19,474
Current Directors who are not Executive Officers as a Group	0
All Employees (excluding current Executive Officers)	287,632

Federal Income Tax Consequences of the Allocation, Vesting, Sale and Forfeiture of the Restricted Stock

The following discussion of the Federal income tax consequences of the issuance, vesting, sale and forfeiture of shares of Restricted Stock under the 1995 Restricted Stock Plan (the "Plan") is based on an analysis of the Code, as currently in effect, existing laws, judicial decisions and administrative rulings and regulations, all of which are subject to change. In addition to being subject to the Federal income tax consequences described below, a Participant may also be subject to state and local tax consequences in the jurisdiction in which he or she works and/or resides.

In general, no income will be recognized by a Participant at the time Restricted Stock is allocated to him or her. Ordinary income will be recognized by a Participant at the time his or her Restricted Stock "vests" (i.e., at the time the Stock Restrictions terminate with respect to such Restricted Stock and the Participant is no longer obligated to redeliver such Restricted Stock to the Company in the event of his or her termination of employment with the Company and its subsidiaries). The amount of such ordinary income with respect to each share of Restricted Stock will equal the excess, if any, of the fair market value of a share of the Class A Common Stock on the date the Restricted Stock vests, over the price paid by the Participant for the Restricted Stock, if any. This ordinary (compensation) income will also constitute wages subject to withholding by the Company. Any subsequent realized gain or loss will be a capital gain or loss with the Participant's holding period measured from the date the Stock Restrictions terminate and with the Participant's basis in each share being equal to the price paid by the Participant per share of Restricted Stock, if any, plus the amount of ordinary income, if any, recognized with respect to such share of Restricted Stock.

Notwithstanding the foregoing, a Participant may within 30 days after Restricted Stock is allocated to him or her under the Plan elect under Section 83(b) of the Code (a "Section 83(b) Election") to include in income as of the date of such allocation the excess, if any, of the fair market value of a share of the Class A Common Stock on the date the Restricted Stock is allocated, over the price paid by the Participant for the Restricted Stock, if any. Such income will be ordinary (compensation) income which will also constitute wages subject to withholding by the Company. If a Participant subsequently vests in Restricted Stock as to which a Section 83(b) Election has been made, such vesting will not

result in a taxable event to the Participant. If a Participant makes a Section 83(b) Election, and subsequently is required under the Plan to sell Restricted Stock with respect to which a Section 83(b) Election was made to the Company for the price paid by the Participant, if any, the Participant will not be entitled to a deduction with respect thereto and will not have a capital loss as a result thereof. If a Participant vests in Restricted Stock as to which the Participant has made a Section 83(b) Election, any subsequent realized gain or loss will be a capital gain or loss with the Participant's holding period measured from the date of allocation and with the Participant's basis in each share of Restricted Stock being equal to the price paid by the Participant for such share, if any, plus the amount of ordinary income, if any, recognized with respect to such share.

The Company is entitled to a deduction for Federal income tax purposes for its taxable year which ends during the Participant's taxable year in which the Participant is required to recognize ordinary income with respect to the Restricted Stock. Such deduction will be in an amount equal to the amount included in income by the Participant.

**APPROVAL OF AMENDMENT TO MSC INDUSTRIAL DIRECT CO., INC.
1995 STOCK OPTION PLAN**

On October 29, 2003, the Board of Directors adopted an amendment to the 1995 Stock Option Plan (the "1995 Option Plan") which will become effective, subject to shareholder approval, on January 6, 2004. The amendment would effect certain technical changes and clarifications in the 1995 Option Plan to coordinate provisions regarding the termination and vesting of options upon termination of employment, and the procedure for amending the 1995 Option Plan, among the Company's 1995 Option Plan, 1998 Option Plan and the 2001 Option Plan. Accordingly, the amendment provides that, consistent with and to conform 1995 Option Plan to certain changes proposed herein to the 2001 Stock Option Plan and the 1998 Stock Option Plan: (i) in the event of a Change in Control (as defined in the amendment to the 1995 Option Plan) of the Company, each Option granted to any Participant which shall not have theretofore expired or otherwise been cancelled or become unexercisable shall become immediately exercisable in full, (ii) options granted to an optionee who ceases employment with the Company and the Subsidiaries, or ceases to serve as a consultant to the Company and the Subsidiaries or as a Non-Employee Director of the Company, voluntarily or for any other reason other than retirement, permanent disability or death, shall, to the extent not theretofore exercised and not otherwise expired or cancelled, terminate upon the earlier of 30 days after the date of termination of the optionee or date of termination of the option (iii) options granted to an optionee who ceases employment with the Company and the Subsidiaries, or ceases to serve as a consultant to the Company and the Subsidiaries or as a Non-Employee Director of the Company, due to retirement on or after attaining age 65 and who have had five years of service with the Company and the Subsidiaries shall become immediately exercisable in full and shall, to the extent not exercised, terminate upon the earlier of one year after date of retirement or date of termination of the option, (iv) options granted to an optionee who ceases employment with the Company and the Subsidiaries, or ceases to serve as a consultant to the Company and the Subsidiaries or as a Non-Employee Director of the Company, due to retirement on or after attaining age 65 but before completing 5 years of service with the Company and the Subsidiaries shall become immediately exercisable in full and shall, to the extent not exercised, terminate upon the earlier of 3 months after date of retirement or date of termination of the option, (v) options granted to an optionee who ceases employment with the Company and the Subsidiaries, or ceases to serve as a consultant or as a Non-Employee Director of the Company, due to death shall become immediately exercisable in full and shall, to the extent not exercised, terminate upon the earlier of one year after the date of qualification of a representative of his or her estate or the date of termination of the option, (vi) options granted to an optionee who ceases employment with the Company and the Subsidiaries, or ceases to serve as a consultant or as a Non-Employee Director of the Company, due to a permanent disability shall become immediately exercisable in full and shall, to the extent not exercised, terminate upon the earlier of one year after the date of the optionee's termination of employment or date of termination of the option, and (vi) the Company's Board of Directors may terminate the 1995 Option Plan at any time and make any modification it deems advisable, subject to the existing rights of Participants owning Options prior to any such amendment, and further subject to shareholder approval if required by applicable law or the listing requirements of the New York Stock Exchange. If the amendment, a copy of which is attached hereto as Annex C, is not approved by the shareholders of the Company, the 1995 Option Plan will remain as presently in effect.

To effectuate this amendment:

(i) Section 10F is hereby added to the MSC Industrial Direct Co., Inc. 1995 Option Plan to read as follows:

"Notwithstanding the provisions of Section 10A, in the event that a Change of Control of the Company shall occur, then, each Option theretofore granted to any Participant which shall not have theretofore expired or otherwise been cancelled or become unexercisable shall

become immediately exercisable in full. For purposes hereof a "Change in Control" of the Company shall occur or be deemed to have occurred only if any of the following events occurs: (i) any "person," as such term is used in Sections 13(d) and 14(d) of the Exchange Act (other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any corporation owned directly or indirectly by the shareholders of the Company in substantially the same proportion as the ownership of stock of the Company) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing more than 50% of the combined voting power of the Company's then outstanding securities; (ii) individuals who, as of the date of grant of an Option, constitute the Board (as of the date of grant, the "Incumbent Board") cease for any reason to constitute at least a majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of the Company, as such terms are used in Rule 14a-11 of Regulation 14A under the Exchange Act) shall be, for purposes of this Plan, considered as though such person were a member of the Incumbent Board; or (iii) the shareholders of the Company approve a merger or consolidation of the Company with any other corporation, other than (x) a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than 60% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation or (y) a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no "person" (as hereinabove defined) acquires more than 50% of the combined voting power of the

Company's then outstanding securities; or (iv) the shareholders of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets. In the event that a Change in Control shall occur, then, from and after the time of such event, neither the provisions of this Section 10F nor any of the rights of any Participant thereunder shall be modified or amended in any way."

(ii) Section 12.A. of the MSC Industrial Direct Co., Inc. 1995 Option Plan will be amended and restated in its entirety as follows:

"In the event a Participant leaves the employ of the Company and the Subsidiaries or ceases to serve as a consultant to the Company and the Subsidiaries and/or as a Non-Employee Director of the Company, whether voluntarily or otherwise but other than by reason of his or her retirement, permanent disability or death, each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall, to the extent not theretofore exercised, terminate upon the earlier to occur of the expiration of 30 days after the date of such Participant's termination of employment or service and the date of termination specified in such Option. Notwithstanding the foregoing, if a Participant's employment by the Company and the Subsidiaries or service as a consultant and/or as a Non-Employee Director of the Company is terminated for "cause" (as defined herein), each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall, to the extent not theretofore exercised, terminate immediately."

(iii) Section 12.B. of the MSC Industrial Direct Co., Inc. 1995 Option Plan will be amended and restated in its entirety as follows:

"In the event a Participant leaves the employ of the Company and the Subsidiaries or ceases to serve as a consultant to the Company and the Subsidiaries and/or as a Non-Employee Director of the Company by reason of his or her retirement on or after his or her 65th birthday and five years of service with the Company and/or its Subsidiaries, each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall become immediately exercisable in full and shall, to the extent not theretofore exercised, terminate upon the earlier to occur of the expiration of one year after the date of such retirement and the date of termination specified in such Option. In the event a Participant leaves the employ of the Company and the Subsidiaries or ceases to serve as a consultant to the Company and the Subsidiaries and/or as a Non-Employee Director of the Company by reason of his or her retirement on or after his or her 65th birthday without having completed five years of service with the Company and/or its Subsidiaries, each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall become immediately exercisable in full and shall, to the extent not theretofore exercised, terminate upon the earlier to occur of the expiration of three months after the date of such retirement and the date of termination specified in such Option."

(iv) Section 12.C. of the MSC Industrial Direct Co., Inc. 1995 Option Plan will be amended and restated in its entirety as follows:

"In the event a Participant's employment with the Company and the Subsidiaries and/or service as a consultant or as a Non-Employee Director of the Company terminates by reason of his or her death, each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall become immediately exercisable in full and shall, to the extent not theretofore exercised, terminate upon the earlier to occur of the expiration of one year after the date of the qualification of a representative of his or her estate and the date of termination specified in such Option. "

(v) Section 12.E. of the MSC Industrial Direct Co., Inc. 1995 Option Plan will be added as follows:

"In the event a Participant's employment with the Company and the Subsidiaries or service as a consultant and/or as a Non-Employee Director of the Company terminates by reason of his or her permanent disability (within the meaning of Section 22(e)(3) of the Code), each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall immediately become exercisable in full and shall, to the extent not theretofore exercised, terminate upon the earlier to occur of one year after the date of such termination of employment or service and the date of termination specified in such option."

(vi) Section 19 of the MSC Industrial Direct Co., Inc. 1995 Option Plan will be amended and restated in its entirety as follows:

"The Board may at any time terminate the Plan or make such modifications of the Plan as it shall deem advisable; provided, however, that to the extent required by applicable laws or the rules of the New York Stock Exchange or such other exchange on which the Company's securities shall be listed or traded, any such modification or termination shall be subject to the approval of the shareholders of the Company; and provided further, however, the provisions of the Plan governing the grant of Non-Employee Director's Formula Options may not be amended except by the vote of a majority of the members of the Board and by the vote of a majority of the members of the Board who are employees of the Company or a Subsidiary.

Except as otherwise provided in Section 13, no termination or amendment of the Plan may, without the consent of the Participant to whom any Option shall theretofore have been granted, adversely affect the rights of such Participant under such Option."

The 1995 Option Plan authorizes the grant of up to an aggregate of 4,000,000 shares of Class A Common Stock to employees of and consultants to the Company and its subsidiaries and to directors of the Company who are not employees. Under the 1995 Option Plan, the Company may grant to eligible individuals incentive stock options, as defined in Section 422(b) of the Code and/or non-incentive stock options.

Set forth below is a summary of the 1995 Option Plan, a copy of which is on file with the Securities and Exchange Commission. All capitalized terms used but not defined herein have the respective meanings ascribed to them in the 1995 Option Plan.

The affirmative vote of holders of a majority of the shares of Class A Common Stock and Class B Common Stock present in person or by proxy at the Meeting is required for approval of the amendment to the 1995 Option Plan.

The Board of Directors recommends a vote FOR the proposal to approve the amendment to the 1995 Option Plan. Each proxy received in response to this solicitation will be voted FOR the proposal to approve the amendment to the 1995 Option Plan, unless otherwise specified in the proxy.

Nature and Purpose of the 1995 Option Plan

The purpose of the 1995 Option Plan is to induce certain employees, directors and consultants to remain in the employ, or to continue to serve as directors and consultants, of the Company and its subsidiaries, to attract new individuals to enter into such employment or service and to encourage such individuals to secure stock ownership in, or increase on reasonable terms their stock ownership in, the Company. The Board of Directors believes that the granting of options under the 1995 Option Plan promotes continuity of management and increased incentive and personal interest in the welfare of the Company by those who are or may become primarily responsible for shaping and carrying out the long-range plans of the Company and securing its continued growth and financial success.

Duration and Modification

The 1995 Option Plan will terminate not later than November 16, 2005. If the proposed amendment to the 1995 Option plan is approved by the shareholders of the Company, the Board of Directors may at any time terminate the 1995 Option Plan or make such modifications to the 1995 Option Plan as it may deem advisable, except that to the extent required by applicable laws or the rules of the New York Stock Exchange or such other exchange on which the Company's securities shall be listed or traded, any such modification or termination shall be subject to the approval of the shareholders of the Company. In addition, the provisions of the 1995 Option Plan governing the grant of Non-Employee Director's Formula Options may not be amended except by the vote of a majority of the members of the Board and by the vote of a majority of the members of the Board who are employees of the Company or a Subsidiary. Further, subject to limited exceptions, no termination or amendment of the 1995 Option Plan may, without the consent of the Participant to whom any Option shall theretofore have been granted, adversely affect the rights of such Participant under such Option.

Administration

The 1995 Option Plan is administered by the Compensation Committee consisting of at least two members of the Board of Directors. It is intended that the Compensation Committee consist of members of the Board of Directors who are "non-employee directors" within the meaning of Rule 16b-3 under the Exchange Act and "outside directors" within the meaning of Section 162(m) of the Code. The members of the Compensation Committee are appointed annually by, and serve at the pleasure of the Board. The Compensation Committee includes the Company's President ex officio, even if he or she is otherwise ineligible to be a member of the Compensation Committee. The present members of the Compensation Committee are Messrs. Fradin, Kelly, Peller and Langton. The Compensation Committee has discretion to determine the participants under the 1995 Option Plan, the time and price at which options will be granted, the period during which options will be exercisable, the number of shares subject to each option and whether an option will be an incentive stock option, a non-incentive stock option or a combination thereof. The Committee will not have the discretion to determine any of the foregoing with respect to the non-discretionary options granted to Non-Employee directors and consultants, and all option granted to Non-Employee directors and consultants are non-incentive stock options. The members of the Compensation Committee do not receive additional compensation for serving on the Compensation Committee other than the Chairman of the Compensation Committee who receives an annual fee of $5,000 for serving as Chairman of the Compensation Committee.

Eligibility and Extent of Participation

The 1995 Option Plan provides for discretionary grants of options to participants (including any director or officer who is also an employee). As of November 24, 2003, approximately 2,694 persons were eligible to receive options pursuant to the 1995 Option Plan.

No single participant (including any director or officer who is also an employee) may receive options under the 1995 Option Plan in any one fiscal year of the Company to purchase more than 1,000,000 shares of Class A Common Stock.

Directors who are not also employees of the Company receive an annual grant of options to purchase 2,500 shares under the 1995 Option Plan at the first meeting of the Company's Board of Directors immediately following each annual meeting of shareholders. The exercise price of such options is the fair market value of a share of Class A Common Stock on the date of grant (the date of the Board meeting). Non-employee directors elected after such meeting receive a pro rata grant on the date of their election.

Exercise of Options

Unless otherwise provided by the Compensation Committee at the time an option is granted, and other than in the case of the annual grant of options to Non-Employee directors, an option will be exercisable one-fifth on and after the first anniversary of the date of grant, two-fifths on and after the second anniversary of the date of grant, three-fifths on and after the third anniversary of the date of grant, four-fifths on and after the fourth anniversary of the date of grant and in full on and after the fifth anniversary of the date of grant.

An option may be exercised by a written notice with respect to a specified number of shares and payment of the exercise price for the number of shares so specified. The exercise price of an option may be paid in cash or, if the Compensation Committee determines at the time an option is granted, in shares of Class A Common Stock. The initial per share exercise price for an incentive stock option may not be less than the fair market value thereof on the date of grant, or 110% of such fair market value with respect to a participant who, at such time, owns stock representing more than 10% of the total combined voting power of the common stock of the Company. The initial per share exercise price for a non-incentive stock option may not be less than 85% of the fair market value thereof on the date of grant. No non-incentive stock option may be granted to any person who is or may reasonably become a "covered employee" under Section 162(m) of the Code, at a price below fair market value on the date of grant. The initial per share exercise price for the options granted to Non-Employee directors shall not be less than the fair market value of the Class A Common Stock on the date of grant.

The market value of the Class A Common Stock as reflected in the closing price of a share of the Class A Common Stock on the New York Stock Exchange on November 24, 2003, was $26.14.

No option granted pursuant to the 1995 Option Plan may be exercised more than 10 years after the date of grant, except that incentive stock options granted to participants who own more than 10% of the total combined voting power of the common stock of the Company at the time the incentive stock option is granted may not be exercised more than five years after the date of grant. No participant may be granted incentive stock options which are exercisable for the first time in any one calendar year with respect to Class A Common Stock having an aggregate fair market value in excess of $100,000 on the date of grant. No option granted under the 1995 Option Plan is transferable by the optionee other than by death.

If the proposed amendment to the 1995 Option Plan is approved by the shareholders of the Company, notwithstanding the provisions of Section 10A, in the event that a Change of Control of the Company shall occur, then, each Option theretofore granted to any Participant which shall not have theretofore expired or otherwise been cancelled or become unexercisable shall become immediately exercisable in full. For purposes hereof a "Change in Control" of the Company shall occur or be deemed to have occurred only if any of the following events occurs:

(i) any "person," as such term is used in Sections 13(d) and 14(d) of the Exchange Act (other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any corporation owned directly or indirectly by the shareholders of the Company in substantially the same proportion as the ownership of stock of the Company) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing more than 50% of the combined voting power of the Company's then outstanding securities; (ii) individuals who, as of the date of grant of an Option, constitute the Board (as of the date of grant, the "Incumbent Board") cease for any reason to constitute at least a majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of the Company, as such terms are used in Rule 14a-11 of Regulation 14A under the Exchange Act) shall be, for purposes of this Plan, considered as though such person were a member of the Incumbent Board; or (iii) the shareholders of the Company approve a merger or consolidation of the Company with any other corporation, other than (x) a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than 60% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation or (y) a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no "person" (as hereinabove defined) acquires more than 50% of the combined voting power of the Company's then outstanding securities; or (iv) the shareholders of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets. In the event that a Change in Control shall occur, then, from and after the time of such event, neither the provisions of Section 10F nor any of the rights of any Participant thereunder shall be modified or amended in any way.

If the proposed amendment to the 1995 Option Plan is approved by the shareholders of the Company, in the event of the death of an optionee, each option granted to him or her, to the extent not otherwise expired, canceled or exercised, will become immediately exercisable in full, and will terminate upon the earlier to occur of the expiration of one year from the date of the qualification of a representative of his or her estate and the date of termination specified in such option.

If the proposed amendment to the 1995 Option Plan is approved by the shareholders of the Company, in the event that an optionee leaves the employ of the Company and its subsidiaries or ceases to serve as a consultant to the Company and its subsidiaries or as a non-employee director of the Company by reason of retirement on or after his or her 65th birthday and five years of service with the Company and/or its subsidiaries, each option granted to him or her, to the extent not otherwise expired, canceled or exercised, will become immediately exercisable in full, and will terminate upon the earlier to occur of the expiration of one year from the date of such retirement or the date of termination specified in such option. In the event that an optionee leaves the employ of the Company and its subsidiaries or ceases to serve as a consultant to the Company and its subsidiaries or as a non-employee director of the Company by reason of retirement on or after his or her 65th birthday and without completing five years of service with the Company and/or its subsidiaries, each option granted to him or her, to the extent not otherwise expired, canceled or exercised, will become immediately exercisable in full, and will terminate upon the earlier to occur of the expiration of three months from the date of such retirement or the date of termination specified in such option.

If the proposed amendment to the 1995 Option Plan is approved by the shareholders of the Company, in the event that an optionee leaves the employ of the Company and its subsidiaries or ceases to serve as a consultant to the Company and its subsidiaries or as a non-employee director of the Company whether voluntarily or otherwise for any reason other than retirement, permanent disability or death, each option granted to him or her generally will, to the extent not theretofore exercised, expired or cancelled, terminate on the earlier to occur of the expiration of 30 days after the date of such optionee's termination and the date of termination specified in such option.

If the proposed amendment to the 1995 Option Plan is approved by the shareholders of the Company, in the event that an optionee leaves the employ of the Company and its subsidiaries or ceases to serve as a consultant to the Company and its subsidiaries or as a non-employee director of the Company by reason of permanent disability (within the meaning of Section 22(e)(3) of the Code), each option granted to him or her will become immediately exercisable in full and to the extent not theretofore exercised, expired or canceled, will terminate upon the earliest to occur of one year after the date of such termination of employment or service and the date of termination specified in such option.

In the event that an optionee leaves the employ of the Company and its subsidiaries or ceases to serve as a consultant or as a director of the Company by reason of his or her termination for "cause," each option granted to him or her, to the extent not otherwise expired, canceled or exercised, will terminate immediately.

The number of shares subject to an option granted under the 1995 Option Plan and the number of shares available for grant but not yet covered by an option will be adjusted in the event of a stock dividend. The number of shares available for grant under the 1995 Option Plan and covered by each option granted thereunder will be adjusted in the event of a reorganization, recapitalization, stock split-up, combination of shares, sale of assets, merger or consolidation in which the Company is the surviving corporation or, as may be determined by the Committee, in the event of any other change affecting the number or kind of the Company's outstanding Class A Common Stock. In the event of the dissolution or liquidation of the Company, or a merger, reorganization or consolidation in which the Company is not the surviving corporation, each outstanding but unexercised option will terminate.

Benefits Under the 1995 Option Plan

The amount of Options received by the indicated persons and groups under the 1995 Option Plan since its inception is as follows:

Name	Number of Options
Mitchell Jacobson	0
Ross Anker	56,000
Shelley Boxer	106,588
Charles Boehlke	0
Roger Fradin	0
Sidney Jacobson	0
Denis Kelly	31,314
Raymond Langton	2,500
Philip Peller	0
David Sandler	112,824
James Schroeder	317,648
Current Executive Officers as a Group	650,590
Current Directors who are not Executive Officers as a Group	33,814
All Employees (excluding current Executive Officers)	2,988,420

Federal Income Tax Consequences of Issuance and Exercise of Options

The following discussion of the Federal income tax consequences of the granting and exercise of options under the 1995 Option Plan, and the sale of Class A Common Stock acquired as a result thereof, is based on an analysis of the Code (as currently in effect), existing laws, judicial decisions and administrative rulings and regulations, all of which are subject to change. In addition to being subject to the Federal income tax consequences described below, an optionee may also be subject to state and/or local income tax consequences in the jurisdiction in which he or she works and/or resides.

Non-Incentive Stock Options.

No income will be recognized by an optionee at the time a non-incentive stock option is granted.

Ordinary income will be recognized by an optionee at the time a non-incentive stock option is exercised, and the amount of such income will be equal to the excess of the fair market value on the exercise date of the shares issued to the optionee over the exercise price. This ordinary (compensation) income will also constitute wages subject to the withholding of income tax and the Company will be required to make whatever arrangements are necessary to ensure that the amount of the tax required to be withheld is available for payment in money.

Capital gain or loss on a subsequent sale or other disposition of the shares of Class A Common Stock acquired upon exercise of a non-incentive stock option will be measured by the difference between the amount realized on the disposition and the tax basis of such shares. The tax basis of the shares acquired upon the exercise of the option will be equal to the sum of the exercise price of an option and the amount included in income with respect to the option.

If an optionee makes payment of the exercise price by delivering shares of Class A Common Stock, he or she generally will not recognize any gain with respect to such shares as a result of such delivery, but the amount of gain, if any, which is not so recognized will be excluded from his or her basis in the new shares received.

The Company will be entitled to a deduction for Federal income tax purposes at such time and in the same amount as the amount included in ordinary income by the optionee upon exercise of his or her non-incentive stock option, subject to the usual rules as to reasonableness of compensation and provided that the Company timely complies with the applicable information reporting requirements.

Incentive Stock Options.

In general, neither the grant nor the timely exercise of an incentive stock option will result in taxable income to an optionee or a deduction to the Company. However, for purposes of the alternative minimum tax, the spread on the exercise of an incentive stock option will be considered as part of the optionee's income.

The sale of the shares of Class A Common Stock received pursuant to the exercise of an incentive stock option which satisfies the holding period rules will result in capital gain to an optionee and will not result in a tax deduction to the Company. To receive incentive stock option treatment as to the shares acquired upon exercise of an incentive-stock option, an optionee must neither dispose of such shares within two years after the option is granted nor within one year after the exercise of the option, provided that in the case of an option that is exercised during the participant's lifetime, the option is exercised no later than 3 months (one year, in the case of a disabled participant) after the date the participant's employment with the Company terminates. In addition, an optionee generally must be an employee of the Company (or a subsidiary of the Company) at all times between the date of grant and the date three months before exercise of the option.

If the holding period rules are not satisfied, the portion of any gain recognized on the disposition of the shares acquired upon the exercise of an incentive stock option that is equal to the lesser of (a) the fair market value of the Class A Common Stock on the date of exercise minus the exercise price or (b) the amount realized on the disposition minus the exercise price, will be treated as ordinary (compensation) income, with any remaining gain being treated as capital gain. The Company will be entitled to a deduction equal to the amount of such ordinary income.

If an optionee makes payment of the exercise price by delivering shares of Class A Common Stock, he or she generally will not recognize any gain with respect to such shares as a result of such delivery, but the amount of gain, if any, which is not so recognized will be excluded from his or her basis in the new shares received. However, the use by an optionee of shares previously acquired pursuant to the exercise of an incentive stock option to exercise an incentive stock option will be treated as a taxable disposition if the transferred shares were not held by the participant for the requisite holding period.

The foregoing is only a summary of the effect of Federal income taxation upon an optionee and the Company with respect to options to purchase shares of Class A Common Stock granted under the Plan. Reference should be made to the applicable provisions of the Code.

**APPROVAL OF AMENDMENT TO MSC INDUSTRIAL DIRECT CO., INC.
1998 STOCK OPTION PLAN**

On October 29, 2003, the Board of Directors adopted an amendment to the 1998 Stock Option Plan (the "1998 Option Plan") which will become effective, subject to shareholder approval, on January 6, 2004. The amendment would effect certain technical changes and clarifications in the 1998 Option Plan to coordinate provisions regarding the termination and vesting of options upon termination of employment, and the procedure for amending the 1998 Option Plan, among the Company's 1995 Option Plan, 1998 Option Plan and the 2001 Option Plan. Additionally, the amendment provides that, consistent with and to conform the 1998 Option Plan to certain changes proposed herein to the 2001 Stock Option Plan and 1995 Stock Option Plan: (i) in the event of a Change in Control (as defined in the amendment to the 1998 Option Plan) of the Company, each Option granted to any Participant which shall not have theretofore expired or otherwise been cancelled or become unexercisable shall become immediately exercisable in full, (ii) options granted to an optionee who ceases employment with the Company and the Subsidiaries, or ceases to serve as a consultant to the Company and the Subsidiaries or as a Non-Employee Director of the Company, voluntarily or for any other reason other than retirement, permanent disability or death, shall, to the extent exercisable on the date of termination and not exercised and not otherwise expired or cancelled, terminate upon the earlier of 30 days after the date of termination of the optionee or date of termination of the option (iii) options granted to an optionee who ceases employment with the Company and the Subsidiaries, or ceases to serve as a consultant to the Company and the Subsidiaries or as a Non-Employee Director of the Company, due to retirement on or after attaining age 65 and who have had five years of service with the Company and the Subsidiaries shall become immediately exercisable in full and shall, to the extent not exercised, terminate upon the earlier of one year after date of retirement or date of termination of the option, (iv) options granted to an optionee who ceases employment with the Company and the Subsidiaries, or ceases to serve as a consultant to the Company and the Subsidiaries or as a Non-Employee Director of the Company, due to retirement on or after attaining age 65 but before completing 5 years of service with the Company and the Subsidiaries shall become immediately exercisable in full and shall, to the extent not exercised, terminate upon the earlier of 3 months after date of retirement or date of termination of the option, (v) options granted to an optionee who ceases employment with the Company and the Subsidiaries, or ceases to serve as a consultant or as a Non-Employee Director of the Company, due to death shall become immediately exercisable in full and shall, to the extent not exercised, terminate upon the earlier of one year after the date of qualification of a representative of his or her estate or the date of termination of the option, (vi) options granted to an optionee who ceases employment with the Company and the Subsidiaries, or ceases to serve as a consultant or as a Non-Employee Director of the Company, due to a permanent disability shall become immediately exercisable in full and shall, to the extent not exercised, terminate upon the earlier of one year after the date of the optionee's termination of employment or date of termination of the option, and (vii) the Company's Board of Directors may terminate the 1998 Option Plan at any time and make any modification it deems advisable, subject to the existing rights of Participants owning Options prior to any such amendment, and further subject to shareholder approval if required by applicable law or the listing requirements of the New York Stock Exchange. If the amendment, a copy of which is attached hereto as Annex D, is not approved by the shareholders of the Company, the 1998 Option Plan will remain as presently in effect.

To effectuate this amendment:

(i) Section 10F is hereby added to the MSC Industrial Direct Co., Inc. 1998 Option Plan to read as follows:

"F. Notwithstanding the provisions of Section 10A, in the event that a Change of Control of the Company shall occur, then, each Option theretofore granted to any Participant which shall not have theretofore expired or otherwise been cancelled or become unexercisable shall

become immediately exercisable in full. For purposes hereof a "Change in Control" of the Company shall occur or be deemed to have occurred only if any of the following events occurs: (i) any "person," as such term is used in Sections 13(d) and 14(d) of the Exchange Act (other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any corporation owned directly or indirectly by the shareholders of the Company in substantially the same proportion as the ownership of stock of the Company) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing more than 50% of the combined voting power of the Company's then outstanding securities; (ii) individuals who, as of the date of grant of an Option, constitute the Board (as of the date of grant, the "Incumbent Board") cease for any reason to constitute at least a majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of the Company, as such terms are used in Rule 14a-11 of Regulation 14A under the Exchange Act) shall be, for purposes of this Plan, considered as though such person were a member of the Incumbent Board; or (iii) the shareholders of the Company approve a merger or consolidation of the Company with any other corporation, other than (x) a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than 60% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation or (y) a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no "person" (as hereinabove defined) acquires more than 50% of the combined voting power of the Company's then outstanding securities; or (iv) the shareholders of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets. In the event that a Change in Control shall occur, then, from and after the time of such event, neither the provisions of this Section 10F nor any of the rights of any Participant thereunder shall be modified or amended in any way."

(ii) Section 12.A. of the MSC Industrial Direct Co., Inc. 1998 Option Plan will be amended and restated in its entirety as follows:

"In the event a Participant leaves the employ of the Company and the Subsidiaries or ceases to serve as a consultant to the Company and the Subsidiaries and/or as a Non-Employee Director of the Company, whether voluntarily or otherwise but other than by reason of his or her retirement, permanent disability or death, each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall, to the extent exercisable on the date of such termination of employment or service and not theretofore exercised, terminate upon the earlier to occur of the expiration of 30 days after the date of such Participant's termination of employment or service and the date of termination specified in such Option. Notwithstanding the foregoing, if a Participant's employment by the Company and the Subsidiaries or service as a consultant and/or as a Non-Employee Director of the Company is terminated for "cause" (as defined herein), each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall, to the extent not theretofore exercised, terminate immediately."

(iii) Section 12.B. of the MSC Industrial Direct Co., Inc. 1998 Option Plan will be amended and restated in its entirety as follows:

"In the event a Participant leaves the employ of the Company and the Subsidiaries or ceases to serve as a consultant to the Company and the Subsidiaries and/or as a Non-Employee Director of the Company by reason of his or her retirement on or after his or her 65th birthday and five years of service with the Company and/or its Subsidiaries, each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall become immediately exercisable in full and shall, to the extent not theretofore exercised, terminate upon the earlier to occur of the expiration of one year after the date of such retirement and the date of termination specified in such Option. In the event a Participant leaves the employ of the Company and the Subsidiaries or ceases to serve as a consultant to the Company and the Subsidiaries and/or as a Non-Employee Director of the Company by reason of his or her retirement on or after his or her 65th birthday without having completed five years of service with the Company and/or its Subsidiaries, each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall become immediately exercisable in full and shall, to the extent not theretofore exercised, terminate upon the earlier to occur of the expiration of three months after the date of such retirement and the date of termination specified in such Option."

(iv) Section 12.C. of the MSC Industrial Direct Co., Inc. 1998 Option Plan will be amended and restated in its entirety as follows:

"In the event a Participant's employment with the Company and the Subsidiaries and/or service as a consultant or as a Non-Employee Director of the Company terminates by reason of his or her death, each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall become immediately exercisable in full and shall, to the extent not theretofore exercised, terminate upon the earlier to occur of the expiration of one year after the date of the qualification of a representative of his or her estate and the date of termination specified in such Option."

(v) Section 12.E. of the MSC Industrial Direct Co., Inc. 1998 Option Plan will be added as follows:

"In the event a Participant's employment with the Company and the Subsidiaries or service as a consultant and/or as a Non-Employee Director of the Company terminates by reason of his or her permanent disability (within the meaning of Section 22(e)(3) of the Code), each Option theretofore granted to him or her which shall not have theretofore expired or otherwise been cancelled shall immediately become exercisable in full and shall, to the extent not theretofore exercised, terminate upon the earlier to occur of one year after the date of such termination of employment or service and the date of termination specified in such option."

(vi) Section 20 of the MSC Industrial Direct Co., Inc. 1998 Option Plan will be amended and restated in its entirety as follows:

"The Board may at any time terminate the Plan or make such modifications of the Plan as it shall deem advisable; provided, however, that to the extent required by applicable laws or the rules of the New York Stock Exchange or such other exchange on which the Company's securities shall be listed or traded, any such modification or termination shall be subject to the approval of the shareholders of the Company; and provided further, however, the provisions of the Plan governing the grant of Non-Employee Director's Formula Options may not be amended except by the vote of a majority of the members of the Board and by the vote of a majority of the members of the Board who are employees of the Company or a Subsidiary.

Except as otherwise provided in Section 13, no termination or amendment of the Plan may, without the consent of the Participant to whom any Option shall theretofore have been granted, adversely affect the rights of such Participant under such Option."

Set forth below is a summary of the 1998 Option Plan, a copy of which is on file with the Securities and Exchange Commission. All capitalized terms used but not defined herein have the respective meanings ascribed to them in the 1998 Option Plan.

The 1998 Option Plan authorizes the grant of up to an aggregate of 6,000,000 shares of Class A Common Stock to employees of and consultants to the Company and its subsidiaries and to directors of the Company who are not employees. Under the 1998 Option Plan, the Company may grant to eligible individuals incentive stock options, as defined in Section 422(b) of the Code and/or non-incentive stock options.

The affirmative vote of holders of a majority of the shares of Class A Common Stock and Class B Common Stock present in person or by proxy at the Meeting is required for approval of the amendment to the 1998 Option Plan.

The Board of Directors recommends a vote FOR the proposal to approve the amendment to the 1998 Option Plan. Each proxy received in response to this solicitation will be voted FOR the proposal to approve the amendment to the 1998 Option Plan, unless otherwise specified in the proxy.

Nature and Purpose of the 1998 Option Plan

The purpose of the 1998 Option Plan is to induce certain employees, directors and consultants to remain in the employ, or to continue to serve as directors and consultants, of the Company and its subsidiaries, to attract new individuals to enter into such employment or service and to encourage such individuals to secure stock ownership in, or increase on reasonable terms their stock ownership in, the Company. The Board of Directors believes that the granting of options under the 1998 Option Plan promotes continuity of management and increased incentive and personal interest in the welfare of the Company by those who are or may become primarily responsible for shaping and carrying out the long-range plans of the Company and securing its continued growth and financial success.

Duration and Modification

The 1998 Option Plan will terminate not later than January 8, 2008. If the proposed amendment to the 1998 Option plan is approved by the shareholders of the Company, the Board of Directors may at any time terminate the 1998 Option Plan or make such modifications to the 1998 Option Plan as it may deem advisable except that to the extent required by applicable laws or the rules of the New York Stock Exchange or such other exchange on which the Company's securities shall be listed or traded, any such modification or termination shall be subject to the approval of the shareholders of the Company. In addition, the provisions of the 1998 Option Plan governing the grant of Non-Employee Director's Formula Options may not be amended except by the vote of a majority of the members of the Board and by the vote of a majority of the members of the Board who are employees of the Company or a Subsidiary. Further, subject to initial exceptions, no termination or amendment of the 1998 Option Plan may, without the consent of the Participant to whom any Option shall theretofore have been granted, adversely affect the rights of such Participant under such Option.

Administration

The 1998 Option Plan is administered by the Compensation Committee, consisting of at least three directors. It is intended that the Compensation Committee consist of members of the Board of Directors who are "non-employee directors" within the meaning of Rule 16b-3 under the Exchange Act and "outside directors" within the meaning of Section 162(m) of the Code. If the Compensation

Committee does not have at least three members who qualify as non-employee directors under Rule 16b-3, the Committee members will make recommendations to the Board of Directors with respect to option grants (instead of the Committee making the determination) and such recommendations will be subject to approval by the full Board of Directors. The members of the Compensation Committee are appointed annually by, and serve at the pleasure of the Board. The present members of the Compensation Committee are Messrs. Fradin, Kelly, Peller and Langton. The Compensation Committee has discretion to determine the participants under the 1998 Option Plan, the time and price at which options will be granted, the period during which options will be exercisable, the number of shares subject to each option and whether an option will be an incentive stock option, a non-incentive stock option or a combination thereof. The Committee will not have the discretion to determine any of the foregoing with respect to the non-discretionary options granted to Non-Employee directors and consultants, and all option granted to Non-Employee directors and consultants are non-incentive stock options. The members of the Compensation Committee do not receive additional compensation for serving on the Compensation Committee other than the Chairman of the Compensation Committee who receives an annual fee of $5,000 for serving as Chairman of the Compensation Committee.

Eligibility and Extent of Participation

The 1998 Option Plan provides for discretionary grants of options to participants (including any director or officer who is also an employee). As of November 24, 2003, approximately 2,694 persons were eligible to receive options pursuant to the 1998 Option Plan.

No single participant (including any director or officer who is also an employee) may receive options under the 1998 Option Plan in any one fiscal year of the Company to purchase more than 400,000 shares of Class A Common Stock.

Directors who are not also employees of the Company receive an annual grant of options to purchase 5,000 shares under the 1998 Option Plan at the first meeting of the Company's Board of Directors immediately following each annual meeting of shareholders. The exercise price of such options is the fair market value of a share of Class A Common Stock on the date of grant (the date of the Board meeting). Non-employee directors elected after such meeting receive a pro rata grant on the date of their election.

Exercise of Options

Unless otherwise provided by the Compensation Committee at the time an option is granted, and other than in the case of the annual grant of options to Non-Employee directors, an option will be exercisable one-fifth on and after the first anniversary of the date of grant, two-fifths on and after the second anniversary of the date of grant, three-fifths on and after the third anniversary of the date of grant, four-fifths on and after the fourth anniversary of the date of grant and in full on and after the fifth anniversary of the date of grant. An option granted on or after January 8, 1999 (other than an option granted to a non-employee director) will, to the extent not already exercisable, become exercisable in full on an optionee's 62nd birthday. An annual grant of options to a non-employee director will be exercisable one-half on and after the first anniversary of the date of grant and in full on and after the second anniversary of the date of grant.

An option may be exercised by a written notice with respect to a specified number of shares and payment of the exercise price for the number of shares so specified. The exercise price of an option may be paid in cash or, if the Compensation Committee determines at the time an option is granted, in shares of Class A Common Stock. The initial per share exercise price for an incentive stock option may not be less than the fair market value thereof on the date of grant, or 110% of such fair market value with respect to a participant who, at such time, owns stock representing more than 10% of the total

combined voting power of the two classes of common stock of the Company. The initial per share exercise price for a non-es;"> 22,187

Due after ten years

62,055 61,460

Total

$109,644 $109,460

The following table presents the fair value and unrealized losses on securities that were temporarily impaired as of June 30, 2008:

	Impairment Period					
	Less than 12 months		12 months or longer		Total	
Descriptions of securities	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
	(Dollars in thousands)					
Government-sponsored entity securities	$11,905	$ 89	$	$	$11,905	$ 89
Municipal securities	383	2			383	2
Mortgage-backed securities	35,232	578	5,573	118	40,805	696
Total temporarily impaired securities	$47,520	$ 669	$ 5,573	$ 118	$53,093	$ 787

All individual securities that have been in a continuous unrealized loss position for 12 months or longer at June 30, 2008 are mortgaged-backed securities that have been issued by U.S. government-sponsored entities and have a AAA credit rating as determined by various rating agencies. These

NOTE 4 INVESTMENT SECURITIES (Continued)

securities have fluctuated in value since their purchase dates because of changes in market interest rates. We concluded that the continuous unrealized loss position for the past 12 months on our securities is a result of the level of market interest rates and not a result of the underlying issuers' ability to repay and are, therefore, temporarily impaired. In addition, we have the intent and ability to hold these securities until their fair value recovers to their cost. Accordingly, we have not recognized the temporary impairment in our consolidated statement of earnings.

As of June 30, 2008 securities available-for-sale with a fair value of $107.5 million were pledged as security for borrowings, public deposits and other purposes as required by various statutes and agreements.

NOTE 5 NET EARNINGS (LOSS) PER SHARE

The following is a summary of the calculation of basic and diluted net earnings (loss) per share for the periods indicated:

	Quarter Ended			Six Months Ended June 30,	
	6/30/08	3/31/08	6/30/07	2008	2007
	(In thousands, except per share data)				
Net earnings (loss)	$(474,514)	$(272,723)	$ 22,525	$(747,237)	$ 51,071
Weighted average shares outstanding used for basic net earnings per share	27,166.8	27,145.2	28,885.9	27,156.0	28,876.6
Effect of dilutive restricted stock and stock options			129.9		130.8
Diluted weighted average shares outstanding	27,166.8	27,145.2	29,015.8	27,156.0	29,007.4
Earnings per share:					
Basic earnings per share	$ (17.47)	$ (10.05)	$ 0.78	$ (27.52)	$ 1.77
Diluted earnings per share	$ (17.47)	$ (10.05)	$ 0.78	$ (27.52)	$ 1.76

In calculating the common stock equivalents for purposes of diluted earnings per share, we selected the transition method provided by FASB Staff Position FAS123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards.* Diluted earnings per share do not include all potentially dilutive shares that may result from outstanding stock options and restricted stock awards that may eventually vest. The number of common shares underlying stock options and shares of restricted stock which were outstanding but not included in the calculation of diluted net earnings per share were 1,011,600 and 761,627 for the quarters ended June 30, 2008 and 2007 and 1,011,600 and 760,735 for the six months ended June 30, 2008 and 2007.

NOTE 6 STOCK COMPENSATION

Time-based and Performance-based Restricted Stock.

At June 30, 2008, there were outstanding 490,288 shares of unvested time-based restricted common stock and 520,000 shares of unvested performance-based restricted common stock awarded in 2006 and 2007. The awarded shares of time-based restricted common stock vest over a service period of three to five years from date of the grant. The awarded shares of performance-based restricted common stock vest in full on the date the Compensation, Nominating and Governance ("CNG") Committee of the Board of Directors, as Administrator of the Company's 2003 Stock Incentive Plan (the "2003 Plan"), determines that the Company achieved certain financial goals established by the CNG Committee as set forth in the grant documents. Both time-based and performance-based restricted common stock vest

NOTE 6 STOCK COMPENSATION (Continued)

immediately upon a change in control of the Company as defined in the 2003 Plan and upon death of the employee.

Compensation expense related to awards of restricted stock is based on the fair value of the underlying stock on the award date and is recognized over the vesting period using the straight-line method. The vesting of performance-based restricted stock awards and recognition of related compensation expense may occur over a shorter vesting period if financial performance targets are achieved earlier than anticipated. During the fourth quarter of 2007 we determined that attainment of the financial targets related to the performance-based restricted stock prior to their expiration was less than probable and suspended amortization of the expense related to these awards. If and when the attainment of such financial targets is deemed probable in future periods, a catch-up adjustment will be recorded and amortization of such performance-based restricted stock will continue. The unvested performance-based restricted stock awarded in 2006 expires in 2013. The unvested performance-based restricted stock awarded in 2007 expires in 2017. Restricted stock amortization totaled $1.5 million and $2.4 million for the quarters ended June 30, 2008 and 2007 and $2.4 million and $4.6 million for the six months ended June 30, 2008 and 2007. Such amounts are included in compensation expense in the accompanying consolidated statements of earnings.

The Company's 2003 Plan permits stock based compensation awards to officers, directors, key employees and consultants. The 2003 Plan authorizes grants of stock-based compensation instruments to purchase or issue up to 3,500,000 shares of authorized but unissued Company common stock, subject to adjustments provided by the 2003 Plan. As of August 4, 2008, there were 457,985 shares available for grant under the 2003 Plan.

NOTE 7 BORROWINGS, SUBORDINATED DEBENTURES AND BROKERED DEPOSITS

Borrowings.

The following table summarizes information on our FHLB advances outstanding, by maturity dates, as of June 30, 2008:

Year of Maturity	Amount	Rate	Next Date Callable by FHLB
	(Dollars in thousands)		
Overnight	$ 106,300	3.12%	N/A
2008	45,000	4.78%	N/A
2009	100,000	3.63%	12/7/2008
2010	75,000	3.04%	1/11/2009
2013	50,000	2.71%	1/11/2009[1]
2017	200,000	3.16%	12/11/2008[1]
2018	25,000	2.61%	1/11/2009[1]
Total	$ 601,300	3.28%	

(1) Quarterly thereafter.

With the exception of overnight borrowings and the $45 million advance due in December 2008, the Bank has entered into a series of fixed rate term advances with the FHLB that have a call option. These advances may be called by the FHLB on the next call date noted above. While the FHLB may call the advances to be repaid for any reason, they are likely to be called if market interest rates are higher than the advances' stated rates on the call dates. If the advances are called by the FHLB, there is no prepayment penalty. We may repay the advances at any time with a prepayment penalty; such

NOTE 7 BORROWINGS, SUBORDINATED DEBENTURES AND BROKERED DEPOSITS (Continued)

prepayment penalty would be determined at that time. Our aggregate remaining secured borrowing capacity from the FHLB was $353.3 million at June 30, 2008. Additionally, the Bank maintains unsecured lines of credit of $165.0 million with correspondent banks for the purchase of overnight funds; these lines are subject to availability of funds.

The Company has a revolving credit line with U.S. Bank, N.A. for $35.0 million. The line matures on August 30, 2008 and is secured by a pledge of all of the outstanding capital stock of Pacific Western. The credit agreement requires the Company to maintain certain financial and capital ratios, among other covenants and conditions. Such covenants include minimum regulatory capital ratios, maximum debt ratios, a minimum return on average assets, minimum and maximum credit quality ratios, and dividend payment limitations. As of June 30, 2008, we, and where applicable, Pacific Western, were in compliance with all covenants covering the agreement. We pay a fee of 25 basis points on the unused amounts. There were no amounts outstanding under the revolving credit agreement as of June 30, 2008 or at the date hereof. We reduced the line amount during the first quarter of 2008 to avoid incurring additional fees on the unused portion of the credit line.

Subordinated Debentures.

The Company had an aggregate of $130.1 million subordinated debentures outstanding at June 30, 2008. During the first quarter we redeemed $8.2 million of subordinated debentures. The remaining subordinated debentures were issued in seven separate series. Each issuance has a maturity of thirty years from its date of issue. The subordinated debentures were issued to trusts established by us or entities we have acquired, which in turn issued trust preferred securities, which total $123.0 million at June 30, 2008. These trust preferred securities are presently considered Tier 1 capital for regulatory purposes. With the exception of Trust I and Trust CI, the subordinated debentures are callable at par, only by the issuer, five years from the date of issuance, subject to certain exceptions. We are permitted to call the debentures in the first five years if the prepayment election relates to one of the following three events: (i) a change in the tax treatment of the debentures stemming from a change in the IRS laws; (ii) a change in the regulatory treatment of the underlying trust preferred securities as Tier 1 capital; and (iii) a requirement to register the underlying trust as a registered investment company. However, redemption in the first five years is subject to a prepayment penalty. Trust I and Trust CI may not be called for 10 years from the date of issuance unless one of the three events described above has occurred and then a prepayment penalty applies. In addition, there is a prepayment penalty if either of these debentures is called 10 to 20 years from the date of their issuance and they may be called at par after 20 years. The proceeds of the subordinated debentures were used primarily to fund several of our acquisitions and to augment regulatory capital.

NOTE 7 BORROWINGS, SUBORDINATED DEBENTURES AND BROKERED DEPOSITS (Continued)

The following table summarizes the terms of each issuance of the subordinated debentures outstanding at June 30, 2008:

Series	Date issued	Amount	Maturity	Earliest Call Date by Company without Penalty[(1)]	Fixed or Variable Rate	Rate Index	Current Rate[(2)]	Next Reset Date
				(Dollars in thousands)				
Trust CI[(3)]	3/23/2000	$ 10,310	3/8/2030	3/8/2020	Fixed	N/A	11.00%	N/A
Trust I	9/7/2000	8,248	9/7/2030	9/7/2020	Fixed	N/A	10.60%	N/A
Trust V	8/15/2003	10,310	9/17/2033	9/17/2008	Variable	3 month LIBOR + 3.10	5.91%	9/17/2008
Trust VI	9/3/2003	10,310	9/15/2033	9/15/2008	Variable	3 month LIBOR + 3.05	5.83%	9/15/2008
Trust CII[(3)]	9/17/2003	5,155	9/17/2033	9/17/2009	Variable	3 month LIBOR + 2.95	5.76%	9/17/2008
Trust VII	2/5/2004	61,856	4/23/2034	4/23/2009	Variable	3 month LIBOR + 2.75	5.55%	10/29/2008
Trust CIII[(3)]	8/15/2005	20,619	9/15/2035	9/15/2010	Fixed[(4)]	N/A	5.85%	9/15/2010
Unamortized premium[(5)]		3,299						
Total		$ 130,107						

(1) As described above, certain issuances may be called earlier without penalty upon the occurrence of certain events.

(2) As of July 28, 2008; excludes debt issuance costs.

(3) Acquired in the Community Bancorp acquisition.

(4) Interest rate is fixed until 9/15/2010 and then is variable at a rate of 3-month LIBOR + 1.69%.

(5) This amount represents the fair value adjustment to the four trusts that we acquired during 2006.

As previously mentioned, the subordinated debentures were issued to trusts established by us, or entities we acquired, which in turn issued $123.0 million of trust preferred securities. These securities are currently included in our Tier I capital for purposes of determining the Company's Tier I and total risk-based capital ratios. The Board of Governors of the Federal Reserve System, which is the holding company's banking regulator, has promulgated a modification of the capital regulations affecting trust preferred securities. Under this modification, beginning March 31, 2009, the Company will be required to use a more restrictive formula to determine the amount of trust preferred securities that can be included in regulatory Tier I capital. At that time, the Company will be allowed to include in Tier I capital an amount of trust preferred securities equal to no more than 25% of the sum of all core capital elements, which is generally defined as shareholders' equity less certain intangibles, including goodwill, core deposit intangibles and customer relationship intangibles, net of any related deferred income tax liability. The regulations currently in effect through December 31, 2008, limit the amount of trust preferred securities that can be included in Tier I capital to 25% of the sum of core capital elements without a deduction for permitted intangibles. We have determined that our Tier I capital ratios would remain above the well-capitalized level had the modification of the capital regulations been in effect at June 30, 2008. We expect that our Tier I capital ratios will be at or above the existing well-capitalized levels on March 31, 2009, the first date on which the modified capital regulations must be applied.

Brokered Deposits.

Brokered deposits totaled $88.3 million at June 30, 2008 and are included in the interest-bearing deposits balances on the accompanying consolidated balance sheet. Such amount includes $17.7 million

NOTE 7 BORROWINGS, SUBORDINATED DEBENTURES AND BROKERED DEPOSITS (Continued)

of customer deposits that were subsequently participated with other FDIC insured financial institutions as a means to provide FDIC deposit insurance coverage for the full amount of our customers' deposits.

NOTE 8 COMMITMENTS AND CONTINGENCES

Lending Commitments.

Pacific Western is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of their customers. Such financial instruments include commitments to extend credit, standby letters of credit and financial guarantees. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of such instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

Commitments to extend credit amounting to $1.1 billion were outstanding as of June 30, 2008 and December 31, 2007. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit and financial guarantees amounting to $84.7 million and $90.9 million were outstanding as of June 30, 2008 and December 31, 2007. Standby letters of credit and financial guarantees are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. Most guarantees expire within one year from the date of issuance. The Company generally requires collateral or other security to support financial instruments with credit risk. Management does not anticipate that any material loss will result from the outstanding commitments to extend credit, standby letters of credit or financial guarantees.

The Company has investments in several small business investment companies and in low income housing project partnerships which provide the Company income tax credits. As of June 30, 2008 the Company had commitments to contribute capital to these entities totaling $433,000.

Legal Matters

On June 8, 2004, the Company was served with an amended complaint naming First Community, the predecessor to PacWest Bancorp, and Pacific Western as defendants in a class action lawsuit filed in Los Angeles Superior Court pending as Gilbert et. al v. Cohn et al, Case No. BC310846 (the "Gilbert Litigation"). A former officer of First Charter Bank, N.A. ("First Charter"), which the Company acquired in October 2001, was also named as a defendant. That former officer left First Charter in May of 1997 and later became a principal of Four Star Financial Services, LLC ("Four Star"), an affiliate of 900 Capital Services, Inc. ("900 Capital").

On April 18, 2005, the plaintiffs filed the second amended class action complaint. The second amended complaint alleged that the former officer of First Charter improperly induced several First Charter customers to invest in 900 Capital or affiliates of 900 Capital and further alleges that Four Star, 900 Capital and some of their affiliated entities perpetuated a fraud upon investors through various accounts at First Charter and Pacific Western with those banks' purported knowing participation in and/or willful ignorance of the scheme. The key allegations in the second amended complaint dated back to the mid-1990s and the second amended complaint alleged several counts for relief including aiding and abetting, conspiracy, fraud, breach of fiduciary duty, relief pursuant to the

NOTE 8 COMMITMENTS AND CONTINGENCIES (Continued)

California Business and Professions Code, negligence and relief under the California Securities Act stemming from an alleged fraudulent scheme and sale of securities issued by 900 Capital and Four Star. In disclosures provided to the parties, plaintiffs have asserted that the named plaintiffs have suffered losses well in excess of $3.85 million, and plaintiffs have asserted that "losses to the class total many tens of millions of dollars." On June 15, 2005, we filed a demurrer to the second amended complaint, and on August 22, 2005, the Court sustained our demurrer as to each of the counts therein, granting plaintiffs leave to amend on four of the six counts, and dismissing the other counts outright.

On August 12, 2005, the Company was notified by Progressive Casualty Insurance Company ("Progressive"), its primary insurance carrier with respect to the Gilbert Litigation, that Progressive had determined that, based upon the allegations in the second amended complaint filed in the Gilbert Litigation, there was no coverage with respect to the Gilbert Litigation under the Company's insurance policy with Progressive. Progressive also notified the Company that it was withdrawing its agreement to fund defense costs for the Gilbert Litigation and reserving its right to seek reimbursement from the Company for any defense costs advanced pursuant to the insurance policy. Through December 31, 2005, Progressive had advanced to the Company approximately $690,000 of defense costs with respect to the Gilbert Litigation.

On August 12, 2005, Progressive filed an action in federal district court for declaratory relief, titled Progressive Casualty Insurance Company, etc., v. First Community Bancorp, etc., et al., Case No. 05-5900 SVW (MAWx) (the "Progressive Litigation"), seeking a declaratory judgment with respect to the parties' rights and obligations under Progressive's policy with the Company. On October 11, 2005, the Company filed in federal court a motion to dismiss or stay the Progressive Litigation.

In November 2005, along with certain other defendants, we reached an agreement in principle with respect to the Gilbert Litigation. That agreement is reflected in a written Stipulation of Settlement dated February 9, 2007, which was executed by all the parties to that settlement and filed with the Court. At a hearing on June 23, 2008 the Los Angeles Superior Court stated that it approved the settlement, and subsequently executed the Final Judgment and Order of Dismissal regarding the claims against the Company and First Charter's former officer. The settlement will become effective once the time for appeal expires without an appeal being taken or once any appeal is resolved in favor of approval of the settlement. Assuming the settlement becomes effective, the Company's contribution to the settlement will be $775,000, which was accrued in 2005.

While we believe that this settlement, if finalized, will end our exposure to the underlying claims in the Gilbert Litigation, we cannot be certain that all conditions to effectiveness of the settlement will be satisfied.

In connection with the Gilbert Litigation settlement, we also reached a settlement with Progressive Casualty Insurance Co. in the Progressive Litigation. The settlement with Progressive, which includes an additional contribution by Progressive under the Company's policy toward the settlement of the Gilbert Litigation and a dismissal by Progressive of any claims against the Company for reimbursement, is contingent upon the consummation of the Gilbert Litigation settlement.

In the ordinary course of our business, we are party to various other legal actions, which we believe are incidental to the operation of our business. Although the ultimate outcome and amount of liability, if any, with respect to these other legal actions to which we are currently a party cannot presently be ascertained with certainty, in the opinion of management, based upon information currently available to us, any resulting liability is not likely to have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

NOTE 9 FAIR VALUE MEASUREMENTS

SFAS No. 157, *Fair Value Measurements*, defines fair value, establishes a framework for measuring fair value including a three-level valuation hierarchy, and expands disclosures about fair value measurements. Fair value is defined in SFAS 157 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date reflecting assumptions that a market participant would use when pricing an asset or liability. The fair value hierarchy of SFAS 157 is as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology that are unobservable and significant to the fair value measurement.

The adoption of SFAS 157 had no impact on either the Company's financial condition or operating results. We have no liabilities being measured using fair value.

Certain assets and liabilities are measured at the lower of cost or fair value in accordance with GAAP. Accordingly, an asset or a liability may, or may not, meet the criteria for fair value measurement during a reporting period; the fair value measurements of these assets and liabilities are considered "nonrecurring" for purposes of SFAS 157. For assets measured at fair value on a nonrecurring basis, the following tables present the level of valuation assumptions used to determine each adjustment, the carrying value of the related assets and the total losses recognized in the quarter and six months ended June 30, 2008. The tables are followed by a description of the valuation methodologies used to measure such assets at fair value.

For the quarter ended June 30, 2008:

Description	Total Fair Value	Fair Value Measurements Using Level 1	Level 2	Level 3	Total Losses
		(Dollars in thousands)			
Goodwill	$	$	$	$	$486,701
Impaired loans	43,198		43,198		4,464
Loans transferred from held-for-sale to the regular portfolio	24,632(1)		24,632		673
Servicing asset	2,565			2,565	100
					$491,938

NOTE 9 FAIR VALUE MEASUREMENTS (Continued)

For the six months ended June 30, 2008:

Description	Total Fair Value	Level 1	Level 2	Level 3	Total Losses
		(Dollars in thousands)			
Goodwill	$	$	$	$	$761,701
Impaired loans	45,953		45,953		4,524
Loans transferred from held-for-sale to the regular portfolio	24,632(1)		24,632		673
Servicing asset	2,565			2,565	255
					$767,153

---

(1) Represents unpaid balance at the time of transfer.

Goodwill. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill was written down to its implied fair value of zero by charges to earnings of $486.7 million and $761.7 million for the quarter and six months ended June 30, 2008. The key inputs used to determine the implied fair value of the Company and the corresponding amount of the write-off included the quoted market price of our common stock, market prices of common stocks of other banking organizations, common stock trading multiples, discounted cash flows, and inputs from comparable transactions. In addition, consideration was given to the value that may arise from synergies and other benefits that would accrue from control over an entity. These valuation inputs are considered to be Level 2 and 3 inputs.

Impaired loans. All of our nonaccrual loans are considered impaired and are reviewed individually for the amount of impairment, if any. Most of our loans are collateral dependent and, accordingly, we measure impaired loans based on the fair value of such collateral. Fair value of the loan's collateral is determined by appraisals or independent valuation, which is then adjusted for the cost related to liquidation of the collateral. These valuation inputs are considered to be Level 2 inputs. The loan balances shown in the above tables represent those nonaccrual loans for which impairment was recognized during the periods based on the fair value of collateral, as these loans were deemed to be collateral-dependant. The amounts shown as losses represent, for the loan balances shown, the impairment recognized during the periods.

Loans transferred from held for-sale to the regular portfolio. SBA loan sales were suspended during the second quarter due to deterioration in the marker for such sales. As a result, we transferred the SBA loans held-for-sale to the regular loan portfolio at the lower of cost or market value. The market values for the loans transferred were based on bids from market participants. At the time of the transfer, we recognized a $673,000 write-down related to $24.6 million in loans.

Servicing asset. In accordance with SFAS No. 156, *Accounting for Servicing of Financial Assets*, the SBA servicing asset, included in other assets in the balance sheet, was written down to its implied fair value of $2.6 million by a charge to earnings of $100,000 in the second quarter of 2008 and $255,000 for the six months ended June 30, 2008. The fair value of the servicing asset is estimated by discounting future cash flows using market-based discount rates and prepayment speeds. The discount rate is based on the current US Treasury yield curve, as published by the Department of the Treasury, plus a spread for the marketplace risk associated with these assets. We utilize estimated prepayment vectors using SBA prepayment information provided by Bloomberg for pools of similar assets to determine the timing of the cash flows. These valuation inputs are considered to be Level 3 inputs.

NOTE 9 FAIR VALUE MEASUREMENTS (Continued)

Securities available-for-sale. The table below presents the balance of securities available-for-sale, which is measured at fair value on a recurring basis. An independent third party performs market valuations of our securities available-for sale, which consist entirely of fixed income investments. The fair values are determined by using several sources for valuing fixed income securities. The techniques include pricing models that vary based on the type of asset being valued and incorporate available trade, bid and other market information. The market valuation sources include observable market inputs and are therefore considered Level 2 inputs for purposes of determining the fair values. See also Note 4 for unrealized gains and losses on securities available for sale.

		Fair Value Measurement Using		
	Total	**Level 1**	**Level 2**	**Level 3**
		(Dollars in thousands)		
Securities available-for-sale	$ 109,460		$ 109,460	

NOTE 10 RECENT ACCOUNTING PRONOUNCEMENTS

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), was effective for us on January 1, 2008. This statement permits companies to choose to measure many financial instruments and certain other items at fair value. Once a company chooses to report an item at fair value, changes in fair value would be reported in earnings at each reporting date. Upon adoption we did not choose to measure any of our financial instruments at fair value and accordingly SFAS 159 had no impact on either the Company's financial condition or operating results.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. This statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combinations we complete prior to January 1, 2009 will be recorded and disclosed following existing GAAP. We expect SFAS 141R will have an impact on our consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of any acquisitions we consummate after the effective date. We are currently assessing the impact of this standard on our future consolidated financial statements.

In June 2008, the FASB issued FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1). FSP EITF 03-6-1 clarified that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders. Awards of this nature are considered participating securities and the two-class method of computing basic and diluted earnings per share must be applied. All of our unvested restricted stock participates with common shareholders in dividends declared and paid by the Company and at June 30, 2008, we had 1,010,288 shares of unvested restricted stock. FSP EITF 03-6-1 is effective for us on January 1, 2009. We are currently assessing the impact this FSP may have, if any, on our operating results.

NOTE 11 DIVIDEND APPROVAL

On July 8, 2008 our Board of Directors declared a quarterly cash dividend of $0.32 per common share payable on August 29, 2008, to stockholders of record at the close of business on August 15, 2008.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Information

This Quarterly Report on Form 10-Q contains certain forward-looking information about the Company and its subsidiaries, which statements are intended to be covered by the safe harbor for "forward-looking statements" provided by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact are forward-looking statements. Such statements involve inherent risks and uncertainties, many of which are difficult to predict and are generally beyond the control of the Company. We caution readers that a number of important factors could cause actual results to differ materially from those expressed in, implied or projected by, such forward-looking statements. Risks and uncertainties include, but are not limited to:

- lower than expected revenues;
- credit quality deterioration or pronounced and sustained reduction in real estate market values could cause an increase in the allowance for credit losses and a reduction in earnings;
- increased competitive pressure among depository institutions;
- the Company's ability to complete future acquisitions and to successfully integrate such acquired entities or achieve expected benefits, synergies and/or operating efficiencies within expected time-frames or at all;
- the possibility that personnel changes will not proceed as planned;
- the cost of additional capital is more than expected;
- a change in the interest rate environment reduces interest margins;
- asset/liability repricing risks and liquidity risks;
- pending legal matters may take longer or cost more to resolve or may be resolved adversely to the Company;
- general economic conditions, either nationally or in the market areas in which the Company does or anticipates doing business, are less favorable than expected;
- environmental conditions, including natural disasters, may disrupt our business, impede our operations, negatively impact the values of collateral securing the Company's loans or impair the ability of our borrowers to support their debt obligations;
- the economic and regulatory effects of the continuing war on terrorism and other events of war, including the war in Iraq;
- legislative or regulatory requirements or changes adversely affecting the Company's business; and
- changes in the securities markets.

If any of these risks or uncertainties materializes, or if any of the assumptions underlying such forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or projected by, such forward-looking statements. The Company assumes no obligation to update such forward-looking statements.

Overview

We are a bank holding company registered under the Bank Holding Company Act of 1956, as amended. Our principal business is to serve as the holding company for our subsidiary bank, Pacific Western Bank, which we refer to as Pacific Western or the Bank.

Pacific Western is a full-service community bank offering a broad range of banking products and services including: accepting time and demand deposits; originating loans, including commercial, real estate construction, SBA guaranteed, consumer, and international loans; and providing other business-oriented products. Our operations are primarily located in Southern California and the Bank focuses on conducting business with small to medium size businesses and the owners and employees of those businesses in our marketplace. Through our asset-based lending and SBA loan production offices we also operate in Arizona, Northern California, the Pacific Northwest, and Texas. At June 30, 2008, our assets totaled $4.3 billion, of which gross loans totaled $3.9 billion. At this date approximately 22% were commercial loans, 55% were commercial real estate loans, 9% were commercial real estate construction loans, 7% were residential real estate construction loans, 6% were residential real estate loans, and 1% were consumer and other loans. These percentages include some foreign loans, primarily to individuals or entities with business in Mexico, representing 1% of total loans. Our portfolio's value and credit quality is affected in large part by real estate trends in Southern California.

Pacific Western competes actively for deposits, and emphasizes solicitation of noninterest-bearing deposits. In managing the top line of our business, we focus on loan growth and loan yield, deposit cost, and net interest margin, as net interest income, on a year-to-date basis, accounts for 90% of our net revenues (net interest income plus noninterest income).

Key Performance Indicators

Among other factors, our operating results depend generally on the following:

The Level of Our Net Interest Income

Net interest income is the excess of interest earned on our interest-earning assets over the interest paid on our interest-bearing liabilities. The recent decline in market interest rates has compressed our net interest margin. Further reductions in market interest rates, if any, could negatively impact both our net interest income and net interest margin going forward. Our primary interest-earning asset is loans. Our interest-bearing liabilities include deposits, borrowings, and subordinated debentures. We attempt to increase our net interest income by maintaining a high loan-to-deposit ratio and high level of transactional deposit accounts, which includes noninterest-bearing deposits and interest-bearing checking accounts. While our deposit balances fluctuate depending on deposit holders' perceptions of alternative yields available in the market, we attempt to minimize these variances by attracting a high percentage of noninterest-bearing deposits, which have no expectation of yield. At June 30, 2008, approximately 39% of our total deposits were noninterest-bearing deposits. Our general policy is to price our deposits in the bottom half or third-quartile of our competitive peer group, resulting in deposit products that bear somewhat lower interest rates. However, recent disruptions in the financial credit and liquidity markets have resulted in increased competition from financial institutions seeking to maintain adequate liquidity, thus placing upward pressure on the rates paid on certain deposit accounts. In addition to deposits, we have borrowing capacity under various credit lines which we use for liquidity needs such as funding loan demand, managing deposit flows and interim acquisition financing. While this borrowing capacity is relatively flexible, it tends to be more expensive than core deposits.

Loan Growth

We generally seek new lending opportunities in the $1 million to $10 million range, try to limit loan maturities for commercial loans to one year, for construction loans up to 18 months, and for commercial real estate loans up to ten years, and to price lending products so as to preserve our interest spread and net interest margin. We sometimes encounter strong competition in pursuing lending opportunities such that potential borrowers obtain loans elsewhere at lower rates than those we offer. We have continued to reduce our exposure to residential construction and foreign loans, including limiting the amount of new loans in these categories.

The Magnitude of Credit Losses

We stress credit quality in originating and monitoring the loans we make and measure our success by the level of our nonperforming assets and the corresponding level of our allowance for credit losses. Our allowance for credit losses is the sum of our allowance for loan losses and our reserve for unfunded loan commitments. Provisions for credit losses are charged to operations as and when needed for both on and off balance sheet credit exposure. Loans which are deemed uncollectible are charged off and deducted from the allowance for loan losses. Recoveries on loans previously charged off are added to the allowance for loan losses. During the six months ended June 30, 2008, we made a provision for credit losses totaling $29.5 million based upon our reserve methodology and considered, among other factors, the level of net charge-offs, the level and trends of classified, criticized, and nonaccrual loans, general market conditions and portfolio concentrations, including the transfer of SBA loans previously held for sale into the regular portfolio.

We actively review our loans to determine whether there has been any deterioration in credit quality stemming from economic conditions or other factors which may affect collectibility of our loans. Changes in economic conditions, such as inflation, unemployment, increases in the general level of interest rates and negative conditions in borrowers' businesses, could negatively impact our customers and cause us to adversely classify loans and increase portfolio loss factors. An increase in classified loans generally results in increased provisions for credit losses. Because we have a concentration in real estate loans, any deterioration in the real estate markets may negatively impact our borrowers and could lead to increased provisions for credit losses.

The Level of Our Noninterest Expense

Our operating noninterest expense (noninterest expense excluding goodwill write-offs, a legal settlement and reorganization costs) includes fixed and controllable overhead, the major components of which are compensation, occupancy, data processing, professional fees and communications expense. We measure success in controlling such costs through monitoring of the efficiency ratio. We calculate the operating efficiency ratio by dividing operating noninterest expense by the sum of net interest income and noninterest income. Accordingly, a lower percentage reflects lower expenses relative to income. The consolidated operating efficiency ratios have been as follows:

Quarterly Period	Ratio
Second quarter of 2008	59.4%
First quarter 2008	54.8%
Fourth quarter 2007	52.6%
Third quarter 2007	48.0%
Second quarter 2007	47.2%

The increase in the operating efficiency ratio for the second quarter of 2008 compared to the other periods presented is due mostly to a decline in net interest income as a result of lower market interest rates. Certain reporting periods include income or expense items that were significant to specific quarters' results and also influenced the efficiency ratio. In particular, during the fourth quarter of 2007 we incurred $1.4 million in prepayment penalties and made a charitable contribution of $1.0 million; these items increased the fourth quarter operating efficiency ratio from 49.1% to 52.6%. See also Results of Operations *Earnings Performance* for further information on non-GAAP financial measures.

Critical Accounting Policies

The Company's accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. The Company has identified several policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the allowance for credit losses and the carrying values of goodwill, other intangible assets and deferred income tax assets. For further information, refer to our Annual Report on Form 10-K for the year ended December 31, 2007.

Results of Operations

Earnings Performance

The discussion in this Form 10-Q of net earnings, earnings per share, performance ratios and comparisons to prior periods will be based on net operating earnings as shown in the following table and described below. The Company uses certain non-GAAP financial measures to provide meaningful supplemental information regarding the Company's operational performance and to enhance investors' overall understanding of such financial performance. These non-GAAP financial measures are presented for supplemental informational purposes only for understanding the Company's operating results and should not be considered a substitute for financial information presented in accordance with GAAP. These non-GAAP financial measures presented by the Company may be different from non-GAAP financial measures used by other companies. The following table presents a reconciliation of the non-GAAP financial measurements to the GAAP financial measurements and certain performance ratios.

Non-GAAP Measurements (Unaudited)

In thousands, except per share data and percentages	Quarter Ended June 30, 2008	Quarter Ended March 31, 2008	Quarter Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net (loss) earnings as reported	$ (474,514)	$ (272,723)	$ 22,525	$ (747,237)	$ 51,071
Legal settlement, net of tax	452			452	
Reorganization costs, net of tax	150		628	150	778
Goodwill write-off	486,701	275,000		761,701	
Net operating earnings	$ 12,789	$ 2,277	$ 23,153	$ 15,066	$ 51,849
GAAP basic shares outstanding	27,166.8	27,145.2	28,885.9	27,156.0	28,876.6
Effect of restricted stock and dilutive stock options[(a)]			129.9		130.8
GAAP diluted shares outstanding	27,166.8	27,145.2	29,015.8	27,156.0	29,007.4
Operating earnings basic shares outstanding	27,166.8	27,145.2	28,885.9	27,156.0	28,876.6
Effect of restricted stock and dilutive stock options	11.5	18.1	129.9	22.0	130.8
Operating earnings diluted shares outstanding	27,178.3	27,163.3	29,015.8	27,178.0	29,007.4
GAAP basic and diluted earnings (loss) per share	$ (17.47)	$ (10.05)	$ 0.78	$ (27.52)	$ 1.76
Net operating diluted earnings per share	$ 0.47	$ 0.08	$ 0.80	$ 0.55	$ 1.79
GAAP return on average assets	(39.18)%	(21.10)%	1.75%	(29.85)%	1.93%
Net operating return on average assets	1.06%	0.18%	1.80%	0.60%	1.96%
GAAP return on average equity	(223.19)%	(96.35)%	7.61%	(150.76)%	8.75%
Net operating return on average equity	6.02%	0.80%	7.83%	3.04%	8.88%
Noninterest expense as reported	$ 524,084	$ 310,310	$ 35,997	$ 834,394	$ 71,390
Legal settlement	(780)			(780)	
Reorganization costs	(258)		(1,083)	(258)	(1,341)
Goodwill write-off	(486,701)	(275,000)		(761,701)	
Operating noninterest expense	$ 36,345	$ 35,310	$ 34,914	$ 71,655	$ 70,049
GAAP efficiency ratio	856.7%	481.6%	48.7%	664.3%	45.3%
Net operating efficiency ratio	59.4%	54.8%	47.2%	57.1%	44.4%

(a) Anti-dilutive for the quarters and year ended June 30, 2008 and March 31, 2008.

We had a net loss of $474.5 million, or $17.47 per diluted share, for the second quarter of 2008 compared to a net loss of $272.7 million, or $10.05 per diluted share for the first quarter of 2008 and net earnings of $22.5 million, or $0.78 per diluted share for the second quarter of 2007. We had a net loss of $747.2 million, or $27.52 per diluted share, for the six months ended June 30, 2008 compared to net earnings of $51.1 million, or $1.76 per diluted share, for the same 2007 period. The net loss for the

2008 periods is due to goodwill write-offs. In response to the volatility in the banking industry and the effect such volatility has had on banking stocks since the beginning of 2008, including PacWest Bancorp's common stock, we wrote-off $275.0 million of goodwill in the first quarter of 2008 and wrote-off the remaining balance of our goodwill totaling $486.7 million in the second quarter of 2008. Such charges had no effect on the Company's or the Bank's cash balances, liquidity or well-capitalized regulatory ratios.

Net earnings, excluding goodwill write-offs, a legal settlement and reorganization costs (hereinafter referred to as "net operating earnings"), totaled $12.8 million, or $0.47 per diluted share, for the quarter ended June 30, 2008, compared to $2.3 million, or $0.08 per diluted share, for the first quarter of 2008 and $23.2 million, or $0.80 per diluted share, for the quarter ended June 30, 2007. In addition to the 2008 goodwill write-offs, we incurred a legal settlement of $452,000 (after-tax) and reorganization costs of $150,000 (after-tax) for the quarter ended June 30, 2008; these charges compare to reorganization costs of $628,000 (after-tax) for the quarter ended June 30, 2007. The increase in net operating earnings for the quarter ended June 30, 2008 compared to the prior quarter is attributed mostly to a lower provision for credit losses. The decrease in net operating earnings for the quarter ended June 30, 2008 compared to the same quarter in 2007 is attributed to a higher provision for credit losses, lower net interest income, lower noninterest income and higher noninterest expense.

Net operating earnings total $15.1 million, or $0.55 per diluted share, for the six months ended June 30, 2008 compared to $51.8 million, or $1.79 per diluted share, for the six months ended June 30, 2007. The decrease in net operating earnings for the year-to-date period is attributed to a higher provision for credit losses, lower net interest income, lower noninterest income and higher noninterest expense. The decrease in net interest income relates mostly to the decline in market interest rates and lower loan balances resulted mostly from the sale of a participating interest in approximately $353 million in commercial real estate mortgage loans in March 2007 combined with our effort to reduce our nonowner-occupied residential loan exposure. The decrease in noninterest income is due mostly to lower gain on sale of loans and lower income related to discounts recognized on acquired loans that have since been repaid.

Net Interest Income. Net interest income, which is our principal source of revenue, represents the difference between interest earned on assets and interest paid on liabilities. Net interest margin is net interest income expressed as a percentage of average interest-earning assets. Net interest income is affected by changes in both interest rates and the volume of average interest-earning assets and interest-bearing liabilities. The following table presents, for the periods indicated, the distribution of average assets, liabilities and shareholders' equity, as well as interest income and yields earned on average interest-earning assets and interest expense and costs on average interest-bearing liabilities:

	Quarter Ended								
	June 30, 2008			March 31, 2008			June 30, 2007		
	Average Balance	Interest Income/ Expense	Yields and Rates	Average Balance	Interest Income/ Expense	Yields and Rates	Average Balance	Interest Income/ Expense	Yields and Rates
	(Dollars in thousands)								
ASSETS									
Loans, net of deferred fees and costs[(1)(2)]	$3,970,704	$ 69,536	7.04%	$4,019,224	$ 75,653	7.57%	$3,945,574	$ 84,277	8.57%
Investment securities[(2)]	146,840	1,861	5.10%	143,379	1,701	4.77%	104,005	1,362	5.25%
Federal funds sold	4,549	23	2.03%	5,032	40	3.20%	69,585	909	5.24%
Other earning assets	326	2	2.47%	324	3	3.72%	498	6	4.83%
Total interest-earning assets	4,122,419	71,422	6.97%	4,167,959	77,397	7.47%	4,119,662	86,554	8.43%
Noninterest-earning assets:									
Other assets	748,146			1,030,130			1,033,326		
Total assets	$4,870,565			$5,198,089			$5,152,988		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Interest checking	$ 373,382	$ 690	0.74%	$ 369,841	$ 931	1.01%	$ 318,185	$ 552	0.70%
Money market	1,085,945	4,875	1.81%	1,089,672	6,968	2.57%	1,062,334	7,872	2.97%
Savings	100,779	41	0.16%	104,905	42	0.16%	130,129	63	0.19%
Time certificates of deposit	426,654	3,313	3.12%	413,712	3,880	3.77%	507,162	5,244	4.15%
Total interest-bearing deposits	1,986,760	8,919	1.81%	1,978,130	11,821	2.40%	2,017,810	13,731	2.73%
Other interest-bearing liabilities	723,115	6,731	3.74%	758,178	7,716	4.09%	423,439	6,369	6.03%
Total interest-bearing liabilities	2,709,875	15,650	2.32%	2,736,308	19,537	2.87%	2,441,249	20,100	3.30%
Noninterest-bearing liabilities:									
Demand deposits	1,256,794			1,273,173			1,464,362		
Other liabilities	48,801			50,207			60,595		
Total liabilities	4,015,470			4,059,688			3,966,206		
Stockholders' equity	855,095			1,138,401			1,186,782		
Total liabilities and stockholders' equity	$4,870,565			$5,198,089			$5,152,988		
Net interest income		$ 55,772			$ 57,860			$ 66,454	
Net interest spread			4.65%			4.60%			5.13%
Net interest margin			5.44%			5.58%			6.47%

(1) Includes nonaccrual loans and loan fees.

(2) Yields on loans and securities have not been adjusted to a tax-equivalent basis because the impact is not material.

Second quarter of 2008 compared to first quarter of 2008

Interest income declined $6.0 million due mainly to lower loan yields from reductions in our base lending rate, lower average construction loan balances and increased nonaccrual loans. The Federal Reserve lowered the Federal funds rate by 225 basis points since year end 2007 and our base lending rate was reduced by the same amount. On the funding side, interest expense decreased $3.9 million compared to the first quarter of 2008 due mostly to the effect declining market interest rates had on our deposit pricing and the cost of wholesale funding through Federal Home Loan Bank ("FHLB") advances.

Our net interest margin for the second quarter of 2008 was 5.44%, a decrease of 14 basis points when compared to the first quarter of 2008. This decrease is due mostly to lower loan yields as a result of lower market interest rates and a higher level of nonaccrual loans. The actual net interest margin was 5.32% in June and when the net reversal of interest income on nonaccrual loans is excluded, the net interest margin for the month of June was 5.55%. The yield on average loans was 6.93% for June and when net reversal of interest income on nonaccrual loans are excluded, the loan yield for June was 7.17%. The decline in the linked-quarter net interest margin was tempered by lower funding costs. The average cost of deposits was 1.11% for the second quarter of 2008 compared to 1.46% for the first quarter of 2008. On a monthly basis our deposit costs declined steadily to 1.08% in June 2008 compared to 1.35% in March 2008. Our relatively low cost of deposits is driven by our disciplined pricing strategy and the high proportion of demand deposits balances within our deposit base. Demand deposits averaged 39% of average total deposits during both the second and first quarters of 2008. Further, the cost of money market deposits and time deposits declined 76 basis points and 65 basis points when compared to the prior quarter. The overall cost of interest-bearing liabilities decreased to 2.32% for the second quarter of 2008 compared to 2.87% for the first quarter of 2008 due mostly to lower market interest rates.

Second quarter of 2008 compared to the second quarter of 2007

The $10.7 million decrease in net interest income for the second quarter of 2008 compared to the same quarter of 2007 was mainly a result of reduced loan interest income due to lower loan yields. Loan interest income decreased $14.7 million as our average loan yields declined in line with the general decline in market interest rates which began in September 2007. Interest expense decreased $4.5 million for the second quarter of 2008 compared to the same quarter of 2007 due to a combination of a decrease in the cost of our funding sources as market interest rates have declined and higher average FHLB borrowings. We continue to use FHLB advances to fund loan growth and deposit flows.

The net interest margin for the second quarter of 2008 declined 103 basis points when compared to the second quarter of 2007. This decrease is due to a combination of lower loan yields, lower average demand deposits and lower overall funding costs. The lower loan yield and cost of funds are due to lower market interest rates. The loan yields for the second quarter of 2008 compared to the same quarter last year were also negatively impacted by the higher level of nonaccrual loans.

	Six Months Ended June 30,					
	2008			2007		
	Average Balance	Interest Income/ Expense	Yields and Rates	Average Balance	Interest Income/ Expense	Yields and Rates
	(Dollars in thousands)					
ASSETS						
Loans, net of deferred fees and costs[(1)(2)]	$3,994,964	$145,189	7.31%	$4,129,896	$175,226	8.56%
Investment securities[(2)]	145,110	3,562	4.94%	108,616	2,738	5.08%
Federal funds sold	4,791	63	2.64%	43,234	1,123	5.24%
Other earning assets	325	5	3.09%	492	12	4.92%
Total interest-earning assets	4,145,190	148,819	7.22%	4,282,238	179,099	8.43%
Noninterest-earning assets:						
Other assets	889,137			1,047,120		
Total assets	$5,034,327			$5,329,358		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest checking	$ 371,611	$ 1,620	0.88%	$ 296,365	$ 717	0.49%
Money market	1,087,809	11,844	2.19%	1,075,930	15,201	2.85%
Savings	102,842	83	0.16%	134,300	121	0.18%
Time certificates of deposit	420,183	7,193	3.44%	539,367	11,117	4.16%
Total interest-bearing deposits	1,982,445	20,740	2.10%	2,045,962	27,156	2.68%
Other interest-bearing liabilities	740,647	14,447	3.92%	549,849	16,054	5.89%
Total interest-bearing liabilities	2,723,092	35,187	2.60%	2,595,811	43,210	3.36%
Noninterest-bearing liabilities:						
Demand deposits	1,264,984			1,497,120		
Other liabilities	49,503			58,787		
Total liabilities	4,037,579			4,151,718		
Stockholders' equity	996,748			1,177,640		
Total liabilities and stockholders' equity	$5,034,327			$5,329,358		
Net interest income		$113,632			$135,889	
Net interest spread			4.62%			5.07%
Net interest margin			5.51%			6.40%

(1) Includes nonaccrual loans and loan fees.

(2) Yields on loans and securities have not been adjusted to a tax-equivalent basis because the impact is not material.

Six Months Analysis

Net interest income decreased $22.3 million to $113.6 million for the six months ended June 30, 2008 compared to the same period of 2007. This decrease was mainly a result of decreased loan interest income from lower loan yields as market rates have declined and lower average loan balances. The lower average loan balances resulted mostly from the sale of the participating interest of approximately $353 million in commercial real estate mortgage loans at the end of March 2007 combined with our efforts to reduce our nonowner-occupied residential construction loan exposure. Interest expense decreased due to a combination of a decrease in the cost of our funding sources as market interest rates have declined and higher average FHLB borrowings.

Our net interest margin for the six months ended June 30, 2008 was 5.51%, a decrease of 89 basis points when compared to the same period of 2007. The decrease in the net interest margin is primarily the result of lower loan yields and lower average demand deposits.

Provision for Credit Losses. The amount of the provision for credit losses in each reporting period is a charge against earnings in that reporting period. The provisions for credit losses are based on our reserve methodology and reflect our judgments about the adequacy of the allowance for loan losses and the reserve for unfunded loan commitments. In determining the amount of the provision for credit losses, we consider certain quantitative and qualitative factors including our historical loan loss experience, the volume and type of lending we conduct, the results of our credit review process, the amounts of classified, criticized and nonperforming assets, regulatory policies, general economic conditions, underlying collateral values, off-balance sheet exposures, and other factors regarding collectibility and impairment. To the extent we experience, for example, increased levels of documentation deficiencies, adverse changes in collateral values, or negative changes in economic and business conditions which adversely affect our borrowers, our classified loans may increase. Increases in our classified loans generally result in provisions for credit losses.

We recorded a $29.5 million provision for credit losses during the first six months of 2008 compared to no provision for credit losses during the comparable 2007 period. Such provision was based on our reserve methodology and considered, among other factors, net charge-offs, the level and trends of classified, criticized, and nonaccrual loans, general market conditions and portfolio concentration, including the transfer of SBA loans held for sale into the regular portfolio.

Increased provisions for credit losses may be required in the future based on loan and unfunded commitment growth and the effect that changes in economic conditions, such as inflation, commodity prices, unemployment, market interest rate levels and real estate values, have on the ability of borrowers to repay their loans, and other conditions specific to our borrowers' businesses.

Noninterest Income. The following table summarizes noninterest income by category for the periods indicated:

	Quarter Ended[(1)]				
	June 30, 2008	**March 31, 2008**	**December 31, 2007**	**September 30, 2007**	**June 30, 2007**
	(Dollars in thousands)				
Service charges and fees on deposit accounts	$3,205	$ 3,224	$ 3,029	$ 2,877	$ 2,850
Other commissions and fees	1,812	1,519	1,817	1,903	1,976
(Loss) gain on sale of loans, net	(572)	269	(543)	(323)	1,779
Increase in cash surrender value of life insurance	617	587	649	597	627
Other income	339	968	400	628	297
Total noninterest income	$5,401	$ 6,567	$ 5,352	$ 5,682	$ 7,529

(1) Our quarterly results include BFI subsequent to its June 25, 2007 acquisition date. BFI is a commercial finance company based in San Jose, California. At the date of acquisition, BFI had $122.6 million in assets, including $84.5 million in loans.

Second quarter of 2008 compared to first quarter of 2008

Noninterest income for the second quarter of 2008 totaled $5.4 million compared to $6.6 million in the first quarter of 2008. The decrease compared to the first quarter of 2008 is due mostly to decreased gain on sale of loans. The net loss on sale of SBA loans was $572,000 for the second quarter of 2008 compared to a net gain of $269,000 for the first quarter of 2008. Due to the depressed SBA loan sale market, we suspended SBA loan sales during the second quarter of 2008. Accordingly, the SBA loans held for sale at the end of March 2008 were either transferred to the regular loan portfolio at the lower of cost or market or sold during the second quarter. Other income for the first quarter of 2008 includes $444,000 related to the payoff of certain acquired loans and a $200,000 income item related to the 2003 sale of a merchant card portfolio; there were no such items in the second quarter of 2008.

Second quarter of 2008 compared to second quarter of 2007

Compared to the second quarter of 2007, noninterest income declined $2.1 million due mainly to lower gain on sale of loans from decreased SBA loan sale activity and the reduced level of SBA market premiums.

Six Months Analysis

Noninterest income declined $9.9 million for the six months ended June 30, 2008 when compared to the $21.9 million earned during the same period in 2007. The decrease in noninterest income resulted largely from lower gain on sale of loans and lower other income. The 2007 period included a $6.6 million gain related to the sale of a participating interest in certain commercial real estate mortgage loans and net gains of $2.7 million on the sale of SBA loans; this compares to net losses of $303,000 recognized in 2008. The 2007 other income category included a $1.9 million gain related to recognizing an unearned discount on the payoff of an acquired loan; this compares to the $444,000 recognized during 2008.

Noninterest Expense. The following table summarizes noninterest expense by category for the periods indicated:

			Quarter Ended[1]		
	June 30, 2008	**March 31, 2008**	**December 31, 2007**	**September 30, 2007**	**June 30, 2007**
			(Dollars in thousands)		
Compensation	$ 18,919	$ 18,846	$ 16,669	$ 17,582	$ 18,267
Occupancy	4,884	4,731	4,871	4,799	4,725
Furniture and equipment	1,046	1,139	1,183	1,258	1,195
Data processing	1,604	1,543	1,475	1,507	1,467
Other professional services	1,669	1,415	1,495	1,574	1,795
Business development	849	756	1,709	780	849
Communications	816	824	779	825	841
Insurance and assessments	810	540	464	468	378
Intangible asset amortization	2,484	2,530	2,621	2,574	2,305
Other	3,264	2,986	4,689	3,157	3,092
Operating noninterest expense	36,345	35,310	35,955	34,524	34,914
Legal settlement	780				
Reorganization costs	258		390		1,083
Goodwill write-off	486,701	275,000			
Total noninterest expense	$ 524,084	$ 310,310	$ 36,345	$ 34,524	$ 35,997
Efficiency ratio	856.7%	481.6%	53.2%	48.0%	48.7%
Operating efficiency ratio	59.4%	54.8%	52.6%	48.0%	47.2%

(1) Our quarterly results include BFI subsequent to June 25, 2007.

Second quarter of 2008 compared to first quarter of 2008

Operating noninterest expense (defined as reported noninterest expense excluding goodwill write-offs, a legal settlement and reorganization costs) for the second quarter of 2008 totaled $36.3 million compared to $35.3 million for the first quarter of 2008. The increase in operating noninterest expense is due mostly to higher professional services, insurance and assessments, and other operating noninterest expense. Professional services increased in the second quarter due to higher litigation costs and consulting fees related to the goodwill write-off. Increased insurance and assessment relates to higher regulatory fees. The increase in other noninterest expense resulted from higher costs to workout nonperforming assets and other problem credits. The second quarter of 2008 legal settlement related to the resolution of an insured charged-off loan and the reorganization costs were for legal and stockholder meeting expenses related to the Company's reincorporation in Delaware.

Noninterest expense includes amortization of time-based and performance-based restricted stock, which is included in compensation, and intangible asset amortization. Restricted stock amortization totaled $1.5 million for the second quarter of 2008 compared to $952,000 for the first quarter of 2008 and $2.4 million for the second quarter of 2007. In the fourth quarter of 2007 we suspended amortization of certain performance-based restricted stock awards whose vesting is dependent on the attainment of specific long-term financial targets. At that time, we concluded that attainment of these financial targets was less than probable. If and when the attainment of such financial targets is deemed probable in future periods, a catch-up adjustment will be recorded and amortization of such performance-based restricted stock will recommence. Amortization expense for all time-based restricted stock awards is estimated to be $5.0 million for 2008. Intangible asset amortization totaled $2.5 million for the second quarter of 2008 and is estimated to be $9.4 million for 2008. The 2008 estimates of both restricted stock award expense and intangible asset amortization are subject to change.

Second quarter of 2008 compared to second quarter of 2007

The increase in operating noninterest expense for the second quarter of 2008 compared to the same quarter of 2007 relates mainly to increased compensation, occupancy and data processing costs, which is due largely to the BFI acquisition completed in June 2007. In addition, insurance and assessments and other expenses increased as described above. Reorganization expenses for the second quarter of 2007 represent mostly severance costs associated with the elimination of staff positions in branch locations.

Six Months Analysis

Operating noninterest expense for the six months ended June 30, 2008 totaled $71.7 million compared to $70.0 million for the same period in 2007. The increase is due to a combination of the increased costs from the BFI acquisition, and increased regulatory assessments, OREO expenses and loan collection costs as previously described.

Income Taxes. Our statutory income tax rate is approximately 42.0%, representing a blend of the statutory federal income tax rate of 35.0% and the California income tax rate of 10.84%. The effective tax rate on net operating earnings for the second quarter of 2008 was 39.9% compared to 26.9% for the first quarter of 2008 and 40.7% for the second quarter of 2007. While the effective tax rates for each of these quarterly period reflect reductions for credits on certain investments and tax-exempt income, such amounts were a higher proportion of taxable income in the first quarter of 2008. The goodwill write-offs are not deductible for tax purposes.

Balance Sheet Analysis

Loans. The following table presents the balance of each major category of loans at the dates indicated:

	At June 30, 2008		At March 31, 2008		At December 31, 2007	
	Amount	% of total	Amount	% of total	Amount	% of total
	(Dollars in thousands)					
Loan Category:						
Domestic:						
Commercial	$ 833,376	21%	$ 849,850	22%	$ 852,279	22%
Real estate, construction	623,605	16	661,782	17	717,419	18
Real estate, mortgage	2,361,529	61	2,309,434	59	2,280,963	58
Consumer	47,500	1	47,506	1	49,943	1
Foreign:						
Commercial	46,096	1	48,737	1	56,916	1
Other, including real estate	1,861	(1)	906	(1)	1,206	(1)
Gross loans	3,913,967	100%	3,918,215	100%	3,958,726	100%
Less: unearned income	(8,911)		(9,208)		(9,508)	
Less: allowance for loan losses	(59,777)		(60,199)		(52,557)	
Total net loans	$3,845,279		$3,848,808		$3,896,661	
Loans held for sale[2]	$		$ 57,309		$ 63,565	

(1) Amount is less than 1%.

(2) Loans held for sale, consisting of SBA 504 and 7(a) loans, were transferred into the regular portfolio during the second quarter of 2008.

Loans, net of unearned income, and loans held for sale decreased $61.3 million to $3.9 billion at June 30, 2008, from March 31, 2008. Commercial and industrial loans declined $24.5 million, construction loans declined $38.2 million and all other loan categories remained approximately the same as we continued to lower our exposure to nonowner-occupied residential construction loans. Due to the depressed SBA loan sale market, we suspended SBA loan sales during the second quarter of 2008. Loans held for sale at the end of March 2008 were either transferred into the regular portfolio at the lower of cost or market value on the date of transfer or they were sold during the second quarter of 2008. At June 30, 2008, the SBA loan portfolio totaled $168.5 million and was composed of $119.1 million in SBA 504 loans and $49.4 million in SBA 7(a) and Express loans.

Allowance for Credit Losses. The allowance for credit losses is the combination of the allowance for loan losses and the reserve for unfunded loan commitments. The allowance for loan losses is reported as a reduction of outstanding loan balances and the reserve for unfunded loan commitments is included within other liabilities. Generally, as loans are funded, the amount of the commitment reserve applicable to such funded loans will be transferred from the reserve for unfunded loan commitments to the allowance for loan losses based on our reserving methodology. At June 30, 2008, the allowance for credit losses was comprised of the allowance for loan losses of $59.8 million and the reserve for unfunded loan commitments of $7.7 million.

An allowance for loan losses is maintained at a level deemed appropriate by management to adequately provide for known and inherent risks in the loan portfolio and other extensions of credit at the balance sheet date. The allowance is based upon a continuing review of the portfolio, past loan loss experience, current economic conditions which may affect the borrowers' ability to pay, and the underlying collateral value of the loans. Loans which are deemed to be uncollectible are charged off and deducted from the allowance. The provision for loan losses and recoveries on loans previously charged off are added to the allowance.

The methodology we use to estimate the amount of our allowance for credit losses is based on both objective and subjective criteria. While some criteria are formula driven, other criteria are subjective inputs included to capture environmental and general economic risk elements which may trigger losses in the loan portfolio, and to account for the varying levels of credit quality in the loan portfolios of the entities we have acquired that have not yet been captured in our objective loss factors.

Specifically, our allowance methodology contains four elements: (a) amounts based on specific evaluations of impaired loans; (b) amounts of estimated losses on several pools of loans categorized by type; (c) amounts of estimated losses for loans adversely classified based on our loan review process; and (d) amounts for environmental and general economic factors that indicate probable losses were incurred but were not captured through the other elements of our allowance process.

Impaired loans are identified at each reporting date based on certain criteria and individually reviewed for impairment. A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due according to the original contractual terms of the loan agreement. We measure impairment of a loan based upon the fair value of the loan's collateral if the loan is collateral dependent or the present value of cash flows, discounted at the loan's effective interest rate, if the loan is not collateralized. If the measurement of impairment for the loan is less than the recorded investment in the loan, a valuation allowance is established with a corresponding charge to operations to increase the allowance for loan losses.

Our loan portfolio, excluding impaired loans which are evaluated individually, is categorized into several pools for purposes of determining allowance amounts by loan pool. The loan pools we currently evaluate are: commercial real estate construction, residential real estate construction, SBA real estate, real estate other, commercial collateralized, commercial unsecured, SBA commercial, consumer, foreign, asset-based, and factoring. Within these loan pools, we evaluate loans not adversely classified, which we refer to as "pass" credits, separately from adversely classified loans. The allowance amounts for pass rated loans and those loans adversely classified are determined using historical loss rates developed through migration analyses.

Finally, in order to ensure our allowance methodology is incorporating recent trends and economic conditions, we apply environmental and general economic factors to our allowance methodology including: credit concentrations; delinquency trends; economic and business conditions; external factors such as fuel and building materials prices, and the effects of adverse weather; the quality of lending management and staff; lending policies and procedures; loss and recovery trends; nature and volume of the portfolio; nonaccrual and problem loan trends; the quality of loan reveiw; and other adjustments for items not covered by other factors.

We recognize the determination of the allowance for loan losses is sensitive to the assigned credit risk ratings and inherent loss rates at any given point in time. Therefore, we perform a sensitivity analysis to provide insight regarding the impact adverse changes in risk ratings may have on our allowance for loan losses. The sensitivity analysis has inherent limitations and is based on various assumptions as of a point in time and, accordingly, it is not necessarily representative of the impact loan risk rating changes may have on the allowance for loan losses. At June 30, 2008, in the event that 1 percent of our loans were downgraded from the pass to substandard category within our current allowance methodology, the allowance for loan losses would increase by approximately $8.4 million. Given current processes employed by the Company, management believes the risk ratings and inherent loss rates currently assigned are appropriate. It is possible that others, given the same information, may at any point in time reach different reasonable conclusions that could be significant to the Company's financial statements. In addition, current risk ratings are subject to change as we continue to review loans within our portfolio and as our borrowers are impacted by economic trends within their market areas.

The following table presents the changes in our allowance for credit losses for the periods indicated:

	As of or for the			
	Quarter Ended June 30, 2008	Quarter Ended March 31, 2008	Year Ended December 31, 2007	Quarter Ended June 30, 2007
	(Dollars in thousands)			
Balance at beginning of period	$ 68,870	$ 61,028	$ 61,179	$ 58,623
Provision for credit losses	3,500	26,000	3,000	
Net charge-offs	(4,922)	(18,158)	(2,836)	94
Reduction for loans sold			(2,461)	(161)
Additions due to acquisitions			2,146	2,146
Balance at end of period	$ 67,448	$ 68,870	$ 61,028	$ 60,702

The credit loss provisions were based on our reserve methodology and considered, among other factors, net charge-offs, the level and trends of classified, criticized, and nonaccrual loans, general market conditions and portfolio concentrations, including the transfer of SBA loans previously held for sale into the regular portfolio during the second quarter of 2008. At June 30, 2008, the allowance for credit losses totaled $67.4 million and represented 1.73% of loans net of unearned income compared to $68.9 million and 1.76% at the end of March. The transfer into the regular portfolio of SBA loans held for sale is the principal reason behind the decline in the allowance for credit losses coverage ratio.

The following table presents the changes in our allowance for loan losses for the periods indicated:

	As of or for the			
	Quarter Ended June 30, 2008	**Quarter Ended March 31, 2008**	**Year Ended December 31, 2007**	**Quarter Ended June 30, 2007**
	(Dollars in thousands)			
Balance at beginning of period	$ 60,199	$ 52,557	$ 52,908	$ 50,352
Loans charged off:				
Commercial	(3,420)	(108)	(2,091)	(285)
Real estate construction	(1,417)	(18,335)	(660)	
Real estate mortgage	(159)	(68)	(454)	
Consumer	(97)	(38)	(166)	(21)
Foreign	(39)		(1,414)	
Total loans charged off	(5,132)	(18,549)	(4,785)	(306)
Recoveries on loans charged off:				
Commercial	151	356	1,591	344
Real estate mortgage	46	26	163	
Consumer	10	9	122	26
Foreign	3		73	30
Total recoveries on loans charged off	210	391	1,949	400
Net charge-offs	(4,922)	(18,158)	(2,836)	94
Provision for loan losses	4,500	25,800	2,800	
Reduction for loans sold			(2,461)	(161)
Additions due to acquisitions			2,146	2,146
Balance at end of period	$ 59,777	$ 60,199	$ 52,557	$ 52,431
Ratios:				
Allowance for loan losses to loans, net	1.53%	1.54%	1.33%	1.36%
Allowance for loan losses to nonaccrual loans	93.2%	188.4%	233.9%	211.4%
Annualized net charge-offs (recoveries) to average loans	0.50%	1.82%	0.07%	(0.01)%

We recorded a $4.5 million provision for loan losses during the second quarter 2008. Based on information currently available, management believes that the allowance for loan losses is adequate and appropriate for the known and inherent risks in our loan portfolio. In making its evaluation, management considers certain quantitative and qualitative factors including the Company's historical loss experience, the volume and type of lending conducted by the Company, the results of our credit review process, the amounts of classified, criticized and nonperforming assets, regulatory policies, general economic conditions, underlying collateral values, and other factors regarding collectibility and impairment. Second quarter commercial loan charge-offs include $2.2 million related to one loan whose borrower became significantly over-extended and was forced into bankruptcy by other lenders. During the first quarter of 2008 we charged off $16.2 million in residential-related construction loans in connection with the sale of such loans and recorded a $25.8 million provision for loan losses. To the extent we experience, for example, increased levels of documentation deficiencies, adverse changes in collateral values, or negative changes in economic and business conditions which adversely affect our borrowers, our classified loans may increase. Higher levels of classified loans generally result in higher allowances for loan losses.

The following table presents the changes in our reserve for unfunded loan commitments for the periods indicated:

	As of or for the			
	Quarter Ended June 30, 2008	Quarter Ended March 31, 2008	Year Ended December 31, 2007	Quarter Ended June 30, 2007
	(Dollars in thousands)			
Balance at beginning of period	$ 8,671	$ 8,471	$ 8,271	$ 8,271
(Reversal)/provision	(1,000)	200	200	
Balance at end of period	$ 7,671	$ 8,671	$ 8,471	$ 8,271

Based on current information, management believes that the reserve for unfunded loan commitments is adequate. In making this determination, we use the same methodology for the reserve for unfunded loan commitments as we do for the allowance for loan losses and consider the same qualitative factors, as well as an estimate of the probability of advances of the commitments correlated to their credit risk rating. The reduction in the reserve for unfunded loan commitments reflects, among other factors, a decrease in the amount of our outstanding loan commitments.

Credit Quality During the first six months of 2008, credit quality was impacted by the sale of certain nonaccrual loans in the first quarter, the reduction in our construction loan exposure, the increase in nonaccrual loans, and the decrease in loans past due 30 days or more.

In mid-March we sold $34.1 million of residential construction-related nonaccrual loans at a loss of $16.2 million which was charged to the allowance for credit losses. These loans were collateralized by both residential construction projects and residential land, and the several quarters needed to workout these troubled credits could have led to increased risk and additional loss. We decided to sell these loans at a substantial discount in order to eliminate from our portfolio the risks presented by these loans and to reduce the management distraction their workout would have caused.

The construction loan portfolio declined $93.8 million during the first six months of 2008 to $623.6 million at the end of June. Within our construction loan portfolio, we reduced our exposure to nonowner-occupied residential construction loans by $90.7 million to $259.3 million at the end of June from year end 2007. This reduction was due to net repayments of $48.9 million, sales of $34.1 million and foreclosures of $7.7 million. The following table presents the details of the nonowner-occupied residential construction portfolio as of the dates indicated.

	As of June 30, 2008			As of March 31, 2008	As of December 31, 2007
Loan Category	Balance	Number of loans	Average loan balance	Balance	Balance
			(Dollars in thousands)		
Residential land acquisition and development	$ 59,352	39	$ 1,522	$ 57,174	$ 80,848
Residential nonowner-occupied single family	97,525	46	2,120	96,381	133,694
Unimproved residential land	42,653	13	3,281	49,761	51,014
Residential multifamily	59,812	14	4,272	84,215	84,533
	$ 259,342	112	$ 2,316	$ 287,531	$ 350,089

The increases in the residential land and nonowner-occupied single family categories during the second quarter of 2008 represent disbursements under existing lending commitments and do not represent new loan originations.

The types of loans included in the nonaccrual category and accruing loans past due between 30 and 89 days as of June 30, 2008 and March 31, 2008 follow. All nonaccrual loans are considered impaired and are evaluated individually for loss exposure. At June 30, 2008, approximately $5.0 million of the allowance for credit losses was allocated to nonaccrual loans.

	Nonaccrual Loans		Accruing and 30 Days Past Due	
	Balance as of			
Loan category	6/30/08	3/31/08	6/30/08	3/31/08
	(Dollars in thousands)			
SBA 504	$ 2,493	$ 2,493	$ 1,898	$ 2,540
SBA 7(a) and Express	13,006	11,011	551	1,913
Residential construction	10,762	7,857		6,715
Commercial real estate	25,322	6,722	2,309	4,411
Commercial construction	6,228			
Commercial	2,966	3,213	2,821	6,089
Commercial land	1,519			
Residential other	284	295	1,045	1,299
Residential land	518	220	1,058	518
Other, including foreign	1,018	144	3,657	841
	$64,116	$31,955	$13,339	$24,326

Included in the nonaccrual loans at the end of June are $15.5 million of SBA related loans representing 24% of total nonaccrual loans at that date. The SBA 504 loans are secured by first trust deeds on owner-occupied business real estate with loan-to-value ratios of generally 50% or less at the time of origination. The 7(a) loans are secured by borrowers' real estate and/or business assets and are covered by a guarantee of the Small Business Administration of up to 85% of the amount of the individual loans. The SBA guaranteed portion on the 7(a) and Express loans shown above is $10.8 million. The increases in the commercial real estate and commercial construction categories are due mostly to five loans totaling $19.8 million. These five loans were underwritten with separate first and second trust deeds with the expectation that the SBA would pay-off our second trust deed by issuing a subordinated debenture. These loans were, however, placed on nonaccrual status prior to the pay-off of the second trust deeds by the SBA and are now reported as secured commercial real estate or commercial construction loans.

Loans on accrual status, but past due between 30 days and 89 days, which we refer to as "accruing and over 30 days past due," decreased $11.0 million to $13.3 million at June 30, 2008, from $24.3 million at March 31, 2008. Past due loans have the potential to become nonaccrual or adversely classified. Increases in nonaccrual and adversely classified loans generally result in increased provisions for loan losses. While the category of loans accruing and over 30 days past due decreased during the second quarter of 2008, no assurance can be given that such trend will continue.

Nonperforming assets include nonaccrual loans and other real estate owned (OREO) and totaled $74.0 million at the end of June compared to $38.0 million at the end of March. OREO totaled $9.9 million at the end of June compared to $6.1 million at the end of March. The increase in OREO is due mostly to foreclosure on a condominium project in San Diego. The ratio of nonperforming assets to loans and OREO was 1.89% at June 30, 2008 compared to 0.96% at March 31, 2008.

A summary of the components of OREO by property type follows at the dates indicated:

Property Type	Balance as of June 30, 2008	Balance as of March 31, 2008
	(Dollars in thousands)	
Improved residential land	$ 3,156	$ 3,156
Commercial real estate	1,024	
Residential real estate	5,706	2,899
Total	$ 9,886	$ 6,055

The following table presents historical credit quality information as of the dates indicated:

	As of or for the Quarter Ended June 30, 2008	As of or for the Year Ended December 31, 2007	As of or for the Quarter Ended June 30, 2007
	(Dollars in thousands)		
ALLOWANCE FOR CREDIT LOSSES:			
Allowance for loan losses	$ 59,777	$ 52,557	$ 52,431
Reserve for unfunded loan commitments	7,671	8,471	8,271
Allowance for credit losses	$ 67,448	$ 61,028	$ 60,702
NONPERFORMING ASSETS:			
Nonaccrual loans	$ 64,116	$ 22,473	$ 24,796
Other real estate owned	9,886	2,736	
Total nonperforming assets	$ 74,002	$ 25,209	$ 24,796
Allowance for credit losses to loans, net of unearned income	1.73%	1.55%	1.58%
Allowance for credit losses to nonaccrual loans	105.2%	271.6%	244.8%
Allowance for credit losses to nonperforming assets	91.1%	242.1%	244.8%

Deposits. The following table presents the balance of each major category of deposits at the dates indicated:

	At June 30, 2008 Amount	At June 30, 2008 % of total	At March 31, 2008 Amount	At March 31, 2008 % of total	At December 31, 2007 Amount	At December 31, 2007 % of total
	(Dollars in thousands)					
Noninterest-bearing	$ 1,239,098	39%	$ 1,277,302	38%	$ 1,211,946	37%
Interest-bearing:						
Interest checking	355,754	11	373,145	11	366,191	11
Money market accounts	1,050,726	33	1,165,337	36	1,135,307	36
Savings	100,422	3	100,505	3	108,223	3
Time deposits under $100,000	207,621	7	136,476	4	138,750	4
Time deposits over $100,000	238,592	7	266,379	8	284,729	9
Total interest-bearing	1,953,115	61	2,041,842	62	2,033,200	63
Total deposits	$ 3,192,213	100%	$ 3,319,144	100%	$ 3,245,146	100%

The second quarter decline in deposits is centered in lower money market balances. We believe this decline results from customers' use of deposit balances to make April tax payments. We continue to attract money to our checking products, which have generated $45.5 million in new deposits during 2008 of which $24.3 million of such deposits was generated in the second quarter. We also offer a sweep product, which represents $100.2 million of our money market balances at June 30, 2008. Deposits by foreign customers, primarily located in Mexico and Canada, totaled $116.5 million, or approximately 3.6% of total deposits at June 30, 2008. Brokered deposits totaled $88.3 million at June 30, 2008 and are included in the "Time deposits under $100,000" category in the above table. Such brokered deposits include $17.7 million of customer deposits that were subsequently participated with other FDIC insured financial institutions as a means to provide FDIC deposit insurance coverage for the full amount of our customers' deposits.

Regulatory Matters

The regulatory capital guidelines as well as the actual capital ratios for Pacific Western and the Company as of June 30, 2008, are as follows:

	Minimum Regulatory Requirements	Actual	
	Well Capitalized	Pacific Western	Company Consolidated
Tier 1 leverage capital ratio	5.00%	9.17%	9.77%
Tier 1 risk-based capital ratio	6.00%	10.22%	10.89%
Total risk-based capital	10.00%	11.47%	12.14%

The Company issued subordinated debentures to trusts that were established by us or entities we have acquired, which, in turn, issued trust preferred securities, which totaled $123.0 million at June 30, 2008. Our trust preferred securities are currently included in our Tier I capital for purposes of determining the Company's Tier I and total risk-based capital ratios. The FRB, which is the holding company's banking regulator, has promulgated a modification of the capital regulations affecting trust preferred securities. Under this modification, effective March 31, 2009, the Company will be required to use a more restrictive formula to determine the amount of trust preferred securities that can be included in regulatory Tier I capital. At that time, the Company will be allowed to include in Tier I capital an amount of trust preferred securities equal to no more than 25% of the sum of all core capital elements, which is generally defined as shareholders' equity, less goodwill net of any related deferred income tax liability. The regulations currently in effect through December 31, 2008 limit the amount of trust preferred securities that can be included in Tier I capital to 25% of the sum of core capital elements without a deduction for goodwill. We have determined that our Tier I capital ratios would remain above the well-capitalized level had the modification of the capital regulations been in effect at June 30, 2008. We expect that our Tier I capital ratios will be at or above the existing well capitalized levels on March 31, 2009, the first date on which the modified capital regulations must be applied.

Reincorporation in Delaware and change of name to PacWest Bancorp from First Community Bancorp

On May 14, 2008, Company changed its state of incorporation from California to Delaware and changed its name to PacWest Bancorp from First Community Bancorp. The reincorporation was effected through a merger with and into PacWest Bancorp, a Delaware corporation and wholly-owned subsidiary of the Company established for such purpose. The merger agreement relating to the reincorporation was approved by the requisite vote of shareholders at the Company's Special Meeting of Shareholders on April 23, 2008. In connection with the reincorporation and name change, the Company also changed its ticker symbol on the NASDAQ Global Select Market to "PACW." Other than the name change, change in ticker symbol and change in corporate domicile, the reincorporation did not result in any change in the business, physical location, management, assets, liabilities or net worth of the Company, nor did it result in any change in location of the Company's employees, including the Company's management.

The reincorporation did not alter any shareholder's percentage ownership interest, or number of shares owned, in the Company. Shareholders are not required to undertake any exchange of the Company's shares, as shares in the California company are deemed to represent an equal number of shares in the Delaware company.

Liquidity Management

Liquidity. The goals of our liquidity management are to ensure the ability of the Company to meet its financial commitments when contractually due and to respond to other demands for funds such as the ability to meet the cash flow requirements of customers who may be either depositors wanting to withdraw funds or borrowers who may need assurance that sufficient funds will be available to meet their credit needs. We have an Executive Asset/Liability Management Committee, or Executive ALM Committee, which is comprised of members of senior management and responsible for managing balance sheet and off-balance sheet commitments to meet the needs of customers while achieving our financial objectives. Our Executive ALM Committee meets regularly to review funding capacities, current and forecasted loan demand, and investment opportunities.

Historically, the Bank's primary liquidity source has been its core deposit base. Over the last several years the Bank's reliance on collateralized FHLB advances has increased as one of its sources of affordable and immediately available liquidity. The level of such wholesale funding is monitored based on the Bank's liquidity requirements, and we maintain what we believe to be an acceptable level of this collateralized borrowing capacity available at all times. The Bank's secured borrowing capacity was $957.0 million, of which $353.3 million was available as of June 30, 2008. In addition to the secured borrowing relationship with the FHLB, to meet short term liquidity needs the Bank maintains adequate balances in liquid assets, which include cash and due from banks, Federal Funds sold, interest-bearing deposits in other financial institutions, and unpledged investment securities available-for-sale. At June 30, 2008, liquid assets as a percent of total deposits were 4.0% and when available secured borrowings are included this ratio increases to 15.1%. Additionally, the Bank maintains unsecured lines of credit of $165.0 million with correspondent banks for purchase of overnight funds. These lines are subject to availability of funds. Another source of liquidity is the holding company's revolving line of credit for $35.0 million. There were no amounts outstanding under the revolving credit agreement as of June 30, 2008 or at the date hereof. We reduced the line amount during the first quarter of 2008 to avoid incurring additional fees on the unused portion of the credit line.

The recent disruption in the financial credit and liquidity markets has had the effect of decreasing the overall liquidity in the marketplace. Competition from financial institutions seeking to maintain adequate liquidity has placed upward pressure on the rates paid for customer deposits. We have lowered the rates paid on certain deposit accounts as market interest rates have declined, consistent with our disciplined deposit pricing strategy; this action, however, has resulted in deposit outflows. We have augmented our funding needs with our collateralized FHLB borrowings. In order to maintain sufficient levels of liquidity given the need to fund loan growth and manage deposit flows, the Bank may also use the secondary market for large denomination time deposits, the availability of which is uncertain and subject to competitive market forces. The Bank has $70.6 million of these large denomination time deposits at June 30, 2008.

The primary sources of liquidity for the Company, on a stand-alone basis, include the dividends from the Bank and our ability to raise capital, issue subordinated debt and secure outside borrowings. The ability of the Company to obtain funds for the payment of dividends to our shareholders and for other cash requirements is largely dependent upon the Bank's earnings. Pacific Western is subject to restrictions under certain federal and state laws and regulations which limit its ability to transfer funds to the Company through intercompany loans, advances or cash dividends. Dividends paid by state banks, such as Pacific Western, are regulated by the DFI under its general supervisory authority as it relates to a bank's capital requirements. A state bank may declare a dividend without the approval of the DFI as long as the total dividends declared in a calendar year do not exceed either the retained earnings or the total of net profits for three previous fiscal years less any dividends paid during such period. During the first quarter of 2008, PacWest received dividends of $106.0 million from the Bank. Further dividends from the Bank to the Company require DFI approval.

At June 30, 2008, the Company had, on a stand-alone basis, approximately $29.6 million in cash on deposit at the Bank. Management believes this amount of cash is sufficient to cover the Company's operating expenses and expected cash dividends on common stock for the remainder of 2008.

On May 16, 2005, we filed a registration statement with the SEC regarding the sale of up to 3,400,000 shares of our common stock, no par value per share, which we may offer and sell, from time to time, in amounts, at prices and on terms that we will determine at the time of any particular offering. To date, we have issued 2,935,766 shares of common stock under this registration statement for net proceeds of $158.5 million.

Contractual Obligations. The known contractual obligations of the Company at June 30, 2008, are as follows:

	At June 30, 2008 and Due				
	Within One Year	One to Three Years	Three to Five Years	After Five Years	Total
	(Dollars in thousands)				
Short-term debt obligations	$151,300	$	$	$	$151,300
Brokered deposits	70,563				70,563
Long-term debt obligations		175,000	50,000	355,107	580,107
Operating lease obligations	12,543	22,655	15,359	24,237	74,794
Other contractual obligations	3,514	6,933			10,447
Total	$237,920	$204,588	$65,359	$379,344	$887,211

The amount of brokered deposits included in the contractual obligations table are wholesale broker deposits only. Such amount does not include $17.7 million of customer deposits that were subsequently participated with other FDIC insured financial institutions as a means to provide FDIC deposit insurance coverage for the full amount of our customers' deposits.

Debt obligations are discussed in Note 7 of Notes to Unaudited Condensed Consolidated Financial Statements contained in "Item 1. Unaudited Consolidated Financial Statements." Operating lease obligations are discussed in the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2007. The other contractual obligations relate to the minimum liability associated with our data and item processing contract with a third-party provider.

We believe that we will be able to meet our contractual obligations as they come due through the maintenance of adequate cash levels. We expect to maintain adequate cash levels through profitability, loan and securities repayment and maturity activity, and continued deposit gathering activities. We believe we have in place sufficient borrowing mechanisms for short-term liquidity needs.

Off-Balance Sheet Arrangements

Our obligations also include off-balance sheet arrangements consisting of loan-related commitments, of which only a portion are expected to be funded. At June 30, 2008, our loan-related commitments, including standby letters of credit and financial guarantees, totaled $1.2 billion. The commitments which result in a funded loan increase our profitability through net interest income. Therefore, during the year, we manage our overall liquidity taking into consideration funded and unfunded commitments as a percentage of our liquidity sources. Our liquidity sources have been and are expected to be sufficient to meet the cash requirements of our lending activities.

Asset/Liability Management and Interest Rate Sensitivity

Interest Rate Risk. Our market risk arises primarily from credit risk and interest rate risk inherent in our lending and deposit gathering activities. To manage our credit risk, we rely on adherence to our underwriting standards and loan policies as well as our allowance for credit losses methodology. To manage our exposure to changes in interest rates, we perform asset and liability management activities which are governed by guidelines pre-established by our Executive ALM Committee and approved by our Board of Directors' Asset/Liability Management Committee ("Board ALCO"). Our Executive ALM Committee and Board ALCO monitor our compliance with our asset/liability policies. These policies focus on providing sufficient levels of net interest income while considering acceptable levels of interest rate exposure as well as liquidity and capital constraints.

Market risk sensitive instruments are generally defined as derivatives and other financial instruments, which include investment securities, loans, deposits, and borrowings. At June 30, 2008, we had not used any derivatives to alter our interest rate risk profile or for any other reason. However, both the repricing characteristics of our fixed rate loans and floating rate loans, as well as our significant percentage of noninterest-bearing deposits compared to interest-earning assets, may influence our interest rate risk profile. Our financial instruments include loans receivable, Federal funds sold, interest-bearing deposits in financial institutions, Federal Home Loan Bank stock, investment securities, deposits, borrowings, and subordinated debentures.

We measure our interest rate risk position on a monthly basis using three methods: (i) net interest income simulation analysis; (ii) market value of equity modeling; and (iii) traditional gap analysis. The results of these analyses are reviewed by the Executive ALM Committee monthly and the Board ALCO quarterly. If hypothetical changes to interest rates cause changes to our simulated net present value of equity and/or net interest income outside our pre-established limits, we may adjust our asset and liability mix in an effort to bring our interest rate risk exposure within our established limits. We evaluated the results of our net interest income simulation and market value of equity models prepared as of June 30, 2008. These simulation models suggest our balance sheet is asset-sensitive over a one year time horizon and liability sensitive over a longer time horizon. This profile suggests that in a rising interest rate environment, our net interest margin would initially increase and then gradually decrease over time; and during a falling or sustained low interest rate environment, our net interest margin would decrease initially and then gradually increase over time. This fairly neutral profile is due to the assumed repricing characteristics of our loans, deposits and borrowings. Approximately 27% of our loan portfolio is eligible to reprice immediately and another 18% of our loan portfolio has a variable interest rate that is currently at its floor. We anticipate immediately changing the rates on approximately 14% of our total deposits and borrowings as interest rates change; and we anticipate fully repricing a majority of the remaining interest bearing deposits and borrowings within the 1 to 2 year time horizon, subject to the embedded optionality in our FHLB putable advances. As more assets than liabilities are expected to reprice immediately as interest rates change, the Company is asset sensitive in the near term. After the one year time horizon cumulatively more liabilities than assets are expected to have repriced which suggests a gradual shift to a liability sensitive profile thereafter.

Net interest income simulation. We used a simulation model to measure the estimated changes in net interest income that would result over the next 12 months from immediate and sustained changes in interest rates as of June 30, 2008. This model is an interest rate risk management tool and the results are not necessarily an indication of our future net interest income. This model has inherent limitations and these results are based on a given set of rate changes and assumptions at one point in time. We have assumed no growth in either our interest-sensitive assets or liabilities over the next 12 months; therefore, the results reflect an interest rate shock to a static balance sheet.

This analysis calculates the difference between net interest income forecasted using both increasing and declining interest rate scenarios and net interest income forecasted using a base market interest rate derived from the current treasury yield curve. In order to arrive at the base case, we extend our balance sheet at June 30, 2008 one year and reprice any assets and liabilities that would contractually reprice or mature during that period using the products' pricing as of June 30, 2008. Based on such repricings, we calculated an estimated net interest income and net interest margin. The effects of certain balance sheet attributes, such as fixed-rate loans, floating rate loans that have reached their floors and the volume of noninterest-bearing deposits as a percentage of earning assets, impact our assumptions and consequently the results of our interest rate risk management model. Changes that may vary significantly from our assumptions include loan and deposit growth or contraction, changes in the mix of our earning assets or funding sources, and future asset/liability management decisions, all of which may have significant effects on our net interest income.

The net interest income simulation model includes various assumptions regarding the repricing relationship for each of our assets and liabilities. Many of our assets are floating rate loans, which are assumed to reprice immediately and to the same extent as the change in market rates according to their contracted index. Some loans and investment vehicles include the opportunity of prepayment (imbedded options) and the simulation model uses national indexes to estimate these prepayments and reinvest the proceeds there from at current simulated yields. Our deposit products reprice at our discretion and are assumed to reprice more slowly, usually repricing less than the change in market rates. Also, a callable option feature on certain borrowings will reprice differently in a rising interest rate environment than in a declining interest rate environment.

The simulation analysis does not account for all factors that impact this analysis, including changes by management to mitigate the impact of interest rate changes or the impact a change in interest rates may have on our credit risk profile, loan prepayment estimates and spread relationships which can change regularly. Interest rate changes cause changes in actual loan prepayment rates which will differ from the market estimates we used in this analysis. In addition, the simulation analysis does not make any assumptions regarding loan fee income, which is a component of our net interest income and tends to increase our net interest margin. Management reviews the model assumptions for reasonableness on a quarterly basis.

The following table presents as of June 30, 2008, forecasted net interest income and net interest margin for the next 12 months using a base case and the estimated change to the base scenario given immediate and sustained upward and downward movements in interest rates of 100, 200 and 300 basis points.

Interest rate scenario	Estimated Net Interest Income	Percentage Change From Base	Estimated Net Interest Margin	Estimated Net Interest Margin Change From Base
	(Dollars in thousands)			
Up 300 basis points	$ 216,448	2.9%	5.33%	0.15%
Up 200 basis points	$ 213,712	1.6%	5.26%	0.08%
Up 100 basis points	$ 212,689	1.1%	5.24%	0.06%
BASE CASE	$ 210,346		5.18%	
Down 100 basis points	$ 208,435	(0.9)%	5.13%	(0.05)%
Down 200 basis points	$ 203,870	(3.1)%	5.02%	(0.16)%
Down 300 basis points	$ 196,501	(6.6)%	4.84%	(0.34)%

Our simulation results as of June 30, 2008 indicate our interest rate risk position was asset sensitive as the simulated impact of an immediate upward movement in interest rates would result in increases in net interest income over the subsequent 12 month period while an immediate downward movement in interest rates would result in a decrease in net interest income over the next 12 months. In comparing the June 30, 2008, simulation results to March 31, 2008, we have become less asset sensitive. The decrease in our asset sensitivity is mostly a result of an increase of overnight borrowings from the FHLB.

Market value of equity. We measure the impact of market interest rate changes on the net present value of estimated cash flows from our assets, liabilities and off-balance sheet items, defined as the market value of equity, using a simulation model. This simulation model assesses the changes in the market value of our interest-sensitive financial instruments that would occur in response to an instantaneous and sustained increase or decrease in market interest rates of 100, 200 and 300 basis points. This analysis assigns significant value to our noninterest-bearing deposit balances. The projections are by their nature forward-looking and therefore inherently uncertain, and include various assumptions regarding cash flows and interest rates. This model is an interest rate risk management tool and the results are not necessarily an indication of our actual future results. Actual results may vary significantly from the results suggested by the market value of equity table. Loan prepayments and deposit attrition, changes in the mix of our earning assets or funding sources, and future asset/liability management decisions, among others, may vary significantly from our assumptions.

The base case is determined by applying various current market discount rates to the estimated cash flows from the different types of assets, liabilities and off-balance sheet items existing at June 30, 2008. The following table shows the projected change in the market value of equity for the set of rate shocks presented as of June 30, 2008:

Interest rate scenario	Estimated Market Value	Percentage Change From Base	Percentage of total assets	Ratio of Estimated Market Value to Book Value
	(Dollars in thousands)			
Up 300 basis points	$ 587,006	(10.7)%	13.5%	156.6%
Up 200 basis points	$ 612,767	(6.8)%	14.1%	163.5%
Up 100 basis points	$ 637,202	(3.1)%	14.7%	170.0%
BASE CASE	$ 657,560		15.1%	175.5%
Down 100 basis points	$ 679,140	3.3%	15.6%	181.2%
Down 200 basis points	$ 690,135	5.0%	15.9%	184.2%
Down 300 basis points	$ 701,509	6.7%	16.2%	187.2%

The results of our market value of equity model indicate a liability sensitive profile as the simulated impact of an immediate upward movement in interest rates would result in a decline in the estimated market value of equity while an immediate downward movement in interest rates would result in an increase in the estimated market value of equity. The June 30, 2008 simulation results, as compared to March 31, 2008, indicate increased liability sensitivity and volatility as a result of the decline in the book value of equity due to the goodwill write-off in the second quarter of 2008. As a result of the decline in the book value of equity, changes in the fair value of the remaining assets and liabilities have a greater impact on the overall change in the estimated market value of equity.

Gap analysis. As part of the interest rate management process, we use a gap analysis. A gap analysis provides information about the volume and repricing characteristics and relationship between the amounts of interest-sensitive assets and interest-bearing liabilities at a particular point in time. An effective interest rate strategy attempts to match the volume of interest sensitive assets and interest bearing liabilities repricing over different time intervals. The following table illustrates the volume and repricing characteristics of our balance sheet at June 30, 2008 over the indicated time intervals:

	At June 30, 2008					
	Amounts Maturing or Repricing In					
	3 Months Or Less	Over 3 Months to 12 Months	Over 1 Year to 5 Years	Over 5 Years	Non-sensitive[1]	Total
	(Dollars in thousands)					
ASSETS						
Cash and deposits in financial institutions	$ 253	$	$	$	$ 117,862	$ 118,115
Federal funds sold	9,000					9,000
Investment securities	43,779	4,378	19,082	76,165		143,404
Loans, net of unearned income	1,717,541	211,287	932,942	1,043,286		3,905,056
Other assets					167,749	167,749
Total assets	$ 1,770,573	$ 215,665	$ 952,024	$ 1,119,451	$ 285,611	$ 4,343,324
LIABILITIES AND SHAREHOLDERS' EQUITY						
Noninterest-bearing demand deposits	$	$	$	$	$ 1,239,098	$ 1,239,098
Interest-bearing demand, money market and savings	1,506,902					1,506,902
Time deposits	180,851	237,100	28,262			446,213
Borrowings[2]	106,300	45,000	225,000	225,000		601,300
Subordinated debentures	87,631		20,619	18,558	3,299	130,107
Other liabilities					44,960	44,960
Shareholders' equity					374,744	374,744
Total liabilities and shareholders' equity	$ 1,881,684	$ 282,100	$ 273,881	$ 243,558	$ 1,662,101	$ 4,343,324
Period gap	$ (111,111)	$ (66,435)	$ 678,143	$ 875,893	$ (1,376,490)	
Cumulative interest-earning assets	$ 1,770,573	$ 1,986,238	$ 2,938,262	$ 4,057,713		
Cumulative interest-bearing liabilities	$ 1,881,684	$ 2,163,784	$ 2,437,665	$ 2,681,223		
Cumulative gap	$ (111,111)	$ (177,546)	$ 500,597	$ 1,376,490		
Cumulative interest-earning assets to cumulative interest-bearing liabilities	94.1%	91.8%	120.5%	151.3%		
Cumulative gap as a percent of:						
Total assets	(2.6)%	(4.1)%	11.5%	31.7%		
Interest earning assets	(2.7)%	(4.4)%	12.3%	33.9%		

(1) Assets or liabilities which do not have a stated interest rate.

(2) Putable FHLB advances are shown based on their contractual maturites.

All amounts are reported at their contractual maturity or repricing periods. This analysis makes certain assumptions as to interest rate sensitivity of savings and interest-bearing checking accounts which have no stated maturity and have had very little price fluctuation in the recent past. Money market accounts are repriced at management's discretion and generally are more rate sensitive.

The preceding table indicates that we had a negative one year cumulative gap of $177.5 million at June 30, 2008, an increase of $6.7 million from the negative gap position of $170.8 million at March 31, 2008. The increase in the negative gap is the result of increased overnight borrowings. This gap position suggests that we are liability sensitive and if rates were to increase, our net interest margin would most likely decrease. Conversely, if rates were to decrease, our net interest margin would most likely increase. The ratio of interest-earning assets to interest-bearing liabilities maturing or repricing within one year at June 30, 2008 is 91.8%. This one year gap position indicates that interest expense is likely to be affected to a greater extent than interest income for any changes in interest rates within one year from June 30, 2008.

The Bank entered into two fixed rate term advances with FHLB totaling $300 million during the fourth quarter of 2007 and three fixed rate term advances with the FHLB totaling $150 million during the first quarter of 2008. These advances may be called by the FHLB on various call dates as detailed in Note 7 of Notes to Unaudited Condensed Consolidated Financial Statements contained in "Item 1. Unaudited Condensed Consolidated Financial Statements." While the FHLB may call the advances to be repaid for any reason, they are likely to be called if market interest rates are higher than the advances' stated rates on the call dates. If the advances are called by the FHLB, there is no prepayment penalty. We may repay the advances with a prepayment penalty at any time.

The gap table has inherent limitations and actual results may vary significantly from the results suggested by the gap table. The gap table assumes a static balance sheet, as does the net interest income simulation, and, accordingly, looks at the repricing of existing assets and liabilities without consideration of new loans and deposits that reflect a more current interest rate environment. Unlike the net interest income simulation, however, the interest rate risk profile of certain deposit products and floating rate loans that have reached their floors cannot be captured effectively in a gap table. Although the table shows the amount of certain assets and liabilities scheduled to reprice in a given time frame, it does not reflect when or to what extent such repricings may actually occur. For example, interest-bearing demand, money market and savings deposits are shown to reprice in the first three months, but we may choose to reprice these deposits more slowly and incorporate only a portion of the movement in market rates based on market conditions at that time. Alternatively, a loan which has reached its floor may not reprice despite a change in market interest rates causing such loan to act like a fixed rate loan regardless of its scheduled repricing date. For example, a loan already at its floor would not reprice if the adjusted rate was less than its floor. The gap table as presented is not able to factor in the flexibility we believe we have in repricing either deposits or the floors on our loans.

We believe the estimated effect of a change in interest rates is better reflected in our net interest income and market value of equity simulations which incorporate many of the factors mentioned.

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

Please see the section above titled "Asset/Liability Management and Interest Rate Sensitivity" in "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" which provides an update to our quantitative and qualitative disclosure about market risk. This analysis should be read in conjunction with text under the caption "Quantitative and Qualitative Disclosure About Market Risk" in our Annual Report on Form 10-K for the year ended December 31, 2007, which text is incorporated herein by reference. Our analysis of market risk and market-sensitive financial information contains forward-looking statements and is subject to the disclosure at the beginning of Item 2 regarding such forward-looking information.

ITEM 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out by the Company's management, with the participation of the Chief Executive Officer and the Chief Financial

Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, these disclosure controls and procedures were effective.

There have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. Legal Proceedings

This disclosure amends and updates our previous disclosure regarding Gilbert et. al v. Cohn et al, Case No. BC310846 currently pending in the Los Angeles Superior Court (the "Gilbert Litigation"), as previously reported in Item 3 to Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

At a hearing on June 23, 2008 the Los Angeles Superior Court stated that it approved the Stipulation of Settlement dated February 9, 2007 (the "Settlement"), and the court subsequently executed a Final Judgment and Order of Dismissal regarding the claims against the Company and First Charter's former officer. The Settlement will become effective once the time for appeal expires without an appeal being taken or once any appeal is resolved in favor of approval of the settlement. Assuming the Settlement becomes effective, the Company's contribution to the Settlement will be $775,000, which was fully accrued in 2005.

While we believe that this Settlement, if finalized, will end our exposure to the underlying claims in the Gilbert Litigation, we cannot be certain that all conditions to effectiveness of the Settlement will be satisfied.

See also Note 8 of the Notes to Unaudited Condensed Consolidated Financial Statements in Part I of this report for additional discussion of legal proceedings, which information is incorporated herein by reference.

In the ordinary course of our business, we are party to various other legal actions, which we believe are incidental to the operation of our business. Although the ultimate outcome and amount of liability, if any, with respect to these other legal actions to which we are currently a party cannot presently be ascertained with certainty, in the opinion of management, based upon information currently available to us, any resulting liability is not likely to have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

ITEM 1A. Risk Factors

There have been no material changes with respect to the risk factors described in Item 1A. to Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, which Item 1A. is incorporated herein by reference.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Issuer Repurchases of Common Stock

Through the Company's Directors Deferred Compensation Plan, or the DDCP, participants in the plan may reinvest deferred amounts in the Company's common stock. The Company has the discretion whether to track purchases of common stock as if made, or to fully fund the DDCP via purchases of stock with deferred amounts. Purchases of Company common stock by the rabbi trust of the DDCP are considered repurchases of common stock by the Company since the rabbi trust is an asset of the Company. Actual purchases of Company common stock via the DDCP are made through open market purchases pursuant to the terms of the DDCP, which includes a predetermined formula and schedule for the purchase of such stock in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934. Pursuant to the terms of the DDCP, generally purchases are actually made or deemed to be made in the open market on the 15th of the month (or the next trading day) following the day on which deferred amounts are contributed to the DDCP, beginning March 15 of each year.

The following table presents stock purchases made during the second quarter of 2008 under our publicly announced share repurchase program and purchases made by the DDCP:

			Publicly Announced Share Repurchase Programs		
	Total Shares Purchased	Average Price Per Share	Total Shares Purchased	Average Price Per Share	Approximate Dollar Value of Shares that May Yet Be Purchased
April 1 April 30, 2008		$ 0.00		$ 0.00	
May 1 May 31, 2008		$ 0.00		$ 0.00	
June 1 June 30, 2008	10,598	$ 17.90		$ 0.00	
Total	10,598	$ 17.90		$ 0.00	$36,247,000

ITEM 4. Submission of Matters to a Vote of Security Holders

I. (a) The Company held a Special Meeting of Shareholders on April 23, 2008.

(c) At the Special Meeting, shareholders voted to approve the reincorporation of the Company from California to Delaware. The results of the voting were as follows:

Matter	Votes For	Votes Against	Abstentions	Broker Non-Votes
To approve the reincorporation of the Company from California to Delaware	18,423,590	120,343	29,566	

II. (a) The Company held its Annual Meeting of Shareholders on May 13, 2008.

(c) At the Annual Meeting, shareholders voted on the election of the Company's directors. All nominees for director were elected. The results of the voting were as follows:

Matter	Votes For	Withheld
Election of Directors:		
Mark N. Baker	24,013,034	369,261
Gary W. Deems	24,206,950	175,345
Stephen M. Dunn	24,131,172	251,123
John M. Eggemeyer	23,639,886	742,409
Barry C. Fitzpatrick	24,115,233	267,062
George E. Langley	24,254,299	127,996
Susan E. Lester	24,139,228	243,067
Timothy B. Matz	23,363,907	1,018,388
Arnold W. Messer	24,137,265	245,030
Daniel B. Platt	24,043,262	339,033
Robert A. Stine	24,049,595	332,700
Matthew P. Wagner	24,245,141	137,154
David S. Williams	23,929,238	453,057

ITEM 6. Exhibits

Exhibit Number	Description
3.1	Certificate of Incorporation, as amended, of PacWest Bancorp, a Delaware corporation (Exhibit 3.1 to Form 8-K filed on May 14, 2008 and incorporated herein by this reference).
3.2	Bylaws of PacWest Bancorp, a Delaware corporation, dated April 22, 2008 (Exhibit 3.2 to Form 8-K filed on May 14, 2008 and incorporated herein by this reference).
31.1	Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

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.

	PACWEST BANCORP
DATE: AUGUST 7, 2008	/s/ VICTOR R. SANTORO
	Victor R. Santoro
	Executive Vice President and Chief Financial Officer

QuickLinks