

FARMERS & MERCHANTS BANCORP INC  
Form 10-Q  
October 24, 2018

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10 Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period September 30, 2018

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission File Number 001-38084

FARMERS & MERCHANTS BANCORP, INC.

(Exact name of registrant as specified in its charter)

OHIO 34-1469491  
(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)

307 North Defiance Street, Archbold, Ohio 43502  
(Address of principal executive offices) (Zip Code)

(419) 446-2501

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Registrant's telephone number, including area code

(Former name, former address and former fiscal year, if changed since last report.)

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

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

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

|                         |                           |
|-------------------------|---------------------------|
| Large accelerated filer | Accelerated filer         |
| Non-accelerated filer   | Smaller reporting company |
| Emerging growth company |                           |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes      No

Indicate the number of shares of each of the issuers' classes of common stock, as of the latest practicable date:

|                            |                                    |
|----------------------------|------------------------------------|
| Common Stock, No Par Value | 9,285,261                          |
| Class                      | Outstanding as of October 19, 2018 |

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10Q

FARMERS & MERCHANTS BANCORP, INC.

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| 101.INS | XBRL Instance Document (1)                                 |    |
| 101.SCH | XBRL Taxonomy Extension Scheme Document (1)                |    |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document (1)  |    |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document (1)   |    |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document (1)        |    |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document (1) |    |

(1) Pursuant to Rule 406T of Regulation S-T, the interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

## ITEM 1 FINANCIAL STATEMENTS

## FARMERS &amp; MERCHANTS BANCORP, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

|  | (in thousands of dollars) |                      |
|--|---------------------------|----------------------|
|  | September 30,<br>2018     | December 31,<br>2017 |
|  | (Unaudited)               |                      |
| <b>Assets</b>  |                           |                      |
| Cash and due from banks  | \$28,782                  | \$ 33,480            |
| Federal funds sold   | 939                       | 987                  |
| Total cash and cash equivalents                                      | 29,721                    | 34,467               |
| Interest-bearing time deposits                                       | 4,019                     | 4,018                |
| Securities - available-for-sale                                      | 183,075                   | 196,398              |
| Other securities, at cost  | 3,717                     | 3,717                |
| Loans held for sale  | 1,679                     | 1,221                |
| Loans, net   | 831,943                   | 816,156              |
| Premises and equipment   | 22,117                    | 21,726               |
| Goodwill   | 4,074                     | 4,074                |
| Mortgage servicing rights  | 2,373                     | 2,299                |
| Other real estate owned  | 717                       | 674                  |
| Bank owned life insurance  | 14,799                    | 14,523               |
| Other assets   | 9,778                     | 7,736                |
| <b>Total Assets</b>  | <b>\$1,108,012</b>        | <b>\$ 1,107,009</b>  |
| <b>Liabilities and Stockholders' Equity</b>                          |                           |                      |
| <b>Liabilities</b>   |                           |                      |
| <b>Deposits</b>  |                           |                      |
| Noninterest-bearing  | \$197,088                 | \$ 199,114           |
| Interest-bearing   |                           |                      |
| NOW accounts   | 314,873                   | 298,711              |
| Savings  | 230,306                   | 233,949              |
| Time   | 186,592                   | 187,566              |
| <b>Total deposits</b>  | <b>928,859</b>            | <b>919,340</b>       |
| Federal funds purchased and securities sold under agreements to      |                           |                      |
| repurchase   | 27,026                    | 39,495               |
| Federal Home Loan Bank (FHLB) advances                               | 5,000                     | 5,000                |
| Dividend payable   | 1,287                     | 1,193                |
| Accrued expenses and other liabilities                               | 6,493                     | 7,844                |
| <b>Total liabilities</b>   | <b>968,665</b>            | <b>972,872</b>       |
| <b>Commitments and Contingencies</b>                                 |                           |                      |
| <b>Stockholders' Equity</b>  |                           |                      |
| Common stock - No par value 20,000,000 shares authorized; issued and |                           |                      |
| outstanding 10,400,000 shares 9/30/18 and 12/31/17                   | 10,589                    | 11,546               |

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|  |             |              |
|--|-------------|--------------|
| Treasury stock - 1,114,739 shares 9/30/18, 1,134,120 shares 12/31/17 | (12,409 )   | (12,160 )    |
| Retained earnings  | 146,072     | 136,577      |
| Accumulated other comprehensive loss                                 | (4,905 )    | (1,826 )     |
| Total stockholders' equity   | 139,347     | 134,137      |
| Total Liabilities and Stockholders' Equity                           | \$1,108,012 | \$ 1,107,009 |

See Notes to Condensed Consolidated Unaudited Financial Statements.

Note: The December 31, 2017, Condensed Consolidated Balance Sheet has been derived from the audited Consolidated Balance Sheet as of that date.

## FARMERS &amp; MERCHANTS BANCORP, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

|  | (in thousands of<br>dollars, except per<br>share data)<br>Three Months Ended<br>September 30,<br>2018 |          | (in thousands of<br>dollars, except per<br>share data)<br>Nine Months Ended<br>September 30,<br>2018 |           |
|--|---|----------|--|-----------|
|  | 2018  | 2017     | 2018   | 2017      |
| <b>Interest Income</b>   |   |          |  |           |
| Loans, including fees  | \$ 10,725   | \$ 9,547 | \$ 31,348  | \$ 27,367 |
| Debt securities:   |   |          |  |           |
| U.S. Treasury and government agencies                                      | 613   | 605      | 1,848  | 1,870     |
| Municipalities   | 275   | 290      | 845  | 905       |
| Dividends  | 56  | 49       | 164  | 135       |
| Federal funds sold and other   | 84  | 44       | 221  | 103       |
| Total interest income  | 11,753  | 10,535   | 34,426   | 30,380    |
| <b>Interest Expense</b>  |   |          |  |           |
| Deposits   | 1,611   | 1,161    | 4,319  | 3,289     |
| Federal funds purchased and securities sold under agreements to repurchase | 134   | 135      | 376  | 366       |
| Borrowed funds   | 20  | 37       | 60   | 110       |
| Total interest expense   | 1,765   | 1,333    | 4,755  | 3,765     |
| Net Interest Income - Before Provision for Loan Losses                     | 9,988   | 9,202    | 29,671   | 26,615    |
| Provision for Loan Losses  | 47  | 99       | 219  | 197       |
| Net Interest Income After Provision<br>For Loan Losses                     | 9,941   | 9,103    | 29,452   | 26,418    |
| <b>Noninterest Income</b>  |   |          |  |           |
| Customer service fees  | 1,392   | 1,320    | 4,323  | 4,131     |
| Other service charges and fees   | 1,097   | 1,134    | 3,149  | 3,214     |
| Net gain on sale of loans  | 184   | 181      | 617  | 600       |
| Net gain on sale of available-for-sale securities                          | 10  | -        | 10   | 47        |
| Total noninterest income   | 2,683   | 2,635    | 8,099  | 7,992     |
| <b>Noninterest Expense</b>   |   |          |  |           |
| Salaries and wages   | 3,391   | 3,236    | 9,926  | 9,374     |
| Employee benefits  | 1,029   | 943      | 3,013  | 2,648     |
| Net occupancy expense  | 478   | 434      | 1,306  | 1,221     |
| Furniture and equipment  | 588   | 493      | 1,660  | 1,456     |
| Data processing  | 364   | 300      | 1,000  | 919       |
| Franchise taxes  | 243   | 226      | 710  | 676       |
| ATM expense  | 327   | 256      | 972  | 853       |
| Advertising  | 236   | 181      | 669  | 548       |
| Net loss on sale of other assets owned                                     | 1   | 13       | 17   | 27        |
| FDIC assessment  | 81  | 82       | 249  | 247       |
| Mortgage servicing rights amortization                                     | 84  | 85       | 264  | 266       |
| Other general and administrative   | 1,304   | 1,108    | 3,618  | 3,291     |

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|                                      |         |          |          |          |
|--------------------------------------|---------|----------|----------|----------|
| Total noninterest expense            | 8,126   | 7,357    | 23,404   | 21,526   |
| Income Before Income Taxes           | 4,498   | 4,381    | 14,147   | 12,884   |
| Income Taxes                         | 623     | 1,159    | 2,391    | 3,600    |
| Net Income                           | \$3,875 | \$ 3,222 | \$11,756 | \$ 9,284 |
| Basic and Diluted Earnings Per Share | \$0.42  | \$ 0.35  | \$1.27   | \$ 1.01  |
| Dividends Declared                   | \$0.14  | \$ 0.13  | \$0.41   | \$ 0.37  |

See Notes to Condensed Consolidated Unaudited Financial Statements



## FARMERS &amp; MERCHANTS BANCORP, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

|  | (in thousands of dollars) |          | (in thousands of dollars) |           |
|--|---------------------------|----------|---------------------------|-----------|
|  | Three Months Ended        |          | Nine Months Ended         |           |
|  | September 30,             |          | September 30,             |           |
|  | 2018                      | 2017     | 2018                      | 2017      |
| Net Income                                       | \$3,875                   | \$ 3,222 | \$11,756                  | \$ 9,284  |
| Other Comprehensive Income (Loss) (Net of Tax):  |                           |          |                           |           |
| Net unrealized gain (loss) on available-for-sale |                           |          |                           |           |
| securities                                       | (617 )                    | (472 )   | (3,432 )                  | 1,984     |
| Reclassification adjustment for gain on sale of  |                           |          |                           |           |
| available-for-sale securities                    | (10 )                     | -        | (10 )                     | (47 )     |
| Net unrealized gain (loss) on available-for-sale |                           |          |                           |           |
| securities                                       | (627 )                    | (472 )   | (3,442 )                  | 1,937     |
| Tax expense (benefit)                            | (132 )                    | (160 )   | (723 )                    | 659       |
| Other comprehensive income (loss)                | (495 )                    | (312 )   | (2,719 )                  | 1,278     |
| Comprehensive Income                             | \$3,380                   | \$ 2,910 | \$9,037                   | \$ 10,562 |

See Notes to Condensed Consolidated Unaudited Financial Statements

## FARMERS &amp; MERCHANTS BANCORP, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands of dollars)  
 Nine Months Ended  
 September 30, 2018      September 30, 2017

|   |           |           |
|---|-----------|-----------|
| <b>Cash Flows from Operating Activities</b>                                       |           |           |
| Net income  | \$ 11,756 | \$ 9,284  |
| Adjustments to reconcile net income to net cash provided by operating activities: |           |           |
| Depreciation  | 1,411     | 1,426     |
| Amortization on available-for-sale securities, net                                | 743       | 843       |
| Amortization of servicing rights  | 264       | 266       |
| Amortization of core deposit intangible   | 126       | 203       |
| Compensation expense related to stock awards                                      | 497       | 346       |
| Deferred income taxes   | (723 )    | 1,116     |
| Provision for loan loss   | 219       | 197       |
| Gain on sale of loans held for sale   | (617 )    | (600 )    |
| Originations of loans held for sale   | (40,814)  | (42,601 ) |
| Proceeds from sale of loans held for sale   | 39,435    | 44,574    |
| Loss on sale of other assets owned  | 17        | 27        |
| Gain on sales of securities available-for-sale                                    | (10 )     | (47 )     |
| Change in other assets and other liabilities, net                                 | (2,531 )  | (2,918 )  |
| Net cash provided by operating activities   | 9,773     | 12,116    |
| <b>Cash Flows from Investing Activities</b>                                       |           |           |
| Activity in available-for-sale securities:  |           |           |
| Maturities, prepayments and calls   | 11,754    | 16,682    |
| Sales   | 6,781     | 13,562    |
| Purchases   | (9,416 )  | (3,387 )  |
| Change in interest-bearing time deposits  | 1         | (626 )    |
| Proceeds from sale of other assets owned  | 8         | 133       |
| Additions to premises and equipment   | (1,911 )  | (1,459 )  |
| Loan originations and principal collections, net                                  | (14,627)  | (39,195 ) |
| Net cash used in investing activities   | (7,410 )  | (14,290 ) |
| <b>Cash Flows from Financing Activities</b>                                       |           |           |
| Net change in deposits  | 9,519     | 61,163    |
| Net change in federal funds purchased and securities sold under agreements        |           |           |
| to repurchase   | (12,469)  | (34,774 ) |
| Purchase of treasury stock  | (490 )    | (183 )    |
| Cash dividends paid on common stock   | (3,669 )  | (3,250 )  |
| Net cash provided by (used in) financing activities                               | (7,109 )  | 22,956    |
| Net Increase (Decrease) in Cash and Cash Equivalents                              | (4,746 )  | 20,782    |
| Cash and cash equivalents - Beginning of year                                     | 34,467    | 28,322    |

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|  |          |           |
|--|----------|-----------|
| Cash and cash equivalents - End of period    | \$29,721 | \$ 49,104 |
| Supplemental Information                     |          |           |
| Cash paid during the year for:               |          |           |
| Interest                                     | \$4,706  | \$ 3,735  |
| Income taxes                                 | \$2,407  | \$ 3,802  |
| Noncash investing activities:                |          |           |
| Transfer of loans to other real estate owned | \$68     | \$ -      |

See Notes to Condensed Consolidated Unaudited Financial Statements.

# ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

## NOTE 1 BASIS OF PRESENTATION AND OTHER

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10Q and Rule 10-01 of Regulation S-X; accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Share data has been adjusted to reflect a 2-for-1 stock split on September 20, 2017. Operating results for the nine months ended September 30, 2018 are not necessarily indicative of the results that are expected for the year ended December 31, 2018. The condensed consolidated balance sheet of the Company as of December 31, 2017, has been derived from the audited consolidated balance sheet of the Company as of that date. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The Company recognizes revenues as they are earned based on contractual terms, as transactions occur, or as services are provided and collectability is reasonably assured. The Company's principal source of revenue is interest income from loans and investment securities. The Company also earns noninterest income from various banking and financial services offered primarily through Farmers & Merchants State Bank. Interest income is primarily recognized on an accrual basis according to nondiscretionary formulas written in contracts, such as loan agreements or investment security contracts. The Company also earns noninterest income from various banking and financial services provided to business and consumer clients such as deposit account, debit card, and mortgage banking services. Revenue is recorded for noninterest income based on the contractual terms for the service or transaction performed.

## NOTE 2 ASSET PURCHASES

The Company purchased an office on December 13, 2013 in Custar, Ohio. Core deposit intangible assets of \$1.17 million were recognized and are being amortized over its remaining economic useful life of the deposits of 7 years on a straight line basis.

The amortization expense for the year ended December 31, 2017 was \$245 thousand, which included the remaining \$78 thousand from the purchase of the Hicksville office on July 9, 2010. Of the \$167 thousand to be expensed in 2018, \$126 thousand has been expensed for the nine months ended September 30, 2018.

| (In Thousands) |        |
|----------------|--------|
| Custar         |        |
| 2018           | \$ 167 |
| 2019           | 167    |
| 2020           | 161    |
|                | \$ 495 |

## NOTE 3 SECURITIES

Mortgage-backed securities, as shown in the following tables, are all government sponsored enterprises. The amortized cost and fair value of securities, with gross unrealized gains and losses at September 30, 2018 and December 31, 2017, follows:

|                                     | (In Thousands)     |            |             |           |
|-------------------------------------|--------------------|------------|-------------|-----------|
|                                     | September 30, 2018 |            |             |           |
|                                     | Amortized          | Gross      | Gross       | Fair      |
|                                     | Cost               | Unrealized | Unrealized  | Value     |
|                                     |                    | Gains      | Losses      |           |
| Available-for-Sale:                 |                    |            |             |           |
| U.S. Treasury                       | \$21,141           | \$ -       | \$ (370 )   | \$20,771  |
| U.S. Government agencies            | 78,753             | -          | (2,986 )    | 75,767    |
| Mortgage-backed securities          | 36,350             | 11         | (1,761 )    | 34,600    |
| State and local governments         | 53,040             | 199        | (1,302 )    | 51,937    |
| Total available-for-sale securities | \$189,284          | \$ 210     | \$ (6,419 ) | \$183,075 |

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 3 SECURITIES (Continued)

|                                     | (In Thousands)    |                              |                               |               |
|-------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
|                                     | December 31, 2017 |                              |                               |               |
|                                     | Cost              | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| Available-for-Sale:                 |                   |                              |                               |               |
| U.S. Treasury                       | \$21,219          | \$ -                         | \$ (241 )                     | \$20,978      |
| U.S. Government agencies            | 82,198            | -                            | (1,732 )                      | 80,466        |
| Mortgage-backed securities          | 40,236            | 64                           | (790 )                        | 39,510        |
| State and local governments         | 55,512            | 437                          | (505 )                        | 55,444        |
| Total available-for-sale securities | \$199,165         | \$ 501                       | \$ (3,268 )                   | \$196,398     |

Investment securities will at times depreciate to an unrealized loss position. The Company utilizes the following criteria to assess whether impairment is other than temporary. No one item by itself will necessarily signal that a security should be recognized as an other than temporary impairment.

1. The fair value of the security has significantly declined from book value.
2. A downgrade has occurred that lowered the credit rating to below investment grade (below Baa3 by Moody and BBB – by Standard and Poors.)
3. Dividends have been reduced or eliminated or scheduled interest payments have not been made.
4. The underwater security has longer than 10 years to maturity and the loss position had existed for more than 3 years.
5. Management does not possess both the intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

If the impairment is judged to be other than temporary, the cost basis of the individual security shall be written down to fair value, thereby establishing a new cost basis. The new cost basis shall not be changed for subsequent recoveries in fair value. The amount of the write down shall be included in current earnings as a realized loss. The recovery in fair value, if any, shall be recognized in earnings when the security is sold. The table below is presented by category of security and length of time in a continuous loss position. The Company currently does not hold any securities with other than temporary impairment.

Information pertaining to securities with gross unrealized losses at September 30, 2018 and December 31, 2017, aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

| (In Thousands)        |                         |  |  |
|-----------------------|-------------------------|--|--|
| September 30, 2018    |                         |  |  |
| Less                  |                         |  |  |
| Than Twelve<br>Months | Twelve Months &<br>Over |  |  |
| Fair                  | Fair                    |  |  |

|                                     | Gross<br>Unrealized<br>Losses Value |          | Gross<br>Unrealized<br>Losses Value |           |
|-------------------------------------|-------------------------------------|----------|-------------------------------------|-----------|
| U.S. Treasury                       | \$(111)                             | \$6,860  | \$(259 )                            | \$13,910  |
| U.S. Government agencies            | (166)                               | 7,424    | (2,820)                             | 68,344    |
| Mortgage-backed securities          | (132)                               | 7,220    | (1,629)                             | 26,657    |
| State and local governments         | (350)                               | 23,413   | (952 )                              | 20,371    |
| Total available-for-sale securities | \$(759)                             | \$44,917 | \$(5,660)                           | \$129,282 |

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 3 SECURITIES (Continued)

|                                     | (In Thousands)    |          |                 |           |
|-------------------------------------|-------------------|----------|-----------------|-----------|
|                                     | December 31, 2017 |          |                 |           |
|                                     | Less              |          |                 |           |
|                                     | Than Twelve       |          | Twelve Months & |           |
|                                     | Months            |          | Over            |           |
|                                     | Gross             |          | Gross           |           |
|                                     | Unrealized        | Fair     | Unrealized      | Fair      |
|                                     | Losses            | Value    | Losses          | Value     |
| U.S. Treasury                       | \$(36 )           | \$6,924  | \$(205 )        | \$14,054  |
| U.S. Government agencies            | (314)             | 27,328   | (1,418)         | 53,139    |
| Mortgage-backed securities          | (70 )             | 7,149    | (720 )          | 28,080    |
| State and local governments         | (205)             | 24,999   | (300 )          | 11,567    |
| Total available-for-sale securities | \$(625)           | \$66,400 | \$(2,643)       | \$106,840 |

Unrealized losses on securities have not been recognized into income because the issuers' bonds are of high credit quality, values have only been impacted by rate changes, and the Company has the intent and ability to hold the securities for the foreseeable future. Additionally, the decline in value is primarily due to changes in interest rates since the securities were purchased. The fair value is expected to recover as the bonds approach the maturity date.

Below are the gross realized gains and losses for the three and nine months ended September 30, 2018 and September 30, 2017.

|   | Three Months |      | Nine Months |       |
|---|--------------|------|-------------|-------|
|   | (In          |      | (In         |       |
|   | Thousands)   |      | Thousands)  |       |
|   | 2018         | 2017 | 2018        | 2017  |
| Gross realized gains                      | \$ 51        | \$ - | \$51        | \$58  |
| Gross realized losses                     | (41 )        | -    | (41 )       | (11 ) |
| Net realized gains                        | \$ 10        | \$ - | \$10        | \$47  |
| Tax expense related to net realized gains | \$ 2         | \$ - | \$2         | \$16  |

The net realized gains on sales and related tax expense is a reclassification out of accumulated other comprehensive income (loss). The net realized gain is included in net gain on sale of available-for-sale securities and the related tax expense is included in income taxes in the condensed consolidated statements of income and comprehensive income.

The amortized cost and fair value of debt securities at September 30, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.



|                                    | (In Thousands) |            |
|------------------------------------|----------------|------------|
|                                    | Amortized      |            |
|                                    | Cost           | Fair Value |
| One year or less                   | \$34,797       | \$34,563   |
| After one year through five years  | 70,423         | 68,544     |
| After five years through ten years | 44,678         | 42,533     |
| After ten years                    | 3,036          | 2,835      |
| Total                              | \$152,934      | \$148,475  |
| Mortgage-backed securities         | 36,350         | 34,600     |
| Total                              | \$189,284      | \$183,075  |

Investments with a carrying value of \$81.2 million and \$82.9 million at September 30, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and securities sold under repurchase agreements.

Other securities include Federal Home Loan Bank of Cincinnati and Farmer Mac stock as of September 30, 2018 and December 31, 2017.

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS

Loan balances as of September 30, 2018 and December 31, 2017:

| Loans:                                 | (In Thousands)     |                   |
|--|--------------------|-------------------|
|  | September 30, 2018 | December 31, 2017 |
| Consumer Real Estate                   | \$83,134           | \$ 83,620         |
| Agricultural Real Estate               | 68,548             | 64,073            |
| Agricultural                           | 103,624            | 95,111            |
| Commercial Real Estate                 | 417,217            | 410,520           |
| Commercial and Industrial              | 119,536            | 126,275           |
| Consumer                               | 41,444             | 37,757            |
| Industrial Development Bonds           | 6,005              | 6,415             |
|  | 839,508            | 823,771           |
| Less: Net deferred loan fees and costs | (810 )             | (747 )            |
|  | 838,698            | 823,024           |
| Less: Allowance for loan losses        | (6,755 )           | (6,868 )          |
| Loans - Net                            | \$831,943          | \$ 816,156        |

The following is a contractual maturity schedule by major category of loans as of September 30, 2018:

|                              | (In Thousands)  |                                  |                  |
|------------------------------|-----------------|----------------------------------|------------------|
|                              | Within One Year | After One Year Within Five Years | After Five Years |
| Consumer Real Estate         | \$4,537         | \$16,239                         | \$62,358         |
| Agricultural Real Estate     | 1,168           | 5,448                            | 61,932           |
| Agricultural                 | 65,987          | 25,287                           | 12,350           |
| Commercial Real Estate       | 16,295          | 146,828                          | 254,094          |
| Commercial and Industrial    | 64,513          | 46,655                           | 8,368            |
| Consumer                     | 4,960           | 26,926                           | 9,558            |
| Industrial Development Bonds | 600             | 65                               | 5,340            |

The distribution of fixed rate loans and variable rate loans by major loan category is as follows as of September 30, 2018:

|                              | (In Thousands) |                  |
|------------------------------|----------------|------------------|
|                              | Fixed<br>Rate  | Variable<br>Rate |
| Consumer Real Estate         | \$38,575       | \$44,559         |
| Agricultural Real Estate     | 49,110         | 19,438           |
| Agricultural                 | 37,032         | 66,592           |
| Commercial Real Estate       | 257,596        | 159,621          |
| Commercial and Industrial    | 45,603         | 73,933           |
| Consumer                     | 37,207         | 4,237            |
| Industrial Development Bonds | 6,005          | -                |

As of September 30, 2018 and December 31, 2017 one to four family residential mortgage loans amounting to \$15.4 and \$17.3 million, respectively, have been pledged as security for future loans and existing loans the Bank has received from the Federal Home Loan Bank.

Unless listed separately, Industrial Development Bonds are included in the Commercial and Industrial category for the remainder of the tables in this Note 4.

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

The following table represents the contractual aging of the recorded investment (in thousands) in past due loans by portfolio classification of loans as of September 30, 2018 and December 31, 2017, net of deferred loan fees and costs:

|                           | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>Than<br>90<br>Days | Total<br>Past<br>Due | Current   | Total<br>Financing<br>Receivables | Recorded<br>Investment ><br>90 Days and<br>Accruing |
|---------------------------|------------------------------|------------------------------|-------------------------------|----------------------|-----------|-----------------------------------|---|
| September 30, 2018        |                              |                              |                               |                      |           |                                   |   |
| Consumer Real Estate      | \$ 555                       | \$ 9                         | \$ 178                        | \$ 742               | \$81,887  | \$ 82,629                         | \$ -  |
| Agricultural Real Estate  | -                            | -                            | -                             | -                    | 68,524    | 68,524                            | -   |
| Agricultural              | -                            | -                            | -                             | -                    | 103,760   | 103,760                           | -   |
| Commercial Real Estate    | -                            | -                            | -                             | -                    | 416,632   | 416,632                           | -   |
| Commercial and Industrial | -                            | -                            | -                             | -                    | 125,612   | 125,612                           | -   |
| Consumer                  | 35                           | -                            | -                             | 35                   | 41,506    | 41,541                            | -   |
| Total                     | \$ 590                       | \$ 9                         | \$ 178                        | \$ 777               | \$837,921 | \$ 838,698                        | \$ -  |
|                           |                              |                              |                               |                      |           |                                   |   |
|                           | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>Than<br>90<br>Days | Total<br>Past<br>Due | Current   | Total<br>Financing<br>Receivables | Recorded<br>Investment ><br>90 Days and<br>Accruing |
| December 31, 2017         |                              |                              |                               |                      |           |                                   |   |
| Consumer Real Estate      | \$ 565                       | \$ 212                       | \$ 113                        | \$ 890               | \$82,310  | \$ 83,200                         | \$ -  |
| Agricultural Real Estate  | -                            | -                            | 101                           | 101                  | 63,943    | 64,044                            | -   |
| Agricultural              | -                            | -                            | -                             | -                    | 95,238    | 95,238                            | -   |
| Commercial Real Estate    | -                            | -                            | 38                            | 38                   | 409,915   | 409,953                           | -   |
| Commercial and Industrial | -                            | 42                           | -                             | 42                   | 132,745   | 132,787                           | -   |
| Consumer                  | 34                           | 2                            | 7                             | 43                   | 37,759    | 37,802                            | -   |
| Total                     | \$ 599                       | \$ 256                       | \$ 259                        | \$ 1,114             | \$821,910 | \$ 823,024                        | \$ -  |

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

The following table presents the recorded investment in nonaccrual loans by class of loans as of September 30, 2018 and December 31, 2017:

|                          | (In Thousands)     |                   |
|--------------------------|--------------------|-------------------|
|                          | September 30, 2018 | December 31, 2017 |
| Consumer Real Estate     | \$384              | \$ 708            |
| Agricultural Real Estate | -                  | 101               |
| Agricultural             | -                  | -                 |
| Commercial Real Estate   | -                  | 38                |
| Commercial & Industrial  | 99                 | 149               |
| Consumer                 | -                  | 7                 |
| Total                    | \$483              | \$ 1,003          |

Following are the characteristics and underwriting criteria for each major type of loan the Bank offers:

**Consumer Real Estate:** Purchase, refinance, or equity financing of one to four family owner occupied dwelling. Success in repayment is subject to borrower's income, debt level, character in fulfilling payment obligations, employment, and others.

**Agricultural Real Estate:** Purchase of farm real estate or for permanent improvements to the farm real estate. Cash flow from the farm operation is the repayment source and is therefore subject to the financial success of the farm operation.

**Agricultural:** Loans for the production and housing of crops, fruits, vegetables, and livestock or to fund the purchase or re-finance of capital assets such as machinery and equipment and livestock. The production of crops and livestock is especially vulnerable to commodity prices and weather. The vulnerability to commodity prices is offset by the farmer's ability to hedge their position by the use of the future contracts. The risk related to weather is often mitigated by requiring crop insurance.

**Commercial Real Estate:** Construction, purchase, and refinance of business purpose real estate. Risks include potential construction delays and overruns, vacancies, collateral value subject to market value fluctuations, interest rate, market demands, borrower's ability to repay in orderly fashion, and others. The Bank does employ stress testing on higher balance loans to mitigate risk by ensuring the customer's ability to repay in a changing rate environment before granting loan approval.

**Commercial and Industrial:** Loans to proprietorships, partnerships, or corporations to provide temporary working capital and seasonal loans as well as long term loans for capital asset acquisition. Risks include adequacy of cash flow, reasonableness of projections, financial leverage, economic trends, management ability and estimated capital expenditures during the fiscal year. The Bank does employ stress testing on higher balance loans to mitigate risk by

ensuring the customer's ability to repay in a changing rate environment before granting loan approval.

Industrial Development Bonds (IDB): Funds for public improvements in the Bank's service area. Repayment ability is based on the continuance of the taxation revenue as the source of repayment.

Consumer: Funding for individual and family purposes. Success in repayment is subject to borrower's income, debt level, character in fulfilling payment obligations, employment, and others.

The Bank uses a nine tier risk rating system to grade its loans. The grade of a loan may change during the life of the loan.

The risk ratings are described as follows.

- 1.Zero (0) Unclassified. Any loan which has not been assigned a classification.
- 2.One (1) Excellent. Credit to premier customers having the highest credit rating based on an extremely strong financial condition, which compares favorably with industry standards (upper quartile of Risk Management Association ratios). Financial statements indicate a sound earnings and financial ratio trend for several years with satisfactory profit margins and excellent liquidity exhibited. Prime credits may also be borrowers with loans fully secured by highly liquid collateral such as traded stocks, bonds, certificates of deposit, savings account, etc. No credit or collateral exceptions exist and the loan adheres to the Bank's loan policy in every respect. Financing alternatives would be readily available and would qualify for unsecured credit. This grade is summarized by high liquidity, minimum risk, strong ratios, and low handling costs.

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

NOTE 4 LOANS (Continued)

3. Two (2) Good. Desirable loans of somewhat less stature than Grade 1, but with strong financial statements. Loan supported by financial statements containing strong balance sheets, generally with a leverage position less than 1.50, and a history of profitability. Probability of serious financial deterioration is unlikely. Possessing a sound repayment source (and a secondary source), which would allow repayment in a reasonable period of time. Individual loans backed by liquid personal assets, established history and unquestionable character.

4. Three (3) Satisfactory. Satisfactory loans of average or slightly above average risk – having some deficiency or vulnerability to changing economic conditions, but still fully collectible. Projects should normally demonstrate acceptable debt service coverage. Generally, customers should have a leverage position less than 2.00. May be some weakness but with offsetting features of other support readily available. Loans that are meeting the terms of repayment.

Loans may be graded 3 when there is no recent information on which to base a current risk evaluation and the following conditions apply:

At inception, the loan was properly underwritten and did not possess an unwarranted level of credit risk:

a. At inception, the loan was secured with collateral possessing a loan-to-value adequate to protect the Bank from loss;

b. The loan exhibited two or more years of satisfactory repayment with a reasonable reduction of the principal balance;

c. During the period that the loan has been outstanding, there has been no evidence of any credit weakness. Some examples of weakness include slow payment, lack of cooperation by the borrower, breach of loan covenants, or the business is in an industry which is known to be experiencing problems. If any of these credit weaknesses are observed, a lower risk grade is warranted.

5. Four (4) Satisfactory / Monitored. A “4” (Satisfactory/Monitored) risk grade may be established for a loan considered satisfactory but which is of average credit risk due to financial weakness or uncertainty. The loans warrant a higher than average level of monitoring to ensure that weaknesses do not advance. The level of risk in Satisfactory/Monitored classification is considered acceptable and within normal underwriting guidelines so long as the loan is given management supervision.

6. Five (5) Special Mention. Loans that possess some credit deficiency or potential weakness which deserve close attention but do not yet warrant substandard classification. Such loans pose unwarranted financial risk that if not corrected could weaken the loan and increase risk in the future. The key distinctions of a 5 (Special Mention) classification are that (1) it is indicative of an unwarranted level of risk, and (2) weaknesses are considered “potential” versus “defined” impairments to the primary source of loan repayment and collateral.

7. Six (6) Substandard. One or more of the following characteristics may be exhibited in loans classified substandard:

a. Loans which possess a defined credit weakness and the likelihood that a loan will be paid from the primary source and are uncertain. Financial deterioration is underway and very close attention is warranted to ensure that the loan is collected without loss.

b. Loans are inadequately protected by the current net worth and paying capacity of the borrower.

c. The primary source of repayment is weakened and the Bank is forced to rely on a secondary source of repayment such as collateral liquidation or guarantees.

d. Loans are characterized by the distinct possibility that the Bank will sustain some loss if deficiencies are not corrected.

e. Unusual courses of action are needed to maintain a high probability of repayment.

f. The borrower is not generating enough cash flow to repay loan principal but continues to make interest payments.

g. The lender is forced into a subordinate position or unsecured collateral position due to flaws in documentation.

- h. Loans have been restructured so that payment schedules, terms and collateral represent concessions to the borrower when compared to the normal loan terms.
- i. The lender is seriously contemplating foreclosure or legal action due to the apparent deterioration in the loan.
- j. There is significant deterioration in the market conditions and the borrower is highly vulnerable to these conditions.

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ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

NOTE 4 LOANS (Continued)

8. Seven (7) Doubtful. One or more of the following characteristics may be exhibited in loans classified Doubtful:

- a. Loans have all of the weaknesses of those classified as Substandard. Additionally, these weaknesses make collection or liquidation in full based on existing conditions improbable.
- b. The primary source of repayment is gone, and there is considerable doubt as to the quality of the secondary source of repayment.
- c. The possibility of loss is high, but because of certain important pending factors which may strengthen the loan, loss classification is deferred until its exact status is known. A Doubtful classification is established deferring the realization of the loss.

- 9. Eight (8) Loss. Loans are considered uncollectable and of such little value that continuing to carry them as assets on the institution's financial statements is not feasible. Loans will be classified Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

The following table represents the risk category of loans by portfolio class, net of deferred fees and costs, based on the most recent analysis performed as of September 30, 2018 and December 31, 2017:

| (In Thousands)     |              |              |             |                |             |
|--------------------|--------------|--------------|-------------|----------------|-------------|
|                    | Agricultural |              | Commercial  | Commercial     | Industrial  |
|                    | Real Estate  | Agricultural | Real Estate | and Industrial | Development |
|                    |              |              |             |                | Bonds       |
| September 30, 2018 |              |              |             |                |             |
| 1-2                | \$4,265      | \$ 5,148     | \$ 3,179    | \$ 2,026       | \$ -        |
| 3                  | 14,710       | 32,613       | 29,383      | 18,411         | 3,189       |
| 4                  | 49,107       | 64,849       | 374,663     | 96,753         | 2,816       |
| 5                  | 431          | 1,150        | 7,528       | 277            | -           |
| 6                  | 11           | -            | 1,879       | 528            | -           |
| 7                  | -            | -            | -           | 1,612          | -           |
| 8                  | -            | -            | -           | -              | -           |
| Total              | \$68,524     | \$ 103,760   | \$ 416,632  | \$ 119,607     | \$ 6,005    |

|                   | Agricultural |              | Commercial  | Commercial     | Industrial  |
|-------------------|--------------|--------------|-------------|----------------|-------------|
|                   | Real Estate  | Agricultural | Real Estate | and Industrial | Development |
|                   |              |              |             |                | Bonds       |
| December 31, 2017 |              |              |             |                |             |
| 1-2               | \$ 4,143     | \$ 6,558     | \$ 1,244    | \$ 9,205       | \$ -        |
| 3                 | 15,244       | 37,267       | 32,498      | 15,277         | 3,489       |
| 4                 | 43,416       | 51,312       | 359,600     | 99,581         | 2,926       |
| 5                 | 1,125        | 101          | 7,758       | 1,381          | -           |
| 6                 | 116          | -            | 8,853       | 817            | -           |
| 7                 | -            | -            | -           | 111            | -           |
| 8                 | -            | -            | -           | -              | -           |
| Total             | \$ 64,044    | \$ 95,238    | \$ 409,953  | \$ 126,372     | \$ 6,415    |

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

For consumer residential real estate, and other, the Company also evaluates credit quality based on the aging status of the loan, as was previously stated, and by payment activity. The following tables present the recorded investment in those classes based on payment activity and assigned risk grading as of September 30, 2018 and December 31, 2017.

|                     | (In Thousands)       |                      |
|---------------------|----------------------|----------------------|
|                     | Consumer Real Estate | Consumer Real Estate |
|                     | September 30,        | December 31,         |
|                     | 2018                 | 2017                 |
| Grade               |                      |                      |
| Pass                | \$82,175             | \$ 82,632            |
| Special Mention (5) | -                    | -                    |
| Substandard (6)     | 454                  | 488                  |
| Doubtful (7)        | -                    | 80                   |
| Total               | \$82,629             | \$ 83,200            |

|               | (In Thousands)    |          |                  |           |
|---------------|-------------------|----------|------------------|-----------|
|               | Consumer - Credit |          | Consumer - Other |           |
|               | September 30,     |          | September 30,    |           |
|               | 2018              | 2017     | 2018             | 2017      |
| Performing    | \$3,800           | \$ 4,108 | \$37,720         | \$ 33,666 |
| Nonperforming | -                 | -        | 21               | 28        |
| Total         | \$3,800           | \$ 4,108 | \$37,741         | \$ 33,694 |

Information about impaired loans as of September 30, 2018, December 31, 2017 and September 30, 2017 are as follows:

|   | (In Thousands)     |                   |                    |
|---|--------------------|-------------------|--------------------|
|   | September 30, 2018 | December 31, 2017 | September 30, 2017 |
| Impaired loans without a valuation allowance  | \$ 1,841           | \$ 1,131          | \$ 1,294           |
| Impaired loans with a valuation allowance     | 970                | 614               | 685                |
| Total impaired loans                          | \$ 2,811           | \$ 1,745          | \$ 1,979           |
| Valuation allowance related to impaired loans | \$ 148             | \$ 106            | \$ 123             |

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|  |          |          |          |
|--|----------|----------|----------|
| Total non-accrual loans                      | \$ 483   | \$ 1,003 | \$ 1,729 |
| Total loans past-due ninety days or more and |          |          |          |
| still accruing                               | \$ -     | \$ -     | \$ -     |
| Quarter ended average investment in impaired |          |          |          |
| loans  | \$ 2,158 | \$ 2,160 | \$ 1,804 |
| Year to date average investment in impaired  |          |          |          |
| loans  | \$ 1,765 | \$ 1,885 | \$ 1,793 |

Additional funds of \$20 thousand are available to be advanced in connection with impaired loans.

The Bank had approximately \$98 thousand of its impaired loans classified as troubled debt restructured (TDR) as of September 30, 2018, \$534 thousand as of December 31, 2017 and \$540 thousand as of September 30, 2017. During the year to date 2018 and 2017, there were no new loans considered TDR.

For the three and nine month period ended September 30, 2018 and 2017, there were no TDRs that subsequently defaulted after modification.

For the nine month period ended September 30, 2018, \$418 thousand of impaired loans classified as TDR involving one relationship was paid off.

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

For the majority of the Bank's impaired loans, the Bank will apply the fair value of collateral or use a measurement incorporating the present value of expected future cash flows discounted at the loan's effective rate of interest. To determine fair value of collateral, collateral asset values securing an impaired loan are periodically evaluated. Maximum time of re-evaluation is every 12 months for chattels and titled vehicles and every two years for real estate. In this process, third party evaluations are obtained. Until such time that updated appraisals are received, the Bank may discount the collateral value used.

The Bank uses the following guidelines as stated in policy to determine when to realize a charge-off, whether a partial or full loan balance. A charge-off in whole or in part is realized when unsecured consumer loans, credit card credits and overdraft lines of credit reach 90 days delinquency. At 120 days delinquent, secured consumer loans are charged down to the value of the collateral, if repossession of the collateral is assured and/or in the process of repossession. Consumer mortgage loan deficiencies are charged down upon the sale of the collateral or sooner upon the recognition of collateral deficiency. Commercial and agricultural credits are charged down at 120 days delinquency, unless an established and approved work-out plan is in place or litigation of the credit will likely result in recovery of the loan balance. Upon notification of bankruptcy, unsecured debt is charged off. Additional charge-off may be realized as further unsecured positions are recognized.

The following tables present loans individually evaluated for impairment by class of loans for three months ended September 30, 2018 and September 30, 2017.

(In Thousands)

| Three Months Ended September 30, 2018 | Unpaid<br>Recorded Principal<br>Investment Balance | Related<br>Allowance | QTD<br>Average<br>Recorded<br>Investment | QTD<br>Interest<br>Income<br>Recognized | QTD<br>Interest<br>Income<br>Recognized<br>Cash Basis |      |
|---------------------------------------|--|----------------------|--|---|---|------|
| With no related allowance recorded:   |  |                      |  |   |   |      |
| Consumer Real Estate                  | \$589  | \$ 589               | \$ -                                     | \$ 645                                  | \$ 9  | \$ 5 |
| Agricultural Real Estate              | -  | -                    | -  | -                                       | -   | -    |
| Agricultural                          | -  | -                    | -  | -                                       | -   | -    |
| Commercial Real Estate                | 196  | 196                  | -  | 197                                     | 3   | -    |
| Commercial and Industrial             | 1,056  | 1,056                | -  | 504                                     | 12  | -    |
| Consumer                              | -  | -                    | -  | -                                       | -   | -    |
| With a specific allowance recorded:   |  |                      |  |   |   |      |
| Consumer Real Estate                  | 174  | 174                  | 26                                       | 227                                     | -   | -    |
| Agricultural Real Estate              | -  | -                    | -  | -                                       | -   | -    |
| Agricultural                          | -  | -                    | -  | -                                       | -   | -    |
| Commercial Real Estate                | -  | -                    | -  | -                                       | -   | -    |
| Commercial and Industrial             | 796  | 796                  | 122                                      | 585                                     | 3   | -    |
| Consumer                              | -  | -                    | -  | -                                       | -   | -    |
| Totals:                               |  |                      |  |   |   |      |
| Consumer Real Estate                  | \$763  | \$ 763               | \$ 26                                    | \$ 872                                  | \$ 9  | \$ 5 |
| Agricultural Real Estate              | \$-  | \$ -                 | \$ -                                     | \$ -                                    | \$ -  | \$ - |

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|                           |         |          |        |          |       |      |
|---------------------------|---------|----------|--------|----------|-------|------|
| Agricultural              | \$-     | \$ -     | \$ -   | \$ -     | \$ -  | \$ - |
| Commercial Real Estate    | \$196   | \$ 196   | \$ -   | \$ 197   | \$ 3  | \$ - |
| Commercial and Industrial | \$1,852 | \$ 1,852 | \$ 122 | \$ 1,089 | \$ 15 | \$ - |
| Consumer                  | \$-     | \$ -     | \$ -   | \$ -     | \$ -  | \$ - |

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

(In Thousands)

| Three Months Ended September 30, 2017 | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | QTD<br>Average<br>Recorded<br>Investment | QTD<br>Interest<br>Income<br>Recognized | QTD<br>Interest<br>Income<br>Recognized<br>Cash Basis |
|---------------------------------------|------------------------|--------------------------------|----------------------|--|---|---|
| With no related allowance recorded:   |                        |                                |                      |  |   |   |
| Consumer Real Estate                  | \$928                  | \$ 928                         | \$ -                 | \$ 926                                   | \$ 8                                    | \$ 5  |
| Agricultural Real Estate              | 205                    | 205                            | -                    | 136                                      | -                                       | -   |
| Agricultural                          | 161                    | 161                            | -                    | 54                                       | -                                       | -   |
| Commercial Real Estate                | -                      | -                              | -                    | -  | -                                       | -   |
| Commercial and Industrial             | -                      | -                              | -                    | -  | -                                       | -   |
| Consumer                              | -                      | -                              | -                    | -  | -                                       | -   |
| With a specific allowance recorded:   |                        |                                |                      |  |   |   |
| Consumer Real Estate                  | 84                     | 84                             | 25                   | 85                                       | -                                       | -   |
| Agricultural Real Estate              | -                      | -                              | -                    | -  | -                                       | -   |
| Agricultural                          | -                      | -                              | -                    | -  | -                                       | -   |
| Commercial Real Estate                | 488                    | 488                            | 67                   | 489                                      | 5                                       | -   |
| Commercial and Industrial             | 113                    | 113                            | 31                   | 114                                      | -                                       | -   |
| Consumer                              | -                      | -                              | -                    | -  | -                                       | -   |
| Totals:                               |                        |                                |                      |  |   |   |
| Consumer Real Estate                  | \$1,012                | \$ 1,012                       | \$ 25                | \$ 1,011                                 | \$ 8                                    | \$ 5  |
| Agricultural Real Estate              | \$205                  | \$ 205                         | \$ -                 | \$ 136                                   | \$ -                                    | \$ -  |
| Agricultural                          | \$161                  | \$ 161                         | \$ -                 | \$ 54                                    | \$ -                                    | \$ -  |
| Commercial Real Estate                | \$488                  | \$ 488                         | \$ 67                | \$ 489                                   | \$ 5                                    | \$ -  |
| Commercial and Industrial             | \$113                  | \$ 113                         | \$ 31                | \$ 114                                   | \$ -                                    | \$ -  |
| Consumer                              | \$-                    | \$ -                           | \$ -                 | \$ -                                     | \$ -                                    | \$ -  |

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

The following tables present loans individually evaluated for impairment by class of loans for nine month period ended September 30, 2018 and September 30, 2017.

(In Thousands)

| Nine Months Ended September 30, 2018 | Unpaid<br>Recorded Principal<br>Investment Balance | Related<br>Allowance | YTD<br>Average<br>Recorded<br>Investment | YTD<br>Interest<br>Income<br>Recognized | YTD<br>Interest<br>Income<br>Recognized<br>Cash Basis |       |
|--------------------------------------|--|----------------------|--|---|---|-------|
| With no related allowance recorded:  |  |                      |  |   |   |       |
| Consumer Real Estate                 | \$589  | \$ 589               | \$ -                                     | \$ 554                                  | \$ 23   | \$ 15 |
| Agricultural Real Estate             | -  | -                    | -  | 22                                      | -   | -     |
| Agricultural                         | -  | -                    | -  | -                                       | -   | -     |
| Commercial Real Estate               | 196  | 196                  | -  | 199                                     | 8   | -     |
| Commercial and Industrial            | 1,056  | 1,056                | -  | 238                                     | 12  | -     |
| Consumer                             | -  | -                    | -  | -                                       | -   | -     |
| With a specific allowance recorded:  |  |                      |  |   |   |       |
| Consumer Real Estate                 | 174  | 174                  | 26                                       | 153                                     | -   | -     |
| Agricultural Real Estate             | -  | -                    | -  | -                                       | -   | -     |
| Agricultural                         | -  | -                    | -  | -                                       | -   | -     |
| Commercial Real Estate               | -  | -                    | -  | 186                                     | -   | -     |
| Commercial and Industrial            | 796  | 796                  | 122                                      | 413                                     | 11  | -     |
| Consumer                             | -  | -                    | -  | -                                       | -   | -     |
| Totals:                              |  |                      |  |   |   |       |
| Consumer Real Estate                 | \$763  | \$ 763               | \$ 26                                    | \$ 707                                  | \$ 23   | \$ 15 |
| Agricultural Real Estate             | \$-  | \$ -                 | \$ -                                     | \$ 22                                   | \$ -  | \$ -  |
| Agricultural                         | \$-  | \$ -                 | \$ -                                     | \$ -                                    | \$ -  | \$ -  |
| Commercial Real Estate               | \$196  | \$ 196               | \$ -                                     | \$ 385                                  | \$ 8  | \$ -  |
| Commercial and Industrial            | \$1,852  | \$ 1,852             | \$ 122                                   | \$ 651                                  | \$ 23   | \$ -  |
| Consumer                             | \$-  | \$ -                 | \$ -                                     | \$ -                                    | \$ -  | \$ -  |



## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

(In Thousands)

| Nine Months Ended September 30, 2017 | Recorded Investment | Unpaid Principal Balance | Related Allowance | YTD Average Recorded Investment | YTD Interest Income Recognized | YTD Interest Income Recognized Cash Basis |
|--------------------------------------|---------------------|--------------------------|-------------------|---------------------------------|--------------------------------|---|
| With no related allowance recorded:  |                     |                          |                   |                                 |                                |   |
| Consumer Real Estate                 | \$928               | \$ 928                   | \$ -              | \$ 959                          | \$ 25                          | \$ 17                                     |
| Agricultural Real Estate             | 205                 | 205                      | -                 | 119                             | -                              | -   |
| Agricultural                         | 161                 | 161                      | -                 | 18                              | -                              | -   |
| Commercial Real Estate               | -                   | -                        | -                 | -                               | -                              | -   |
| Commercial and Industrial            | -                   | -                        | -                 | -                               | -                              | -   |
| Consumer                             | -                   | -                        | -                 | -                               | -                              | -   |
| With a specific allowance recorded:  |                     |                          |                   |                                 |                                |   |
| Consumer Real Estate                 | 84                  | 84                       | 25                | 89                              | -                              | -   |
| Agricultural Real Estate             | -                   | -                        | -                 | -                               | -                              | -   |
| Agricultural                         | -                   | -                        | -                 | -                               | -                              | -   |
| Commercial Real Estate               | 488                 | 488                      | 67                | 493                             | 17                             | 2   |
| Commercial and Industrial            | 113                 | 113                      | 31                | 115                             | -                              | -   |
| Consumer                             | -                   | -                        | -                 | -                               | -                              | -   |
| Totals:                              |                     |                          |                   |                                 |                                |   |
| Consumer Real Estate                 | \$1,012             | \$ 1,012                 | \$ 25             | \$ 1,048                        | \$ 25                          | \$ 17                                     |
| Agricultural Real Estate             | \$205               | \$ 205                   | \$ -              | \$ 119                          | \$ -                           | \$ -                                      |
| Agricultural                         | \$161               | \$ 161                   | \$ -              | \$ 18                           | \$ -                           | \$ -                                      |
| Commercial Real Estate               | \$488               | \$ 488                   | \$ 67             | \$ 493                          | \$ 17                          | \$ 2                                      |
| Commercial and Industrial            | \$113               | \$ 113                   | \$ 31             | \$ 115                          | \$ -                           | \$ -                                      |
| Consumer                             | \$-                 | \$ -                     | \$ -              | \$ -                            | \$ -                           | \$ -                                      |

As of September 30, 2018, the Company had \$68 thousand of foreclosed residential real estate property obtained by physical possession and \$174 thousand of consumer mortgage loans secured by residential real estate properties for which foreclosure proceedings are in process according to local jurisdictions. As of September 30, 2017, the Company had \$25 thousand of foreclosed residential real estate property obtained by physical possession and \$59 thousand of consumer mortgage loans secured by residential real estate properties for which foreclosure proceedings were in process according to local jurisdictions.

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

The Allowance for Loan and Lease Losses (ALLL) has a direct impact on the provision expense. An increase in the ALLL is funded through recoveries and provision expense. The following tables summarize the activities in the allowance for credit losses.

|   | (In Thousands)     |                     |
|---|--------------------|---------------------|
|   | Nine Months Ended  | Twelve Months Ended |
|   | September 30, 2018 | December 31, 2017   |
| Allowance for Loan & Lease Losses         |                    |                     |
| Balance at beginning of year              | \$6,868            | \$ 6,784            |
| Provision for loan loss                   | 219                | 222                 |
| Loans charged off                         | (450 )             | (288 )              |
| Recoveries                                | 118                | 150                 |
| Allowance for Loan & Lease Losses         | \$6,755            | \$ 6,868            |
| Allowance for Unfunded Loan Commitments & |                    |                     |
| Letters of Credit                         | \$333              | \$ 227              |
| Total Allowance for Credit Losses         | \$7,088            | \$ 7,095            |

The Company segregates its ALLL into two reserves: The ALLL and the Allowance for Unfunded Loan Commitments and Letters of Credit (AULC). When combined, these reserves constitute the total Allowance for Credit Losses (ACL).

The AULC is reported within other liabilities on the balance sheet while the ALLL is netted within the loans, net asset line. The ACL presented above represents the full amount of reserves available to absorb possible credit losses.

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## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

The following table breaks down the activity within ACL for each loan portfolio classification and shows the contribution provided by both the recoveries and the provision along with the reduction of the allowance caused by charge-offs.

Additional analysis, presented in thousands, related to the allowance for credit losses for three months ended September 30, 2018 and September 30, 2017 is as follows:

|  |             |              |              |                            |            |                 | Unfunded    |       |         |
|--|-------------|--------------|--------------|----------------------------|------------|-----------------|-------------|-------|---------|
|  |             |              |              |                            |            |                 | Loan        |       |         |
|  |             |              |              |                            |            |                 | Commitment  |       |         |
|  |             |              |              |                            |            |                 | &           |       |         |
|  |             |              |              |                            |            |                 | Letters     |       |         |
|  |             |              |              |                            |            |                 | of          |       |         |
|  | Consumer    | Agricultural |              | Commercial                 | Commercial |                 |             |       |         |
|  | Real Estate | Real Estate  | Agricultural | Real Estate and Industrial | Commercial | Consumer Credit | Unallocated | Total |         |
| Three Months Ended September 30, 2018  |             |              |              |                            |            |                 |             |       |         |
| ALLOWANCE FOR CREDIT LOSSES:           |             |              |              |                            |            |                 |             |       |         |
| Beginning balance                      | \$251       | \$255        | \$751        | \$3,260                    | \$1,420    | \$459           | \$315       | \$393 | \$7,104 |
| Charge Offs                            | (29 )       | -            | -            | -                          | -          | (94 )           | -           | -     | (123 )  |
| Recoveries                             | 18          | -            | -            | 3                          | 3          | 18              | -           | -     | 42      |
| Provision (Credit)                     | (5 )        | (3 )         | (8 )         | 9                          | (25 )      | 88              | -           | (9 )  | 47      |
| Other Non-interest expense related to  |             |              |              |                            |            |                 |             |       |         |
| unfunded                               | -           | -            | -            | -                          | -          | -               | 18          | -     | 18      |
| Ending Balance                         | \$235       | \$252        | \$743        | \$3,272                    | \$1,398    | \$471           | \$333       | \$384 | \$7,088 |
| Ending balance: individually evaluated |             |              |              |                            |            |                 |             |       |         |
| for impairment                         | \$26        | \$-          | \$-          | \$-                        | \$122      | \$-             | \$-         | \$-   | \$148   |

Ending balance:  
collectively  
evaluated

|                |        |        |        |          |          |        |        |        |          |
|----------------|--------|--------|--------|----------|----------|--------|--------|--------|----------|
| for impairment | \$ 209 | \$ 252 | \$ 743 | \$ 3,272 | \$ 1,276 | \$ 471 | \$ 333 | \$ 384 | \$ 6,940 |
|----------------|--------|--------|--------|----------|----------|--------|--------|--------|----------|

Ending balance:  
loans acquired  
with

|                                |      |      |      |      |      |      |      |      |      |
|--------------------------------|------|------|------|------|------|------|------|------|------|
| deteriorated<br>credit quality | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
|--------------------------------|------|------|------|------|------|------|------|------|------|

#### FINANCING

#### RECEIVABLES:

|                |           |           |            |            |            |           |      |      |            |
|----------------|-----------|-----------|------------|------------|------------|-----------|------|------|------------|
| Ending balance | \$ 82,629 | \$ 68,524 | \$ 103,760 | \$ 416,632 | \$ 125,612 | \$ 41,541 | \$ - | \$ - | \$ 838,698 |
|----------------|-----------|-----------|------------|------------|------------|-----------|------|------|------------|

Ending balance:  
individually  
evaluated

|                |        |      |      |        |          |      |      |      |          |
|----------------|--------|------|------|--------|----------|------|------|------|----------|
| for impairment | \$ 763 | \$ - | \$ - | \$ 196 | \$ 1,852 | \$ - | \$ - | \$ - | \$ 2,811 |
|----------------|--------|------|------|--------|----------|------|------|------|----------|

Ending balance:  
collectively  
evaluated

|                |           |           |            |            |            |           |      |      |            |
|----------------|-----------|-----------|------------|------------|------------|-----------|------|------|------------|
| for impairment | \$ 81,866 | \$ 68,524 | \$ 103,760 | \$ 416,436 | \$ 123,760 | \$ 41,541 | \$ - | \$ - | \$ 835,887 |
|----------------|-----------|-----------|------------|------------|------------|-----------|------|------|------------|

Ending balance:  
loans acquired  
with

|                                |        |      |      |      |      |      |      |      |        |
|--------------------------------|--------|------|------|------|------|------|------|------|--------|
| deteriorated<br>credit quality | \$ 118 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 118 |
|--------------------------------|--------|------|------|------|------|------|------|------|--------|

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

|   |             |              |              |             |                |           | Unfunded   |             |            |
|---|-------------|--------------|--------------|-------------|----------------|-----------|------------|-------------|------------|
|   |             |              |              |             |                |           | Loan       |             |            |
|   |             |              |              |             |                |           | Commitment |             |            |
|   |             |              |              |             |                |           | &          |             |            |
|   |             |              |              |             |                |           | Letters    |             |            |
|   |             |              |              |             |                |           | of         |             |            |
|   | Consumer    | Agricultural |              | Commercial  | Commercial     |           |            |             |            |
|   | Real Estate | Real Estate  | Agricultural | Real Estate | and Industrial | Consumer  | Credit     | Unallocated | Total      |
| Three Months Ended September 30, 2017                           |             |              |              |             |                |           |            |             |            |
| ALLOWANCE FOR CREDIT LOSSES:                                    |             |              |              |             |                |           |            |             |            |
| Beginning balance   | \$ 250      | \$ 253       | \$ 596       | \$ 3,076    | \$ 1,352       | \$ 407    | \$ 219     | \$ 924      | \$ 7,077   |
| Charge Offs   | -           | -            | -            | (19 )       | -              | (92 )     | -          | -           | (111 )     |
| Recoveries  | -           | -            | -            | 4           | 2              | 18        | -          | -           | 24         |
| Provision (Credit)  | 26          | (5 )         | 17           | 56          | 38             | 90        | -          | (123 )      | 99         |
| Other Non-interest expense related to                           |             |              |              |             |                |           |            |             |            |
| unfunded  | -           | -            | -            | -           | -              | -         | 9          | -           | 9          |
| Ending Balance  | \$ 276      | \$ 248       | \$ 613       | \$ 3,117    | \$ 1,392       | \$ 423    | \$ 228     | \$ 801      | \$ 7,098   |
| Ending balance: individually evaluated                          |             |              |              |             |                |           |            |             |            |
| for impairment  | \$ 25       | \$ -         | \$ -         | \$ 67       | \$ 31          | \$ -      | \$ -       | \$ -        | \$ 123     |
| Ending balance: collectively evaluated                          |             |              |              |             |                |           |            |             |            |
| for impairment  | \$ 251      | \$ 248       | \$ 613       | \$ 3,050    | \$ 1,361       | \$ 423    | \$ 228     | \$ 801      | \$ 6,975   |
| Ending balance: loans acquired with deteriorated credit quality | \$ -        | \$ -         | \$ -         | \$ -        | \$ -           | \$ -      | \$ -       | \$ -        | \$ -       |
| FINANCING RECEIVABLES:  |             |              |              |             |                |           |            |             |            |
| Ending balance  | \$ 83,875   | \$ 63,571    | \$ 87,239    | \$ 393,913  | \$ 130,720     | \$ 35,887 | \$ -       | \$ -        | \$ 795,205 |
|   | \$ 1,012    | \$ 205       | \$ 161       | \$ 488      | \$ 113         | \$ -      | \$ -       | \$ -        | \$ 1,979   |

Ending balance:  
individually  
evaluated

for impairment

Ending balance:  
collectively  
evaluated

|                |           |           |           |            |            |           |      |      |            |
|----------------|-----------|-----------|-----------|------------|------------|-----------|------|------|------------|
| for impairment | \$ 82,863 | \$ 63,366 | \$ 87,078 | \$ 393,425 | \$ 130,607 | \$ 35,887 | \$ - | \$ - | \$ 793,226 |
|----------------|-----------|-----------|-----------|------------|------------|-----------|------|------|------------|

Ending balance:  
loans acquired with

deteriorated credit  
quality

|        |      |      |      |      |      |      |      |        |
|--------|------|------|------|------|------|------|------|--------|
| \$ 194 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 194 |
|--------|------|------|------|------|------|------|------|--------|

Additional analysis, presented in thousands, related to the allowance for credit losses for nine months ended September 30, 2018 and September 30, 2017 is as follows:

39

Ending balance:  
loans acquired  
with

deteriorated  
credit quality

FINANCING

RECEIVABLES:

|                |           |           |            |            |            |           |      |      |            |
|----------------|-----------|-----------|------------|------------|------------|-----------|------|------|------------|
| Ending balance | \$ 82,629 | \$ 68,524 | \$ 103,760 | \$ 416,632 | \$ 125,612 | \$ 41,541 | \$ - | \$ - | \$ 838,698 |
|----------------|-----------|-----------|------------|------------|------------|-----------|------|------|------------|

Ending balance:  
individually  
evaluated

|                |        |      |      |        |          |      |      |      |          |
|----------------|--------|------|------|--------|----------|------|------|------|----------|
| for impairment | \$ 763 | \$ - | \$ - | \$ 196 | \$ 1,852 | \$ - | \$ - | \$ - | \$ 2,811 |
|----------------|--------|------|------|--------|----------|------|------|------|----------|

Ending balance:  
collectively  
evaluated

|                |           |           |            |            |            |           |      |      |            |
|----------------|-----------|-----------|------------|------------|------------|-----------|------|------|------------|
| for impairment | \$ 81,866 | \$ 68,524 | \$ 103,760 | \$ 416,436 | \$ 123,760 | \$ 41,541 | \$ - | \$ - | \$ 835,887 |
|----------------|-----------|-----------|------------|------------|------------|-----------|------|------|------------|

Ending balance:  
loans acquired  
with

|                                |        |      |      |      |      |      |      |      |        |
|--------------------------------|--------|------|------|------|------|------|------|------|--------|
| deteriorated<br>credit quality | \$ 118 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 118 |
|--------------------------------|--------|------|------|------|------|------|------|------|--------|



## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 4 LOANS (Continued)

|  | Consumer    |             | Agricultural |             | Commercial     |            | Commercial |                 | Unfunded<br>Loan<br>Commitment<br>&<br>Letters<br>of |       |
|--|-------------|-------------|--------------|-------------|----------------|------------|------------|-----------------|--|-------|
|  | Real Estate | Real Estate | Agricultural | Real Estate | and Industrial | Commercial | Commercial | Consumer Credit | Unallocated  | Total |
| Nine Months Ended<br>September 30, 2017      |             |             |              |             |                |            |            |                 |  |       |
| ALLOWANCE<br>FOR CREDIT<br>LOSSES:           |             |             |              |             |                |            |            |                 |  |       |
| Beginning balance                            | \$ 316      | \$ 241      | \$ 616       | \$ 3,250    | \$ 1,318       | \$ 394     | \$ 217     | \$ 649          | \$ 7,001   |       |
| Charge Offs                                  | -           | -           | -            | (19 )       | -              | (189 )     | -          | -               | (208 )   |       |
| Recoveries                                   | 13          | -           | 2            | 11          | 8              | 63         | -          | -               | 97   |       |
| Provision (Credit)                           | (53 )       | 7           | (5 )         | (125 )      | 66             | 155        | -          | 152             | 197  |       |
| Other Non-interest<br>expense related to     |             |             |              |             |                |            |            |                 |  |       |
| unfunded                                     | -           | -           | -            | -           | -              | -          | 11         | -               | 11   |       |
| Ending Balance                               | \$ 276      | \$ 248      | \$ 613       | \$ 3,117    | \$ 1,392       | \$ 423     | \$ 228     | \$ 801          | \$ 7,098   |       |
| Ending balance:<br>individually<br>evaluated |             |             |              |             |                |            |            |                 |  |       |
| for impairment                               | \$ 25       | \$ -        | \$ -         | \$ 67       | \$ 31          | \$ -       | \$ -       | \$ -            | \$ 123   |       |
| Ending balance:<br>collectively<br>evaluated |             |             |              |             |                |            |            |                 |  |       |
| for impairment                               | \$ 251      | \$ 248      | \$ 613       | \$ 3,050    | \$ 1,361       | \$ 423     | \$ 228     | \$ 801          | \$ 6,975   |       |
| Ending balance:<br>loans acquired with       |             |             |              |             |                |            |            |                 |  |       |
| deteriorated credit<br>quality               | \$ -        | \$ -        | \$ -         | \$ -        | \$ -           | \$ -       | \$ -       | \$ -            | \$ -   |       |
| FINANCING<br>RECEIVABLES:                    |             |             |              |             |                |            |            |                 |  |       |
| Ending balance                               | \$ 83,875   | \$ 63,571   | \$ 87,239    | \$ 393,913  | \$ 130,720     | \$ 35,887  | \$ -       | \$ -            | \$ 795,205   |       |

Ending balance:  
individually  
evaluated

|                |          |        |        |        |        |      |      |      |          |
|----------------|----------|--------|--------|--------|--------|------|------|------|----------|
| for impairment | \$ 1,012 | \$ 205 | \$ 161 | \$ 488 | \$ 113 | \$ - | \$ - | \$ - | \$ 1,979 |
|----------------|----------|--------|--------|--------|--------|------|------|------|----------|

Ending balance:  
collectively  
evaluated

|                |           |           |           |            |            |           |      |      |            |
|----------------|-----------|-----------|-----------|------------|------------|-----------|------|------|------------|
| for impairment | \$ 82,863 | \$ 63,366 | \$ 87,078 | \$ 393,425 | \$ 130,607 | \$ 35,887 | \$ - | \$ - | \$ 793,226 |
|----------------|-----------|-----------|-----------|------------|------------|-----------|------|------|------------|

Ending balance:  
loans acquired with

|                                |        |      |      |      |      |      |      |      |        |
|--------------------------------|--------|------|------|------|------|------|------|------|--------|
| deteriorated credit<br>quality | \$ 194 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 194 |
|--------------------------------|--------|------|------|------|------|------|------|------|--------|

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 5 EARNINGS PER SHARE

Basic earnings per share are calculated using the two-class method. The two-class method is an earnings allocation formula under which earnings per share is calculated from common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings distributed and undistributed, are allocated to participating securities and common shares based on their respective rights to receive dividends. Unvested share-based payment awards that contain non-forfeitable rights to dividends are considered participating securities (i.e. unvested restricted stock), not subject to performance based measures. Basic earnings per share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding. Application of the two-class method for participating securities results a more dilutive basic earnings per share as the participating securities are allocated the same amount of income as if they are outstanding for purposes of basic earnings per share. There is no additional potential dilution in calculating diluted earnings per share, therefore basic and diluted earnings per share are the same amounts. Other than the restricted stock plan, the Company has no other stock based compensation plans.

|  | (in thousands of dollars) |               | (in thousands of dollars) |               |
|--|---------------------------|---------------|---------------------------|---------------|
|  | Three Months Ended        |               | Nine Months Ended         |               |
|  | September 30,             | September 30, | September 30,             | September 30, |
|  | 2018                      | 2017          | 2018                      | 2017          |
| Earnings per share   |                           |               |                           |               |
| Net income   | \$3,875                   | \$ 3,222      | \$11,756                  | \$ 9,284      |
| Less: distributed earnings allocated to participating securities                             | (13 )                     | (12 )         | (38 )                     | (33 )         |
| Less: undistributed earnings allocated to participating securities                           | (26 )                     | (19 )         | (80 )                     | (55 )         |
| Net earnings available to common shareholders  | \$3,836                   | \$ 3,191      | \$11,638                  | \$ 9,196      |
| Weighted average common shares outstanding including participating securities <sup>(1)</sup> | 9,274,507                 | 9,252,919     | 9,268,819                 | 9,245,514     |
| Less: average unvested restricted shares <sup>(1)</sup>                                      | (93,242 )                 | (88,596 )     | (92,683 )                 | (87,074 )     |
| Weighted average common shares outstanding <sup>(1)</sup>                                    | 9,181,265                 | 9,164,323     | 9,176,136                 | 9,158,440     |
| Basic earnings and diluted per share <sup>(1)</sup>  | \$0.42                    | \$ 0.35       | \$1.27                    | \$ 1.01       |



ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair values of financial instruments are management's estimate of the values at which the instruments could be exchanged in a transaction between willing parties. These estimates are subjective and may vary significantly from amounts that would be realized in actual transactions. In addition, other significant assets are not considered financial assets including deferred tax assets, premises, equipment and intangibles. Further, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered in any of the estimates.

The following assumptions and methods were used in estimating the fair value for financial instruments:

Cash and Cash Equivalents

The carrying amounts reported in the balance sheet for cash, cash equivalents and federal funds sold approximate their fair values. Also included in this line item are the carrying amounts of interest-bearing deposits maturing within ninety days which approximate their fair values. Fair values of other interest-bearing deposits are estimated using discounted cash flow analyses based on current rates for similar types of deposits.

Interest Bearing Time Deposits

Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow analysis that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Securities – Available-for-sale

Fair values for securities, excluding Federal Home Loan Bank and Farmer Mac stock, are based on quoted market price, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Other Securities

The carrying value of Federal Home Loan Bank and Farmer Mac stock, listed as "other securities", approximates fair value based on the respective redemption provisions.

Loans Held for Sale

The carrying amount approximates fair value due to insignificant amount of time between origination and date of sale.

Loans, net

The fair values of the loans are estimated using a credit mark adjustment along with discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers with similar credit quality. The

credit mark adjustment was estimated using merger and acquisition analysis of nationwide bank and thrift deals.

#### Deposits

The fair values disclosed for deposits with no defined maturities are equal to their carrying amounts, which represent the amount payable on demand. The carrying amounts for variable-rate, fixed term money market accounts and certificates of deposit approximate their fair value at the reporting date. Fair value for fixed-rate certificates of deposit are estimated using a discounted cash flow analysis that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

#### Federal Funds Purchased and Securities Sold Under Agreements to Repurchase

The carrying value of federal funds purchased and securities sold under agreements to repurchase approximates fair values.

#### FHLB Advances

Fair values or FHLB advances are estimated using discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types or borrowing arrangements.

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

## Accrued Interest Receivable and Payable

The carrying amounts of accrued interest approximate their fair values.

## Off Balance Sheet Financial Instruments

Fair values for off-balance sheet, credit related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counter-parties' credit standing.

The estimated fair values, and related carrying or notional amounts, for on and off-balance sheet financial instruments as of September 30, 2018 and December 31, 2017 are reflected below.

|  | (In Thousands)     |            |          |         |           |
|--|--------------------|------------|----------|---------|-----------|
|  | September 30, 2018 |            |          |         |           |
|  | Carrying Amount    | Fair Value | Level 1  | Level 2 | Level 3   |
| <b>Financial Assets:</b>                                 |                    |            |          |         |           |
| Cash and Cash Equivalents                                | \$29,721           | \$29,721   | \$29,721 | \$-     | \$-       |
| Interest-bearing time deposits                           | 4,019              | 4,019      | -        | 4,019   | -         |
| Securities - available-for-sale                          | 183,075            | 183,075    | 20,771   | 160,911 | 1,393     |
| Other Securities   | 3,717              | 3,717      | -        | -       | 3,717     |
| Loans held for sale                                      | 1,679              | 1,679      | -        | -       | 1,679     |
| Loans, net   | 831,943            | 815,856    | -        | -       | 815,856   |
| Interest receivable                                      | 5,826              | 5,826      | -        | -       | 5,826     |
| <b>Financial Liabilities:</b>                            |                    |            |          |         |           |
| Interest bearing Deposits                                | \$545,179          | \$545,208  | \$-      | \$-     | \$545,208 |
| Non-interest bearing Deposits                            | 197,088            | 197,088    | -        | 197,088 | -         |
| Time Deposits  | 186,592            | 186,690    | -        | -       | 186,690   |
| Total Deposits   | 928,859            | 928,986    | -        | 197,088 | 731,898   |
| <b>Federal Funds Purchased and Securities Sold Under</b> |                    |            |          |         |           |
| Agreement to Repurchase                                  | 27,026             | 27,026     | -        | -       | 27,026    |
| Federal Home Loan Bank advances                          | 5,000              | 5,001      | -        | -       | 5,001     |
| Interest payable   | 367                | 367        | -        | -       | 367       |

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

|  | (In Thousands)    |            |          |         |           |
|--|-------------------|------------|----------|---------|-----------|
|  | December 31, 2017 |            |          |         |           |
|  | Carrying Amount   | Fair Value | Level 1  | Level 2 | Level 3   |
| <b>Financial Assets:</b>                                 |                   |            |          |         |           |
| Cash and Cash Equivalents                                | \$34,467          | \$34,467   | \$34,467 | \$-     | \$-       |
| Interest-bearing time deposits                           | 4,018             | 4,009      | -        | 4,009   | -         |
| Securities - available-for-sale                          | 196,398           | 196,398    | 20,978   | 173,992 | 1,428     |
| Other Securities   | 3,717             | 3,717      | -        | -       | 3,717     |
| Loans held for sale                                      | 1,221             | 1,221      | -        | -       | 1,221     |
| Loans, net   | 816,156           | 819,193    | -        | -       | 819,193   |
| Interest receivable                                      | 4,276             | 4,276      | -        | -       | 4,276     |
| <b>Financial Liabilities:</b>                            |                   |            |          |         |           |
| Interest bearing Deposits                                | \$532,660         | \$532,660  | \$-      | \$-     | \$532,660 |
| Non-interest bearing Deposits                            | 199,114           | 199,114    | -        | 199,114 | -         |
| Time Deposits  | 187,566           | 188,335    | -        | -       | 188,335   |
| Total Deposits   | 919,340           | 920,109    | -        | 199,114 | 720,995   |
| <b>Federal Funds Purchased and Securities Sold Under</b> |                   |            |          |         |           |
| Agreement to Repurchase                                  | 39,495            | 39,495     | -        | -       | 39,495    |
| Federal Home Loan Bank advances                          | 5,000             | 5,021      | -        | -       | 5,021     |
| Interest payable   | 318               | 318        | -        | -       | 318       |

## Fair Value Measurements

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities in active markets that the Company has the ability to access.

Available-for-sale securities, when quoted prices are available in an active market, securities are valued using the quoted price and are classified as Level 1.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Available-for-sale securities classified as Level 2 are valued using the prices obtained from an independent pricing service. The prices are not adjusted. Securities of obligations of state and political subdivisions are valued using a type of matrix, or grid, pricing in which securities are benchmarked against the treasury rate based on credit rating. Substantially all assumptions used by the independent pricing service are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the



marketplace.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability. The Bank holds some local municipals that the Bank evaluates based on the credit strength of the underlying project. The fair value is determined by valuing similar credit payment streams at similar rates.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The following summarizes financial assets measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017, segregated by level or the valuation inputs within the fair value hierarchy utilized to measure fair value:

Assets and Liabilities Measured at Fair Value on a Recurring Basis (In Thousands)

|  | Quoted Prices in<br>Active Markets<br>for Identical | Significant<br>Observable<br>Inputs | Significant<br>Observable<br>Inputs |
|--|---|-------------------------------------|-------------------------------------|
| September 30, 2018                       | Assets (Level 1)                                    | (Level 2)                           | (Level 3)                           |
| Assets - (Securities Available-for-Sale) |   |                                     |                                     |
| U.S. Treasury                            | \$ 20,771   | \$ -                                | \$ -                                |
| U.S. Government agencies                 | -   | 75,767                              | -                                   |
| Mortgage-backed securities               | -   | 34,600                              | -                                   |
| State and local governments              | -   | 50,544                              | 1,393                               |
| Total Securities Available-for-Sale      | \$ 20,771   | \$ 160,911                          | \$ 1,393                            |

|  | Quoted Prices in<br>Active Markets<br>for Identical | Significant<br>Observable<br>Inputs | Significant<br>Observable<br>Inputs |
|--|---|-------------------------------------|-------------------------------------|
| December 31, 2017                        | Assets (Level 1)                                    | (Level 2)                           | (Level 3)                           |
| Assets - (Securities Available-for-Sale) |   |                                     |                                     |
| U.S. Treasury                            | \$ 20,978   | \$ -                                | \$ -                                |
| U.S. Government agencies                 | -   | 80,466                              | -                                   |
| Mortgage-backed securities               | -   | 39,510                              | -                                   |
| State and local governments              | -   | 54,016                              | 1,428                               |
| Total Securities Available-for-Sale      | \$ 20,978   | \$ 173,992                          | \$ 1,428                            |

The following table represents the changes in the Level 3 fair-value category of which unobservable inputs are relied upon as of September 30, 2018 and September 30, 2017.

(In Thousands)  
Fair Value Measurements Using  
Significant

|                               | Unobservable Inputs (Level 3) |                 |
|-------------------------------|-------------------------------|-----------------|
|                               | State and Local               | State and Local |
|                               | Governments                   | Governments     |
|                               | Tax-Exempt                    | Total           |
| Balance at January 1, 2018    | \$- \$ 1,428                  | \$ 1,428        |
| Change in Market Value        | - (35 )                       | (35 )           |
| Payments & Maturities         | - -                           | -               |
| Balance at September 30, 2018 | \$- \$ 1,393                  | \$ 1,393        |

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

|                               | (In Thousands)                |                 |                 |
|-------------------------------|-------------------------------|-----------------|-----------------|
|                               | Fair Value Measurements Using |                 |                 |
|                               | Significant                   |                 |                 |
|                               | Unobservable Inputs (Level 3) |                 |                 |
|                               | State and Local               | State and Local | State and Local |
|                               | Governments                   | Governments     | Governments     |
|                               | Tax-Exempt                    | Taxable         | Total           |
| Balance at January 1, 2017    | \$-                           | \$ 1,418        | \$ 1,418        |
| Change in Market Value        | -                             | 24              | 24              |
| Payments & Maturities         | -                             | -               | -               |
| Balance at September 30, 2017 | \$-                           | \$ 1,442        | \$ 1,442        |

Most of the Company's available-for-sale securities, including any bonds issued by local municipalities, have CUSIP numbers or have similar characteristics of those in the municipal markets, making them marketable and comparable as Level 2.

The Company also has assets that, under certain conditions, are subject to measurement at fair value on a non-recurring basis. At September 30, 2018 and December 31, 2017, such assets consist primarily of collateral dependent impaired loans. Collateral dependent impaired loans categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired. The Company estimates the fair value of the loans based on the present value of expected future cash flows using management's best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals.)

At September 30, 2018 and December 31, 2017, fair value of collateral dependent impaired loans categorized as Level 3 was \$822 and \$508 thousand, respectively. The specific allocation for impaired loans was \$148 and \$106 thousand as of September 30, 2018 and December 31, 2017, respectively, which are accounted for in the allowance for loan losses (see Note 4).

Other real estate is reported at either the lower of the fair value of the real estate minus the estimated costs to sell the asset or the cost of the asset. The determination of fair value of the real estate relies primarily on appraisals from third parties. If the fair value of the real estate, minus the estimated costs to sell the asset, is less than the asset's cost, the deficiency is recognized as a valuation allowance against the asset through a charge to expense. The valuation allowance is therefore increased or decreased, through charges or credits to expense, for changes in the asset's fair value or estimated selling costs.

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The following table presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements:

|                            | (In<br>Thousands)<br>Fair Value at<br>September 30,<br>2018 | Valuation Technique  | Unobservable Inputs                         | Range<br>(Weighted<br>Average) |
|----------------------------|---|----------------------|---|--------------------------------|
|                            |   |                      | Credit strength of underlying project<br>or | 0-5%                           |
| State and local government | \$ 1,393  | Discounted Cash Flow | entity / Discount rate                      | (3.92% )                       |
| Collateral dependent       |   | Collateral based     | Discount to reflect current market          | 0-50%                          |
| impaired loans             | 822   | measurements         | conditions and ultimate collectability      | (15.28%)                       |
| Other real estate owned -  |   |                      | Discount to reflect current                 | — %                            |
| residential                | -   | Appraisals           | market                                      | ( — )                          |
| Other real estate owned -  |   |                      | Discount to reflect current                 | — %                            |
| commercial                 | -   | Appraisals           | market                                      | ( — )                          |

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## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

|  | (In<br>Thousands)<br>Fair Value at<br>December 31,<br>2017 | Valuation Technique              | Unobservable Inputs<br>Credit strength of underlying project or<br>entity / Discount rate | Range<br>(Weighted<br>Average) |
|--|--|----------------------------------|---|--------------------------------|
| State and local government               | \$ 1,428   | Discounted Cash Flow             |   | 0-5%<br>(3.68%)                |
| Collateral dependent<br>impaired loans   | 508  | Collateral based<br>measurements | Discount to reflect current market<br>conditions and ultimate collectability              | 0-50%<br>(17.28%)              |
| Other real estate owned -<br>residential | 22   | Appraisals                       | Discount to reflect current<br>market   | 0-20%<br>(2.22%)               |
| Other real estate owned -<br>commercial  | 266  | Appraisals                       | Discount to reflect current<br>market   | 0-20%<br>(5.15%)               |

The following table presents impaired loans and other real estate owned as recorded at fair value on September 30, 2018 and December 31, 2017:

| Assets Measured at Fair Value on a Nonrecurring Basis at September 30, 2018<br>(In Thousands) |                                     |  |   |   |
|---|-------------------------------------|--|---|---|
|   | Balance at<br>September 30,<br>2018 | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets (Level 1) | Significant<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |
| Collateral dependent  |                                     |  |   |   |
| impaired loans  | \$ 822                              | \$ -   | \$ -  | \$ 822  |
| Other real estate   | -                                   | -  | -   | -   |

|                     |   |   |   |   |
|---------------------|---|---|---|---|
| owned - residential |   |   |   |   |
| Other real estate   |   |   |   |   |
| owned - commercial  | - | - | - | - |

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2017  
(In Thousands)

|                      | Balance at<br>December 31,<br>2017 | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets (Level 1) |   |    | Significant<br>Observable Inputs<br>(Level 2) |    | Significant<br>Unobservable Inputs<br>(Level 3) |  |
|----------------------|------------------------------------|--|---|----|---|----|---|--|
|                      |                                    |  |   |    |   |    |   |  |
| Collateral dependent |                                    |  |   |    |   |    |   |  |
| impaired loans       | \$ 508                             | \$   | - | \$ | -   | \$ | 508   |  |
| Other real estate    |                                    |  |   |    |   |    |   |  |
| owned - residential  | 22                                 |  | - |    | -   |    | 22  |  |
| Other real estate    |                                    |  |   |    |   |    |   |  |
| owned - commercial   | 266                                |  | - |    | -   |    | 266   |  |

## ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

## NOTE 7 FEDERAL FUNDS PURCHASED AND SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Company had \$1.5 million and \$10.4 million in Federal Funds Purchased as of September 30, 2018 and as of December 31, 2017, respectively. During the same time periods, the company also had \$25.6 million and \$29.1 million in securities sold under agreement to repurchase.

September 30, 2018  
Remaining Contractual Maturity of the Agreements (In  
Thousands)

|                                 |         | Overnight &<br>Continuous | Up to 30 days | 30-90 days | Greater Than<br>90 days | Total   |
|---------------------------------|---------|---------------------------|---------------|------------|-------------------------|---------|
| Federal funds purchased         | \$1,452 | \$ -                      | \$ -          | \$ -       | \$ -                    | \$1,452 |
| Repurchase Agreements;          |         |                           |               |            |                         |         |
| US Treasury & agency securities | 819     | -                         | -             | 24,755     | 25,574                  |         |
|                                 | \$2,271 | \$ -                      | \$ -          | \$ 24,755  | \$27,026                |         |

December 31, 2017  
Remaining Contractual Maturity of the Agreements (In  
Thousands)

|                                 |          | Overnight &<br>Continuous | Up to 30 days | 30-90 days | Greater Than<br>90 days | Total |
|---------------------------------|----------|---------------------------|---------------|------------|-------------------------|-------|
| Federal funds purchased         | \$10,425 | \$ -                      | \$ -          | \$ -       | \$10,425                |       |
| Repurchase Agreements;          |          |                           |               |            |                         |       |
| US Treasury & agency securities | 6,145    | -                         | -             | 22,925     | 29,070                  |       |
|                                 | \$16,570 | \$ -                      | \$ -          | \$ 22,925  | \$39,495                |       |

## NOTE 8 PROPOSED BUSINESS COMBINATION



The Company signed a definitive merger agreement whereby F&M will acquire Limberlost Bancshares, Inc. (“Limerlost”), Geneva, Indiana, the holding company for Bank of Geneva, in a combination stock and cash transaction. Bank of Geneva operates six full-service offices in northeast Indiana and has approximately \$287 million in assets, \$257 million in loans, \$212 million in deposits and \$30.6 million in consolidated equity as of June 30, 2018. Limerlost is taxed as an S-Corporation.

Subject to the terms of the merger agreement, which has been approved by the Board of Directors of each company, Limerlost shareholders will receive 1,830 shares of F&M common stock for each outstanding share of Limerlost common stock plus \$8,465 in cash. Limerlost currently has 1,000 shares of common stock outstanding. Based on the F&M closing share price as of August 17, 2018, the transaction is valued at approximately \$88.765 million in aggregate.

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

NOTE 9 RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued ASU No. 2014-09 “Revenue from Contracts with Customers (Topic 606)” ASU 2014-09 requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. On July 9, 2015, the FASB approved amendments deferring the effective date by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this update recognized at the date of initial application. Early application was permitted but not before the original public entity effective date, i.e., annual periods beginning after December 15, 2016. The Company has adopted ASU 2014-09 on January 1, 2018 and ASU No 2014-09 did not have a significant impact on its financial statements. Several of the Company’s revenue streams were reviewed as a result of the standard.

In January 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-01 “Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU 2016-01 is intended to improve the recognition and measurement of financial instruments by requiring equity investments to be measured at fair value with changes in fair value recognized in net income; requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured and amortized at cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU 2016-01 is effective for annual periods and interim periods within those annual periods, beginning after December 15, 2017. The amendments should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption. The Company adopted ASU 2016-01 on January 1, 2018 and it did not have a material impact on the consolidated financial statement. The Bank’s equity securities are membership stocks in the Federal Home Loan Bank and Farmer Mac and thereby excluded from fair value pricing. For exit pricing on loans, the company used recent Merger and Acquisition Transaction Metrics compiled by S&P Global Market Intelligence for the second half of 2017. This provided the credit mark to be used along with the fair value adjustment based on the yield metrics of the portfolio.

In February 2016, the FASB issued ASU No. 2016-02 “Leases (Topic 842).” ASU 2016-02 establishes a right of use model that requires a lessee to record a right of use asset and a lease liability for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. A lease will be treated as sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor doesn’t convey risks and rewards or control, an operating lease results. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within

those fiscal years for public business entities. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, with certain practical expedients available. Early adoption is permitted. The Company is assessing the impact of ASU 2016-02 on its accounting and disclosures and currently has very limited exposure to the rule.

In June 2016, FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration.

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

NOTE 9 RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

The ASU is effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 (i.e., January 1, 2020, for calendar year entities). Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently gathering information, reviewing possible vendors and has formed a committee to formulate the methodology to be used. Most importantly, the Company is gathering as much data as possible to enable review scenarios and determine which calculations will produce the most reliable results. At this time, an external advisor has been contracted. The Company is in the early stages of CECL conversion analysis.

In November 2016, the FASB issued ASU No. 2016-18 “Statement of Cash Flows (Topic 230) – Restricted Cash.” ASU-2016-18 provides amendments to cash flow statement classification and presentation to explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and should be applied using a retrospective transition method to each period presented. Early adoption is permitted including adoption in an interim period. The Company has adopted ASU 2016-18 on January 1, 2018 and does not currently have restricted cash or restricted cash equivalents. In the future, restricted cash or restricted cash equivalents will be presented in accordance with the guidance.

In January 2017, the FASB issued ASU No. 2017-01 “Business Combinations (Topic 805) – Clarifying the Definition of a Business.” ASU 2017-01 provides amendments to clarify the definition of a business and affect all companies and other reporting organizations that must determine whether they have acquired or sold a business. The amendments are intended to help companies and other organizations evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and adoption is permitted under certain circumstances. The company has adopted ASU 2017-01 on