

FARMERS & MERCHANTS BANCORP INC

Form 10-Q

October 25, 2017

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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, 2017**

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 (State or other jurisdiction of incorporation or organization)	34-1469491 (IRS Employer Identification No.)
307 North Defiance Street, Archbold, Ohio (Address of principal executive offices)	43502 (Zip Code)
(419) 446-2501	

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	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 issuer's classes of common stock, as of the latest practicable date:

Common Stock, No Par Value	9,266,676
Class	Outstanding as of October 25, 2017

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10Q

FARMERS & MERCHANTS BANCORP, INC.

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- ⁽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.

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ITEM 1 FINANCIAL STATEMENTS

FARMERS & MERCHANTS BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	Condensed Consolidated Balance Sheets (in thousands of dollars)	
	September 30, 2017 (Unaudited)	December 31, 2016
Assets		
Cash and due from banks	\$ 48,313	\$ 27,348
Federal funds sold	791	974
Total cash and cash equivalents	49,104	28,322
Interest-bearing time deposits	2,541	1,915
Securities - available-for-sale	192,811	218,527
Other securities, at cost	3,717	3,717
Loans held for sale	2,147	2,055
Loans, net	788,335	751,310
Premises and equipment	21,473	21,457
Goodwill	4,074	4,074
Mortgage servicing rights	2,264	2,192
Other real estate owned	615	774
Bank owned life insurance	14,446	14,376
Other assets	8,628	7,176
Total Assets	\$ 1,090,155	\$ 1,055,895
Liabilities and Stockholders Equity		
Liabilities		
Deposits		
Noninterest-bearing	\$ 189,963	\$ 186,390
Interest-bearing		
NOW accounts	294,911	230,446
Savings	224,911	226,537
Time	193,581	198,830
Total deposits	903,366	842,203
Federal Funds purchased and securities sold under agreements to repurchase	35,550	70,324
Federal Home Loan Bank (FHLB) advances	10,000	10,000
Dividend payable	1,193	1,053
Accrued expenses and other liabilities	7,157	6,738
Total liabilities	957,266	930,318

Commitments and Contingencies**Stockholders Equity**

Common stock - No par value 20,000,000 shares authorized; issued and outstanding 10,400,000 shares 9/30/17 and 12/31/16 ⁽¹⁾	11,388	11,947
Treasury Stock - 1,133,324 shares 9/30/17, 1,158,250 shares 12/31/16 ⁽¹⁾	(12,126)	(12,267)
Retained earnings	134,320	127,869
Accumulated other comprehensive loss	(693)	(1,972)
Total stockholders equity	132,889	125,577
Total Liabilities and Stockholders Equity	\$ 1,090,155	\$ 1,055,895

⁽¹⁾ Share data has been adjusted to reflect a 2-for-1 stock split on September 20, 2017
See Notes to Condensed Consolidated Unaudited Financial Statements.

Note: The December 31, 2016, Condensed Consolidated Balance Sheet has been derived from the audited Consolidated Balance Sheet as of that date.

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FARMERS & MERCHANTS BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME & COMPREHENSIVE INCOME

(Unaudited)

(in thousands of dollars, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Interest Income				
Loans, including fees	\$ 9,547	\$ 8,629	\$ 27,367	\$ 24,997
Debt securities:				
U.S. Treasury and government agencies	605	559	1,870	1,734
Municipalities	290	344	905	1,093
Dividends	49	36	135	111
Federal funds sold	7	7	10	9
Other	37	15	93	37
Total interest income	10,535	9,590	30,380	27,981
Interest Expense				
Deposits	1,161	947	3,289	2,686
Federal funds purchased and securities sold under agreements to repurchase	135	115	366	346
Borrowed funds	37	37	110	110
Total interest expense	1,333	1,099	3,765	3,142
Net Interest Income - Before Provision for Loan Losses				
Provision for Loan Losses	99	308	197	924
Net Interest Income After Provision For Loan Losses				
Noninterest Income	9,103	8,183	26,418	23,915
Customer service fees	1,320	1,711	4,131	4,497
Other service charges and fees	1,134	941	3,214	2,850
Net gain on sale of loans	181	216	600	619
Net gain on sale of available for sale securities		47	47	503
Total noninterest income	2,635	2,915	7,992	8,469
Noninterest Expense				
Salaries and Wages	3,236	2,981	9,374	8,661
Employee benefits	943	849	2,648	2,426
Net occupancy expense	434	359	1,221	1,083

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Furniture and equipment	493	438	1,456	1,293
Data processing	300	360	919	1,132
Franchise taxes	226	219	676	658
Net (gain) loss on sale of other assets owned	13	(6)	27	39
FDIC Assessment	82	126	247	368
Mortgage servicing rights amortization	85	123	266	311
Other general and administrative	1,545	1,473	4,692	4,594
Total other operating expenses	7,357	6,922	21,526	20,565
Income Before Income Taxes	4,381	4,176	12,884	11,819
Income Taxes	1,159	1,161	3,600	3,349
Net Income	3,222	3,015	9,284	8,470
Other Comprehensive Income (Loss)				
(Net of Tax):				
Net unrealized gain (loss) on available for sale securities	(472)	58	1,984	2,652
Reclassification adjustment for gain on sale of available for sale securities		(47)	(47)	(503)
Net unrealized gain (loss) on available for sale securities	(472)	11	1,937	2,149
Tax expense (benefit)	(160)	4	659	731
Other comprehensive income (loss)	(312)	7	1,278	1,418
Comprehensive Income	\$ 2,910	\$ 3,022	\$ 10,562	\$ 9,888
Earnings Per Share - Basic and Diluted ⁽¹⁾	\$ 0.35	\$ 0.33	\$ 1.00	\$ 0.92
Dividends Declared ⁽¹⁾	\$ 0.13	\$ 0.12	\$ 0.37	\$ 0.34

⁽¹⁾ Share data has been adjusted to reflect a 2-for-1 stock split on September 20, 2017

See Notes to Condensed Consolidated Unaudited Financial Statements

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FARMERS & MERCHANTS BANCORP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	(in thousands of dollars)	
	Nine Months Ended	
	September 30, 2017	September 30, 2016
Cash Flows from Operating Activities		
Net income	\$ 9,284	\$ 8,470
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,426	1,112
Amortization on available for sale securities, net	843	833
Amortization of servicing rights	266	311
Amortization of core deposit intangible	203	242
Compensation expense related to stock awards	346	297
Provision for loan loss	197	924
Gain on sale of loans held for sale	(600)	(619)
Originations of loans held for sale	(42,601)	(44,296)
Proceeds from sale of loans held for sale	44,574	44,119
Loss on sale of other assets owned	27	39
Gain on sales of securities available for sale	(47)	(503)
Change in other assets and other liabilities, net	(1,667)	(1,300)
Net cash provided by operating activities	12,251	9,629
Cash Flows from Investing Activities		
Activity in available-for-sale securities:		
Maturities, prepayments and calls	16,682	22,910
Sales	13,562	45,418
Purchases	(3,387)	(55,863)
Change in interest-bearing time deposits	(626)	(1,915)
Proceeds from sales of other assets owned	17	20
Additions to premises and equipment	(1,459)	(1,901)
Loan originations and principal collections, net	(39,195)	(52,996)
Net cash used in investing activities	(14,406)	(44,327)
Cash Flows from Financing Activities		
Net change in deposits	61,163	66,762
Net change in federal funds purchased and securities sold under agreements to repurchase	(34,774)	(19,328)
Purchase of Treasury Stock	(202)	(194)
Cash dividends paid on common stock	(3,250)	(3,062)

Net cash provided by financing activities	22,937		44,178
Net Increase in Cash and Cash Equivalents	20,782		9,480
Cash and cash equivalents - Beginning of year	28,322		22,018
Cash and cash equivalents - End of period	\$ 49,104	\$	31,498
Supplemental Information			
Cash paid during the year for:			
Interest	\$ 3,735	\$	3,098
Income taxes	\$ 3,802	\$	3,810
Noncash investing activities:			
Transfer of loans to other real estate owned	\$	\$	376

See Notes to Condensed Consolidated Unaudited Financial Statements.

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NOTE 1 BASIS OF PRESENTATION

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, 2017 are not necessarily indicative of the results that are expected for the year ended December 31, 2017. The condensed consolidated balance sheet of the Company as of December 31, 2016, 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, 2016.

NOTE 2 ASSET PURCHASES

The Company recognized core deposit intangible assets of \$1.09 million with the purchase of the Hicksville office on July 9, 2010. These were amortized over an estimated remaining economic useful life of the deposits of 7 years on a straight line basis.

An office was purchased 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, 2016 was \$323 thousand. Of the \$245 thousand to be expensed in 2017, \$203 thousand has been expensed for the nine months ended September 30, 2017.

	(In Thousands)		
	Hicksville	Custar	Total
2017	\$ 78	\$ 167	\$ 245
2018		167	167
2019		167	167
2020		161	161
	\$ 78	\$ 662	\$ 740

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

NOTE 3 SECURITIES

The amortized cost and fair value of securities, with gross unrealized gains and losses at September 30, 2017 and December 31, 2016, follows:

	(In Thousands)			
	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale:				
U.S. Treasury	\$ 15,790	\$	\$ (114)	\$ 15,676
U.S. Government agencies	79,224		(1,064)	78,160
Mortgage-backed securities	42,409	142	(561)	41,990
State and local governments	56,438	779	(232)	56,985
Total available-for-sale securities	\$ 193,861	\$ 921	\$ (1,971)	\$ 192,811

	(In Thousands)			
	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale:				
U.S. Treasury	\$ 24,920	\$ 1	\$ (146)	\$ 24,775
U.S. Government agencies	84,266	3	(1,795)	82,474
Mortgage-backed securities	49,155	185	(879)	48,461
State and local governments	63,173	634	(990)	62,817
Total available-for-sale securities	\$ 221,514	\$ 823	\$ (3,810)	\$ 218,527

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.

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

NOTE 3 SECURITIES (Continued)

Information pertaining to securities with gross unrealized losses at September 30, 2017 and December 31, 2016, aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

	(In Thousands)			
	September 30, 2017			
	Less Than Twelve Months		Twelve Months & Over	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. Treasury	\$ (114)	\$ 15,676	\$	\$
U.S. Government agencies	(554)	62,910	(510)	15,251
Mortgage-backed securities	(288)	22,344	(273)	10,360
State and local governments	(130)	8,776	(102)	6,032
Total available-for-sale securities	\$ (1,086)	\$ 109,706	\$ (885)	\$ 31,643

	(In Thousands)			
	December 31, 2016			
	Less Than Twelve Months		Twelve Months & Over	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. Treasury	\$ (146)	\$ 15,745	\$	\$
U.S. Government agencies	(1,795)	77,471		
Mortgage-backed securities	(879)	36,474		
State and local governments	(983)	37,540	(7)	526
Total available-for-sale securities	\$ (3,803)	\$ 167,230	\$ (7)	\$ 526

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.

	Three Months (In Thousands)		Nine Months (In Thousands)	
	2017	2016	2017	2016
Gross realized gains	\$	\$ 47	\$ 58	\$ 514
Gross realized losses			(11)	(11)
Net realized gains	\$	\$ 47	\$ 47	\$ 503
Tax expense related to net realized gains	\$	\$ 16	\$ 16	\$ 171

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 tax expense in the condensed consolidated statements of income and comprehensive income.

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

NOTE 3 SECURITIES (Continued)

The amortized cost and fair value of debt securities at September 30, 2017, 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	\$ 9,014	\$ 9,017
After one year through five years	88,228	88,088
After five years through ten years	50,404	49,979
After ten years	3,806	3,737
Total	\$ 151,452	\$ 150,821
Mortgage-backed securities	42,409	41,990
Total	\$ 193,861	\$ 192,811

Investments with a carrying value of \$84.5 million and \$129.4 million at September 30, 2017 and December 31, 2016, 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, 2017 and December 31, 2016.

NOTE 4 LOANS

Loan balances as of September 30, 2017 and December 31, 2016:

	(In Thousands)	
Loans:	September 30, 2017	December 31, 2016
Consumer Real Estate	\$ 84,283	\$ 86,234
Agricultural Real Estate	63,603	62,375
Agricultural	87,095	84,563
Commercial Real Estate	394,481	377,481
Commercial and Industrial	124,078	109,256
Consumer	35,843	33,179
Industrial Development Bonds	6,555	5,732

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	795,938	758,820
Less: Net deferred loan fees and costs	(733)	(726)
	795,205	758,094
Less: Allowance for loan losses	(6,870)	(6,784)
Loans Net	\$ 788,335	\$ 751,310

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

NOTE 4 LOANS (Continued)

The following is a contractual maturity schedule by major category of loans as of September 30, 2017:

	(In Thousands)		
	Within One Year	After One Year Within Five Years	After Five Years
Consumer Real Estate	\$ 2,153	\$ 14,237	\$ 67,893
Agricultural Real Estate	401	5,495	57,707
Agricultural	51,979	25,915	9,201
Commercial Real Estate	10,875	120,924	262,682
Commercial and Industrial	68,139	34,860	21,079
Consumer	5,077	23,025	7,741
Industrial Development Bonds	831	85	5,639

The distribution of fixed rate loans and variable rate loans by major loan category is as follows as of September 30, 2017:

	(In Thousands)	
	Fixed Rate	Variable Rate
Consumer Real Estate	\$ 47,662	\$ 36,621
Agricultural Real Estate	46,557	17,046
Agricultural	35,708	51,387
Commercial Real Estate	266,316	128,165
Commercial and Industrial	58,560	65,518
Consumer	31,554	4,289
Industrial Development Bonds	6,555	

As of September 30, 2017 and December 31, 2016 one to four family residential mortgage loans amounting to \$17.7 and \$17.9 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.

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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, 2017 and December 31, 2016, net of deferred loan fees and costs:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
September 30, 2017							
Consumer Real Estate	\$ 532	\$ 0	\$ 505	\$ 1,037	\$ 82,838	\$ 83,875	\$
Agricultural Real Estate	104		101	205	63,366	63,571	
Agricultural		2	124	126	87,113	87,239	
Commercial Real Estate			98	98	393,815	393,913	
Commercial and Industrial					130,720	130,720	
Consumer	37	8		45	35,842	35,887	
Total	\$ 673	\$ 10	\$ 828	\$ 1,511	\$ 793,694	\$ 795,205	\$ 0

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
December 31, 2016							
Consumer Real Estate	\$ 882	\$ 15	\$ 507	\$ 1,404	\$ 84,469	\$ 85,873	\$
Agricultural Real Estate	12		132	144	62,192	62,336	
Agricultural	101			101	84,591	84,692	
Commercial Real Estate	60			60	376,827	376,887	
Commercial and Industrial					115,093	115,093	
Consumer	29	6		35	33,178	33,213	
Total	\$ 1,084	\$ 21	\$ 639	\$ 1,744	\$ 756,350	\$ 758,094	\$ 0

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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, 2017 and December 31, 2016:

	(In Thousands)	
	September 30, 2017	December 31, 2016
Consumer Real Estate	\$ 1,176	\$ 1,091
Agricultural Real Estate	101	132
Agricultural	193	
Commercial Real Estate	98	
Commercial & Industrial	152	161
Consumer	9	
Total	\$ 1,729	\$ 1,384

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

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.

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.

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.

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.

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 federal crop insurance.

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.

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.

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

NOTE 4 LOANS (Continued)

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.
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 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 the credit weaknesses is 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 deserves close attention, but which 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, 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.

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

NOTE 4 LOANS (Continued)

- 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; however, 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.
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, however, 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.
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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, 2017 and December 31, 2016:

	(In Thousands)				
	Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Industrial Development Bonds
September 30, 2017					
1-2	\$ 3,973	\$ 5,316	\$ 1,639	\$ 10,166	\$
3	14,762	31,796	26,253	15,037	3,568
4	43,491	49,712	349,120	96,923	2,987
5	1,124	254	10,686	1,379	
6	221	161	6,215	547	
7				113	
8					
Total	\$ 63,571	\$ 87,239	\$ 393,913	\$ 124,165	\$ 6,555

	(In Thousands)				
	Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Industrial Development Bonds
December 31, 2016					
1-2	\$ 4,399	\$ 7,334	\$ 677	\$ 10,060	\$
3	16,660	31,397	27,858	14,064	2,640
4	39,808	44,560	333,523	83,100	3,092
5	1,209	1,234	8,321	1,379	
6	260	167	6,508	641	
7				117	
8					
Total	\$ 62,336	\$ 84,692	\$ 376,887	\$ 109,361	\$ 5,732

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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, 2017 and December 31, 2016.

Grade	(In Thousands)	
	Consumer Real Estate September 30, 2017	Consumer Real Estate December 31, 2016
Pass	\$ 83,471	\$ 85,322
Special Mention (5)		25
Substandard (6)	320	368
Doubtful (7)	84	158
Total	\$ 83,875	\$ 85,873

	(In Thousands)			
	Consumer - Credit		Consumer - Other	
	September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016
Performing	\$ 3,845	\$ 4,061	\$ 32,013	\$ 29,120
Nonperforming	1		28	32
Total	\$ 3,846	\$ 4,061	\$ 32,041	\$ 29,152

Information about impaired loans as of September 30, 2017, December 31, 2016 and September 30, 2016 are as follows:

	(In Thousands)		
	September 30, 2017	December 31, 2016	September 30, 2016
Impaired loans without a valuation allowance	\$ 1,294	\$ 1,141	\$ 515
Impaired loans with a valuation allowance	685	711	891

Total impaired loans	\$ 1,979	\$ 1,852	\$ 1,406
Valuation allowance related to impaired loans	\$ 123	\$ 135	\$ 125
Total non-accrual loans	\$ 1,729	\$ 1,384	\$ 1,132
Total loans past-due ninety days or more and still accruing	\$	\$	\$
Quarter ended average investment in impaired loans	\$ 1,804	\$ 1,684	\$ 1,499
Year to date average investment in impaired loans	\$ 1,793	\$ 1,802	\$ 1,843

No additional funds are committed to be advanced in connection with impaired loans.

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

NOTE 4 LOANS (Continued)

The Bank had approximately \$540 thousand of its impaired loans classified as troubled debt restructured (TDR) as of September 30, 2017, \$557 thousand as of December 31, 2016 and \$562 thousand as of September 30, 2016. During the year to date 2017, there were no new loans considered TDR.

The following table represents three and nine months ended September 30, 2017.

Three Months September 30, 2017 (in thousands)	Number of Contracts Modified in the Last 3 Months	Pre-	Post-	Nine Months September 30, 2017 (in thousands)	Number of Contracts Modified in the Last 9 Months	Pre-	Post-
		Modification Recorded	Modification Recorded			Modification Recorded	Modification Recorded
Troubled Debt Restructurings		Investment	Investment	Troubled Debt Restructurings		Investment	Investment
None		\$	\$	None		\$	\$

The following table represents three and nine months ended September 30, 2016.

Three Months September 30, 2016 (in thousands)	Number of Contracts Modified in the Last 3 Months	Pre-	Post-	Nine Months September 30, 2016 (in thousands)	Number of Contracts Modified in the Last 9 Months	Pre-	Post-
		Modification Recorded	Modification Recorded			Modification Recorded	Modification Recorded
Troubled Debt Restructurings		Investment	Investment	Troubled Debt Restructurings		Investment	Investment
Consumer Real Estate		\$	\$	Consumer Real Estate	1	\$ 138	\$ 138

For the three and nine month period ended September 30, 2017 and 2016, there were no TDRs that subsequently defaulted after modification.

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.

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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 three months ended September 30, 2017 and September 30, 2016.

	(In Thousands)					
	Recorded	Unpaid Principal	Related Allowance	QTD Average Recorded	QTD Interest Income	QTD Interest Income Recognized Cash Basis
Three Months Ended September 30, 2017	Investment	Balance	Allowance	Investment	Recognized	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	\$	\$	\$	\$	\$	\$

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

NOTE 4 LOANS (Continued)

	(In Thousands)					
	Recorded	Unpaid Principal	Related Allowance	QTD Average Recorded Investment	QTD Interest Income Recognized	QTD Interest Income Recognized Cash Basis
Three Months Ended September 30, 2016	Investment	Balance	Allowance	Investment	Recognized	Basis
With no related allowance recorded:						
Consumer Real Estate	\$ 383	\$ 383	\$	\$ 51	\$	\$
Agricultural Real Estate	132	132		132		
Agricultural						
Commercial Real Estate				345	4	4
Commercial and Industrial				446	6	
Consumer						
With a specific allowance recorded:						
Consumer Real Estate	329	329	35	377	4	1
Agricultural Real Estate						
Agricultural						
Commercial Real Estate	444	444	68	30		
Commercial and Industrial	118	118	22	118		
Consumer						
Totals:						
Consumer Real Estate	\$ 712	\$ 712	\$ 35	\$ 428	\$ 4	\$ 1
Agricultural Real Estate	\$ 132	\$ 132	\$	\$ 132	\$	\$
Agricultural	\$	\$	\$	\$	\$	\$
Commercial Real Estate	\$ 444	\$ 444	\$ 68	\$ 375	\$ 4	\$ 4
Commercial and Industrial	\$ 118	\$ 118	\$ 22	\$ 564	\$ 6	\$
Consumer	\$	\$	\$	\$	\$	\$

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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 months ended September 30, 2017 and September 30, 2016.

	(In Thousands)					
	Recorded	Unpaid Principal	Related Allowance	YTD Average Recorded	YTD Interest Income	YTD Interest Income Recognized Cash Basis
Nine Months Ended September 30, 2017	Investment	Balance	Allowance	Investment	Recognized	
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	\$	\$	\$	\$	\$	\$

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

NOTE 4 LOANS (Continued)

	(In Thousands)					
	Recorded	Unpaid Principal	Related Allowance	YTD Average Recorded Investment	YTD Interest Income Recognized	YTD Interest Income Recognized Cash Basis
Nine Months Ended September 30, 2016	Investment	Balance	Allowance	Investment	Recognized	Basis
With no related allowance recorded:						
Consumer Real Estate	\$ 383	\$ 383	\$	\$ 78	\$ 1	\$ 1
Agricultural Real Estate	132	132		152	1	
Agricultural						
Commercial Real Estate				367	17	16
Commercial and Industrial				450	18	
Consumer						
With a specific allowance recorded:						
Consumer Real Estate	329	329	35	387	11	7
Agricultural Real Estate				13		
Agricultural						
Commercial Real Estate	444	444	68	254		
Commercial and Industrial	118	118	22	142		
Consumer						
Totals:						
Consumer Real Estate	\$ 712	\$ 712	\$ 35	\$ 465	\$ 12	\$ 8
Agricultural Real Estate	\$ 132	\$ 132	\$	\$ 165	\$ 1	\$
Agricultural	\$	\$	\$	\$	\$	\$
Commercial Real Estate	\$ 444	\$ 444	\$ 68	\$ 621	\$ 17	\$ 16
Commercial and Industrial	\$ 118	\$ 118	\$ 22	\$ 592	\$ 18	\$
Consumer	\$	\$	\$	\$	\$	\$

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 are in process according to local jurisdictions. As of September 30, 2016, the Company had \$808 thousand of foreclosed residential real estate property obtained by physical possession and \$211 thousand of consumer mortgage loans secured by residential real estate properties for which foreclosure proceedings were in process according to local jurisdictions.

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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 September 30, 2017	Twelve Months Ended December 31, 2016
Allowance for Loan & Lease Losses		
Balance at beginning of year	\$ 6,784	\$ 6,057
Provision for loan loss	197	1,121
Loans charged off	(208)	(550)
Recoveries	97	156
Allowance for Loan & Lease Losses	\$ 6,870	\$ 6,784
Allowance for Unfunded Loan Commitments & Letters of Credit	 \$ 228	 \$ 217
Total Allowance for Credit Losses	\$ 7,098	\$ 7,001

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, 2017 and September 30, 2016 is as follows:

	Consumer Real Estate	Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Consumer	Unfunded Loan Commitment & Letters of CrediUnallocated	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	\$ 251	\$ 248	\$ 613	\$ 3,050	\$ 1,361	\$ 423	\$ 228	\$ 801	\$ 6,975

impairment

Ending balance: loans acquired with deteriorated credit quality	\$	\$	\$	\$	\$	\$	\$	\$	\$
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**FINANCING
RECEIVABLES:**

Ending balance	\$ 83,875	\$ 63,571	\$ 87,239	\$ 393,913	\$ 130,720	\$ 35,887	\$	\$	\$ 795,205
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Ending balance: individually evaluated for impairment	\$ 1,012	\$ 205	\$ 161	\$ 488	\$ 113	\$	\$	\$	\$ 1,979
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Ending balance: collectively evaluated for impairment	\$ 82,863	\$ 63,366	\$ 87,078	\$ 393,425	\$ 130,607	\$ 35,887	\$	\$	\$ 793,226
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Ending balance: loans acquired with deteriorated credit quality	\$ 194	\$	\$	\$	\$	\$	\$	\$	\$ 194
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ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

NOTE 4 LOANS (Continued)

	Consumer Real Estate	Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Consumer	Unfunded Loan Commitment & Letters of Credit	Unallocated	Total
Three Months Ended September 30, 2016									
ALLOWANCE FOR CREDIT LOSSES:									
Beginning balance	\$ 413	\$ 229	\$ 591	\$ 2,717	\$ 1,215	\$ 365	\$ 219	\$ 963	\$ 6,712
Charge Offs	(42)		(3)	(90)		(83)			(218)
Recoveries	1		4	2	3	19			29
Provision (Credit)	(86)	5	(12)	376	(23)	59		(11)	308
Other Non-interest expense related to unfunded							8		8
Ending Balance	\$ 286	\$ 234	\$ 580	\$ 3,005	\$ 1,195	\$ 360	\$ 227	\$ 952	\$ 6,839
Ending balance: individually evaluated for impairment	\$ 35	\$	\$	\$ 68	\$ 22	\$	\$	\$	\$ 125
Ending balance: collectively evaluated for impairment	\$ 251	\$ 234	\$ 580	\$ 2,937	\$ 1,173	\$ 360	\$ 227	\$ 952	\$ 6,714
Ending balance: loans acquired with deteriorated credit quality	\$ 1	\$	\$	\$	\$	\$	\$	\$	\$ 1

**FINANCING
RECEIVABLES:**

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Ending balance	\$ 85,977	\$ 59,458	\$ 79,332	\$ 369,721	\$ 111,953	\$ 30,616	\$	\$	\$ 737,057
Ending balance: individually evaluated for impairment	\$ 712	\$ 132	\$	\$ 444	\$ 118	\$	\$	\$	\$ 1,406
Ending balance: collectively evaluated for impairment	\$ 85,265	\$ 59,326	\$ 79,332	\$ 369,277	\$ 111,835	\$ 30,616	\$	\$	\$ 735,651
Ending balance: loans acquired with deteriorated credit quality	\$ 265	\$	\$	\$	\$	\$	\$	\$	\$ 265

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

NOTE 4 LOANS (Continued)

Additional analysis, presented in thousands, related to the allowance for credit losses for nine months ended September 30, 2017 and September 30, 2016 is as follows:

	Consumer Real Estate	Agricultural Real Estate	Agricultural Agricultural	Commercial Real Estate	Commercial and Industrial	Consumer	Unfunded Loan Commitment & Letters of Credit	Unallocated	Total
Nine Months Ended September 30, 2017									
ALLOWANCE FOR CREDIT 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 expense related to unfunded							11		11
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
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Ending balance:

individually
evaluated for
impairment

\$ 1,012	\$ 205	\$ 161	\$ 488	\$ 113	\$	\$	\$	\$ 1,979
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Ending balance:

collectively
evaluated for
impairment

\$ 82,863	\$ 63,366	\$ 87,078	\$ 393,425	\$ 130,607	\$ 35,887	\$	\$	\$ 793,226
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Ending balance:

loans acquired with
deteriorated credit
quality

\$ 194	\$	\$	\$	\$	\$	\$	\$	\$ 194
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ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)

NOTE 4 LOANS (Continued)

	Consumer Real Estate	Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Consumer	Unfunded Loan Commitment & Letters of Credit	Unallocated	Total
Nine Months Ended September 30, 2016									
ALLOWANCE FOR CREDIT LOSSES:									
Beginning balance	\$ 338	\$ 211	\$ 582	\$ 2,516	\$ 1,229	\$ 337	\$ 208	\$ 844	\$ 6,265
Charge Offs	(106)		(21)	(93)	(20)	(236)			(476)
Recoveries	23		9	7	8	60			107
Provision (Credit)	31	23	10	575	(22)	199		108	924
Other Non-interest expense related to unfunded							19		19
Ending Balance	\$ 286	\$ 234	\$ 580	\$ 3,005	\$ 1,195	\$ 360	\$ 227	\$ 952	\$ 6,839
Ending balance: individually evaluated for impairment	\$ 35	\$	\$	\$ 68	\$ 22	\$	\$	\$	\$ 125
Ending balance: collectively evaluated for impairment	\$ 251	\$ 234	\$ 580	\$ 2,937	\$ 1,173	\$ 360	\$ 227	\$ 952	\$ 6,714
Ending balance: loans acquired with deteriorated credit quality	\$ 1	\$	\$	\$	\$	\$	\$	\$	1

**FINANCING
RECEIVABLES:**

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Ending balance	\$ 85,977	\$ 59,458	\$ 79,332	\$ 369,721	\$ 111,953	\$ 30,616	\$	\$	\$ 737,057
Ending balance: individually evaluated for impairment	\$ 712	\$ 132	\$	\$ 444	\$ 118	\$	\$	\$	\$ 1,406
Ending balance: collectively evaluated for impairment	\$ 85,265	\$ 59,326	\$ 79,332	\$ 369,277	\$ 111,835	\$ 30,616	\$	\$	\$ 735,651
Ending balance: loans acquired with deteriorated credit quality	\$ 265	\$	\$	\$	\$	\$	\$	\$	\$ 265

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ITEM 1 NOTES TO CONDESED 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			
	Three Months Ended		Year to Date Ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Earnings per share				
Net income	\$ 3,222	\$ 3,015	\$ 9,284	\$ 8,470
Less: distributed earnings allocated to participating securities	(12)	(10)	(33)	(27)
Less: undistributed earnings allocated to participating securities	(19)	(16)	(54)	(45)
Net earnings available to common shareholders	\$ 3,191	\$ 2,989	\$ 9,197	\$ 8,398
Weighted average common shares outstanding including participating securities ⁽¹⁾	9,252,919	9,225,532	9,245,514	9,218,376
Less: average unvested restricted shares ⁽¹⁾	(88,596)	(80,422)	(87,074)	(77,866)
Weighted average common shares outstanding ⁽¹⁾	9,164,323	9,145,110	9,158,440	9,140,510
Basic earnings and diluted per share ⁽¹⁾	\$ 0.35	\$ 0.33	\$ 1.00	\$ 0.92

⁽¹⁾ Share data has been adjusted to reflect a 2-for-1 stock split on September 20, 2017

NOTE 6 FAIR VALUE OF INSTRUMENTS

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.

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

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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 redemption provisions of the Federal Home Loan Bank.

Loans Held for Sale

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

Loans, net

For those variable-rate loans that re-price frequently, and with no significant change in credit risk, fair values are based on carrying values. The fair values of the fixed rate and all other loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers with similar credit quality.

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.

Accrued Interest Receivable and Payable

The carrying amounts of accrued interest approximate their fair values.

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

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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.

FHLB Advances

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

The estimated fair values, and related carrying or notional amounts, for on and off-balance sheet financial instruments as of September 30, 2017 and December 31, 2016 are reflected below.

	(In Thousands)				
	September 30, 2017				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and Cash Equivalents	\$ 49,104	\$ 49,104	\$ 49,104	\$	\$
Interest-bearing time deposits	2,541	2,541		2,541	
Securities - available-for-sale	192,811	192,811	15,676	175,693	1,442
Other Securities	3,717	3,717			3,717
Loans held for sale	2,147	2,147			2,147
Loans, net	788,335	790,893			790,893
Interest receivable	5,106	5,106			5,106
Financial Liabilities:					
Interest bearing Deposits	\$ 519,822	\$ 519,865	\$	\$	\$ 519,865
Non-interest bearing Deposits	189,963	189,963		189,963	
Time Deposits	193,581	194,342			194,342
Total Deposits	\$ 903,366	\$ 904,170	\$	\$ 189,963	\$ 714,207
Federal Funds Purchased and Securities Sold Under					
Agreement to Repurchase	\$ 35,550	\$ 35,550	\$	\$	\$ 35,550
Federal Home Loan Bank advances	10,000	10,041			10,041
Interest payable	285	285			285

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

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

	(In Thousands)				
	December 31, 2016				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and Cash Equivalents	\$ 28,322	\$ 28,322	\$ 28,322	\$	\$
Interest-bearing time deposits	1,915	1,918		1,918	
Securities - available-for-sale	218,527	218,527	24,775	192,334	1,418
Other Securities	3,717	3,717			3,717
Loans held for sale	2,055	2,055			2,055
Loans, net	751,310	753,357			753,357
Interest receivable	3,880	3,880			3,880
Financial Liabilities:					
Interest bearing Deposits	\$ 456,983	\$ 456,983	\$	\$	\$ 456,983
Non-interest bearing Deposits	186,390	186,390		186,390	
Time Deposits	198,830	199,658			199,658
Total Deposits	\$ 842,203	\$ 843,031	\$	\$ 186,390	\$ 656,641
Federal Funds Purchased and Securities Sold Under					
Agreement to Repurchase	\$ 70,324	\$ 70,324	\$	\$	\$ 70,324
Federal Home Loan Bank advances	10,000	10,041			10,041
Interest payable	256	256			256
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.

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

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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.

The following summarizes financial assets measured at fair value on a recurring basis as of September 30, 2017 and December 31, 2016, 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 Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Observable Inputs (Level 3)
September 30, 2017			
Assets - (Securities Available-for-Sale)			
U.S. Treasury	\$ 15,676	\$	\$
U.S. Government agencies		78,160	
Mortgage-backed securities		41,990	
State and local governments		55,543	1,442
Total Securities Available-for-Sale	\$ 15,676	\$ 175,693	\$ 1,442
December 31, 2016			
Assets - (Securities Available-for-Sale)			
U.S. Treasury	\$ 24,775	\$	\$
U.S. Government agencies		82,474	
Mortgage-backed securities		48,461	
State and local governments		61,399	1,418
Total Securities Available-for-Sale	\$ 24,775	\$ 192,334	\$ 1,418

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

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The following table represents the changes in the Level 3 fair-value category of which unobservable inputs are relied upon as of September 30, 2017 and September 30, 2016.

	(In Thousands)		
	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	State and Local Governments Tax-Exempt	State and Local Governments Taxable	State and Local Governments 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

	(In Thousands)		
	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	State and Local Governments Tax-Exempt	State and Local Governments Taxable	State and Local Governments Total
Balance at January 1, 2016	\$ 5,904	\$ 1,448	\$ 7,352
Change in Market Value		93	93
Payments & Maturities	(5,904)		(5,904)
Balance at September 30, 2016	\$	\$ 1,541	\$ 1,541

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, 2017 and December 31, 2016, 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.)

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

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

At September 30, 2017 and December 31, 2016, fair value of collateral dependent impaired loans categorized as Level 3 was \$562 and \$576 thousand, respectively. The specific allocation for impaired loans was \$123 and \$135 thousand as of September 30, 2017 and December 31, 2016, 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 recog