

FARMERS & MERCHANTS BANCORP
Form 10-Q
May 08, 2015

UNITED STATES
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 ended March 31, 2015

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: 000-26099

FARMERS & MERCHANTS BANCORP
(Exact name of registrant as specified in its charter)

Delaware 94-3327828
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

111 W. Pine Street, Lodi, California 95240
(Address of principal Executive offices) (Zip Code)

Registrant's telephone number, including area code (209) 367-2300

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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 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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

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

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

Number of shares of common stock of the registrant: 785,782 outstanding as of April 30, 2015.

FARMERS & MERCHANTS BANCORP

FORM 10-Q

TABLE OF CONTENTS

PART I. - <u>FINANCIAL INFORMATION</u>	<u>Page</u>
Item 1 - <u>Financial Statements</u>	
<u>Consolidated Balance Sheets (Unaudited) as of March 31, 2015, December 31, 2014 and March 31, 2014.</u>	3
<u>Consolidated Statements of Income (Unaudited) for the Three Months Ended March 31, 2015 and 2014.</u>	4
<u>Consolidated Statements of Comprehensive Income (Unaudited) for the Three Months Ended March 31, 2015 and 2014.</u>	5
<u>Consolidated Statements of Changes in Shareholders' Equity (Unaudited) for the Three Months Ended March 31, 2015 and 2014.</u>	6
<u>Consolidated Statements of Cash Flows (Unaudited) for the Three Months Ended March 31, 2015 and 2014.</u>	7
<u>Notes to the Consolidated Financial Statements (Unaudited)</u>	8
Item 2 - <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	34
Item 3 - <u>Quantitative and Qualitative Disclosures About Market Risk</u>	53
Item 4 - <u>Controls and Procedures</u>	55
PART II. - <u>OTHER INFORMATION</u>	
Item 1 - <u>Legal Proceedings</u>	56
Item 1A - <u>Risk Factors</u>	56
Item 2 - <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	56
Item 3 - <u>Defaults Upon Senior Securities</u>	56
Item 4 - <u>Mine Safety Disclosures</u>	57
Item 5 - <u>Other Information</u>	57
Item 6 - <u>Exhibits</u>	57

Signatures 57

Index to Exhibits 58

31(a) Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31(b) Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

2

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FARMERS & MERCHANTS BANCORP

Consolidated Balance Sheets

(in thousands)

	March 31, 2015 (Unaudited)	December 31, 2014	March 31, 2014 (Unaudited)
Assets			
Cash and Cash Equivalents:			
Cash and Due from Banks	\$33,746	\$42,375	\$39,042
Interest Bearing Deposits with Banks	110,190	34,750	134,685
Total Cash and Cash Equivalents	143,936	77,125	173,727
Investment Securities:			
Available-for-Sale	365,184	366,542	399,743
Held-to-Maturity	63,463	63,863	65,655
Total Investment Securities	428,647	430,405	465,398
Loans & Leases:			
Loans & Leases	1,705,320	1,712,244	1,363,030
Less: Allowance for Credit Losses	38,940	35,401	34,277
Loans & Leases, Net	1,666,380	1,676,843	1,328,753
Premises and Equipment, Net	26,693	25,821	22,692
Bank Owned Life Insurance	54,454	53,990	52,564
Interest Receivable and Other Assets	93,925	96,367	84,167
Total Assets	\$2,414,035	\$2,360,551	\$2,127,301
Liabilities			
Deposits:			
Demand	\$578,820	\$610,133	\$489,786
Interest Bearing Transaction	340,045	341,397	287,174
Savings and Money Market	699,308	644,260	639,370
Time	493,600	468,283	424,284
Total Deposits	2,111,773	2,064,073	1,840,614
Subordinated Debentures	10,310	10,310	10,310
Interest Payable and Other Liabilities	50,664	52,990	58,426
Total Liabilities	2,172,747	2,127,373	1,909,350
Shareholders' Equity			
Preferred Stock: No Par Value, 1,000,000 Shares Authorized, None Issued or Outstanding	-	-	-
Common Stock: Par Value \$0.01, 7,500,000 Shares Authorized, 785,782, 784,082 and 777,882 Shares Issued and Outstanding at March 31, 2015, December 31, 2014 and March 31, 2014, Respectively	8	8	8
Additional Paid-In Capital	78,569	77,804	75,014
Retained Earnings	159,236	152,833	143,632

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Accumulated Other Comprehensive Income (Loss)	3,475	2,533	(703)
Total Shareholders' Equity	241,288	233,178	217,951
Total Liabilities and Shareholders' Equity	\$2,414,035	\$2,360,551	\$2,127,301

The accompanying notes are an integral part of these unaudited consolidated financial statements

3

Table of Contents

FARMERS & MERCHANTS BANCORP

Consolidated Statements of Income (Unaudited)

(in thousands except per share data)

Three Months
 Ended March 31,
 2015 2014

Interest Income

Interest and Fees on Loans & Leases	\$19,127	\$16,271
Interest on Deposits with Banks	58	64
Interest on Investment Securities:		
Taxable	1,586	2,115
Exempt from Federal Tax	522	597
Total Interest Income	21,293	19,047

Interest Expense

Deposits	712	600
Subordinated Debentures	80	80
Total Interest Expense	792	680

Net Interest Income	20,501	18,367
Provision for Credit Losses	600	-
Net Interest Income After Provision for Credit Losses	19,901	18,367

Non-Interest Income

Service Charges on Deposit Accounts	898	938
Net Gain on Sale of Investment Securities	1	3
Increase in Cash Surrender Value of Life Insurance	464	455
Debit Card and ATM Fees	777	735
Net Gain on Deferred Compensation Investments	765	443
Other	1,759	588
Total Non-Interest Income	4,664	3,162

Non-Interest Expense

Salaries and Employee Benefits	10,099	8,237
Net Gain on Deferred Compensation Investments	765	443
Occupancy	639	622
Equipment	732	703
Legal Fees	109	47
FDIC Insurance	284	252
Other	1,590	1,336
Total Non-Interest Expense	14,218	11,640

Income Before Income Taxes	10,347	9,889
Provision for Income Taxes	3,944	3,607
Net Income	\$6,403	\$6,282
Basic Earnings Per Common Share	\$8.15	\$8.08

The accompanying notes are an integral part of these unaudited consolidated financial statements

Table of Contents

FARMERS & MERCHANTS BANCORP

Consolidated Statements of Comprehensive Income (Unaudited)

(in thousands)

	Three Months Ended March 31,	
	2015	2014
Net Income	\$6,403	\$6,282
Other Comprehensive Income		
Increase in Net Unrealized Gain on Available-for-Sale Securities	1,627	3,048
Deferred Tax Expense Related to Unrealized Gains	(684)	(1,282)
Reclassification Adjustment for Realized Gains on Available-for-Sale Securities Included in Net Income	(1)	(3)
Deferred Tax Benefit Related to Reclassification Adjustment	-	2
Change in Net Unrealized Gain on Available-for-Sale Securities, Net of Tax	942	1,765
Total Other Comprehensive Income	942	1,765
Comprehensive Income	\$7,345	\$8,047

The accompanying notes are an integral part of these unaudited consolidated financial statements

Table of Contents

FARMERS & MERCHANTS BANCORP

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

(in thousands except share data)

	Common Shares Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), net	Total Shareholders' Equity
Balance, January 1, 2014	777,882	\$ 8	\$ 75,014	\$ 137,350	\$ (2,468)) \$ 209,904
Net Income		-	-	6,282	-	6,282
Change in Net Unrealized Gains on Securities Available-for-Sale, net of tax		-	-	-	1,765	1,765
Balance, March 31, 2014	777,882	\$ 8	\$ 75,014	\$ 143,632	\$ (703)) \$ 217,951
Balance, January 1, 2015	784,082	\$ 8	\$ 77,804	\$ 152,833	\$ 2,533	\$ 233,178
Net Income		-	-	6,403	-	6,403
Issuance of Common Stock	1,700	-	765	-	-	765
Change in Net Unrealized Gains on Securities Available-for-Sale, net of tax		-	-	-	942	942
Balance, March 31, 2015	785,782	\$ 8	\$ 78,569	\$ 159,236	\$ 3,475	\$ 241,288

The accompanying notes are an integral part of these unaudited consolidated financial statements

Table of ContentsFARMERS & MERCHANTS BANCORP
Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended	
	March	March
	31,	31,
	2015	2014
(in thousands)		
Operating Activities:		
Net Income	\$6,403	\$6,282
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Credit Losses	600	-
Depreciation and Amortization	363	340
Net Amortization of Investment Security Premiums & Discounts	375	404
Net Gain on Sale of Investment Securities	(1)	(3)
Net Change in Operating Assets & Liabilities:		
Net Decrease in Interest Receivable and Other Assets	1,872	4,360
Net (Decrease) Increase in Interest Payable and Other Liabilities	(2,326)	10,258
Net Cash Provided by Operating Activities	7,286	21,641
Investing Activities:		
Purchase of Investment Securities Available-for-Sale	(19,814)	(14,636)
Proceeds from Sold, Matured or Called Securities Available-for-Sale	22,629	22,208
Purchase of Investment Securities Held-to-Maturity	(205)	(565)
Proceeds from Matured or Called Securities Held-to-Maturity	587	3,415
Net Loans & Leases Paid, Originated or Acquired	6,895	25,176
Principal Collected on Loans & Leases Previously Charged Off	2,968	33
Additions to Premises and Equipment	(1,235)	(145)
Net Cash Provided by Investing Activities	11,825	35,486
Financing Activities:		
Net Increase in Deposits	47,700	32,923
Net Cash Provided by Financing Activities	47,700	32,923
Increase in Cash and Cash Equivalents	66,811	90,050
Cash and Cash Equivalents at Beginning of Period	77,125	83,677
Cash and Cash Equivalents at End of Period	\$143,936	\$173,727
Supplementary Data		
Cash Payments Made for Income Taxes	\$85	\$-
Issuance of Common Stock	\$765	\$-
Interest Paid	\$737	\$687

The accompanying notes are an integral part of these unaudited consolidated financial statements

Table of Contents

FARMERS & MERCHANTS BANCORP

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Significant Accounting Policies

Farmers & Merchants Bancorp (the “Company”) was organized March 10, 1999. Primary operations are related to traditional banking activities through its subsidiary Farmers & Merchants Bank of Central California (the “Bank”) which was established in 1916. The Bank’s wholly owned subsidiaries include Farmers & Merchants Investment Corporation and Farmers/Merchants Corp. Farmers & Merchants Investment Corporation has been dormant since 1991. Farmers/Merchants Corp. acts as trustee on deeds of trust originated by the Bank.

The Company’s other subsidiaries include F & M Bancorp, Inc. and FMCB Statutory Trust I. F & M Bancorp, Inc. was created in March 2002 to protect the name F & M Bank. During 2002, the Company completed a fictitious name filing in California to begin using the streamlined name “F & M Bank” as part of a larger effort to enhance the Company’s image and build brand name recognition. In December 2003, the Company formed a wholly owned subsidiary, FMCB Statutory Trust I. FMCB Statutory Trust I is a non-consolidated subsidiary per Generally Accepted Accounting Principles in the United States of America (“U.S. GAAP”) and was formed for the sole purpose of issuing Trust Preferred Securities and related subordinated debentures.

The accounting and reporting policies of the Company conform to U.S. GAAP and prevailing practice within the banking industry. The following is a summary of the significant accounting and reporting policies used in preparing the consolidated financial statements.

Basis of Presentation

The accompanying consolidated financial statements and notes thereto have been prepared in accordance with accounting principles generally accepted in the United States of America for financial information.

These statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim reporting on Form 10-Q. Accordingly, certain disclosures normally presented in the notes to the annual consolidated financial statements prepared in accordance with U.S. GAAP have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. The results of operations for the three-month period ended March 31, 2015 may not necessarily be indicative of future operating results.

The accompanying consolidated financial statements include the accounts of the Company and the Company’s wholly owned subsidiaries, F & M Bancorp, Inc. and the Bank, along with the Bank’s wholly owned subsidiaries, Farmers & Merchants Investment Corporation and Farmers/Merchants Corp. Significant inter-company transactions have been eliminated in consolidation.

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Certain amounts in the prior years' financial statements and related footnote disclosures have been reclassified to conform to the current-year presentation. These reclassifications had no effect on previously reported net income or total shareholders' equity. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments), which are necessary for a fair presentation of financial results for the periods presented.

Table of Contents

Cash and Cash Equivalents

For purposes of the Consolidated Statements of Cash Flows, the Company has defined cash and cash equivalents as those amounts included in the balance sheet captions Cash and Due from Banks, Interest Bearing Deposits with Banks, Federal Funds Sold and Securities Purchased Under Agreements to Resell. For these instruments, the carrying amount is a reasonable estimate of fair value.

Investment Securities

Investment securities are classified at the time of purchase as held-to-maturity (“HTM”) if it is management’s intent and the Company has the ability to hold the securities until maturity. These securities are carried at cost, adjusted for amortization of premium and accretion of discount using a level yield of interest over the estimated remaining period until maturity. Losses, reflecting a decline in value judged by the Company to be other than temporary, are recognized in the period in which they occur.

Securities are classified as available-for-sale (“AFS”) if it is management’s intent, at the time of purchase, to hold the securities for an indefinite period of time and/or to use the securities as part of the Company’s asset/liability management strategy. These securities are reported at fair value with aggregate unrealized gains or losses excluded from income and included as a separate component of shareholders’ equity, net of related income taxes. Fair values are based on quoted market prices or broker/dealer price quotations on a specific identification basis. Gains or losses on the sale of these securities are computed using the specific identification method.

Trading securities, if any, are acquired for short-term appreciation and are recorded in a trading portfolio and are carried at fair value, with unrealized gains and losses recorded in non-interest income.

Management evaluates securities for other-than-temporary impairment (“OTTI”) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: (1) OTTI related to credit loss, which must be recognized in the income statement; and (2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

In order to determine OTTI for purchased beneficial interests that, on the purchase date, were not highly rated, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

Loans & Leases

Loans & leases are reported at the principal amount outstanding net of unearned discounts and deferred loan & lease fees and costs. Interest income on loans & leases is accrued daily on the outstanding balances using the simple interest method. Loan & lease origination fees are deferred and recognized over the contractual life of the loan or lease as an adjustment to the yield. Loans & leases are placed on non-accrual status when the collection of principal or interest is in doubt or when they become past due for 90 days or more unless they are both well-secured and in the process of collection. For this purpose, a loan or lease is considered well-secured if it is collateralized by property having a net realizable value in excess of the amount of the loan or lease or is guaranteed by a financially capable party. When a loan or lease is placed on non-accrual status, the accrued and unpaid interest receivable is reversed and charged

against current income; thereafter, interest income is recognized only as it is collected in cash. Additionally, cash would be applied to principal if all principal was not expected to be collected. Loans & leases placed on non-accrual status are returned to accrual status when the loans or leases are paid current as to principal and interest and future payments are expected to be made in accordance with the contractual terms of the loan or lease.

Table of Contents

A loan or lease is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Impaired loans & leases are either: (1) non-accrual loans & leases; or (2) restructured loans & leases that are still accruing interest. Loans or leases determined to be impaired are individually evaluated for impairment. When a loan or lease is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the loan or lease's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan or lease's observable market price, or the fair value of the collateral if the loan or lease is collateral dependent. A loan or lease is collateral dependent if the repayment of the loan or lease is expected to be provided solely by the underlying collateral.

A restructuring of a loan or lease constitutes a troubled debt restructuring ("TDR") if the Company for economic or legal reasons related to the borrower's (the term "borrower" is used herein to describe a customer who has entered into either a loan or lease transaction) financial difficulties grants a concession to the borrower that it would not otherwise consider. Restructured loans & leases typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. If the restructured loan or lease was current on all payments at the time of restructure and management reasonably expects the borrower will continue to perform after the restructure, management may keep the loan or lease on accrual. Loans & leases that are on nonaccrual status at the time they become TDR, remain on nonaccrual status until the borrower demonstrates a sustained period of performance, which the Company generally believes to be six consecutive months of payments, or equivalent. A loan or lease can be removed from TDR status if it was restructured at a market rate in a prior calendar year and is currently in compliance with its modified terms. However, these loans or leases continue to be classified as impaired and are individually evaluated for impairment as described above.

Generally, the Company will not restructure loans or leases for borrowers unless: (1) the existing loan or lease is brought current as to principal and interest payments; and (2) the restructured loan or lease can be underwritten to reasonable underwriting standards. If these standards are not met other actions will be pursued (e.g., foreclosure) to collect outstanding loan or lease amounts. After restructure a determination is made whether the loan or lease will be kept on accrual status based upon the underwriting and historical performance of the restructured credit.

Allowance for Credit Losses

The allowance for credit losses is an estimate of probable incurred credit losses inherent in the Company's loan & lease portfolio as of the balance sheet date. The allowance is established through a provision for credit losses, which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan & lease growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of three primary components: specific reserves related to impaired loans & leases; general reserves for inherent losses related to loans & leases that are not impaired; and an unallocated component that takes into account the imprecision in estimating and allocating allowance balances associated with macro factors.

The determination of the general reserve for loans & leases that are collectively evaluated for impairment is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, qualitative factors that include economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan & lease portfolio, and probable losses inherent in the portfolio taken as a whole.

The Company maintains a separate allowance for each portfolio segment (loan & lease type). These portfolio segments include: (1) commercial real estate; (2) agricultural real estate; (3) real estate construction (including land and development loans); (4) residential 1st mortgages; (5) home equity lines and loans; (6) agricultural; (7) commercial; (8) consumer and other; and (9) equipment leases. The allowance for credit losses attributable to each portfolio segment, which includes both individually evaluated impaired loans & leases and loans & leases that are

collectively evaluated for impairment, is combined to determine the Company's overall allowance, which is included on the consolidated balance sheet.

Table of Contents

The Company assigns a risk rating to all loans & leases and periodically performs detailed reviews of all such loans & leases over a certain threshold to identify credit risks and assess overall collectability. For smaller balance loans & leases, such as consumer and residential real estate, a credit grade is established at inception, and then updated only when the loan or lease becomes contractually delinquent or when the borrower requests a modification. For larger balance loans, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans & leases. These credit quality indicators are used to assign a risk rating to each individual loan or lease. These risk ratings are also subject to examination by independent specialists engaged by the Company. The risk ratings can be grouped into five major categories, defined as follows:

Pass – A pass loan or lease is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention – A special mention loan or lease has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or lease or in the Company's credit position at some future date. Special mention loans & leases are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard – A substandard loan or lease is not adequately protected by the current financial condition and paying capacity of the borrower or the value of the collateral pledged, if any. Loans or leases classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans or leases classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, based on currently known facts, conditions and values, highly questionable or improbable.

Loss – Loans or leases classified as loss are considered uncollectible. Once a loan or lease becomes delinquent and repayment becomes questionable, the Company will address collateral shortfalls with the borrower and attempt to obtain additional collateral. If this is not forthcoming and payment in full is unlikely, the Company will estimate its probable loss and immediately charge-off some or all of the balance.

The general reserve component of the allowance for credit losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk; (2) historical losses; and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below:

Commercial Real Estate – Commercial real estate mortgage loans are generally considered to possess a higher inherent risk of loss than the Company's commercial, agricultural and consumer loan types. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Real Estate Construction – Real estate construction loans, including land loans, are generally considered to possess a higher inherent risk of loss than the Company's commercial, agricultural and consumer loan types. A major risk arises from the necessity to complete projects within specified cost and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability

of construction projects.

Commercial – These loans are generally considered to possess a moderate inherent risk of loss because they are shorter-term; typically made to relationship customers; generally underwritten to existing cash flows of operating businesses; and may be collateralized by fixed assets, inventory and/or accounts receivable. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

11

Table of Contents

Agricultural Real Estate and Agricultural – These loans are generally considered to possess a moderate inherent risk of loss since they are typically made to relationship customers and are secured by crop production, livestock and related real estate. These loans are vulnerable to two risk factors that are largely outside the control of Company and borrowers: commodity prices and weather conditions.

Leases – Equipment leases are generally considered to possess a moderate inherent risk of loss. As Lessor, the Company is subject to both the credit risk of the borrower and the residual value risk of the equipment. Credit risks are underwritten using the same credit criteria the Company would use when making an equipment term loan. Residual value risk is managed through the use of qualified, independent appraisers that establish the residual values the Company uses in structuring a lease.

Residential 1st Mortgages and Home Equity Lines and Loans – These loans are generally considered to possess a low inherent risk of loss, although this is not always true as evidenced by the weakness in residential real estate values over the past five years. The degree of risk in residential real estate lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Consumer & Other – A consumer installment loan portfolio is usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made for consumer purchases. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's and Bank's regulators, including the Federal Reserve Bank (“FRB”), the California Department of Business Oversight (“DBO”) and the Federal Deposit Insurance Corporation (“FDIC”), as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

Allowance for Credit Losses on Off-Balance-Sheet Credit Exposures

The Company also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in Interest Payable and Other Liabilities on the Company's Consolidated Balance Sheet.

Premises and Equipment

Premises, equipment, and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation is computed principally by the straight line method over the estimated useful lives of the assets. Estimated useful lives of buildings range from 30 to 40 years, and for furniture and equipment from 3 to 7 years. Leasehold improvements are amortized over the lesser of the terms of the respective leases, or their useful lives, which are generally 5 to 10 years. Remodeling and capital improvements are capitalized while maintenance and repairs are charged directly to occupancy expense.

Other Real Estate

Other real estate, which is included in other assets, is expected to be sold and is comprised of properties no longer utilized for business operations and property acquired through foreclosure in satisfaction of indebtedness. These properties are recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value

less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Initial losses on properties acquired through full or partial satisfaction of debt are treated as credit losses and charged to the allowance for credit losses at the time of acquisition. Subsequent declines in value from the recorded amounts, routine holding costs, and gains or losses upon disposition, if any, are included in non-interest expense as incurred.

Table of Contents

Income Taxes

The Company uses the liability method of accounting for income taxes. This method results in the recognition of deferred tax assets and liabilities that are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The deferred provision for income taxes is the result of the net change in the deferred tax asset and deferred tax liability balances during the year. This amount combined with the current taxes payable or refundable results in the income tax expense for the current year.

The Company follows the standards set forth in the “Income Taxes” topic of the Financial Accounting Standards Board (“FASB”) Accounting Standard Codification (“ASC”), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements. This standard prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest expense and penalties associated with unrecognized tax benefits, if any, are included in the provision for income taxes in the Unaudited Consolidated Statements of Income.

Dividends and Basic Earnings Per Common Share

The Company’s common stock is not traded on any exchange. The shares are primarily held by local residents and are not actively traded. Basic earnings per common share amounts are computed by dividing net income by the weighted average number of common shares outstanding for the period. There are no common stock equivalent shares. Therefore, there is no presentation of diluted basic earnings per common share. See Note 6.

Segment Reporting

The “Segment Reporting” topic of the FASB ASC requires that public companies report certain information about operating segments. It also requires that public companies report certain information about their products and services, the geographic areas in which they operate, and their major customers. The Company is a holding company for a community bank, which offers a wide array of products and services to its customers. Pursuant to its banking strategy, emphasis is placed on building relationships with its customers, as opposed to building specific lines of business. As a result, the Company is not organized around discernible lines of business and prefers to work as an integrated unit to customize solutions for its customers, with business line emphasis and product offerings changing over time as needs and demands change. Therefore, the Company only reports one segment.

Derivative Instruments and Hedging Activities

The “Derivatives and Hedging” topic of the FASB ASC establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. All

derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. Changes in the fair value of those derivatives are accounted for depending on the intended use of the derivative and the resulting designation under specified criteria. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, designed to minimize interest rate risk, the effective portions of the change in the fair value of the derivative are recorded in other comprehensive income (loss), net of related income taxes. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings.

Table of Contents

From time to time, the Company utilizes derivative financial instruments such as interest rate caps, floors, swaps, and collars. These instruments are purchased and/or sold to reduce the Company's exposure to changing interest rates. The Company marks to market the value of its derivative financial instruments and reflects gain or loss in earnings in the period of change or in other comprehensive income (loss). The Company was not utilizing any derivative instruments as of or for the periods ended March 31, 2015, December 31, 2014 or March 31, 2014.

Comprehensive Income

The "Comprehensive Income" topic of the FASB ASC establishes standards for the reporting and display of comprehensive income and its components in the financial statements. Other comprehensive income (loss) refers to revenues, expenses, gains, and losses that U.S. GAAP recognize as changes in value to an enterprise but are excluded from net income. For the Company, comprehensive income includes net income and changes in fair value of its available-for-sale investment securities.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

2. Investment Securities

The amortized cost, fair values, and unrealized gains and losses of the securities available-for-sale are as follows (in thousands):

	Amortized	Gross		Fair/Book
	Cost	Unrealized	Unrealized	Value
		Gains	Losses	
March 31, 2015				
Government Agency & Government-Sponsored Entities	\$ 68,064	\$69	\$1	\$ 68,132
US Treasury Notes	19,818	148	-	19,966
Mortgage Backed Securities ⁽¹⁾	270,820	5,977	196	276,601
Other	485	-	-	485
Total	\$ 359,187	\$6,194	\$197	\$ 365,184

	Amortized	Gross		Fair/Book
	Cost	Unrealized	Unrealized	Value
		Gains	Losses	
December 31, 2014				
Government Agency & Government-Sponsored Entities	\$ 78,051	\$61	\$3	\$ 78,109
Mortgage Backed Securities ⁽¹⁾	283,636	4,969	657	287,948
Other	485	-	-	485
Total	\$ 362,172	\$5,030	\$660	\$ 366,542

	Amortized	Gross		Fair/Book
	Cost	Unrealized	Unrealized	Value
		Gains	Losses	
March 31, 2014				
Government Agency & Government-Sponsored Entities	\$ 18,242	\$184	\$-	\$ 18,426
Mortgage Backed Securities ⁽¹⁾	331,434	3,674	5,378	329,730
Corporate Securities	49,045	370	63	49,352
Other	2,235	-	-	2,235
Total	\$ 400,956	\$4,228	\$5,441	\$ 399,743

(1) All Mortgage Backed Securities consist of securities collateralized by residential real estate and were issued by an agency or government sponsored entity of the U.S. government.

14

Table of Contents

The book values, estimated fair values and unrealized gains and losses of investments classified as held-to-maturity are as follows (in thousands):

	Book Value	Gross Unrealized		Fair Value
		Gains	Losses	
March 31, 2015				
Obligations of States and Political Subdivisions	\$61,324	\$766	\$ 11	\$62,079
Other	2,139	-	-	2,139
Total	\$63,463	\$766	\$ 11	\$64,218

	Book Value	Gross Unrealized		Fair Value
		Gains	Losses	
December 31, 2014				
Obligations of States and Political Subdivisions	\$61,716	\$782	\$ 10	\$62,488
Other	2,147	-	-	2,147
Total	\$63,863	\$782	\$ 10	\$64,635

	Book Value	Gross Unrealized		Fair Value
		Gains	Losses	
March 31, 2014				
Obligations of States and Political Subdivisions	\$62,890	\$711	\$ 257	\$63,344
Mortgage Backed Securities ⁽¹⁾	4	-	-	4
Other	2,761	-	-	2,761
Total	\$65,655	\$711	\$ 257	\$66,109

⁽¹⁾ All Mortgage Backed Securities consist of securities collateralized by residential real estate and were issued by an agency or government sponsored entity of the U.S. government.

Fair values are based on quoted market prices or dealer quotes. If a quoted market price or dealer quote is not available, fair value is estimated using quoted market prices for similar securities.

The amortized cost and estimated fair values of investment securities at March 31, 2015 by contractual maturity are shown in the following table (in thousands):

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair/Book Value	Book Value	Fair Value
March 31, 2015				
Within one year	\$67,480	\$67,483	\$2,739	\$2,740
After one year through five years	20,887	21,100	16,132	16,294
After five years through ten years	-	-	10,313	10,423
After ten years	-	-	34,279	34,761
	88,367	88,583	63,463	64,218
Investment securities not due at a single maturity date:				
Mortgage-backed securities	270,820	276,601	-	-
Total	\$359,187	\$365,184	\$63,463	\$64,218

Expected maturities of mortgage-backed securities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Table of Contents

The following tables show those investments with gross unrealized losses and their market value aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at the dates indicated (in thousands):

	Less Than 12 Months Fair Value	Unrealized Loss	12 Months or More Fair Value	Unrealized Loss	Total Fair Value	Unrealized Loss
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March 31, 2015

Securities Available-for-SaleGovernment Agency & Government-Sponsored
Entities

\$24,998 \$ 1 \$- \$ - \$24,998 \$ 1

Mortgage Backed Securities

13,033 28 25,942 168 38,975 196

Total

\$38,031 \$ 29 \$25,942 \$ 168 \$63,973 \$ 197

Securities Held-to-Maturity

Obligations of States and Political Subdivisions

\$1,340 \$ 11 \$- \$ - \$1,340 \$ 11

Total

\$1,340 \$ 11 \$- \$ - \$1,340 \$ 11

	Less Than 12 Months Fair Value	Unrealized Loss	12 Months or More Fair Value	Unrealized Loss	Total Fair Value	Unrealized Loss
--	--------------------------------------	--------------------	------------------------------------	--------------------	------------------------	--------------------

December 31, 2014

Securities Available-for-SaleGovernment Agency & Government-Sponsored
Entities

\$66,980 \$ 3 \$- \$ - \$66,980 \$ 3

Mortgage Backed Securities

14,487 151 33,574 506 48,061 657

Total

\$81,467 \$ 154 \$33,574 \$ 506 \$115,041 \$ 660

Securities Held-to-Maturity

Obligations of States and Political Subdivisions

\$849 \$ 5 \$876 \$ 5 \$1,725 \$ 10

Total

\$849 \$ 5 \$876 \$ 5 \$1,725 \$ 10

	Less Than 12 Months Fair Value	Unrealized Loss	12 Months or More Fair Value	Unrealized Loss	Total Fair Value	Unrealized Loss
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March 31, 2014

Securities Available-for-Sale

Mortgage Backed Securities

\$123,313 \$ 4,506 \$15,981 \$ 872 139,294 \$ 5,378

Corporate Securities

3,794 39 2,474 24 6,268 63

Total

\$127,107 \$ 4,545 \$18,455 \$ 896 \$145,562 \$ 5,441

Securities Held-to-Maturity

Obligations of States and Political Subdivisions

\$9,038 \$ 257 \$- \$ - \$9,038 \$ 257

Total

\$9,038 \$ 257 \$- \$ - \$9,038 \$ 257

As of March 31, 2015, the Company held 275 investment securities of which six were in a loss position for less than twelve months. Three securities were in a loss position for twelve months or more. Management periodically evaluates each investment security for other-than-temporary impairment relying primarily on industry analyst reports and observations of market conditions and interest rate fluctuations. Management believes it will be able to collect all amounts due according to the contractual terms of the underlying investment securities.

Securities of Government Agency and Government Sponsored Entities – At March 31, 2015, one security of government agency and government sponsored entities was in a loss position for less than 12 months. None were in a loss position for 12 months or more. The unrealized losses on the Company's investments in securities of government agency and government sponsored entities were \$1,000 at March 31, 2015, \$3,000 at December 31, 2014 and \$0 at March 31, 2014. The unrealized loss was caused by interest rate fluctuations. Repayment of these investments is guaranteed by an agency or government sponsored entity of the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the securities and it is more likely than not that the Company will not have to sell the securities before recovery of their cost basis, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2015 and December 31, 2014.

Table of Contents

Mortgage Backed Securities – At March 31, 2015, two mortgage backed security investments were in a loss position for less than 12 months and three were in a loss position for 12 months or more. The unrealized losses on the Company's investment in mortgage backed securities were \$196,000, \$657,000, and \$5.4 million at March 31, 2015, December 31, 2014, and March 31, 2014, respectively. The unrealized losses on the Company's investment in mortgage backed securities were caused by interest rate fluctuations. The contractual cash flows of these investments are guaranteed by an agency or government sponsored entity of the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the securities and it is more likely than not that the Company will not have to sell the securities before recovery of their cost basis, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2015, December 31, 2014 and March 31, 2014, respectively.

Obligations of States and Political Subdivisions - At March 31, 2015, three obligations of states and political subdivisions were in a loss position for less than 12 months. None were in a loss position for 12 months or more. As of March 31, 2015, over ninety-seven percent of the Company's bank-qualified municipal bond portfolio is rated at either the issue or issuer level, and all of these ratings are "investment grade." The Company monitors the status of the three percent of the portfolio that is not rated and at the current time does not believe any of them to be exhibiting financial problems that could result in a loss in any individual security.

The unrealized losses on the Company's investment in obligations of states and political subdivisions were \$11,000, \$10,000, and \$257,000 at March 31, 2015, December 31, 2014 and March 31, 2014, respectively. Management believes that any unrealized losses on the Company's investments in obligations of states and political subdivisions were primarily caused by interest rate fluctuations. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Because the Company does not intend to sell the securities and it is more likely than not that the Company will not have to sell the securities before recovery of their cost basis, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2015, December 31, 2014 and March 31, 2014, respectively.

Corporate Securities - The Company did not hold any corporate securities at March 31, 2015 or December 31, 2014. The unrealized losses on the Company's investment in corporate securities at March 31, 2014 were \$63,000. Changes in the prices of corporate securities are primarily influenced by: (1) changes in market interest rates; (2) changes in perceived credit risk in the general economy or in particular industries; (3) changes in the perceived credit risk of a particular company; and (4) day to day trading supply, demand and liquidity.

Proceeds from sales and calls of securities were as follows:

(in thousands)	Proceeds	Gains	Losses
Three Months Ended March 31, 2015	\$ 475	\$ 1	\$ -
Three Months Ended March 31, 2014	\$ 2,988	\$ 3	\$ -

Pledged Securities

As of March 31, 2015, securities carried at \$196.4 million were pledged to secure public deposits, Federal Home Loan Bank ("FHLB") borrowings, and other government agency deposits as required by law. This amount was \$178.8 million at December 31, 2014, and \$332.0 million at March 31, 2014.

The decrease in pledged securities since March 31, 2014 was due to the Company's use of a \$165 million standby Letter of Credit ("LC") issued by the FHLB as collateral for Public Deposits. The LC was issued December 4, 2014, and matures December 2, 2016, with a maintenance fee of 10 basis points per annum.

Table of Contents

3. Loans & Leases and Allowance for Credit Losses

The following tables show the allocation of the allowance for credit losses by portfolio segment and by impairment methodology at the dates indicated (in thousands):

March 31, 2015	Commercial Real Estate	Agricultural Real Estate	Real Estate Construction	Residential 1st Mortgages	Home Equity Lines & Loans	Agricultural	Commercial	Consumer & Other	Leases	Unallocated	Total
Year-To-Date Allowance for Credit Losses:											
Beginning Balance-											
January 1, 2015	\$7,842	\$4,185	\$1,669	\$1,022	\$2,426	\$6,104	\$8,195	\$218	\$2,211	\$1,529	\$35,000
Charge-Offs	-	-	-	-	-	-	(12)	(17)	-	-	(2,938)
Recoveries	2,938	-	-	-	5	1	2	22	-	-	2,966
Provision	(2,826)	2,716	247	(349)	(335)	(1,503)	756	(11)	288	1,617	600
Ending Balance- March 31, 2015	\$7,954	\$6,901	\$1,916	\$673	\$2,096	\$4,602	\$8,941	\$212	\$2,499	\$3,146	\$38,000
Ending Balance Individually Evaluated for Impairment											
Ending Balance Collectively Evaluated for Impairment	61	-	-	72	53	129	1,118	37	-	-	1,470
Ending Balance Individually Evaluated for Impairment											
Ending Balance Collectively Evaluated for Impairment	7,893	6,901	1,916	601	2,043	4,473	7,823	175	2,499	3,146	37,000
Ending Balance Individually Evaluated for Impairment											
Ending Balance Collectively Evaluated for Impairment	\$529,550	\$351,866	\$101,616	\$182,431	\$31,724	\$216,231	\$236,141	\$4,915	\$50,846	\$-	\$1,700,000
Ending Balance Individually Evaluated for Impairment											
Ending Balance Collectively Evaluated for Impairment	3,573	-	4,363	2,080	1,668	457	4,840	44	-	-	17,000
Ending Balance Individually Evaluated for Impairment											
Ending Balance Collectively Evaluated for Impairment	\$525,977	\$351,866	\$97,253	\$180,351	\$30,056	\$215,774	\$231,301	\$4,871	\$50,846	\$-	\$1,683,000

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December 31, 2014	Commercial Real Estate	Agricultural Real Estate	Real Estate Construction	Residential 1st Mortgages	Home Equity Lines & Loans	Agricultural Commercial	Commercial	Consumer & Other	Leases	Unallocated	Total
Year-To-Date Allowance for Credit Losses:											
Beginning Balance- January 1, 2014	\$5,178	\$3,576	\$654	\$1,108	\$2,767	\$12,205	\$5,697	\$176	\$639	\$2,274	\$34,536
Charge-Offs	-	-	-	(73)	(70)	-	(1)	(132)	-	-	(276)
Recoveries	11	-	-	-	58	8	86	65	-	-	228
Provision	2,653	609	1,015	(13)	(329)	(6,109)	2,413	109	1,572	(745)	1,173
Ending Balance- December 31, 2014	\$7,842	\$4,185	\$1,669	\$1,022	\$2,426	\$6,104	\$8,195	\$218	\$2,211	\$1,529	\$35,261
Ending Balance Individually Evaluated for Impairment	377	-	-	422	329	114	914	41	-	-	2,197
Ending Balance Collectively Evaluated for Impairment Loans & Leases:	7,465	4,185	1,669	600	2,097	5,990	7,281	177	2,211	1,529	33,064
Ending Balance Individually Evaluated for Impairment	\$491,903	\$357,207	\$96,519	\$171,880	\$33,017	\$281,963	\$230,819	\$4,719	\$44,217	\$-	\$1,778,438
Ending Balance Collectively Evaluated for Impairment	20,066	-	4,386	2,108	1,643	461	4,874	46	-	-	33,984
Ending Balance Collectively Evaluated for Impairment	\$471,837	\$357,207	\$92,133	\$169,772	\$31,374	\$281,502	\$225,945	\$4,673	\$44,217	\$-	\$1,778,438

Table of Contents

March 31, 2014	Commercial Real Estate	Agricultural Real Estate	Real Estate Construction	Residential 1st Mortgages	Home Equity Lines & Loans	Agricultural	Commercial	Consumer & Other	Leases	Unallocated	Total
Year-To-Date Allowance for Credit Losses:											
Beginning Balance- January 1, 2014	\$5,178	\$3,576	\$654	\$1,108	\$2,767	\$12,205	\$5,697	\$176	\$639	\$2,274	\$34,2
Charge-Offs	-	-	-	(3)	-	-	-	(27)	-	-	(30
Recoveries	-	-	-	-	12	1	5	15	-	-	33
Provision	1,248	(189)	423	(5)	(131)	(2,605)	724	7	282	246	-
Ending Balance- March 31, 2014	\$6,426	\$3,387	\$1,077	\$1,100	\$2,648	\$9,601	\$6,426	\$171	\$921	\$2,520	\$34,2
Ending Balance Individually Evaluated for Impairment	245	-	226	340	313	118	814	48	-	-	2,10
Ending Balance Collectively Evaluated for Impairment	6,181	3,387	851	760	2,335	9,483	5,612	123	921	2,520	32,1
Loans: Ending Balance	\$402,865	\$326,112	\$55,751	\$156,094	\$34,289	\$209,228	\$155,802	\$4,721	\$18,168	\$-	\$1,36
Ending Balance Individually Evaluated for Impairment	22,046	-	4,473	1,701	2,055	587	5,100	48	-	-	36,0
Ending Balance Collectively Evaluated for Impairment	\$380,819	\$326,112	\$51,278	\$154,393	\$32,234	\$208,641	\$150,702	\$4,673	\$18,168	\$-	\$1,32

The ending balance of loans individually evaluated for impairment includes restructured loans in the amount of \$9.8 million at March 31, 2015, \$26.4 million at December 31, 2014 and \$28.9 million at March 31, 2014, which are no longer disclosed or classified as TDRs.

Table of Contents

The following tables show the loan & lease portfolio allocated by management's internal risk ratings at the dates indicated (in thousands):

	Pass	Special Mention	Substandard	Total Loans & Leases
March 31, 2015				
Loans & Leases:				
Commercial Real Estate	\$520,613	\$8,834	\$ 103	\$529,550
Agricultural Real Estate	351,866	-	-	351,866
Real Estate Construction	99,920	1,696	-	101,616
Residential 1st Mortgages	181,021	744	666	182,431
Home Equity Lines & Loans	30,772	83	869	31,724
Agricultural	215,507	453	271	216,231
Commercial	220,491	12,086	3,564	236,141
Consumer & Other	4,687	-	228	4,915
Leases	50,846			50,846
Total	\$1,675,723	\$23,896	\$ 5,701	\$1,705,320

	Pass	Special Mention	Substandard	Total Loans
December 31, 2014				
Loans & Leases:				
Commercial Real Estate	\$483,146	\$8,651	\$ 106	\$491,903
Agricultural Real Estate	357,207	-	-	357,207
Real Estate Construction	94,887	1,632	-	96,519
Residential 1st Mortgages	170,462	744	674	171,880
Home Equity Lines and Loans	32,054	85	878	33,017
Agricultural	281,232	679	52	281,963
Commercial	211,036	18,143	1,640	230,819
Consumer & Other	4,449	-	270	4,719
Leases	44,217	-	-	44,217
Total	\$1,678,690	\$29,934	\$ 3,620	\$1,712,244

	Pass	Special Mention	Substandard	Total Loans & Leases
March 31, 2014				
Loans & Leases:				
Commercial Real Estate	\$389,366	\$13,126	\$ 373	\$402,865
Agricultural Real Estate	326,112	-	-	326,112
Real Estate Construction	54,120	1,631	-	55,751
Residential 1st Mortgages	154,743	767	584	156,094
Home Equity Lines & Loans	33,196	-	1,093	34,289
Agricultural	208,308	843	77	209,228
Commercial	137,125	16,928	1,749	155,802
Consumer & Other	4,529	-	192	4,721
Leases	18,168			18,168
Total	\$1,325,667	\$33,295	\$ 4,068	\$1,363,030

See "Note 1. Significant Accounting Policies - Allowance for Credit Losses" for a description of the internal risk ratings used by the Company. There were no loans or leases outstanding at March 31, 2015, December 31, 2014, and March 31, 2014, rated doubtful or loss.

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Table of Contents

The following tables show an aging analysis of the loan & lease portfolio by the time past due at the dates indicated (in thousands):

March 31, 2015	30-59 Days Past Due	60-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total Loans & Leases
Loans & Leases:							
Commercial Real Estate	\$ 719	\$ -	\$ -	\$ 103	\$ 822	\$ 528,728	\$ 529,550
Agricultural Real Estate	-	-	-	-	-	351,866	351,866
Real Estate Construction	-	-	-	-	-	101,616	101,616
Residential 1st Mortgages	99	-	-	74	173	182,258	182,431
Home Equity Lines & Loans	-	-	-	616	616	31,108	31,724
Agricultural	-	-	-	14	14	216,217	216,231
Commercial	-	-	-	1,573	1,573	234,568	236,141
Consumer & Other	9	-	-	13	22	4,893	4,915
Leases	-	-	-	-	-	50,846	50,846
Total	\$ 827	\$ -	\$ -	\$ 2,393	\$ 3,220	\$ 1,702,100	\$ 1,705,320

December 31, 2014	30-59 Days Past Due	60-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total Loans & Leases
Loans & Leases:							
Commercial Real Estate	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 491,903	\$ 491,903
Agricultural Real Estate	-	-	-	-	-	357,207	357,207
Real Estate Construction	-	-	-	-	-	96,519	96,519
Residential 1st Mortgages	-	-	-	77	77	171,803	171,880
Home Equity Lines and Loans	79	-	-	576	655	32,362	33,017
Agricultural	-	-	-	18	18	281,945	281,963
Commercial	-	-	-	1,586	1,586	229,233	230,819
Consumer & Other	10	-	-	13	23	4,696	4,719
Leases	-	-	-	-	-	44,217	44,217
Total	\$ 89	\$ -	\$ -	\$ 2,270	\$ 2,359	\$ 1,709,885	\$ 1,712,244

March 31, 2014	30-59 Days Past Due	60-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total Loans & Leases
Loans & Leases:							
Commercial Real Estate	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 402,865	\$ 402,865
Agricultural Real Estate	-	-	-	-	-	326,112	326,112
Real Estate Construction	-	-	-	-	-	55,751	55,751
Residential 1st Mortgages	-	-	-	316	316	155,778	156,094
Home Equity Lines & Loans	30	-	-	969	999	33,290	34,289
Agricultural	-	25	-	32	57	209,171	209,228
Commercial	-	-	-	1,801	1,801	154,001	155,802
Consumer & Other	5	-	-	15	20	4,701	4,721
Leases	-	-	-	-	-	18,168	18,168
Total	\$ 35	\$ 25	\$ -	\$ 3,133	\$ 3,193	\$ 1,359,837	\$ 1,363,030

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Table of Contents

The following tables show information related to impaired loans & leases for the periods indicated (in thousands):

	Recorded	Unpaid	Related	Average	Interest
	Investment	Principal	Allowance	Recorded	Income
March 31, 2015		Balance		Investment	Recognized
With no related allowance recorded:					
Commercial Real Estate	\$ 192	\$ 192	\$ -	\$ 96	\$ 2
Residential 1st Mortgages	569	632	-	285	4
Home Equity Lines & Loans	661	701	-	331	1
Agricultural	14	27	-	7	-
Commercial	48	48	-	24	1
	\$ 1,484	\$ 1,600	\$ -	\$ 743	\$ 8
With an allowance recorded:					
Residential 1st Mortgages	\$ 359	\$ 429	\$ 18	\$ 648	\$ 4
Home Equity Lines & Loans	138	156	7	545	1
Agricultural	443	443	129	452	7
Commercial	4,793	4,889	1,118	4,768	25
Consumer & Other	43	49	37	45	1
	\$ 5,776	\$ 5,966	\$ 1,309	\$ 6,458	\$ 38
Total	\$ 7,260	\$ 7,566	\$ 1,309	\$ 7,201	\$ 46

	Recorded	Unpaid	Related	Average	Interest
	Investment	Principal	Allowance	Recorded	Income
December 31, 2014		Balance		Investment	Recognized
With no related allowance recorded:					
Commercial Real Estate	\$ -	\$ -	\$ -	\$ 49	\$ 4
Home Equity Lines and Loans	-	-	-	169	-
Agricultural	-	-	-	15	-
Commercial	-	-	-	1,620	54
	\$ -	\$ -	\$ -	\$ 1,853	\$ 58
With an allowance recorded:					
Commercial Real Estate	\$ 92	\$ 92	\$ 2	\$ 47	\$ 4
Residential 1st Mortgages	937	1,069	187	612	9
Home Equity Lines and Loans	951	1,020	190	803	10
Agricultural	461	473	114	473	28
Commercial	4,742	4,813	910	3,182	54
Consumer & Other	46	51	41	46	2
	\$ 7,229	\$ 7,518	\$ 1,444	\$ 5,163	\$ 107
Total	\$ 7,229	\$ 7,518	\$ 1,444	\$ 7,016	\$ 165

	Recorded	Unpaid	Related	Average	Interest
	Investment	Principal	Allowance	Recorded	Income
March 31, 2014		Balance		Investment	Recognized
With no related allowance recorded:					
Commercial Real Estate	\$ 98	\$ 98	\$ -	\$ 49	\$ 2
Home Equity Lines & Loans	677	686	-	339	-
Agricultural	32	41	-	16	-
Commercial	3,331	3,389	-	1,666	27
	\$ 4,138	\$ 4,214	\$ -	\$ 2,070	\$ 29
With an allowance recorded:					

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Residential 1st Mortgages	\$ 411	\$ 443	\$ 82	\$ 674	\$ 1
Home Equity Lines & Loans	394	414	120	673	-
Agricultural	473	473	118	467	7
Commercial	1,627	1,657	814	3,185	-
Consumer & Other	48	51	48	47	1
	\$ 2,953	\$ 3,038	\$ 1,182	\$ 5,046	\$ 9
Total	\$ 7,091	\$ 7,252	\$ 1,182	\$ 7,116	\$ 38

Total recorded investment shown in the prior tables will not equal the total ending balance of loans & leases individually evaluated for impairment on the allocation of allowance tables. This is because the calculation of recorded investment takes into account charge-offs, net unamortized loan & lease fees & costs, unamortized premium or discount, and accrued interest. This table also excludes impaired loans that were previously modified in a troubled debt restructuring, are currently performing and are no longer disclosed or classified as TDRs.

Table of Contents

At March 31, 2015, the Company allocated \$1.3 million of specific reserves to \$6.5 million of troubled debt restructured loans & leases, of which \$4.9 million were performing. The Company had no commitments at March 31, 2015 to lend additional amounts to customers with outstanding loans or leases that are classified as TDRs.

During the three-month period ending March 31, 2015, the terms of certain loans & leases were modified as troubled debt restructurings. The modification of the terms of such loans & leases can include one or a combination of the following: a reduction of the stated interest rate; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

Modifications involving a reduction of the stated interest rate of the loan were for 10 years. Modifications involving an extension of the maturity date were for 10 years.

The following table presents loans or leases by class modified as TDRs during the three-month period ended March 31, 2015 (in thousands):

	March 31, 2015	
	Pre-Modification Number of Outstanding Loans of Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings		
Commercial	1 \$ 131	\$ 119
Total	1 \$ 131	\$ 119

The TDR described above increased the allowance for credit losses by \$114,000 and resulted in charge-offs of \$12,000 for the three months ended March 31, 2015.

During the three-months ended March 31, 2015, there were no payment defaults on loans or leases modified as troubled debt restructurings within twelve months following the modification. The Company considers a loan or lease to be in payment default once it is greater than 90 days contractually past due under the modified terms.

At December 31, 2014, the Company allocated \$1.3 million of specific reserves to \$6.6 million of troubled debt restructured loans, of which \$5.0 million were performing. The Company had no commitments at December 31, 2014 to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

During the period ending December 31, 2014, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 4 to 30 years. Modifications involving an extension of the maturity date were for periods ranging from 6 months to 30 years.

Table of Contents

The following table presents loans or leases by class modified as TDRs for the period ended December 31, 2014 (in thousands):

	December 31, 2014	
	Pre-Modification Number of Loans	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings		
Residential 1st Mortgages	5 \$ 857	\$ 804
Home Equity Lines and Loans	3 98	89
Agricultural	1 32	32
Commercial	1 18	18
Consumer & Other	1 7	7
Total	11 \$ 1,012	\$ 950

The troubled debt restructurings described above increased the allowance for credit losses by \$28,000 and resulted in charge-offs of \$63,000 for the twelve months ended December 31, 2014.

During the period ended December 31, 2014, there were no payment defaults on loans modified as troubled debt restructurings within twelve months following the modification. The Company considers a loan to be in payment default once it is greater than 90 days contractually past due under the modified terms.

At March 31, 2014, the Company allocated \$1.1 million of specific reserves to \$6.3 million of troubled debt restructured loans & leases, of which \$4.0 million were performing. The Company had no commitments at March 31, 2014 to lend additional amounts to customers with outstanding loans or leases that are classified as TDRs.

During the three-month period ending March 31, 2014, the terms of certain loans & leases were modified as troubled debt restructurings. The modification of the terms of such loans & leases can include one or a combination of the following: a reduction of the stated interest rate; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

There were no modifications involving a reduction of the stated interest rates. Modifications involving an extension of the maturity date were for periods ranging from 5 years to 30 years.

The following table presents loans or leases by class modified as TDRs during the three-month period ended March 31, 2014 (in thousands):

	March 31, 2014	
	Pre-Modification Number of Loans	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings		
Residential 1st Mortgages	2 \$ 247	\$ 245
Agricultural	1 32	32
Total	3 \$ 279	\$ 277

The TDRs described above had no impact on the allowance for credit losses but resulted in charge-offs of \$2,000 for the three-month period ending March 31, 2014.

Table of Contents

During the three-months ended March 31, 2014, there were no payment defaults on loans or leases modified as troubled debt restructurings within twelve months following the modification. The Company considers a loan or lease to be in payment default once it is greater than 90 days contractually past due under the modified terms.

4. Fair Value Measurements

The Company follows the “Fair Value Measurement and Disclosures” topic of the FASB ASC, which establishes a framework for measuring fair value in U.S. GAAP and expands disclosures about fair value measurements. This standard applies whenever other standards require, or permit, assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, the FASB clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, this standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy is as follows:

Level 1 inputs – Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity’s own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

Securities classified as AFS are reported at fair value on a recurring basis utilizing Level 1, 2 and 3 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

The Company does not record all loans & leases at fair value on a recurring basis. However, from time to time, a loan or lease is considered impaired and an allowance for credit losses is established. Once a loan or lease is identified as individually impaired, management measures impairment in accordance with the “Receivable” topic of the FASB ASC. The fair value of impaired loans or leases is estimated using one of several methods, including collateral value when the loan is collateral dependent, market value of similar debt, enterprise value, and discounted cash flows. Impaired loans & leases not requiring an allowance represent loans & leases for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans & leases. Impaired loans & leases where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. The fair value of collateral dependent impaired loans is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including sales comparison, cost and the income approach. Adjustments are often made in the appraisal process by the appraisers to take into account differences between the

comparable sales and income and other available data. Such adjustments can be significant and typically result in a Level 3 classification of the inputs for determining fair value. The valuation technique used for Level 3 nonrecurring impaired loans is primarily the sales comparison approach less selling costs of 10%.

Table of Contents

Other Real Estate (“ORE”) is reported at fair value on a non-recurring basis. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including sales comparison, cost and the income approach. Adjustments are often made in the appraisal process by the appraisers to take into account differences between the comparable sales and income and other available data. Such adjustments can be significant and typically result in a Level 3 classification of the inputs for determining fair value. The valuation technique used for Level 3 nonrecurring ORE is primarily the sales comparison approach less selling costs of 10%.

At March 31, 2015, formal foreclosure proceedings were in process for \$616,000 of consumer mortgage loans secured by residential real estate properties.

Table of Contents

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring basis and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value for the periods indicated.

		Fair Value Measurements At March 31, 2015, Using Quoted Prices in Active Markets for Identical Assets (Level 1)			Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)	Fair Value Total					
Available-for-Sale Securities:						
Government Agency & Government-Sponsored Entities	\$68,132	\$-	\$ 68,132	\$	-	
US Treasury Notes	19,966	-	19,966		-	
Mortgage Backed Securities	276,601	-	276,601		-	
Other	485	175	310		-	
Total Assets Measured at Fair Value On a Recurring Basis	\$365,184	\$175	\$ 365,009	\$	-	

		Fair Value Measurements At December 31, 2014, Using Quoted Prices in Active Markets for Identical Assets (Level 1)			Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)	Fair Value Total					
Available-for-Sale Securities:						
Government Agency & Government-Sponsored Entities	\$78,109	\$10,005	\$ 68,104	\$	-	
Mortgage Backed Securities	287,948	-	287,948		-	
Other	485	175	310		-	
Total Assets Measured at Fair Value On a Recurring Basis	\$366,542	\$10,180	\$ 356,362	\$	-	

		Fair Value Measurements At March 31, 2014, Using Quoted Prices in Active Markets for Identical Assets (Level 1)			Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)	Fair Value Total					

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	Assets (Level 1)			
Available-for-Sale Securities:				
Government Agency & Government-Sponsored Entities	\$18,426	\$13,399	\$ 5,027	\$ -
Mortgage Backed Securities	329,730	-	329,730	-
Corporate Securities	49,352	7,966	41,386	-
Other	2,235	1,925	310	-
Total Assets Measured at Fair Value On a Recurring Basis	\$399,743	\$23,290	\$ 376,453	\$ -

Fair values for Level 2 available-for-sale investment securities are based on quoted market prices for similar securities. During the quarters ended March 31, 2015 and 2014, there were no transfers in or out of Level 1, 2, or 3.

Table of Contents

The following tables present information about the Company's other real estate and impaired loans or leases, classes of assets or liabilities that the Company carries at fair value on a non-recurring basis, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value for the periods indicated. Not all impaired loans or leases are carried at fair value. Impaired loans or leases are only included in the following tables when their fair value is based upon a current appraisal of the collateral, and if that appraisal results in a partial charge-off or the establishment of a specific reserve.

(in thousands)	Fair Value Total	Fair Value Measurements At March 31, 2015, Using		
		Quoted Prices in Active Markets for Identifiable Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans				
Residential 1st Mortgage	\$341	\$-	\$-	\$ 341
Home Equity Lines and Loans	130	-	-	130
Agricultural	314	-	-	314
Commercial	3,674	-	-	3,674
Consumer	6	-	-	6
Total Impaired Loans	4,465	-	-	4,465
Other Real Estate				
Real Estate Construction	2,441	-	-	2,441
Agricultural Real Estate	858	-	-	858
Total Other Real Estate	3,299	-	-	3,299
Total Assets Measured at Fair Value On a Non-Recurring Basis	\$7,764	\$-	\$-	\$ 7,764

(in thousands)	Fair Value Total	Fair Value Measurements At December 31, 2014, Using		
		Quoted Prices in Active Markets for Identifiable Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans				
Commercial Real Estate	\$90	\$-	\$-	\$ 90
Residential 1st Mortgage	748	-	-	748
Home Equity Lines and Loans	759	-	-	759
Agricultural	346	-	-	346
Commercial	3,832	-	-	3,832

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Consumer	6			6
Total Impaired Loans	5,781	-	-	5,781
Other Real Estate				
Real Estate Construction	2,441	-	-	2,441
Agricultural Real Estate	858	-	-	858
Total Other Real Estate	3,299	-	-	3,299
Total Assets Measured at Fair Value On a Non-Recurring Basis	\$9,080	\$-	\$-	\$ 9,080

28

Table of Contents

(in thousands)	Fair Value Total	Fair Value Measurements At March 31, 2014, Using Quoted Prices in Active Markets for Identifiable Inputs (Level 1)			Significant Unobservable Inputs (Level 3)
		Other Observable Inputs (Level 2)			
Impaired Loans					
Residential 1st Mortgage	\$329	\$-	\$-	\$	\$ 329
Home Equity Lines and Loans	273	-	-	-	273
Agricultural	354	-	-	-	354
Commercial	814	-	-	-	814
Total Impaired Loans	1,770	-	-	-	1,770
Other Real Estate					
Real Estate Construction	2,441	-	-	-	2,441
Agricultural Real Estate	853	-	-	-	853
Total Other Real Estate	3,294	-	-	-	3,294
Total Assets Measured at Fair Value On a Non-Recurring Basis	\$5,064	\$-	\$-	\$-	\$ 5,064

The Company's property appraisals are primarily based on the sales comparison approach and the income approach methodologies, which consider recent sales of comparable properties, including their income generating characteristics, and then make adjustments to reflect the general assumptions that a market participant would make when analyzing the property for purchase. These adjustments may increase or decrease an appraised value and can vary significantly depending on the location, physical characteristics and income producing potential of each property. Additionally, the quality and volume of market information available at the time of the appraisal can vary from period to period and cause significant changes to the nature and magnitude of comparable sale adjustments. Given these variations, comparable sale adjustments are generally not a reliable indicator for how fair value will increase or decrease from period to period. Under certain circumstances, management discounts are applied based on specific characteristics of an individual property.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a nonrecurring basis at March 31, 2015:

(in thousands)	Fair Value	Valuation Technique	Unobservable Inputs	Range, Weighted Avg.
Impaired Loans				
Residential 1st Mortgage	\$341	Sales Comparison Approach	Adjustment for Difference Between Comparable Sales	2% -5%, 4%
Home Equity Lines and Loans	\$130	Sales Comparison Approach	Adjustment for Difference Between Comparable Sales	1% - 3%, 2%
Agricultural	\$314	Income Approach	Capitalization Rate	16% - 16%, 16%
Commercial	\$3,674	Income Approach	Capitalization Rate	5% - 16%, 7%
Consumer	\$6	Sales Comparison Approach	Adjustment for Difference Between Comparable Sales	1% - 2%, 2%

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Other Real Estate				
Real Estate		Sales Comparison	Adjustment for Difference Between	10% - 10%, 10%
Construction	\$2,441	Approach	Comparable Sales	
Agricultural Real Estate	\$858	Sales Comparison	Adjustment for Difference Between	10% - 10%, 10%
		Approach	Comparable Sales	

29

Table of Contents

5. Fair Value of Financial Instruments

U.S. GAAP requires disclosure of fair value information about financial instruments, whether or not recognized on the balance sheet, for which it is practical to estimate that value. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. The use of assumptions and various valuation techniques, as well as the absence of secondary markets for certain financial instruments, will likely reduce the comparability of fair value disclosures between financial institutions. In some cases, book value is a reasonable estimate of fair value due to the relatively short period of time between origination of the instrument and its expected realization.

The following tables summarize the book value and estimated fair value of financial instruments for the periods indicated:

	Carrying Amount	Fair Value of Financial Instruments Using Quoted Prices in Active Markets for			Total Estimated Fair Value
		Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
March 31, 2015 (in thousands)					
Assets:					
Cash and Cash Equivalents	\$ 143,936	\$ 143,936	\$ -	\$ -	\$ 143,936
Investment Securities Available-for-Sale:					
Government Agency & Government-Sponsored Entities	68,132	-	68,132	-	68,132
US Treasury Notes	19,966		19,966		19,966
Mortgage Backed Securities	276,601		276,601	-	276,601
Other	485	175	310	-	485
Total Investment Securities Available-for-Sale	365,184	175	365,009	-	365,184
Investment Securities Held-to-Maturity:					
Obligations of States and Political Subdivisions	61,324	-	48,583	13,496	62,079
Other	2,139	-	2,139	-	2,139
Total Investment Securities Held-to-Maturity	63,463	-	50,722	13,496	64,218
FHLB Stock	7,677	N/A	N/A	N/A	N/A
Loans & Leases, Net of Deferred Fees & Allowance:					
Commercial Real Estate	521,596	-	-	519,698	519,698
Agricultural Real Estate	344,965	-	-	346,742	346,742
Real Estate Construction	99,700	-	-	99,861	99,861
Residential 1st Mortgages	181,758	-	-	185,210	185,210
Home Equity Lines and Loans	29,628	-	-	31,332	31,332
Agricultural	211,629	-	-	210,769	210,769
Commercial	227,200	-	-	224,783	224,783
Consumer & Other	4,703	-	-	4,747	4,747

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Leases	48,347			48,779	48,779
Unallocated Allowance	(3,146)	-	-	(3,146)	(3,146)
Total Loans & Leases, Net of Deferred Fees & Allowance	1,666,380	-	-	1,668,775	1,668,775
Accrued Interest Receivable	7,324	-	7,324	-	7,324
Liabilities:					
Deposits:					
Demand	578,820	578,820	-	-	578,820
Interest Bearing Transaction	340,045	340,045	-	-	340,045
Savings and Money Market	699,308	699,308	-	-	699,308
Time	493,600	-	493,600	-	493,600
Total Deposits	2,111,773	1,618,173	493,600	-	2,111,773
Subordinated Debentures	10,310	-	6,250	-	6,250
Accrued Interest Payable	433	-	433	-	433

30

Table of Contents

December 31, 2014 (in thousands)	Carrying Amount	Fair Value of Financial Instruments Using Quoted Prices in Active Markets for			Total Estimated Fair Value
		Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets:					
Cash and Cash Equivalents	\$77,125	\$77,125	\$ -	\$ -	\$77,125
Investment Securities Available-for-Sale:					
Government Agency & Government-Sponsored Entities	78,109	10,005	68,104	-	78,109
Mortgage Backed Securities	287,948	-	287,948	-	287,948
Other	485	175	310	-	485
Total Investment Securities Available-for-Sale	366,542	10,180	356,362	-	366,542
Investment Securities Held-to-Maturity:					
Obligations of States and Political Subdivisions	61,716	-	49,085	13,403	62,488
Other	2,147	-	2,147	-	2,147
Total Investment Securities Held-to-Maturity	63,863	-	51,232	13,403	64,635
FHLB Stock	7,677	N/A	N/A	N/A	N/A
Loans & Leases, Net of Deferred Fees & Allowance:					
Commercial Real Estate	484,061	-	-	481,037	481,037
Agricultural Real Estate	353,022	-	-	353,288	353,288
Real Estate Construction	94,850	-	-	95,022	95,022
Residential 1st Mortgages	170,858	-	-	173,916	173,916
Home Equity Lines and Loans	30,591	-	-	32,456	32,456
Agricultural	275,859	-	-	274,195	274,195
Commercial	222,624	-	-	222,175	222,175
Consumer & Other	4,501	-	-	4,535	4,535
Leases	42,006	-	-	40,298	40,298
Unallocated Allowance	(1,529)	-	-	(1,529)	(1,529)
Total Loans & Leases, Net of Deferred Fees & Allowance	1,676,843	-	-	1,675,393	1,675,393
Accrued Interest Receivable	7,797	-	7,797	-	7,797
Liabilities:					
Deposits:					
Demand	610,133	610,133	-	-	610,133
Interest Bearing Transaction	341,397	341,397	-	-	341,397
Savings and Money Market	644,260	644,260	-	-	644,260
Time	468,283	-	468,161	-	468,161
Total Deposits	2,064,073	1,595,790	468,161	-	2,063,951

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Subordinated Debentures	10,310	-	6,227	-	6,227
Accrued Interest Payable	378	-	378	-	378

31

Table of Contents

March 31, 2014 (in thousands)	Carrying Amount	Fair Value of Financial Instruments Using Quoted Prices in Active Markets			Total Estimated Fair Value
		for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets:					
Cash and Cash Equivalents	\$ 173,727	\$ 173,727	\$ -	\$ -	\$ 173,727
Investment Securities Available-for-Sale:					
Government Agency & Government-Sponsored Entities	18,426	13,399	5,027	-	18,426
Mortgage Backed Securities	329,730		329,730	-	329,730
Corporate Securities	49,352	7,966	41,386	-	49,352
Other	2,235	1,925	310	-	2,235
Total Investment Securities Available-for-Sale	399,743	23,290	376,453	-	399,743
Investment Securities Held-to-Maturity:					
Obligations of States and Political Subdivisions	62,890	-	49,348	13,996	63,344
Mortgage Backed Securities	4	-	4	-	4
Other	2,761	-	2,761	-	2,761
Total Investment Securities Held-to-Maturity	65,655	-	52,113	13,996	66,109
FHLB Stock	7,187	N/A	N/A	N/A	N/A
Loans & Leases, Net of Deferred Fees & Allowance:					
Commercial Real Estate	396,439	-	-	397,090	397,090
Agricultural Real Estate	322,725	-	-	326,210	326,210
Real Estate Construction	54,674	-	-	55,040	55,040
Residential 1st Mortgages	154,994	-	-	157,714	157,714
Home Equity Lines and Loans	31,641	-	-	33,994	33,994
Agricultural	199,627	-	-	198,836	198,836
Commercial	149,376	-	-	149,450	149,450
Consumer & Other	4,550	-	-	4,599	4,599
Leases	17,247	-	-	17,080	17,080
Unallocated Allowance	(2,520)	-	-	(2,520)	(2,520)
Total Loans & Leases, Net of Deferred Fees & Allowance	1,328,753	-	-	1,337,493	1,337,493
Accrued Interest Receivable	6,732	-	6,732	-	6,732
Liabilities:					
Deposits:					
Demand	489,786	489,786	-	-	489,786
Interest Bearing Transaction	287,174	287,174	-	-	287,174
Savings and Money Market	639,370	639,370	-	-	639,370

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Time	424,284	-	424,568	-	424,568
Total Deposits	1,840,614	1,416,330	424,568	-	1,840,898
Subordinated Debentures	10,310	-	6,220	-	6,220
Accrued Interest Payable	345	-	345	-	345

32

Table of Contents

Fair value estimates presented herein are based on pertinent information available to management as of March 31, 2015, December 31, 2014, and March 31, 2014. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purpose of these financial statements since that date, and; therefore, current estimates of fair value may differ significantly from the amounts presented above. The methods and assumptions used to estimate the fair value of each class of financial instrument listed in the table above are explained below.

Cash and Cash Equivalents - The carrying amounts reported in the balance sheet for cash and due from banks, interest-bearing deposits with banks, federal funds sold, and securities purchased under agreements to resell are a reasonable estimate of fair value. All cash and cash equivalents are classified as Level 1.

Investment Securities - Fair values for investment securities consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Based on the available market information the classification level could be 1, 2, or 3.

Federal Home Loan Bank Stock - It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Loans & Leases, Net of Deferred Loan & Lease Fees & Allowance - Fair values of loans & leases are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans & leases are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans & leases are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans & leases do not necessarily represent an exit price.

Deposit Liabilities - The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 1 classification. Fair values for fixed-maturity certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Subordinated Debentures - The fair values of the Company's Subordinated Debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

Accrued Interest Receivable and Payable - The carrying amount of accrued interest receivable and payable approximates their fair value resulting in a Level 2 classification.

6. Dividends and Basic Earnings Per Common Share

Farmers & Merchants Bancorp common stock is not traded on any exchange. The shares are primarily held by local residents and are not actively traded. No cash dividends were declared during the first quarter of 2015 or 2014.

Basic earnings per common share amounts are computed by dividing net income by the weighted average number of common shares outstanding for the period. The following table calculates the basic earnings per common share for the three months ended March 31, 2015 and 2014.

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(net income in thousands)	2015	2014
Net Income	\$6,403	\$6,282
Weighted Average Number of Common Shares Outstanding	785,366	777,882
Basic Earnings Per Common Share Amount	\$8.15	\$8.08

33

Table of Contents

7. Recent Accounting Pronouncements

In January, 2014, the FASB issued Accounting Standards Update (ASU) 2014-04 - Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. This Update clarifies when an in-substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The objective of the amendments in this Update is to reduce diversity in practice. An in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The amendments in this Update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The adoption of this ASU did not have a material impact on the Company's financial position, results of operation, cash flows, or disclosure.

Item 2. Management's Discussion And Analysis Of Financial Condition And Results Of Operations

The following is management's discussion and analysis of the major factors that influenced our financial performance for the three months ended March 31, 2015. This analysis should be read in conjunction with our 2014 Annual Report to Shareholders on Form 10-K, and with the unaudited financial statements and notes as set forth in this report.

Forward-Looking Statements

This Form 10-Q contains various forward-looking statements, usually containing the words "estimate," "project," "expect," "objective," "goal," or similar expressions and includes assumptions concerning Farmers & Merchants Bancorp's (together with its subsidiaries, the "Company" or "we") operations, future results, and prospects. These forward-looking statements are based upon current expectations and are subject to risks and uncertainties. In connection with the "safe-harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Company provides the following cautionary statement identifying important factors which could cause the actual results of events to differ materially from those set forth in or implied by the forward-looking statements and related assumptions.

Such factors include the following: (1) continuing economic sluggishness in the Central Valley of California; (2) significant changes in interest rates and prepayment speeds; (3) credit risks of lending and investment activities; (4) changes in federal and state banking laws or regulations; (5) competitive pressure in the banking industry; (6) changes in governmental fiscal or monetary policies; (7) uncertainty regarding the economic outlook resulting from the continuing war on terrorism, as well as actions taken or to be taken by the U.S. or other governments as a result of further acts or threats of terrorism; (8) ongoing drought conditions in California and the resulting impact on the Company's agricultural customers; (9) expansion into new geographic markets and new lines of business; and (10) other factors discussed in Item 1A. Risk Factors located in the Company's 2014 Annual Report on Form 10-K.

Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. The Company undertakes no obligation to update any forward-looking statements to reflect events or circumstances arising after the date on which they are made.

Introduction

Farmers & Merchants Bancorp, or the Company, is a bank holding company formed March 10, 1999. Its subsidiary, Farmers & Merchants Bank of Central California, or the Bank, is a California state-chartered bank formed in 1916.

The Bank serves the needs of its customers through twenty-four full-service branches and a stand-alone ATM. The service area includes Sacramento, San Joaquin, Stanislaus, Merced, Contra Costa and Orange Counties with branches in Sacramento, Elk Grove, Galt, Lodi, Stockton, Linden, Modesto, Turlock, Hilmar, Merced, Walnut Creek, Concord and Irvine.

Table of Contents

As a bank holding company, the Company is subject to regulation and examination by the Board of Governors of the Federal Reserve System (“FRB”). As a California, state-chartered, non-fed member bank, the Bank is subject to regulation and examination by the California Department of Business Oversight (“DBO”) and the Federal Deposit Insurance Corporation (“FDIC”).

Overview

At the present time, the Company’s primary service area remains the mid Central Valley of California, a region that can be significantly impacted by the seasonal needs of the agricultural industry. Accordingly, discussion of the Company’s Financial Condition and Results of Operations is influenced by the seasonal banking needs of its agricultural customers (e.g., during the spring and summer customers draw down their deposit balances and increase loan borrowing to fund the purchase of equipment and planting of crops. Correspondingly, deposit balances are replenished and loans repaid in fall and winter as crops are harvested and sold).

The state of California has experienced drought conditions since 2013 and this situation did not change during this winter’s rainy season. Importantly, most of the Company’s agricultural customers have access to their own ground water supplies and protected riparian rights and, therefore, are not as dependent on the delivery of surface water as growers in other parts of California. Although management continues to believe that current conditions will not have a material impact on credit quality during 2015, the lack of rain will have a continuing adverse impact on our agricultural customers’ operating costs, crop yields and crop quality. The longer the drought continues, the more significant this impact will become, particularly if ground water levels reach critical stage.

For the three months ended March 31, 2015, Farmers & Merchants Bancorp reported net income of \$6,403,000, earnings per share of \$8.15 and return on average assets of 1.08%. Return on average shareholders’ equity was 10.76% for the three months ended March 31, 2015.

For the three months ended March 31, 2014, Farmers & Merchants Bancorp reported net income of \$6,282,000, earnings per share of \$8.08 and return on average assets of 1.20%. Return on average shareholders’ equity was 11.70% for the three months ended March 31, 2014.

The primary reasons for the Company’s improved earnings performance in the first quarter of 2015 as compared to the same period last year were: (1) a \$2.1 million increase in net interest income; and (2) a \$1.5 million increase in the non-interest income. These positive impacts were partially offset by: (1) a \$600,000 provision for credit losses; and (2) a \$2.6 million increase in non-interest expense.

The following is a summary of the financial results for the three-month period ended March 31, 2015 compared to March 31, 2014.

- Net income increased 1.9% to \$6,403,000 from \$6,282,000.
- Earnings per share increased 0.9% to \$8.15 from \$8.08.
- Total assets increased 13.5% to \$2.4 billion.
- Total loans & leases increased 25.1% to \$1.7 billion.
- Total deposits increased 14.7% to \$2.1 billion.

Table of Contents

Results of Operations

Net Interest Income / Net Interest Margin

The tables on the following pages reflect the Company's average balance sheets and volume and rate analysis for the three month periods ended March 31, 2015 and 2014.

The average yields on earning assets and average rates paid on interest-bearing liabilities have been computed on an annualized basis for purposes of comparability with full year data. Average balance amounts for assets and liabilities are the computed average of daily balances.

Net interest income is the amount by which the interest and fees on loans & leases and other interest earning assets exceed the interest paid on interest bearing sources of funds. For the purpose of analysis, the interest earned on tax-exempt investments and municipal loans is adjusted to an amount comparable to interest subject to normal income taxes. This adjustment is referred to as "taxable equivalent" and is noted wherever applicable.

The Volume and Rate Analysis of Net Interest Income summarizes the changes in interest income and interest expense based on changes in average asset and liability balances (volume) and changes in average rates (rate). For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to: (1) changes in volume (change in volume multiplied by initial rate); (2) changes in rate (change in rate multiplied by initial volume); and (3) changes in rate/volume (allocated in proportion to the respective volume and rate components).

The Company's earning assets and rate sensitive liabilities are subject to repricing at different times, which exposes the Company to income fluctuations when interest rates change. In order to minimize income fluctuations, the Company attempts to match asset and liability maturities. However, some maturity mismatch is inherent in the asset and liability mix. See "Item 3. Quantitative and Qualitative Disclosures about Market Risk – Interest Rate Risk."

Net interest income increased \$2.1 million or 11.6% to \$20.5 million during the first quarter of 2015 compared to \$18.4 million for the first quarter of 2014. On a fully tax equivalent basis, net interest income increased 11.2% and totaled \$20.8 million at March 31, 2015, compared to \$18.7 million at March 31, 2014. As more fully discussed below, the increase in net interest income was primarily due to a \$260.2 million increase in average earning assets.

Net interest income on a taxable equivalent basis, expressed as a percentage of average total earning assets, is referred to as the net interest margin. For the quarter ended March 31, 2015, the Company's net interest margin was 3.85% compared to 3.92% for the quarter ended March 31, 2014. This decrease in net interest margin was due primarily to a decline in earning asset yields that exceeded a corresponding drop in funding costs.

Average loans & leases totaled \$1.7 billion for the quarter ended March 31, 2015; an increase of \$308.5 million compared to the average balance for the quarter ended March 31, 2014. Loans & leases increased from 70.7% of average earning assets at March 31, 2014 to 76.4% at March 31, 2015. As a result of the continuing impact of the sustained low rate environment since late 2008, the annualized yield on the Company's loan portfolio declined to 4.63% for the quarter ended March 31, 2015, compared to 4.83% for the quarter ended March 31, 2014. Overall, the positive impact on interest revenue from the increase in loan & lease balances exceeded the negative impact of a decline in yields, resulting in interest revenue from loans & leases increasing 17.6% to \$19.1 million for quarter ended March 31, 2015. The Company has been experiencing aggressive competitor pricing for loans & leases to which it may need to continue to respond in order to retain key customers. This could place even greater negative pressure on future loan & lease yields and net interest margin.

The investment portfolio is the other main component of the Company's earning assets. Since the risk factor for investments is typically lower than that of loans or leases, the yield earned on investments is generally less than that of

loans & leases. Average investment securities totaled \$424.6 million for the quarter ended March 31, 2015; a decrease of \$39.6 million compared to the average balance for the quarter ended March 31, 2014. Tax equivalent interest income on securities decreased \$643,000 to \$2.4 million for the quarter ended March 31, 2015, compared to \$3.0 million for the quarter ended March 31, 2014. The average investment portfolio yield, on a tax equivalent (TE) basis, was 2.25% for the quarter ended March 31, 2015, compared to 2.61% for the quarter ended March 31, 2014. See “Financial Condition – Investment Securities” for a discussion of the Company’s investment strategy in 2015. Net interest income on the Schedule of Year-to-Date Average Balances and Interest Rates is shown on a tax equivalent basis, which is higher than net interest income as reflected on the Consolidated Statement of Income because of adjustments that relate to income on securities that are exempt from federal income taxes.

Table of Contents

Farmers & Merchants Bancorp
Year-to-Date Average Balances and Interest Rates
(Interest and Rates on a Taxable Equivalent Basis)
(in thousands)

	Three Months Ended March 31, 2015				Three Months Ended March 31, 2014			
	Balance	Interest	Annualized Yield/Rate		Balance	Interest	Annualized Yield/Rate	
Assets								
Interest Bearing Deposits With Banks	\$93,453	\$58	0.25	%	\$102,142	\$64	0.25	%
Investment Securities								
U.S. Treasuries	5,945	19	1.28	%	-	-	0.00	%
Government Agency & Government-Sponsored Entities	76,278	39	0.20	%	21,369	55	1.03	%
Obligations of States and Political Subdivisions - Non-Taxable	61,569	801	5.21	%	64,329	916	5.70	%
Mortgage Backed Securities	278,137	1,522	2.19	%	324,507	1,907	2.35	%
Other	2,629	6	0.91	%	53,964	153	1.13	%
Total Investment Securities	424,558	2,387	2.25	%	464,169	3,031	2.61	%
Loans & Leases								
Real Estate	1,130,388	13,522	4.85	%	935,838	11,519	4.99	%
Home Equity Line & Loans	32,072	422	5.34	%	34,829	475	5.53	%
Agricultural	227,904	2,218	3.95	%	214,141	2,141	4.05	%
Commercial	231,141	2,396	4.20	%	159,021	1,884	4.80	%
Consumer	4,840	72	6.03	%	6,258	71	4.60	%
Other	-	-	0.00	%	70	1	5.79	%
Leases	47,186	497	4.27	%	14,867	180	4.91	%
Total Loans & Leases	1,673,531	19,127	4.64	%	1,365,024	16,271	4.83	%
Total Earning Assets	2,191,542	\$21,572	3.99	%	1,931,335	\$19,366	4.07	%
Unrealized Gain (Loss) on Securities								
Available-for-Sale	5,545				(1,975)		
Allowance for Credit Losses	(35,446)			(34,270)		
Cash and Due From Banks	36,746				32,604			
All Other Assets	173,503				161,930			
Total Assets	\$2,371,890				\$2,089,624			
Liabilities & Shareholders' Equity								
Interest Bearing Deposits								
Transaction	\$341,038	\$46	0.05	%	\$290,018	\$33	0.05	%
Savings and Money Market	678,842	290	0.17	%	619,852	240	0.16	%
Time Deposits	479,948	376	0.32	%	426,462	327	0.31	%
Total Interest Bearing Deposits	1,499,828	712	0.19	%	1,336,332	600	0.18	%
Federal Home Loan Bank Advances	3	-	0.00	%	5	-	0.00	%
Subordinated Debentures	10,310	80	3.10	%	10,310	80	3.10	%
Total Interest Bearing Liabilities	1,510,141	\$792	0.21	%	1,346,647	\$680	0.20	%
Interest Rate Spread			3.78	%			3.86	%
Demand Deposits (Non-Interest Bearing)	576,231				482,603			
All Other Liabilities	47,520				45,600			

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Total Liabilities	2,133,892			1,874,850			
Shareholders' Equity	237,998			214,774			
Total Liabilities & Shareholders' Equity	\$2,371,890			\$2,089,624			
Impact of Non-Interest Bearing Deposits and Other Liabilities		0.07	%		0.06	%	
Net Interest Income and Margin on Total Earning Assets		20,780	3.85	%	18,686	3.92	%
Tax Equivalent Adjustment		(279)			(319)		
Net Interest Income		\$20,501	3.79	%	\$18,367	3.86	%

Notes: Yields on municipal securities have been calculated on a fully taxable equivalent basis. Loan interest income includes fee income and unearned discount in the amount of \$1.3 million and \$956,000 for the quarters ended March 31, 2015 and 2014, respectively. Yields on securities available-for-sale are based on historical cost.

Table of ContentsFarmers & Merchants Bancorp
Volume and Rate Analysis of Net Interest Revenue
(Interest and Rates on a Taxable Equivalent Basis)

(in thousands)	Three Months Ended		
	Mar. 31, 2015 compared to Mar. 31, 2014		
	Volume	Rate	Net Chg.
Interest Earning Assets			
Interest Bearing Deposits With Banks	\$(5)	\$(1)	\$(6)
Investment Securities			
U.S. Treasuries	19	0	19
Government Agency & Government-Sponsored Entities	55	(71)	(16)
Obligations of States and Political Subdivisions - Non-Taxable	(38)	(77)	(115)
Mortgage Backed Securities	(260)	(124)	(384)
Other	(122)	(25)	(147)
Total Investment Securities	(346)	(297)	(643)
Loans & Leases			
Real Estate	2,344	(342)	2,002
Home Equity Line & Loans	(37)	(16)	(53)
Agricultural	136	(59)	77
Commercial	776	(264)	512
Consumer	(18)	19	1
Other	(1)	-	(1)
Leases	344	(27)	317
Total Loans & Leases	3,544	(689)	2,855
Total Earning Assets	3,193	(987)	2,206
Interest Bearing Liabilities			
Interest Bearing Deposits			
Transaction	7	6	13
Savings and Money Market	24	26	50
Time Deposits	42	7	49
Total Interest Bearing Deposits	73	39	112
Total Interest Bearing Liabilities	73	39	112
Total Change	\$3,120	\$(1,026)	\$2,094

Notes: Rate/volume variance is allocated based on the percentage relationship of changes in volume and changes in rate to the total "net change." The above figures have been rounded to the nearest whole number.

Interest bearing deposits with banks and overnight investments in Federal Funds Sold are additional earning assets available to the Company. Interest bearing deposits with banks consisted of FRB deposits. Deposits with the FRB earn interest at the Fed Funds rate, which has been 0.25% since December 2008. Average interest bearing deposits with banks for the quarter ended March 31, 2015, was \$93.5 million, a decrease of \$8.7 million compared to the average balance for the quarter ended March 31, 2014. Interest income on interest bearing deposits with banks for the quarter ended March 31, 2015, decreased \$6,000 to \$58,000 compared to the quarter ended March 31, 2014.

Average interest-bearing liabilities increased \$163.5 million or 12.1% during the first quarter of 2015. Of that increase: (1) interest-bearing transaction deposits increased \$51.0 million; (2) savings and money market deposits

increased \$59.0 million; (3) time deposits increased \$53.5 million; (4) FHLB advances decreased \$2,000 (see “Financial Condition – Federal Home Loan Bank Advances and Federal Reserve Bank Borrowings”); and (5) subordinated debt remained unchanged (see “Financial Condition – Subordinated Debentures”).

Table of Contents

Total interest expense on interest bearing deposits was \$712,000 for the first quarter of 2015 as compared to \$600,000 million for the first quarter of 2014. The average rate paid on interest-bearing deposits was 0.19% for the first quarter of 2015 compared to 0.18% for the first quarter of 2014.

Provision and Allowance for Credit Losses

As a financial institution that assumes lending and credit risks as a principal element of its business, credit losses will be experienced in the normal course of business. The Company has established credit management policies and procedures that govern both the approval of new loans & leases and the monitoring of the existing portfolio. The Company manages and controls credit risk through comprehensive underwriting and approval standards, dollar limits on loans & leases to one borrower (the term “borrower” is used herein to describe a customer who has entered into either a loan or lease transaction), and by restricting loans & leases made primarily to its principal market area where management believes it is best able to assess the applicable risk. Additionally, management has established guidelines to ensure the diversification of the Company’s credit portfolio such that even within key portfolio sectors such as real estate or agriculture, the portfolio is diversified across factors such as location, building type, crop type, etc. Management reports regularly to the Board of Directors regarding trends and conditions in the loan & lease portfolio and regularly conducts credit reviews of individual loans & leases. Loans & leases that are performing but have shown some signs of weakness are subject to more stringent reporting and oversight.

Allowance for Credit Losses

The allowance for credit losses is an estimate of probable incurred credit losses inherent in the Company's loan & lease portfolio as of the balance sheet date. The allowance is established through a provision for credit losses, which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan & lease growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of three primary components: specific reserves related to impaired loans & leases; general reserves for inherent losses related to loans & leases that are not impaired; and an unallocated component that takes into account the imprecision in estimating and allocating allowance balances associated with macro factors.

A loan or lease is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Loans & leases determined to be impaired are individually evaluated for impairment. When a loan or lease is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the loan’s or lease's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan’s or lease's observable market price, or the fair value of the collateral if the loan or lease is collateral dependent. A loan or lease is collateral dependent if the repayment of the loan or lease is expected to be provided solely by the underlying collateral.

A restructuring of a loan or lease constitutes a troubled debt restructuring (“TDR”) under ASC 310-40, if the Company for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that it would not otherwise consider. Restructured loans or leases typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. If the restructured loan or lease was current on all payments at the time of restructure and management reasonably expects the borrower will continue to perform after the restructure, management may keep the loan or lease on accrual. Loans & leases that are on nonaccrual status at the time they become TDR, remain on nonaccrual status until the borrower demonstrates a sustained period of performance, which the Company generally believes to be six consecutive months of payments, or equivalent. A loan or lease can be removed from TDR status if it was restructured at a market rate in a prior calendar year and is currently in compliance with its modified terms. However, these loans or leases continue to be classified as impaired and are individually evaluated for impairment.

The determination of the general reserve for loans or leases that are collectively evaluated for impairment is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors that include economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan & lease portfolio, and probable losses inherent in the portfolio taken as a whole.

Table of Contents

The Company maintains a separate allowance for each portfolio segment (loan & lease type). These portfolio segments include: (1) commercial real estate; (2) agricultural real estate; (3) real estate construction (including land and development loans); (4) residential 1st mortgages; (5) home equity lines and loans; (6) agricultural; (7) commercial; (8) consumer & other; and (9) equipment leases. See “Financial Condition – Loans & Leases” for examples of loans & leases made by the Company. The allowance for credit losses attributable to each portfolio segment, which includes both impaired loans & leases and loans & leases that are not impaired, is combined to determine the Company's overall allowance, which is included on the consolidated balance sheet.

The Company assigns a risk rating to all loans & leases and periodically performs detailed reviews of all such loans & leases over a certain threshold to identify credit risks and assess overall collectability. For smaller balance loans & leases, such as consumer and residential real estate, a credit grade is established at inception, and then updated only when the loan or lease becomes contractually delinquent or when the borrower requests a modification. For larger balance loans, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans & leases. These credit quality indicators are used to assign a risk rating to each individual loan or lease. These risk ratings are also subject to examination by independent specialists engaged by the Company. The risk ratings can be grouped into five major categories, defined as follows:

Pass – A pass loan or lease is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention – A special mention loan or lease has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or lease position at some future date. Special mention loans & leases are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard – A substandard loan or lease is not adequately protected by the current financial condition and paying capacity of the borrower or the value of the collateral pledged, if any. Loans or leases classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well-defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans or leases classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, based on currently known facts, conditions and values, highly questionable or improbable.

Loss – Loans or leases classified as loss are considered uncollectible. Once a loan or lease becomes delinquent and repayment becomes questionable, the Company will address collateral shortfalls with the borrower and attempt to obtain additional collateral. If this is not forthcoming and payment in full is unlikely, the Bank will estimate its probable loss and immediately charge-off some or all of the balance.

The general reserve component of the allowance for credit losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk; (2) historical losses; and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below:

Commercial Real Estate – Commercial real estate mortgage loans are generally considered to possess a higher inherent risk of loss than the Company's commercial, agricultural and consumer loan types. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates

of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Real Estate Construction – Real estate construction loans, including land loans, are generally considered to possess a higher inherent risk of loss than the Company’s commercial, agricultural and consumer loan types. A major risk arises from the necessity to complete projects within specified cost and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Table of Contents

Commercial – These loans are generally considered to possess a moderate inherent risk of loss because they are shorter-term; typically made to relationship customers; generally underwritten to existing cash flows of operating businesses; and may be collateralized by fixed assets, inventory and/or accounts receivable. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Agricultural Real Estate and Agricultural – These loans are generally considered to possess a moderate inherent risk of loss since they are typically made to relationship customers and are secured by crop production, livestock and related real estate. These loans are vulnerable to two risk factors that are largely outside the control of Company and borrowers: commodity prices and weather conditions.

Leases – Equipment leases are generally considered to possess a moderate inherent risk of loss. As Lessor, the company is subject to both the credit risk of the borrower and the residual value risk of the equipment. Credit risks are underwritten using the same credit criteria the Company would use when making an equipment term loan. Residual value risk is managed through the use of qualified, independent appraisers that establish the residual values the Company uses in structuring a lease.

Residential 1st Mortgages and Home Equity Lines and Loans – These loans are generally considered to possess a low inherent risk of loss, although this is not always true as evidenced by the weakness in residential real estate values over the past five years. The degree of risk in residential real estate lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Consumer & Other – A consumer installment loan portfolio is usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made for consumer purchases. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

In addition, the Company's and Bank's regulators, including the FRB, DBO and FDIC, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

Provision for Credit Losses

Changes in the provision for credit losses between years are the result of management's evaluation, based upon information currently available, of the adequacy of the allowance for credit losses relative to factors such as the credit quality of the loan & lease portfolio, loan & lease growth, current credit losses, and the prevailing economic climate and its effect on borrowers' ability to repay loans & leases in accordance with the terms of the notes.

The Central Valley of California was one of the hardest hit areas in the country during the recession. In many areas, housing prices declined as much as 60% and unemployment reached 15% or more. Although the economy has stabilized throughout most of the Central Valley, housing prices for the most part have not recovered significantly and unemployment levels remain well above those in other areas of the state and country. While, in management's opinion, the Company's levels of net charge-offs and non-performing assets as of March 31, 2015, compare very favorably to our peers at the present time, carefully managing credit risk remains a key focus of the Company.

The state of California has experienced drought conditions since 2013 and this situation did not change during this winter's rainy season. Importantly, most of the Company's agricultural customers have access to their own ground

water supplies and protected riparian rights and, therefore, are not as dependent on the delivery of surface water as growers in other parts of California. Although management continues to believe that current conditions will not have a material impact on credit quality during 2015, the lack of rain will have a continuing adverse impact on our agricultural customers' operating costs, crop yields and crop quality. The longer the drought continues, the more significant this impact will become, particularly if ground water levels reach critical stage. Although Management believes that there is no material impact to the Company's credit quality during 2015, management has increased the overall level of the allowance for credit losses to better position the Company for any long-term impact of continuing drought conditions.

Table of Contents

The Company made a \$600,000 provision for credit losses during the first quarter of 2015 compared to no provision during the first quarter of 2014. Net recoveries during the first quarter of 2015 were \$2.9 million compared to net recoveries of \$3,000 in the first quarter of 2014. During the first quarter of 2015 the Company was able to fully recover the entire \$2.9 million that was charged-off during 2010 on a restructured commercial real estate loan. In addition to the full recovery of the charged off principal, this transaction also resulted in the recovery of \$353,000 in interest income and the client's payment of a financing fee of \$1.1 million. See "Overview – Looking Forward: 2015 and Beyond", "Critical Accounting Policies and Estimates – Allowance for Credit Losses" and "Item 7A. Quantitative and Qualitative Disclosures About Market Risk-Credit Risk" located in the Company's 2014 Annual Report on Form 10-K.

After reviewing all factors above, based upon information currently available, management concluded that the allowance for credit losses as of March 31, 2015, was adequate.

	Three Months Ended	
	March 31,	
Allowance for Credit Losses (in thousands)	2015	2014
Balance at Beginning of Period	\$35,401	\$34,274
Loans or Leases Charged Off	(29)	(30)
Recoveries of Loans or Leases Previously Charged Off	2,968	33
Provision Charged to Expense	600	-
Balance at End of Period	\$38,940	\$34,277

The table below breaks out current quarter activity by portfolio segment (in thousands):

March 31, 2015	Commercial Real Estate	Agricultural Real Estate	Real Estate Construction	Residential Mortgage	Home Equity Lines & Loans	Agricultural	Commercial	Consumer & Other	Leases	Unallocated	Total
	Year-To-Date Allowance for Credit Losses:										
Beginning Balance- January 1, 2015	\$7,842	\$4,185	\$1,669	\$1,022	\$2,426	\$6,104	\$8,195	\$218	\$2,211	\$1,529	\$35,401
Charge-Offs	-	-	-	-	-	-	(12)	(17)	-	-	(29)
Recoveries	2,938	-	-	-	5	1	2	22	-	-	2,968
Provision	(2,826)	2,716	247	(349)	(335)	(1,503)	756	(11)	288	1,617	600
Ending Balance- March 31, 2015	\$7,954	\$6,901	\$1,916	\$673	\$2,096	\$4,602	\$8,941	\$212	\$2,499	\$3,146	\$38,940

The Allowance for Credit Losses at March 31, 2015 increased \$3.5 million from December 31, 2014. The allowance allocated to the following portfolio segments did change materially during the quarter:

While Commercial Real Estate allowance balances did not change materially, a \$2.9 million recovery on a previously charged off loan resulted in a decrease of \$2.8 million in the required provision.

Agricultural Real Estate allowance balances increased \$2.7 million primarily due to increased qualitative factors in the Company's allowance calculation related to the longer-term impact of continuing drought conditions in California.

Agricultural allowance balances decreased \$1.5 million, as a result of seasonal decreases in loan balances, offset somewhat by increases in drought qualitative factors.

Table of Contents

Unallocated allowance balances increased \$1.6 million. These balances are generally associated with macro risk factors which are difficult to precisely estimate and allocate. Factors that we considered during this quarter include: (i) the continuing sluggish economy in our primary service area; (ii) the long term impact of drought conditions on a broader group of borrowers than just those directly involved in the agricultural industry; and (iii) the long term impact of political changes on water policy.

See “Management’s Discussion and Analysis - Financial Condition – Classified Loans & Leases and Non-Performing Assets” for further discussion regarding these loan categories.

See “Note 3. Allowance for Credit Losses” for additional details regarding the provision and allowance for credit losses.

Non-Interest Income

Non-interest income includes: (1) service charges and fees from deposit accounts; (2) net gains and losses from investment securities; (3) increases in the cash surrender value of bank owned life insurance; (4) debit card and ATM fees; (5) net gains and losses on non-qualified deferred compensation plans; and (6) fees from other miscellaneous business services.

Overall, non-interest income increased \$1.5 million or 47.5% for the three months ended March 31, 2015, compared to the same period of 2014. This increase was primarily due to: (1) a \$322,000 increase in the net gain on deferred compensation investments; and (2) a \$1.1 million financing fee related to the full recovery of a loan previously charged off (see “Provision for Credit Losses”).

Balances in non-qualified deferred compensation plans may be invested in financial instruments whose market value fluctuates based upon trends in interest rates and stock prices. Although Generally Accepted Accounting Principles require these investment gains/losses be recorded in non-interest income, an offsetting entry is also required to be made to non-interest expense resulting in no effect on the Company’s net income.

Non-Interest Expense

Non-interest expense for the Company includes expenses for: (1) salaries and employee benefits; (2) net gain on deferred compensation investment; (3) occupancy; (4) equipment; (5) supplies; (6) legal fees; (7) professional services; (8) data processing; (9) marketing; (10) deposit insurance; and (11) other miscellaneous expenses.

Overall, non-interest expense increased \$2.6 million or 22.1% for the three months ended March 31, 2015, compared to the same period in 2014. This increase was primarily comprised of: (1) a \$1.9 million increase in salaries and employee benefits primarily related to: (a) new staff added for the branches in Walnut Creek, Concord and Irvine; and (b) increased contributions to retirement and profit sharing plans; (2) a \$322,000 increase in the net gain on deferred compensation investments; and (3) a \$62,000 increase in legal fee expense.

Balances in non-qualified deferred compensation plans may be invested in financial instruments whose market value fluctuates based upon trends in interest rates and stock prices. Although Generally Accepted Accounting Principles require these investment gains/losses be recorded in non-interest income, an offsetting entry is also required to be made to non-interest expense resulting in no effect on the Company’s net income.

Income Taxes

The provision for income taxes increased 9.3% to \$3.9 million for the first quarter of 2015 compared to the first quarter of 2014. The effective tax rate for the first quarter of 2015 was 38.1% compared to 36.5% for the first quarter of 2014. The Company’s effective tax rate fluctuates from quarter to quarter due primarily to changes in the mix of taxable and tax-exempt earning sources. The effective rates were lower than the statutory rate of 42% due primarily to benefits regarding the cash surrender value of life insurance; California enterprise zone hiring tax credit; and tax-exempt interest income on municipal securities and loans.

Current tax law causes the Company's current taxes payable to approximate or exceed the current provision for taxes on the income statement. Three provisions have had a significant effect on the Company's current income tax liability: (1) the restrictions on the deductibility of credit losses; (2) deductibility of retirement and other long-term employee benefits only when paid; and (3) the statutory deferral of deductibility of California franchise taxes on the Company's federal return.

Table of Contents

Financial Condition

This section discusses material changes in the Company's balance sheet at March 31, 2015, as compared to December 31, 2014 and to March 31, 2014. As previously discussed (see "Overview") the Company's financial condition can be influenced by the seasonal banking needs of its agricultural customers.

Investment Securities and Federal Funds Sold

The investment portfolio provides the Company with an income alternative to loans & leases. The debt securities in the Company's investment portfolio have historically been comprised primarily of: (1) mortgage-backed securities issued by federal government-sponsored entities; (2) debt securities issued by government agencies and government-sponsored entities; and (3) investment grade bank-qualified municipal bonds. However, during 2012, when loan demand lagged deposit growth resulting in significant liquidity, the Company began to selectively add investment grade corporate securities (floating rate and fixed rate with maturities less than 5 years) to the portfolio in order to obtain yields that exceed government agency securities of equivalent maturity without subjecting the Company to the interest rate risk associated with mortgage-backed securities. This portfolio of corporate securities was sold during the 3rd quarter of 2014 in order to fund the Company's increase in loan balances.

The Company's investment portfolio at March 31, 2015 was \$428.6 million compared to \$430.4 million at the end of 2014, a decrease of \$1.8 million or 0.4%. At March 31, 2014, the investment portfolio totaled \$465.4 million. The mix of the investment portfolio has changed over the past three to five years. To protect against future increases in market interest rates, while at the same time generating some reasonable level of current yields, the Company has invested most of its available funds in either shorter term government agency & government-sponsored entity securities and shorter term (10, 15, and 20 year) mortgage-backed securities.

The Company's total investment portfolio currently represents 17.8% of the Company's total assets as compared to 18.2% at December 31, 2014, and 21.9% at March 31, 2014.

As of March 31, 2015 the Company held \$61.3 million of municipal investments, of which \$47.8 million were bank-qualified municipal bonds, all classified as HTM. In order to comply with Section 939A of the Dodd-Frank Act, the Company: (1) only invests in bonds rated AA or better; and (2) performs its own credit analysis on new purchases of municipal bonds. As of March 31, 2015, ninety-seven percent of the Company's bank-qualified municipal bond portfolio is rated at either the issue or issuer level, and all of these ratings are "investment grade." The Company monitors the status of all municipal investments with particular attention paid to the approximately three percent (\$1.4 million) of the portfolio that is not rated, and at the current time does not believe any of them to be exhibiting financial problems that could result in a loss in any individual security. In June 2014, the Company sold \$375,000 of municipal bonds from a single issuer. The Company took this action under the provisions of ASC 320-10-25-6(a), which allow for the sale of HTM securities where there is "evidence of a significant deterioration in the issuer's creditworthiness."

Not included in the investment portfolio are interest bearing deposits with banks and overnight investments in Federal Funds Sold. Interest bearing deposits with banks consisted of FRB deposits. The FRB currently pays interest on the deposits that banks maintain in their FRB accounts, whereas historically banks had to sell these Federal Funds to other banks in order to earn interest. Since balances at the FRB are effectively risk free, the Company elected to maintain its excess cash at the FRB. Interest bearing deposits with banks totaled \$110.2 million at March 31, 2015, \$34.8 million at December 31, 2014 and \$134.7 million at March 31, 2014.

The Company classifies its investments as HTM, trading, or AFS. Securities are classified as HTM and are carried at amortized cost when the Company has the intent and ability to hold the securities to maturity. Trading securities are securities acquired for short-term appreciation and are carried at fair value, with unrealized gains and losses recorded in non-interest income. As of March 31, 2015, December 31, 2014 and March 31, 2014, there were no securities in the trading portfolio. Securities classified as AFS include securities, which may be sold to effectively manage interest rate

risk exposure, prepayment risk, satisfy liquidity demands and other factors. These securities are reported at fair value with aggregate, unrealized gains or losses excluded from income and included as a separate component of shareholders' equity, net of related income taxes.

Table of Contents

Loans & Leases

Loans & leases can be categorized by borrowing purpose and use of funds. Common examples of loans & leases made by the Company include:

Commercial and Agricultural Real Estate - These are loans secured by farmland, commercial real estate, multifamily residential properties, and other non-farm, non-residential properties within our market area. Commercial mortgage term loans can be made if the property is either income producing or scheduled to become income producing based upon acceptable pre-leasing, and the income will be the Bank's primary source of repayment for the loan. Loans are made both on owner occupied and investor properties; generally do not exceed 15 years (and may have pricing adjustments on a shorter timeframe); have debt service coverage ratios of 1.00 or better with a target of greater than 1.20; and fixed rates that are most often tied to treasury indices with an appropriate spread based on the amount of perceived risk in the loan.

Real Estate Construction - These are loans for development and construction (the Company generally requires the borrower to fund the land acquisition) and are secured by commercial or residential real estate. These loans are generally made only to experienced local developers with whom the Bank has a successful track record; for projects in our service area; with Loan To Value (LTV) below 75%; and where the property can be developed and sold within 2 years. Commercial construction loans are made only when there is a written take-out commitment from the Bank or an acceptable financial institution or government agency. Most acquisition, development and construction loans are tied to the prime rate with an appropriate spread based on the amount of perceived risk in the loan.

Residential 1st Mortgages - These are loans primarily made on owner occupied residences; generally underwritten to income and LTV guidelines similar to those used by FNMA and FHLMC; however, we will make loans on rural residential properties up to 20 acres. Most residential loans have terms from ten to twenty years and carry fixed rates priced off of treasury rates. The Company has always underwritten mortgage loans based upon traditional underwriting criteria and does not make loans that are known in the industry as "subprime," "no or low doc," or "stated income."

Home Equity Lines and Loans - These are loans made to individuals for home improvements and other personal needs. Generally, amounts do not exceed \$250,000; Combined Loan To Value (CLTV) does not exceed 80%; FICO scores are at or above 670; Total Debt Ratios do not exceed 43%; and in some situations the Company is in a 1st lien position.

Agricultural - These are loans and lines of credit made to farmers to finance agricultural production. Lines of credit are extended to finance the seasonal needs of farmers during peak growing periods; are usually established for periods no longer than 12 to 24 months; are often secured by general filing liens on livestock, crops, crop proceeds and equipment; and are most often tied to the prime rate with an appropriate spread based on the amount of perceived risk in the loan. Term loans are primarily made for the financing of equipment, expansion or modernization of a processing plant, or orchard/vineyard development; have maturities from five to seven years; and fixed rates that are most often tied to treasury indices with an appropriate spread based on the amount of perceived risk in the loan.

Commercial - These are loans and lines of credit to businesses that are sole proprietorships, partnerships, limited liability companies ("LLC") and corporations. Lines of credit are extended to finance the seasonal working capital needs of customers during peak business periods; are usually established for periods no longer than 12 to 24 months; are often secured by general filing liens on accounts receivable, inventory and equipment; and are most often tied to the prime rate with an appropriate spread based on the amount of perceived risk in the loan. Term loans are primarily made for the financing of equipment, expansion or modernization of a plant or purchase of a business; have maturities from five to seven years; and fixed rates that are most often tied to treasury indices with an appropriate spread based on the amount of perceived risk in the loan.

Table of Contents

Consumer - These are loans to individuals for personal use, and primarily include loans to purchase automobiles or recreational vehicles, and unsecured lines of credit. The Company has a very minimal consumer loan portfolio, and loans are primarily made as an accommodation to deposit customers.

Leases –These are leases to businesses or individuals, for the purpose of financing the acquisition of equipment. They can be either “finance leases” where the lessee retains the tax benefits of ownership but obtains 100% financing on their equipment purchases; or “true tax leases” where the Company, as lessor, places reliance on equipment residual value and in doing so obtains the tax benefits of ownership. Leases typically have a maturity of three to ten years, and fixed rates that are most often tied to treasury indices with an appropriate spread based on the amount of perceived risk. Credit risks are underwritten using the same credit criteria the Company would use when making an equipment term loan. Residual value risk is managed through the use of qualified, independent appraisers that establish the residual values the Company uses in structuring a lease.

The Company accounts for leases with Investment Tax Credits (ITC) under the deferred method as established in ASC 740-10. ITC are viewed and accounted for as a reduction of the cost of the related assets and presented as deferred income on the Company’s financial statement.

See “Item 3. Quantitative and Qualitative Disclosures About Market Risk-Credit Risk” for a discussion about the credit risks the Company assumes and its overall credit risk management practices.

Each loan or lease type involves risks specific to the: (1) borrower; (2) collateral; and (3) loan & lease structure. See “Results of Operations - Provision and Allowance for Credit Losses” for a more detailed discussion of risks by loan & lease type. The Company’s current underwriting policies and standards are designed to mitigate the risks involved in each loan & lease type. The Company’s policies require that loans & leases are approved only to those borrowers exhibiting a clear source of repayment and the ability to service existing and proposed debt. The Company’s underwriting procedures for all loan & lease types require careful consideration of the borrower, the borrower’s financial condition, the borrower’s management capability, the borrower’s industry, and the economic environment affecting the loan or lease.

Most loans & leases made by the Company are secured, but collateral is the secondary or tertiary source of repayment; cash flow is our primary source of repayment. The quality and liquidity of collateral are important and must be confirmed before the loan is made.

In order to be responsive to borrower needs, the Company prices loans & leases: (1) on both a fixed rate and adjustable rate basis; (2) over different terms; and (3) based upon different rate indices; as long as these structures are consistent with the Company’s interest rate risk management policies and procedures (see Item 3. Quantitative and Qualitative Disclosures About Market Risk-Interest Rate Risk).

Overall, the Company's loan & lease portfolio at March 31, 2015 totaled \$1.7 billion, an increase of \$342.3 million or 25.1% over March 31, 2014. This increase has occurred despite the continuing sluggish economic conditions in the Central Valley of California and is a result of: (1) the Company’s intensified business development efforts directed toward credit-qualified borrowers; (2) entry into the equipment leasing business; and (3) expansion of our service area into Walnut Creek and Irvine. No assurances can be made that this growth in the loan & lease portfolio will continue.

Loans & leases at March 31, 2015 decreased \$6.9 million from December 31, 2014. This small overall decrease was a result of \$71.0 million in normal seasonal pay downs of loans made to the Company’s agricultural customers offset by growth in other portfolio segments.

Table of Contents

The following table sets forth the distribution of the loan & lease portfolio by type and percent as of the periods indicated.

Loan & Lease Portfolio (in thousands)	March 31, 2015		December 31, 2014		March 31, 2014	
	\$	%	\$	%	\$	%
Commercial Real Estate	\$534,134	31.3 %	\$495,316	28.9 %	\$406,495	29.8 %
Agricultural Real Estate	351,866	20.6 %	357,207	20.8 %	326,112	23.9 %
Real Estate Construction	101,616	5.9 %	96,519	5.6 %	55,751	4.1 %
Residential 1st Mortgages	182,431	10.7 %	171,880	10.0 %	156,094	11.4 %
Home Equity Lines and Loans	31,724	1.9 %	33,017	1.9 %	34,289	2.5 %
Agricultural	216,231	12.7 %	281,963	16.4 %	209,228	15.3 %
Commercial	236,141	13.8 %	230,819	13.5 %	155,802	11.4 %
Consumer & Other	4,915	0.3 %	4,719	0.3 %	4,721	0.3 %
Leases	49,988	2.9 %	44,217	2.6 %	18,168	1.3 %
Total Gross Loans & Leases	1,709,046	100.1 %	1,715,657	100.0 %	1,366,660	100.0 %
Less: Unearned Income	3,726		3,413		3,630	
Subtotal	1,705,320		1,712,244		1,363,030	
Less: Allowance for Credit Losses	38,940		35,401		34,277	
Net Loans & Leases	\$1,666,380		\$1,676,843		\$1,328,753	

Classified Loans & Leases and Non-Performing Assets

All loans & leases are assigned a credit risk grade using grading standards developed by bank regulatory agencies. See “Results of Operations - Provision and Allowance for Credit Losses” for more detail on risk grades. The Company utilizes the services of a third-party independent loan review firm to perform evaluations of individual loans & leases and review the credit risk grades the Company places on loans & leases. Loans & leases that are judged to exhibit a higher risk profile are referred to as “classified loans & leases,” and these loans & leases receive increased management attention. As of March 31, 2015, classified loans totaled \$5.7 million compared to \$3.6 million at December 31, 2014 and \$4.1 million at March 31, 2014.

Classified loans & leases with higher levels of credit risk can be further designated as “impaired” loans & leases. A loan or lease is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. See “Results of Operations - Provision and Allowance for Credit Losses” for further details. Impaired loans & leases consist of: (1) non-accrual loans & leases; and/or (2) restructured loans & leases that are still performing (i.e., accruing interest).

Non-Accrual Loans & leases - Accrual of interest on loans & leases is generally discontinued when a loan or lease becomes contractually past due by 90 days or more with respect to interest or principal. When loans & leases are 90 days past due, but in management's judgment are well secured and in the process of collection, they may not be classified as non-accrual. When a loan or lease is placed on non-accrual status, all interest previously accrued but not collected is reversed. Income on such loans & leases is then recognized only to the extent that cash is received and where the future collection of principal is probable. As of March 31, 2015 non-accrual loans & leases totaled \$2.4 million. At December 31, 2014 and March 31, 2014, non-accrual loans & leases totaled \$2.3 million and \$3.1 million, respectively.

Restructured Loans & Leases - A restructuring of a loan or lease constitutes a TDR under ASC 310-40, if the Company for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured loans or leases typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. If the restructured loan or lease was current on all payments at the time of restructure and management reasonably expects the borrower will continue to

perform after the restructure, management may keep the loan or lease on accrual. Loans & leases that are on nonaccrual status at the time they become TDR loans, remain on nonaccrual status until the borrower demonstrates a sustained period of performance, which the Company generally believes to be six consecutive months of payments, or equivalent. A loan or lease can be removed from TDR status if it was restructured at a market rate in a prior calendar year and is currently in compliance with its modified terms. However, these loans or leases continue to be classified as impaired and are individually evaluated for impairment.

Table of Contents

As of March 31, 2015, restructured loans & leases on accrual totaled \$4.9 million as compared to \$5.0 million at December 31, 2014. Restructured loans on accrual at March 31, 2014 were \$4.0 million.

Other Real Estate - Loans where the collateral has been repossessed are classified as other real estate ("ORE") or, if the collateral is personal property, the loan is classified as other assets on the Company's financial statements.

The following table sets forth the amount of the Company's non-performing loans & leases (defined as non-accrual loans & leases plus accruing loans & leases past due 90 days or more) and ORE as of the dates indicated.

Non-Performing Assets

(in thousands)	March 31, 2015	Dec. 31, 2014	March 31, 2014
Non-Performing Loans & Leases	\$2,391	\$2,270	\$3,133
Other Real Estate	3,299	3,299	3,294
Total Non-Performing Assets	\$5,690	\$5,569	\$6,427
Non-Performing Loans & Leases as a % of Total Loans & Leases	0.14 %	0.13 %	0.19 %
Restructured Loans & Leases (Performing)	\$4,865	\$4,955	\$3,956

Although management believes that non-performing loans & leases are generally well-secured and that potential losses are provided for in the Company's allowance for credit losses, there can be no assurance that future deterioration in economic conditions and/or collateral values will not result in future credit losses. Specific reserves of \$933,000, \$940,000, and \$1.0 million have been established for non-performing loans & leases at March 31, 2015, December 31, 2014 and March 31, 2014, respectively.

Foregone interest income on non-accrual loans & leases which would have been recognized during the period, if all such loans & leases had been current in accordance with their original terms, totaled \$24,000 for the three months ended March 31, 2015, \$92,000 for the year ended December 31, 2014, and \$13,000 for the three months ended March 31, 2014.

The Company reported \$3.3 million of ORE at March 31, 2015, December 31, 2014, and March 31, 2014. The March 31, 2015, December 31, 2014 and March 31, 2014 values are all net of a \$3.7 million reserve for ORE valuation allowance.

Except for those classified and non-performing loans & leases discussed above, the Company's management is not aware of any loans & leases as of March 31, 2015, for which known financial problems of the borrower would cause serious doubts as to the ability of these borrowers to materially comply with their present loan or lease repayment terms, or any known events that would result in the loan or lease being designated as non-performing at some future date. However:

The Central Valley was one of the hardest hit areas in the country during the recession. In many areas housing prices declined as much as 60% and unemployment reached 15% or more. Although the economy has stabilized throughout most of the Central Valley, housing prices for the most part have not recovered significantly and unemployment levels remain well above those in other areas of the state and country.

- The state of California has experienced drought conditions since 2013 and this situation did not change during this winter's rainy season. Importantly, most of the Company's agricultural customers have access to their own ground water supplies and protected riparian rights and, therefore, are not as dependent on the

delivery of surface water as growers in other parts of California. Although management continues to believe that current conditions will not have a material impact on credit quality during 2015, the lack of rain will have a continuing adverse impact on our agricultural customers' operating costs, crop yields and crop quality. The longer the drought continues, the more significant this impact will become, particularly if ground water levels reach critical stage.

Table of Contents

See “Part I, Item 1A. Risk Factors” in the Company’s 2014 Annual Report on Form 10-K.

Deposits

One of the key sources of funds to support earning assets is the generation of deposits from the Company’s customer base. The ability to grow the customer base and subsequently deposits is a significant element in the performance of the Company.

The Company's deposit balances at March 31, 2015 have increased \$271.2 million or 14.7% compared to March 31, 2014. In addition to the Company’s ongoing business development activities for deposits, the following factors positively impacted year-over-year deposit growth: (1) the Federal government’s decision to permanently increase FDIC deposit insurance limits from \$100,000 to \$250,000 per depositor; and (2) the Company’s strong financial results and position and F&M Bank’s reputation as one of the most safe and sound banks in its market territory. The Company expects that, at some point, deposit customers may begin to diversify how they invest their money (e.g., move funds back into the stock market or other investments) and this could impact future deposit growth.

Although total deposits have increased 14.7% since March 31, 2014, importantly, low cost transaction accounts have continued to grow at a strong pace:

- Demand and interest-bearing transaction accounts increased \$141.9 million or 18.3% since March 31, 2014.
- Savings and money market accounts have increased \$60.0 million or 9.4% since March 31, 2014.
- Time deposit accounts have increased \$69.3 million or 16.3% since March 31, 2014.

The Company's deposit balances at March 31, 2015 have increased \$47.7 million or 2.3% compared to December 31, 2014. Savings and money market deposits increased 8.5% or \$55.0 million while demand and interest-bearing transaction accounts decreased by \$32.7 million or 3.4% and time deposit accounts increased by \$25.3 million or 5.4%. Deposit trends in the first half of the year can be impacted by the seasonal needs of our agricultural customers.

Federal Home Loan Bank Advances and Federal Reserve Bank Borrowings

Lines of credit with the Federal Reserve Bank and the Federal Home Loan Bank are other key sources of funds to support earning assets. These sources of funds are also used to manage the Company’s interest rate risk exposure, and as opportunities arise, to borrow and invest the proceeds at a positive spread through the investment portfolio. There were no FHLB Advances at March 31, 2015, December 31, 2014, or March 31, 2014. There were no Federal Funds purchased or advances from the FRB at March 31, 2015, December 31, 2014 or March 31, 2014.

As of March 31, 2015 the Company has additional borrowing capacity of \$274.5 million with the Federal Home Loan Bank and \$340.7 million with the Federal Reserve Bank. Any borrowings under these lines would be collateralized with loans that have been accepted for pledging at the FHLB and FRB.

Long-Term Subordinated Debentures

On December 17, 2003, the Company raised \$10 million through an offering of trust-preferred securities (“TPS”). See Note 13 located in “Item 8. Financial Statements and Supplementary Data” of the Company’s 2014 Annual Report on Form 10-K. Although this amount is reflected as subordinated debt on the Company’s balance sheet, under current regulatory guidelines, our TPS will continue to qualify as regulatory capital (See “Basel III Regulatory Capital Rules”). These securities accrue interest at a variable rate based upon 3-month LIBOR plus 2.85%. Interest rates reset quarterly and were 3.12% as of March 31, 2015, 3.09% at December 31, 2014 and 3.08% at March 31, 2014. The average rate paid for these securities for the first quarter of 2015 and 2014 was 3.10%. Additionally, if the Company decided to defer interest on the subordinated debentures, the Company would be prohibited from paying cash dividends on the Company’s common stock.

Table of Contents

Capital

The Company relies primarily on capital generated through the retention of earnings to satisfy its capital requirements. The Company engages in an ongoing assessment of its capital needs in order to support business growth and to insure depositor protection. Shareholders' Equity totaled \$241.3 million at March 31, 2015, \$233.2 million at December 31, 2014, and \$218.0 million at March 31, 2014.

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain actions by regulators that, if undertaken, could have a material effect on the Company and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios set forth in the table below (all terms as defined in the regulations). As of March 31, 2015, that the Company and the Bank exceeded all capital adequacy requirements to which they are subject.

In its most recent notification from the FDIC the Bank was categorized as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," the Bank must maintain certain ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the institution's categories.

(in thousands)	Actual		Regulatory Capital Requirements		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
The Company:						
As of March 31, 2015						
Total Capital Ratio	\$273,813	13.25%	\$165,353	8.0 %	N/A	N/A
Common Equity Tier 1 Capital Ratio	\$247,813	11.99%	\$93,011	4.5 %	N/A	N/A
Tier 1 Capital Ratio	\$247,813	11.99%	\$124,015	6.0 %	N/A	N/A
Tier 1 Leverage Ratio	\$247,813	10.45%	\$94,891	4.0 %	N/A	N/A

Table of Contents

(in thousands)	Actual		Regulatory Capital Requirements		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
The Bank:						
As of March 31, 2015						
Total Capital Ratio	\$273,709	13.24%	\$165,339	8.0 %	\$206,674	10.0 %
Common Equity Tier 1 Capital Ratio	\$247,711	11.99%	\$93,003	4.5 %	\$134,338	6.5 %
Tier 1 Capital Ratio	\$247,711	11.99%	\$124,004	6.0 %	\$165,339	8.0 %
Tier 1 Leverage Ratio	\$247,711	10.45%	\$94,846	4.0 %	\$118,558	5.0 %

As previously discussed (see “Long-Term Subordinated Debentures”), in order to supplement its regulatory capital base, during December 2003 the Company issued \$10 million of trust preferred securities. On March 1, 2005, the Federal Reserve Board issued its final rule effective April 11, 2005, concerning the regulatory capital treatment of trust preferred securities (“TPS”) by bank holding companies (“BHCs”). Under the final rule BHCs may include TPS in Tier 1 capital in an amount equal to 25% of the sum of core capital net of goodwill. Any portion of trust-preferred securities not qualifying as Tier 1 capital would qualify as Tier 2 capital subject to certain limitations. The Company has received notification from the Federal Reserve Bank of San Francisco that all of the Company’s trust preferred securities currently qualify as Tier 1 capital.

The Company is not considered the primary beneficiary of this Trust (variable interest entity), therefore the trust is not consolidated in the Company’s financial statements, but rather the subordinated debentures are shown as a liability.

In 1998, the Board approved the Company’s first common stock repurchase program. This program has been extended and expanded several times since then, and most recently, on September 11, 2012, the Board of Directors approved increasing the funds available for the Company’s common stock repurchase program to \$20 million over the three-year period ending September 30, 2015. See “Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities” of the Company’s 2014 Annual Report on Form 10-K for additional information.

There were no stock repurchases during the first quarter of 2015 or 2014. The remaining dollar value of shares that may yet be purchased under the Company’s Common Stock Repurchase Plan is approximately \$20 million.

On August 5, 2008, the Board of Directors approved a Share Purchase Rights Plan (the “Rights Plan”), pursuant to which the Company entered into a Rights Agreement dated August 5, 2008, with Registrar and Transfer Company as Rights Agent. See “Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities” of the Company’s 2014 Annual Report on Form 10-K for further explanation.

On January 23, 2015, the Company issued 1,700 shares of common stock to the Bank’s non-qualified defined contribution retirement plans. These shares were issued at a price of \$450 per share based upon a valuation completed by a nationally recognized bank consulting and advisory firm and in reliance upon the exemption in Section 4(2) of the Securities Act of 1933, as amended, the regulations promulgated thereunder. Most of the proceeds were contributed to the Bank as equity capital.

Basel III Regulatory Capital Rules

Both the FRB and FDIC have approved final rules that substantially amend the regulatory risk-based capital rules previously applicable to the Company and the Bank. These rules would implement the Basel III regulatory capital

reforms and changes required by the Dodd-Frank Act.

51

Table of Contents

The final rules include new minimum risk-based capital and leverage ratios, which would be phased in over time. The new minimum capital level requirements applicable to the Company and the Bank under the final rules will be: (i) a common equity Tier 1 capital ratio of 4.5% of Risk Weighted Assets (“RWA”); (ii) a Tier 1 capital ratio of 6% of RWA; (iii) a total capital ratio of 8% of RWA; and (iv) a Tier 1 leverage ratio of 4% of total assets. The final rules also establish a "capital conservation buffer" of 2.5% above each of the new regulatory minimum capital ratios, which would result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0% of RWA; (ii) a Tier 1 capital ratio of 8.5% of RWA, and (iii) a total capital ratio of 10.5% of RWA. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount.

The final rules also implement other revisions to the current capital rules but, in general, those revisions are not as onerous as originally thought when the proposed rules were issued in June 2012. For instance, the Company’s subordinated debentures will continue to qualify for Tier 1 under the rules. The Company believes that it is currently in compliance with all of these new capital requirements (as fully phased-in) and that they will not result in any restrictions on the Company’s business activity.

Critical Accounting Policies and Estimates

This “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” is based upon the Company’s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. In preparing the Company’s financial statements management makes estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. These judgments govern areas such as the allowance for credit losses, the fair value of financial instruments and accounting for income taxes.

For a full discussion of the Company’s critical accounting policies and estimates see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” in the Company’s 2014 Annual Report on Form 10-K.

Off Balance Sheet Commitments

In the normal course of business the Company enters into financial instruments with off balance sheet risks in order to meet the financing needs of its customers. These financial instruments consist of commitments to extend credit, letters of credit and other types of financial guarantees. The Company had the following off balance sheet commitments as of the dates indicated.

(in thousands)	March 31, 2015	December 31, 2014	March 31, 2014
Commitments to Extend Credit	\$604,429	\$539,288	\$508,578
Letters of Credit	9,841	9,734	7,509
Performance Guarantees Under Interest Rate Swap Contracts Entered Into Between Our Borrowing Customers and Third Parties	3,288	2,042	-

The Company's exposure to credit loss in the event of nonperformance by the other party with regard to standby letters of credit, undisbursed loan commitments, and financial guarantees is represented by the contractual notional amount of those instruments. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. The Company uses the same credit policies in making commitments and conditional obligations as it does for recorded balance sheet items. The Company may or may not require collateral or other security to support financial instruments with credit risk. Evaluations of each customer's creditworthiness are performed on a case-by-case basis.

Standby letters of credit are conditional commitments issued by the Company to guarantee performance of or payment for a customer to a third party. Most standby letters of credit are issued for 18 months or less. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Additionally, the Company

maintains a reserve for off balance sheet commitments which totaled \$142,000 at March 31, 2015, December 31, 2014, and March 31, 2014. We do not anticipate any material losses as a result of these transactions.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Risk Management

The Company has adopted risk management policies and procedures, which aim to ensure the proper control and management of all risk factors inherent in the operation of the Company, most importantly credit risk, interest rate risk and liquidity risk. These risk factors are not mutually exclusive. It is recognized that any product or service offered by the Company may expose the Company to one or more of these risk factors.

Credit Risk

Credit risk is the risk to earnings or capital arising from an obligor's failure to meet the terms of any contract or otherwise fail to perform as agreed. Credit risk is found in all activities where success depends on counterparty, issuer, or borrower performance.

Credit risk in the investment portfolio and correspondent bank accounts is addressed through defined limits in the Company's policy statements. In addition, certain securities carry insurance to enhance credit quality of the bond.

In order to control credit risk in the loan & lease portfolio the Company has established credit management policies and procedures that govern both the approval of new loans & leases and the monitoring of the existing portfolio. The Company manages and controls credit risk through comprehensive underwriting and approval standards, dollar limits on loans & leases to one borrower, and by restricting loans & leases made primarily to its principal market area where management believes it is best able to assess the applicable risk. Additionally, management has established guidelines to ensure the diversification of the Company's credit portfolio such that even within key portfolio sectors such as real estate or agriculture, the portfolio is diversified across factors such as location, building type, crop type, etc. However, as a financial institution that assumes credit risks as a principal element of its business, credit losses will be experienced in the normal course of business. The allowance for credit losses is maintained at a level considered by management to be adequate to provide for risks inherent in the loan & lease portfolio. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs.

The Company's methodology for assessing the appropriateness of the allowance is applied on a regular basis and considers all loans & leases. The systematic methodology consists of three parts.

Part 1 - includes a detailed analysis of the loan & lease portfolio in two phases. The first phase is conducted in accordance with the "Receivables" topic of the FASB ASC. Individual loans & leases are reviewed to identify them for impairment. A loan or lease is impaired when principal and interest are deemed uncollectible in accordance with the original contractual terms of the loan or lease. Impairment is measured as either the expected future cash flows discounted at each loan's or lease's effective interest rate, the fair value of the loan's or lease's collateral if the loan or lease is collateral dependent, or an observable market price of the loan or lease, if one exists. Upon measuring the impairment, the Company will ensure an appropriate level of allowance is present or established.

Central to the first phase of the analysis of the loan & lease portfolio is the risk rating system. The originating credit officer assigns each borrower an initial risk rating, which is based primarily on a thorough analysis of that borrower's financial position in conjunction with industry and economic trends. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior credit administration personnel. Credits are monitored by credit administration personnel for deterioration in a borrower's financial condition, which would impact the ability of the borrower to perform under the contract. Risk ratings are adjusted as necessary. Risk ratings are reviewed by both the Company's independent third-party credit examiners and bank examiners from the DBO and FDIC.

Based on the risk rating system, specific allowances are established in cases where management has identified significant conditions or circumstances related to a credit that management believes indicates that the loan or lease is

impaired and there is a probability of loss. Management performs a detailed analysis of these loans & leases, including, but not limited to, cash flows, appraisals of the collateral, conditions of the marketplace for liquidating the collateral, and assessment of the guarantors. Management then determines the inherent loss potential and allocates a portion of the allowance for losses as a specific allowance for each of these credits.

Table of Contents

The second phase is conducted by segmenting the loan & lease portfolio by risk rating and into groups of loans & leases with similar characteristics in accordance with the “Contingency” topic of the FASB ASC. In this second phase, groups of loans & leases with similar characteristics are reviewed and the appropriate allowance factor is applied based on the historical average charge-off rate for each particular group of loans or leases.

Part 2 - considers qualitative internal and external factors that may affect a loan or lease’s collectability, is based upon management’s evaluation of various conditions, the effects of which are not directly measured in the determination of the historical and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments. The conditions evaluated in connection with the second element of the analysis of the allowance include, but are not limited to the following conditions that existed as of the balance sheet date:

- § general economic and business conditions affecting the key service areas of the Company;
- § credit quality trends (including trends in collateral values, delinquencies and non-performing loans & leases);
- § loan & lease volumes, growth rates and concentrations;
- § loan & lease portfolio seasoning;
- § specific industry and crop conditions;
- § recent loss experience; and
- § duration of the current business cycle.

Part 3 - An unallocated allowance often occurs due to the imprecision in estimating and allocating allowance balances associated with macro factors such as: (1) the continuing sluggish economic conditions in the Central Valley; and (2) the long term impact of drought conditions currently being experienced in California.

Management reviews all of these conditions in discussion with the Company’s senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable impaired credit or portfolio segment as of the evaluation date, management’s estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specifically identifiable impaired credit or portfolio segment as of the evaluation date, management’s evaluation of the inherent loss related to such condition is reflected in the second element of the allowance or in the unallocated allowance.

Management believes, that based upon the preceding methodology, and using information currently available, the allowance for credit losses at March 31, 2015 was adequate. No assurances can be given that future events may not result in increases in delinquencies, non-performing loans & leases, or net loan & lease charge-offs that would require increases in the provision for credit losses and thereby adversely affect the results of operations.

Interest Rate Risk

The mismatch between maturities of interest sensitive assets and liabilities results in uncertainty in the Company’s earnings and economic value and is referred to as interest rate risk. The Company does not attempt to predict interest rates and positions the balance sheet in a manner, which seeks to minimize, to the extent possible, the effects of changing interest rates.

The Company measures interest rate risk in terms of potential impact on both its economic value and earnings. The methods for governing the amount of interest rate risk include: (1) analysis of asset and liability mismatches (Gap analysis); (2) the utilization of a simulation model; and (3) limits on maturities of investment, loan & lease, and deposit products, which reduces the market volatility of those instruments.

The Gap analysis measures, at specific time intervals, the divergence between earning assets and interest bearing liabilities for which repricing opportunities will occur. A positive difference, or Gap, indicates that earning assets will reprice faster than interest-bearing liabilities. This will generally produce a greater net interest margin during periods

of rising interest rates and a lower net interest margin during periods of declining interest rates. Conversely, a negative Gap will generally produce a lower net interest margin during periods of rising interest rates and a greater net interest margin during periods of decreasing interest rates.

Table of Contents

The interest rates paid on deposit accounts do not always move in unison with the rates charged on loans & leases. In addition, the magnitude of changes in the rates charged on loans & leases is not always proportionate to the magnitude of changes in the rate paid for deposits. Consequently, changes in interest rates do not necessarily result in an increase or decrease in the net interest margin solely as a result of the differences between repricing opportunities of earning assets or interest bearing liabilities.

The Company also utilizes the results of a dynamic simulation model to quantify the estimated exposure of net interest income to sustained interest rate changes. The sensitivity of the Company's net interest income is measured over a rolling one-year horizon.

The simulation model estimates the impact of changing interest rates on interest income from all interest-earning assets and the interest expense paid on all interest-bearing liabilities reflected on the Company's balance sheet. This sensitivity analysis is compared to policy limits, which specify a maximum tolerance level for net interest income exposure over a one-year horizon assuming no balance sheet growth, given a 200 basis point upward and a 100 basis point downward shift in interest rates. A shift in rates over a 12-month period is assumed. Results that exceed policy limits, if any, are analyzed for risk tolerance and reported to the Board with appropriate recommendations. At March 31, 2015, the Company's estimated net interest income sensitivity to changes in interest rates, as a percent of net interest income was an increase in net interest income of 3.25% if rates increase by 200 basis points and a decrease in net interest income of 0.35% if rates decline 100 basis points. Comparatively, at December 31, 2014, the Company's estimated net interest income sensitivity to changes in interest rates, as a percent of net interest income was an increase in net interest income of 2.98% if rates increase by 200 basis points and a decrease in net interest income of 0.17% if rates decline 100 basis points.

The estimated sensitivity does not necessarily represent a Company forecast and the results may not be indicative of actual changes to the Company's net interest income. These estimates are based upon a number of assumptions including: the nature and timing of interest rate levels including yield curve shape; prepayments on loans & leases and securities; pricing strategies on loans & leases and deposits; replacement of asset and liability cash flows; and other assumptions. While the assumptions used are based on current economic and local market conditions, there is no assurance as to the predictive nature of these conditions including how customer preferences or competitor influences might change.

Liquidity Risk

Liquidity risk is the risk to earnings or capital resulting from the Company's inability to meet its obligations when they come due without incurring unacceptable losses. It includes the ability to manage unplanned decreases or changes in funding sources and to recognize or address changes in market conditions that affect the Company's ability to liquidate assets or acquire funds quickly and with minimum loss of value. The Company endeavors to maintain a cash flow adequate to fund operations, handle fluctuations in deposit levels, respond to the credit needs of borrowers, and to take advantage of investment opportunities as they arise.

The Company's principal operating sources of liquidity include (see "Item 8. Financial Statements and Supplementary Data – Consolidated Statements of Cash Flows" of the Company's 2014 Annual Report on Form 10-K) cash and cash equivalents, cash provided by operating activities, principal payments on loans & leases, proceeds from the maturity or sale of investments, and growth in deposits. To supplement these operating sources of funds the Company maintains Federal Funds credit lines of \$74.0 million and repurchase lines of \$100.0 million with major banks. As of March 31, 2015 the Company has additional borrowing capacity of \$274.9 million with the FHLB and \$340.7 million with the FRB. Borrowings under these lines are collateralized with loans or securities that have been accepted for pledging at the FHLB and FRB.

At March 31, 2015, the Company had available sources of liquidity, which included cash and cash equivalents and unpledged investment securities AFS of approximately \$356.6 million, which represents 14.8% of total assets.

ITEM 4. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures designed to ensure that information is recorded and reported in all filings of financial reports. Such information is reported to the Company's management, including its Chief Executive Officer and its Chief Financial Officer to allow timely and accurate disclosure based on the definition of "disclosure controls and procedures" in Rule 13a-15(e). In designing these controls and procedures, management recognizes that they can only provide reasonable assurance of achieving the desired control objectives. Management also evaluated the cost-benefit relationship of possible controls and procedures.

55

Table of Contents

As of the end of the period covered by this report, the Company carried out an evaluation of the effectiveness of Company's disclosure controls and procedures under the supervision and with the participation of the Chief Executive Officer, the Chief Financial Officer and other senior management of the Company. The evaluation was based, in part, upon reports and affidavits provided by a number of executives. Based on the foregoing, the Company's Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect the internal controls over financial reporting subsequent to the date the Company completed its evaluation.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

Certain lawsuits and claims arising in the ordinary course of business have been filed or are pending against the Company or its subsidiaries. Based upon information available to the Company, its review of such lawsuits and claims and consultation with its counsel, the Company believes the liability relating to these actions, if any, would not have a material adverse effect on its consolidated financial statements.

There are no material proceedings adverse to the Company to which any director, officer or affiliate of the Company is a party.

ITEM 1A. Risk Factors

See "Item 1A. Risk Factors" in the Company's 2014 Annual Report to Shareholders on Form 10-K. In management's opinion, there have been no material changes in risk factors since the filing of the 2014 Form 10-K.

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

There were no shares repurchased by Farmers & Merchants Bancorp during the first quarter of 2015. The remaining dollar value of shares that may yet be purchased under the Company's Stock Repurchase Plan is approximately \$20.0 million.

The common stock of Farmers & Merchants Bancorp is not widely held or listed on any exchange. However, trades are reported on the OTCQX (prior to January 12, 2015, the Over the Counter ("OTC") Bulletin Board) under the symbol "FMCB." Additionally, management is aware that there are private transactions in the Company's common stock.

On January 23, 2015, the Company issued 1,700 shares of common stock to the Bank's non-qualified defined contribution retirement plans. These shares were issued at a price of \$450 per share based upon a valuation completed by a nationally recognized bank consulting and advisory firm and in reliance upon the exemption in Section 4(2) of the Securities Act of 1933, as amended, the regulations promulgated thereunder. Most of the proceeds were contributed to the Bank as equity capital.

ITEM 3. Defaults Upon Senior Securities

Not applicable

Table of Contents

ITEM 4. Mine Safety Disclosures

Not applicable

ITEM 5. Other Information

None

ITEM 6. Exhibits

See "Index to Exhibits"

SIGNATURES

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

FARMERS & MERCHANTS BANCORP

Date: May 8, 2015 /s/ Kent A. Steinwert

Kent A. Steinwert
Chairman, President
& Chief Executive Officer
(Principal Executive Officer)

Date: May 8, 2015 /s/ Stephen W. Haley

Stephen W. Haley
Executive Vice President and
Chief Financial Officer
(Principal Financial & Accounting Officer)

Table of Contents

Index to Exhibits

<u>Exhibit No.</u>	<u>Description</u>
<u>31(a)</u>	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
<u>31(b)</u>	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
<u>32</u>	Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document
101.DEF	XBRL Definition Linkbase Document