



2012 ANNUAL REPORT



◆ *THE "COMMUNITY" BANK THAT PUTS PEOPLE FIRST* ◆
Member FDIC

February 28, 2013

Dear Stockholders, Customers, and Friends:

We are pleased to report that your Bank achieved its third consecutive year of record earnings. Net income for the year ended December 31, 2012 was \$3,157,991 or \$4.02 per share compared to \$2,266,511 or \$2.92 per share in 2011, an increase of \$891,480 or 39%. The increase in net income is due primarily to loan portfolio growth and a significant decrease in loan losses.

Return on average equity increased to 12.10% in 2012 compared to 9.40% in 2011. Return on average assets increased to 1.19% in 2012 compared to 0.90% in 2011. Cash dividends paid to shareholders in 2012 increased to \$0.98 per common share from \$0.91 per common share in 2011. During 2012, the price of Farmers and Merchants Bank stock increased \$2 per share or 8.3%, from \$24 to \$26. As of February 28, 2013, the price had increased to \$29.56, a 13.7% increase since the beginning of the year.

Asset growth continued at a strong rate during 2012. The year-end total of \$276 million represented a 9% increase from \$254 million at December 31, 2011. Loans outstanding increased 14% to \$213 million at December 31, 2012 from \$187 million at the end of 2011. Deposits increased 8%, growing to \$224 million at December 31, 2012 from \$207 million at December 31, 2011. Stockholders' Equity increased \$2.5 million or 10% to \$27.2 million at December 31, 2012 from \$24.7 million at the end of 2011.

The Bank's outstanding performance in 2012 earned it a #2 ranking state-wide among Maryland state chartered banks for the third consecutive year as determined by the Financial Management Consulting Group. We were the highest rated bank in the Baltimore Metropolitan area for the third consecutive year. The rankings were based upon profitability, efficiency, and asset quality among other criteria.

We are pleased to announce that the Bank has greatly expanded the investor relations section of our website – www.fmb1919.com. The investor relations section includes press releases, financial information, stock information, peer analysis, and information about the Bank's officers and directors. We encourage you to take a look.

The outstanding financial performance of Farmers and Merchants Bank is the result of the hard work and dedication of our directors, officers, and staff. Quality service, conservative management, and a disciplined approach to growth continue to be our focus. On behalf of the Board of Directors and staff, we thank you for your confidence in and your continued support of our excellent community bank.

Sincerely yours,

Kenneth W. Hoffmeyer
Chairman

James R. Bosley, Jr.
President

Farmers and Merchants Bank

About The Bank

General

Farmers and Merchants Bank (the "Bank") was incorporated October 24, 1919 under the laws of Maryland. The Bank is a Federal Deposit Insurance Corporation ("FDIC") insured independent community bank headquartered in Upperco, Maryland. The Bank currently has seven branch locations in Carroll and Baltimore Counties. The Bank's general market area runs along the Route 30, Route 795, and Route 140 corridors south from Owings Mills and north to the Pennsylvania state line including the areas of Reisterstown, Upperco, Hampstead, Manchester, and Westminster.

Services of the Bank

The Bank provides comprehensive commercial and retail banking services to small and medium-sized businesses and to individuals. The following types of services are offered by the Bank:

Commercial Services

- Loans, including commercial mortgages, lines of credit, a wide range of demand, term, and time loans, for purposes such as fixed asset purchases, as well as loans guaranteed by the Small Business Administration ("SBA") and the Farm Services Agency ("FSA")
- Commercial checking accounts and Remote Deposit Banking services
- Certificates of Deposit and other interest-bearing accounts
- Direct deposit of payroll
- Merchant credit card services
- Letters of Credit.

Consumer Services

- Transaction accounts, including checking and NOW accounts
- Savings accounts
- Certificates of Deposit
- Money Market Accounts
- Individual Retirement Accounts
- Holiday and Vacation Club accounts
- Mortgages (Permanent and Construction)
- Home Equity loans
- Installment and Line of Credit loans
- Land loans
- Car and truck loans
- Agricultural loans
- Educational loans
- VISA Debit cards

The Bank offers 24 hour ATMs, including access to the Allpoint Network, on-line banking, safe deposit boxes, money orders, savings bonds, official checks, night depository, 24 hour Dial-A-Bank Telephone Access System, internet banking, remote deposit, and wire transfers. The Bank does not offer general trust services.

Farmers and Merchants Bank

MISSION STATEMENT

The mission of Farmers and Merchants Bank is to improve the quality of life in our community by being a people-oriented, independent, profitable community bank dedicated to providing products and services that fulfill the financial needs of individuals and businesses.

LOCATIONS

**Main Office
15226 Hanover Pike
Upperco, MD 21155
410-833-6600**

**Hampstead Office
735 Hanover Pike
Hampstead, MD 21074
410-239-4448**

**Westminster Office
275 Clifton Boulevard
Westminster, MD 21157
410-857-1100**

**Commercial Loan Center
Westminster Office
275 Clifton Boulevard
Westminster, MD 21157
410-857-1700**

**Greenmount Office
2320 Hanover Pike
Hampstead, MD 21074
410-374-3436**

**Reisterstown Office
P.O. Box 249
25 Westminster Pike
Reisterstown, MD 21136
410-517-3060**

**Mortgage Division
Hampstead Office
735 Hanover Pike
Hampstead, MD 21074
410-239-9650**

**Operations Center
P.O. Box 249
25 Westminster Pike
Reisterstown, MD 21136
410-517-3065**

**Owings Mills Office
9320 Lakeside Boulevard
Owings Mills, MD 21117
410-356-8200**

**Atrium Village
Senior Living Community
4730 Atrium Court
Owings Mills, MD 21117
410-998-8847**

**Commercial Loan Center
Owings Mills Office
9320 Lakeside Boulevard
Owings Mills, MD 21117
410-356-9303**

**Farmers and Merchants Bank
Directors
2012**

Kenneth W. Hoffmeyer, Chairman
Retired Associate Controller
Johns Hopkins University

Paul F. Wooden, Jr., Vice Chairman
President
Taylor Technologies, Inc.

James R. Bosley, Jr.
President and CEO
Farmers and Merchants Bank

Roger D. Cassell
President
Communications Electronics, Inc.

Edward A. Halle, Jr.
Attorney, Fowley & Beckley, P.A.

Ronald W. Hux
President, Douron, Inc.

T. Edward Lippy
President, Lippy Brothers, Inc.

J. Lawrence Mekulski
Principal, KLNb, LLC

Rudolf W. Nechay
President
Industrial Refrigeration Services, Inc.
General Refrigeration, Inc.
Polytemp Corporation

Bruce L. Schindler
President
Bob Davidson Ford Lincoln

John J. Schuster, Jr.
President, Schuster Enterprises, Inc.

W. Ralph Wisner
Vice President and Secretary
Wisner Farms, Inc.

**Farmers and Merchants Bank
Officers
2012**

James R. Bosley, Jr.
President,
Chief Executive Officer

Christopher T. Oswald
Senior Vice President,
Chief Operations Officer

Mark C. Krebs
Senior Vice President,
Chief Financial Officer

Senior Vice Presidents

Julie A. Harris-Hare.....Data Processing
Cheryl Y. Lewis Lending
J. Ritchie Solter.....Commercial Lending
Yvonne G. Zeminski...Branch Administration

Vice Presidents

Lynnette Kitzmiller.....Corporate Secretary
Kevin P. Bankert.....Commercial Loan Officer
M. Eugene Bosley...Commercial Loan Officer
Gary A. Harris.....Commercial Loan Officer
J. Thomas Turner.....Mortgage Officer

Other Bank Officers

Paul A. Davolos..Commercial Banking Officer
T. Jeffrey Horner.....Controller
Mark W. Lutrey.....Auditor

Assistant Vice Presidents

Loan Officers

Debora A. Smith
Betty J. Higgs-Swartz
Callie L. Jennings

Assistant Vice Presidents

Branch Managers

Amy L. Collins.....Greenmount
Rachel L. Heird.....Owings Mills
Kelly P. Johnson.....Hampstead
Wendy A. Panek.....Reisterstown
Shannon M. Panek-Close.....Main Office
Deborah Zepp.....Westminster

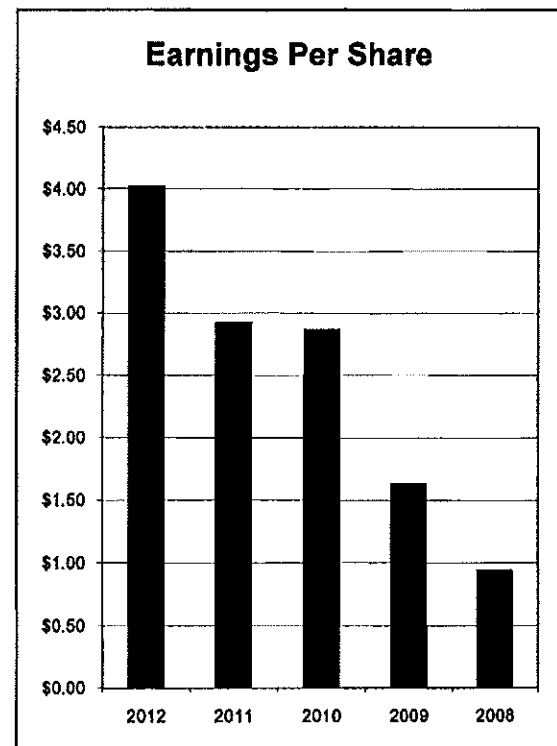
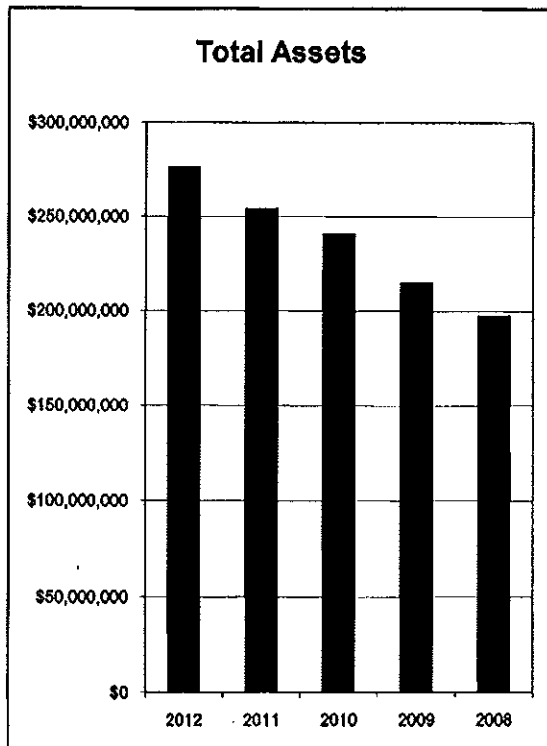
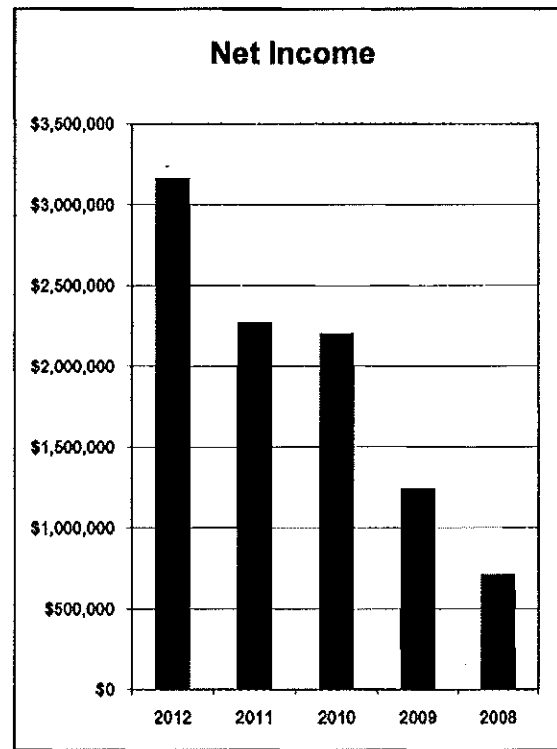
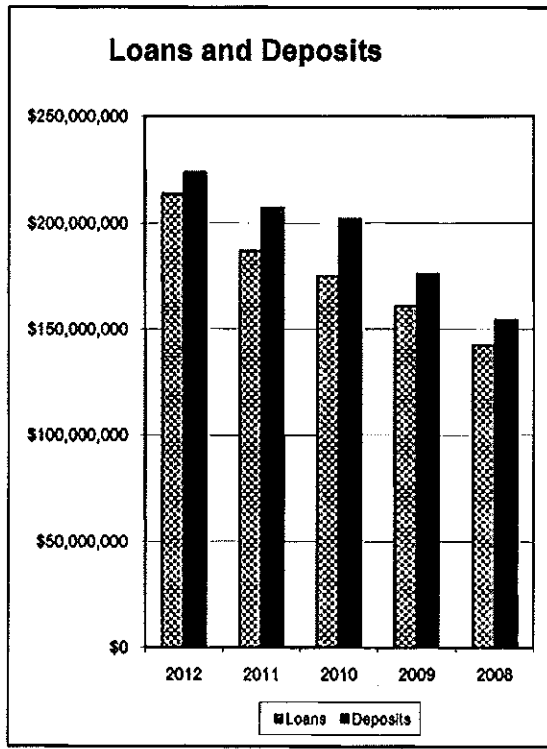
Farmers and Merchants Bank

Selected Consolidated Financial Data

	2012	2011	2010	2009	2008
OPERATING DATA					
Interest income	\$ 13,334,852	\$ 12,662,321	\$ 11,617,437	\$ 10,716,699	\$ 9,817,939
Interest expense	<u>1,543,127</u>	<u>1,844,423</u>	<u>2,255,263</u>	<u>3,196,670</u>	<u>3,384,201</u>
Net interest income	11,791,725	10,817,898	9,362,174	7,520,029	6,433,738
Provision for loan losses	<u>280,000</u>	<u>1,575,000</u>	<u>635,000</u>	<u>750,000</u>	<u>520,000</u>
Net interest income after provision for loan losses	11,511,725	9,242,898	8,727,174	6,770,029	5,913,738
Noninterest income	1,553,405	1,815,569	1,707,695	1,788,807	1,799,602
Noninterest expense	<u>8,146,562</u>	<u>7,615,046</u>	<u>7,000,305</u>	<u>6,674,128</u>	<u>6,774,376</u>
Income before income taxes	4,918,568	3,443,421	3,434,564	1,884,708	938,964
Income taxes	<u>1,760,577</u>	<u>1,176,910</u>	<u>1,236,827</u>	<u>646,936</u>	<u>234,201</u>
Net income	<u>\$ 3,157,991</u>	<u>\$ 2,266,511</u>	<u>\$ 2,197,737</u>	<u>\$ 1,237,772</u>	<u>\$ 704,763</u>
PER SHARE DATA					
Net income (Basic)	\$4.02	\$2.92	\$2.87	\$1.63	\$0.94
Dividends	\$0.98	\$0.91	\$0.75	\$0.60	\$0.99
Book value per share	\$34.25	\$31.43	\$29.20	\$27.37	\$26.53
Dividend payout ratio	24.38%	31.16%	26.13%	36.81%	105.17%
KEY RATIOS					
Return on average assets	1.19%	0.90%	0.97%	0.59%	0.39%
Return on average equity	12.10%	9.40%	9.95%	6.02%	3.52%
Net yield on interest-earning assets	4.82%	4.70%	4.46%	3.87%	3.88%
Efficiency ratio	61.05%	60.28%	63.24%	71.70%	82.28%
Average equity to average assets	9.81%	9.61%	9.74%	9.88%	11.09%
AT PERIOD END					
Total assets	\$ 275,678,997	\$ 253,901,460	\$ 240,427,031	\$ 214,703,396	\$ 197,271,437
Loans, net and loans held for sale	215,732,977	187,670,721	176,040,884	162,086,511	142,375,750
Cash, federal funds sold, and other interest-earning deposits	14,162,898	14,314,474	11,602,545	14,737,250	12,887,914
Securities	29,138,128	35,781,959	39,321,424	24,978,938	29,828,781
Deposits	223,777,174	207,275,557	201,990,686	175,914,655	154,332,920
Borrowings	23,805,224	21,188,190	15,131,657	17,235,751	21,968,438
Stockholders' equity	27,185,871	24,709,508	22,610,425	20,911,870	20,045,076
SELECTED AVERAGE BALANCES					
Total assets	\$ 266,001,542	\$ 250,795,495	\$ 226,927,649	\$ 208,096,804	\$ 180,780,956
Loans, net and loans held for sale	203,674,734	183,542,258	166,059,163	155,472,880	122,890,944
Cash, federal funds sold, and other interest-earning deposits	11,374,026	13,013,934	19,239,869	7,578,188	11,810,737
Securities	35,441,510	38,685,424	28,938,039	27,395,016	31,208,413
Deposits	216,758,404	206,454,365	188,050,432	167,803,586	144,044,763
Borrowings	22,075,830	19,534,304	16,088,557	18,874,328	16,030,065
Stockholders' equity	26,101,101	24,100,462	22,093,758	20,566,797	20,047,843
ASSET QUALITY					
Nonperforming assets	\$ 2,987,707	\$ 4,789,067	\$ 2,957,476	\$ 2,963,332	\$ 3,791,678
Nonperforming assets/total assets	1.08%	1.89%	1.23%	1.38%	1.92%
Allowance for loan losses/total loans	1.24%	1.33%	1.37%	1.21%	1.05%

Farmers and Merchants Bank

Selected Consolidated Financial Data



The Board of Directors and Stockholders
Farmers and Merchants Bank
Upperco, Maryland

Report of Independent Auditors

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Farmers and Merchants Bank and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Farmers and Merchants Bank and Subsidiary as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Rowles & Company, LLP

Baltimore, Maryland
February 28, 2013

Farmers and Merchants Bank and Subsidiary
Consolidated Balance Sheets

December 31,	2012	2011
Assets		
Cash and due from banks	\$ 13,436,044	\$ 13,390,890
Federal funds sold and other interest bearing deposits	<u>726,854</u>	<u>923,584</u>
Cash and cash equivalents	14,162,898	14,314,474
Certificate of deposit in other bank	100,000	100,000
Securities available for sale	18,601,126	24,457,394
Securities held to maturity	10,537,002	11,324,565
Federal Home Loan Bank stock, at cost	560,900	622,400
Loans held for sale	2,256,400	586,000
Loans, less allowance for loan losses of \$2,680,963 and \$2,518,511	213,476,577	187,084,721
Premises and equipment	5,909,003	5,876,643
Accrued interest receivable	920,264	877,062
Deferred income taxes	921,039	806,043
Other real estate owned	1,509,640	1,221,541
Bank owned life insurance	5,868,794	5,727,469
Other assets	<u>855,354</u>	<u>903,148</u>
	<u>\$ 275,678,997</u>	<u>\$ 253,901,460</u>
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	\$ 42,894,281	\$ 35,821,988
Interest-bearing	<u>180,882,893</u>	<u>171,453,569</u>
Total deposits	223,777,174	207,275,557
Securities sold under repurchase agreements	19,805,224	18,188,190
Federal Home Loan Bank of Atlanta advances	4,000,000	3,000,000
Accrued interest payable	168,620	206,363
Other liabilities	<u>742,108</u>	<u>521,842</u>
	<u>248,493,126</u>	<u>229,191,952</u>
Stockholders' equity		
Common stock, par value \$10 per share, authorized 5,000,000 shares; issued and outstanding 793,791 shares in 2012 and 786,085 shares in 2011	7,937,908	7,860,847
Surplus	8,170,655	8,054,288
Undivided profits	10,887,141	8,498,007
Accumulated other comprehensive income	<u>190,167</u>	<u>296,366</u>
	<u>27,185,871</u>	<u>24,709,508</u>
	<u>\$ 275,678,997</u>	<u>\$ 253,901,460</u>

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

Farmers and Merchants Bank and Subsidiary**Consolidated Statements of Income**

Years Ended December 31,	2012	2011
Interest income		
Loans, including fees	\$ 12,201,793	\$ 11,167,950
Investment securities - taxable	743,363	1,133,475
Investment securities - tax exempt	370,069	344,040
Federal funds sold and other interest earning assets	19,627	16,856
Total interest income	<u>13,334,852</u>	<u>12,662,321</u>
Interest expense		
Deposits	1,397,558	1,687,002
Securities sold under repurchase agreements	132,648	147,339
Federal Home Loan Bank advances and other borrowings	12,921	10,082
Total interest expense	<u>1,543,127</u>	<u>1,844,423</u>
Net interest income	11,791,725	10,817,898
Provision for loan losses	<u>280,000</u>	<u>1,575,000</u>
Net interest income after provision for loan losses	<u>11,511,725</u>	<u>9,242,898</u>
Noninterest income		
Service charges on deposit accounts	813,408	880,979
Mortgage banking income	394,316	397,313
Bank owned life insurance cash surrender value increase	141,324	176,483
Net gain on sale of securities	72,687	82,098
Write down of security	-	(14,000)
Gain on sale of land	-	188,353
Gain on sale of other real estate owned	4,842	-
Other fees and commissions	126,828	104,343
Total noninterest income	<u>1,553,405</u>	<u>1,815,569</u>
Noninterest expense		
Salaries	3,741,911	3,539,560
Employee benefits	999,140	912,211
Occupancy	613,837	578,912
Furniture and equipment	527,579	449,507
Federal Deposit Insurance premiums	173,253	210,621
Other	2,090,842	1,924,235
Total noninterest expense	<u>8,146,562</u>	<u>7,615,046</u>
Income before income taxes	4,918,568	3,443,421
Income taxes	<u>1,760,577</u>	<u>1,176,910</u>
Net income	<u>\$ 3,157,991</u>	<u>\$ 2,266,511</u>
Earnings per share - basic and diluted	<u>\$ 4.02</u>	<u>\$ 2.92</u>

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

Farmers and Merchants Bank and Subsidiary
Consolidated Statements of Comprehensive Income

Years Ended December 31,	2012	2011
Net income	\$ 3,157,991	\$ 2,266,511
Other comprehensive income, net of income taxes		
Securities available for sale		
Net unrealized gains (losses) arising during the period	(102,689)	481,068
Reclassification adjustment for realized gains and write-downs included in net income	<u>(72,687)</u>	<u>(68,098)</u>
Total unrealized gain on investment securities available for sale	(175,376)	412,970
Income tax expense (benefit) relating to investment securities available for sale	<u>(69,177)</u>	162,896
Total other comprehensive income	<u>(106,199)</u>	<u>250,074</u>
Total comprehensive income	<u>\$ 3,051,792</u>	<u>\$ 2,516,585</u>

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

Farmers and Merchants Bank and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity

	Common stock			Undivided	Accumulated other	Total
	Shares	Par value	Surplus	profits	comprehensive income	stockholders' equity
Balance, December 31, 2010	774,238	\$ 7,742,376	\$ 7,882,965	\$ 6,938,792	\$ 46,292	\$ 22,610,425
Net income	-	-	-	2,266,511	-	2,266,511
Unrealized gain on securities available for sale net of income tax expense of \$162,896	-	-	-	-	250,074	250,074
Cash dividends, \$0.91 per share	-	-	-	(707,296)	-	(707,296)
Dividends reinvested	11,847	118,471	171,323	-	-	289,794
Balance, December 31, 2011	786,085	7,860,847	8,054,288	8,498,007	296,366	24,709,508
Net income	-	-	-	3,157,991	-	3,157,991
Unrealized loss on securities available for sale net of income tax benefit of \$69,177	-	-	-	-	(106,199)	(106,199)
Cash dividends, \$0.98 per share	-	-	-	(768,857)	-	(768,857)
Dividends reinvested	12,752	127,525	184,250	-	-	311,775
Common stock repurchased	(5,046)	(50,464)	(67,883)	-	-	(118,347)
Balance, December 31, 2012	<u>793,791</u>	<u>\$ 7,937,908</u>	<u>\$ 8,170,655</u>	<u>\$ 10,887,141</u>	<u>\$ 190,167</u>	<u>\$ 27,185,871</u>

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

Farmers and Merchants Bank and Subsidiary
Consolidated Statements of Cash Flows

Years Ended December 31,	2012	2011
Cash flows from operating activities		
Interest received	\$ 13,368,306	\$ 12,653,330
Fees and commissions received	1,334,551	1,382,635
Interest paid	(1,580,870)	(1,873,323)
Proceeds from sale of mortgage loans held for sale	21,207,605	25,211,757
Origination of mortgage loans held for sale	(22,878,005)	(24,632,257)
Cash paid to suppliers and employees	(7,494,847)	(6,981,205)
Income taxes paid	(1,650,632)	(1,371,134)
	<u>2,306,108</u>	<u>4,389,803</u>
Cash flows from investing activities		
Proceeds from maturity and call of securities		
Available for sale	15,490,570	12,043,595
Held to maturity	2,624,453	2,034,777
Proceeds from sale of securities		
Available for sale	1,212,716	1,511,837
Held to maturity	348,629	319,800
Purchase of securities		
Available for sale	(11,293,145)	(10,886,475)
Held to maturity	(2,013,526)	(1,046,305)
Loans made to customers, net of principal collected	(27,787,214)	(13,795,906)
(Purchase) redemption of stock in FHLB of Atlanta	61,500	(63,800)
Other real estate owned proceeds	690,445	16,498
Purchase of bank owned life insurance	-	(1,018,000)
Proceeds from the sale of land	-	199,400
Purchases of premises, equipment and software	(335,334)	(1,917,197)
	<u>(21,000,906)</u>	<u>(12,601,776)</u>
Cash flows from financing activities		
Net increase (decrease) in		
Noninterest-bearing deposits	7,072,293	2,957,362
Interest-bearing deposits	9,429,324	2,327,509
Securities sold under repurchase agreements	1,617,034	3,056,533
Federal Home Loan Bank of Atlanta advances	1,000,000	3,000,000
Dividends paid, net of reinvestments	(457,082)	(417,502)
Common stock repurchased	(118,347)	-
	<u>18,543,222</u>	<u>10,923,902</u>
Net increase (decrease) in cash and cash equivalents	(151,576)	2,711,929
Cash and cash equivalents at beginning of period	<u>14,314,474</u>	<u>11,602,545</u>
Cash and cash equivalents at end of period	<u>\$ 14,162,898</u>	<u>\$ 14,314,474</u>

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

Farmers and Merchants Bank and Subsidiary

Consolidated Statements of Cash Flows

Years Ended December 31,	2012	2011
Reconciliation of net income to net cash provided by operating activities		
Net income	\$ 3,157,991	\$ 2,266,511
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	310,724	259,956
Provision for loan losses	280,000	1,575,000
Net gain on disposal of investment securities	(72,687)	(82,098)
Write down of investment security	-	14,000
Write down of other real estate owned	65,000	-
Net gain on sale of other real estate owned	(4,842)	-
Net gain on sale of land	-	(188,353)
Net loss on disposal of equipment	2,343	4,277
Decrease (increase) in mortgage loans held for sale	(1,670,400)	579,500
Deferred income taxes	(45,819)	37,443
Amortization of premiums and accretion of discounts, net	171,445	43,305
Increase (decrease) in		
Deferred loan fees	76,656	11,569
Accrued interest payable	(37,743)	(28,900)
Other liabilities	220,266	62,842
Decrease (increase) in		
Accrued interest receivable	(43,202)	(20,560)
Bank owned life insurance cash surrender value	(141,325)	(176,483)
Other assets	37,701	31,794
	<u>\$ 2,306,108</u>	<u>\$ 4,389,803</u>

Noncash transactions for the transfer of loans to other real estate owned totaled \$1,038,702 and \$0 in the years ended December 31, 2012 and 2011, respectively.

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

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

The accounting and reporting policies reflected in the financial statements conform to accounting principles generally accepted in the United States and to general practices within the banking industry. Management makes estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosures of commitments and contingent liabilities at the balance sheet date, and revenues and expenses during the year. These estimates and assumptions may affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Principles of consolidation

The consolidated financial statements include the accounts of Farmers and Merchants Bank ("the Bank") and its subsidiary, Reliable Community Financial Services, Inc. Intercompany balances and transactions have been eliminated.

Business

The Bank provides banking services to individuals and businesses located in Baltimore County, Maryland, Carroll County, Maryland and surrounding areas of northern Maryland.

Reliable Community Financial Services, Inc. can provide a wide range of investment and insurance products to its customers.

Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform to the current year presentation. These reclassifications had no effect on net income.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, money market funds, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Comprehensive income

Comprehensive income includes net income and the unrealized gains or losses on investment securities available for sale, net of income taxes.

Investment securities

As securities are purchased, management determines if the securities should be classified as held to maturity or available for sale. Securities which management has the intent and ability to hold to maturity are recorded at amortized cost, which is cost adjusted for amortization of premiums and accretion of discounts to maturity. Securities held to meet liquidity needs or which may be sold before maturity are classified as available for sale and carried at fair value with unrealized gains and losses included in stockholders' equity on an after-tax basis. Gains and losses on disposal are determined using the specific-identification method. The Bank amortizes premiums and accretes discounts using the interest method.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

Loans and allowance for loan losses

Loans are stated at the current amount of unpaid principal, adjusted for deferred origination costs, deferred origination fees, and the allowance for loan losses. Interest on loans is accrued based on the principal amounts outstanding. Origination fees and costs are amortized to income over the terms of loans. The accrual of interest is discontinued when any portion of the principal or interest is 90 days past due and collateral is insufficient to discharge the debt in full.

Loans are considered impaired when, based on current information, management considers it unlikely that the collection of principal and interest payments will be made according to contractual terms. Generally, loans are not reviewed for impairment until the accrual of interest has been discontinued or are included on the watch list. If collection of principal is evaluated as a loss, all payments are applied to principal.

The allowance for loan losses represents an amount which, in management's judgment, will be adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. The Bank's allowance for loan losses consists of three elements: (i) specific valuation allowances determined based on probable losses on specific loans; (ii) historical valuation allowances determined based on historical loan loss experience for similar loans with similar characteristics; and (iii) adjustments to the historical valuation allowances based on general economic conditions and other qualitative risk factors both internal and external to the Bank.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Management maintains a watch list of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; (iii) the economic environment; and (iv) for commercial borrowers, the industry in which the borrower operates. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans. The Bank calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool over the prior eight quarters. The historical loss ratios are updated quarterly based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool.

Adjustments to the historical valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Bank. In general, such adjustments are determined by evaluating, among other things: (i) the impact of economic conditions on the portfolio; (ii) changes in asset quality, including delinquency trends; (iii) the impact of changing interest rates on portfolio risk; (iv) changes in legislative and regulatory policy; (v) the composition and concentrations of credit; and (vi) the effectiveness of the internal loan review function. Management evaluates these qualitative factors on a quarterly basis. Each factor could result in an adjustment that is positive, negative, or no impact.

Loan losses are charged to the allowance when management believes that collection is unlikely. Collections of loans previously charged off are added to the allowance at the time of recovery.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

Loans held for sale

Loans held for sale are carried at the lower of aggregate cost or market value based on the current fair market value of each outstanding loan. Sales of loans are recorded when the proceeds are received, with any gain or loss recorded in mortgage banking income.

Premises and equipment

Premises and equipment are recorded at cost less accumulated depreciation and amortization. Depreciation on buildings and equipment is computed over the estimated useful lives of the assets using the straight-line method. Leasehold improvements are amortized using the straight-line method over the term of the lease or the estimated useful lives of the asset, whichever is shorter.

Other real estate owned

Real estate acquired through foreclosure or by deed in lieu of foreclosure is recorded at the lower of cost or fair market value less estimated costs to sell on the date acquired. Losses incurred at the time of acquisition of the property are charged to the allowance for loan losses. Subsequent reductions in the estimated value of the property are included in other noninterest expense.

Income taxes

The provision for income taxes includes income taxes payable for the current year and deferred income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement bases and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

Per share data

Earnings per share are determined by dividing net income by the weighted average number of shares of common stock outstanding, giving retroactive effect to any stock dividends. Weighted average shares were 785,142 and 777,434 for 2012 and 2011, respectively. There are no potentially dilutive shares outstanding.

Subsequent events

The Bank has evaluated subsequent events for potential recognition and/or disclosure through February 28, 2013, the date the consolidated financial statements were available to be issued. Note 17 - Litigation discloses the lone subsequent event.

2. Cash and Equivalents

The Bank normally carries balances with other banks that exceed the federally insured limit. Average balances carried in excess of the limit during 2012 and 2011 were \$601,889 and \$1,174,949, respectively. The Bank sold federal funds to other banks, excluding the Federal Home Loan Bank ("FHLB") of Atlanta, on an unsecured basis that averaged \$601,889 and \$601,656 for 2012 and 2011, respectively.

Banks are required to carry noninterest-bearing cash reserves of specified percentages of deposit balances. The Bank's normal balances of cash on hand and on deposit with other banks are sufficient to satisfy the reserve requirements.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

3. Investment Securities

Investment securities are summarized as follows:

December 31, 2012	Amortized cost	Unrealized gains	Unrealized losses	Fair value
<i>Available for sale</i>				
U. S. government agency	\$ 1,000,000	\$ 626	\$ -	\$ 1,000,626
State and municipal	<u>2,486,178</u>	<u>200,999</u>	<u>-</u>	<u>2,687,177</u>
	3,486,178	201,625	-	3,687,803
Mortgage-backed securities	14,794,907	180,706	68,290	14,907,323
Equity security	<u>6,000</u>	<u>-</u>	<u>-</u>	<u>6,000</u>
	<u>\$ 18,287,085</u>	<u>\$ 382,331</u>	<u>\$ 68,290</u>	<u>\$18,601,126</u>
<i>Held to maturity</i>				
U. S. government agency	\$ -	\$ -	\$ -	\$ -
State and municipal	<u>9,244,178</u>	<u>527,857</u>	<u>13,113</u>	<u>9,758,922</u>
	9,244,178	527,857	13,113	9,758,922
Mortgage-backed securities	<u>1,292,824</u>	<u>282,158</u>	<u>-</u>	<u>1,574,982</u>
	<u>\$ 10,537,002</u>	<u>\$ 810,015</u>	<u>\$ 13,113</u>	<u>\$11,333,904</u>
December 31, 2011				
<i>Available for sale</i>				
U. S. government agency	\$ 1,000,000	\$ 2,151	\$ -	\$ 1,002,151
State and municipal	<u>2,489,003</u>	<u>185,333</u>	<u>-</u>	<u>2,674,336</u>
	3,489,003	187,484	-	3,676,487
Mortgage-backed securities	20,472,974	378,443	76,510	20,774,907
Equity security	<u>6,000</u>	<u>-</u>	<u>-</u>	<u>6,000</u>
	<u>\$ 23,967,977</u>	<u>\$ 565,927</u>	<u>\$ 76,510</u>	<u>\$ 24,457,394</u>
<i>Held to maturity</i>				
U. S. government agency	\$ 130,128	\$ 4,269	\$ -	\$ 134,397
State and municipal	<u>8,385,857</u>	<u>387,820</u>	<u>-</u>	<u>8,773,677</u>
	8,515,985	392,089	-	8,908,074
Mortgage-backed securities	<u>2,808,580</u>	<u>562,072</u>	<u>-</u>	<u>3,370,652</u>
	<u>\$ 11,324,565</u>	<u>\$ 954,161</u>	<u>\$ -</u>	<u>\$ 12,278,726</u>

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

3. Investment Securities (Continued)

Contractual maturities, shown below, will differ from actual maturities because borrowers and issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

December 31, 2012	Available for Sale		Held to Maturity	
	Amortized cost	Fair value	Amortized cost	Fair value
Within one year	\$ -	\$ -	\$ -	\$ -
Over one to five years	-	-	-	-
Over five to ten years	-	-	2,138,477	2,232,082
Over ten years	<u>3,486,178</u>	<u>3,687,803</u>	<u>7,105,701</u>	<u>7,526,840</u>
	3,486,178	3,687,803	9,244,178	9,758,922
Mortgage-backed securities, due in monthly installments	14,794,907	14,907,323	1,292,824	1,574,982
Equity security	<u>6,000</u>	<u>6,000</u>	-	-
	<u>\$ 18,287,085</u>	<u>\$ 18,601,126</u>	<u>\$ 10,537,002</u>	<u>\$ 11,333,904</u>
December 31, 2011				
Within one year	\$ -	\$ -	\$ 130,128	\$ 134,397
Over one to five years	-	-	1,104,627	1,118,785
Over five to ten years	-	-	388,408	396,560
Over ten years	<u>3,489,003</u>	<u>3,676,487</u>	<u>6,892,822</u>	<u>7,258,332</u>
	3,489,003	3,676,487	8,515,985	8,908,074
Mortgage-backed securities, due in monthly installments	20,472,974	20,774,907	2,808,580	3,370,652
Equity security	<u>6,000</u>	<u>6,000</u>	-	-
	<u>\$ 23,967,977</u>	<u>\$ 24,457,394</u>	<u>\$ 11,324,565</u>	<u>\$ 12,278,726</u>

The equity security of \$6,000 represents an investment in stock issued by a Maryland bank that provides services for other banks in Maryland and surrounding states. It does not pay dividends and is not actively traded.

Securities with a carrying value of \$21,226,790 and \$21,674,549 as of December 31, 2012 and 2011, respectively, were pledged as collateral for securities sold under repurchase agreements.

In 2012, the Bank realized gross gains of \$94,820 and gross losses of \$22,133 on the sale of 9 securities with gross proceeds of \$1,561,345

In 2011, the Bank realized gross gains of \$88,860 and gross losses of \$6,762 on the sale of 30 securities with gross proceeds of \$1,831,637.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

3. Investment Securities (Continued)

The following table sets forth the Bank's gross unrealized losses on a continuous basis for investment securities, by category and length of time at December 31, 2012.

Description of investments	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
U.S. government agency	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
State and municipal	-	-	544,190	13,113	544,190	13,113
Mortgage-backed securities	<u>1,844,172</u>	<u>42,538</u>	<u>5,125,280</u>	<u>25,752</u>	<u>6,969,452</u>	<u>68,290</u>
Total	<u>\$ 1,844,172</u>	<u>\$ 42,538</u>	<u>\$ 5,669,470</u>	<u>\$ 38,865</u>	<u>\$ 7,513,642</u>	<u>\$ 81,403</u>

Management has the ability and intent to hold securities classified as held to maturity until they mature, at which time the Bank should receive full value for the securities. As of December 31, 2012, management did not have the intent to sell any of the securities classified as available for sale before a recovery of cost. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased as well as other market conditions for each particular security based upon the structure and remaining principal balance. The fair values of the investment securities are expected to recover as the securities approach their maturity dates or repricing dates or if market yields for such investments decline. Based on these factors, as of December 31, 2012, management believes the unrealized losses detailed in the table above are temporary and, accordingly, none of these unrealized losses have been recognized in the Bank's consolidated statement of income.

4. Related Party Transactions

Certain executive officers and directors of the Bank, including members of their immediate families and companies in which they are significant owners (more than 10%), were indebted to the Bank. The loans were made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with borrowers who are not related to the Bank. During the years ended December 31, 2012 and 2011, the activity of these loans was as follows:

	2012	2011
Balance, beginning of year	\$ 7,957,083	\$ 9,367,215
Additions	7,979,495	3,049,400
Amounts collected	(6,013,219)	(4,459,532)
Change in related parties	<u>(70,353)</u>	<u>-</u>
Balance, end of year	<u>\$ 9,853,006</u>	<u>\$ 7,957,083</u>

Unused lines of credit to related parties totaled \$3,752,821 and \$2,839,548, at December 31, 2012 and 2011, respectively. Letters of credit were issued to directors totaling \$45,319 and \$64,589 at December 31, 2012 and 2011, respectively.

Deposits at the Bank from directors, officers and related parties totaled \$9,325,256 and \$8,228,152 at December 31, 2012 and 2011, respectively.

Payments to a company controlled by a director totaled \$2,600 in 2012 and \$62,754 in 2011. Payments to a retailer affiliated with a director totaled \$259 in 2012 and \$318 in 2011. Another director was paid \$3,000 in 2012 and 2011 for his oversight of branch office repairs and maintenance.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

5. Loans

Major categories of loans at December 31, 2012 and 2011 are as follows:

	2012	2011
Commercial	\$ 12,893,153	\$ 10,908,301
Commercial real estate		
Construction/Land development	16,893,113	18,906,285
Other	149,575,825	121,391,973
Consumer	878,889	532,255
Residential real estate	<u>36,330,552</u>	<u>38,201,754</u>
	216,571,532	189,940,568
Less: Allowance for loan losses	2,680,963	2,518,511
Deferred origination fees net of costs	<u>413,992</u>	<u>337,336</u>
	<u>\$ 213,476,577</u>	<u>\$ 187,084,721</u>

The maturity and rate repricing distribution of the loan portfolio as of December 31, 2012 and 2011, is as follows:

	2012	2011
Variable rate, immediately	\$ 19,961,692	\$ 17,280,774
Due within one year	45,140,185	28,908,009
Due over one to five years	134,747,323	131,436,300
Due over five years	<u>16,722,332</u>	<u>12,315,485</u>
	<u>\$ 216,571,532</u>	<u>\$ 189,940,568</u>

Year-end nonaccrual loans, segregated by class of loans, were as follows:

	2012	2011
Commercial	\$ -	\$ 22,400
Commercial real estate		
Construction/Land development	979,875	426,907
Other	437,071	1,435,896
Residential real estate	<u>61,121</u>	<u>1,682,323</u>
Total	<u>\$ 1,478,067</u>	<u>\$ 3,567,526</u>

At December 31, 2012, the Bank had 4 nonaccrual loans to 4 borrowers totaling \$1,478,067. The loans are secured by real estate and business assets, and are personally guaranteed. Gross interest income of \$97,878 would have been recorded in 2012 if these nonaccrual loans had been current and performing in accordance with the original terms. The Bank has allocated \$6,366 of its allowance for loan losses for these nonaccrual loans. The balance of nonaccrual loans is net of charge-offs of \$276,604 at December 31, 2012.

At December 31, 2011, the Bank had 13 nonaccrual loans to 10 borrowers totaling \$3,567,526. The loans are secured by real estate and business assets, and are personally guaranteed. Gross interest income of \$270,678 would have been recorded in 2011 if these nonaccrual loans had been current and performing in accordance with the original terms. The Bank has allocated \$128,864 of its allowance for loan losses for these nonaccrual loans. The balance of nonaccrual loans is net of charge-offs of \$1,578,887 at December 31, 2011.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

5. Loans (Continued)

An age analysis of past due loans, segregated by class of loans, as of year-end, is as follows:

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or more Past Due	Total Past Due	Current	Total Loans	Past Due Over 89 Days and Accruing
2012							
Commercial	\$ 180,314	\$ -	\$ -	\$ 180,314	\$ 12,712,839	\$ 12,893,153	\$ -
Commercial real estate							
Constr./Land dev.	1,653,931	-	979,875	2,633,806	14,259,307	16,893,113	-
Other	2,448,384	-	437,071	2,885,455	146,690,370	149,575,825	-
Consumer	-	-	-	-	878,889	878,889	-
Residential real estate	3,469	-	61,121	64,590	36,265,962	36,330,552	-
Total	\$ 4,286,098	\$ -	\$ 1,478,067	\$ 5,764,165	\$ 210,807,367	\$ 216,571,532	\$ -
2011							
Commercial	\$ -	\$ -	\$ 22,400	\$ 22,400	\$ 10,885,901	\$ 10,908,301	\$ -
Commercial real estate							
Constr./Land dev.	256,466	-	426,907	683,373	18,222,912	18,906,285	-
Other	-	-	1,435,896	1,435,896	119,956,077	121,391,973	-
Consumer	-	-	-	-	532,255	532,255	-
Residential real estate	27,765	-	1,682,323	1,710,088	36,491,666	38,201,754	-
Total	\$ 284,231	\$ -	\$ 3,567,526	\$ 3,851,757	\$ 186,088,811	\$ 189,940,568	\$ -

Year-end impaired loans, segregated by class of loans, are set forth in the following table:

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Recognized
2012							
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 11,200	\$ -
Commercial real estate							
Construction/Land development	2,322,789	2,227,676	-	2,227,676	-	1,925,809	52,172
Other	437,071	-	437,071	437,071	6,366	936,483	-
Residential real estate	242,612	61,121	-	61,121	-	893,985	-
	\$ 3,002,472	\$ 2,288,797	\$ 437,071	\$ 2,725,868	\$ 6,366	\$ 3,767,477	\$ 52,172
2011							
Commercial	\$ 50,254	\$ 7,500	\$ 14,901	\$ 22,401	\$ 14,901	\$ 11,200	
Commercial real estate							
Construction/Land development	1,773,278	426,907	1,197,034	1,623,941	36,828	811,971	
Other	2,384,710	693,000	742,895	1,435,895	111,500	1,659,553	
Residential real estate	2,179,731	910,720	816,129	1,726,849	9,165	1,480,819	
	\$ 6,387,973	\$ 2,038,127	\$ 2,770,959	\$ 4,809,086	\$ 172,394	\$ 3,963,543	

At December 31, 2012, the Bank had no loans classified as a troubled debt restructuring (TDR). At December 31, 2011, the Bank had one commercial real estate loan classified as a TDR. The loan is included in impaired loans above with a recorded investment amount of \$693,000. A foreclosure sale was held in 2012 and the property was subsequently sold to a third party.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

5. Loans (Continued)

The Bank grades every loan as an assessment of risk. The factors used to determine the grade are the payment history of the loan and the borrower, the value of the collateral and net worth of the guarantor, and cash flow projections of the borrower. Excellent, Above Average, and Average grades are assigned to loans with limited or no delinquent payments and more than sufficient collateral and/or cash flow. Loans with Below Average and Especially Mentioned grades typically have a higher frequency of delinquent payments and/or collateral/cash flow that may not be sufficient to support the loan. Loans with Substandard and Doubtful grades have such a high frequency of delinquent payments and/or the collateral/cash flow is insufficient to support the loan that the loan is included on the Bank's watch list.

Loans by credit grade, segregated by loan type, at year-end, are as follows:

	Commercial	Commercial real estate		Residential Real Estate	Consumer	Total
		Construction/ Land Dev.	Other			
2012						
Excellent	\$ 2,175,593	\$ -	\$ -	\$ 443,830	\$ 80,444	\$ 2,699,867
Above Average	448,073	1,411,075	13,115,766	5,985,228	175,438	21,135,580
Average	9,245,642	3,845,272	114,835,331	26,288,331	522,618	154,737,194
Below Average	606,815	7,369,947	2,146,003	2,162,046	11,242	12,296,053
Especially Mentioned	181,529	1,506,368	15,048,310	1,389,996	-	18,126,203
Substandard	235,501	2,760,451	4,430,415	61,121	53,680	7,541,168
Doubtful	-	-	-	-	35,467	35,467
	<u>\$ 12,893,153</u>	<u>\$ 16,893,113</u>	<u>\$ 149,575,825</u>	<u>\$ 36,330,552</u>	<u>\$ 878,889</u>	<u>\$ 216,571,532</u>

	Commercial	Commercial real estate		Residential Real Estate	Consumer	Total
		Construction/ Land Dev.	Other			
2011						
Excellent	\$ 74,576	\$ -	\$ -	\$ 403,693	\$ 28,579	\$ 506,848
Above Average	2,159,904	2,784,437	15,999,168	6,159,001	196,514	27,299,024
Average	7,345,303	6,522,389	85,496,692	25,532,951	175,033	125,072,368
Below Average	752,647	4,132,297	2,584,515	3,632,703	25,288	11,127,450
Especially Mentioned	251,505	3,304,425	12,329,237	2,182,847	-	18,068,014
Substandard	309,465	2,162,737	4,982,361	290,559	59,770	7,804,892
Doubtful	14,901	-	-	-	47,071	61,972
	<u>\$ 10,908,301</u>	<u>\$ 18,906,285</u>	<u>\$ 121,391,973</u>	<u>\$ 38,201,754</u>	<u>\$ 532,255</u>	<u>\$ 189,940,568</u>

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

5. Loans (Continued)

The following table details activity in the allowance for loan losses by portfolio for the years ended December 31, 2012 and 2011. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
2012						
Beginning balance	\$ 92,871	\$ 1,914,855	\$ 478,240	\$ 8,800	\$ 23,745	\$ 2,518,511
Provision for loan losses	27,431	376,518	(145,218)	811	20,458	280,000
Charge-offs	(12,833)	(270,437)	(5,641)	-	-	(288,911)
Recoveries	1,200	149,337	19,626	1,200	-	171,363
Net charge-offs	(11,633)	(121,100)	13,985	1,200	-	(117,548)
Ending balance	<u>\$ 108,669</u>	<u>\$ 2,170,273</u>	<u>\$ 347,007</u>	<u>\$ 10,811</u>	<u>\$ 44,203</u>	<u>\$ 2,680,963</u>
Year-end amount allocated to						
Loans individually evaluated for impairment	\$ -	\$ 6,366	\$ -	\$ -	\$ -	\$ 6,366
Loans collectively evaluated for impairment	108,669	2,163,907	347,007	10,811	44,203	2,674,597
Ending balance	<u>\$ 108,669</u>	<u>\$ 2,170,273</u>	<u>\$ 347,007</u>	<u>\$ 10,811</u>	<u>\$ 44,203</u>	<u>\$ 2,680,963</u>
2011						
Beginning balance	\$ 98,387	\$ 1,868,629	\$ 303,603	\$ 18,039	\$ 147,852	\$ 2,436,510
Provision for loan losses	22,337	1,141,928	546,081	(11,239)	(124,107)	1,575,000
Charge-offs	(27,853)	(1,098,152)	(384,555)	-	-	(1,510,560)
Recoveries	-	2,450	13,111	2,000	-	17,561
Net charge-offs	(27,853)	(1,095,702)	(371,444)	2,000	-	(1,492,999)
Ending balance	<u>\$ 92,871</u>	<u>\$ 1,914,855</u>	<u>\$ 478,240</u>	<u>\$ 8,800</u>	<u>\$ 23,745</u>	<u>\$ 2,518,511</u>
Year-end amount allocated to						
Loans individually evaluated for impairment	\$ 14,901	\$ 148,328	\$ 9,165	\$ -	\$ -	\$ 172,394
Loans collectively evaluated for impairment	77,970	1,766,527	469,075	8,800	23,745	2,346,117
Ending balance	<u>\$ 92,871</u>	<u>\$ 1,914,855</u>	<u>\$ 478,240</u>	<u>\$ 8,800</u>	<u>\$ 23,745</u>	<u>\$ 2,518,511</u>

Loans were evaluated for impairment as follows:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Total
December 31, 2012					
Loans individually evaluated for impairment	\$ -	\$ 2,664,747	\$ 61,121	\$ -	\$ 2,725,868
Loans collectively evaluated for impairment	12,893,153	163,804,191	36,269,431	878,889	213,845,664
	<u>\$ 12,893,153</u>	<u>\$ 166,468,938</u>	<u>\$ 36,330,552</u>	<u>\$ 878,889</u>	<u>\$ 216,571,532</u>
December 31, 2011					
Loans individually evaluated for impairment	\$ 22,401	\$ 3,059,836	\$ 1,726,849	\$ -	\$ 4,809,086
Loans collectively evaluated for impairment	10,885,900	137,238,422	36,474,905	532,255	185,131,482
	<u>\$ 10,908,301</u>	<u>\$ 140,298,258</u>	<u>\$ 38,201,754</u>	<u>\$ 532,255</u>	<u>\$ 189,940,568</u>

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

5. Loans (Continued)

Loans with a balance of approximately \$49.2 million were pledged as collateral to the FHLB of Atlanta as of December 31, 2012. Loans with a balance of approximately \$38.7 million were pledged as collateral to the Federal Reserve Bank of Richmond as of December 31, 2012. At December 31, 2012 and 2011, the Bank serviced participation loans for others totaling \$13.7 million and \$12.1 million, respectively.

The Bank makes loans to customers located primarily in Baltimore County and Carroll County, Maryland and in surrounding areas of northern Maryland. Although the loan portfolio is diversified, many loans are secured by real estate and its performance will be influenced by the economy of the region, including local real estate markets.

6. Premises and Equipment

A summary of premises and equipment is as follows:

	Useful lives	2012	2011
Land and improvements	-	\$1,952,998	\$ 1,952,998
Buildings and improvements	15-39 years	5,460,212	5,430,514
Furniture and equipment	3-10 years	2,811,942	2,811,319
		10,225,152	10,194,831
Accumulated depreciation and amortization		4,316,149	4,318,188
		<u>\$5,909,003</u>	<u>\$ 5,876,643</u>
Depreciation and amortization expense		<u>\$ 300,632</u>	<u>\$ 254,343</u>

Software with a net book value of \$54,126 and \$464 as of December 31, 2012 and 2011, respectively, is included in other assets. Amortization expense of \$10,092 and \$5,613 was recorded in 2012 and 2011, respectively.

7. Lease Commitments

The Bank has an operating lease for the land on which the Hampstead branch is located. The initial term of the lease expired on September 30, 2009 and the lease was renewed for a five year term with an expiration date of September 30, 2014. The lease has options to renew for seven additional consecutive five-year terms. Effective in July 2012, the Bank entered into an operating license for certain facilities where the Greenmount branch is located. The initial term of the lease is for five years with options to renew for two additional consecutive five-year terms. The Bank has an operating lease for its Atrium branch facility with a term of one year and nine one-year renewals. The lease was renewed in 2012 for another year.

Future minimum payments under the agreements are as follows:

Year	Amount
2013	\$ 85,205
2014	76,665
2015	44,865
2016	46,659
2017	27,843
	<u>\$281,237</u>

Rent expense was \$78,814 and \$88,881 in 2012 and 2011, respectively.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

8. Credit Commitments

Outstanding loan commitments, unused lines of credit, and letters of credit as of December 31, are as follows:

	2012	2011
Loan commitments		
Construction and land development	\$ 295,000	\$ 1,184,848
Commercial	500,000	-
Commercial real estate	12,754,000	13,818,298
Residential	2,180,801	1,648,500
	<u>\$15,729,801</u>	<u>\$16,651,646</u>
Unused lines of credit		
Home-equity lines	\$ 3,297,925	\$ 3,739,249
Commercial lines	18,620,563	22,948,602
	<u>\$21,918,488</u>	<u>\$26,687,851</u>
Letters of credit	<u>\$ 2,156,765</u>	<u>\$ 1,838,679</u>

Loan commitments and lines of credit are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have interest rates at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

The maximum exposure to credit loss in the event of nonperformance by the customer is the contractual amount of the commitment. Loan commitments, lines of credit and letters of credit are made on the same terms, including collateral, as outstanding loans. Management is not aware of any accounting loss that is likely to be incurred as a result of funding its credit commitments.

9. Retirement Plans

The Bank has a profit sharing plan qualifying under Section 401(k) of the Internal Revenue Code. All employees age 21 or more with six months of service and 1,000 annual employment hours are eligible for participation in the plan. The Bank matches employee contributions up to 4% of total compensation and may make additional discretionary contributions. Employee and employer contributions are 100% vested when made. The Bank's contributions to this plan, included in expenses, were \$127,001 and \$116,292 for 2012 and 2011, respectively.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

9. Retirement Plan (Continued)

The Bank has entered into agreements with 12 employees to provide certain life insurance benefits payable in connection with policies of life insurance on those employees that are owned by the Bank. Each of the agreements provides for the amount of death insurance benefits to be paid to beneficiaries of the insured. For this plan, the Bank expensed \$4,412 and \$4,573 in 2012 and 2011, respectively.

In 2010, the Bank adopted a supplemental executive retirement plan for two of its executives. The plan provides cash compensation to the executive officers under certain circumstances, including a separation of service. The benefits vest over the period from adoption to a certain age for each executive. The Bank recorded expenses, including interest, of \$152,769 and \$139,868 in 2012 and 2011, respectively, for these plans.

10. Interest-Bearing Deposits

Major classifications of interest-bearing deposits are as follows:

	2012	2011
NOW	\$ 23,510,475	\$ 22,331,843
Money market	31,584,420	26,365,055
Savings	29,725,209	25,980,245
Certificates of deposit, \$100,000 or more	44,023,041	43,483,596
Other time deposits	52,039,748	53,292,830
	<u>\$ 180,882,893</u>	<u>\$ 171,453,569</u>

As of December 31, 2012, certificates of deposit mature as follows:

<u>Year</u>	<u>Amount</u>
2013	\$ 63,143,941
2014	16,150,164
2015	11,401,201
2016	2,127,512
2017	3,239,971
	<u>\$ 96,062,789</u>

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

11. Borrowed Funds

Borrowed funds consist of securities sold under repurchase agreements, which essentially represent overnight or term borrowings from customers, advances from the FHLB of Atlanta, the Federal Reserve Bank of Richmond (the "FRB"), and overnight borrowings from a commercial bank. The government agency securities that are the collateral for these agreements are owned by the Bank and maintained in the custody of an unaffiliated agent designated by the Bank. Additional information is as follows:

	2012	2011
Amounts outstanding at year-end:		
Securities sold under repurchase agreements	<u>\$ 19,805,224</u>	<u>\$ 18,188,190</u>
Federal Home Loan Bank advances	<u>\$ 4,000,000</u>	<u>\$ 3,000,000</u>
Federal Home Loan Bank advances mature in:		
2013	\$ 2,000,000	
2014	\$ 2,000,000	
Weighted average rate paid at December 31:		
Securities sold under repurchase agreements	0.67%	0.89%
Federal Home Loan Bank advances	0.35%	0.30%
Maximum month-end amount outstanding:		
Securities sold under repurchase agreements	\$ 20,518,431	\$ 19,384,434
Federal Home Loan Bank advance	7,000,000	7,500,000
Average amount outstanding:		
Securities sold under repurchase agreements	\$ 17,970,639	\$ 15,472,657
Federal Home Loan Bank advance	4,095,628	4,060,274
Borrowings from commercial banks	8,197	1,373
Average rate paid during the year:		
Securities sold under repurchase agreements	0.74%	0.95%
Federal Home Loan Bank advance	0.20%	0.25%
Borrowings from commercial banks	0.57%	0.51%
Investment securities underlying the securities agreements at year end:		
Carrying value	\$ 21,226,790	\$ 21,674,549
Estimated fair value	21,841,766	22,247,600
Loans pledged to the Federal Home Loan Bank at year-end:		
Carrying value	\$ 49,186,265	\$ 47,076,077
Loans pledged to the Federal Reserve Bank at year-end:		
Carrying value	\$ 38,656,669	\$ 40,008,132

The Bank is approved to borrow up to 75% of eligible pledged single family residential loans and 50% of eligible pledged commercial loans, or approximately \$32.2 million, under a secured line of credit with the FHLB of Atlanta. In addition, the Bank has a facility with the FRB whereby the Bank can borrow up to \$33.1 million. The Bank also has available an unsecured federal funds line of credit of \$2 million and a secured federal funds line of credit of \$9 million from a commercial bank.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

12. Other Noninterest Expenses

Other noninterest expenses include the following:

	2012	2011
Professional services	\$ 258,289	\$ 261,872
Automated teller machine and debit card expenses	245,715	369,411
Other real estate owned	241,718	14,951
Advertising	203,908	187,753
Postage, delivery, and armored carrier	181,005	159,770
Directors fees	171,360	174,469
Stationery, printing, and supplies	163,545	163,331
Telephone	136,660	123,222
Correspondent bank services	54,914	53,994
Travel and conferences	54,000	43,200
Internet banking fees	47,570	67,665
Foreclosure related expenses	41,487	43,041
Liability insurance	38,385	36,809
Education and training	35,835	15,310
Maryland state assessment	32,390	31,438
Dues and subscriptions	30,051	33,239
Remote deposit expenses	25,041	15,731
Contributions	24,934	20,860
Credit reports	24,864	19,533
Other	79,171	88,636
	<u>\$2,090,842</u>	<u>\$1,924,235</u>

13. Income Taxes

The components of income tax expense are as follows:

	2012	2011
Current		
Federal	\$ 1,403,430	\$ 862,049
State	<u>402,966</u>	<u>277,418</u>
	1,806,396	1,139,467
Deferred	<u>(45,819)</u>	<u>37,443</u>
	<u>\$ 1,760,577</u>	<u>\$1,176,910</u>

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

13. Income Taxes (Continued)

The components of the deferred tax expense are as follows:

	2012	2011
Depreciation	\$ 96,413	\$ 129,650
Provision for loan losses	(49,501)	87,849
Other real estate owned allowance for loss	(93,894)	(5,819)
Write-down of equity securities	-	(5,522)
Nonaccrual interest	63,163	(110,456)
Post-retirement benefits	(62,000)	(58,259)
	<u>\$ (45,819)</u>	<u>\$ 37,443</u>

The components of the net deferred tax asset are as follows:

Deferred tax assets		
Allowance for loan losses	\$ 844,495	\$ 794,994
Other real estate owned loss	258,639	164,745
Write-down of equity securities	5,522	5,522
Nonaccrual interest	66,432	129,595
Post-retirement benefits	175,165	113,165
	<u>1,350,253</u>	<u>1,208,021</u>
Deferred tax liabilities		
Depreciation	305,341	208,928
Unrealized gain on securities available-for-sale	123,873	193,050
	<u>429,214</u>	<u>401,978</u>
Net deferred tax asset	<u>\$ 921,039</u>	<u>\$ 806,043</u>

The differences between the federal income tax rate of 34% and the effective tax rate for the Bank are reconciled as follows:

Statutory federal income tax rate	34.0 %	34.0 %
Increase (decrease) resulting from:		
Federal tax-exempt income	(3.5)	(5.0)
State income taxes, net of federal income tax benefit	5.2	5.0
Nondeductible expenses	0.1	0.2
	<u>35.8 %</u>	<u>34.2 %</u>

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

14. Capital Standards

The Federal Deposit Insurance Corporation has adopted risk-based capital standards for banking organizations. These standards require ratios of capital to assets for minimum capital adequacy and to be classified as well capitalized under prompt corrective action provisions. The following tables set forth the Bank's actual capital ratios as of December 31, 2012 and 2011, as well as the ratios necessary to be classified as adequately capitalized (minimum) and well capitalized.

(Dollars in thousands)	Actual		Minimum Capital Adequacy		To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2012						
Total capital (to risk-weighted assets)	\$ 29,677	13.35%	\$ 17,782	8.00%	\$ 22,228	10.00%
Tier 1 capital (to risk-weighted assets)	26,996	12.14%	8,891	4.00%	13,337	6.00%
Tier 1 capital (to average assets)	26,996	9.92%	10,886	4.00%	13,608	5.00%
December 31, 2011						
Total capital (to risk-weighted assets)	\$ 26,893	13.56%	\$ 15,868	8.00%	\$ 19,835	10.00%
Tier 1 capital (to risk-weighted assets)	24,413	12.31%	7,934	4.00%	11,901	6.00%
Tier 1 capital (to average assets)	24,413	9.62%	10,148	4.00%	12,685	5.00%

Tier 1 capital consists of common stock, surplus, and undivided profits. Total capital includes a limited amount of the allowance for loan losses. In calculating risk-weighted assets, specified risk percentages are applied to each category of asset and off-balance sheet items.

Failure to meet the capital requirements could affect the Bank's ability to pay dividends and accept deposits and may significantly affect the operations of the Bank.

In the most recent regulatory report, the Bank was categorized as well capitalized under the prompt corrective action regulations. Management knows of no events or conditions that are likely to change this classification.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

15. Fair Value

Accounting standards define fair value as the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants. The price in the principal market used to measure the fair value of the asset or liability is not adjusted for transaction costs. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The standards require the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. The standards establish a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

The fair value hierarchy is as follows:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect the Bank's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Bank uses the following methods and significant assumptions to estimate the fair values of the following assets:

- Securities available for sale: The fair values of securities available for sale are determined by obtaining quoted prices from a nationally recognized securities pricing agent. If quoted market prices are not available, fair value is determined using quoted market prices for similar securities. The equity security shown on the Bank's balance sheets is an investment in a closely-held banker's bank.
- Other real estate owned ("OREO"): Nonrecurring fair value adjustments to OREO reflect full or partial write-downs that are based on the OREO's observable market price or current appraised value of the real estate. Because the market for OREO is not active, OREO subjected to nonrecurring fair value adjustments based on the current appraised value of the real estate are classified as Level 3.
- Impaired loans: Nonrecurring fair value adjustments to impaired loans reflect full or partial write-downs and reserves that are based on the impaired loan's observable market price or current appraised value of the collateral. Since the market for impaired loans is not active, such loans subjected to nonrecurring fair value adjustments based on the current appraised value of the collateral are classified as Level 3.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

15. Fair Value (continued)

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2012 and 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Carrying Value:			
	Level 1	Level 2	Level 3	Total
<u>December 31, 2012</u>				
Recurring				
Available for sale securities				
U.S. government agency	\$ -	\$ 1,000,626	\$ -	\$ 1,000,626
State and municipal	-	2,687,177	-	2,687,177
Mortgage-backed securities	-	14,907,323	-	14,907,323
Equity security	-	-	6,000	6,000
	<u>\$ -</u>	<u>\$ 18,595,126</u>	<u>\$ 6,000</u>	<u>\$ 18,601,126</u>
Nonrecurring				
Other real estate owned	\$ -	\$ -	\$ 1,509,640	\$ 1,509,640
Impaired loans	-	-	2,719,502	2,719,502
<u>December 31, 2011</u>				
Recurring				
Available for sale securities				
U.S. government agency	\$ -	\$ 1,002,151	\$ -	\$ 1,002,151
State and municipal	-	2,674,336	-	2,674,336
Mortgage-backed securities	-	20,774,907	-	20,774,907
Equity security	-	-	6,000	6,000
	<u>\$ -</u>	<u>\$ 24,451,394</u>	<u>\$ 6,000</u>	<u>\$ 24,457,394</u>
Nonrecurring				
Other real estate owned	\$ -	\$ -	\$ 1,221,541	\$ 1,221,541
Impaired loans	-	-	4,636,692	4,636,692

Reconciliation of Level 3 Inputs

	Equity Security	Other Real Estate Owned	Impaired Loans
December 31, 2011 balance	\$ 6,000	\$ 1,221,541	\$ 4,636,692
Additions	-	1,038,702	1,145,010
Write-downs	-	(65,000)	-
Charge-offs, net of recoveries	-	-	(118,748)
Loan loss provision	-	-	166,028
Proceeds from sale	-	(690,445)	-
Gain (loss) on sale	-	4,842	-
Principal payments received	-	-	(2,070,778)
Transfer to other real estate owned	-	-	(1,038,702)
December 31, 2012 balance	<u>\$ 6,000</u>	<u>\$ 1,509,640</u>	<u>\$ 2,719,502</u>

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

15. Fair Value (continued)

The estimated fair value of financial instruments that are reported at amortized cost in the Bank's consolidated balance sheets, segregated by the level of the valuation inputs were as follows:

	December 31, 2012		December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Level 1 inputs				
Cash and cash equivalents	\$ 14,162,898	\$ 14,162,898	\$ 14,314,474	\$ 14,314,474
Level 2 inputs				
Securities held to maturity	10,537,002	11,333,904	11,324,565	12,278,726
Loans held for sale	2,256,400	2,299,187	586,000	590,117
Federal Home Loan Bank stock	560,900	560,900	622,400	622,400
Level 3 inputs				
Loans, net	213,476,577	217,957,813	187,084,721	188,785,883
Financial liabilities				
Level 1 inputs				
Noninterest-bearing deposits	\$ 42,894,281	\$ 42,894,281	\$ 35,821,988	\$ 35,821,988
Securities sold under repurchase agreements	19,805,224	19,805,224	18,188,190	18,188,190
Level 3 inputs				
Interest-bearing deposits	180,882,893	181,582,893	171,453,569	172,185,569
Federal Home Loan Bank advances	4,000,000	3,994,000	3,000,000	2,996,000

The fair values of fixed-rate loans are estimated to be the present values of scheduled payments discounted using interest rates currently in effect. The fair values of variable-rate loans, including loans with a demand feature, are estimated to equal the carrying amount. The valuation of a loan is adjusted for probable loan losses.

The fair values of interest-bearing checking, savings, and money market deposit accounts are equal to their carrying amounts. The fair values of fixed-maturity time deposits are estimated based on interest rates currently offered for deposits of similar remaining maturities.

The fair value of credit commitments are considered to be the same as the contractual amounts, and are not included in the table above. These commitments generate fees that approximate those currently charged to originate similar commitments.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

16. Quarterly Results of Operations

	Three Months Ended			
	Unaudited			
2012	December 31	September 30	June 30	March 31
Interest income	\$ 3,352,407	\$ 3,383,496	\$ 3,408,788	\$ 3,190,161
Interest expense	360,372	383,801	388,379	410,575
Net interest income	2,992,035	2,999,695	3,020,409	2,779,586
Provision for loan losses	-	70,000	140,000	70,000
Net income	812,834	867,606	868,980	608,571
Earnings per share - basic and diluted	\$ 1.03	\$ 1.10	\$ 1.11	\$ 0.78
2011				
Interest income	\$ 3,205,253	\$ 3,223,750	\$ 3,140,318	\$ 3,093,000
Interest expense	430,078	453,121	467,880	493,344
Net interest income	2,775,175	2,770,629	2,672,438	2,599,656
Provision for loan losses	575,000	650,000	200,000	150,000
Net income	534,853	380,000	671,598	680,060
Earnings per share - basic and diluted	\$ 0.68	\$ 0.49	\$ 0.87	\$ 0.88

17. Litigation

In February 2013 the Bank received notice of an asserted claim of \$98,189 that stems from a failed development project. The claimant alleges that it provided site services to the developer in reliance on the Bank's loan agreement with the developer. The developer has defaulted and the Bank has discontinued the extension of credit. The Bank intends to vigorously defend the claim.

In the ordinary course of its business, the Bank is periodically party to various other legal actions normally associated with a financial institution. Management does not believe that any of these normal course proceedings are likely to have a material adverse effect on the financial condition or liquidity of the Bank.

Farmers and Merchants Bank

MARKET FOR THE BANK'S COMMON EQUITY AND OTHER RELATED SHAREHOLDER MATTERS

The Bank's Articles of Incorporation authorize the Bank to issue up to 5,000,000 shares of common stock, par value \$10.00 per share (the "Common Stock"). As of February 28, 2013 there were 793,791 shares of Common Stock issued and outstanding held by approximately 593 stockholders of record.

The shares of Common Stock are traded in the over-the-counter market through the NASDAQ Stock Market's Over-the-Counter Bulletin Board ("OTCBB") under the symbol "FMFG.OB". The table below sets forth, to the best of the Bank's knowledge, the per share high and low bid prices for each quarterly period during the past two years as reported through the OTCBB and the cash dividends declared by the Bank during those periods. These prices reflect inter-dealer prices, do not include retail mark-up, mark-down or commission, and may not represent actual transactions.

	<u>High</u>	<u>Low</u>	<u>Dividend Per Share</u>
<u>2012</u>			
Quarter ended December 31	\$28.75	\$25.05	\$0.50
Quarter ended September 30	26.00	22.78	0.00
Quarter ended June 30	25.00	23.01	0.48
Quarter ended March 31	25.00	21.50	0.00
<u>2011</u>			
Quarter ended December 31	\$26.35	\$20.25	\$0.46
Quarter ended September 30	28.00	23.60	0.00
Quarter ended June 30	28.50	25.00	0.45
Quarter ended March 31	26.99	24.25	0.00

As a depository institution whose deposits are insured by the FDIC, the Bank may not pay dividends or distribute any of its capital assets while it remains in default on any assessment due the FDIC. The Bank currently is not in default on any of its obligations to the FDIC. The Bank's ability to pay dividends is also limited by certain restrictions imposed on Maryland banks and corporations generally. Under Maryland law, the Bank may declare cash dividends from undivided profits or, with the prior approval of the Maryland Commissioner of Financial Regulation, out of surplus in excess of 100% of its required capital stock, and (in either case) after providing for due or accrued expenses, losses, interest and taxes. Notwithstanding the above, dividends are at the discretion of the Board of Directors, and there can be no assurance that the Bank will declare or pay cash dividends at any time.

The Bank has adopted a Dividend Reinvestment Plan that permits stockholders to reinvest cash dividends in shares of Common Stock. Stockholders who elect to reinvest their dividends in Common Stock will receive the number of shares equal to the amount of the dividend divided by the applicable purchase price per share.

Farmers and Merchants Bank

Stockholder Information

Corporate Headquarters

15226 Hanover Pike
Upperco, MD 21155
410-833-6600

Annual Meeting

The annual meeting of stockholders will be held
April 23, 2013 at 3:00 p.m.
at the Piney Branch Golf and Country Club,
located at 5301 Trenton Mill Road, Upperco, Maryland 21155.
All shareholders are invited to attend.

Securities Markets

Shares of common stock of Farmers and Merchants Bank
are publicly traded on the NASDAQ Stock Market's Over-the-Counter
Bulletin Board under the trading symbol "FMFG."

The market maker is the brokerage firm of RBC Wealth Management
100 Light Street, Baltimore, Maryland 21202.

Direct inquiries to: Charles Luck at (302) 252-9437 or (866) 544-0438, or Derek Ehman
at (410) 785-6000.

Transfer Agent

American Stock Transfer & Trust Company
6201 15th Avenue
Brooklyn, NY 12219
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**A copy of the Farmers and Merchants Bank annual report, including financial
statements, may be obtained without charge upon written request to:**

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