FARMERS & MERCHANTS BANK

2013 ANNUAL REPORT

FARMERS & MERCHANTS BANK

THE "COMMUNITY" BANK THAT PUTS PEOPLE FIRST

Member FDIC

February 27, 2014

Dear Stockholders, Customers, and Friends:

We are proud to report that your Bank achieved its fourth consecutive year of record earnings. Net income for the year ended December 31, 2013 was $3,260,951 or $2.05 per share compared to $3,157,991 or $2.01 per share in 2012, an increase of $102,960 or 3%. The increase in net income is due primarily to loan portfolio growth and a decrease in loan losses, offset by a slightly lower interest margin.

Return on average equity was 11.42% in 2013 compared to 12.10% in 2012. Return on average assets was 1.16% in 2013 compared to 1.19% in 2012. Cash dividends paid to shareholders in 2013 increased to $0.54 per common share from $0.49 per common share in 2012. The Bank's board of directors also declared a 2 for 1 stock split in the form of a 100% stock dividend in October. During 2013, the price of Farmers and Merchants Bank stock increased $4.79 per share or 37%, from $13.00 to $17.79. The total return for the year, including the cash dividends, was 41%.

Assets, particularly loans, continued to grow at a significant pace during 2013. The year-end asset total of $300 million represented a 9% increase from $276 million at December 31, 2012. Loans outstanding increased 14% to $242 million at December 31, 2013 from $213 million at the end of 2012. Deposits increased 7%, growing to $239 million at December 31, 2013 from $224 million at December 31, 2012. Stockholders' Equity increased $2.1 million or 8% to $29.3 million at December 31, 2013 from $27.2 million at the end of 2012.

The Bank's outstanding performance in 2013 earned it a #3 ranking state-wide among the 73 Maryland state headquartered banks as determined by the Financial Management Consulting Group. This is our fourth consecutive year in the top 3. The rankings were based upon numerous criteria including profitability, efficiency, and asset quality. The ranking for asset quality which is a primary focus of the Bank was #2.

Please visit the Bank's 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.

Our continuing financial success is the direct result of our strict adherence to sound banking fundamentals coupled with the diligence of our directors, officers and staff. Our dedication to providing unparalleled customer service continues to drive everything that we do. On behalf of the board of directors and staff, we thank you for your confidence in and your support of our outstanding 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, 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
2013

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.

Steven W. Eline
President
Eline Funeral Home

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

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
2013

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
Dawn Koslowski.....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

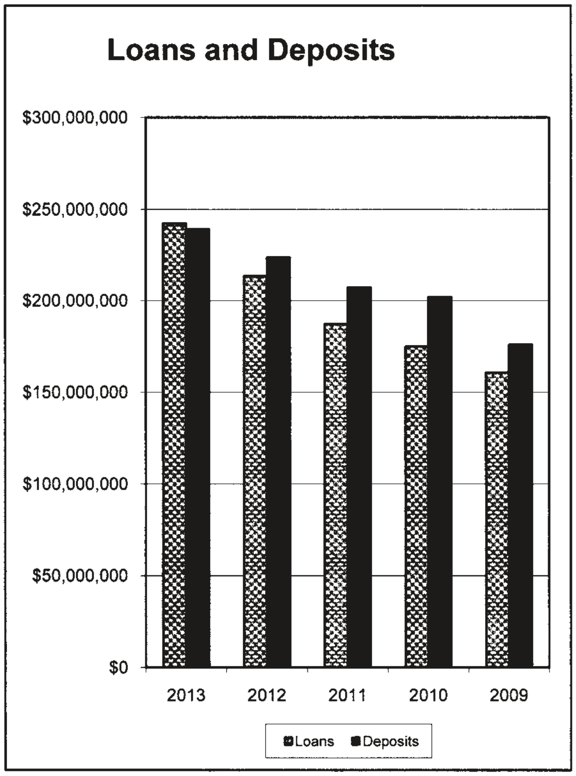
Assistant Vice Presidents
Branch Managers

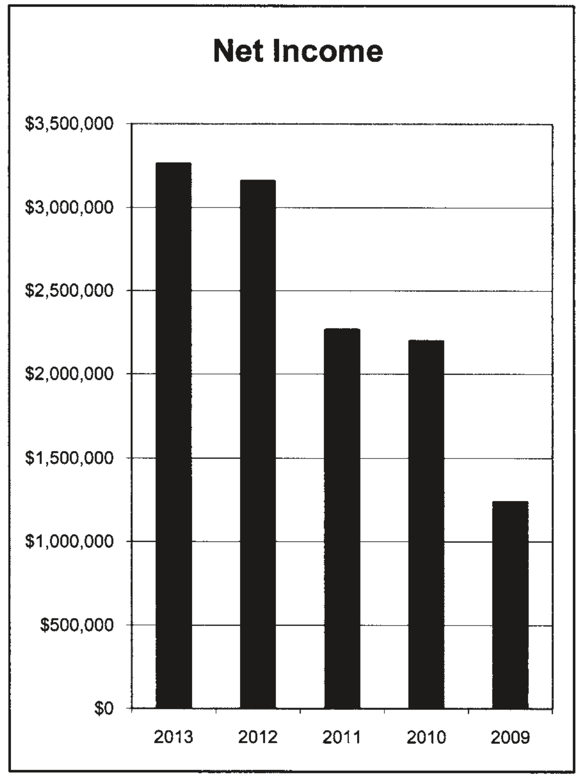
Amy L. Collins...........................Greenmount
Rachel L. Heird........................Owings Mills
Kelly P. Johnson.........................Hampstead
Wendy A. Panek.......................Reisterstown
Shannon M. Panek-Close..........Main Office
Deborah Zepp.........................Westminster

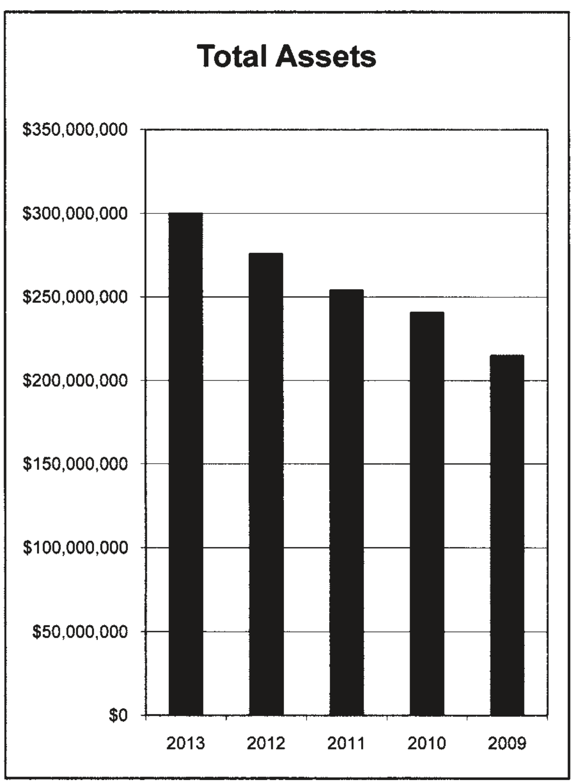
Farmers and Merchants Bank
Selected Consolidated Financial Data

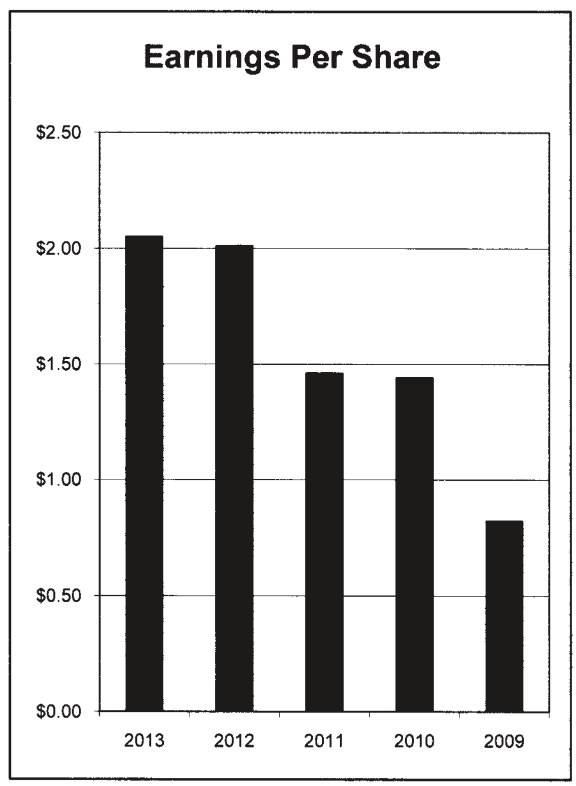
	2013	2012	2011	2010	2009
OPERATING DATA					
Interest income	$ 13,145,932	$ 13,334,852	$ 12,662,321	$ 11,617,437	$ 10,716,699
Interest expense	1,229,962	1,543,127	1,844,423	2,255,263	3,196,670
Net interest income	11,915,970	11,791,725	10,817,898	9,362,174	7,520,029
Provision for loan losses	-	280,000	1,575,000	635,000	750,000
Net interest income after provision for loan losses	11,915,970	11,511,725	9,242,898	8,727,174	6,770,029
Noninterest income	1,416,552	1,488,405	1,815,569	1,707,695	1,788,807
Noninterest expense	8,233,724	8,081,562	7,615,046	7,000,305	6,674,128
Income before income taxes	5,098,798	4,918,568	3,443,421	3,434,564	1,884,708
Income taxes	1,837,847	1,760,577	1,176,910	1,236,827	646,936
Net income	$ 3,260,951	$ 3,157,991	$ 2,266,511	$ 2,197,737	$ 1,237,772
PER SHARE DATA					
Net income (Basic)	$2.05	$2.01	$1.46	$1.44	$0.82
Dividends	$0.54	$0.49	$0.46	$0.38	$0.30
Book value per share	$18.22	$17.12	$15.72	$14.60	$13.69
Dividend payout ratio	26.34%	24.38%	31.16%	26.13%	36.81%
KEY RATIOS					
Return on average assets	1.16%	1.19%	0.90%	0.97%	0.59%
Return on average equity	11.42%	12.10%	9.40%	9.95%	6.02%
Net yield on interest-earning assets	4.57%	4.82%	4.70%	4.46%	3.87%
Efficiency ratio	61.76%	60.85%	60.28%	63.24%	71.70%
Average equity to average assets	10.12%	9.81%	9.61%	9.74%	9.88%
AT PERIOD END					
Total assets	$ 299,696,863	$ 275,678,997	$ 253,901,460	$ 240,427,031	$ 214,703,396
Loans, net and loans held for sale	242,400,282	215,732,977	187,670,721	176,040,884	162,086,511
Cash, federal funds sold, and other interest-earning deposits	11,652,949	14,162,898	14,314,474	11,602,545	14,737,250
Securities	28,886,337	29,138,128	35,781,959	39,321,424	24,978,938
Deposits	239,301,461	223,777,174	207,275,557	201,990,686	175,914,655
Borrowings	30,028,849	23,805,224	21,188,190	15,131,657	17,235,751
Stockholders' equity	29,309,236	27,185,871	24,709,508	22,610,425	20,911,870
SELECTED AVERAGE BALANCES					
Total assets	$ 282,166,001	$ 266,001,542	$ 250,795,495	$ 226,927,649	$ 208,096,804
Loans, net and loans held for sale	221,296,084	203,674,734	183,542,258	166,059,163	155,472,880
Cash, federal funds sold, and other interest-earning deposits	14,287,631	11,429,805	13,013,934	19,239,869	7,578,188
Securities	31,502,253	35,385,731	38,685,424	28,938,039	27,395,016
Deposits	226,685,504	216,758,404	206,454,365	188,050,432	167,803,586
Borrowings	25,844,870	22,075,830	19,534,304	16,088,557	18,874,328
Stockholders' equity	28,543,659	26,101,101	24,100,462	22,093,758	20,566,797
ASSET QUALITY					
Nonperforming assets	$ 2,219,391	$ 2,987,707	$ 4,789,067	$ 2,957,476	$ 2,963,332
Nonperforming assets/total assets	0.74%	1.08%	1.89%	1.23%	1.38%
Allowance for loan losses/total loans	1.07%	1.24%	1.33%	1.37%	1.21%

Farmers and Merchants Bank
Selected Consolidated Financial Data









ROWLES
& Company, LLP
Certified Public Accountants

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, 2013 and 2012, 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, 2013 and 2012, 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 27, 2014

8100 Sandpiper Circle, Suite 308, Baltimore, Maryland 21236
443-725-5395 FAX 443-725-5074
Website: www.Rowles.com

Farmers and Merchants Bank and Subsidiary

Consolidated Balance Sheets

December 31,		2013		2012
Assets				
Cash and due from banks	$	**11,065,572**	$	13,436,044
Federal funds sold and other interest-bearing deposits		**587,377**		726,854
Cash and cash equivalents		**11,652,949**		14,162,898
Certificate of deposit in other bank		**100,000**		100,000
Securities available for sale		**17,977,889**		18,595,126
Securities held to maturity		**10,908,448**		10,537,002
Federal Home Loan Bank stock, at cost		**780,900**		560,900
Loans held for sale		**-**		2,256,400
Loans, less allowance for loan losses of $2,626,954 and $2,680,963		**242,400,282**		213,476,577
Premises and equipment		**5,750,628**		5,909,003
Accrued interest receivable		**836,662**		920,264
Deferred income taxes		**1,380,343**		921,039
Other real estate owned		**1,136,006**		1,509,640
Bank owned life insurance		**5,974,953**		5,868,794
Other assets		**797,803**		861,354
	$	**299,696,863**	$	275,678,997
Liabilities and Stockholders' Equity				
Deposits				
Noninterest-bearing	$	**44,098,306**	$	42,894,281
Interest-bearing		**195,203,155**		180,882,893
Total deposits		**239,301,461**		223,777,174
Securities sold under repurchase agreements		**20,028,849**		19,805,224
Federal Home Loan Bank of Atlanta advances		**10,000,000**		4,000,000
Accrued interest payable		**135,861**		168,620
Other liabilities		**921,456**		742,108
		270,387,627		248,493,126
Stockholders' equity				
Common stock, par value $10 per share, authorized 5,000,000 shares; issued and outstanding 1,608,375 shares in 2013 and 793,791 shares in 2012		**16,083,751**		7,937,908
Surplus		**8,694,119**		8,170,655
Undivided profits		**4,945,798**		10,887,141
Accumulated other comprehensive income		**(414,432)**		190,167
		29,309,236		27,185,871
	$	**299,696,863**	$	275,678,997

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,	2013	2012
Interest income		
Loans, including fees	$ 12,284,998	$ 12,201,793
Investment securities - taxable	440,879	743,363
Investment securities - tax exempt	391,472	370,069
Federal funds sold and other interest earning assets	28,583	19,627
Total interest income	13,145,932	13,334,852
Interest expense		
Deposits	1,085,588	1,397,558
Securities sold under repurchase agreements	116,824	132,648
Federal Home Loan Bank advances and other borrowings	27,550	12,921
Total interest expense	1,229,962	1,543,127
Net interest income	11,915,970	11,791,725
Provision for loan losses	-	280,000
Net interest income after provision for loan losses	11,915,970	11,511,725
Noninterest income		
Service charges on deposit accounts	775,873	813,408
Mortgage banking income	413,183	394,316
Bank owned life insurance income	106,160	141,324
Net gain on sale of securities	73,684	72,687
Gain(loss) on sale and write down of other real estate owned	(60,224)	(60,158)
Other fees and commissions	107,876	126,828
Total noninterest income	1,416,552	1,488,405
Noninterest expense		
Salaries	3,947,668	3,741,911
Employee benefits	1,097,782	999,140
Occupancy	575,021	613,837
Furniture and equipment	515,550	527,579
Federal Deposit Insurance premiums	150,680	173,253
Other	1,947,023	2,025,842
Total noninterest expense	8,233,724	8,081,562
Income before income taxes	5,098,798	4,918,568
Income taxes	1,837,847	1,760,577
Net income	$ 3,260,951	$ 3,157,991
Earnings per share - basic and diluted	$ 2.05	$ 2.01

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,		2013		2012
Net income	**$**	**3,260,951**	$	3,157,991
Other comprehensive income, net of income taxes				
Securities available for sale				
Net unrealized gains (losses) arising during the period		**(1,080,229)**		(150,896)
Reclassification adjustment for realized gains, losses and write-downs included in net income		**81,799**		(24,480)
Total unrealized gain on investment securities available for sale		**(998,430)**		(175,376)
Income tax expense (benefit) relating to investment securities available for sale		**(393,831)**		(69,177)
Total other comprehensive income		**(604,599)**		(106,199)
Total comprehensive income	**$**	**2,656,352**	$	3,051,792

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

Farmers and Merchants Bank and Subsidiary

Consolidated Statements of Changes in Stockholders' Equity

	Common stock				Accumulated other	Total
	Shares	Par value	Surplus	Undivided profits	comprehensive income	stockholders' equity
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, $0.49 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	**793,791**	**7,937,908**	**8,170,655**	**10,887,141**	**190,167**	**27,185,871**
Net income	-	-	-	**3,260,951**	-	**3,260,951**
Unrealized loss on securities available for sale net of income tax benefit of $393,831	-	-	-	-	**(604,599)**	**(604,599)**
Cash dividends, $0.54 per share	-	-	-	**(860,322)**	-	**(860,322)**
Dividends reinvested	**15,387**	**153,871**	**173,464**	-	-	**327,335**
Stock dividend	**799,197**	**7,991,972**		**(7,991,972)**		
Transfer	-	-	**350,000**	**(350,000)**	-	-
Balance, December 31, 2013	**1,608,375**	**$ 16,083,751**	**$ 8,694,119**	**$ 4,945,798**	**$ (414,432)**	**$ 29,309,236**

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,	2013	2012
Cash flows from operating activities		
Interest received	$ 13,309,653	$ 13,368,306
Fees and commissions received	1,138,696	1,334,551
Interest paid	(1,262,721)	(1,580,870)
Proceeds from sale of mortgage loans held for sale	19,686,066	21,207,605
Origination of mortgage loans held for sale	(17,429,666)	(22,878,005)
Cash paid to suppliers and employees	(6,967,481)	(7,494,847)
Income taxes paid	(2,277,353)	(1,650,632)
	6,197,194	2,306,108
Cash flows from investing activities		
Proceeds from maturity and call of securities		
Available for sale	7,454,264	15,490,570
Held to maturity	707,068	2,624,453
Proceeds from sale of securities		
Available for sale	5,934,891	1,212,716
Held to maturity	910,286	348,629
Purchase of securities		
Available for sale	(14,014,664)	(11,293,145)
Held to maturity	(1,840,767)	(2,013,526)
Loans made to customers, net of principal collected	(29,093,824)	(27,787,214)
(Purchase) redemption of stock in FHLB of Atlanta	(220,000)	61,500
Other real estate owned proceeds	421,716	690,445
Disbursements for other real estate owned, net	(18,306)	-
Purchases of premises, equipment and software	(162,732)	(335,334)
	(29,922,068)	(21,000,906)
Cash flows from financing activities		
Net increase (decrease) in		
Noninterest-bearing deposits	1,204,025	7,072,293
Interest-bearing deposits	14,320,262	9,429,324
Securities sold under repurchase agreements	223,625	1,617,034
Federal Home Loan Bank of Atlanta advances	6,000,000	1,000,000
Dividends paid, net of reinvestments	(532,987)	(457,082)
Common stock repurchased	-	(118,347)
	21,214,925	18,543,222
Net increase (decrease) in cash and cash equivalents	(2,509,949)	(151,576)
Cash and cash equivalents at beginning of period	14,162,898	14,314,474
Cash and cash equivalents at end of period	$ 11,652,949	$ 14,162,898

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,	**2013**	2012
Reconciliation of net income to net cash provided by operating activities		
Net income	**$ 3,260,951**	$ 3,157,991
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	**335,827**	310,724
Provision for loan losses	**-**	280,000
Net gain on sale of investment securities:		
Available for sale	**81,799**	(24,480)
Held to maturity	**(155,483)**	(48,207)
Write down of other real estate owned	**158,237**	65,000
Net gain on sale of other real estate owned	**(98,013)**	(4,842)
Net loss on disposal of equipment	**-**	2,343
Decrease (increase) in mortgage loans held for sale	**2,256,400**	(1,670,400)
Deferred income taxes	**(65,473)**	(45,819)
Amortization of premiums and accretion of discounts, net	**175,967**	171,445
Increase (decrease) in		
Deferred loan fees	**80,119**	76,656
Accrued interest payable	**(32,759)**	(37,743)
Other liabilities	**179,348**	220,266
Decrease (increase) in		
Accrued interest receivable	**83,602**	(43,202)
Bank owned life insurance cash surrender value	**(106,159)**	(141,325)
Other assets	**42,831**	37,701
	$ 6,197,194	$ 2,306,108

Noncash transactions for the transfer of loans to other real estate owned totaled **$90,000** and $1,038,702 in the years ended December 31, 2013 and 2012, respectively.

The accompanying notes are an integral part of these 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 2012 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.

Federal Home Loan Bank stock

As a member of the Federal Home Loan Bank, the Bank is required to purchase stock based on its total assets. Additional stock is purchased and redeemed based on the outstanding Federal Home Loan Bank advances to the Bank. The stock is recorded at cost on the balance sheet.

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. Past due status is based on the contractual terms of the loan. Management may make an exception to reporting a loan as past due, if the past due status is solely due to the loan being past maturity, the Bank intends to extend the loan, and the borrower is making principal and interest payments in accordance with the terms of the matured note.

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 to twenty quarters. As of December 31, 2013, management used a twelve quarter period for the historical loss ratio calculation. As of December 31, 2012, management used an eight quarter period for the historical loss ratio calculation. 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.

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 with any gains or losses on sale in noninterest income.

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. In October 2013, the Bank's board of directors declared a 2 for 1 stock split in the form of a 100% stock dividend. Weighted average shares were **1,593,363** and 1,570,284 for 2013 and 2012, respectively. There are no potentially dilutive shares outstanding.

Subsequent events

The Bank has evaluated subsequent events for potential recognition and/or disclosure through February 27, 2014, the date the consolidated financial statements were available to be issued. No recognition or disclosure is required.

2. **Cash and Equivalents**

The Bank normally carries balances with other banks that exceed the federally insured limit. The average balance carried in excess of the limit, including unsecured federal funds sold to the same banks, was $7,904,125 and $7,207,545 during the years ended December 31, 2013 and 2012, respectively.

Deposits held in noninterest-bearing transaction accounts are aggregated with any interest-bearing deposits the owner may hold in the same category. The combined total is insured up to at least $250,000.

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.

3. Investment Securities

Investment securities are summarized as follows:

December 31, 2013	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Available for sale				
U. S. government agency	$ 4,495,959	$ -	$ 445,074	$ 4,050,885
State and municipal	2,123,372	77,432	-	2,200,804
	6,619,331	77,432	445,074	6,251,689
Mortgage-backed securities	12,042,949	33,722	350,471	11,726,200
	$ 18,662,280	$ 111,154	$ 795,545	$17,977,889
Held to maturity				
U. S. government agency	$ -	$ -	$ -	$ -
State and municipal	10,627,095	112,455	380,716	10,358,834
	10,627,095	112,455	380,716	10,358,834
Mortgage-backed securities	281,353	29,233	-	310,586
	$ 10,908,448	$ 141,688	$ 380,716	$10,669,420
December 31, 2012				
Available for sale				
U. S. government agency	$ 1,000,000	$ 626	$ -	$ 1,000,626
State and municipal	2,486,178	200,999	-	2,687,177
	3,486,178	201,625	-	3,687,803
Mortgage-backed securities	14,794,907	180,706	68,290	14,907,323
	$ 18,281,085	$ 382,331	$ 68,290	$ 18,595,126
Held to maturity				
U. S. government agency	$ -	$ -	$ -	$ -
State and municipal	9,244,178	527,857	13,113	9,758,922
	9,244,178	527,857	13,113	9,758,922
Mortgage-backed securities	1,292,824	282,158	-	1,574,982
	$ 10,537,002	$ 810,015	$ 13,113	$ 11,333,904

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.

	Available for Sale		Held to Maturity	
December 31, 2013	Amortized cost	Fair value	Amortized cost	Fair value
Within one year	$ -	$ -	$ -	$ -
Over one to five years	-	-	-	-
Over five to ten years	-	-	**2,566,041**	**2,601,392**
Over ten years	**6,619,331**	**6,251,689**	**8,061,054**	**7,757,442**
	6,619,331	**6,251,689**	**10,627,095**	**10,358,834**
Mortgage-backed securities, due in monthly installments	**12,042,949**	**11,726,200**	**281,353**	**310,586**
	$ 18,662,280	**$ 17,977,889**	**$ 10,908,448**	**$ 10,669,420**
December 31, 2012				
Within one year	$ -	$ -	$ -	$ -
Over one to five years	-	-	-	-
Over five to ten years	-	-	2,138,477	2,232,082
Over ten years	3,486,178	3,687,803	7,105,701	7,526,840
	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
	$ 18,281,085	$ 18,595,126	$ 10,537,002	$ 11,333,904

Securities with a carrying value of **$23,700,996** and $21,226,790 as of December 31, 2013 and 2012, respectively, were pledged as collateral for securities sold under repurchase agreements.

In 2013, the Bank realized gross gains of **$202,660** and gross losses of **$128,976** on the sale of **28** securities with gross proceeds of **$6,845,177**. 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. Securities sold in 2013 and 2012 included securities classified as held to maturity. The remaining principal balance of all held to maturity securities sold equaled 15% or less of the principal balance at the time of purchase.

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

December 31, 2013	Less than 12 months		12 months or more		Total	
Description of investments	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
U.S. government agency	**$ 4,050,885**	**$ 445,074**	**$ -**	**$ -**	**$ 4,050,885**	**$ 445,074**
State and municipal	**4,165,022**	**336,561**	**504,495**	**44,155**	**4,669,517**	**380,716**
Mortgage-backed securities	**8,462,275**	**342,043**	**946,203**	**8,428**	**9,408,478**	**350,471**
Total	**$ 16,678,182**	**$ 1,123,678**	**$ 1,450,698**	**$ 52,583**	**$ 18,128,880**	**$ 1,176,261**

3. **Investment Securities** (Continued)

December 31, 2012	Less than 12 months		12 months or more		Total	
Description of investments	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	1,844,172	42,538	5,125,280	25,752	6,969,452	68,290
Total	$ 1,844,172	$ 42,538	$ 5,669,470	$ 38,865	$ 7,513,642	$ 81,403

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, 2013, 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 the these factors, as of December 31, 2013, 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, 2013 and 2012, the activity of these loans was as follows:

	2013	2012
Balance, beginning of year	**$ 9,853,006**	$ 7,957,083
Additions	**10,307,752**	7,979,495
Amounts collected	**(3,723,111)**	(6,013,219)
Change in related parties	**(1,882,644)**	(70,353)
Balance, end of year	**$ 14,555,003**	$ 9,853,006

Unused lines of credit to related parties totaled **$521,012** and $3,752,821, at December 31, 2013 and 2012, respectively. Letters of credit were issued to directors totaling **$26,534** and $45,319 at December 31, 2013 and 2012, respectively.

Deposits at the Bank from directors, officers and related parties totaled **$8,772,511** and $9,325,256 at December 31, 2013 and 2012, respectively.

Payments to companies controlled by directors totaled **$36,275** in 2013 and $2,600 in 2012. Payments to a retailer affiliated with a director totaled **$753** in 2013 and $259 in 2012. Another director was paid **$3,000** in 2013 and 2012 for his oversight of branch office repairs and maintenance.

5. Loans

Major categories of loans at December 31, 2013 and 2012 are as follows:

	2013	2012
Commercial	$ 16,595,975	$ 12,893,153
Commercial real estate		
Construction/Land development	18,040,381	16,893,113
Other	170,369,522	149,575,825
Consumer	810,429	878,889
Residential real estate	39,705,040	36,330,552
	245,521,347	216,571,532
Less: Allowance for loan losses	2,626,954	2,680,963
Deferred origination fees net of costs	494,111	413,992
	$ 242,400,282	$ 213,476,577

The maturity and rate repricing distribution of the loan portfolio as of December 31, 2013 and 2012, is as follows:

	2013	2012
Variable rate, immediately	$ 24,230,866	$ 19,961,692
Due within one year	30,407,506	45,140,185
Due over one to five years	139,819,628	134,747,323
Due over five years	51,063,347	16,722,332
	$ 245,521,347	$ 216,571,532

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

	2013	2012
Commercial	$ -	$ -
Commercial real estate		
Construction/Land development	-	979,875
Other	932,428	437,071
Residential real estate	150,957	61,121
Total	$ 1,083,385	$ 1,478,067

At December 31, 2013, the Bank had 4 nonaccrual loans to 4 borrowers totaling **$1,083,385**. The loans are secured by real estate and business assets, and are personally guaranteed. Gross interest income of **$62,918** would have been recorded in 2013 if these nonaccrual loans had been current and performing in accordance with the original terms. The Bank has allocated **$0** of its allowance for loan losses for these nonaccrual loans. The balance of nonaccrual loans is net of charge-offs of **$181,491** at December 31, 2013.

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.

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 90 Days or More and Accruing
2013							
Commercial	$ -	$ -	$ -	$ -	$ 16,595,975	$ 16,595,975	$ -
Commercial real estate							
Construction/Land development	-	-	-	-	18,040,381	18,040,381	-
Other	-	-	932,428	932,428	169,437,094	170,369,522	
Consumer	-	-	-	-	810,429	810,429	-
Residential real estate	24,261	-	150,957	175,218	39,529,822	39,705,040	-
Total	$ 24,261	$ -	$ 1,083,385	$ 1,107,646	$ 244,413,701	$ 245,521,347	$ -
2012							
Commercial	$ 180,314	$ -	$ -	$ 180,314	$ 12,712,839	$ 12,893,153	$ -
Commercial real estate							
Construction/Land development	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	$ -

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
2013							
Commercial	$ -	$ -	$ -	$ -		$ -	$ -
Commercial real estate							
Construction/Land development	866,660	866,660	-	866,660	-	1,547,168	40,467
Other	932,428	932,428	-	932,428	-	684,750	-
Residential real estate	332,448	150,957	-	150,957	-	106,039	-
	$ 2,131,536	$ 1,950,045	$ -	$ 1,950,045	$ -	$ 2,337,957	$ 40,467
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

At December 31, 2013 and 2012, the Bank had no loans classified as a troubled debt restructuring.

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 real estate				
	Commercial	Construction/ Land Dev.	Other	Residential Real Estate	Consumer	Total
2013						
Excellent	**$ 953,725**	**$ -**	**$ -**	**$ 232,729**	**$ 109,408**	**$ 1,295,862**
Above Average	**49,163**	**188,024**	**11,653,451**	**5,888,065**	**152,218**	**17,930,921**
Average	**14,207,016**	**7,810,935**	**135,981,421**	**30,561,926**	**438,657**	**188,999,955**
Below Average	**955,769**	**3,365,735**	**7,180,133**	**1,514,102**	**21,383**	**13,037,122**
Especially Mentioned	**265,441**	**5,282,816**	**10,698,548**	**1,187,252**	**-**	**17,434,057**
Substandard	**164,861**	**1,392,871**	**4,855,969**	**320,966**	**51,014**	**6,785,681**
Doubtful	**-**	**-**	**-**	**-**	**37,749**	**37,749**
	$ 16,595,975	**$ 18,040,381**	**$ 170,369,522**	**$ 39,705,040**	**$ 810,429**	**$ 245,521,347**

		Commercial real estate				
	Commercial	Construction/ Land Dev.	Other	Residential Real Estate	Consumer	Total
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
	$ 12,893,153	$ 16,893,113	$ 149,575,825	$ 36,330,552	$ 878,889	$ 216,571,532

5. **Loans** (Continued)

The following table details activity in the allowance for loan losses by portfolio for the years ended December 31, 2013 and 2012. 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
2013						
Beginning balance	$ 108,669	$ 2,170,273	$ 347,007	$ 10,811	$ 44,203	$ 2,680,963
Provision for loan losses	(3,294)	22,287	(24,758)	(4,947)	10,712	-
Charge-offs	-	(66,078)	-	-	-	(66,078)
Recoveries	4,276	-	1,507	6,286	-	12,069
Net charge-offs (recoveries)	4,276	(66,078)	1,507	6,286	-	(54,009)
Ending balance	$ 109,651	$ 2,126,482	$ 323,756	$ 12,150	$ 54,915	$ 2,626,954
Year-end amount allocated to						
Loans individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -
Loans collectively evaluated for impairment	109,651	2,126,482	323,756	12,150	54,915	2,626,954
Ending balance	$ 109,651	$ 2,126,482	$ 323,756	$ 12,150	$ 54,915	$ 2,626,954
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 (recoveries)	(11,633)	(121,100)	13,985	1,200	-	(117,548)
Ending balance	$ 108,669	$ 2,170,273	$ 347,007	$ 10,811	$ 44,203	$ 2,680,963
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	$ 108,669	$ 2,170,273	$ 347,007	$ 10,811	$ 44,203	$ 2,680,963

Loans were evaluated for impairment as follows:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Total
December 31, 2013					
Loans individually evaluated for impairment	$ -	$ 1,799,088	$ 150,957	$ -	$ 1,950,045
Loans collectively evaluated for impairment	16,595,975	186,610,815	39,554,083	810,429	243,571,302
	$ 16,595,975	$ 188,409,903	$ 39,705,040	$ 810,429	$ 245,521,347
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
	$ 12,893,153	$ 166,468,938	$ 36,330,552	$ 878,889	$ 216,571,532

5. **Loans** (Continued)

Loans with a balance of approximately **$51.9** million were pledged as collateral to the FHLB of Atlanta as of December 31, 2013. Loans with a balance of approximately **$40.6** million were pledged as collateral to the Federal Reserve Bank of Richmond as of December 31, 2013. At December 31, 2013 and 2012, the Bank serviced participation loans for others totaling **$27.6** million and $13.7 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	**2013**	2012
Land and improvements	-	**$ 1,952,998**	$ 1,952,998
Buildings and improvements	15-39 years	**5,476,356**	5,460,212
Furniture and equipment	3-10 years	**2,929,008**	2,811,942
		10,358,362	10,225,152
Accumulated depreciation and amortization		**4,607,734**	4,316,149
		$ 5,750,628	$ 5,909,003
Depreciation and amortization expense		**$ 321,107**	$ 300,632

Software with a net book value of **$58,891** and $54,126 as of December 31, 2013 and 2012, respectively, is included in other assets. Amortization expense of **$14,720** and $10,092 was recorded in 2013 and 2012, 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. The Bank intends to renew the lease for another five year term in 2014. The minimum payments due for the additional five years have been included in the future minimum payments. 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 2013 for another year.

Future minimum payments under the agreements are as follows:

Year	Amount
2014	$ 87,743
2015	90,805
2016	93,975
2017	76,692
2018	50,477
Thereafter	38,703
	$438,395

Rent expense was **$88,113** and $78,814 in 2013 and 2012, respectively.

8. Credit Commitments

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

	2013	2012
Loan commitments		
Construction and land development	**$ 1,900,000**	$ 295,000
Commercial	**2,908,000**	500,000
Commercial real estate	**10,006,500**	12,754,000
Residential	**1,911,400**	2,180,801
	$ 16,725,900	$ 15,729,801
Unused lines of credit		
Home-equity lines	**$ 3,276,845**	$ 3,297,925
Commercial lines	**21,697,253**	18,620,563
	$ 24,974,098	$ 21,918,488
Letters of credit	**$ 2,690,615**	$ 2,156,765

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 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 **$131,422** and $127,001 for 2013 and 2012, respectively.

9. **Retirement Plans** (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 **$4,840** and $4,412 in 2013 and 2012, 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 **$204,842** and $152,769 in 2013 and 2012, respectively, for these plans.

Retirement plan expenses are included in employee benefits on the consolidated statements of income.

10. **Interest-Bearing Deposits**

Major classifications of interest-bearing deposits are as follows:

	2013	2012
NOW	**$ 26,240,242**	$ 23,510,475
Money market	**38,950,469**	31,584,420
Savings	**32,581,703**	29,725,209
Certificates of deposit, $100,000 or more	**44,317,854**	44,023,041
Other time deposits	**53,112,887**	52,039,748
	$195,203,155	$ 180,882,893

As of December 31, 2013, certificates of deposit mature as follows:

Year	Amount
2014	51,908,121
2015	20,489,289
2016	16,708,187
2017	3,113,844
2018	5,211,300
	$ 97,430,741

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:

		2013	2012
Amounts outstanding at year-end:			
Securities sold under repurchase agreements		**$ 20,028,849**	$ 19,805,224
Federal Home Loan Bank advances		**$ 10,000,000**	$ 4,000,000
Federal Home Loan Bank advances mature in:			
	2014	**$ 4,000,000**	$ 2,000,000
	2015	**4,000,000**	2,000,000
	2016	**2,000,000**	-
Weighted average rate paid at December 31:			
Securities sold under repurchase agreements		**0.57%**	0.67%
Federal Home Loan Bank advances		**0.50%**	0.35%
Maximum month-end amount outstanding:			
Securities sold under repurchase agreements		**$ 21,382,784**	$ 20,518,431
Federal Home Loan Bank advances		**10,000,000**	7,000,000
Average amount outstanding:			
Securities sold under repurchase agreements		**$ 19,398,264**	$ 17,970,639
Federal Home Loan Bank advances		**6,446,575**	4,095,628
Borrowings from commercial banks		**30**	8,197
Average rate paid during the year:			
Securities sold under repurchase agreements		**0.60%**	0.74%
Federal Home Loan Bank advances		**0.43%**	0.20%
Borrowings from commercial banks		**0.50%**	0.57%
Investment securities underlying the securities agreements at year end:			
Carrying value		**$ 23,700,996**	$ 21,226,790
Estimated fair value		**23,442,239**	21,841,766
Loans pledged to the Federal Home Loan Bank at year-end:			
Carrying value		**$ 51,935,941**	$ 49,186,265
Loans pledged to the Federal Reserve Bank at year-end:			
Carrying value		**$ 40,642,854**	$ 38,656,669

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 $35.0 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.

12. Other Noninterest Expenses

Other noninterest expenses include the following:

	2013	2012
Professional services	**$ 299,460**	$ 258,289
Automated teller machine and debit card expenses	**247,007**	245,715
Advertising	**203,193**	203,908
Postage, delivery, and armored carrier	**181,386**	181,005
Directors fees	**161,883**	171,360
Stationery, printing, and supplies	**151,268**	163,545
Telephone	**141,761**	136,660
Internet banking fees	**90,571**	47,570
Other real estate owned	**64,639**	176,718
Correspondent bank services	**51,845**	54,914
Travel and conferences	**51,782**	54,000
Dues and subscriptions	**41,854**	30,051
Liability insurance	**40,597**	38,385
Maryland state assessment	**34,568**	32,390
Credit reports	**25,067**	24,864
Foreclosure related expenses	**21,909**	41,487
Contributions	**20,900**	24,934
Remote deposit expenses	**20,856**	25,041
Education and training	**18,933**	35,835
Other	**77,544**	79,171
	$1,947,023	$ 2,025,842

13. Income Taxes

The components of income tax expense are as follows:

	2013	2012
Current		
Federal	**$ 1,498,493**	$ 1,403,430
State	**404,827**	402,966
	1,903,320	1,806,396
Deferred	**(65,473)**	(45,819)
	$ 1,837,847	$ 1,760,577

13. **Income Taxes** (Continued)

The components of the deferred tax expense are as follows:

	2013	2012
Depreciation	**$ (16,955)**	$ 96,413
Provision for loan losses	**-**	(49,501)
Other real estate owned allowance for loss	**38,442**	(93,894)
Nonaccrual interest	**(4,251)**	63,163
Post-retirement benefits	**(82,709)**	(62,000)
	$ (65,473)	$ (45,819)

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

Deferred tax assets		
Allowance for loan losses	**$ 844,495**	$ 844,495
Other real estate owned allowance for loss	**220,197**	258,639
Write-down of equity securities	**5,522**	5,522
Nonaccrual interest	**70,683**	66,432
Post-retirement benefits	**257,874**	175,165
Unrealized loss on securities available for sale	**269,958**	-
	1,668,729	1,350,253
Deferred tax liabilities		
Depreciation	**288,386**	305,341
Unrealized gain on securities available for sale	**-**	123,873
	288,386	429,214
Net deferred tax asset	**$ 1,380,343**	$ 921,039

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	**(3.3)**	(3.5)
State income taxes, net of federal income tax benefit	**5.2**	5.2
Nondeductible expenses	**0.1**	0.1
	36.0 %	35.8 %

The Bank does not have material uncertain tax positions and did not recognize any adjustments for unrecognized tax benefits. The Bank remains subject to examination of income tax returns for the years ending after December 31, 2009.

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, 2013 and 2012, 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	
December 31, 2013	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	**32,351**	**12.89%**	**20,073**	**8.00%**	**25,091**	**10.00%**
Tier 1 capital (to risk-weighted assets)	**29,724**	**11.85%**	**10,037**	**4.00%**	**15,055**	**6.00%**
Tier 1 capital (to average assets)	**29,724**	**10.00%**	**11,888**	**4.00%**	**14,861**	**5.00%**
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%

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.

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.

- 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.

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, 2013 and 2012, 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
December 31, 2013				
Recurring				
Available for sale securities				
U.S. government agency	$ -	$ **4,050,885**	$ -	$ **4,050,885**
State and municipal	-	**2,200,804**	-	**2,200,804**
Mortgage-backed securities	-	**11,726,200**	-	**11,726,200**
	$ -	$ **17,977,889**	$ -	$ **17,977,889**
Nonrecurring				
Other real estate owned	$ -	$ -	$ **1,136,006**	$ **1,136,006**
Impaired loans	-	-	**1,950,045**	**1,950,045**
December 31, 2012				
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
	$ -	$ 18,595,126	$ -	$ 18,595,126
Nonrecurring				
Other real estate owned	$ -	$ -	$ 1,509,640	$ 1,509,640
Impaired loans	-	-	2,719,502	2,719,502

Reconciliation of Level 3 Inputs

	Other Real Estate Owned	Impaired Loans
December 31, 2012 balance	$ **1,509,640**	$ **2,719,502**
Additions	**108,306**	**1,327,988**
Write-downs	**(158,237)**	-
Charge-offs, net of recoveries	-	**(66,078)**
Loan loss provision	-	**6,366**
Proceeds from sale	**(421,716)**	**(841,850)**
Gain (loss) on sale	**98,013**	-
Principal payments received	-	**(1,105,883)**
Transfer to other real estate owned	-	**(90,000)**
December 31, 2013 balance	$ **1,136,006**	$ **1,950,045**

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, 2013		December 31, 2012	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	**$ 11,652,949**	**$ 11,652,949**	$ 14,162,898	$ 14,162,898
Securities held to maturity	**10,908,448**	**10,669,420**	10,537,002	11,333,904
Loans held for sale	**-**	**-**	2,256,400	2,299,187
Federal Home Loan Bank stock	**780,900**	**780,900**	560,900	560,900
Loans, net	**242,400,282**	**244,582,282**	213,476,577	217,957,813
Financial liabilities				
Noninterest-bearing deposits	**$ 44,098,306**	**$ 44,098,306**	$ 42,894,281	$ 42,894,281
Securities sold under repurchase agreements	**20,028,849**	**20,028,849**	19,805,224	19,805,224
Interest-bearing deposits	**195,203,155**	**195,642,155**	180,882,893	181,582,893
Federal Home Loan Bank advances	**10,000,000**	**10,029,000**	4,000,000	3,994,000

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.

16. Quarterly Results of Operations

	Three Months Ended Unaudited			
2013	December 31	September 30	June 30	March 31
Interest income	**$ 3,411,168**	**$ 3,321,359**	**$ 3,180,259**	**$ 3,233,146**
Interest expense	**285,416**	**290,460**	**318,391**	**335,695**
Net interest income	**3,125,752**	**3,030,899**	**2,861,868**	**2,897,451**
Provision for loan losses	**-**	**-**	**-**	**-**
Net income	**813,776**	**848,951**	**748,096**	**850,128**
Earnings per share - basic and diluted	**$ 0.51**	**$ 0.53**	**$ 0.47**	**$ 0.54**
2012				
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	$ 0.52	$ 0.55	$ 0.56	$ 0.39

17. Litigation

In the ordinary course of its business, the Bank is periodically party to various 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, 2014 there were 1,608,375 shares of Common Stock issued and outstanding held by approximately 576 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.

	High	Low	Dividend Per Share
2013			
Quarter ended December 31	$22.00	$16.76	$0.28
Quarter ended September 30	18.50	16.00	0.00
Quarter ended June 30	16.63	14.20	0.26
Quarter ended March 31	15.50	13.00	0.00
2012			
Quarter ended December 31	$14.38	$12.03	$0.25
Quarter ended September 30	13.00	11.39	0.00
Quarter ended June 30	12.50	11.51	0.24
Quarter ended March 31	12.50	10.75	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 22, 2014 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."

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Website
www.fmb1919.com

A copy of the Farmers and Merchants Bank annual report, including financial statements, may be obtained without charge upon written request to:

Mark C. Krebs, Senior Vice President, Chief Financial Officer
Farmers and Merchants Bank
P. O. Box 249
25 Westminster Pike
Reisterstown, Maryland 21136

In Memory of

RUDOLF W. "RUDY" NECHAY

February 16, 1944 – July 23, 2013

It is with saddened hearts that we report to you the passing of director Rudolf W. "Rudy" Nechay. Rudy served the bank faithfully, as a bank director, for over 5 years. His distinguished service included membership on our Executive Committee, Audit Committee, Compensation Committee, Facilities Committee, and Asset-Liability Committee. He was a loyal bank customer for over thirty-five years. He was an esteemed businessman through the mid-Atlantic region and was respected nationally throughout the industry of commercial refrigeration systems and associations. He was a devoted family man who will be remembered for his quick wit, wisdom and passion for the Baltimore Ravens. His guidance and friendship will be missed by all.

We express our sincerest condolences to his family.