FARMERS & MERCHANTS BANK

2015 ANNUAL REPORT

FARMERS & BANK MERCHANTS

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

Member FDIC

February 25, 2016

Dear Stockholders, Customers, and Friends:

Your Bank achieved its sixth consecutive year of record earnings. Net income for the year ended December 31, 2015 was $4,268,222 or $2.61 per share compared to $3,573,973 or $2.21 per share in 2014, an increase of $694,249 or 19%. The increase in net income is due primarily to our strong net interest margin resulting from the continued high-quality loan growth that the Bank has experienced over the last several years. We also benefitted from a non-recurring gain on the sale of other real estate owned which was partially offset by one-time bank owned life insurance fees. The net total of these events, after income taxes, was $297,094. If the impact of these non-recurring items is excluded, we would still have experienced record net income of $3,971,128 or $2.43 per share in 2015.

Return on average equity was 12.26% in 2015 compared to 11.43% in 2014. Return on average assets was 1.29% in 2015 compared to 1.15% in 2014. Cash dividends paid to shareholders in 2015 increased 8% to $0.64 per common share from $0.59 per common share in 2014. During 2015, the price of Farmers and Merchants Bank stock increased $4.15 per share or 21%, from $19.95 to $24.10. The total return for the year, including the cash dividends, was 24%.

Total assets of $345 million as of December 31, 2015 increased 7% from $323 million as of December 31, 2014. The book value of the common stock of the Bank was $21.99 per share at December 31, 2015, compared to $20.08 per share at December 31, 2014.

The Bank's outstanding performance in 2015 earned it a #3 ranking state-wide among the 61 Maryland state headquartered banks as determined by the Financial Management Consulting Group. This is our sixth consecutive year in the top 3. We were the second highest rated bank in the Baltimore Metropolitan area and have been ranked in the top 2 for six consecutive years. The rankings were based upon numerous criteria including profitability, efficiency, and asset quality.

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.

Prudent oversight and management by our Board of Directors and Officers coupled with the hard work, dedication and unparalleled customer service provided by our staff is the reason for our continuing financial success. We are focused on creating an exceptional experience for our customers while providing strong returns for our shareholders. 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,

Paul F. Wooden, Jr.
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 Telephone Access System, internet banking, mobile 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

Corporate Office 4510 Lower Beckleysville Road Suite H Hampstead, MD 21074 410-374-1510	Main Office 15226 Hanover Pike Upperco, MD 21155 410-833-6600	Greenmount Office 2320 Hanover Pike Hampstead, MD 21074 410-374-3436
Hampstead Office 735 Hanover Pike Hampstead, MD 21074 410-239-4448	Reisterstown Office P.O. Box 249 25 Westminster Pike Reisterstown, MD 21136 410-517-3060	Atrium Village Senior Living Community 4730 Atrium Court Owings Mills, MD 21117 410-998-8847
Westminster Office 275 Clifton Boulevard Westminster, MD 21157 410-857-1100	Mortgage Division Hampstead Office 735 Hanover Pike Hampstead, MD 21074 410-239-9650	Owings Mills Office 9320 Lakeside Boulevard Owings Mills, MD 21117 410-356-8200
Commercial Loan Center Westminster Office 275 Clifton Boulevard Westminster, MD 21157 410-857-1700	Operations Center P.O Box 249 25 Westminster Pike Reisterstown, MD 21136 410-517-3065	Commercial Loan Center Owings Mills Office 9320 Lakeside Boulevard Owings Mills, MD 21117 410-356-9303

Farmers and Merchants Bank Directors

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

John J. Schuster, Jr., Vice Chairman
President
Schuster Enterprises, 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.

Kenneth W. Hoffmeyer
Retired Associate Controller
Johns Hopkins University

Ronald W. Hux
President
Douron, Inc.

T. Edward Lippy
Trustee
Lippy Brothers Farms S.T.

J. Lawrence Mekulski
Principal
KLNB, LLC

Bruce L. Schindler
President
Bob Davidson Ford Lincoln

Director Emeritus

W. Ralph Wisner
President
Wisner Farms, Inc.

Farmers and Merchants Bank Officers

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

T. Jeffrey Horner.......................Controller
Mark W. Lutrey...........................Auditor

Assistant Vice Presidents
Loan Officers

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

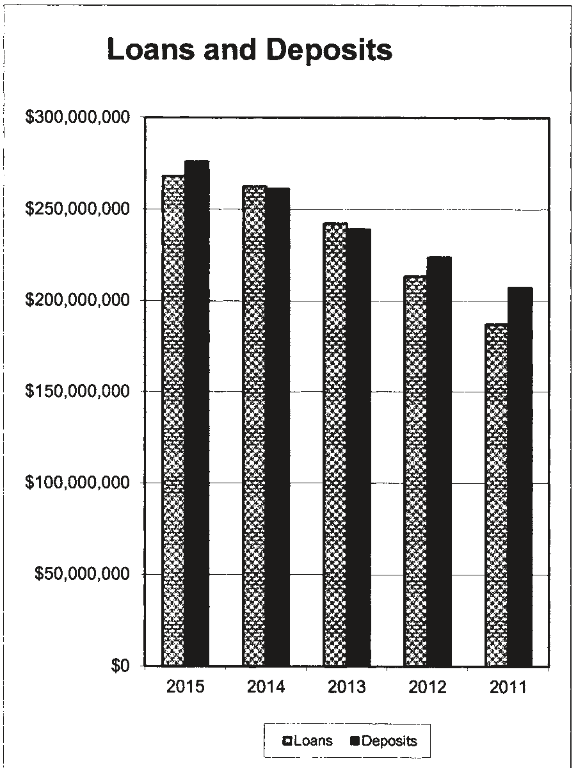
Assistant Vice Presidents
Branch Managers

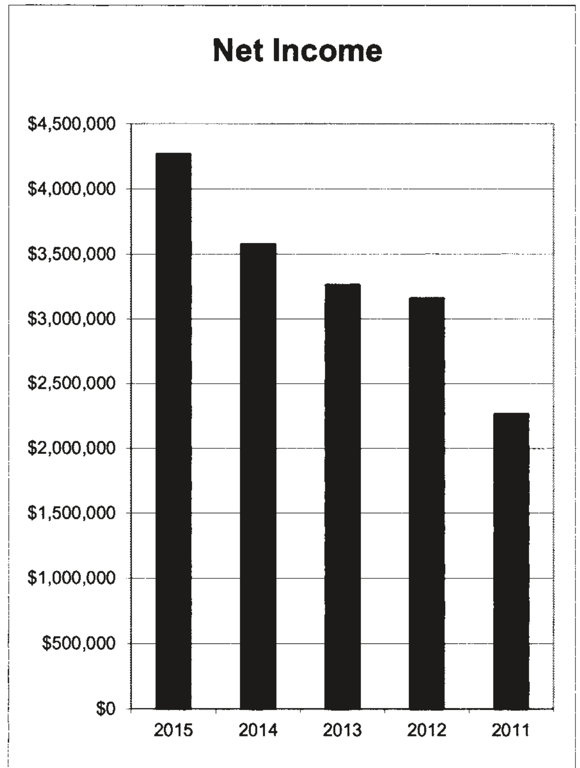
Amy L. Collins.........................Greenmount
Rachel L. Heird.....................Owings Mills
Kelly P. Johnson......................Hampstead
Wendy A. Panek....................Reisterstown
Shannon M. Panek-Close..........Main Office
Deborah Zepp.........................Westminster

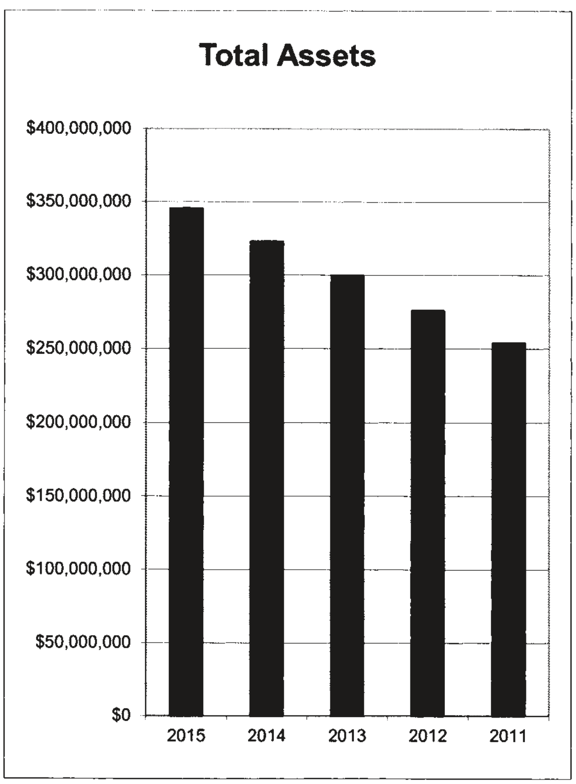
Farmers and Merchants Bank
Selected Consolidated Financial Data

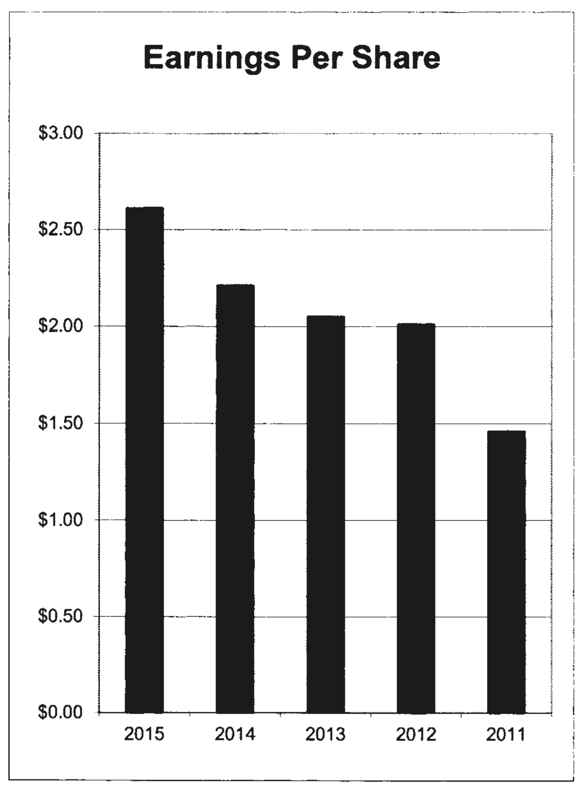
	2015	2014	2013	2012	2011
OPERATING DATA					
Interest income	$ 14,705,401	$ 14,080,625	$ 13,145,932	$ 13,334,852	$ 12,662,321
Interest expense	1,189,646	1,157,044	1,229,962	1,543,127	1,844,423
Net interest income	13,515,755	12,923,581	11,915,970	11,791,725	10,817,898
Provision for loan losses	-	124,000	-	280,000	1,575,000
Net interest income after provision for loan losses	13,515,755	12,799,581	11,915,970	11,511,725	9,242,898
Noninterest income	1,986,260	1,240,360	1,416,552	1,488,405	1,815,569
Noninterest expense	8,703,588	8,421,114	8,233,724	8,081,562	7,615,046
Income before income taxes	6,798,427	5,618,827	5,098,798	4,918,568	3,443,421
Income taxes	2,530,205	2,044,854	1,837,847	1,760,577	1,176,910
Net income	$ 4,268,222	$ 3,573,973	$ 3,260,951	$ 3,157,991	$ 2,266,511
PER SHARE DATA					
Net income (Basic)	$2.61	$2.21	$2.05	$2.01	$1.46
Dividends	$0.64	$0.59	$0.54	$0.49	$0.46
Book value per share	$21.99	$20.08	$18.22	$17.12	$15.72
Dividend payout ratio	24.52%	26.70%	26.34%	24.38%	31.16%
KEY RATIOS					
Return on average assets	1.29%	1.15%	1.16%	1.19%	0.90%
Return on average equity	12.26%	11.43%	11.42%	12.10%	9.40%
Net yield on interest-earning assets	4.33%	4.47%	4.57%	4.82%	4.70%
Efficiency ratio	56.14%	59.45%	61.76%	60.85%	60.28%
Average equity to average assets	10.50%	10.05%	10.12%	9.81%	9.61%
AT PERIOD END					
Total assets	$ 345,309,996	$ 322,787,387	$ 299,696,863	$ 275,678,997	$ 253,901,460
Loans, net and loans held for sale	268,249,402	262,642,513	242,400,282	215,732,977	187,670,721
Cash, federal funds sold, and other interest-earning deposits	20,192,839	12,583,313	11,652,949	14,162,898	14,314,474
Securities	40,248,651	31,521,616	28,886,337	29,138,128	35,781,959
Deposits	275,964,737	261,210,530	239,301,461	223,777,174	207,275,557
Borrowings	31,490,619	27,639,327	30,028,849	23,805,224	21,188,190
Stockholders' equity	36,223,361	32,702,470	29,309,236	27,185,871	24,709,508
SELECTED AVERAGE BALANCES					
Total assets	$ 331,522,302	$ 311,036,540	$ 282,166,001	$ 266,001,542	$ 250,795,495
Loans, net and loans held for sale	269,406,618	250,184,181	221,296,084	203,674,734	183,542,258
Cash, federal funds sold, and other interest-earning deposits	15,227,040	15,887,073	14,287,631	11,429,805	13,013,934
Securities	31,988,098	29,825,093	31,502,253	35,385,731	38,685,424
Deposits	265,634,314	249,741,172	226,685,504	216,758,404	206,454,365
Borrowings	29,363,070	28,672,245	25,844,870	22,075,830	19,534,304
Stockholders' equity	34,810,159	31,268,365	28,543,659	26,101,101	24,100,462
ASSET QUALITY					
Nonperforming assets	$ 1,429,313	$ 943,846	$ 2,219,391	$ 2,987,707	$ 4,789,067
Nonperforming assets/total assets	0.41%	0.29%	0.74%	1.08%	1.89%
Allowance for loan losses/total loans	0.95%	1.05%	1.07%	1.24%	1.33%

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, 2015 and 2014, 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, 2015 and 2014, 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 25, 2016

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443-725-5395 FAX 443-725-5074
Website: www.Rowles.com

Farmers and Merchants Bank and Subsidiary
Consolidated Balance Sheets

December 31,	2015	2014
Assets		
Cash and due from banks	**$ 18,535,302**	$ 12,048,532
Federal funds sold and other interest-bearing deposits	**1,657,537**	534,781
Cash and cash equivalents	**20,192,839**	12,583,313
Certificate of deposit in other bank	**100,000**	100,000
Securities available for sale	**23,644,584**	19,882,400
Securities held to maturity	**16,604,067**	11,639,216
Federal Home Loan Bank stock, at cost	**758,100**	719,800
Mortgage loans held for sale	**-**	310,650
Loans, less allowance for loan losses of **$2,583,445** and $2,780,249	**268,249,402**	262,331,863
Premises and equipment	**5,647,933**	5,536,122
Accrued interest receivable	**850,923**	868,427
Deferred income taxes	**1,220,105**	1,253,449
Other real estate owned	**472,500**	943,846
Bank owned life insurance	**6,541,381**	6,069,117
Other assets	**1,028,162**	549,184
	$ 345,309,996	$ 322,787,387
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	**$ 58,043,942**	$ 52,060,433
Interest-bearing	**217,920,795**	209,150,097
Total deposits	**275,964,737**	261,210,530
Securities sold under repurchase agreements	**20,490,619**	19,639,327
Federal Home Loan Bank of Atlanta advances	**11,000,000**	8,000,000
Accrued interest payable	**137,968**	146,268
Other liabilities	**1,493,311**	1,088,792
	309,086,635	290,084,917
Stockholders' equity		
Common stock, par value $10 per share, authorized 5,000,000 shares; issued and outstanding 1,647,541 shares in 2015 and 1,628,544 shares in 2014	**16,475,415**	16,285,440
Surplus	**9,889,659**	9,236,495
Undivided profits	**9,960,410**	7,187,774
Accumulated other comprehensive income	**(102,123)**	(7,239)
	36,223,361	32,702,470
	$ 345,309,996	$ 322,787,387

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,	2015	2014
Interest income		
Loans, including fees	$ 13,809,312	$ 13,218,189
Investment securities - taxable	479,217	450,583
Investment securities - tax exempt	367,030	366,520
Federal funds sold and other interest earning assets	49,842	45,333
Total interest income	14,705,401	14,080,625
Interest expense		
Deposits	1,005,317	993,355
Securities sold under repurchase agreements	99,886	109,315
Federal Home Loan Bank advances and other borrowings	84,443	54,374
Total interest expense	1,189,646	1,157,044
Net interest income	13,515,755	12,923,581
Provision for loan losses	-	124,000
Net interest income after provision for loan losses	13,515,755	12,799,581
Noninterest income		
Service charges on deposit accounts	748,310	774,737
Mortgage banking income	393,884	276,957
Bank owned life insurance income	72,264	94,163
Net (loss) gain on sale of securities	(5,508)	31,727
Gain (loss) on sale and write down of other real estate owned	550,474	(111,262)
Gain on sale of loans	107,830	61,914
Other fees and commissions	119,006	112,124
Total noninterest income	1,986,260	1,240,360
Noninterest expense		
Salaries	4,240,524	4,180,246
Employee benefits	1,131,389	1,104,712
Occupancy	640,083	637,735
Furniture and equipment	609,458	548,691
Federal Deposit Insurance Corporation premiums	168,135	162,611
Other	1,913,999	1,787,119
Total noninterest expense	8,703,588	8,421,114
Income before income taxes	6,798,427	5,618,827
Income taxes	2,530,205	2,044,854
Net income	$ 4,268,222	$ 3,573,973
Earnings per share - basic and diluted	$ 2.61	$ 2.21

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,	2015	2014
Net income	**$ 4,268,222**	$ 3,573,973
Other comprehensive income (loss), net of income taxes:		
Securities available for sale		
Net unrealized gain (loss) arising during the period	**(148,511)**	667,760
Reclassification adjustment for realized gains and losses included in net income	**(8,179)**	4,675
Total unrealized gain (loss) on investment securities available for sale	**(156,690)**	672,435
Income tax expense (benefit) relating to investment securities available for sale	**(61,806)**	265,242
Total other comprehensive income (loss)	**(94,884)**	407,193
Total comprehensive income	**$ 4,173,338**	$ 3,981,166

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, 2013	1,608,375	$ 16,083,751	$ 8,694,119	$ 4,945,798	$ (414,432)	$ 29,309,236
Net income	-	-	-	3,573,973	-	3,573,973
Unrealized gain on securities available for sale net of income tax expense of $265,242	-	-	-	-	407,193	407,193
Cash dividends, $0.59 per share	-	-		(951,997)	-	(951,997)
Dividends reinvested	20,169	201,689	162,376	-	-	364,065
Transfer	-	-	380,000	(380,000)	-	-
Balance, December 31, 2014	**1,628,544**	**16,285,440**	**9,236,495**	**7,187,774**	**(7,239)**	**32,702,470**
Net income	**-**	**-**	**-**	**4,268,222**	**-**	**4,268,222**
Unrealized loss on securities available for sale net of income tax benefit of $61,806	**-**	**-**	**-**	**-**	**(94,884)**	**(94,884)**
Cash dividends, $0.64 per share	**-**	**-**	**-**	**(1,045,586)**	**-**	**(1,045,586)**
Dividends reinvested	**18,997**	**189,975**	**203,164**	**-**	**-**	**393,139**
Transfer	**-**	**-**	**450,000**	**(450,000)**	**-**	**-**
Balance, December 31, 2015	**1,647,541**	**$ 16,475,415**	**$ 9,889,659**	**$ 9,960,410**	**$ (102,123)**	**$ 36,223,361**

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,	2015	2014
Cash flows from operating activities		
Interest received	$ 14,669,641	$ 14,038,504
Fees and commissions received	1,346,530	1,055,731
Interest paid	(1,197,946)	(1,146,637)
Proceeds from sale of mortgage loans held for sale	16,503,589	12,264,144
Origination of mortgage loans held for sale	(16,192,939)	(12,574,794)
Cash paid to suppliers and employees	(8,204,143)	(7,275,468)
Income taxes paid	(2,573,681)	(2,323,262)
Cash provided by operating activities	4,351,051	4,038,218
Cash flows from investing activities		
Proceeds from maturity and call of securities		
Available for sale	4,753,161	3,190,755
Held to maturity	2,975,000	123,298
Proceeds from sale of securities		
Available for sale	538,991	2,080,279
Held to maturity	521,411	737,983
Purchase of securities		
Available for sale	(12,190,544)	(6,554,061)
Held to maturity	(5,560,761)	(1,602,318)
Loans made to customers, net of principal collected	(5,864,275)	(20,113,065)
Redemption (purchase) of stock in FHLB of Atlanta	(38,300)	61,100
Other real estate owned proceeds	1,021,820	148,738
Purchase of bank owned life insurance	(400,000)	-
Purchases of premises, equipment and software	(451,080)	(112,178)
Cash used by investing activities	(14,694,577)	(22,039,469)
Cash flows from financing activities		
Net increase (decrease) in		
Noninterest-bearing deposits	5,983,509	7,962,127
Interest-bearing deposits	8,770,698	13,946,942
Securities sold under repurchase agreements	851,292	(389,522)
Federal Home Loan Bank of Atlanta advances	3,000,000	(2,000,000)
Dividends paid, net of reinvestments	(652,447)	(587,932)
Cash provided by financing activities	17,953,052	18,931,615
Net increase in cash and cash equivalents	7,609,526	930,364
Cash and cash equivalents at beginning of period	12,583,313	11,652,949
Cash and cash equivalents at end of period	$ 20,192,839	$ 12,583,313

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,	2015	2014
Reconciliation of net income to net cash provided by operating activities		
Net income	**$ 4,268,222**	$ 3,573,973
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	**385,711**	354,358
Provision for loan losses	**-**	124,000
Net loss (gain) on sale of investment securities:		
Available for sale	**(8,179)**	4,675
Held to maturity	**13,687**	(36,402)
Write down of other real estate owned	**22,500**	170,000
Net gain on sale of other real estate owned	**(572,974)**	(58,738)
Decrease (increase) in mortgage loans held for sale	**310,650**	(310,650)
Deferred income taxes	**95,150**	(138,348)
Amortization of premiums and accretion of discounts, net	**73,509**	92,947
Increase (decrease) in		
Deferred loan fees	**(53,264)**	(10,356)
Accrued interest payable	**(8,300)**	10,407
Other liabilities	**404,519**	167,336
Decrease (increase) in		
Accrued interest receivable	**17,504**	(31,765)
Bank owned life insurance cash surrender value	**(72,264)**	(94,164)
Other assets	**(525,420)**	220,945
Cash provided by operating activities	**$ 4,351,051**	$ 4,038,218
Noncash transactions:		
Transfer of loans to other real estate owned	**$ -**	$ 67,840

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 of America 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 2014 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 when the collateral value, if the loan is collateral dependent, or the discounted cash flows of the impaired loan is lower than the carrying value.

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, 2015 and 2014, management used a twenty quarter period for the historical loss ratio. 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)

Mortgage loans held for sale

Mortgage loans held for sale are carried at the lower of aggregate cost or fair value based on the current fair 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 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. Weighted average shares were **1,633,897** and 1,613,752 for 2015 and 2014, respectively. There are no potentially dilutive shares outstanding.

Subsequent events

The Bank has evaluated subsequent events for potential recognition and/or disclosure through February 25, 2016, 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 **$7,772,791** and $8,562,226 during the years ended December 31, 2015 and 2014, 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 $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.

Farmers and Merchants Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

3. Investment Securities

Investment securities are summarized as follows:

December 31, 2015	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Available for sale				
State and municipal	**$ 1,253,031**	**$ 96,211**	**$ -**	**$ 1,349,242**
Mortgage-backed securities	**22,524,260**	**37,120**	**266,038**	**22,295,342**
	$ 23,777,291	**$ 133,331**	**$ 266,038**	**$23,644,584**
Held to maturity				
U. S. government agency	**$ 2,960,758**	**$ 1,373**	**$ 33,231**	**$ 2,928,900**
State and municipal	**13,643,309**	**345,506**	**30,818**	**13,957,997**
	$ 16,604,067	**$ 346,879**	**$ 64,049**	**$16,886,897**

December 31, 2014	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Available for sale				
U. S. government agency	$ 4,496,327	$ 657	$ 79,892	$ 4,417,092
State and municipal	1,255,702	137,677	-	1,393,379
	5,752,029	138,334	79,892	5,810,471
Mortgage-backed securities	14,142,326	77,591	147,988	14,071,929
	$ 19,894,355	$ 215,925	$ 227,880	$ 19,882,400
Held to maturity				
State and municipal	$ 11,639,216	$ 321,029	$ 41,193	$ 11,919,052

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, 2015	Amortized cost	Fair value	Amortized cost	Fair value
Within one year	$ -	$ -	$ -	$ -
Over one to five years	-	-	-	-
Over five to ten years	**501,991**	**552,070**	**2,276,250**	**2,308,733**
Over ten years	**751,040**	**797,172**	**14,327,817**	**14,578,164**
	1,253,031	**1,349,242**	**16,604,067**	**16,886,897**
Mortgage-backed securities, due in monthly installments	**22,524,260**	**22,295,342**	**-**	**-**
	$23,777,291	**$ 23,644,584**	**$ 16,604,067**	**$ 16,886,897**
December 31, 2014				
Within one year	$ -	$ -	$ -	$ -
Over one to five years	-	-	-	-
Over five to ten years	496,327	479,802	3,002,230	3,063,694
Over ten years	5,255,702	5,330,669	8,636,986	8,855,358
	5,752,029	5,810,471	11,639,216	11,919,052
Mortgage-backed securities, due in monthly installments	14,142,326	14,071,929	-	-
	$ 19,894,355	$ 19,882,400	$ 11,639,216	$ 11,919,052

Securities with a carrying value of **$26,036,893** and $26,794,657 as of December 31, 2015 and 2014, respectively, were pledged as collateral for securities sold under repurchase agreements and municipal deposits.

In 2015, the Bank realized gross gains of **$10,586** and gross losses of **$16,094** on the sale of **four** securities with gross proceeds of **$1,060,402**. In 2014, the Bank realized gross gains of **$41,818** and gross losses of **$10,091** on the sale of **ten** securities with gross proceeds of **$2,818,262**. In 2015 and 2014, the Bank sold securities classified as held to maturity including state and municipal securities with an amortized cost of **$530,812** and $513,671, respectively, due to the credit deterioration of the issuers. In addition, the Bank sold mortgage-backed securities held to maturity in each year, where the principal balance of the security 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, 2015	Less than 12 months		12 months or more		Total	
Description of investments	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. government agency	**$ -**	**$ -**	**$ 1,927,527**	**$ 33,231**	**$ 1,927,527**	**$ 33,231**
State and municipal	**573,034**	**5,535**	**804,623**	**25,283**	**1,377,657**	**30,818**
Mortgage-backed securities	**15,299,536**	**156,187**	**3,431,902**	**109,851**	**18,731,438**	**266,038**
Total	**$ 15,872,570**	**$ 161,722**	**$ 6,164,052**	**$ 168,365**	**$ 22,036,622**	**$ 330,087**

3. **Investment Securities** (Continued)

December 31, 2014	Less than 12 months		12 months or more		Total	
Description of investments	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. government agency	$ -	$ -	$ 3,416,435	$ 79,892	$ 3,416,435	$ 79,892
State and municipal	510,891	4,208	2,094,194	36,985	2,605,085	41,193
Mortgage-backed securities	3,119,251	22,896	4,381,967	125,092	7,501,218	147,988
Total	$ 3,630,142	$ 27,104	$ 9,892,596	$ 241,969	$ 13,522,738	$ 269,073

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, 2015, management did not have the intent to sell any of the securities 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, 2015, 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, 2015 and 2014, the activity of these loans was as follows:

	2015	**2014**
Balance, beginning of year	**$ 12,732,702**	$ 14,555,003
Additions	**3,473,398**	2,728,675
Amounts collected	**(3,057,374)**	(4,550,976)
Balance, end of year	**$ 13,148,726**	$ 12,732,702

Unused lines of credit to related parties totaled **$2,240,340** and $2,322,270, at December 31, 2015 and 2014, respectively. Letters of credit were issued to directors totaling $6,534 at December 31, 2015 and 2014, respectively.

Deposits at the Bank from directors, officers and related parties totaled **$13,732,380** and $11,348,191 at December 31, 2015 and 2014, respectively.

Payments to companies controlled by directors totaled **$90,479** in 2015 and $30,190 in 2014. Payments to a retailer affiliated with a director totaled **$2,779** in 2015 and $53 in 2014. Another director was paid **$3,000** in 2015 and 2014 for his oversight of branch office repairs and maintenance. The Bank occasionally utilizes the services of a real estate firm where another director is a partner, although no compensation was paid in 2015 or 2014.

5. **Loans**

Major categories of loans at December 31, 2015 and 2014 are as follows:

	2015	2014
Real estate:		
Commercial	$ 186,703,868	$ 181,881,566
Construction and land development	12,820,165	18,592,315
Residential	51,290,828	45,687,752
Commercial	19,562,302	18,581,523
Consumer	886,175	852,711
	271,263,338	265,595,867
Less: Allowance for loan losses	2,583,445	2,780,249
Deferred origination fees net of costs	430,491	483,755
	$ 268,249,402	$ 262,331,863

The maturity and rate repricing distribution of the loan portfolio as of December 31, 2015 and 2014, is as follows:

	2015	2014
Variable rate, immediately	$ 27,803,011	$ 27,460,011
Due within one year	33,826,370	25,152,507
Due over one to five years	153,408,126	155,316,949
Due over five years	56,225,831	57,666,400
	$ 271,263,338	$ 265,595,867

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

	2015	2014
Commercial real estate	$ 956,813	$ -
Residential real estate	-	-
Total	$ 956,813	$ -

At December 31, 2015, the Bank had two nonaccrual construction and land development loans to one borrower totaling $956,813. The loans were secured by real estate and business assets, and were personally guaranteed. Gross interest income of $35,631 would have been recorded in 2015 if these nonaccrual loans had been current and performing in accordance with the original terms. The Bank allocated $167,211 of its allowance for loan losses for these nonaccrual loans. The balance of nonaccrual loans was net of charge-offs of $200,000 at December 31, 2015.

At December 31, 2014, the Bank had no nonaccrual loans.

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
December 31, 2015							
Real estate:							
Commercial	$ -	$ -	$ -	$ -	$ 186,703,868	$ 186,703,868	$ -
Construction and land development	-	-	956,813	956,813	11,863,352	12,820,165	-
Residential	-	-	-	-	51,290,828	51,290,828	-
Commercial	-	-	-	-	19,562,302	19,562,302	-
Consumer	-	-	-	-	886,175	886,175	-
Total	$ -	$ -	$ 956,813	$ 956,813	$ 270,306,525	$ 271,263,338	$ -
December 31, 2014							
Real estate:							
Commercial	$ -	$ -	$ -	$ -	$ 181,881,566	$ 181,881,566	$ -
Construction and land development	-	-	-	-	18,592,315	18,592,315	-
Residential	193,794	-	-	193,794	45,493,958	45,687,752	-
Commercial	-	-	-	-	18,581,523	18,581,523	-
Consumer	-	-	-	-	852,711	852,711	-
Total	$ 193,794	$ -	$ -	$ 193,794	$ 265,402,073	$ 265,595,867	$ -

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
December 31, 2015							
Real estate:							
Commercial	$ 2,240,046	$ 2,240,046	$ -	$ 2,240,046	$ -	$ 2,281,563	$ 115,663
Construction and land development	1,156,813	-	956,813	956,813	167,211	990,429	13,540
Commercial	203,635	203,635	-	203,635	-	220,421	15,644
	$ 3,600,494	$ 2,443,681	$ 956,813	$ 3,400,494	$ 167,211	$ 3,492,413	$ 144,847
December 31, 2014							
Real estate:							
Construction and land development	$ 1,024,044	$ -	$ 1,024,044	$ 1,024,044	$ 167,418	$ 945,352	$ 43,263

At December 31, 2015, the Bank had two loans classified as a troubled debt restructuring. Both are included in impaired loans above. The first is a commercial real estate other loan with a balance of $2,240,046. The second is a commercial loan with a balance of $203,635. Both loans are paying as agreed. At December 31, 2014, the Bank had no loans classified as a troubled debt restructuring.

5. **Loans** (Continued)

As part of our portfolio risk management, the Bank assigns a risk grade to each loan. 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, Pass Watch, and Special Mention 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:

December 31, 2015	Excellent	Above average	Average	Below average	Pass watch	Special mention	Substandard	Doubtful	Total
Real estate:									
Commercial	**$ -**	**$11,100,467**	**$151,135,140**	**$ 11,019,894**	**$ 3,505,988**	**$ 6,162,661**	**$ 3,779,718**	**$ -**	**$ 186,703,868**
Construction and land development	**-**	**285,534**	**10,037,269**	**418,834**	**-**	**-**	**2,078,528**	**-**	**12,820,165**
Residential	**181,662**	**3,478,378**	**43,722,191**	**2,502,477**	**731,122**	**-**	**674,998**	**-**	**51,290,828**
Commercial	**1,932,013**	**46,401**	**14,685,120**	**1,184,530**	**199,950**	**203,635**	**1,310,653**	**-**	**19,562,302**
Consumer	**67,862**	**253,706**	**481,073**	**11,207**	**46,802**	**-**	**-**	**25,525**	**886,175**
	$ 2,181,537	**$15,164,486**	**$220,060,793**	**$ 15,136,942**	**$ 4,483,862**	**$ 6,366,296**	**$ 7,843,897**	**$ 25,525**	**$ 271,263,338**

December 31, 2014	Excellent	Above average	Average	Below average	Pass watch	Special mention	Substandard	Doubtful	Total
Real estate:									
Commercial	$ -	$11,913,875	$150,376,313	$ 4,579,919	$ 4,146,591	$ 6,991,545	$ 3,873,323	$ -	$ 181,881,566
Construction and land development	-	453,450	10,329,503	1,150,425	1,587,275	2,377,032	2,694,630	-	18,592,315
Residential	197,646	3,692,659	38,425,315	1,582,748	1,622,627	-	166,757	-	45,687,752
Commercial	682,616	13,447	14,556,047	1,309,478	-	236,845	1,783,090	-	18,581,523
Consumer	87,577	268,451	391,234	21,170	49,067	-	-	35,212	852,711
	$ 967,839	$16,341,882	$214,078,412	$ 8,643,740	$ 7,405,560	$ 9,605,422	$ 8,517,800	$ 35,212	$ 265,595,867

5. **Loans** (Continued)

The following table details activity in the allowance for loan losses by portfolio for the years ended December 31, 2015 and 2014. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

						Allowance for loan losses ending balance evaluated for impairment:		Outstanding loan balances evaluated for impairment:	
December 31, 2015	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Individually	Collectively	Individually	Collectively
Real estate:									
Commercial	**$ 1,848,163**	**$ (129,907)**	**$ -**	**$ -**	**$ 1,718,256**	**$ -**	**$ 1,718,256**	**$ 2,240,046**	**$184,463,822**
Construction and land development	**458,211**	**48,771**	**(200,000)**	**-**	**306,982**	**167,211**	**139,771**	**956,813**	**11,863,352**
Residential	**278,943**	**42,299**		**842**	**322,084**	**-**	**322,084**	**-**	**51,290,828**
Commercial	**171,104**	**(41,096)**	**-**	**2,354**	**132,362**	**-**	**132,362**	**203,635**	**19,358,667**
Consumer	**8,215**	**(315)**			**7,900**	**-**	**7,900**	**-**	**886,175**
Unallocated	**15,613**	**80,248**	**-**	**-**	**95,861**	**-**	**95,861**	**-**	**-**
	$ 2,780,249	**$ -**	**$ (200,000)**	**$ 3,196**	**$ 2,583,445**	**$ 167,211**	**$ 2,416,234**	**$ 3,400,494**	**$267,862,844**

						Allowance for loan losses ending balance evaluated for impairment:		Outstanding loan balances evaluated for impairment:	
December 31, 2014	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Individually	Collectively	Individually	Collectively
Real estate:									
Commercial	$ 1,955,984	$ (107,821)	$ -	$ -	$ 1,848,163	$ -	$ 1,848,163	$ -	$181,881,566
Construction and land development	170,498	287,713		-	458,211	167,418	290,793	1,024,044	17,568,271
Residential	323,756	(66,316)	(4,602)	26,105	278,943	-	278,943	-	45,687,752
Commercial	109,651	59,853	-	1,600	171,104	-	171,104	-	18,581,523
Consumer	12,150	(10,127)		6,192	8,215	-	8,215	-	852,711
Unallocated	54,915	(39,302)	-	-	15,613	-	15,613	-	-
	$ 2,626,954	$ 124,000	$ (4,602)	$ 33,897	$ 2,780,249	$ 167,418	$ 2,612,831	$ 1,024,044	$264,571,823

Loans with a balance of approximately **$58** million were pledged as collateral to the FHLB of Atlanta as of December 31, 2015. Loans with a balance of approximately **$34** million were pledged as collateral to the Federal Reserve Bank of Richmond as of December 31, 2015. At December 31, 2015 and 2014, the Bank serviced participation loans for others totaling **$27.5** and $21.5 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	**2015**	2014
Land and improvements	-	**$ 1,952,998**	$ 1,952,998
Buildings and improvements	15-39 years	**5,659,635**	5,476,356
Furniture and equipment	3-10 years	**3,308,986**	3,041,186
		10,921,619	10,470,540
Accumulated depreciation and amortization		**5,273,686**	4,934,418
		$ 5,647,933	$ 5,536,122
Depreciation and amortization expense		**$ 339,269**	$ 326,684

Software with a net book value of **$251,983** and $102,643 as of December 31, 2015 and 2014, respectively, is included in other assets. Amortization expense of **$46,442** and $27,674 was recorded in 2015 and 2014, 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 has been renewed for two five year terms with an expiration date of September 30, 2019. The lease has options to renew for six additional consecutive five-year terms. Effective in July 2012, the Bank entered into an operating lease 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 2015 for another year. The Bank entered into an operating lease for the corporate headquarters in September 2015. The lease expires in September 2020 with options to renew for four additional consecutive five year terms.

Future minimum payments under the agreements are as follows:

Year	Amount
2016	$ 128,370
2017	132,385
2018	114,082
2019	72,706
2020	24,303
Thereafter	-
	$ 471,846

Rent expense was **$103,140** and $90,526 in 2015 and 2014, respectively.

8. Credit Commitments

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

	2015	2014
Loan commitments		
Construction and land development	**$ -**	$ 1,776,000
Commercial	**482,000**	2,557,831
Commercial real estate	**14,898,000**	10,488,230
Residential	**4,766,130**	2,112,500
	$20,146,130	$ 16,934,561
Unused lines of credit		
Home-equity lines	**$ 3,307,863**	$ 3,775,208
Commercial lines	**33,231,204**	27,432,639
	$36,539,067	$ 31,207,847
Letters of credit	**$ 1,408,460**	$ 1,208,505

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 were **$153,534** and $148,211 for 2015 and 2014, 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 **$4,433** and $4,078 in 2015 and 2014, respectively.

In 2010 and 2015, the Bank adopted supplemental executive retirement plans for three of its executives. The plans provide cash compensation to the executive officers under certain circumstances, including a separation of service. The benefits vest over the period from adoption to a specified age for each executive. The Bank recorded expenses, including interest, of **$228,929** and $183,124 in 2015 and 2014, 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:

	2015	2014
NOW	**$ 35,533,282**	$ 30,598,625
Money market	**52,598,431**	49,905,062
Savings	**36,343,747**	32,879,090
Certificates of deposit, $250,000 or more	**16,979,039**	17,958,614
Other time deposits	**76,466,296**	77,808,706
	$217,920,795	$ 209,150,097

As of December 31, 2015, certificates of deposit mature as follows:

Year	Amount
2016	$ 49,900,344
2017	20,296,266
2018	16,530,768
2019	2,908,859
2020	3,809,098
	$ 93,445,335

11. Borrowed Funds

Borrowed funds consist of securities sold under repurchase agreements, which 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:

	2015	2014
Amounts outstanding at year-end:		
Securities sold under repurchase agreements	**$ 20,490,619**	$ 19,639,327
Federal Home Loan Bank advances	**$ 11,000,000**	$ 8,000,000
Federal Home Loan Bank advances mature in:		
2015	**$ -**	$ 4,000,000
2016	**5,000,000**	4,000,000
2017	**1,000,000**	-
2018	**5,000,000**	-
Weighted average rate paid at December 31:		
Securities sold under repurchase agreements	**0.53%**	0.56%
Federal Home Loan Bank advances	**0.94%**	0.63%
Maximum month-end amount outstanding:		
Securities sold under repurchase agreements	**$ 20,655,156**	$ 20,718,947
Federal Home Loan Bank advances	**11,000,000**	10,000,000
Average amount outstanding:		
Securities sold under repurchase agreements	**$ 18,582,245**	$ 18,831,119
Federal Home Loan Bank advances	**10,778,082**	9,841,096
Borrowings from FRB and commercial banks	**2,742**	30
Average rate paid during the year:		
Securities sold under repurchase agreements	**0.54%**	0.58%
Federal Home Loan Bank advances	**0.75%**	0.55%
Borrowings from FRB and commercial banks	**0.52%**	0.50%
Investment securities underlying the repurchase agreements at year end:		
Carrying value	**$ 21,127,194**	$ 21,883,670
Estimated fair value	**21,355,393**	22,132,447
Loans pledged to the Federal Home Loan Bank at year-end:		
Carrying value	**$ 57,812,753**	$ 46,848,333
Loans pledged to the Federal Reserve Bank at year-end:		
Carrying value	**$ 34,487,029**	$ 45,744,325

The Bank is approved to borrow approximately $43.4 million against eligible pledged single family residential loans, eligible pledged multi-family loans, and eligible pledged commercial loans 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 $26.7 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:

	2015	2014
Automated teller machine and debit card expenses	**$ 263,220**	$ 261,493
Professional services	**224,333**	168,298
Advertising	**196,112**	209,215
Directors fees	**188,476**	190,105
Postage, delivery, and armored carrier	**179,109**	175,964
Stationery, printing, and supplies	**153,491**	137,431
Telephone	**149,375**	144,624
Internet banking fees	**111,471**	84,953
Correspondent bank services	**63,240**	51,940
Travel and conferences	**56,173**	50,945
Liability insurance	**46,880**	47,600
Maryland state assessment	**39,279**	36,970
Dues and subscriptions	**37,538**	31,095
Other real estate owned	**32,695**	32,788
Remote deposit expenses	**28,782**	30,752
Contributions	**22,715**	24,561
Credit reports	**21,619**	18,357
Education and training	**11,378**	14,615
Other	**88,113**	75,413
	$ 1,913,999	$ 1,787,119

13. Income Taxes

The components of income tax expense are as follows:

	2015	2014
Current		
Federal	**$ 1,893,991**	$ 1,719,151
State	**541,064**	464,051
	2,435,055	2,183,202
Deferred	**95,150**	(138,348)
	$ 2,530,205	$ 2,044,854

13. **Income Taxes** (Continued)

The components of the deferred tax expense are as follows:

	2015	2014
Depreciation	$ 106,757	$ (19,342)
Provision for loan losses	31,094	(48,771)
Other real estate owned allowance for loss	63,403	(67,056)
Nonaccrual interest	(14,054)	70,683
Post-retirement benefits	(92,050)	(73,862)
	$ 95,150	$ (138,348)

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

Deferred tax assets		
Allowance for loan losses	$ 862,172	$ 893,266
Other real estate owned allowance for loss	223,850	287,253
Write-down of equity securities	5,522	5,522
Nonaccrual interest	14,054	-
Post-retirement benefits	423,786	331,736
Unrealized loss on securities available for sale	66,522	4,716
	1,595,906	1,522,493
Deferred tax liabilities		
Depreciation	375,801	269,044
	375,801	269,044
Net deferred tax asset	$1,220,105	$ 1,253,449

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	(2.2)	(2.8)
State income taxes, net of federal income tax benefit	5.2	5.2
Nondeductible expenses	0.1	-
Other	0.1	-
	37.2 %	36.4 %

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, 2011.

14. Capital Standards

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

The Basel III Capital Rules became effective for the Bank on January 1, 2015 (subject to a phase-in period for certain provisions). Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of Common Equity Tier 1 capital, Tier 1 capital, and Total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined).

In connection with the adoption of the Basel III Capital Rules, the Bank elected to opt-out of the requirement to include accumulated other comprehensive income in Common Equity Tier 1 capital. Common Equity Tier 1 capital for the Bank is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities and subject to transition provisions.

Under the revised prompt corrective action requirements, as of January 1, 2015, insured depository institutions are required to meet the following in order to qualify as "well capitalized:" (1) a common equity Tier 1 risk-based capital ratio of 6.5%; (2) a Tier 1 risk-based capital ratio of 8%; (3) a total risk-based capital ratio of 10%; and (4) a Tier 1 leverage ratio of 5%. Management believes that, as of December 31, 2015, the Bank met all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements were currently in effect.

The implementation of the capital conservation buffer will begin on January 1, 2016, at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have current applicability to the Bank.

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

The following table presents actual and required capital ratios as of December 31, 2015, for the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2015, based on the phase-in provisions of the Basel III Capital Rules. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules. The table also presents actual and required capital ratios as of December 31, 2014, under the rules in effect prior to the Basel III Capital Rules.

As of December 31, 2015, the most recent notification from the FDIC has categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain ratios as set forth in the table. There have been no conditions or events since that notification that management believes have changed the Bank's category.

14. **Capital Standards** (Continued)

The FDIC, through formal or informal agreement, has the authority to require an institution to maintain higher capital ratios than those provided by statute, to be categorized as well capitalized under the regulatory framework for prompt corrective action.

(Dollars in thousands)	Actual		Minimum Capital Adequacy		To Be Well Capitalized	
December 31, 2015	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	**38,908**	**13.69%**	**22,739**	**8.00%**	**28,424**	**10.00%**
Tier 1 capital (to risk-weighted assets)	**36,325**	**12.78%**	**17,055**	**6.00%**	**22,739**	**8.00%**
Common equity tier 1 (to risk-weighted assets)	**36,325**	**12.78%**	**12,791**	**4.50%**	**18,476**	**6.50%**
Tier 1 leverage (to average assets)	**36,325**	**10.64%**	**13,662**	**4.00%**	**17,077**	**5.00%**
December 31, 2014						
Total capital (to risk-weighted assets)	35,489	13.21%	21,495	8.00%	26,869	10.00%
Tier 1 capital (to risk-weighted assets)	32,709	12.17%	10,748	4.00%	16,121	6.00%
Tier 1 capital (to average assets)	32,709	10.16%	12,880	4.00%	16,100	5.00%

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.

15. Fair Value (Continued)

- 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.

The following table summarizes financial assets measured at fair value on a recurring and nonrecurring basis as of December 31, 2015 and 2014, 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, 2015				
Recurring				
Available for sale securities				
State and municipal	$ -	$ 1,349,242	$ -	$ 1,349,242
Mortgage-backed securities	-	22,295,342	-	22,295,342
	$ -	$ 23,644,584	$ -	$ 23,644,584
Nonrecurring				
Other real estate owned	$ -	$ -	$ 472,500	$ 472,500
Impaired loans	-	-	3,233,283	3,233,283
December 31, 2014				
Recurring				
Available for sale securities				
U.S. government agency	$ -	$ 4,417,092	$ -	$ 4,417,092
State and municipal	-	1,393,379	-	1,393,379
Mortgage-backed securities	-	14,071,929	-	14,071,929
	$ -	$ 19,882,400	$ -	$ 19,882,400
Nonrecurring				
Other real estate owned	$ -	$ -	$ 943,846	$ 943,846
Impaired loans	-	-	856,626	856,626

15. Fair Value (continued)

Reconciliation of Level 3 Inputs

	Other Real Estate Owned	Impaired Loans
December 31, 2014 balance	$ 943,846	$ 856,626
Additions	-	2,560,416
Advances	-	600,621
Write-downs	(22,500)	(200,000)
Loan loss provision	-	207
Proceeds from sale	(1,021,820)	-
Gain (loss) on sale	572,974	-
Principal payments received	-	(584,587)
December 31, 2015 balance	$ 472,500	$ 3,233,283

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, 2015		December 31, 2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$20,192,939	$20,192,939	$ 12,583,313	$ 12,583,313
Securities held to maturity	16,604,067	16,886,897	11,639,216	11,919,052
Mortgage loans held for sale	-	-	310,650	317,556
Federal Home Loan Bank stock	758,100	758,100	719,800	719,800
Loans, net	268,249,402	269,852,000	262,331,863	264,070,957
Financial liabilities				
Noninterest-bearing deposits	$58,043,942	$58,043,942	$ 52,060,433	$ 52,060,433
Securities sold under repurchase agreements	20,490,619	20,490,619	19,639,327	19,639,327
Interest-bearing deposits	217,920,795	211,316,000	209,150,097	209,320,097
Federal Home Loan Bank advances	11,000,000	11,006,000	8,000,000	8,015,000

The fair value of mortgage loans held for sale is determined by the expected sales price. 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.

15. Fair Value (continued)

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			
2015	December 31	September 30	June 30	March 31
Interest income	**$3,728,982**	**$ 3,685,503**	**$3,671,377**	**$3,619,539**
Interest expense	**313,295**	**303,055**	**289,256**	**284,040**
Net interest income	**3,415,687**	**3,382,448**	**3,382,121**	**3,335,499**
Provision for loan losses	**(15,000)**	**-**	**-**	**15,000**
Net income	**1,081,074**	**1,236,261**	**1,022,579**	**928,308**
Earnings per share - basic and diluted	**$ 0.66**	**$ 0.75**	**$ 0.63**	**$ 0.57**
2014				
Interest income	$ 3,612,709	$ 3,532,273	$ 3,573,709	$ 3,361,934
Interest expense	290,116	293,207	292,591	281,130
Net interest income	3,322,593	3,239,066	3,281,118	3,080,804
Provision for loan losses	60,000	-	50,000	14,000
Net income	939,218	911,432	896,494	826,829
Earnings per share - basic and diluted	$ 0.58	$ 0.56	$ 0.56	$ 0.51

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 26, 2016 there were 1,647,541 shares of Common Stock issued and outstanding held by approximately 584 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
2015			
Quarter ended December 31	$24.10	$22.80	$0.33
Quarter ended September 30	26.00	21.30	0.00
Quarter ended June 30	21.50	19.70	0.31
Quarter ended March 31	20.52	19.95	0.00
2014			
Quarter ended December 31	$20.50	$19.30	$0.30
Quarter ended September 30	20.00	18.50	0.00
Quarter ended June 30	20.00	17.75	0.29
Quarter ended March 31	18.00	17.15	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
4510 Lower Beckleysville Road, Suite H
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410-374-1510

Annual Meeting
The annual meeting of stockholders will be held
April 26, 2016 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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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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