FARMERS AND MERCHANTS BANCSHARES, INC.
2016 ANNUAL REPORT

FARMERS & MERCHANTS BANK

THE "COMMUNITY" BANK THAT PUTS PEOPLE FIRST

Member FDIC

April 6, 2017

Dear Stockholders, Customers, and Friends:

Farmers and Merchants Bancshares, Inc. (the "Company"), the parent of Farmers and Merchants Bank (the "Bank"), achieved its second best year of earnings in the history of the Company. Net income for the year ended December 31, 2016 (restated – see Note 2 of the audited financial statements) was $3,909,129 or $2.37 per share compared to $4,268,222 or $2.61 per share in 2015. The decrease in net income of $359,093 is due primarily to a significant decline in noninterest income. This is a result of non-recurring transactions included in 2015's noninterest revenue totaling $530,706 that, net of taxes, increased 2015's net income by $297,094. Without these non-recurring transactions, 2015's net income would have been $3,971,128 or $2.43 per share, just slightly better than 2016.

Return on average equity was 10.26% in 2016 compared to 12.26% in 2015. Return on average assets was 1.08% in 2016 compared to 1.29% in 2015. Cash dividends paid to shareholders in 2016 increased 9% to $0.70 per common share from $0.64 per common share in 2015. During 2016, the price of the Bank's stock increased $1.65 per share or 7%, from $24.10 to $25.75. The total return for the year, including the cash dividends, was 10%.

Total assets of $380 million as of December 31, 2016 increased 10% from $345 million as of December 31, 2015. The loan portfolio increased 10% to $295 million at December 31, 2016 from $268 million at December 31, 2015. Deposits also increased 10% to $303 million at December 31, 2016 from $276 million at the end of 2015. The book value of the common stock of the Bank was $23.55 per share at December 31, 2016, compared to $21.99 per share at the end of 2015.

Our outstanding performance in 2016 earned the Bank a top 5 ranking state-wide among the 55 Maryland state headquartered banks as determined by the Financial Management Consulting Group. This is our seventh consecutive year in the top 5. Also, we were the highest rated bank in the Baltimore Metropolitan area and have been ranked in the top 2 for seven consecutive years. The rankings were based upon numerous criteria including profitability, efficiency, and asset quality.

Please visit the Company'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 Company's officers and directors.

Prudent oversight and diligent 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 Farmers and Merchants Bancshares, Inc.

Sincerely yours,

Paul F. Wooden, Jr.
Chairman

James R. Bosley, Jr.
President

Farmers and Merchants Banchares, Inc.

About The Company

General

Farmers and Merchants Bancshares, Inc. (the "Company") was incorporated on August 8, 2016. The Company has two wholly-owned subsidiaries, Farmers and Merchants Bank (the "Bank") and Series Protected Cell FCB-4 (the "Insurance Subsidiary"). 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. The Insurance Subsidiary is a captive insurance entity that provides insurance coverage for Farmers and Merchants Bank.

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 Bancshares, Inc.

MISSION STATEMENT

The mission of Farmers and Merchants Bancshares, Inc. through our wholly-owned subsidiary, 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.

Farmers and Merchants Bank

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 Bancshares, Inc.
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 Bancshares, Inc.
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
Retired Principal
KLNB, LLC

Bruce L. Schindler
President
Bob Davidson Ford Lincoln

Teresa L. Smack
President
Terry's Tag & Title

Farmers and Merchants Bancshares, Inc.
Officers

James R. Bosley, Jr., President & CEO
Mark C. Krebs, Treasurer & CFO
Christopher T. Oswald, Sr. Vice President
Lynnette Kitzmiller, Secretary

Farmers and Merchants Bank
Officers

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

Christopher T. Oswald
SVP/Chief Operations Officer

Mark C. Krebs
SVP/Chief Financial Officer

Senior Vice Presidents

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

Vice Presidents

Lynnette Kitzmiller.........Corporate Secretary
Kevin P. Bankert..........Commercial Banking
M. Eugene Bosley.........Commercial Banking
William D. Sherman.......Commercial Banking
J. Thomas Turner.............Mortgage Officer

Other Bank Officers

T. Jeffrey Horner........................Controller
Mark W. Lutrey............................Auditor
Suzette L. Covalt.........Commercial Banking

Assistant Vice Presidents
Loan Officers

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

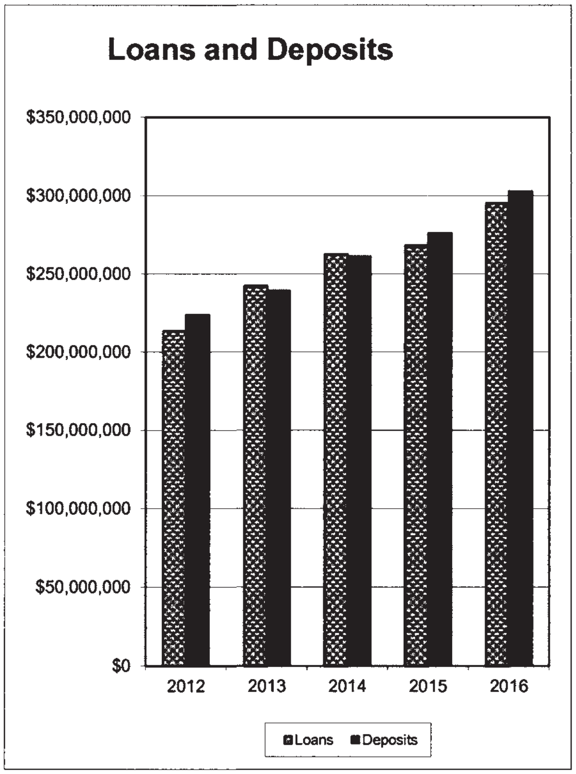
Assistant Vice Presidents
Branch Managers

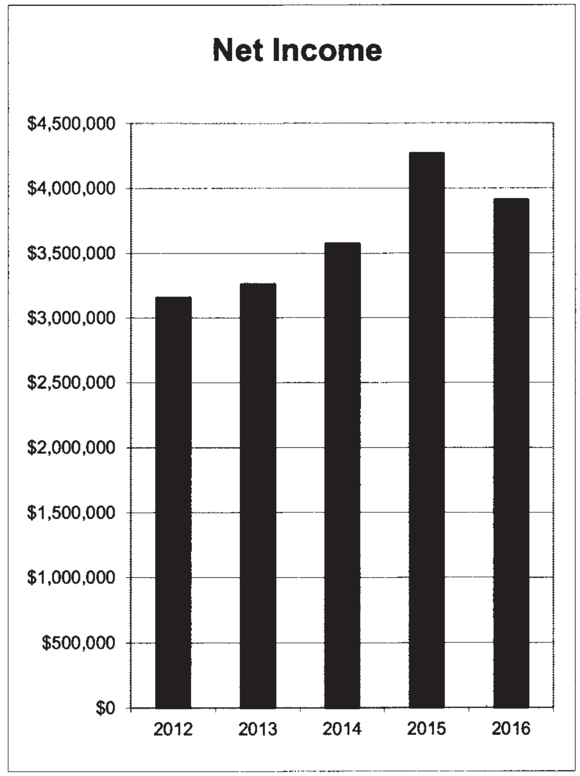
Amy L. Collins..........................Greenmount
Rachel L. Heird......................Owings Mills
Kelly P. Johnson.......................Hampstead
Wendy A. Panek.....................Reisterstown
Shannon M. Panek-Close..........Main Office
Deborah A. Zepp...................Westminster

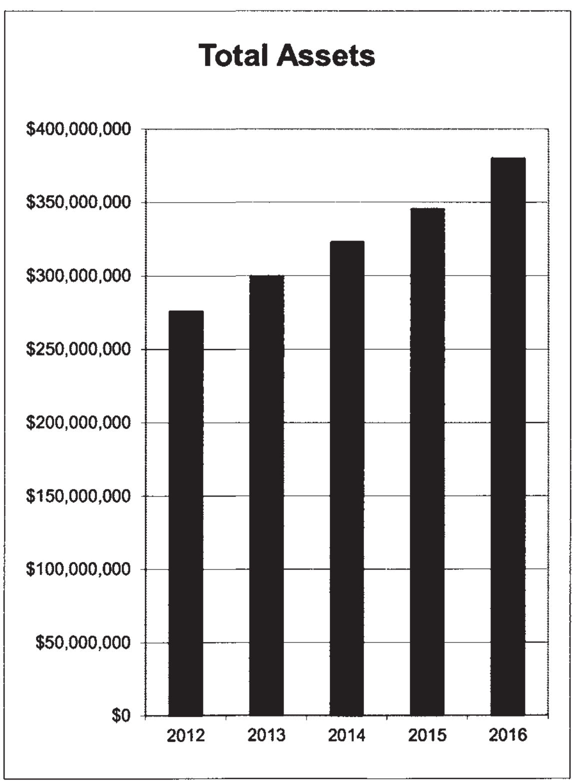
Farmers and Merchants Bancshares, Inc.
Selected Consolidated Financial Data

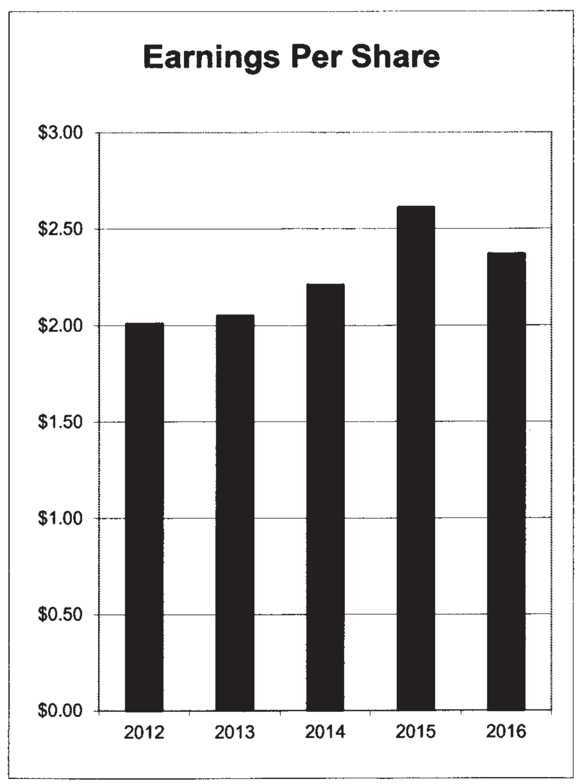
	2016 Restated	2015	2014	2013	2012
OPERATING DATA					
Interest income	$ 15,351,497	$ 14,705,401	$ 14,080,625	$ 13,145,932	$ 13,334,852
Interest expense	1,346,120	1,189,646	1,157,044	1,229,962	1,543,127
Net interest income	14,005,377	13,515,755	12,923,581	11,915,970	11,791,725
Provision for loan losses	-	-	124,000	-	280,000
Net interest income after provision for loan losses	14,005,377	13,515,755	12,799,581	11,915,970	11,511,725
Noninterest income	1,465,197	1,986,260	1,240,360	1,416,552	1,488,405
Noninterest expense	9,534,625	8,703,588	8,421,114	8,233,724	8,081,562
Income before income taxes	5,935,949	6,798,427	5,618,827	5,098,798	4,918,568
Income taxes	2,026,820	2,530,205	2,044,854	1,837,847	1,760,577
Net income	$ 3,909,129	$ 4,268,222	$ 3,573,973	$ 3,260,951	$ 3,157,991
PER SHARE DATA					
Net income (Basic)	$2.37	$2.61	$2.21	$2.05	$2.01
Dividends	$0.70	$0.64	$0.59	$0.54	$0.49
Book value per share	$23.55	$21.99	$20.08	$18.22	$17.12
Dividend payout ratio	29.58%	24.52%	26.70%	26.34%	24.38%
KEY RATIOS					
Return on average assets	1.08%	1.29%	1.15%	1.16%	1.19%
Return on average equity	10.26%	12.26%	11.43%	11.42%	12.10%
Net yield on interest-earning assets	4.13%	4.33%	4.47%	4.57%	4.82%
Efficiency ratio	61.63%	56.14%	59.45%	61.76%	60.85%
Average equity to average assets	10.56%	10.50%	10.05%	10.12%	9.81%
AT PERIOD END					
Total assets	$ 379,831,359	$ 345,309,996	$ 322,787,387	$ 299,696,863	$ 275,678,997
Loans, net and loans held for sale	296,171,072	268,249,402	262,642,513	242,400,282	215,732,977
Cash, federal funds sold, and other interest-earning deposits	13,312,915	20,192,839	12,583,313	11,652,949	14,162,898
Securities	52,373,567	40,248,651	31,521,616	28,886,337	29,138,128
Deposits	302,715,136	275,964,737	261,210,530	239,301,461	223,777,174
Borrowings	36,226,159	31,490,619	27,639,327	30,028,849	23,805,224
Stockholders' equity	39,012,277	36,223,361	32,702,470	29,309,236	27,185,871
SELECTED AVERAGE BALANCES					
Total assets	$ 361,005,005	$ 331,522,302	$ 311,036,540	$ 282,166,001	$ 266,001,542
Loans, net and loans held for sale	281,709,043	269,406,618	250,184,181	221,296,084	203,674,734
Cash, federal funds sold, and other interest-earning deposits	13,271,319	15,227,040	15,887,073	14,287,631	11,429,805
Securities	50,876,488	31,988,098	29,825,093	31,502,253	35,385,731
Deposits	284,921,811	265,634,314	249,741,172	226,685,504	216,758,404
Borrowings	36,175,989	29,363,070	28,672,245	25,844,870	22,075,830
Stockholders' equity	38,115,746	34,810,159	31,268,365	28,543,659	26,101,101
ASSET QUALITY					
Nonperforming assets	$ 1,166,889	$ 1,429,313	$ 943,846	$ 2,219,391	$ 2,987,707
Nonperforming assets/total assets	0.31%	0.41%	0.29%	0.74%	1.08%
Allowance for loan losses/total loans	0.79%	0.95%	1.05%	1.07%	1.24%

Farmers and Merchants Bancshares, Inc.
Selected Consolidated Financial Data
Restated









ROWLES
& Company, LLP
Certified Public Accountants

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Farmers and Merchants Bancshares, Inc.
Hampstead, Maryland

We have audited the accompanying consolidated balance sheets of Farmers and Merchants Bancshares, Inc. and Subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2016. Farmers and Merchants Bancshares' management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Farmers and Merchants Bancshares, Inc. and Subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, the financial statements as of and for the year ended December 31, 2016, have been restated to correct a misstatement.

Rowles & Company, LLP

Baltimore, Maryland
February 28, 2017 (April 6, 2017, as to the effects of the restatement discussed in Note 2)

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

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Consolidated Balance Sheets

December 31,		2016 Restated		2015
Assets				
Cash and due from banks	**$**	**12,334,358**	$	18,535,302
Federal funds sold and other interest-bearing deposits		**978,557**		1,657,537
Cash and cash equivalents		**13,312,915**		20,192,839
Certificate of deposit in other bank		**100,000**		100,000
Securities available for sale		**34,385,939**		23,644,584
Securities held to maturity		**17,987,628**		16,604,067
Federal Home Loan Bank stock, at cost		**778,300**		758,100
Mortgage loans held for sale		**884,500**		-
Loans, less allowance for loan losses of **$2,363,086** and $2,583,445		**295,286,572**		268,249,402
Premises and equipment		**5,449,678**		5,647,933
Accrued interest receivable		**956,963**		850,923
Deferred income taxes		**1,029,019**		1,220,105
Other real estate owned		**414,000**		472,500
Bank owned life insurance		**6,721,003**		6,541,381
Other assets		**2,524,842**		1,028,162
	$	**379,831,359**	$	345,309,996
Liabilities and Stockholders' Equity				
Deposits				
Noninterest-bearing	**$**	**62,791,835**	$	58,043,942
Interest-bearing		**239,923,301**		217,920,795
Total deposits		**302,715,136**		275,964,737
Securities sold under repurchase agreements		**27,226,159**		20,490,619
Federal Home Loan Bank of Atlanta advances		**9,000,000**		11,000,000
Accrued interest payable		**141,903**		137,968
Other liabilities		**1,735,884**		1,493,311
		340,819,082		309,086,635
Stockholders' equity				
Common stock, par value $.01 per share in 2016 and $10 per share in 2015, authorized 5,000,000 shares; issued and outstanding 1,656,390 shares in 2016 and 1,647,541 shares in 2015		**16,564**		16,475,415
Additional paid-in capital		**26,562,919**		9,889,659
Retained earnings		**12,713,099**		9,960,410
Accumulated other comprehensive income		**(280,305)**		(102,123)
		39,012,277		36,223,361
	$	**379,831,359**	$	345,309,996

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

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Consolidated Statements of Income

Years Ended December 31,	2016 Restated	2015
Interest income		
Loans, including fees	$ 14,024,899	$ 13,809,312
Investment securities - taxable	762,383	479,217
Investment securities - tax exempt	501,530	367,030
Federal funds sold and other interest earning assets	62,685	49,842
Total interest income	15,351,497	14,705,401
Interest expense		
Deposits	1,098,987	1,005,317
Securities sold under repurchase agreements	144,620	99,886
Federal Home Loan Bank advances and other borrowings	102,513	84,443
Total interest expense	1,346,120	1,189,646
Net interest income	14,005,377	13,515,755
Provision for loan losses	-	-
Net interest income after provision for loan losses	14,005,377	13,515,755
Noninterest income		
Service charges on deposit accounts	758,075	748,310
Mortgage banking income	471,982	393,884
Bank owned life insurance income	179,622	72,264
Net (loss) gain on sale of securities	-	(5,508)
Gain (loss) on sale and write down of other real estate owned	(57,065)	550,474
Gain on sale of loans	-	107,830
Other fees and commissions	112,583	119,006
Total noninterest income	1,465,197	1,986,260
Noninterest expense		
Salaries	4,661,703	4,240,524
Employee benefits	1,217,508	1,131,389
Occupancy	649,055	640,083
Furniture and equipment	649,865	609,458
Other	2,356,494	2,082,134
Total noninterest expense	9,534,625	8,703,588
Income before income taxes	5,935,949	6,798,427
Income taxes	2,026,820	2,530,205
Net income	$ 3,909,129	$ 4,268,222
Earnings per share - basic and diluted	$ 2.37	$ 2.61

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

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

Years Ended December 31,	2016 Restated	2015
Net income	**$ 3,909,129**	$ 4,268,222
Other comprehensive income (loss), net of income taxes:		
Securities available for sale		
Net unrealized gain (loss) arising during the period	**(294,248)**	(148,511)
Reclassification adjustment for realized gains and losses included in net income	**-**	(8,179)
Total unrealized gain (loss) on investment securities available for sale	**(294,248)**	(156,690)
Income tax expense (benefit) relating to investment securities available for sale	**(116,066)**	(61,806)
Total other comprehensive income (loss)	**(178,182)**	(94,884)
Total comprehensive income	**$ 3,730,947**	$ 4,173,338

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

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

	Common stock		Additional paid-in	Retained	Accumulated other comprehensive	Total stockholders'
	Shares	Par value	capital	earnings	income	equity
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**
Net income - Restated	-	-	-	**3,909,129**	-	**3,909,129**
Unrealized loss on securities available for sale net of income tax benefit of $116,066	-	-	-	-	**(178,182)**	**(178,182)**
Par value change as a result of the holding company formation	-	**(16,547,340)**	**16,547,340**	-	-	-
Cash dividends, $0.70 per share	-	-	-	**(1,156,440)**	-	**(1,156,440)**
Dividends reinvested	**8,849**	**88,489**	**125,920**	-	-	**214,409**
Balance, December 31, 2016 - Restated	**1,656,390**	**$ 16,564**	**$ 26,562,919**	**$ 12,713,099**	**$ (280,305)**	**$ 39,012,277**

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

Farmers and Merchants Bancshares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

Years Ended December 31,	**2016 Restated**	2015
Cash flows from operating activities		
Interest received	**$ 15,284,615**	$ 14,669,641
Fees and commissions received	**1,285,575**	1,346,530
Interest paid	**(1,342,185)**	(1,197,946)
Proceeds from sale of mortgage loans held for sale	**22,360,618**	16,503,589
Origination of mortgage loans held for sale	**(23,245,118)**	(16,192,939)
Cash paid to suppliers and employees	**(9,441,840)**	(8,204,143)
Income taxes paid	**(2,462,983)**	(2,573,681)
Cash provided by operating activities	**2,438,682**	4,351,051
Cash flows from investing activities		
Proceeds from maturity and call of securities		
Available for sale	**8,101,190**	4,753,161
Held to maturity	**3,306,926**	2,975,000
Proceeds from sale of securities		
Available for sale	**298,379**	543,277
Held to maturity	**-**	517,125
Purchase of securities		
Available for sale	**(19,590,432)**	(12,190,544)
Held to maturity	**(4,692,897)**	(5,560,761)
Loans made to customers, net of principal collected	**(27,083,940)**	(5,864,275)
Redemption (purchase) of stock in FHLB of Atlanta	**(20,200)**	(38,300)
Other real estate owned proceeds	**-**	1,021,820
Purchase of bank owned life insurance	**-**	(400,000)
Purchases of premises, equipment and software	**(181,540)**	(451,080)
Cash used by investing activities	**(39,862,514)**	(14,694,577)
Cash flows from financing activities		
Net increase (decrease) in		
Noninterest-bearing deposits	**4,747,893**	5,983,509
Interest-bearing deposits	**22,002,506**	8,770,698
Securities sold under repurchase agreements	**6,735,540**	851,292
Federal Home Loan Bank of Atlanta advances	**(2,000,000)**	3,000,000
Dividends paid, net of reinvestments	**(942,031)**	(652,447)
Cash provided by financing activities	**30,543,908**	17,953,052
Net increase in cash and cash equivalents	**(6,879,924)**	7,609,526
Cash and cash equivalents at beginning of period	**20,192,839**	12,583,313
Cash and cash equivalents at end of period	**$ 13,312,915**	$ 20,192,839

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

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Years Ended December 31,	2016 Restated	2015
Reconciliation of net income to net cash provided by operating activities		
Net income	**$ 3,909,129**	$ 4,268,222
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	**448,895**	385,711
Net loss (gain) on sale of investment securities:		
Available for sale	**-**	(8,179)
Held to maturity	**-**	13,687
Write down of other real estate owned	**58,500**	22,500
Net gain on sale of other real estate owned	**-**	(572,974)
Mutual fund dividend	**(7,612)**	-
Decrease (increase) in mortgage loans held for sale	**(884,500)**	310,650
Deferred income taxes	**307,153**	95,150
Amortization of premiums and accretion of discounts, net	**165,281**	73,509
Increase (decrease) in		
Deferred loan fees	**46,770**	(53,264)
Accrued interest payable	**3,935**	(8,300)
Other liabilities	**242,573**	404,519
Decrease (increase) in		
Accrued interest receivable	**(106,040)**	17,504
Bank owned life insurance cash surrender value	**(179,622)**	(72,264)
Other assets	**(1,565,780)**	(525,420)
Cash provided by operating activities	**$ 2,438,682**	$ 4,351,051

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 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 Bancshares, Inc. and its wholly owned subsidiaries, Farmers and Merchants Bank (the "Bank"), and Series Protected Cell FCB-4 (the "Insurance Subsidiary"), and one indirect subsidiary, Reliable Community Financial Services, Inc. (collectively the "Company", "we", "us", or "our"). The Insurance Subsidiary is a series investment, 100% owned by the Company, in First Community Bankers Insurance Co., LLC, a Tennessee "series" limited liability company and licensed property and casualty insurance company. Intercompany balances and transactions have been eliminated. Farmers and Merchants Bancshares, Inc. was formed effective November 1, 2016 and the Insurance Subsidiary was formed effective November 7, 2016. Results prior to November 1, 2016 are solely attributable to Farmers and Merchants Bank and its subsidiary Reliable Community Financial Services, Inc.

Business

Farmers and Merchants Bank provides banking services to individuals and businesses located in Baltimore County, Maryland, Carroll County, Maryland and surrounding areas of northern Maryland. The Insurance Subsidiary is a captive insurance entity that provides insurance coverage for Farmers and Merchants Bank. 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 2015 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 Company 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.

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 Company intends to extend the loan, and the borrower is making principal and interest payments in accordance with the terms of the matured note. 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. If collection of principal is evaluated as doubtful, all payments are applied to principal. 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.

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 Company'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 Company.

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 Company 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, 2016 and 2015, 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 Company. 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 and mortgage banking income

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.

The Company sells its mortgage loans to third party investors servicing released. Upon sale and delivery, loans are legally isolated from the Company and the Company has no ability to restrict or constrain the ability of third party investors to pledge or exchange the mortgage loans. The Company does not have the entitlement or ability to repurchase the mortgage loans or unilaterally cause third party investors to put the mortgage loans back to the Company.

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 **1,652,014** and 1,633,897 for 2016 and 2015, respectively. There are no potentially dilutive shares outstanding.

Subsequent events

The Company has evaluated events and transactions occurring subsequent to the statement of financial condition date of December 31, 2016 for items that should potentially be recognized or disclosed in these financial statements as prescribed by ASC Topic 855, Subsequent Events.

2. **Restatement**

Subsequent to the issuance of our 2016 Annual Report, the Company identified an error in its 2016 annual consolidated financial statements related to income taxes. Income tax expense for the year ended December 31, 2016 was understated by $393,735 and net income was overstated by the same amount because the income tax benefit from the prepaid captive insurance premium was overstated. A portion of the tax benefit from this transaction should have been deferred until 2017. The Company has concluded that this error is material to the consolidated financial statements for the year ended December 31, 2016.

The Consolidated Balance Sheet, Consolidated Statement of Operations, Consolidated Statement of Comprehensive Income, Consolidated Statement of Stockholders' Equity, and Consolidated Statement of Cash Flows, Notes 14, 15, 16, and 17 in these financial statements were updated to reflect the restatement.

2. **Restatement** (Continued)

Impacted Consolidated Balance Sheet Accounts as of December 31, 2016:

	As previously reported	Restatement adjustments	As restated
Cash and due from banks	$ 13,504,081	$ (1,169,723)	$ 12,334,358
Cash and cash equivalents	14,482,638	(1,169,723)	13,312,915
Deferred income taxes	1,420,891	(391,872)	1,029,019
Other assets	1,356,982	1,167,860	2,524,842
Total assets	380,225,094	(393,735)	379,831,359
Retained earnings	13,106,834	(393,735)	12,713,099
Total stockholders' equity	39,406,012	(393,735)	39,012,277
Total liabilities and stockholders' equity	380,225,094	(393,735)	379,831,359

Impacted Consolidated Statements of Income Accounts for the year ended December 31, 2016:

	As previously reported	Restatement adjustments	As restated
Income taxes	$ 1,633,085	$ 393,735	$ 2,026,820
Net income	4,302,864	(393,735)	3,909,129
Earnings per share - basic and diluted	2.60	(0.23)	2.37

Impacted Consolidated Statements of Cash Flows for the year ended December 31, 2016:

	As previously reported	Restatement adjustments	As restated
Cash paid to suppliers and employees	$ (8,272,117)	$ (1,169,723)	$ (9,441,840)
Cash provided by operating activities	3,608,405	(1,169,723)	2,438,682
Net increase in cash and cash equivalents	(5,710,201)	(1,169,723)	(6,879,924)
Cash and cash equivalents at the end of period	14,482,638	(1,169,723)	13,312,915
Net income	4,302,864	(393,735)	3,909,129
Deferred income taxes	(84,719)	391,872	307,153
Other assets	(397,920)	(1,167,860)	(1,565,780)

The Consolidated Statements of Comprehensive Income and Changes in Stockholders' Equity were corrected for the $393,735 decrease in net income.

3. **Cash and Equivalents**

The Company 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 **$7,042,956** and $7,772,791 during the years ended December 31, 2016 and 2015, 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 Company's normal balances of cash on hand and on deposit with other banks are sufficient to satisfy the reserve requirements.

4. Investment Securities

Investment securities are summarized as follows:

December 31, 2016	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Available for sale				
State and municipal	**$ 1,515,863**	**$ 62,512**	**$ 12,048**	**$ 1,566,327**
Mutual fund	**507,612**	**-**	**15,369**	**492,243**
SBA pools	**2,280,415**	**-**	**16,581**	**2,263,834**
Mortgage-backed securities	**30,544,941**	**20,139**	**501,545**	**30,063,535**
	$ 34,848,831	**$ 82,651**	**$ 545,543**	**$34,385,939**
Held to maturity				
State and municipal	**$ 17,987,628**	**$ 163,239**	**$ 317,068**	**$17,833,799**

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

4. **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, 2016	Amortized cost	Fair value	Amortized cost	Fair value
Within one year	**$ 507,612**	**$ 492,243**	**$ -**	**$ -**
Over one to five years	**-**	**-**	**-**	**-**
Over five to ten years	**1,136,919**	**1,163,288**	**2,657,130**	**2,702,121**
Over ten years	**378,944**	**403,039**	**15,330,498**	**15,131,678**
	2,023,475	**2,058,570**	**17,987,628**	**17,833,799**
Mortgage-backed securities and SBA pools, due in monthly installments	**32,825,356**	**32,327,369**	**-**	**-**
	$ 34,848,831	**$ 34,385,939**	**$ 17,987,628**	**$ 17,833,799**
December 31, 2015				
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

Securities with a carrying value of **$33,146,328** and $26,036,893 as of December 31, 2016 and 2015, respectively, were pledged as collateral for securities sold under repurchase agreements and municipal deposits.

In 2016, the Company realized no gain or loss on the sale of **one** security with gross proceeds of **$298,379**. In 2015, the Company 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 2015, the Company sold securities classified as held to maturity including state and municipal securities with an amortized cost of $530,812 due to the credit deterioration of the issuers.

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

December 31, 2016	Less than 12 months		12 months or more		Total	
Description of investments	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
State and municipal	**$ 8,558,230**	**$ 329,116**	**$ -**	**$ -**	**$ 8,558,230**	**$ 329,116**
Mutual fund	**492,243**	**15,369**	**-**	**-**	**492,243**	**15,369**
SBA pools	**2,263,834**	**16,581**	**-**	**-**	**2,263,834**	**16,581**
Mortgage-backed securities	**26,726,037**	**473,451**	**1,353,900**	**28,094**	**28,079,937**	**501,545**
Total	**$ 38,040,344**	**$ 834,517**	**$ 1,353,900**	**$ 28,094**	**$ 39,394,244**	**$ 862,611**

4. **Investment Securities** (Continued)

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

Management has the ability and intent to hold securities classified as held to maturity until they mature, at which time the Company should receive full value for the securities. As of December 31, 2016, 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, 2016, management believes the unrealized losses detailed in the table above are temporary and, accordingly, none of these unrealized losses have been recognized in the Company's consolidated statement of income.

5. **Related Party Transactions**

Certain executive officers and directors of the Company, including members of their immediate families and companies in which they are significant owners (more than 10%), were indebted to the Company. 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 Company. During the years ended December 31, 2016 and 2015, the activity of these loans was as follows:

	2016	**2015**
Balance, beginning of year	**$ 13,148,726**	$ 12,732,702
Additions	**3,987,121**	3,473,398
Amounts collected	**(4,205,038)**	(3,057,374)
Change in related parties	**(148,576)**	-
Balance, end of year	**$ 12,782,233**	$ 13,148,726

Unused lines of credit to related parties totaled **$2,220,128** and $2,240,340, at December 31, 2016 and 2015, respectively. Letters of credit were issued to directors totaling **$6,534** at December 31, 2016 and 2015, respectively.

Deposits at the Company from related parties totaled **$15,933,380** and $13,732,380 at December 31, 2016 and 2015, respectively.

Payments to companies controlled by directors totaled **$2,697** in 2016 and $90,479 in 2015. Payments to a retailer affiliated with a director totaled **$82** in 2016 and $2,779 in 2015. Another director was paid **$1,000** in 2016 and $3,000 in 2015 for his oversight of branch office repairs and maintenance. The Company occasionally utilizes the services of a real estate firm where another director was a partner, although no compensation was paid in 2016 or 2015.

6. Loans

Major categories of loans at December 31, 2016 and 2015 are as follows:

	2016	2015
Real estate:		
Commercial	**$ 206,145,076**	$ 186,703,868
Construction and land development	**14,392,992**	12,820,165
Residential	**54,710,809**	51,290,828
Commercial	**22,152,773**	19,562,302
Consumer	**725,269**	886,175
	298,126,919	271,263,338
Less: Allowance for loan losses	**2,363,086**	2,583,445
Deferred origination fees net of costs	**477,261**	430,491
	$ 295,286,572	$ 268,249,402

The maturity and rate repricing distribution of the loan portfolio as of December 31, 2016 and 2015, is as follows:

	2016	2015
Variable rate, immediately	**$ 41,628,685**	$ 27,803,011
Due within one year	**48,381,221**	33,826,370
Due over one to five years	**126,810,275**	153,408,126
Due over five years	**81,306,738**	56,225,831
	$ 298,126,919	$ 271,263,338

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

	2016	2015
Commercial real estate	**$ 752,889**	$ 956,813

At December 31, 2016, the Company had **two** nonaccrual construction and land development loans to one borrower totaling **$752,889**. The loans were secured by real estate and business assets, and were personally guaranteed. Gross interest income of **$38,028** would have been recorded in 2016 if these nonaccrual loans had been current and performing in accordance with the original terms. The Company allocated **$16,587** of its allowance for loan losses for these nonaccrual loans. The balance of nonaccrual loans was net of charge-offs of **$400,000** at December 31, 2016.

At December 31, 2015, the Company 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 Company 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.

6. **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, 2016							
Real estate:							
Commercial	$ -	$ -	$ -	$ -	$ 206,145,076	$ 206,145,076	$ -
Construction and land development	-	-	752,889	752,889	13,640,103	14,392,992	-
Residential	824,554	-	-	824,554	53,886,255	54,710,809	-
Commercial	48,719	-	-	48,719	22,104,054	22,152,773	-
Consumer	-	-	-	-	725,269	725,269	-
Total	$ 873,273	$ -	$ 752,889	$ 1,626,162	$ 296,500,757	$ 298,126,919	$ -
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	$ -

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, 2016							
Real estate:							
Commercial	$ 2,455,090	$ 2,183,509	$ 241,580	$ 2,425,089	$ 7,580	$ 2,332,568	$ 125,260
Construction and land development	1,152,889	-	752,889	752,889	16,587	854,851	-
Commercial	164,766	164,766	-	164,766	-	184,201	14,442
	$ 3,772,745	$ 2,348,275	$ 994,469	$ 3,342,744	$ 24,167	$ 3,371,620	$ 139,702
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	478,407	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	$ 2,980,391	$ 144,847

Impaired loans also include certain loans that have been modified in troubled debt restructurings ("TDRs") where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

6. **Loans** (Continued)

At December 31, 2016, the Company had **three** loans classified as a troubled debt restructuring. All are included in impaired loans above. The first is a commercial real estate loan with a balance of **$2,183,509**. The second is a commercial loan with a balance of **$164,766**. These two loans are paying as agreed. The third loan was restructured in 2016 with a balance of **$271,580**. The loan is a commercial real estate loan with a balance of **$241,580** at December 31, 2016 which is net of a **$30,000** charge-off. The Company has allocated $7,580 of its allowance for loan losses for this loan.

At December 31, 2015, the Company had two loans classified as a troubled debt restructuring. Both are included in impaired loans above. The first is a commercial real estate 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.

As part of our portfolio risk management, the Company 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, Average and Acceptable grades are assigned to loans with limited or no delinquent payments and more than sufficient collateral and/or cash flow.

A description of the general characteristics of loans characterized as watch list or classified is as follows:

Pass/Watch

Loans graded as Pass/Watch are secured by generally acceptable assets which reflect above-average risk. The loans warrant closer scrutiny by management than is routine, due to circumstances affecting the borrower, the borrower's industry, or the overall economic environment. Borrowers may reflect weaknesses such as inconsistent or weak earnings, break even or moderately deficit cash flow, thin liquidity, minimal capacity to increase leverage, or volatile market fundamentals or other industry risks. Such loans are typically secured by acceptable collateral, at or near appropriate margins, with realizable liquidation values.

Special Mention

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

Borrowers may exhibit poor liquidity and leverage positions resulting from generally negative cash flow or negative trends in earnings. Access to alternative financing may be limited to finance companies for business borrowers and may be unavailable for commercial real estate borrowers.

Substandard

A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Borrowers may exhibit recent or unexpected unprofitable operations, an inadequate debt service coverage ratio, or marginal liquidity and capitalization. These loans require more intense supervision by Bank management.

Doubtful

A doubtful loan has all the weaknesses inherent as a substandard loan with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

6. **Loans** (Continued)

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

December 31, 2016	Excellent	Above average	Average	Acceptable	Pass watch	Special mention	Substandard	Doubtful	Total
Real estate:									
Commercial	$ -	$ 9,584,756	$147,668,371	$ 32,474,566	$ 3,883,813	$ 8,644,563	$ 3,889,007	$ -	$ 206,145,076
Construction and land development	-	178,078	10,178,876	2,039,090	-	153,611	1,843,337	-	14,392,992
Residential	110,142	2,811,362	42,715,571	8,059,118	351,182	-	663,434	-	54,710,809
Commercial	1,666,880	77,745	18,469,572	1,228,598	545,212	164,766	-	-	22,152,773
Consumer	42,577	121,306	476,465	51,339	-	-	3,840	29,742	725,269
	$ 1,819,599	$12,773,247	$219,508,855	$ 43,852,711	$ 4,780,207	$ 8,962,940	$ 6,399,618	$ 29,742	$ 298,126,919

December 31, 2015	Excellent	Above average	Average	Acceptable	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

6. **Loans** (Continued)

The following table details activity in the allowance for loan losses by portfolio for the years ended December 31, 2016 and 2015. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

December 31, 2016	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Allowance for loan losses ending balance evaluated for impairment: Individually	Collectively	Outstanding loan balances evaluated for impairment: Individually	Collectively
Real estate:									
Commercial	**$ 1,718,256**	**$ 29,493**	**$ (30,000)**	**$ -**	**$ 1,717,749**	**$ 7,580**	**$ 1,710,169**	**$ 2,425,089**	**$203,719,987**
Construction and land development	**306,982**	**97,878**	**(200,000)**	**-**	**204,860**	**16,587**	**188,273**	**752,889**	**13,640,103**
Residential	**322,084**	**(184,773)**	**-**	**110,126**	**247,437**	**-**	**247,437**	**-**	**54,710,809**
Commercial	**132,362**	**93,383**	**(100,485)**	**-**	**125,260**	**-**	**125,260**	**164,766**	**21,988,007**
Consumer	**7,900**	**926**	**-**	**-**	**8,826**	**-**	**8,826**	**-**	**725,269**
Unallocated	**95,861**	**(36,907)**	**-**	**-**	**58,954**	**-**	**58,954**	**-**	**-**
	$ 2,583,445	**$ -**	**$ (330,485)**	**$ 110,126**	**$ 2,363,086**	**$ 24,167**	**$ 2,338,919**	**$ 3,342,744**	**$294,784,175**

December 31, 2015	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Allowance for loan losses ending balance evaluated for impairment: Individually	Collectively	Outstanding loan balances evaluated for impairment: 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

Loans with a balance of approximately **$61** million were pledged as collateral to the FHLB of Atlanta as of December 31, 2016. Loans with a balance of approximately **$41** million were pledged as collateral to the Federal Reserve Bank of Richmond as of December 31, 2016. At December 31, 2016 and 2015, the Company serviced participation loans for others totaling **$31.0** and $27.5 million, respectively.

The Company 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.

7. Premises and Equipment

A summary of premises and equipment is as follows:

	Useful lives	2016	2015
Land and improvements	-	**$ 1,952,998**	$ 1,952,998
Buildings and improvements	15-39 years	**5,659,635**	5,659,635
Furniture and equipment	3-10 years	**3,490,526**	3,308,986
		11,103,159	10,921,619
Accumulated depreciation and amortization		**5,653,481**	5,273,686
		$ 5,449,678	$ 5,647,933
Depreciation and amortization expense		**$ 379,795**	$ 339,269

Software with a net book value of **$185,253** and $251,983 as of December 31, 2016 and 2015, respectively, is included in other assets. Amortization expense of **$69,100** and $46,442 was recorded in 2016 and 2015, respectively.

8. Lease Commitments

The Company 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 Company 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 Company 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 2016 for another year. The Company 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
2017	$ 108,993
2018	83,835
2019	72,678
2020	24,303
2021	-
Thereafter	-
	$ 289,809

Rent expense was **$128,200** and $103,140 in 2016 and 2015, respectively.

9. Credit Commitments

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

	2016	2015
Loan commitments		
Construction and land development	$ 250,000	$ -
Commercial	1,050,000	482,000
Commercial real estate	17,134,718	14,898,000
Residential	3,894,689	4,766,130
	$22,329,407	$ 20,146,130
Unused lines of credit		
Home-equity lines	$ 3,345,309	$ 3,307,863
Commercial lines	27,182,226	33,231,204
	$30,527,535	$ 36,539,067
Letters of credit	$ 1,281,848	$ 1,408,460

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.

10. Retirement Plans

The Company 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 Company 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 Company's contributions to this plan were **$165,224** and $153,534 for 2016 and 2015, respectively.

10. **Retirement Plans** (Continued)

The Company 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 Company. Each of the agreements provides for the amount of death insurance benefits to be paid to beneficiaries of the insured. For this plan, the Company expensed **$4,816** and $4,433 in 2016 and 2015, respectively.

In 2010 and 2015, the Company 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 Company recorded expenses, including interest, of **$240,193** and $228,929 in 2016 and 2015, respectively, for these plans.

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

11. **Interest-Bearing Deposits**

Major classifications of interest-bearing deposits are as follows:

	2016	2015
NOW	**$ 40,090,252**	$ 35,533,282
Money market	**64,859,044**	52,598,431
Savings	**40,158,833**	36,343,747
Certificates of deposit, $250,000 or more	**15,233,383**	16,979,039
Other time deposits	**79,581,789**	76,466,296
	$239,923,301	$ 217,920,795

As of December 31, 2016, certificates of deposit mature as follows:

Year	Amount
2017	**$ 44,931,000**
2018	**22,124,546**
2019	**20,824,692**
2020	**3,325,772**
2021	**3,509,162**
Thereafter	**100,000**
	$ 94,815,172

12. **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 Company and maintained in the custody of an unaffiliated agent designated by the Company. Additional information is as follows:

	2016	2015
Amounts outstanding at year-end:		
Securities sold under repurchase agreements	**$ 27,226,159**	$ 20,490,619
Federal Home Loan Bank advances	**$ 9,000,000**	$ 11,000,000
Federal Home Loan Bank advances mature in:		
2016	**$ -**	$ 5,000,000
2017	**2,000,000**	1,000,000
2018	**5,000,000**	5,000,000
2019	**2,000,000**	-
Weighted average rate paid at December 31:		
Securities sold under repurchase agreements	**0.63%**	0.53%
Federal Home Loan Bank advances	**1.11%**	0.94%
Maximum month-end amount outstanding:		
Securities sold under repurchase agreements	**$ 32,287,740**	$ 20,655,156
Federal Home Loan Bank advances	**16,000,000**	11,000,000
Average amount outstanding:		
Securities sold under repurchase agreements	**$ 25,320,795**	$ 18,582,245
Federal Home Loan Bank advances	**10,833,333**	10,778,082
Borrowings from FRB and commercial banks	**21,861**	2,742
Average rate paid during the year:		
Securities sold under repurchase agreements	**0.64%**	0.54%
Federal Home Loan Bank advances	**0.94%**	0.75%
Borrowings from FRB and commercial banks	**0.67%**	0.52%
Investment securities underlying the repurchase agreements at year end:		
Carrying value	**$ 28,191,745**	$ 21,127,194
Estimated fair value	**28,165,979**	21,355,393
Loans pledged to the Federal Home Loan Bank at year-end:		
Carrying value	**$ 60,858,326**	$ 57,812,753
Loans pledged to the Federal Reserve Bank at year-end:		
Carrying value	**$ 40,954,231**	$ 34,487,029

The Company is approved to borrow approximately $53.3 million against eligible pledged single family residential loans, eligible pledged multi-family loans, eligible pledged commercial loans, and eligible securities under a secured line of credit with the FHLB of Atlanta. In addition, the Company has a facility with the FRB whereby the Company can borrow up to $30.3 million. The Company also has available an unsecured federal funds line of credit of $2 million and a secured federal funds line of credit of $9 million from a commercial bank.

Farmers and Merchants Bancshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

13. Other Noninterest Expenses

Other noninterest expenses include the following:

	2016	2015
Automated teller machine and debit card expenses	**$ 331,368**	$ 263,220
Professional services	**311,702**	224,333
Advertising	**217,116**	196,112
Directors fees	**189,263**	188,476
Stationery, printing, and supplies	**188,070**	153,491
Telephone	**185,532**	149,375
Postage, delivery, and armored carrier	**179,344**	179,109
Federal Deposit Insurance Corporation premiums	**147,940**	168,135
Internet banking fees	**143,210**	111,471
Correspondent bank services	**79,278**	63,240
Travel and conferences	**48,970**	56,173
Liability insurance	**46,917**	46,880
Maryland state regulatory assessment	**41,531**	39,279
Dues and subscriptions	**39,752**	37,538
Remote deposit expenses	**29,722**	28,782
Credit reports	**25,276**	21,619
Contributions	**23,160**	22,715
Education and training	**15,669**	11,378
Other real estate owned	**15,252**	32,695
Other	**97,422**	88,113
	$ 2,356,494	$ 2,082,134

14. Income Taxes

The components of income tax expense are as follows:

	2016 Restated	2015
Current		
Federal	**$ 1,355,273**	$ 1,893,991
State	**364,394**	541,064
	1,719,667	2,435,055
Deferred	**307,153**	95,150
	$ 2,026,820	$ 2,530,205

14. **Income Taxes** (Continued)

The components of the deferred tax expense are as follows:

	2016 Restated	2015
Depreciation	$ (46,226)	$ 106,757
Provision for loan losses	96,206	31,094
Other real estate owned allowance for loss	(23,075)	63,403
Nonaccrual interest	(15,000)	(14,054)
Prepaid captive insurance premium	393,735	-
Post-retirement benefits	(96,624)	(92,050)
	$ 309,016	$ 95,150

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

Deferred tax assets		
Allowance for loan losses	$ 765,966	$ 862,172
Other real estate owned allowance for loss	246,925	223,850
Write-down of equity securities	5,522	5,522
Nonaccrual interest	29,055	14,054
Post-retirement benefits	520,410	423,786
Unrealized loss on securities available for sale	182,588	66,522
	1,750,466	1,595,906
Deferred tax liabilities		
Prepaid captive insurance premium	393,735	-
Depreciation	329,575	375,801
	723,310	375,801
Net deferred tax asset	$1,027,156	$ 1,220,105

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

Statutory federal income tax rate	34.0 %	34.0 %
Increase (decrease) resulting from:		
Federal tax-exempt income	(4.9)	(2.2)
State income taxes, net of federal income tax benefit	4.9	5.2
Nondeductible expenses	0.1	0.1
Other	-	0.1
	34.1 %	37.2 %

Included in Federal tax-exempt income is the insurance premium revenue of the Insurance Subsidiary.

The Company does not have material uncertain tax positions and did not recognize any adjustments for unrecognized tax benefits. The Company remains subject to examination of income tax returns for the years ending after December 31, 2012.

15. Capital Standards

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional, discretionary actions by the regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our 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, 2016, the Bank met all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements were fully 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. Management believes that, as of December 31, 2016, 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 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, 2016 and 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, 2016 and 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.

As of December 31, 2016, 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.

15. **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, 2016	Amount	Ratio	Amount	Ratio	Amount	Ratio
	Restated	Restated				
Total capital (to risk-weighted assets)	**41,385**	**13.18%**	**27,076**	**8.63%**	**31,392**	**10.00%**
Tier 1 capital (to risk-weighted assets)	**39,022**	**12.43%**	**20,797**	**6.63%**	**25,114**	**8.00%**
Common equity tier 1 (to risk-weighted assets)	**39,022**	**12.43%**	**16,089**	**5.13%**	**20,405**	**6.50%**
Tier 1 leverage (to average assets)	**39,022**	**10.39%**	**15,025**	**4.00%**	**18,781**	**5.00%**

(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%

16. 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.

16. Fair Value (Continued)

- Level 3: Significant unobservable inputs that reflect the Company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company 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. Since 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. The appraised value is obtained annually from an independent third party appraiser and is reduced by expected sales costs, which has historically been 10% of the appraised value.
- 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 appraised value is obtained annually from an independent third party appraiser and is reduced by expected sales costs, which has historically been 10% of the appraised value.

The following table summarizes financial assets measured at fair value on a recurring and nonrecurring basis as of December 31, 2016 and 2015, 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, 2016				
Recurring				
Available for sale securities				
State and municipal	$ -	$ 1,566,327	$ -	$ 1,566,327
Mutual Fund	492,243	-	-	492,243
SBA pools	-	2,263,834	-	2,263,834
Mortgage-backed securities	-	30,063,535	-	30,063,535
	$ 492,243	$ 33,893,696	$ -	$ 34,385,939
Nonrecurring				
Other real estate owned	$ -	$ -	$ 414,000	$ 414,000
Impaired loans	-	-	3,318,577	3,318,577
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

16. Fair Value (continued)

Reconciliation of Level 3 Inputs

	Other Real Estate Owned	Impaired Loans
December 31, 2015 balance	$ 472,500	$ 3,233,283
Additions	-	271,580
Advances	-	604,695
Write-downs	(58,500)	(230,000)
Loan loss provision	-	143,044
Principal payments received	-	(704,025)
December 31, 2016 balance	$ 414,000	$ 3,318,577

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

	December 31, 2016		December 31, 2015	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Level 1 inputs	Restated	Restated		
Cash and cash equivalents	$ 13,312,915	$ 13,312,915	$ 20,192,939	$ 20,192,939
Level 2 inputs				
Securities held to maturity	17,987,628	17,833,799	16,604,067	16,886,897
Mortgage loans held for sale	884,500	902,061	-	-
Federal Home Loan Bank stock	778,300	778,300	758,100	758,100
Level 3 inputs				
Loans, net	295,286,572	297,982,000	268,249,402	269,852,000
Financial liabilities				
Level 1 inputs				
Noninterest-bearing deposits	$ 62,791,835	$ 62,791,835	$ 58,043,942	$ 58,043,942
Securities sold under repurchase agreements	27,226,159	27,226,159	20,490,619	20,490,619
Level 2 inputs				
Interest-bearing deposits	239,923,301	230,394,000	217,920,795	211,316,000
Federal Home Loan Bank advances	9,000,000	8,975,000	11,000,000	11,006,000

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.

16. 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.

17. Quarterly Results of Operations

	Three Months Ended Unaudited			
2016	December 31	September 30	June 30	March 31
	Restated			
Interest income	**$3,992,191**	**$ 3,856,566**	**$3,731,160**	**$3,771,580**
Interest expense	**368,885**	**340,099**	**322,540**	**314,596**
Net interest income	**3,623,306**	**3,516,467**	**3,408,620**	**3,456,984**
Provision for loan losses	-	-	-	-
Net income	**1,016,101**	**1,040,372**	**916,188**	**936,468**
Earnings per share - basic and diluted	**$ 0.61**	**$ 0.63**	**$ 0.56**	**$ 0.57**

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

18. Litigation

In the ordinary course of its business, the Company 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 Company.

Farmers and Merchants Bancshares, Inc.

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

The Company's Articles of Incorporation authorize the Company to issue up to 5,000,000 shares of common stock, par value $.01 per share (the "Common Stock"). As of February 28, 2017 there were 1,656,390 shares of Common Stock issued and outstanding held by approximately 587 stockholders of record.

Although many trades occur through privately-negotiated transactions, the shares of the Company's common stock are traded in the over-the-counter market by certain broker-dealers and price quotations are available through the OTC Markets Group's OTC Pink Market (the "Pink Market") under the symbol "FMFG". Prior to the Reorganization, the Bank's common stock was also traded in the over-the-counter market and price quotations were likewise available through the Pink Market under the same trading symbol. The following table sets forth, for the periods indicated, high and low bid information for the common stock as reported through the Pink Market. Price information for periods ending prior to November 1, 2016 relate to transactions in the Bank's common stock. These prices do not include retail mark-ups, markdowns or commissions, and may not necessarily represent actual transactions. The table also shows the per share cash dividends declared during these periods.

	High	Low	Dividend Per Share
2016			
Quarter ended December 31	$26.55	$24.11	$0.36
Quarter ended September 30	25.51	24.50	0.00
Quarter ended June 30	27.25	25.00	0.34
Quarter ended March 31	25.15	24.10	0.00
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

The Company's ability to declare and pay dividends is limited by federal banking laws and Maryland corporation laws. Subject to these laws, the payment of dividends are at the discretion of the Company's board of directors, who considers such factors as operating results, financial condition, capital adequacy, regulatory requirements, and stockholder return. The Company's ability to pay dividends will be largely dependent on its receipt of dividends from the Bank and/or the Insurance Subsidiary. Like the Company, the Bank's ability to declare and pay dividends is subject to limitations imposed by federal and Maryland banking and Maryland corporation laws, and the Insurance Subsidiary's ability to declare and pay dividends is subject to limitations imposed by Tennessee insurance laws. Accordingly, there can be no assurance that dividends will be declared on the shares of the common stock in any future fiscal quarter.

Farmers and Merchants Bancshares, Inc.

Stockholder Information

Corporate Headquarters
4510 Lower Beckleysville Road, Suite H
Hampstead, MD 21074
410-374-1510

Annual Meeting
The annual meeting of stockholders will be held
April 25, 2017 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 Bancshares, Inc.
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 Bancshares, Inc. 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
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