FARMERS AND MERCHANTS BANCSHARES, INC.

2017 ANNUAL REPORT

FARMERS & MERCHANTS BANK

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

Member FDIC

February 28, 2018

Dear Stockholders, Customers, and Friends:

Farmers and Merchants Bancshares, Inc. (the "Company"), the parent of Farmers and Merchants Bank (the "Bank"), announced that net income for the year ended December 31, 2017 was $3,789,241, or $2.28 per common share compared to $3,909,129, or $2.37 per common share in 2016. We were on pace throughout the year to exceed our 2016 results, however our net income for 2017 was significantly affected by $410,391, or $0.25 per common share in additional income tax expense recognized in the quarter ended December 31, 2017 as a result of the Tax Cuts and Jobs Act enacted in December 2017. While this legislation will provide a permanent reduction of the federal corporate income tax rate from 34% to 21% to take effect in 2018, the enactment of the law during 2017 required the Company to revalue its net deferred tax asset in 2017. Without the additional tax expense, the Company's net income would have been $4,199,632, or $2.53 per common share. The good news is that our core operations are strong and when combined with this tax reduction our opportunities for success going forward are very promising.

Return on average equity was 9.26% in 2017 compared to 10.26% in 2016. Return on average assets was 0.96% in 2017 compared to 1.08% in 2016. Excluding the additional tax expense noted above, the return on equity would have been 10.26% and the return on assets would have been 1.06%. Cash dividends paid to stockholders in 2017 increased 9% to $0.76 per common share from $0.70 per common share in 2016. During 2017, the price of the Company's stock increased $3.75 per share or 15%, from $25.75 to $29.50. The total return for the year, including the cash dividends, was 18%.

Total assets at December 31, 2017 were $403 million, an increase of 6% from the $380 million recorded at December 31, 2016. The loan portfolio increased 13% to $333 million at December 31, 2017 from $295 million at December 31, 2016. Deposits increased 6% to $320 million at December 31, 2017 from $303 million at the end of 2016. The book value of the common stock of the Company was $25.06 per share at December 31, 2017, compared to $23.55 per share at the end of 2016.

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 Bancshares, 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
Managing Executive
The Taylor Foundation & Taylor Properties, LLC

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.

Ronald W. Hux
President
Douron, Inc.

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

J. Lawrence Mekulski
Retired Principal
KLNB, LLC

Louna S. Primm
Retired Bank Executive

Bruce L. Schindler
President
Bob Davidson Ford Lincoln

Teresa L. Smack
President
Terry's Tag & Title

Director Emeritus

Kenneth W. Hoffmeyer

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
EVP/Chief Operations Officer

Mark C. Krebs
EVP/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

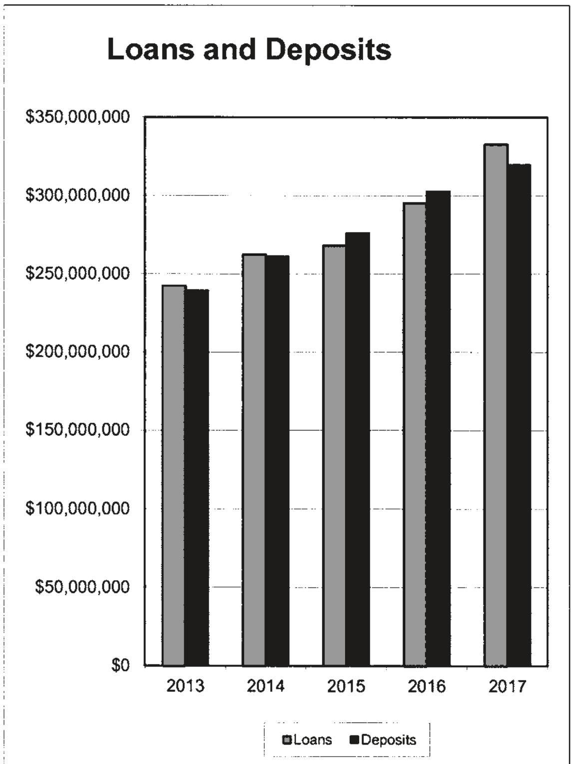
Assistant Vice Presidents
Branch Managers

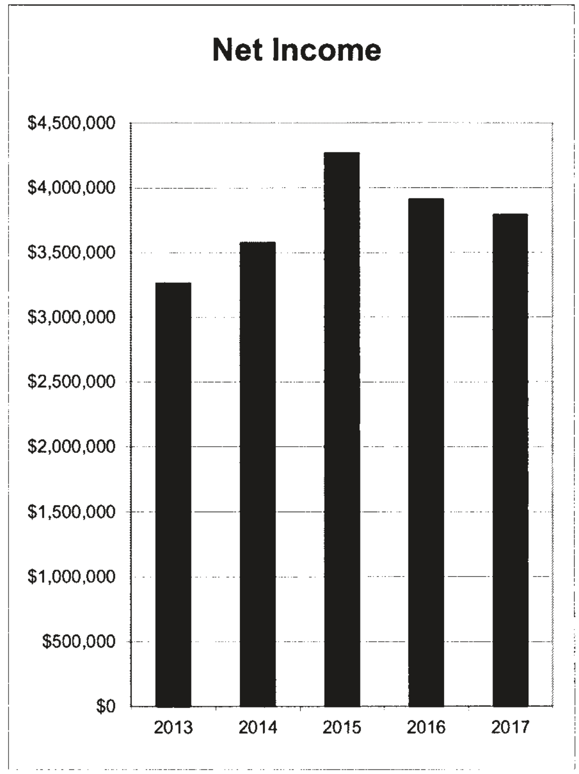
Amy L. Collins…………..……......Greenmount
Rachel L. Heird……………......…Owings Mills
Kelly P. Johnson…………………..….Hampstead
Wendy A. Panek……………......Reisterstown
Shannon M. Panek-Close………Main Office
Deborah A. Zepp………………..Westminster

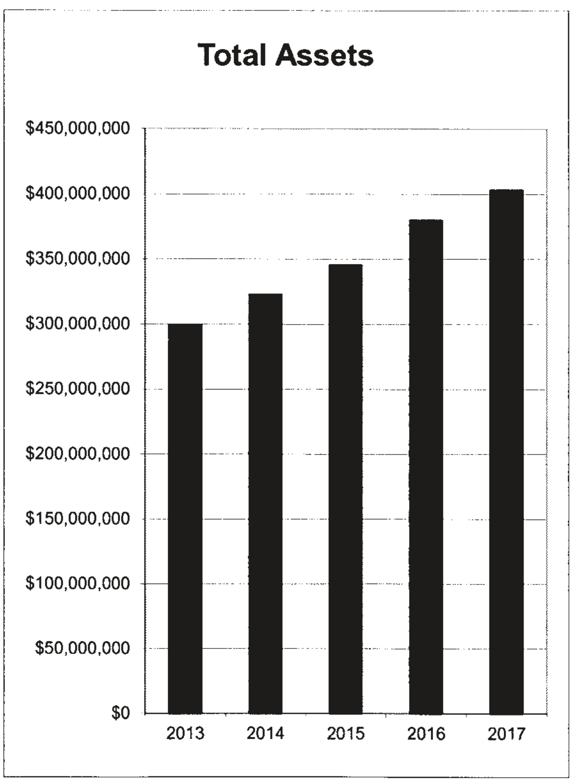
Farmers and Merchants Bancshares, Inc.
Selected Consolidated Financial Data

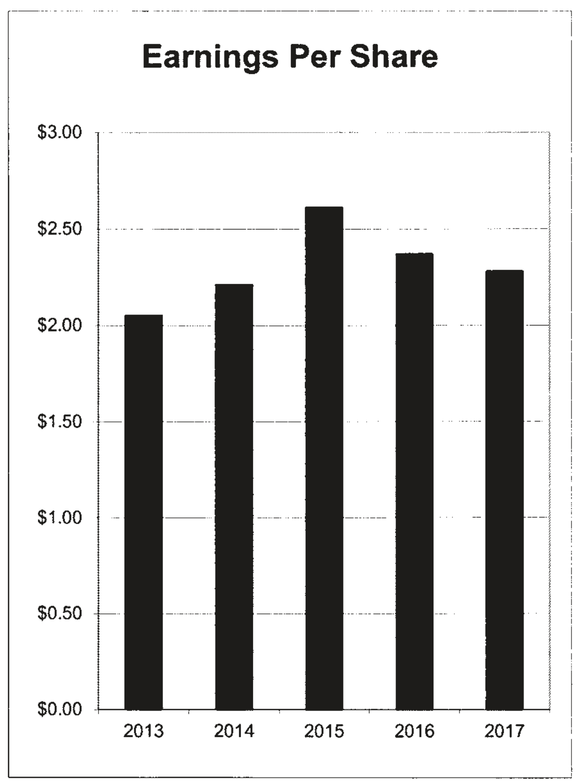
	2017	2016	2015	2014	2013
OPERATING DATA					
Interest income	$ 16,594,803	$ 15,351,497	$ 14,705,401	$ 14,080,625	$ 13,145,932
Interest expense	1,707,240	1,346,120	1,189,646	1,157,044	1,229,962
Net interest income	14,887,563	14,005,377	13,515,755	12,923,581	11,915,970
Provision for loan losses	410,000	-	-	124,000	-
Net interest income after provision for loan losses	14,477,563	14,005,377	13,515,755	12,799,581	11,915,970
Noninterest income	1,337,094	1,465,197	1,986,260	1,240,360	1,416,552
Noninterest expense	10,023,102	9,534,625	8,703,588	8,421,114	8,233,724
Income before income taxes	5,791,555	5,935,949	6,798,427	5,618,827	5,098,798
Income taxes	2,002,314	2,026,820	2,530,205	2,044,854	1,837,847
Net income	$ 3,789,241	$ 3,909,129	$ 4,268,222	$ 3,573,973	$ 3,260,951
PER SHARE DATA					
Net income (Basic)	$2.28	$2.37	$2.61	$2.21	$2.05
Dividends	$0.76	$0.70	$0.64	$0.59	$0.54
Book value per share	$25.06	$23.55	$21.99	$20.08	$18.22
Dividend payout ratio	33.33%	29.58%	24.52%	26.70%	26.34%
KEY RATIOS					
Return on average assets	0.96%	1.08%	1.29%	1.15%	1.16%
Return on average equity	9.26%	10.26%	12.26%	11.43%	11.42%
Net yield on interest-earning assets	3.96%	4.13%	4.33%	4.47%	4.57%
Efficiency ratio	61.78%	61.63%	56.14%	59.45%	61.76%
Average equity to average assets	10.32%	10.56%	10.50%	10.05%	10.12%
AT PERIOD END					
Total assets	$ 402,904,469	$ 379,831,359	$ 345,309,996	$ 322,787,387	$ 299,696,863
Loans, net and loans held for sale	332,861,406	296,171,072	268,249,402	262,642,513	242,400,282
Cash, federal funds sold, and other interest-earning deposits	7,237,385	13,312,915	20,192,839	12,583,313	11,652,949
Securities	46,637,573	52,373,567	40,248,651	31,521,616	28,886,337
Deposits	319,796,424	302,715,136	275,964,737	261,210,530	239,301,461
Borrowings	38,768,507	36,226,159	31,490,619	27,639,327	30,028,849
Stockholders' equity	41,798,932	39,012,277	36,223,361	32,702,470	29,309,236
SELECTED AVERAGE BALANCES					
Total assets	$ 396,454,271	$ 361,005,005	$ 331,522,302	$ 311,036,540	$ 282,166,001
Loans, net and loans held for sale	316,724,821	281,709,043	269,406,618	250,184,181	221,296,084
Cash, federal funds sold, and other interest-earning deposits	12,428,778	13,271,319	15,227,040	15,887,073	14,287,631
Securities	51,508,146	50,876,488	31,988,098	29,825,093	31,502,253
Deposits	315,159,559	284,921,811	265,634,314	249,741,172	226,685,504
Borrowings	38,627,588	36,175,989	29,363,070	28,672,245	25,844,870
Stockholders' equity	40,926,674	38,115,746	34,810,159	31,268,365	28,543,659
ASSET QUALITY					
Nonperforming assets	$ 2,511,243	$ 1,166,889	$ 1,429,313	$ 943,846	$ 2,219,391
Nonperforming assets/total assets	0.62%	0.31%	0.41%	0.29%	0.74%
Allowance for loan losses/total loans	0.73%	0.79%	0.95%	1.05%	1.07%

Farmers and Merchants Bancshares, Inc.
Selected Consolidated Financial Data









Farmers and Merchants Bancshares, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto for the years ended December 31, 2017 and 2016, which are presented elsewhere in this annual report.

The Company was incorporated on August 8, 2016 for the purpose of becoming the bank holding company of the Bank in a share exchange transaction that was intended to constitute a tax-free exchange under Section 351 of the IRC. This reorganization was consummated on November 1, 2016, at which time the Bank became a wholly-owned subsidiary of the Company and all of the Bank's stockholders became stockholders of the Company by virtue of the conversion of their shares of common stock of the Bank into an equal number of shares of common stock of the Company. Although we use the terms "Company", "we", "us", and "our" in this section of the annual report, the discussion and analysis with respect to periods ending prior to November 1, 2016 relate to the operations of the Bank and its consolidated subsidiaries, and the discussion and analysis with respect to periods ending on and after November 1, 2016 relate to the operations of the Company and its consolidated subsidiaries, including the Bank.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

The consolidated financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and follow general practices within the industry in which the Company operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements; accordingly, as this information changes, the consolidated financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the consolidated financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available.

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements presented elsewhere in the annual report. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for loan losses as the accounting area that requires the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

The allowance for loan losses represents management's estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the balance sheet.

Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for loan losses.

FINANCIAL CONDITION

Total assets were $402,904,469 at December 31, 2017, an increase of $23,073,110, or 6.1%, over the $379,831,359 recorded at December 31, 2016. The increase was due primarily to an increase of $37,247,134 in loans, offset by a decrease of $6,075,530 in cash and cash equivalents and a decrease of $5,952,548 in securities available for sale.

Total liabilities were $361,105,537 at December 31, 2017, an increase of $20,286,455, or 6.0%, over the $340,819,082 recorded at December 31, 2016. The increase was due primarily to increases of $17,081,288 in deposits and $8,000,000 in Federal Home Loan Bank ("FHLB") advances, offset by a $5,457,652 decrease in securities sold under repurchase agreements. The increase in deposits was comprised of a $15,469,990 increase in interest-bearing accounts and a $1,611,298 increase in noninterest-bearing accounts.

Stockholders' equity was $41,798,932 at December 31, 2017 compared to $39,012,277 at December 31, 2016, an increase of $2,786,655. The increase was due to net income for 2017 of $3,789,241, offset by dividends paid, net of reinvestments, of $953,525 and a decrease in the after tax unrealized loss on available for sale securities of $49,061.

Loans

Major categories of loans at December 31, 2017, 2016, 2015, 2014, and 2013 are as follows:

	2017		2016		2015		2014		2013	
Real estate:										
Commerical	$ 234,026,574	70%	$ 206,145,076	69%	$ 186,703,868	69%	$ 181,881,566	68%	$ 170,369,522	69%
Construction/Land development	18,160,366	5%	14,392,992	5%	12,820,165	5%	18,592,315	7%	18,040,381	7%
Residential	59,241,416	18%	54,710,809	18%	51,290,828	19%	45,687,752	17%	39,705,040	16%
Commercial	23,613,543	7%	22,152,773	7%	19,562,302	7%	18,581,523	7%	16,595,975	7%
Consumer	554,017	0%	725,269	0%	886,175	0%	852,711	0%	810,429	0%
	335,595,916	100%	298,126,919	100%	271,263,338	100%	265,595,867	100%	245,521,347	100%
Less: Allowance for loan losses	2,458,911		2,363,086		2,583,445		2,780,249		2,626,954	
Deferred origination fees net of cost	603,299		477,261		430,491		483,755		494,111	
	$ 332,533,706		$ 295,286,572		$ 268,249,402		$ 262,331,863		$ 242,400,282	

The Company had no foreign loans for any of the years presented.

Loans increased by $37,247,134 or 12.6% to $332,533,706 at December 31, 2017 from $295,286,572 at December 31, 2016. The growth was due to increases in commercial real estate loans of $27,881,498, construction/land development loans of $3,767,374, residential real estate loans of $4,530,607, and commercial loans of $1,460,770, offset by a decrease in consumer loans of $171,252. The allowance for loan losses increased $95,825 to $2,458,911 at December 31, 2017 as compared to $2,363,086 at December 31, 2016.

The following table sets forth at December 31, 2017 the maturity and rate repricing distribution of the loan portfolio. Demand loans and overdrafts are reported as due in one year or less. The table does not take into account prepayments or scheduled principal repayment assumptions, which could shorten the average loan life.

	Maturing Within One Year	Maturing After One Year But Within Five Years	Maturing After Five Years	Total
Real estate:				
Commerical	$ 32,458,075	$ 97,994,717	$ 103,573,782	$ 234,026,574
Construction/Land development	2,198,652	12,146,774	3,814,940	18,160,366
Residential	6,997,987	35,869,778	16,373,651	59,241,416
Commercial	12,696,672	7,158,583	3,758,288	23,613,543
Consumer	63,916	360,518	129,583	554,017
	$ 54,415,302	$ 153,530,370	$ 127,650,244	$ 335,595,916
Classified by Sensitivity to Change In Interest Rates				
Fixed-Interest Rate Loans	$ 35,490,907	$ 138,002,587	$ 101,176,975	$ 274,670,469
Adjustable-Interest Rate Loans	18,924,395	15,527,783	26,473,269	60,925,447
	$ 54,415,302	$ 153,530,370	$ 127,650,244	$ 335,595,916

The Company has adopted policies and procedures that seek to mitigate credit risk and to maintain the quality of the loan portfolio. These policies include underwriting standards for new credits as well as the continuous monitoring and reporting of asset quality and the adequacy of the allowance for loan losses. These policies, coupled with continuous training efforts, have provided effective checks and balances for the risk associated with the lending process. Lending authority is based on the level of risk, size of the loan, and the experience of the lending officer. The Company's policy is to make the majority of its loan commitments in the market area it serves. Management believes that this tends to reduce risk because management is familiar with the credit histories of loan applicants and has in-depth knowledge of the risk to which a given credit is subject. Although the loan portfolio is diversified, its performance will be influenced by the economy of the region.

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
2017							
Real estate:							
Commerical	$ -	$ -	$ 2,245,743	$ 2,245,743	$ 231,780,831	$ 234,026,574	$ -
Construction/Land development	-	-	-	-	18,160,366	18,160,366	-
Residential	-	-	146,459	146,459	59,094,957	59,241,416	146,459
Commercial	-	-	-	-	23,613,543	23,613,543	-
Consumer	-	-	-	-	554,017	554,017	-
Total	$ -	$ -	$ 2,392,202	$ 2,392,202	$ 333,203,714	$ 335,595,916	$ 146,459

	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
2016							
Real estate:							
Commerical	$ -	$ -	$ -	$ -	$ 206,145,076	$ 206,145,076	$ -
Construction/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	$ -

	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
2015							
Real estate:							
Commerical	$ -	$ -	$ -	$ -	$ 186,703,868	$ 186,703,868	$ -
Construction/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	$ -

	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
2014							
Real estate:							
Commerical	$ -	$ -	$ -	$ -	$ 181,881,566	$ 181,881,566	$ -
Construction/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	$ -

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or more Past Due	Total Past Due	Current	Total Loans	Past Due 90 Days or More and Accruing
2013							
Real estate:							
Commerical	$ -	$ -	$ 932,428	$ 932,428	$ 169,437,094	$ 170,369,522	$ -
Construction/Land development	-	-	-	-	18,040,381	18,040,381	-
Residential	24,261	-	150,957	175,218	39,529,822	39,705,040	
Commercial	-	-	-	-	16,595,975	16,595,975	-
Consumer	-	-	-	-	810,429	810,429	-
Total	$ 24,261	$ -	$ 1,083,385	$ 1,107,646	$ 244,413,701	$ 245,521,347	$ -

It is the Company's policy to place a loan in nonaccrual status whenever there is substantial doubt about the ability of the borrower to pay principal or interest on any outstanding credit. Management considers such factors as payment history, the nature of the collateral securing the loan, and the overall economic situation of the borrower when making a nonaccrual decision. Management closely monitors nonaccrual loans. The Company returns a nonaccrual loan to accruing status when (i) the loan is brought current with the full payment of all principal and interest arrearages, (ii) all contractual payments are thereafter made on a timely basis for at least six months, and (iii) management determines, based on a credit review, that it is reasonable to expect that future payments will be made as and when required by the contract..

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

	2017	2016	2015	2014	2013
Non-accrual loans					
Commercial real estate	$ 2,245,743	$ -	$ -	$ -	$ 932,428
Construction/Land development	-	752,889	956,813	-	-
Residential real estate	-	-	-	-	150,957
Total non-accrual loans	$ 2,245,743	$ 752,889	$ 956,813	$ -	$ 1,083,385

At December 31, 2017, the Company had one nonaccrual commercial real estate loan totaling $2,245,743. The loan was secured by real estate and business assets and was personally guaranteed. Gross interest income of $82,070 would have been recorded in 2017 if this nonaccrual loan had been current and performing in accordance with the original terms. The Company allocated $127,213 of its allowance for loan losses for this nonaccrual loan. The balance of the nonaccrual loan was net of charge-offs of $275,000 at December 31, 2017.

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, 2017, the Company had two residential real estate loans totaling $146,459 that were delinquent 90 days or greater in addition to the nonaccrual loans noted above. At December 31, 2016, the Company had no loans delinquent 90 days or greater other than the nonaccrual loans noted above.

Year-end impaired loans are set forth in the following table:

	2017	2016	2015	2014	2013
Impaired loans no valuation allowance	$ 2,937,439	$ 2,348,275	$ 2,443,681	$ -	$ 1,950,045
Impaired loans with a valuation allowance	2,245,743	994,469	956,813	1,024,044	-
Total impaired loans	$ 5,183,182	$ 3,342,744	$ 3,400,494	$ 1,024,044	$ 1,950,045
Valuation allowance related to impaired loans	$ 127,213	$ 24,167	$ 167,211	$ 167,418	$ -

At December 31, 2017, the Company had three commercial real estate loans totaling $2,937,439 classified as a troubled debt restructuring. Two loans totaling $774,274 were restructured as a trouble debt restructuring during 2017. All are included in impaired loans above. Each loan is paying as agreed. There have been no charge-offs or allowances associated with these three loans.

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.

	2017	2016	2015	2014	2013
Restructured loans (TDRs):					
Performing as agreed	$ 2,937,439	$ 2,348,275	$ 2,443,681	$ -	$ -
Not performing as agreed	-	241,580	-	-	-
Total TDRs	$ 2,937,439	$ 2,589,855	$ 2,443,681	$ -	$ -

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 any guarantor, and cash flow projections of the borrower. Special mention, Substandard, and Doubtful grades are assigned to loans with a higher frequency of delinquent payments and/or the collateral and/or cash flow are insufficient to support the loan and such loans are included on the Company's watch list:

	2017	2016	2015	2014	2013
Special mention	$ 5,391,589	$ 8,962,940	$ 6,366,296	$ 9,605,422	$ 17,434,057
Substandard	4,625,568	6,399,618	7,843,897	8,517,800	6,785,681
Doubtful	2,274,162	29,742	25,525	35,212	37,749
Total	$ 12,291,319	$ 15,392,300	$ 14,235,718	$ 18,158,434	$ 24,257,487

The allowance for loan losses is a reserve established through a provision for loan losses and is charged to expense. 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 loss methodology includes allowance allocations calculated in accordance with Accounting Standards Codification ("ASC") Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions.

The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, classified and criticized loans and net charge-offs or recoveries, among other factors.

Although management believes, based on information currently available, that the Company's allowance for loan losses is sufficient to cover losses inherent in its loan portfolio at this time, no assurances can be given that the Company's level of allowance for loan losses will be sufficient to cover future loan losses incurred by the Company or that future adjustments to the allowance for loan losses will not be necessary if economic or other conditions differ substantially from the economic and other conditions at the time management determined the current level of the allowance for loan losses.

The following table details activity in the allowance for loan losses by portfolio for the years ended December 31, 2017, 2016, 2015, 2014, and 2013. 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, 2017	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	$ 1,717,749	$ 419,868	$ (275,000)	$ 4,780	$ 1,867,397	$ 127,213	$ 1,740,184	$ 5,183,182	$228,843,392
Construction and land development	204,860	65,850	(47,436)	-	223,274	-	223,274	-	18,160,366
Residential	247,437	368	-	148	247,953	-	247,953	-	59,241,416
Commercial	125,260	(41,240)	-	3,333	87,353	-	87,353	-	23,613,543
Consumer	8,826	(1,799)	-	-	7,027	-	7,027	-	554,017
Unallocated	58,954	(33,047)	-	-	25,907	-	25,907	-	-
	$ 2,363,086	$ 410,000	$ (322,436)	$ 8,261	$ 2,458,911	$ 127,213	$ 2,331,698	$ 5,183,182	$330,412,734

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

December 31, 2014	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Allowance for loan losses ending balance evaluated for impairment: Individually	Allowance for loan losses ending balance evaluated for impairment: Collectively	Outstanding loan balances evaluated for impairment: Individually	Outstanding loan balances evaluated for impairment: 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

December 31, 2013	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Allowance for loan losses ending balance evaluated for impairment: Individually	Allowance for loan losses ending balance evaluated for impairment: Collectively	Outstanding loan balances evaluated for impairment: Individually	Outstanding loan balances evaluated for impairment: Collectively
Real estate:									
Commercial	$ 2,025,788	$ (69,804)	$ -	$ -	$ 1,955,984	$ -	$ 1,955,984	$ 932,428	$ 169,437,094
Construction and land development	144,485	92,091	(66,078)	-	170,498	-	170,498	866,660	17,173,721
Residential	347,007	(24,758)	-	1,507	323,756	-	323,756	150,957	39,554,083
Commercial	108,669	(3,294)	-	4,276	109,651	-	109,651	-	16,595,975
Consumer	10,811	(4,947)	-	6,286	12,150	-	12,150	-	810,429
Unallocated	44,203	10,712	-	-	54,915	-	54,915	-	-
	$ 2,680,963	$ -	$ (66,078)	$ 12,069	$ 2,626,954	$ -	$ 2,626,954	$ 1,950,045	$ 243,571,302

	2017	2016	2015	2014	2013
Allowance for loan losses to total loans outstanding	0.73%	0.79%	0.95%	1.05%	1.07%
Ratio of net charge-offs to average loans oustanding during the period	0.10%	0.08%	0.07%	-0.01%	0.02%

The Company recorded $314,175 in net charge-offs in 2017 versus $220,359 in net charge-offs in 2016. The provision for loan losses was $410,000 in 2017 and $0 in 2016.

Other Real Estate Owned

Other real estate owned ("OREO") at December 31, 2017 and 2016 included one property with a carrying value of $265,500 and $414,000, respectively. The property is land in Cecil County, Maryland and was acquired through foreclosure in 2007. The property consists of 10.43 acres which is in the process of being divided into 5 lots to be sold individually.

	2017	2016	2015	2014	2013
Other Real Estate Owned	$ 265,500	$ 414,000	$ 472,500	$ 943,846	$ 1,136,006

Investment Securities

Investment securities decreased $5,735,994 or 11.0% to $46,637,573 at December 31, 2017 from $52,373,567 at December 31, 2016. At December 31, 2017 and 2016, the Company had classified 61% and 66%, respectively, of the investment portfolio as available for sale. The remaining balance of the portfolio was classified as held to maturity.

Securities classified as available for sale are held for an indefinite period of time and may be sold in response to changing market and interest rate conditions as part of the Company's asset/liability management strategy. Available for sale securities are carried at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of income taxes. Securities classified as held to maturity, which management has both the positive intent and ability to hold to maturity, are reported at amortized cost. The Company does not currently follow a strategy of making security purchases with a view to near-term sales, and, therefore, does not own trading securities. The Company manages the investment portfolio within policies that seek to achieve desired levels of liquidity, manage interest rate sensitivity, meet earnings objectives, and provide required collateral for deposit and borrowing activities.

The following table sets forth the carrying value of investment securities at December 31:

	2017	2016	2015
Available for sale			
State and municipal	$ 1,539,207	$ 1,566,327	$ 1,349,242
Mutual fund	503,881	492,243	-
SBA pools	3,199,846	2,263,834	-
Mortgage-backed securities	23,190,457	30,063,535	22,295,342
	$ 28,433,391	$ 34,385,939	$ 23,644,584
Held to maturity			
U.S. government agency	$ -	$ -	$ 2,960,758
State and municipal	18,204,182	17,987,628	13,643,309
	$ 18,204,182	$ 17,987,628	$ 16,604,067

The following table sets forth the scheduled maturities of investment securities at December 31, 2017:

	Available for Sale			Held to Maturity		
	Amortized Cost	Fair Value	Yield	Amortized Cost	Fair Value	Yield
Within 1 year	$ 518,352	$ 503,881	2.10%	$ 165,677	$ 168,260	3.82%
Over 1 to 5 years	-	-	-	780,336	794,512	2.29%
Over 5 to 10 years	1,133,940	1,150,564	4.15%	1,792,019	1,831,833	3.89%
Over 10 years	376,908	388,643	5.02%	15,466,150	15,513,022	3.24%
	2,029,200	2,043,088	3.79%	18,204,182	18,307,627	3.27%
SBA Pools	3,212,771	3,199,846	2.07%	-	-	-
Mortgage-backed securities	23,735,332	23,190,457	1.97%	-	-	-
	$ 28,977,303	$ 28,433,391	2.11%	$ 18,204,182	$ 18,307,627	3.27%

SBA pools and mortgage-backed securities are due in monthly installments.

Deposits

Total deposits were $319,796,424 at December 31, 2017 compared to $302,715,136 at December 31, 2016, an increase of $17,081,288, or 5.6%. The increase was due to a $19,387,731 increase in time deposits, a $3,744,407 increase in savings accounts, a $3,446,149 increase in interest bearing checking accounts, and a $1,611,298 increase in noninterest-bearing accounts, offset by an $11,108,297 decrease in money market accounts. The following table shows the average balances and average costs of deposits for the years ended December 31:

	2017		2016		2015	
	Average Balance	Cost	Average Balance	Cost	Average Balance	Cost
Noninterest bearing demand deposits	$ 60,346,388	0.00%	$ 58,845,893	0.00%	$ 53,031,662	0.00%
Interest bearing demand deposits	42,370,867	0.14%	36,431,530	0.13%	32,071,483	0.13%
Savings and money market deposits	104,943,540	0.23%	94,995,586	0.23%	84,712,733	0.23%
Time deposits	107,498,764	1.00%	94,648,802	0.88%	95,818,436	0.81%
	$ 315,159,559	0.44%	$ 284,921,811	0.39%	$ 265,634,314	0.38%

As of December 31, 2017, certificates of deposit of $100,000 or more mature as follows:

Period	Balance
3 months or less	$ 8,099,599
Over 3 months to 6 months	7,780,556
Over 6 months to 12 months	10,307,820
Over 12 months	21,937,969
Total	$ 48,125,944

Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, lines of credit, including home-equity lines and commercial lines, and letters of credit. Loan commitments generally have interest rates at current market values, fixed expiration dates, and may require a fee. Lines of credit generally have variable interest rates and do not necessarily represent future cash flow requirements because it is unlikely that all customers will draw upon their lines in full at any one time. Letters of credit are commitments issued to guarantee the performance of a customer to a third party. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

For commitments to extend credit, lines of credit, and letters of credit, the Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual notional amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

At December 31, 2017, the Company's off-balance sheet financial instruments were as follows:

Loan commitments	$ 9,433,500
Unused lines of credit	$ 40,005,063
Letters of credit	$ 1,827,513

Management does not believe that any of the foregoing arrangements are reasonably likely to have a materially adverse effect on the Company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Borrowings and Other Contractual Obligations

The Company's contractual obligations consist primarily of borrowings and operating leases for various facilities.

Securities sold under agreements to repurchase represent overnight borrowings from customers. Securities owned by the Company which are used as collateral for these borrowings are primarily U.S. government agency securities.

Specific information about the Company's borrowings and contractual obligations is set forth in the following table:

		At December 31,		
		2017	2016	2015
Amount oustanding at year-end:				
Securities sold under repurchase agreements		$ 21,768,507	$ 27,226,159	$ 20,490,619
Federal Home Loan Bank advances		17,000,000	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	14,000,000	5,000,000	5,000,000
	2019	3,000,000	2,000,000	-
Weighted average rate paid at December 31:				
Securites sold under repurchase agreements		0.65%	0.63%	0.53%
Federal Home Loan Bank advances		1.35%	1.11%	0.94%
Maximum amount of borrowings outstanding at any month end:				
Securities sold under repurchase agreeents		$ 30,786,064	$ 32,287,740	$ 20,655,156
Federal Home Loan Bank advances		18,000,000	16,000,000	11,000,000
Average amount of borrowings oustanding with respect to:				
Securities sold under repurchase agreements		$ 24,702,931	$ 25,320,795	$ 18,582,245
Federal Home Loan Bank advances		13,846,575	10,833,333	10,778,082
Borrowings from FRB and commerical banks		78,082	21,861	2,742
Weighted average rate paid for the year:				
Securities sold under repurchase agreements		0.66%	0.64%	0.54%
Federal Home Loan Bank advances		1.20%	0.94%	0.75%
Borrowings from FRB and commerical banks		1.64%	0.67%	0.52%

The terms of the Company's operating leases, including the future minimum payments under those leases, are disclosed in Note 7 to the consolidated financial statements.

RESULTS OF OPERATIONS

Overview

The Company reported net income of $3,789,241 for the year ended December 31, 2017 compared to $3,909,129 for the year ended December 31, 2016. The decrease of $119,888 over 2016 was due to an increase in noninterest expense of $488,477, an increase in the provision for loan losses of $410,000, and a decrease in noninterest income of $128,103, offset by an increase in net interest income of $882,186 and a decrease in income taxes of $24,506.

Net Interest Income

The primary source of income for the Company is net interest income, which is the difference between interest income on interest-earning assets, such as investment securities and loans, and interest expense incurred on interest-bearing sources of funds, such as deposits and borrowings.

For the year ended December 31, 2017, the Company recorded net interest income of $14,887,563 compared to $14,005,377 for 2016, an increase of $882,186. The increase was attributable primarily to an increase in the average balance of interest-earning assets, offset by a decline in the net yield. Average interest earning assets increased $37,264,448 to $376,167,393 in 2017 from $338,902,945 in 2016. The net average tax equivalent yield on interest earning assets declined 17 basis points to 4.04% in 2017 when compared to the 4.21% recorded in 2016.

Total interest income for the year ended December 31, 2017 increased by $1,243,306 to $16,594,803, compared to $15,351,497 for 2016. The increase was due primarily to the aforementioned increase in average interest earning assets, offset by the decline in the yield on interest earning assets.

Interest income from loans was $15,189,238 in 2017 compared to $14,024,899 in 2016, an increase of $1,164,339. This increase was attributable to a $35,020,732 increase in the average balance of loans to $319,825,707 in 2017 from $284,804,975 in 2016, offset by a 17 basis point decrease in the average yield on loans to 4.75% in 2017 from 4.92% in 2016.

For the year ended December 31, 2017, the Company recorded interest income on securities of $1,308,357. For the same period of 2016, interest income on securities was $1,263,913. The $44,444 increase in 2017 was attributable to a $1,949,692 increase in the average balance of securities to $50,251,527 in 2017 from $48,301,835 in 2016 and a 5 basis point increase in the average tax equivalent yield on securities to 3.18% in 2017 from 3.13% in 2016.

Interest income on federal funds sold and other interest-earning assets (FHLB stock and certificates of deposit) increased $34,523 to $97,208 in 2017 compared to $62,685 in 2016. The increase was due to a 50 basis point increase in the average tax equivalent yield to 1.64% in 2017 from 1.14% in 2016, and a $294,024 increase in the average balance of federal funds sold and other interest-earning assets to $6,090,159 in 2017 from $5,796,135 in 2016.

Total interest expense increased $361,120 to $1,707,240 in 2017 compared to $1,346,120 in 2016. The increase was primarily due to an increase of $31,188,853 in the average balance of interest-bearing liabilities to $293,440,759 in 2017 from $262,251,906 in 2016 and a 7 basis point increase in the cost of interest-bearing liabilities to 0.58% in 2017 from 0.51% in 2016.

Interest paid on NOW, savings, and money market deposit accounts increased $32,053 to $299,586 in 2017 compared to $267,533 in 2016. The increase was due to a $15,887,291 increase in the average balance of these deposits to $147,314,407 in 2017 from $131,427,116 in 2016. The cost of funds was unchanged in 2017 when compared to 2016.

Interest paid on time deposits increased $247,268 to $1,078,722 in 2017 compared to $831,454 in 2016. The increase in interest expense was due to an increase of 12 basis points in the average rate paid to 1.00% in 2017 from 0.88% in 2016 and an increase of $12,849,962 in the average balance to $107,498,764 in 2017 from $94,648,802 in 2016.

Interest paid on securities sold under repurchase agreements increased $17,294 to $161,914 in 2017 compared to $144,620 in 2016. The increase was attributable to an increase of 9 basis points in the average rate to 0.66% in 2017 from 0.57% in 2016, offset by a $617,864 decrease in the average balance of securities sold under repurchase agreements to $24,702,931 in 2017 from $25,320,795 in 2016.

Interest paid on FHLB advances and other borrowings increased $64,505 to $167,018 in 2017 from $102,513 in 2016. The increase was attributable to an increase of 26 basis points in the average rate to 1.20% in 2017 from 0.94% in 2016 and a $3,069,463 increase in the average balance of FHLB advances and other borrowings to $13,924,657 in 2017 from $10,855,194 in 2016.

The following table sets forth certain information relating to the Company's average interest-earning assets and interest-bearing liabilities for the periods indicated. The yields are calculated by dividing interest income or expense by the average daily balance of assets or liabilities, respectively. Non-accruing loans are included in the average balance.

	2017			2016			2015		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield	Average Balance	Interest	Yield
Assets:									
Loans	$ 319,825,707	$ 15,189,238	4.75%	$ 284,804,975	$ 14,024,899	4.92%	$ 273,626,511	$ 13,809,312	5.05%
Securities, taxable	32,115,690	715,689	2.23%	32,808,588	769,115	2.34%	19,646,452	487,091	2.48%
Securities, tax exempt	18,135,837	883,901	4.87%	15,493,247	740,395	4.78%	11,394,819	552,338	4.85%
Federal funds sold and other interest earning assets	6,090,159	99,840	1.64%	5,796,135	66,231	1.14%	7,142,004	52,697	0.74%
Total interest-earning assets	376,167,393	16,888,668	4.49%	338,902,945	15,600,640	4.60%	311,809,786	14,901,438	4.78%
Noninterest-earning assets	20,286,878			22,102,060			19,742,516		
Total assets	$ 396,454,271			$ 361,005,005			$ 331,552,302		
Liabilities and Stockholders' Equity:									
NOW, savings, and money market	$ 147,314,407	299,586	0.20%	$ 131,427,116	267,533	0.20%	$ 116,784,216	233,437	0.20%
Certificates of deposit	107,498,764	1,078,722	1.00%	94,648,802	831,454	0.88%	95,818,436	771,880	0.81%
Securities sold under repurchase agreements	24,702,931	161,914	0.66%	25,320,795	144,620	0.57%	18,582,245	99,886	0.54%
FHLB advances and other borrowings	13,924,657	167,018	1.20%	10,855,194	102,513	0.94%	10,780,825	84,443	0.78%
Total interest-bearing deposits	293,440,759	1,707,240	0.58%	262,251,907	1,346,120	0.51%	241,965,722	1,189,646	0.49%
Noninterest-bearing deposits	60,346,388			58,845,893			53,031,662		
Noninterest-bearing liabilities	1,740,450			1,791,459			1,744,759		
Total liabilities	355,527,597			322,889,259			296,742,143		
Stockholders' equity	40,926,674			38,115,746			34,810,159		
Total liabilities and stockholders' equity	$ 396,454,271			$ 361,005,005			$ 331,552,302		
Net interest income		$ 15,181,428			$ 14,254,520			$ 13,711,792	
Interest rate spread			3.91%			4.09%			4.29%
Net yield on interest-earning assets			4.04%			4.21%			4.40%
Ratio of average interest-earning assets to average interest-bearing liabilities			128.19%			129.23%			128.87%

Interest on tax-exempt investments are reported on a fully taxable equivalent basis

The following table sets forth the dollar amount of changes in interest income and interest expense for the major categories of the Company's interest-earning assets and interest-bearing liabilities. The table distinguishes between (i) changes in net interest income attributed to volume (change in volume multiplied by the prior year's interest rate), and (ii) changes in net interest income attributed to rate (change in rate multiplied by the prior year's volume). The change in interest due to the combined rate and volume changes is allocated proportionally to the change in volume and rate.

RATE/VOLUME ANALYSIS

	Year ended December 31, 2017 compared to 2016 Change due to variance in			Year ended December 31, 2016 compared to 2015 Change due to variance in		
	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Loans	$ 1,676,977	$ (512,638)	$ 1,164,339	$ 555,567	$ (339,980)	$ 215,587
Securities, taxable	(15,865)	(36,080)	(51,945)	306,856	(23,690)	283,166
Securities, tax exempt	86,969	9,420	96,389	132,661	1,839	134,500
Federal funds sold and other interest-earning assets	3,326	31,197	34,523	(10,711)	23,554	12,843
Total interest-earning assets	1,751,407	(508,101)	1,243,306	984,373	(338,277)	646,096
Interest expense:						
NOW, savings, and money market	32,309	(256)	32,053	29,738	4,358	34,096
Certificates of deposit	120,725	126,543	247,268	(9,524)	69,098	59,574
Securities sold under repurchase agreements	(3,603)	20,897	17,294	38,212	6,822	45,034
FHLB advances and other borrowings	32,991	31,514	64,505	586	17,484	18,070
Total interest-bearing liabilities	182,422	178,698	361,120	59,012	97,762	156,774
Change in net interest income	$ 1,568,985	$ (686,799)	$ 882,186	$ 925,361	$ (436,039)	$ 489,322

Noninterest Income

Total noninterest income decreased by $128,103, or 8.7%, to $1,337,094 in 2017 from $1,465,197 in 2016. Gain on sale and write down of other real estate owned decreased $91,435 due to a write-down of the value of the property included as OREO. Mortgage division revenue decreased $192,618 during 2017 when compared to 2016 as a result of decreased refinance activity. Service charges on deposit accounts decreased $57,284, primarily due to lower overdraft fees. Gain on sale of loans increased $223,251 as a result of two SBA loan sales in 2017, as compared to none in 2016.

Noninterest Expense

Total noninterest expense increased by $488,477 or 5.1% to $10,023,102 in 2017 from $9,534,625 in 2016. The increase was due primarily to increases in salary and employee benefit expenses, occupancy, and other expenses.

Salary and benefit expense increased $341,484 or 5.8% to $6,220,695 in 2017 compared to $5,879,211 in 2016. The increase was due primarily to several new positions, merit increases in salaries paid to existing staff and higher bonuses as a result higher loan production, along with higher payroll taxes and benefits.

Occupancy expenses increased $35,118 or 5.4% to $684,173 in 2017 compared to $649,055 in 2016 due primarily to branch office repairs.

Other expenses increased by $117,164, or 5.0%, to $2,473,658 in 2017 when compared to the $2,356,494 recorded in 2016. Professional services increased by $141,144 as a result of higher legal costs in connection with the SEC registration, the implementation of a new dividend reinvestment plan, and collections efforts on impaired loans. ATM and debit card expenses decreased $45,456 as a result of negotiating more favorable terms.

Income Taxes

On December 22, 2017, the President of the United States signed the Tax Cuts and Jobs Act (the "Tax Act") into law, which, among other things, reduced the Federal income tax rate for C Corporations from 35% to 21% effective January 1, 2018. The Tax Act required the Company to revalue, using the new 21% Federal income tax rate, all of its deferred tax assets and liabilities based on the rates at which they are scheduled to reverse. This revaluation required the Company to recognize a one-time tax expense of $410,391 in the fourth quarter of 2017.

The Company's effective tax rate increased to 34.6% in 2017, from 34.1% in 2016. The increase was due to the revaluation of deferred tax assets and liabilities discussed above, offset by higher percentage of Federal tax-exempt income (primarily tax exempt interest income on state and municipal investments and the premium revenue of the Insurance Subsidiary) as a percentage of net income before income tax expense in 2017 when compared to 2016. Note 13 to the consolidated financial statements provides additional information about the Company's taxes, including a reconciliation of the Company's effective tax rate to the Federal statutory rate of 34%.

INTEREST RATE RISK

The Company's principal market risk is exposure to the risk that the interest rates associated with our interest-bearing liabilities and interest-earning assets will fluctuate. This risk arises from the Company's lending, investing and deposit-taking activities, and is affected by many factors, including economic and financial conditions, movements in interest rates and consumer preferences. Interest rate fluctuation has a direct impact on the Company's net interest income. Net interest income is susceptible to interest rate risk when deposits and other short-term liabilities have different repricing intervals than do loans, investments and other interest-earning assets. When interest-earning assets mature or reprice faster than interest-bearing liabilities, a decline in interest rates may cause a decline in net interest income. Conversely, when interest-bearing liabilities mature or reprice faster than interest-earning assets, an increase in interest rates may cause a decline in net interest income.

The Company recognizes that there are many types of interest rate risk. Management believes that the three types that pose the greatest potential threat to current and long-term earnings are:

- Repricing risk – the difference in the timing of the scheduled maturity and re-pricing dates of assets and liabilities within a certain time frame;

- Option risk – interest rate related options embedded in the Company's assets and liabilities which change the cash flow characteristics of the assets and liabilities; and
- Yield curve / basis risk – changes in the relationship between different interest rates with the same maturity or interest rates across a maturity spectrum which create compression or expansion of our net interest margin.

The Company uses earnings at risk and economic value at risk measures to quantify our exposure to these types of interest rate risk. We believe that using simulations that measure all three types of risks in combination is a more efficient tool for measurement, and we therefore do not routinely process models to isolate each risk. Rather, we combine the three types of analyses, which we believe provides a better overall result than a simulation based on a single system and a more economical use of resources than targeted models. Following is a description of the analyses to be utilized:

Earnings at Risk

Earnings at Risk ("EAR") measures exposure to net changes in net interest income ("NII"), and is considered the Company's best source of managing short-term interest rate risk (one-year and two-year time frames). EAR is a dynamic analysis, which can capture all the different forms of interest rate risk under many different interest rate scenarios, and using various assumptions for growth, optionality, and yield curve structure.

Economic Value of Equity

Economic Value of Equity ("EVE") is management's primary analytical tool for measuring long-term interest rate risk, and helps to measure if the long-term safety and soundness of the Company is being compromised for the sake of short-term results. However, the Company also recognizes the inherent difficulties of calculating a definitive value for many sections of the balance sheet as well as the weakness that EVE ignores future events (e.g., growth, etc.). These difficulties, coupled with the nature of our core business, allow the Company to adopt wide limits for this measure.

In order to mitigate the impact of changing interest rates, the Board of Directors has established policies and procedures that include acceptable parameters for the relationship between rate sensitive assets to rate sensitive liabilities as measured by earnings at risk and economic value at risk. The Asset/Liability Committee reviews rate sensitivity measures on a quarterly basis. Material deviations from policy parameters are reported to the Board of Directors and corrective action is initiated and monitored.

Measures of NII at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year. They do not necessarily indicate the long-term prospects or economic value of the institution.

Based upon the simulation analysis performed at December 31, 2017 and 2016, management estimated the following changes in NII, assuming the indicated rate changes:

Change in Rate	2017	2016
400 basis point increase	$ (879,000)	$(909,000)
300 basis point increase	(580,000)	(628,000)
200 basis point increase	(348,000)	(398,000)
100 basis point increase	(171,000)	(199,000)
100 basis point decrease	46,000	(106,000)
200 basis point decrease	(115,000)	(292,000)
300 basis point decrease	(174,000)	(475,000)

LIQUIDITY MANAGEMENT

Liquidity describes our ability to meet financial obligations that arise out of the ordinary course of business. Liquidity is primarily needed to meet depositor withdrawal requirements, to fund loans, and to fund our other debts and obligations as they come due in the normal course of business. We maintain our asset liquidity position internally through short-term investments, the maturity distribution of the investment portfolio, loan repayments, and income from earning assets. On the liability side of the balance sheet, liquidity is affected by the timing of maturing liabilities and the ability to generate new deposits or borrowings as needed. The Bank is approved to borrow 75% of eligible pledged single family residential loans and 50% of eligible pledged commercial loans as well as investment securities, or approximately $52.9 million under a secured line of credit with the FHLB. The Bank also has a facility with the Federal Reserve Bank of Richmond (the "Reserve Bank") under which the Bank can borrow approximately $30.1 million. Finally, the Bank has an $11,000,000 ($2,000,000 unsecured and $9,000,000 secured) overnight federal funds line of credit available from a commercial bank. FHLB advances of $17,000,000 and $9,000,000 were outstanding as of December 31, 2017 and 2016, respectively. There were no borrowings from the Reserve Bank or our commercial bank lender at December 31, 2017 and 2016. Management believes that we have adequate liquidity sources to meet all anticipated liquidity needs over the next 12 months. Management knows of no trend or event which is likely to have a material impact on our ability to maintain liquidity at satisfactory levels.

Information about the various financial obligations, including contractual obligations and commitments that may require future cash payments, to which we are subject is set forth above under the captions "Off-Balance Sheet Transactions" and "Borrowings and Other Contractual Obligations".

CAPITAL RESOURCES AND ADEQUACY

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, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices.

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).

Additional information regarding the capital requirements that apply to us can be found in footnote 14 of the consolidated financial statements and notes thereto included in the Annual Report.

The following table presents actual and required capital ratios as of December 31, 2017 and 2016, 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, 2017 and 2016, 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.

(Dollars in thousands)	Actual		Minimum Capital Adequacy		To Be Well Capitalized	
December 31, 2017	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$ 44,039	12.54%	$ 32,477	9.25%	$ 35,110	10.00%
Tier 1 capital (to risk-weighted assets)	41,580	11.84%	25,455	7.25%	28,088	8.00%
Common equity tier 1 (to risk-weighted assets)	41,580	11.84%	20,188	5.75%	22,822	6.50%
Tier 1 leverage (to average assets)	41,580	10.31%	16,135	4.00%	20,169	5.00%
December 31, 2016						
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%

The Company intends to fund future growth primarily with cash, federal funds, maturities of investment securities and deposit growth. Management knows of no other trend or event that will have a material impact on capital.

RECENT ACCOUNTING PRONOUNCEMENTS

Management has the responsibility for the selection and use of appropriate accounting policies. The significant accounting policies used by the Company are described in the notes to the consolidated financial statements.

The following accounting guidance has been approved by the Financial Accounting Standards Board and would apply to the Company if the Company entered into an applicable activity.

In January 2016, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in ASU 2016-01, among other things: (i) requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (ii) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables); and (iii) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost. The amendments within this ASU are effective for fiscal years beginning after December 15, 2017, and for interim periods within those fiscal years. The new guidance permits early adoption of the provision that exempts private companies and not-for-profit organizations from having to disclose at fair value information about financial instruments measured at amortized cost. The Company is currently assessing the impact that ASU 2016-01 will have on its financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 841)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (i) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (ii) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses". The ASU sets forth a "current expected credit loss" (CECL) model which requires the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of this ASU on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, "Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20) – Premium Amortization on Purchased Callable Debt Securities." ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. ASU 2017-08 will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 and is not expected to have a significant impact on our financial statements.

The accounting policies adopted by management are consistent with authoritative GAAP and are consistent with those followed by our peers.

ROWLES
& Company, LLP
Certified Public Accountants

Report of Independent Registered Public Accounting Firm

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

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Farmers and Merchants Bancshares, Inc. (the Company) as of December 31, 2017 and 2016, and the related statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2017, and the related notes (collectively referred to as the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, 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.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Rowles & Company, LLP

We have served as the Company's auditor since 1997.
Baltimore, Maryland
February 28, 2018

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,		**2017**		2016
Assets				
Cash and due from banks	**$**	**6,235,186**	$	12,334,358
Federal funds sold and other interest-bearing deposits		**1,002,199**		978,557
Cash and cash equivalents		**7,237,385**		13,312,915
Certificate of deposit in other bank		**100,000**		100,000
Securities available for sale		**28,433,391**		34,385,939
Securities held to maturity		**18,204,182**		17,987,628
Federal Home Loan Bank stock, at cost		**1,063,600**		778,300
Mortgage loans held for sale		**327,700**		884,500
Loans, less allowance for loan losses of **$2,458,911** and $2,363,086		**332,533,706**		295,286,572
Premises and equipment		**5,206,271**		5,449,678
Accrued interest receivable		**1,020,256**		956,963
Deferred income taxes		**998,032**		1,029,019
Other real estate owned		**265,500**		414,000
Bank owned life insurance		**6,891,590**		6,721,003
Other assets		**622,856**		2,524,842
	$	**402,904,469**	$	379,831,359
Liabilities and Stockholders' Equity				
Deposits				
Noninterest-bearing	**$**	**64,403,133**	$	62,791,835
Interest-bearing		**255,393,291**		239,923,301
Total deposits		**319,796,424**		302,715,136
Securities sold under repurchase agreements		**21,768,507**		27,226,159
Federal Home Loan Bank of Atlanta advances		**17,000,000**		9,000,000
Accrued interest payable		**180,620**		141,903
Other liabilities		**2,359,986**		1,735,884
		361,105,537		340,819,082
Stockholders' equity				
Common stock, par value $.01 per share, authorized 5,000,000 shares; issued and outstanding 1,667,813 shares in 2017 and 1,656,390 shares in 2016		**16,678**		16,564
Additional paid-in capital		**26,869,796**		26,562,919
Retained earnings		**15,306,625**		12,713,099
Accumulated other comprehensive income		**(394,167)**		(280,305)
		41,798,932		39,012,277
	$	**402,904,469**	$	379,831,359

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,	2017	2016
Interest income		
Loans, including fees	$ 15,189,238	$ 14,024,899
Investment securities - taxable	710,438	762,383
Investment securities - tax exempt	597,919	501,530
Federal funds sold and other interest earning assets	97,208	62,685
Total interest income	16,594,803	15,351,497
Interest expense		
Deposits	1,378,308	1,098,987
Securities sold under repurchase agreements	161,914	144,620
Federal Home Loan Bank advances and other borrowings	167,018	102,513
Total interest expense	1,707,240	1,346,120
Net interest income	14,887,563	14,005,377
Provision for loan losses	410,000	-
Net interest income after provision for loan losses	14,477,563	14,005,377
Noninterest income		
Service charges on deposit accounts	700,791	758,075
Mortgage banking income	279,364	471,982
Bank owned life insurance income	170,588	179,622
Gain (loss) on sale and write down of other real estate owned	(148,500)	(57,065)
Gain on sale of loans	223,251	-
Other fees and commissions	111,600	112,583
Total noninterest income	1,337,094	1,465,197
Noninterest expense		
Salaries	4,931,432	4,661,703
Employee benefits	1,289,263	1,217,508
Occupancy	684,173	649,055
Furniture and equipment	644,576	649,865
Other	2,473,658	2,356,494
Total noninterest expense	10,023,102	9,534,625
Income before income taxes	5,791,555	5,935,949
Income taxes	2,002,314	2,026,820
Net income	$ 3,789,241	$ 3,909,129
Earnings per share - basic and diluted	$ 2.28	$ 2.37

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,	2017	2016
Net income	**$ 3,789,241**	$ 3,909,129
Other comprehensive income (loss), net of income taxes:		
Securities available for sale		
Net unrealized loss arising during the period	**(81,019)**	(294,248)
Income tax benefit	**31,958**	116,066
Total other comprehensive loss	**(49,061)**	(178,182)
Total comprehensive income	**$ 3,740,180**	$ 3,730,947

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, 2015	1,647,541	$	16,475,415	$	9,889,659	$	9,960,410	$	(102,123)	$	36,223,361
Net income	-		-		-		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	**1,656,390**		**16,564**		**26,562,919**		**12,713,099**		**(280,305)**		**39,012,277**
Net income	-		-		-		**3,789,241**		-		**3,789,241**
Unrealized loss on securities available for sale net of income tax benefit of $31,958	-		-		-		-		**(49,061)**		**(49,061)**
Reclassification due to adoption of ASU No. 2018-02	-		-		-		**64,801**		**(64,801)**		-
Cash dividends, $0.76 per share	-		-		-		**(1,260,516)**		-		**(1,260,516)**
Dividends reinvested	**11,423**		**114**		**306,877**		-		-		**306,991**
Balance, December 31, 2017	**1,667,813**	**$**	**16,678**	**$**	**26,869,796**	**$**	**15,306,625**	**$**	**(394,167)**	**$**	**41,798,932**

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,	**2017**	2016
Cash flows from operating activities		
Interest received	**$ 16,646,808**	$ 15,284,615
Fees and commissions received	**1,316,507**	1,285,575
Interest paid	**(1,668,523)**	(1,342,185)
Proceeds from sale of mortgage loans held for sale	**13,063,992**	22,360,618
Origination of mortgage loans held for sale	**(12,507,192)**	(23,245,118)
Cash paid to suppliers and employees	**(7,773,163)**	(9,441,840)
Income taxes paid	**(1,170,196)**	(2,462,983)
Cash provided by operating activities	**7,908,233**	2,438,682
Cash flows from investing activities		
Proceeds from maturity and call of securities		
Available for sale	**6,854,680**	8,101,190
Held to maturity	**1,612,309**	3,306,926
Proceeds from sale of securities		
Available for sale	**-**	298,379
Purchase of securities		
Available for sale	**(1,132,224)**	(19,590,432)
Held to maturity	**(1,805,924)**	(4,692,897)
Loans made to customers, net of principal collected	**(37,783,172)**	(27,083,940)
Redemption (purchase) of stock in FHLB of Atlanta	**(285,300)**	(20,200)
Purchases of premises, equipment and software	**(114,243)**	(181,540)
Cash used by investing activities	**(32,653,874)**	(39,862,514)
Cash flows from financing activities		
Net increase (decrease) in		
Noninterest-bearing deposits	**1,611,298**	4,747,893
Interest-bearing deposits	**15,469,990**	22,002,506
Securities sold under repurchase agreements	**(5,457,652)**	6,735,540
Federal Home Loan Bank of Atlanta advances	**8,000,000**	(2,000,000)
Dividends paid, net of reinvestments	**(953,525)**	(942,031)
Cash provided by financing activities	**18,670,111**	30,543,908
Net increase (decrease) in cash and cash equivalents	**(6,075,530)**	(6,879,924)
Cash and cash equivalents at beginning of period	**13,312,915**	20,192,839
Cash and cash equivalents at end of period	**$ 7,237,385**	$ 13,312,915

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,	**2017**	2016
Reconciliation of net income to net cash provided by operating activities		
Net income	**$ 3,789,241**	$ 3,909,129
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	**419,281**	448,895
Provision for loan losses	**410,000**	-
Write down of other real estate owned	**148,500**	58,500
Write down of other assets	**1,500**	-
Mutual fund dividend	**(10,740)**	(7,612)
Decrease (increase) in mortgage loans held for sale	**556,800**	(884,500)
Deferred income taxes	**(347,446)**	307,153
Revaluation of deferred tax asset due to change in corporate income tax rate	**410,391**	-
Amortization of premiums and accretion of discounts, net	**136,874**	165,281
Increase (decrease) in		
Deferred loan fees	**126,038**	46,770
Accrued interest payable	**38,717**	3,935
Other liabilities	**624,102**	242,573
Decrease (increase) in		
Accrued interest receivable	**(63,293)**	(106,040)
Bank owned life insurance cash surrender value	**(170,587)**	(179,622)
Other assets	**1,838,855**	(1,565,780)
Cash provided by operating activities	**$ 7,908,233**	$ 2,438,682

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

Farmers and Merchants Bancshares, Inc. and Subsidiaries

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 Bancshares, Inc. and its wholly owned subsidiaries, Farmers and Merchants Bank (the "Bank"), and Series Protected Cell FCB-4 (the "Insurance Subsidiary"), and one subsidiary of the Bank, 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 2016 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 the loans 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 impaired loans; (ii) historical valuation allowances determined based on historical loan loss experience for impaired 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 impaired 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, 2017 and 2016, 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 as well as changes to policies and experience of loan personnel. 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 **1,658,384** and 1,652,014 for 2017 and 2016, 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, 2017 for items that should potentially be recognized or disclosed in these financial statements as prescribed by ASC Topic 855, Subsequent Events.

2. 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 **$5,991,573** and $6,542,956 during the years ended December 31, 2017 and 2016, 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.

3. Investment Securities

Investment securities are summarized as follows:

December 31, 2017	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Available for sale				
State and municipal	**$ 1,510,848**	**$ 38,494**	**$ 10,135**	**$ 1,539,207**
Mutual fund	**518,352**	**-**	**14,471**	**503,881**
SBA pools	**3,212,771**	**75**	**13,000**	**3,199,846**
Mortgage-backed securities	**23,735,332**	**8,787**	**553,662**	**23,190,457**
	$ 28,977,303	**$ 47,356**	**$ 591,268**	**$28,433,391**
Held to maturity				
State and municipal	**$ 18,204,182**	**$ 225,349**	**$ 121,904**	**$18,307,627**

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

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, 2017	Amortized cost	Fair value	Amortized cost	Fair value
Within one year	**$ 518,352**	**$ 503,881**	**$ 165,677**	**$ 168,260**
Over one to five years	**-**	**-**	**780,336**	**794,512**
Over five to ten years	**1,133,940**	**1,150,564**	**1,792,019**	**1,831,833**
Over ten years	**376,908**	**388,643**	**15,466,150**	**15,513,022**
	2,029,200	**2,043,088**	**18,204,182**	**18,307,627**
Mortgage-backed securities and SBA pools, due in monthly installments	**26,948,103**	**26,390,303**	**-**	**-**
	$ 28,977,303	**$ 28,433,391**	**$ 18,204,182**	**$ 18,307,627**
December 31, 2016				
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

Securities with a carrying value of **$31,982,381** and $39,818,557 as of December 31, 2017 and 2016, respectively, were pledged as collateral for securities sold under repurchase agreements, municipal deposits, and borrowings.

In 2017, the Company had no security sales. In 2016, the Company realized no gain or loss on the sale of one security with gross proceeds of $298,379.

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, 2017	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	**$ 812,630**	**$ 1,519**	**$ 3,444,443**	**$ 130,520**	**$ 4,257,073**	**$ 132,039**
Mutual fund	**-**	**-**	**503,881**	**14,471**	**503,881**	**14,471**
SBA pools	**551,780**	**1,903**	**2,109,832**	**11,097**	**2,661,612**	**13,000**
Mortgage-backed securities	**2,871,597**	**41,413**	**19,571,511**	**512,249**	**22,443,108**	**553,662**
Total	**$ 4,236,007**	**$ 44,835**	**$ 25,629,667**	**$ 668,337**	**$ 29,865,674**	**$ 713,172**

3. **Investment Securities** (Continued)

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

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, 2017, 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, 2017, 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.

4. **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, 2017 and 2016, the activity of these loans was as follows:

	2017	**2016**
Balance, beginning of year	**$ 12,782,233**	$ 13,148,726
Additions	**5,921,920**	3,987,121
Amounts collected	**(3,126,837)**	(4,205,038)
Change in related parties	**-**	(148,576)
Balance, end of year	**$ 15,577,316**	$ 12,782,233

Unused lines of credit to related parties totaled **$746,842** and $2,220,128, at December 31, 2017 and 2016, respectively. Letters of credit were issued to directors totaling **$6,534** at December 31, 2017 and 2016, respectively.

Deposits at the Company from related parties totaled **$18,592,732** and $15,933,380 at December 31, 2017 and 2016, respectively.

Payments to companies controlled by directors totaled **$10,278** in 2017 and $2,697 in 2016. The Company occasionally utilizes the services of a real estate firm where another director was a partner, although no compensation was paid in 2017 or 2016.

5. Loans

Major categories of loans at December 31, 2017 and 2016 are as follows:

	2017	2016
Real estate:		
Commercial	**$ 234,026,574**	$ 206,145,076
Construction and land development	**18,160,366**	14,392,992
Residential	**59,241,416**	54,710,809
Commercial	**23,613,543**	22,152,773
Consumer	**554,017**	725,269
	335,595,916	298,126,919
Less: Allowance for loan losses	**2,458,911**	2,363,086
Deferred origination fees net of costs	**603,299**	477,261
	$ 332,533,706	$ 295,286,572

The maturity and rate repricing distribution of the loan portfolio as of December 31, 2017 and 2016, is as follows:

	2017	2016
Variable rate, immediately	**$ 55,901,161**	$ 41,628,685
Due within one year	**42,042,744**	48,381,221
Due over one to five years	**136,475,036**	126,810,275
Due over five years	**101,176,975**	81,306,738
	$ 335,595,916	$ 298,126,919

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

	2017	2016
Real eatate:		
Commercial	**$ 2,245,743**	$ -
Construction and land development	**-**	752,889
Total	**$ 2,245,743**	$ 752,889

At December 31, 2017, the Company had **one** nonaccrual commercial real estate loan totaling **$2,245,743**. The loan was secured by real estate and business assets, and was personally guaranteed. Gross interest income of **$82,070** would have been recorded in 2017 if this nonaccrual loan had been current and performing in accordance with the original terms. The Company allocated **$127,213** of its allowance for loan losses for this nonaccrual loan. The balance of the nonaccrual loan was net of charge-offs of **$275,000** at December 31, 2017.

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.

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, 2017							
Real estate:							
Commercial	**$ -**	**$ -**	**$ 2,245,743**	**$ 2,245,743**	**$ 231,780,831**	**$ 234,026,574**	**$ -**
Construction and land development	**-**	**-**	**-**	**-**	**18,160,366**	**18,160,366**	**-**
Residential	**-**	**-**	**146,459**	**146,459**	**59,094,957**	**59,241,416**	**146,459**
Commercial	**-**	**-**	**-**	**-**	**23,613,543**	**23,613,543**	**-**
Consumer	**-**	**-**	**-**	**-**	**554,017**	**554,017**	**-**
Total	**$ -**	**$ -**	**$ 2,392,202**	**$ 2,392,202**	**$ 333,203,714**	**$ 335,595,916**	**$ 146,459**
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	$ -

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, 2017							
Commercial real estate	**$ 5,458,182**	**$ 2,937,439**	**$ 2,245,743**	**$ 5,183,182**	**$ 127,213**	**$ 3,804,136**	**$ 268,652**
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

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.

5. **Loans** (Continued)

At December 31, 2017, the Company had **three** commercial real estate loans totaling **$2,937,439** classified as a troubled debt restructuring. **Two** loans totaling **$774,274** were restructured as a trouble debt restructuring during 2017. All are included in impaired loans above. Each loan is paying as agreed. There have been no charge-offs or allowances associated with these **three** loans.

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.

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.

5. **Loans** (Continued)

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

December 31, 2017	Excellent	Above average	Average	Acceptable	Pass watch	Special mention	Substandard	Doubtful	Total
Real estate:									
Commercial	$ -	$ 6,115,925	$127,639,361	$ 79,619,726	$ 9,041,882	$ 5,391,589	$ 3,972,348	$ 2,245,743	$ 234,026,574
Construction and land development	-	173,633	9,288,372	4,978,964	3,719,397	-	-	-	18,160,366
Residential	53,948	1,260,128	35,254,016	18,659,174	3,363,570	-	650,580	-	59,241,416
Commercial	1,581,878	121,919	16,225,350	5,545,562	138,834	-	-	-	23,613,543
Consumer	5,210	96,484	351,093	70,171	-	-	2,640	28,419	554,017
	$ 1,641,036	$ 7,768,089	$188,758,192	$108,873,597	$ 16,263,683	$ 5,391,589	$ 4,625,568	$ 2,274,162	$ 335,595,916

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

5. **Loans** (Continued)

The following table details activity in the allowance for loan losses by portfolio for the years ended December 31, 2017 and 2016. 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, 2017	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	**$ 1,717,749**	**$ 419,868**	**$ (275,000)**	**$ 4,780**	**$ 1,867,397**	**$ 127,213**	**$ 1,740,184**	**$ 5,183,182**	**$228,843,392**
Construction and land development	**204,860**	**65,850**	**(47,436)**	**-**	**223,274**	**-**	**223,274**	**-**	**18,160,366**
Residential	**247,437**	**368**	**-**	**148**	**247,953**	**-**	**247,953**	**-**	**59,241,416**
Commercial	**125,260**	**(41,240)**	**-**	**3,333**	**87,353**	**-**	**87,353**	**-**	**23,613,543**
Consumer	**8,826**	**(1,799)**	**-**	**-**	**7,027**	**-**	**7,027**	**-**	**554,017**
Unallocated	**58,954**	**(33,047)**	**-**	**-**	**25,907**	**-**	**25,907**	**-**	**-**
	$ 2,363,086	**$ 410,000**	**$ (322,436)**	**$ 8,261**	**$ 2,458,911**	**$ 127,213**	**$ 2,331,698**	**$ 5,183,182**	**$330,412,734**

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

Loans with a balance of approximately **$64** million were pledged as collateral to the FHLB of Atlanta as of December 31, 2017. Loans with a balance of approximately **$41** million were pledged as collateral to the Federal Reserve Bank of Richmond as of December 31, 2017. At December 31, 2017 and 2016, the Company serviced participation loans for others totaling **$31.7** and $31.0 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.

6. Premises and Equipment

A summary of premises and equipment is as follows:

	Useful lives	2017	2016
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	**3,604,769**	3,490,526
		11,217,402	11,103,159
Accumulated depreciation and amortization		**6,011,131**	5,653,481
		$ 5,206,271	$ 5,449,678
Depreciation and amortization expense		**$ 357,650**	$ 379,795

Software with a net book value of **$126,538** and $185,253 as of December 31, 2017 and 2016, respectively, is included in other assets. Amortization expense of **$61,631** and $69,100 was recorded in 2017 and 2016, respectively.

7. 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 was for five years and, effective January 2018, the lease has been renewed for one five-year term with an option to renew for an additional five-year term. 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 2017 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 including those option years for which the Company is reasonably certain to renew are as follows:

Year	Amount
2018	$ 133,224
2019	137,388
2020	141,680
2021	146,120
2022	150,707
Thereafter	1,067,216
	$ 1,776,335

Rent expense was **$130,608** and $128,200 in 2017 and 2016, respectively.

8. Credit Commitments

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

	2017	2016
Loan commitments		
Construction and land development	$ -	$ 250,000
Commercial	1,295,000	1,050,000
Commercial real estate	7,478,500	17,134,718
Residential	660,000	3,894,689
	$ 9,433,500	$ 22,329,407
Unused lines of credit		
Home-equity lines	$ 3,390,515	$ 3,345,309
Commercial lines	36,614,548	27,182,226
	$40,005,063	$ 30,527,535
Letters of credit	$ 1,827,513	$ 1,281,848

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 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 **$170,142** and $165,224 for 2017 and 2016, respectively.

9. **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 **$5,228** and $4,816 in 2017 and 2016, 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 **$255,859** and $240,193 in 2017 and 2016, 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:

	2017	2016
NOW	**$ 43,536,401**	$ 40,090,252
Money market	**53,750,747**	64,859,044
Savings	**43,903,240**	40,158,833
Certificates of deposit, $250,000 or more	**15,896,054**	15,233,383
Other time deposits	**98,306,849**	79,581,789
	$255,393,291	$ 239,923,301

As of December 31, 2017, certificates of deposit mature as follows:

Year	Amount
2018	**$ 57,820,534**
2019	**30,745,897**
2020	**15,963,309**
2021	**5,507,825**
2022	**3,526,876**
Thereafter	**638,462**
	$114,202,903

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

		2017	2016
Amounts outstanding at year-end:			
Securities sold under repurchase agreements		**$ 21,768,507**	$ 27,226,159
Federal Home Loan Bank advances are summarized as follows:			
Maturity date	Interest Rate	Amount	
1/17/2017	0.75%	**$ -**	$ 1,000,000
4/21/2017	0.71%	**-**	1,000,000
1/16/2018	1.13%	**1,000,000**	1,000,000
1/30/2018	1.25%	**2,000,000**	-
2/12/2018	1.14%	**2,000,000**	2,000,000
3/15/2018	1.17%	**2,000,000**	-
5/24/2018	1.26%	**2,000,000**	-
6/28/2018	1.69%	**3,000,000**	-
8/13/2018	1.32%	**2,000,000**	2,000,000
9/23/2019	1.25%	**2,000,000**	2,000,000
11/22/2019	1.99%	**1,000,000**	-
	Total	**$ 17,000,000**	$ 9,000,000
Weighted average rate paid at December 31:			
Securities sold under repurchase agreements		**0.65%**	0.63%
Federal Home Loan Bank advances		**1.35%**	1.11%
Maximum month-end amount outstanding during the year ended December 31:			
Securities sold under repurchase agreements		**$ 30,786,064**	$ 32,287,740
Federal Home Loan Bank advances		**18,000,000**	16,000,000
Average amount outstanding during the year ended December 31:			
Securities sold under repurchase agreements		**$ 24,702,931**	$ 25,320,795
Federal Home Loan Bank advances		**13,846,575**	10,833,333
Borrowings from FRB and commercial banks		**78,082**	21,861
Average rate paid during the year ended December 31:			
Securities sold under repurchase agreements		**0.66%**	0.64%
Federal Home Loan Bank advances		**1.20%**	0.94%
Borrowings from FRB and commercial banks		**1.64%**	0.67%
Investment securities underlying the repurchase agreements at December 31:			
Carrying value		**$ 22,363,793**	$ 28,191,745
Estimated fair value		**22,484,092**	28,165,979
Loans and investment securities pledged to the Federal Home Loan Bank at December 31:			
Carrying value - loans		**$ 68,406,154**	$ 69,998,207
Carrying value - investment securities		**4,749,970**	6,709,360
Loans pledged to the Federal Reserve Bank at December 31:			
Carrying value		**$ 40,717,623**	$ 40,954,231

The Company is approved to borrow approximately $52.9 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 $30.1 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.

12. Other Noninterest Expenses

Other noninterest expenses include the following:

	2017	2016
Professional services	$ 452,846	$ 311,702
Automated teller machine and debit card expenses	285,912	331,368
Advertising	236,564	217,116
Telephone	178,875	185,532
Directors fees	178,796	189,263
Postage, delivery, and armored carrier	172,607	179,344
Stationery, printing, and supplies	170,301	188,070
Internet banking fees	157,962	143,210
Federal Deposit Insurance Corporation premiums	125,943	147,940
Correspondent bank services	84,119	79,278
Travel and conferences	51,509	48,970
Liability insurance	49,332	46,917
Maryland state regulatory assessment	44,897	41,531
Dues and subscriptions	39,574	39,752
Remote deposit expenses	30,895	29,722
Insurance claims	27,413	-
Other real estate owned	24,441	15,252
Credit reports	23,450	25,276
Contributions	23,439	23,160
Education and training	21,932	15,669
Other	92,851	97,422
	$ 2,473,658	$ 2,356,494

13. Income Taxes

The components of income tax expense are as follows:

	2017	2016
Current		
Federal	$ 1,532,959	$ 1,353,410
State	406,410	364,394
	1,939,369	1,717,804
Revaluation of deferred tax asset due to change in corporate tax rate	410,391	-
Deferred	(347,446)	309,016
	$ 2,002,314	$ 2,026,820

The Tax Cuts and Jobs Act will reduce the Company's federal corporate income tax rate from 34% to 21% beginning in 2018. Because the legislation was passed in 2017, the Company was required to revalue its net deferred tax asset in 2017 using the 21% rate resulting in additional income tax expense in 2017. The Company recorded net income tax expense of **$410,391** related to this revaluation. Of this amount, **$64,801** of expense was attributable to the Company's net deferred tax asset for unrealized losses on available for sale securities. In addition to adjusting the deferred tax asset for this item, the Company recorded an adjustment to accumulated other comprehensive income with a transfer to retained earnings.

13. **Income Taxes** (Continued)

The components of the deferred tax expense are as follows:

	2017	2016
Depreciation	**$ (62,449)**	$ (46,226)
Provision for loan losses	**(132,991)**	96,206
Other real estate owned allowance for loss	**(58,576)**	(23,075)
Nonaccrual interest	**(3,633)**	(15,000)
Prepaid captive insurance premium	**13,781**	393,735
Write-down of equity securities	**(592)**	-
Post-retirement benefits	**(102,986)**	(96,624)
	$(347,446)	$ 309,016

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

	2017	2016
Deferred tax assets		
Allowance for loan losses	**$ 627,127**	$ 765,966
Other real estate owned allowance for loss	**213,123**	246,925
Write-down of equity securities	**4,265**	5,522
Nonaccrual interest	**22,804**	29,055
Post-retirement benefits	**434,891**	520,410
Unrealized loss on securities available for sale	**149,671**	182,588
	1,451,881	1,750,466
Deferred tax liabilities		
Prepaid captive insurance premium	**282,990**	391,872
Depreciation	**170,859**	329,575
	453,849	721,447
Net deferred tax asset	**$ 998,032**	$ 1,029,019

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

	2017	2016
Statutory federal income tax rate	**34.0 %**	34.0 %
Increase (decrease) resulting from:		
Federal tax-exempt income	**(10.8)**	(4.9)
State income taxes, net of federal income tax benefit	**3.9**	4.9
Nondeductible expenses	**0.1**	0.1
Revaluation of deferred tax asset due to change in corporate tax rate	**7.1**	-
Other	**0.3**	-
	34.6 %	34.1 %

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, 2013.

14. 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, 2017, 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 began on January 1, 2016, at the 0.625% level and will 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, 2017, 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, 2017 and 2016, 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, 2017 and 2016, 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, 2017, 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, 2017	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	**$ 44,039**	**12.54%**	**$ 32,477**	**9.25%**	**$ 35,110**	**10.00%**
Tier 1 capital (to risk-weighted assets)	**41,580**	**11.84%**	**25,455**	**7.25%**	**28,088**	**8.00%**
Common equity tier 1 (to risk-weighted assets)	**41,580**	**11.84%**	**20,188**	**5.75%**	**22,822**	**6.50%**
Tier 1 leverage (to average assets)	**41,580**	**10.31%**	**16,135**	**4.00%**	**20,169**	**5.00%**

(Dollars in thousands)	Actual		Minimum Capital Adequacy		To Be Well Capitalized	
December 31, 2016	Amount	Ratio	Amount	Ratio	Amount	Ratio
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%

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 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, 2017 and 2016, 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, 2017				
Recurring				
Available for sale securities				
State and municipal	$ -	$ 1,539,207	$ -	$ 1,539,207
Mutual Fund	503,881	-	-	503,881
SBA pools	-	3,199,846	-	3,199,846
Mortgage-backed securities	-	23,190,457	-	23,190,457
	$ 503,881	$ 27,929,510	$ -	$ 28,433,391
Nonrecurring				
Other real estate owned	$ -	$ -	$ 265,500	$ 265,500
Impaired loans	-	-	5,055,969	5,055,969
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

15. **Fair Value (continued)**

Reconciliation of Level 3 Inputs

	Other Real Estate Owned	Impaired Loans
December 31, 2016 balance	**$ 414,000**	**$ 3,318,577**
Additions	**-**	**3,242,425**
Advances	**-**	**1,382,256**
Write-downs	**(148,500)**	**(322,436)**
Loan loss provision	**-**	**(103,046)**
Principal payments received	**-**	**(2,461,807)**
December 31, 2017 balance	**$ 265,500**	**$ 5,055,969**

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, 2017		December 31, 2016	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Level 1 inputs				
Cash and cash equivalents	**$ 7,237,385**	**$ 7,237,385**	$ 13,312,915	$ 13,312,915
Level 2 inputs				
Securities held to maturity	**18,204,182**	**18,307,627**	17,987,628	17,833,799
Mortgage loans held for sale	**327,700**	**332,558**	884,500	902,061
Federal Home Loan Bank stock	**1,063,600**	**1,063,600**	778,300	778,300
Level 3 inputs				
Loans, net	**332,533,706**	**332,689,848**	295,286,572	297,982,000
Financial liabilities				
Level 1 inputs				
Noninterest-bearing deposits	**$ 64,403,133**	**$ 64,403,133**	$ 62,791,835	$ 62,791,835
Securities sold under repurchase agreements	**21,768,507**	**21,768,507**	27,226,159	27,226,159
Level 2 inputs				
Interest-bearing deposits	**255,393,291**	**244,403,291**	239,923,301	230,394,000
Federal Home Loan Bank advances	**17,000,000**	**16,957,000**	9,000,000	8,975,000

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. **Parent Company Financial Information**

The condensed financial statements for the Company (parent only) are presented below:

Balance Sheets

December 31,	2017	2016
Assets		
Cash and cash equivalents	$ 48,384	$ 52,086
Investment in subsidiaries	41,743,068	38,952,711
Other assets	7,480	7,480
	$ 41,798,932	$ 39,012,277
Liabilities and Stockholders' Equity		
Stockholders' equity		
Common stock, par value $.01 per share, authorized 5,000,000 shares; issued and outstanding 1,667,813 shares in 2017 and 1,656,390 shares in 2016	16,678	16,564
Additional paid-in capital	26,869,796	26,562,919
Retained earnings	15,306,625	12,713,099
Accumulated other comprehensive income	(394,167)	(280,305)
	41,798,932	39,012,277
	$ 41,798,932	$ 39,012,277

16. **Parent Company Financial Information (continued)**

Statements of Income

Years Ended December 31,	**2017**	2016
Income		
Cash dividends from subsidiary	**$ 1,250,278**	$ 696,301
Total income	**1,250,278**	696,301
Noninterest expense	**455**	22,000
Income before before income taxes and equity in undistributed income of subsidiaries	**1,249,823**	674,301
Income taxes (benefit)	**-**	(7,480)
Income before before equity in undistributed income of subsidiaries	**1,249,823**	681,781
Equity in undistributed income of subsidiaries	**2,539,418**	3,227,348
	$ 3,789,241	$ 3,909,129

Statements of Cash Flows

Years Ended December 31,	**2017**	2016
Cash flows from operating activities		
Net Income	**$ 3,789,241**	$ 3,909,129
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed income of subsidiaries	**(2,539,418)**	(3,227,348)
Other	**-**	(7,480)
Cash provided by operating activities	**1,249,823**	674,301
Cash flows from investing activities		
Contibution of capital to subsdiaries	**(300,000)**	(25,675)
Cash used by investing activities	**(300,000)**	(25,675)
Cash flows from financing activities		
Dividends paid, net of reinvestments	**(953,525)**	(596,540)
Cash provided by financing activities	**(953,525)**	(596,540)
Net increase (decrease) in cash and cash equivalents	**(3,702)**	52,086
Cash and cash equivalents at beginning of period	**52,086**	-
Cash and cash equivalents at end of period	**$ 48,384**	$ 52,086

17. Quarterly Results of Operations

	Three Months Ended Unaudited			
2017	December 31	September 30	June 30	March 31
Interest income	**$4,264,414**	**$ 4,232,017**	**$4,121,760**	**$3,976,612**
Interest expense	**466,104**	**442,805**	**412,618**	**385,713**
Net interest income	**3,798,310**	**3,789,212**	**3,709,142**	**3,590,899**
Provision for loan losses	**60,000**	**225,000**	**75,000**	**50,000**
Net income	**656,339**	**1,014,456**	**1,134,889**	**983,557**
Earnings per share - basic and diluted	**$ 0.39**	**$ 0.61**	**$ 0.69**	**$ 0.59**
2016	December 31	September 30	June 30	March 31
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

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 COMPANY'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 1,667,863 shares of Common Stock issued and outstanding held by approximately 568 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
2017			
Quarter ended December 31	$33.00	$27.85	$0.39
Quarter ended September 30	28.50	27.15	0.00
Quarter ended June 30	28.25	27.00	0.37
Quarter ended March 31	27.50	25.25	0.00
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

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 24, 2018 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."

Janney Montgomery Scott, LLC. makes a market in Farmers and Merchants Bancshares Inc. common stock.
For information, please contact Douglas Velnoskey at 443-201-2088

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Website
www.fmb1919.com

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, Executive Vice President, Chief Financial Officer
Farmers and Merchants Bank
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Reisterstown, Maryland 21136