



# Farmers and Merchants Bancshares, Inc.

Annual Meeting of Shareholders

April 25, 2017



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# Highlights for 2016

- 2016 net income of \$3,909,129 was the second best in the Company's history, only 2015's net income of \$4,268,222 was higher
  - 2015's net income excluding non-recurring items was \$3,971,128
  - Return on equity: 10.26% in 2016 vs. 12.26% in 2015
  - Return on assets: 1.08% in 2016 vs. 1.29% in 2015
- Strong growth:
  - Total assets increased by 10%
  - Investments increased by 27%
  - Loans outstanding increased by 10%
  - Deposits increased by 10%
- Dividends paid increased to \$.70 per share, up from \$.64 per share in 2015
- The stock price increased by 7% from \$24.10 to \$25.75 per share
- Ranked as the #1 performing Maryland state chartered bank in the Baltimore area and #5 in the entire state



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# Highlights for 2016

- In October, the stockholders approved the formation of a bank holding company, Farmers and Merchants Bancshares, Inc.
  - Improved ability to raise capital
  - Increased flexibility in acquisitions
  - Engage in “non-banking” activities
    - Captive insurance subsidiary
- In November, the Captive Insurance Subsidiary was formed
  - Insures the Bank against risks for which insurance coverage is not typically available or too expensive in the commercial marketplace
  - The Captive structure is tax advantaged (IRS section 831(b))
    - The premium paid by the Bank is tax deductible
    - The premium revenue received by the Captive is not taxable if it does not exceed \$2.2 million

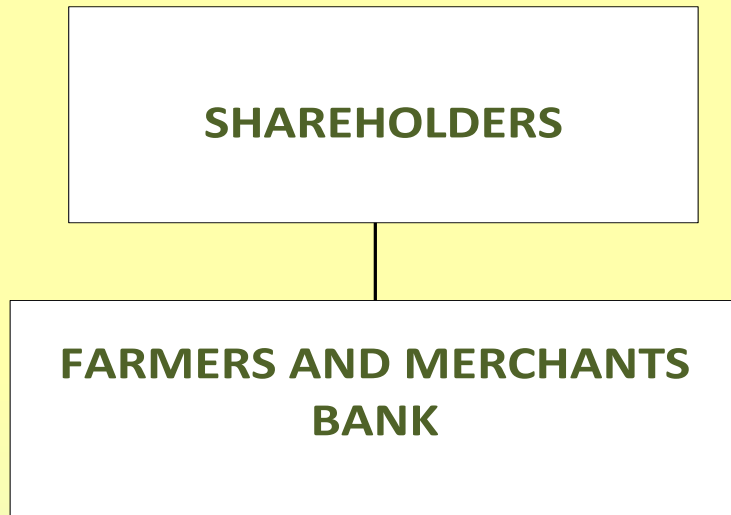


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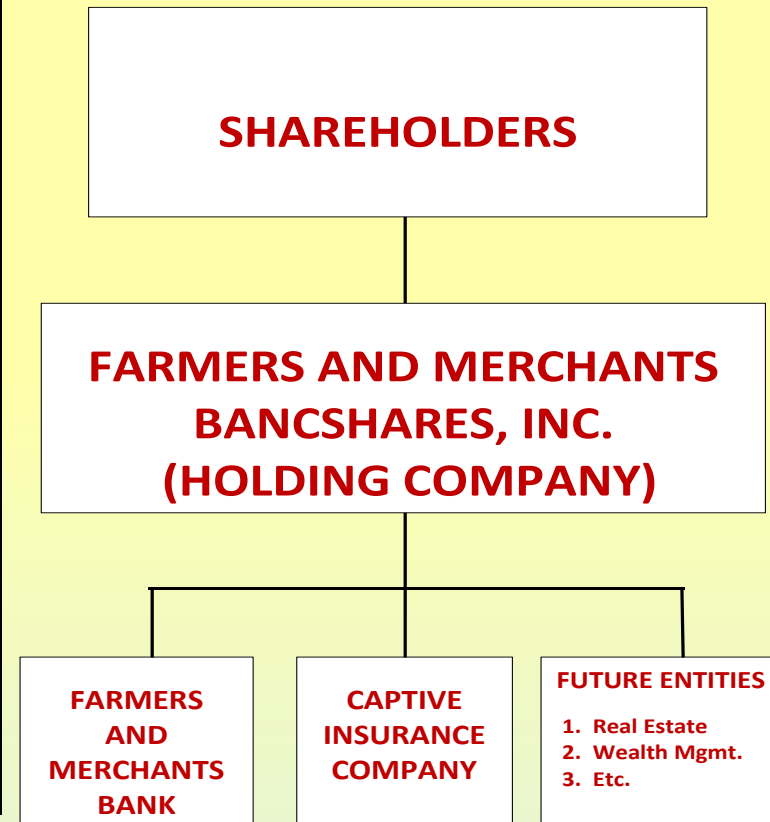
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# Holding Company

## FARMERS AND MERCHANTS BANK



## FARMERS AND MERCHANTS BANCSHARES, INC.



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# Restatement of 2016's Earnings

- As previously communicated to all stockholders, due to an error in the accounting for income taxes, we restated our earnings from what was originally reported
  - The error relates to the accounting for the insurance premium paid in the fourth quarter of 2016 by the Bank to the newly formed captive insurance subsidiary. Income tax expense was understated by \$393,735 because a significant portion of the tax benefit from this transaction, although fully deductible on our 2016 income tax return, should have been deferred until 2017 for our GAAP financial statements. This is a timing difference, not a permanent difference.
  - The change to net income and other key measurements are:

	<u>Restated</u>	<u>Previously reported</u>	<u>Difference</u>
Net Income	\$ 3,909,129	\$ 4,302,864	\$ (393,735)
Earnings per share	\$ 2.37	\$ 2.60	\$ (0.23)
Return on average equity	10.26%	11.29%	-1.03%
Return on average assets	1.08%	1.19%	-0.11%



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# Balance Sheet Highlights for 2016

- Assets increased \$35 million to \$380 million
- Investments increased \$11 million to \$54 million
- Loans increased \$28 million to \$296 million
- Deposits increased \$27 million to \$303 million
- Stockholders' equity increased \$2.8 million to \$39.0 million



# Total Assets

(in thousands)

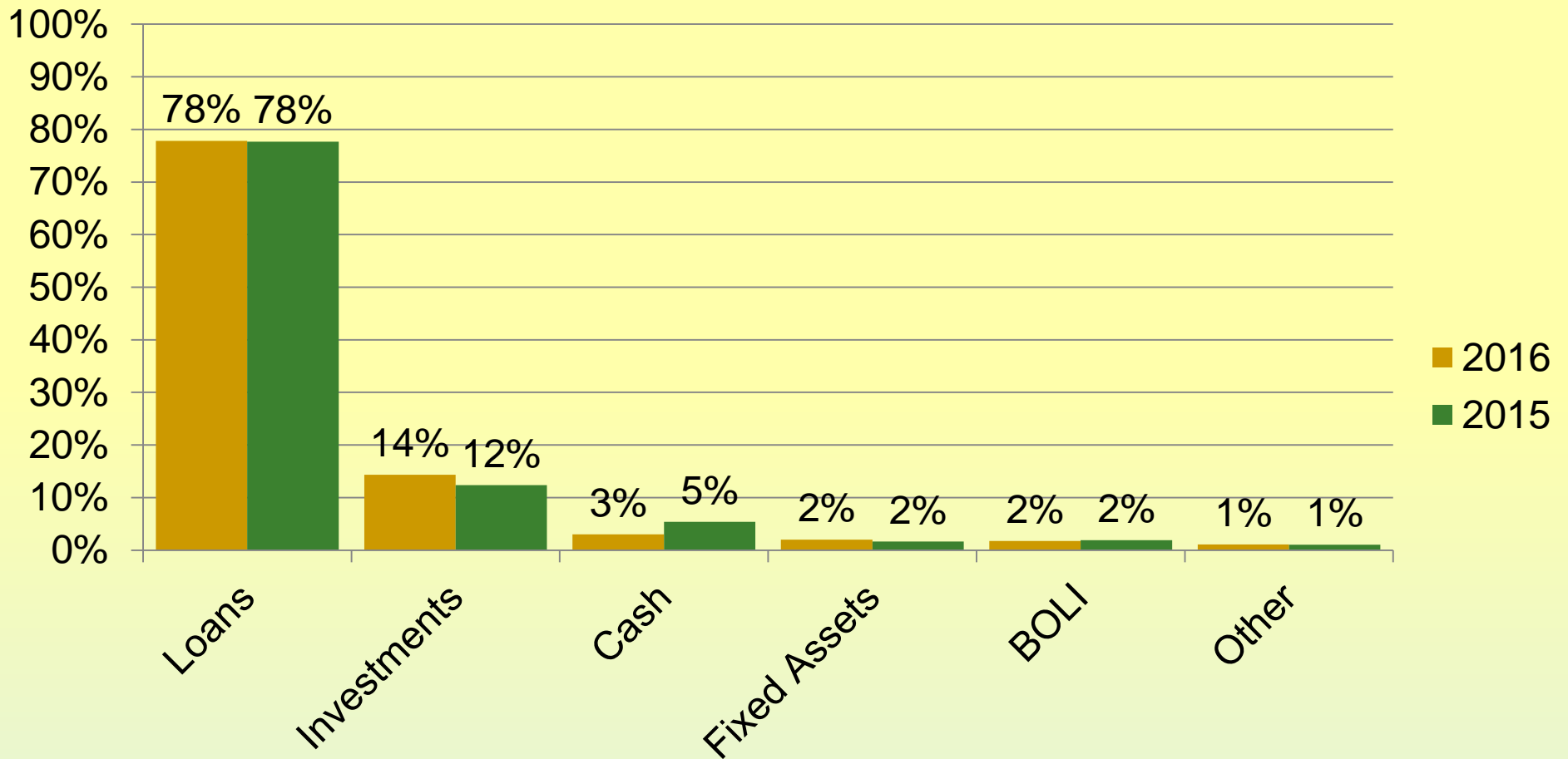
	12/31/2016	12/31/2015	Change
Cash & Due From Banks	\$ 12,334	\$ 18,535	\$ (6,201)
Investments	54,230	42,765	11,465
Loans & Loans Held For Sale	296,171	268,249	27,922
Fixed Assets	5,450	5,648	(198)
Bank Owned Life Insurance	6,721	6,541	180
Other	4,925	3,572	1,353
Total	<u>\$ 379,831</u>	<u>\$ 345,310</u>	<u>\$ 34,521</u>



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# Asset Distribution 2016 versus 2015



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# Loan Quality

- Loan losses remained low in 2016
  - Net charge-offs totaled \$220,359 compared to net charge-offs of \$196,804 in 2015
- Non performing assets to total assets remain low at 0.31% at 12/31/16, compared to 0.41% at 12/31/15 and 0.29% at 12/31/14.
- Net loan losses to loans outstanding was 0.08% in 2016 and 0.07% in 2015 compared to 0.10% and 0.12% for our national peer group.
- Non-current loans (90 days or more past due) to total loans was 0.52% at 12/31/16 and 0.35% at 12/31/15 compared to 0.79% and 0.87% for our national peer group.
- The Bank was ranked #3 for asset quality among all state headquartered banks.

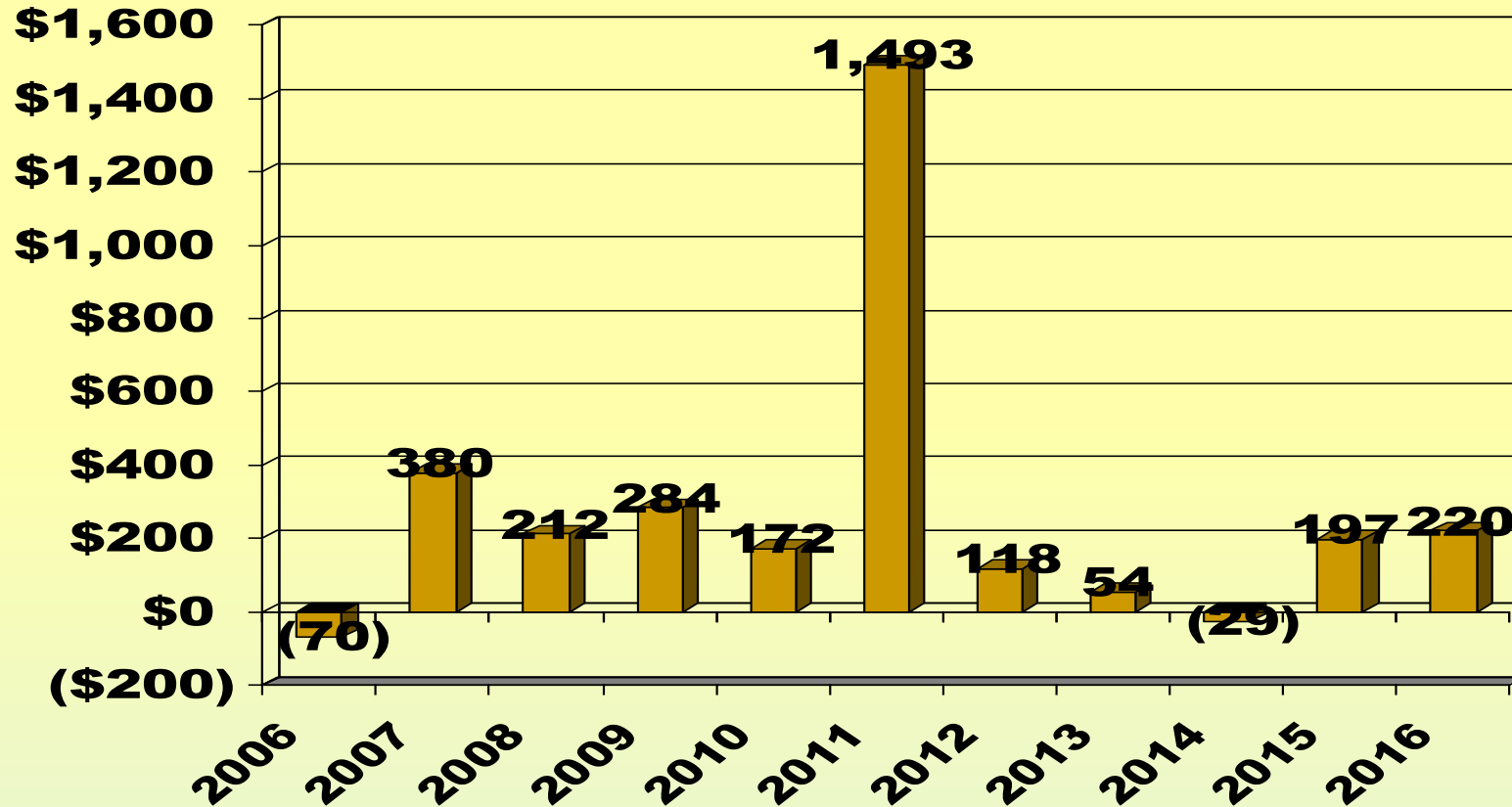


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# Loan Charge-off Trend

**Net Loan Chargeoffs (Recoveries)**  
**(in thousands)**



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# Liabilities and Equity

(in thousands)

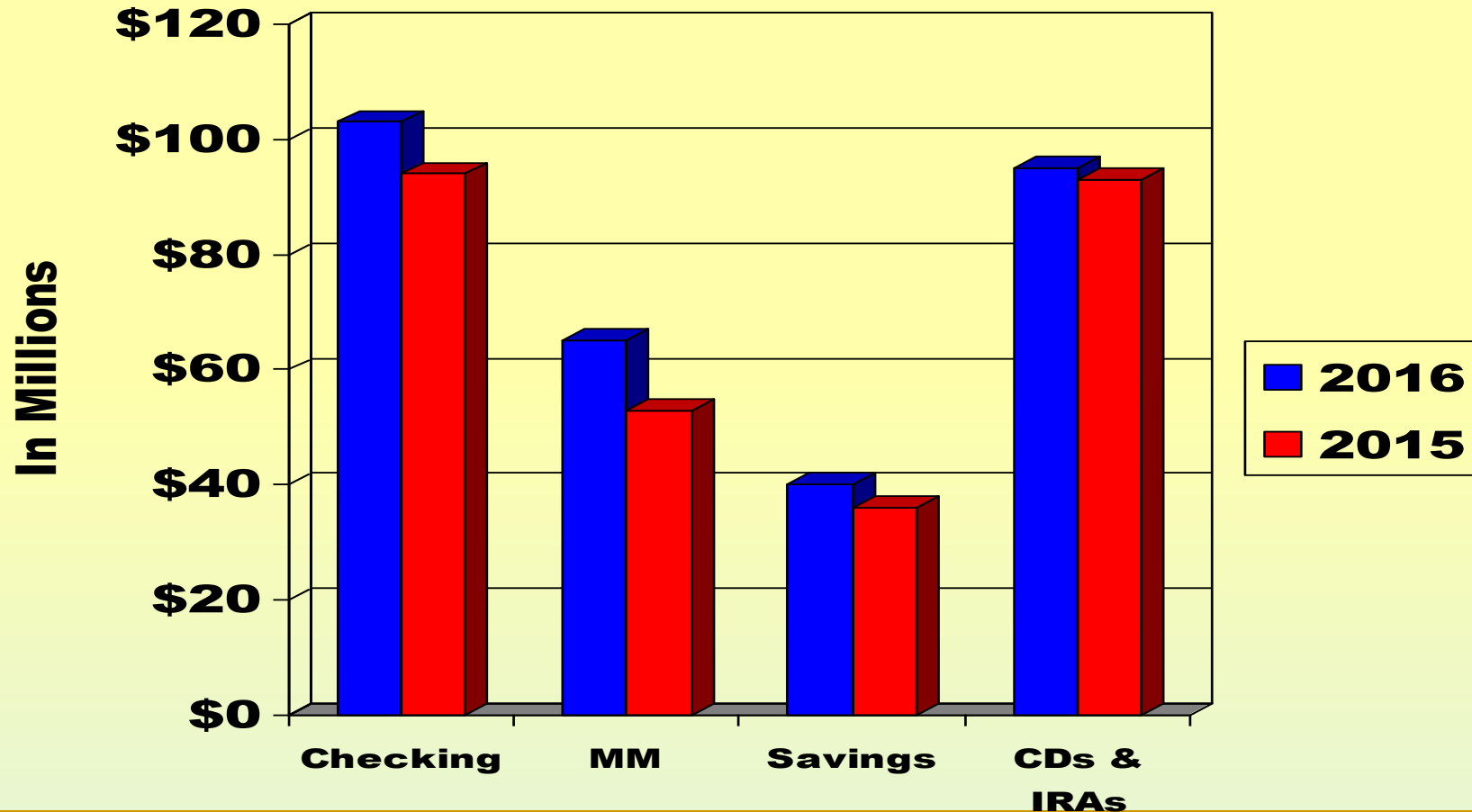
	12/31/2016	12/31/2015	Change
Deposits	\$ 302,715	\$ 275,965	\$ 26,750
Repurchase Agreements	27,226	20,491	6,735
FHLB Advances	9,000	11,000	(2,000)
Other	1,878	1,631	247
Total Liabilities	<u>340,819</u>	<u>309,087</u>	<u>31,732</u>
Stockholders' Equity	39,012	36,223	2,789
Total	<u>\$ 379,831</u>	<u>\$ 345,310</u>	<u>\$ 34,521</u>



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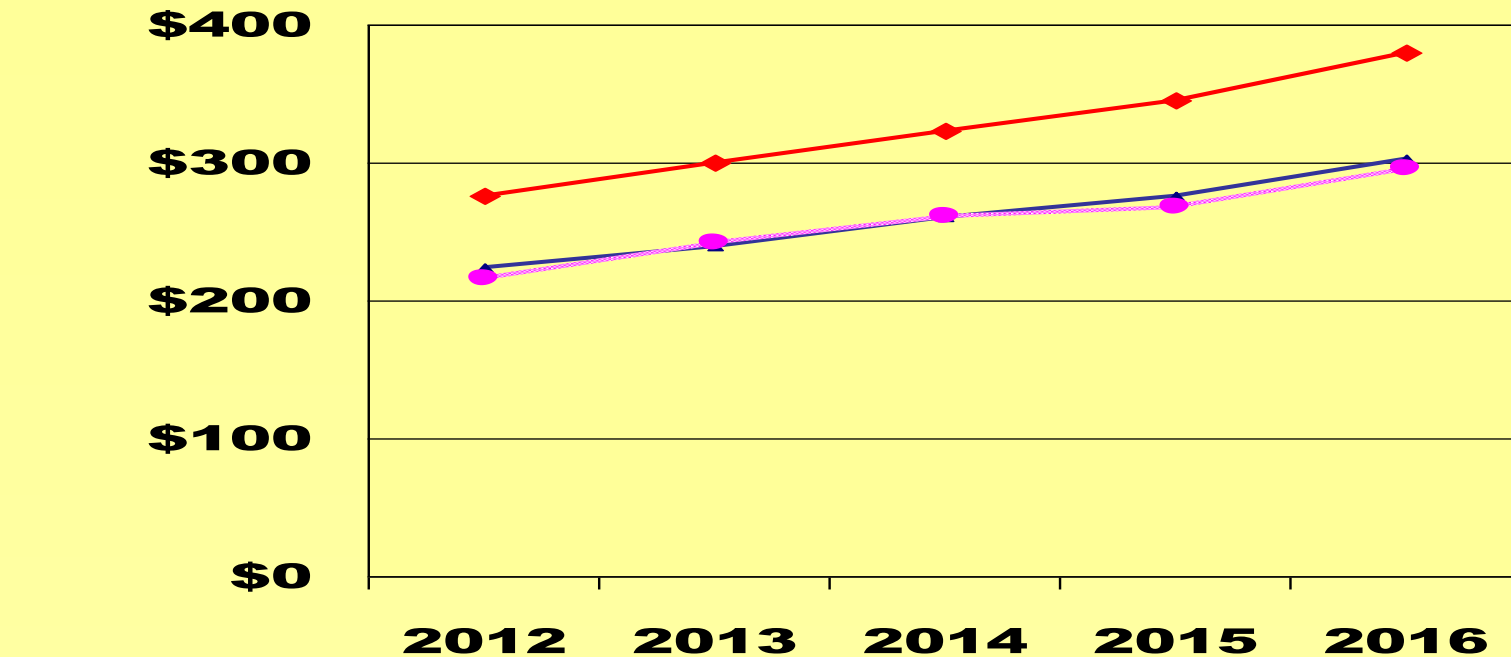
# Deposit Composition 2016 versus 2015



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# Balance Sheet Five Year Trend



In Millions

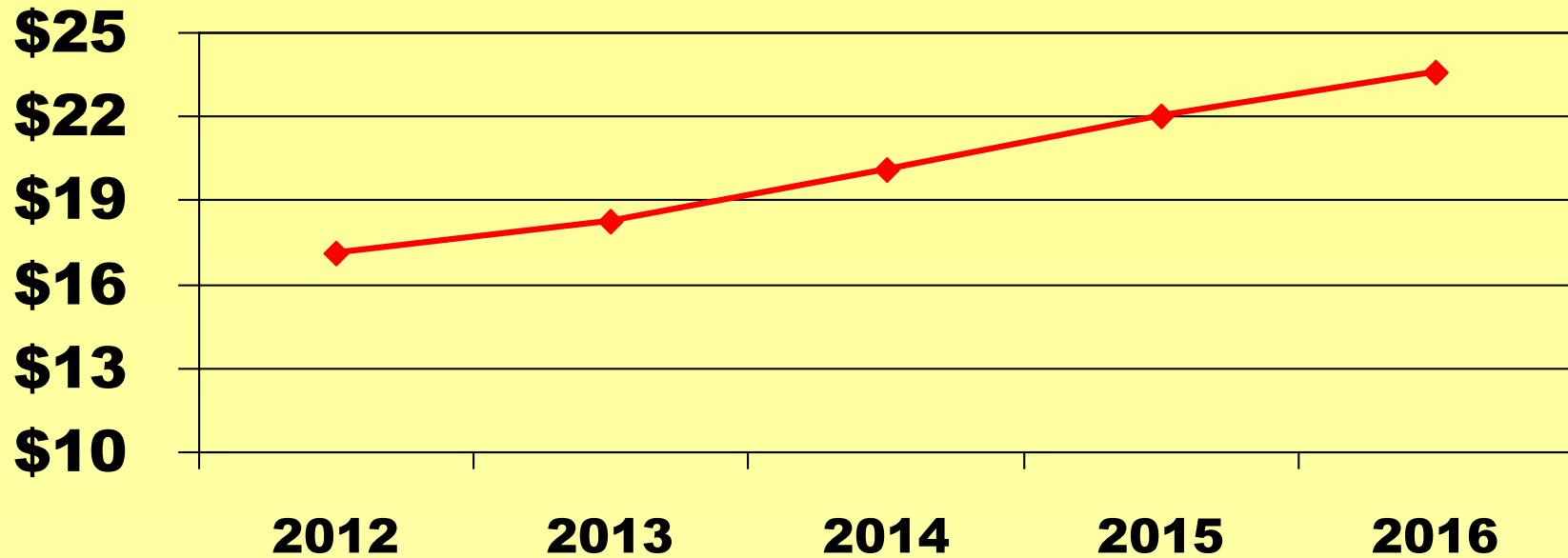
—◆— **Total Assets**    —▲— **Deposits**    —●— **Loans**



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# Book Value per Share Five Year Trend



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# Income Statement Highlights for 2016

- Net Income down \$359,000 to \$3,909,000
  - Excluding 2015's non-recurring items, net income was down only \$62,000
- Earnings Per Share was \$2.37 in 2016 compared to \$2.61 in 2015
- Net Interest Income increased by \$489,000
  - Net yield on interest-earning assets decreased to 4.13% in 2016 from 4.33% in 2015
- Provision for Loan Losses was \$0 for both years
- Operating Expenses up \$830,000 or 10%
  - Efficiency ratio was 62% versus the national peer avg. of 66%



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# Income Statement

(in thousands)

	2016	2015	Change
Interest - Loans	\$ 14,025	\$ 13,809	\$ 216
Interest - Investments	1,326	896	430
Total Interest Income	15,351	14,705	646
Interest Expense	(1,346)	(1,189)	(157)
Net Interest Income	14,005	13,516	489
Loan Loss Provision	-	-	-
Other Income	1,465	1,986	(521)
Operating Expenses	(9,534)	(8,704)	(830)
Income Before Taxes	5,936	6,798	(862)
Income Taxes	(2,027)	(2,530)	503
Net Income	\$ 3,909	\$ 4,268	\$ (359)

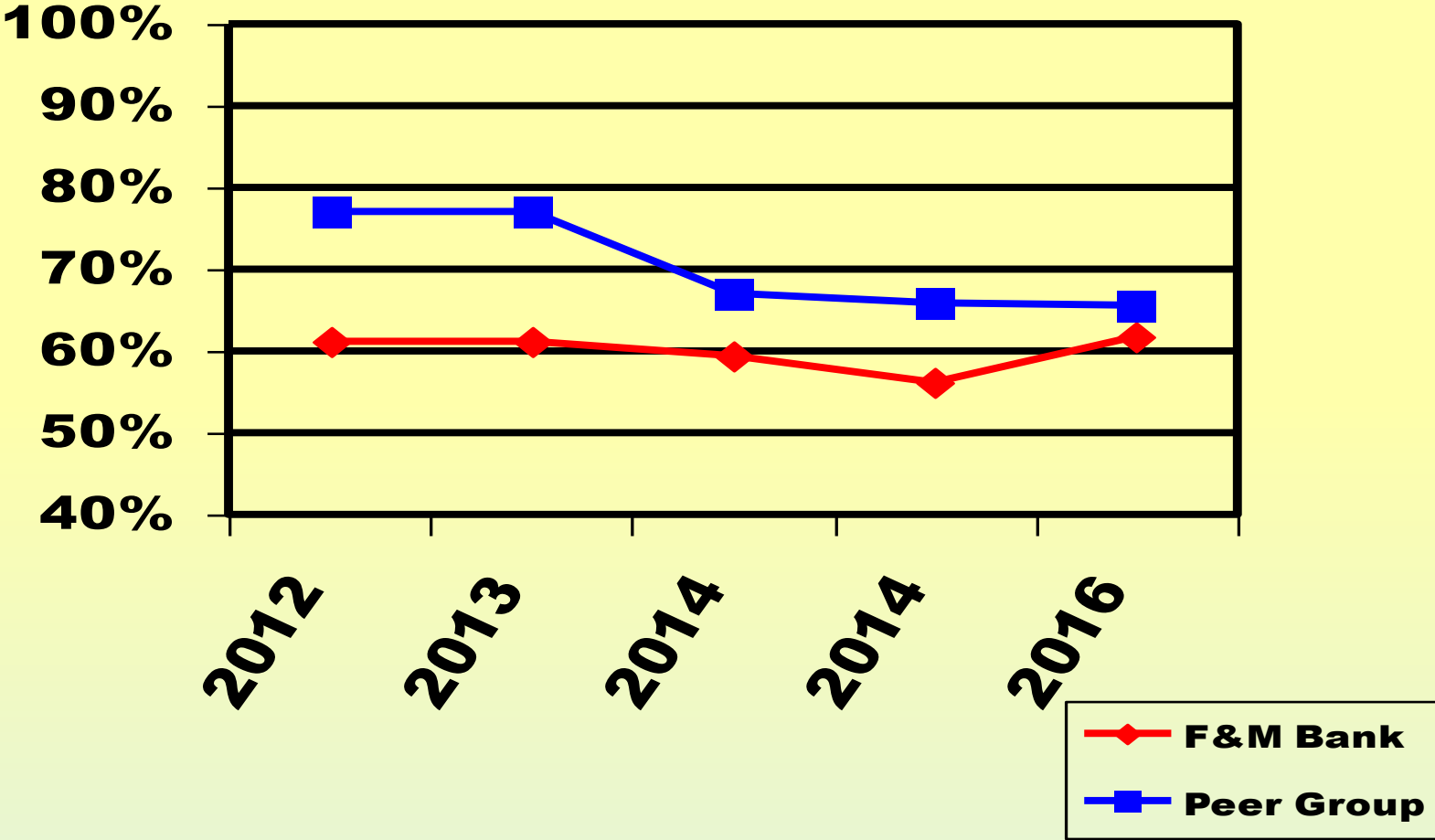


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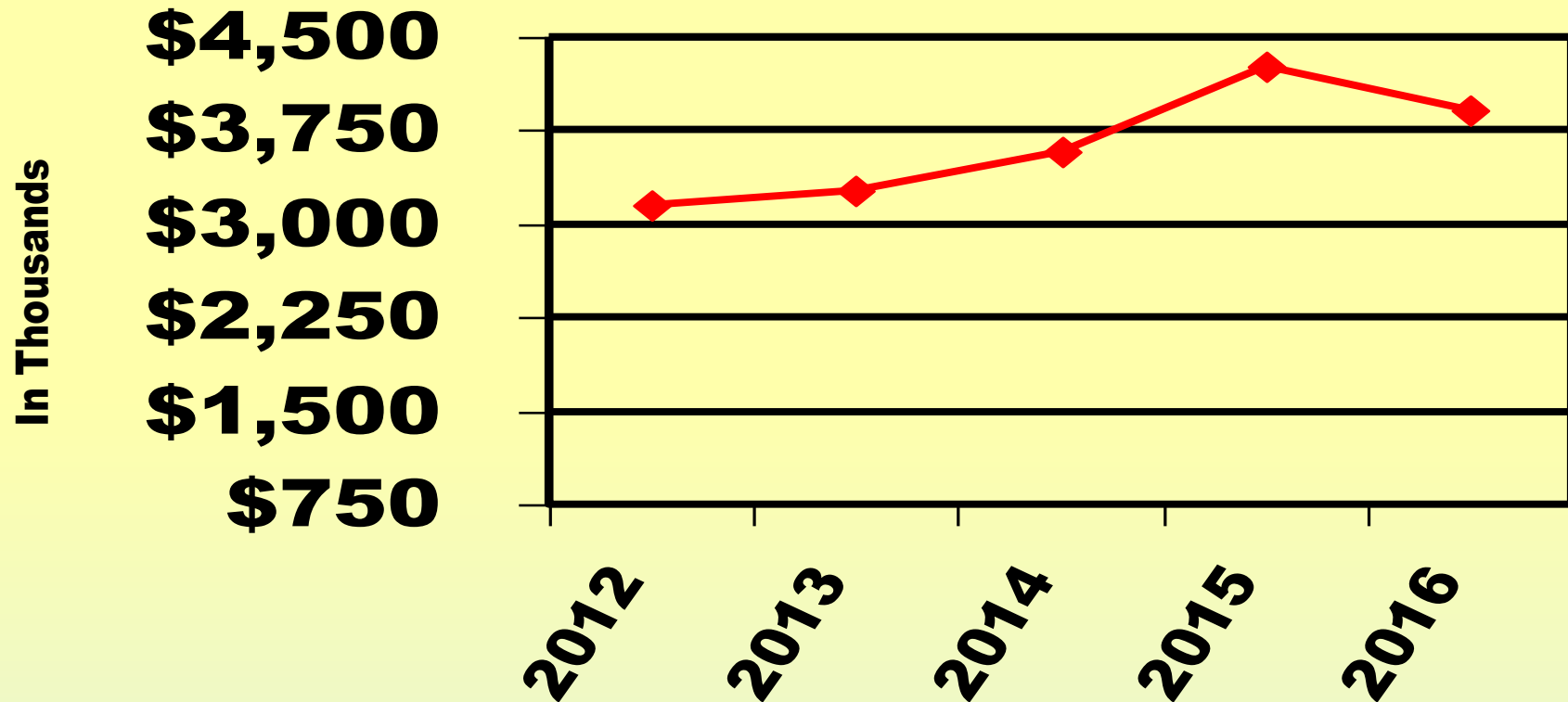
# Efficiency Ratio

## Five Year Trend



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# Net Income Five Year Trend

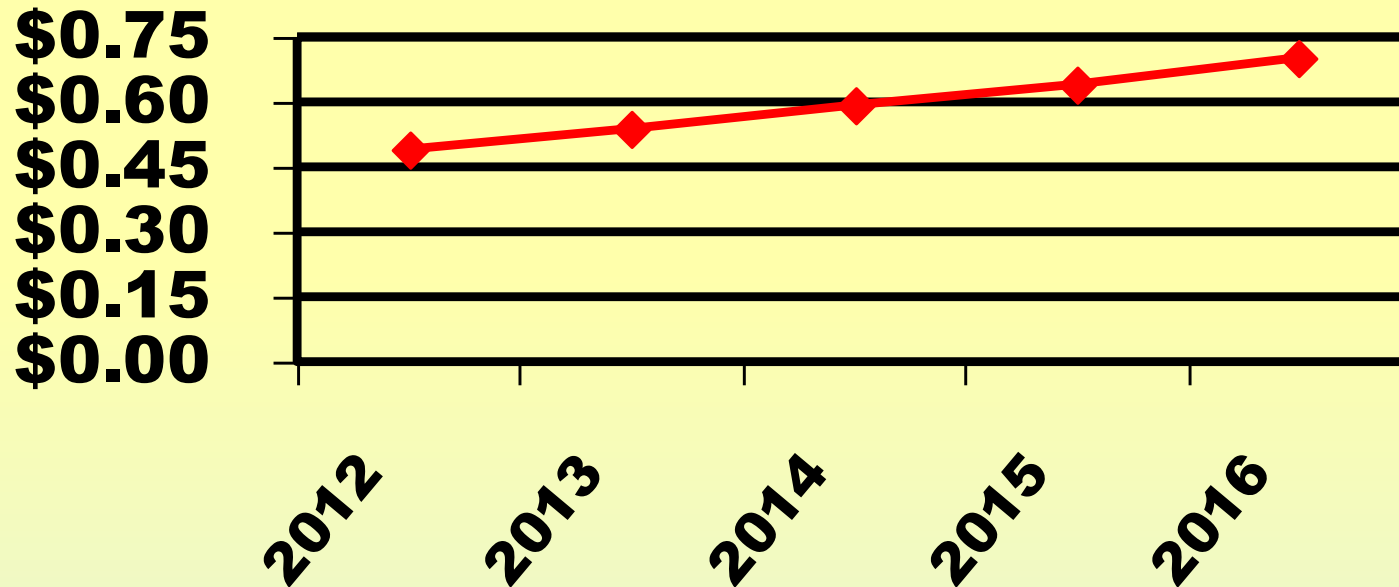


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# Cash Dividends per Share Five Year Trend

Cash dividends increased \$0.06 to \$0.70 in 2016 from \$0.64 in 2015 .



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# Maryland State Chartered Banks

(selected local banks)

## Return on Average Assets

Ranked by 2016 Return

	2016	2015	2014	5 Year Average
CFG Community	2.07%	1.52%	1.19%	1.84%
<b>F&amp;M Bank</b>	<b>1.08%</b>	<b>1.29%</b>	<b>1.15%</b>	<b>1.17%</b>
Columbia Bank	0.94%	0.88%	0.79%	0.85%
Howard Bancorp	0.61%	0.19%	1.92%	0.74%
Harford Bank	0.57%	0.66%	0.93%	0.68%
New Windsor State	0.57%	0.53%	0.42%	0.39%
Bay Bank	0.35%	0.43%	0.69%	0.41%
Bank of Glen Burnie	0.27%	0.35%	0.49%	0.51%
Carroll Community	0.19%	0.20%	0.35%	0.18%
First Mariner	0.11%	-0.68%	-0.98%	-0.30%

Source: FDIC Uniform Bank Performance Report



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# Maryland State Chartered Banks

## 2016 Performance Rankings - Top 5 and Selected Local Banks

Rank	Bank Name	City	Assets (millions)	Prior Year Rank	5 year Avg. Rank
1	Eagle Bank	Bethesda	\$ 6,877	1	1
2	Sandy Spring	Olney	5,080	4	5
3	Capital Bank	Rockville	901	5	5
4	Old Line	Bowie	1,713	7	7
<b>5</b>	<b>F&amp;M Bank</b>	<b>Upperco</b>	<b>379</b>	<b>3</b>	<b>3</b>
6	CFG Community	Baltimore	711	2	4
11	Columbia Bank	Columbia	2,283	11	11
16	Howard	Ellicott City	1,027	32	19
17	New Windsor	New Windsor	309	13	26
30	Harford	Aberdeen	335	28	23
34	Bank of Glen Burnie	Glen Burnie	386	29	24
36	Bay Bank	Lutherville	620	25	30
42	Hamilton	Towson	495	51	52
47	Carroll Community	Sykesville	165	37	45
50	First Mariner	Baltimore	973	55	56

Source: Financial Management Consulting Group

Criteria: Profitability, Efficiency, & Asset Quality

Number of State Headquartered Banks: 55



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# Our Predictions for 2016

## (compared to what actually happened)

- Modest economic growth will allow the Federal Reserve to justify two increases of .25% each for a .50% increase in the Federal Funds Rate
  - *The Fed increased rates .25% in 2016 and another .25% in March 2017*
  - These increases will put modest upward pressure on short term deposit rates increasing our cost of funds slightly
    - *Deposit costs increased by 2 basis points*
  - Loan rates are not expected to increase as quickly – the yield curve will flatten
    - *The yield on loans declined by 13 basis points*



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# Our Predictions for 2016

## (compared to what actually happened)

- Aggressive competition from Banks and Non-Bank entities (Insurance Companies) will keep commercial loan rates low
  - Older loans will reset at lower rates, decreasing our interest revenue
    - *The yield on loans declined by 13 basis points.*
- In either of the above scenarios, the Bank's net interest margin will decrease
  - *The net interest margin declined to 4.13% in 2016 from 4.33% in 2015*
    - *Our net interest spread is still very healthy, ranking us #8 in the state.*



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# Our Predictions for 2017

- The Bank's net interest margin will decrease as deposit rates will increase (due to Federal Reserve increases) more quickly than yields on assets
  
- The Dividend Reinvestment Plan (DRIP) which had to be discontinued with the formation of the holding company will be back in place during 2017
  - Shareholders will have to enroll in the new plan
    - All shareholders will receive a copy of the new plan along with an enrollment form
  - We hope to have the DRIP in place for the typical June dividend
  - The dividend may be delayed until July to ensure that shareholders have ample time to enroll



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# Stockholder Value

- Bank stock prices have improved in the Mid Atlantic and Nationally as a percentage of book value:
  - Price to Book at 12/31/16:
    - Farmers & Merchants – 1.09 (1.10 @ 12/31/15)
    - Mid-Atlantic median – 1.25(1.07 @ 12/31/15)
    - National median – 1.42 (1.25 @ 12/31/15)
  - 12/31/04 average – 2.96
- Long term value will be enhanced by remaining well-capitalized, maximizing profits and growing assets and deposits.
- The Bank's common stock is listed on the NASDAQ Over-the-Counter Bulletin Board under the symbol FMFG



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# Bank Stock Price Changes

Ranked by 2016 change

	2016	2015	2014
<b>New Windsor State Bank (A)</b>	104%	3%	15%
<b>Old Line Bancshares</b>	36%	11%	9%
<b>Bank of America Corp</b>	31%	-6%	15%
<b>Bay Bank</b>	30%	15%	-11%
<b>M &amp; T Bank Corp</b>	29%	-4%	8%
<b>County First Bank</b>	25%	-16%	-3%
<b>BB&amp;T Corp</b>	24%	-3%	4%
<b>PNC</b>	23%	4%	18%
<b>Citigroup</b>	15%	-4%	4%
<b>Howard Bancorp</b>	14%	16%	21%
<b>Farmers and Merchants</b>	7%	21%	12%
<b>Carroll Community</b>	-2%	-4%	0%
<b>Harford Bank</b>	-14%	14%	12%

(A) - New Windsor was sold to ACNB - the appreciation reflects the sales price

Source: Bloomberg & Yahoo Finance



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# Bank Stock Dividend Yields

Current (April 14, 2017) Yield

	<u>Current</u>	<u>Prior Year</u>
<b>BB&amp;T Corp</b>	<b>2.72%</b>	<b>3.22%</b>
<b>Farmers and Merchants</b>	<b>2.67%</b>	<b>2.62%</b>
<b>Harford Bank</b>	<b>2.58%</b>	<b>2.25%</b>
<b>M &amp; T Bank Corp</b>	<b>1.86%</b>	<b>2.50%</b>
<b>PNC</b>	<b>1.85%</b>	<b>2.39%</b>
<b>County First Bank</b>	<b>1.37%</b>	<b>1.83%</b>
<b>Bank of America Corp</b>	<b>1.30%</b>	<b>1.47%</b>
<b>Old Line Bancshares</b>	<b>1.14%</b>	<b>1.33%</b>
<b>Citigroup</b>	<b>1.08%</b>	<b>0.47%</b>
<b>New Windsor</b>	<b>0.78%</b>	<b>1.50%</b>
<b>Howard Bancorp</b>	<b>0.00%</b>	<b>0.00%</b>
<b>Carroll Community</b>	<b>0.00%</b>	<b>0.00%</b>
<b>Bay Bank</b>	<b>0.00%</b>	<b>0.00%</b>

Source: Bloomberg & Yahoo Finance



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# 2017 First Quarter Results

## Farmers and Merchants Bancshares is off to another good start

- 2017 net income of \$983,557 or \$0.59 per share compared to \$936,468 or \$0.57 per share in the first quarter of 2016
- Return on average equity was 9.96% compared to 10.14% in 2016 Q1
- Return on average assets was 1.02% compared to 1.09% in 2016 Q1
- Assets increased to \$399 million at March 31, 2017 compared to \$380 million at December 31, 2016
- The book value per share was \$24.15 at March 31, 2017, up from \$23.55 at December 31, 2016



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# Summary

## Farmers and Merchants Bancshares is:

- Well capitalized
- Profitable
- An active lender in the community
- Growing assets and deposits



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# Best Wishes in 2017



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