FARMERS & MERCHANTS BANCORP INC
Form 10-K
February 25, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2012

or

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from to

Commission File Number 0-14492

FARMERS & MERCHANTS BANCORP, INC.

OHIO	**34-1469491**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**
307 North Defiance Street	
Archbold, Ohio	**43502**
(Address of principal Executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (419) 446-2501

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
None	**None**

Securities registered pursuant to Section 12(g) of the Act:

Common shares without par value

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or Section 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes ¨ No x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of June 30, 2012, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $99,534,532.50

As of February 25, 2013, the Registrant had 5,200,000 shares of common stock issued of which 4,683,958 shares are outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of Form 10-K Portions of the definitive Proxy Statement for the 2012 Annual Meeting of Shareholders of Farmers & Merchants Bancorp, Inc.

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FARMERS & MERCHANTS BANCORP, INC.

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** The following materials from Farmers & Merchants Bancorp, Inc. on Form 10-K for the year ended December 31, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Income and Comprehensive Income; (iii) the Consolidated Statements of Cash Flows and (iv) Notes to Consolidated Financial Statements, tagged as blocks of text.

**

As provided in Rule 406T of Regulation S-T, this information shall not be deemed filed for the purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability under those sections.

Total Pages: 114

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Statements contained in this portion of the Company s annual report may be forward-looking statements, as that term is defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of such words as intend, believe, expect, anticipate, should, planned, estimated, and potential. Such forward-looking statements are based on current expectations, but may differ materially from those currently anticipated due to a number of factors, which include, but are not limited to, factors discussed in documents filed by the Company with the Securities and Exchange Commission from time to time. Other factors which could have a material adverse effect on the operations of the Company and its subsidiaries which include, but are not limited to, changes in interest rates, general economic conditions, legislative and regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Bank s market area, changes in relevant accounting principles and guidelines and other factors over which management has no control. The forward-looking statements are made as of the date of this report, and the Company assumes no obligation to update the forward-looking statements or to update the reasons why actual results could differ from those projected in the forward-looking statements.

PART 1.

ITEM 1. BUSINESS

General

Farmers & Merchants Bancorp, Inc. (Company) is a bank holding company incorporated under the laws of Ohio in 1985. Our primary subsidiary, The Farmers & Merchants State Bank (Bank) is a community bank operating in Northwest Ohio since 1897. We report our financial condition and net income on a consolidated basis and we report only one segment.

Our executive offices are located at 307 North Defiance Street, Archbold, Ohio 43502, and our telephone number is (419) 446-2501.

For a discussion of the general development of the Company s business throughout 2012, please see the portion of Management s Discussion and Analysis of Financial Condition and Results of Operations captioned 2012 in Review .

Nature of Activities

The Bank s primary service area, Northwest Ohio and Northeast Indiana, continued to experience high but declining unemployment. After reaching a high of 11% unemployment for Ohio in March 2010 and Indiana reaching its high in August 2010 at 10.20%, the unemployment rate decreased in each of the ensuing months and closed the 2012 year at 6.7% for Ohio and 8.2% for Indiana. The agricultural industry continued its strong performance in 2012 even with the drought. Automotive showed improvement with car dealers in our marketing area ending with more profitable numbers than in recent years. Overall, business profits are improving, however borrowing activity remains sluggish. New 1-4 family residential and construction remain weak. The consumer confidence index increased from an average of 45% in 2009 to 53% in 2010 and December, 2011 topped 64.5%. 2012 had reached a four year high at 73.1% in October; however it dropped in December to 65.1%, based on concerns of the fiscal cliff and possible tax increases.

The Farmers & Merchants State Bank engages in general commercial banking business. Their activities include commercial, agricultural and residential mortgage, consumer and credit card lending activities. Because the Bank s offices are located in Northwest Ohio and Northeast Indiana, a substantial amount of the loan portfolio is comprised of loans made to customers in the farming industry for such things as farm land, farm equipment, livestock and operating loans for seed, fertilizer, and feed. Other types of lending activities include loans for home improvements, and loans for such items as autos, trucks, recreational vehicles, motorcycles, etc.

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The Bank also provides checking account services, as well as savings and time deposit services such as certificates of deposits. In addition ATM s (automated teller machines) are provided at most branch locations along with other independent locations including major employers and hospitals in the market area. The Bank has custodial services for IRA s (Individual Retirement Accounts) and HSA s (Health Savings Accounts). The Bank provides on-line banking access for consumer and business customers. For consumers, this includes bill-pay and on-line statement opportunities. For business customers, it provides the option of electronic transaction origination such as wire and ACH file transmittal. In addition the Bank offers remote deposit capture or electronic deposit processing. Mobile banking was added in 2012 and has been widely accepted and used by consumers.

The Bank s underwriting policies, exercised through established procedures, facilitate operating in a safe and sound manner in accordance with supervisory and regulatory guidance. Within this sphere of safety and soundness, the Bank s practice has been to avoid promoting innovative, unproven credit products which may not be in the best interest of the Bank or its customers. The Bank does offer a hybrid loan. Hybrid loans are loans that start as a fixed rate mortgage but after a set number of years automatically adjust to an adjustable rate mortgage. The Bank offers a three year fixed rate mortgage after which the interest rate will adjust annually. The majority of the Bank s adjustable rate mortgages are of this type. In order to offer longer term fixed rate mortgages, the Bank does participate in the Freddie Mac, Farmer Mac and Small Business Lending programs. The Bank also retains the servicing on these partially or 100% sold loans. In order for the customer to participate in these programs they must meet the requirements established by these agencies.

The Bank does not have a program to fund sub-prime loans. Sub-prime loans are characterized as a lending program or strategy that target borrowers who pose a significantly higher risk of default than traditional retail banking customers.

Following are the characteristics and underwriting criteria for each major type of loan the Bank offers:

Commercial Real Estate: Construction, purchase, and refinance of business purpose real estate. Risks include loan amount in relation to construction delays and overruns, vacancies, collateral value subject to market value fluctuations, interest rate, market demands, borrower s ability to repay in orderly fashion, and others. The Bank does employ stress testing on higher balance loans to mitigate risk by ensuring the customer s ability to repay in a changing rate environment before granting loan approval.

Agricultural Real Estate: Purchase of farm real estate or for permanent improvements to the farm real estate. Cash flow from the farm operation is the repayment source and is therefore subject to the financial success of the farm operation.

Consumer Real Estate: Purchase, refinance, or equity financing of one to four family owner occupied dwelling. Success in repayment is subject to borrower s income, debt level, character in fulfilling payment obligations, employment, and others.

Commercial/Industrial: Loans to proprietorships, partnerships, or corporations to provide temporary working capital and seasonal loans as well as long term loans for capital asset acquisition. Risks include adequacy of cash flow, reasonableness of profit projections, financial leverage, economic trends, management ability, and others. The Bank does employ stress testing on higher balance loans to mitigate risk by ensuring the customer s ability to repay in a changing rate environment before granting loan approval.

Agricultural: Loans for the production and housing of crops, fruits, vegetables, and livestock or to fund the purchase or re-finance of capital assets such as machinery and equipment, and livestock. The production of crops and livestock is especially vulnerable to commodity prices and weather. The vulnerability to commodity prices is offset by the farmer s ability to hedge their position by the use of future contracts. The risk related to weather is often mitigated by requiring federal crop insurance.

Consumer: Funding for individual and family purposes. Success in repayment is subject to borrower s income, debt level, character in fulfilling payment obligations, employment, and others.

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Industrial Development Bonds: Funds for public improvements in the Bank s service area. Repayment ability is based on the continuance of the taxation revenue as the source of repayment.

All loan requests are reviewed as to credit worthiness and are subject to the Bank s underwriting guidelines as to secured versus unsecured credit. Secured loans are in turn subject to loan to value (LTV) requirements based on collateral types as set forth in the Bank s Loan Policy. In addition, credit scores of principal borrowers are reviewed and an approved exception from an additional officer is required should a credit score not meet the Bank s Loan Policy guidelines.

Consumer Loans**:**

Maximum loan to value (LTV) for cars, trucks and light trucks vary from 90% to 110% depending on whether direct or indirect. Loans above 100% are generally due to additional charges for extended warranties and/or insurance coverage periods of lost wages or death.

Boats, campers, motorcycles, RV s and Motor Coaches range from 80%-90% based on age of vehicle.

1st or 2nd mortgages on 1-4 family homes range from 75%-90% with in-house first real estate mortgages requiring private mortgage insurance on those exceeding 80% LTV.

Raw land LTV maximum ranges from 65%-75% depending on whether or not the property has been improved.

Commercial/Agriculture/Real Estate:

Maximum LTVs range from 70%-80% depending on type.

Accounts Receivable:

Up 80% LTV

Inventory:

Agriculture:

Livestock and grain up to 80% LTV, crops (insured) up to 75% and Warehouse Receipts up to 87%

Commercial:

Maximum LTV of 50% on raw and finished goods

Used vehicles, new recreational vehicles and manufactured homes not to exceed (NTE) 80% LTV

Equipment:

New not to exceed 80% of invoice, used NTE 50% of listed book or 75% of appraised value

Restaurant equipment up to 35% of market value

Heavy trucks, titled trailers and NTE 75% LTV and aircraft up to 75% of appraised value

We also provide checking account services, as well as savings and time deposit services such as certificates of deposits. In addition, ATM s (automated teller machines) are also provided at our Ohio offices in Archbold, Wauseon, Stryker, West Unity, Bryan, Delta, Napoleon, Montpelier, Swanton, Defiance, Hicksville and Perrysburg, along with ones at our Auburn and Angola, Indiana offices. Two ATM s are located at Sauder Woodworking Co., Inc., a major employer in Archbold. Additional locations in Ohio are at Northwest State Community College, Archbold; Community Hospitals of Williams County, Bryan; Fairlawn Haven Wyse Commons, Archbold; R&H Restaurant, Fayette; Delta Eagles, Sauder Village, Archbold; Fulton County Health Center, Wauseon; downtown Defiance; and a mobile trailer ATM. In Indiana, four

additional remote ATM s are located at St. Joe; at Kaiser s Supermarket and Therma-Tru in Butler; and at DeKalb Memorial Hospital in Auburn.

F&M Investment Services, the brokerage department of the Bank, opened for business in April, 1999. Securities are offered through Raymond James Financial Services, Inc.

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956. Our subsidiary bank is in turn regulated and examined by the Ohio Division of Financial Institutions, and the Federal Deposit Insurance Corporation. The activities of our bank subsidiary are also subject to other federal and state laws and regulations.

The Bank s primary market includes communities located in the Ohio counties of Defiance, Fulton, Henry, Lucas, Williams, and Wood. The commercial banking business in this market is highly competitive, with approximately 17 other depository institutions currently doing business in the Bank s primary market. In our banking activities, we compete directly with other commercial banks, credit unions, farm credit services, and savings and loan institutions in each of our operating localities. In a number of our locations, we compete against entities which are much larger than us. The primary factors in competing for loans and deposits are the rates charged as well as location and quality of the services provided. On December 31, 2007, the Bank acquired the Knisely Bank of Indiana, expanding its market with

the addition of offices in Butler and Auburn, Indiana, both located in DeKalb County. An additional office was opened in the summer of 2008 in Angola, Indiana, located in Steuben County. On July 9, 2010 the Bank purchased a branch office in Hicksville, Ohio shortening the distance between our Ohio and Indiana office. During 2012, the Bank purchased land in Waterville, Ohio and began construction of an office. The office is expected to open in second quarter 2013 providing growth opportunity and extension of the market area.

At December 31, 2012, we had 248 full time equivalent employees. The employees are not represented by a collective bargaining unit. We provide our employees with a comprehensive benefit program, some of which are contributory. We consider our employee relations to be excellent.

Supervision and Regulation

General

The Company is a corporation organized under the laws of the State of Ohio. The business in which the Company and its subsidiary are engaged is subject to extensive supervision, regulation and examination by various bank regulatory authorities. The supervision, regulation and examination to which the Company and its subsidiary are subject are intended primarily for the protection of depositors and the deposit insurance funds that insure the deposits of banks, rather than for the protection of shareholders.

Several of the more significant regulatory provisions applicable to banks and bank holding companies to which the Company and its subsidiary are subject are discussed below, along with certain regulatory matters concerning the Company and its subsidiary. To the extent that the following information describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory provisions. Any change in applicable law or regulation may have a material effect on the business and prospects of the Company and its subsidiary.

Regulatory Agencies

The Company is a registered bank holding company and is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the Federal Reserve Board) pursuant to the Bank Holding Company Act of 1956, as amended.

The Bank is an Ohio chartered commercial bank. It is subject to regulation and examination by both the Ohio Division of Financial Institutions (ODFI) and the Federal Deposit Insurance Corporation (FDIC).

Holding Company Activities

As a bank holding company incorporated and doing business within the State of Ohio, the Company is subject to regulation and supervision under the Bank Holding Act of 1956, as amended (the Act). The Company is required to file with the Federal Reserve Board on quarterly basis information pursuant to the Act. The Federal Reserve Board may conduct examinations or inspections of the Company and its subsidiary.

The Company is required to obtain prior approval from the Federal Reserve Board for the acquisition of more than five percent of the voting shares or substantially all of the assets of any bank or bank holding company. In addition, the Company is generally prohibited by the Act from acquiring direct or indirect ownership or control of more than five percent of the voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiaries. The Company may, however, subject to the prior approval of the Federal Reserve Board, engage in, or acquire shares of companies engaged in activities which are deemed by the Federal Reserve Board by order or by regulation to be so closely related to banking or managing and controlling a bank as to be a proper activity.

On November 12, 1999, the Gramm-Leach-Bliley Act (the GLB Act) was enacted into law. The GLB Act made sweeping changes with respect to the permissible financial services which various types of financial institutions may now provide. The Glass-Steagall Act, which had generally prevented banks from affiliation with securities and insurance firms, was repealed. Pursuant to the GLB Act, bank holding companies may elect to become a financial holding company, provided that all of the depository institution subsidiaries of the bank holding company are well capitalized and well managed under applicable regulatory standards.

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Under the GLB Act, a bank holding company that has elected to become a financial holding company may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. Activities that are financial in nature include securities underwriting, dealing and market-making, sponsoring mutual funds and investment companies, insurance underwriting and agency, merchant banking, and activities that the Federal Reserve Board has determined to be closely related to banking. No Federal Reserve Board approval is required for the Company to acquire a company, other than a bank holding company, bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. Prior Federal Reserve Board approval is required before the Company may acquire the beneficial ownership or control of more than 5% of the voting shares, or substantially all of the assets, of a bank holding company, bank or savings association. If any subsidiary bank of the Company ceases to be well capitalized or well managed under applicable regulatory standards, the Federal Reserve Board may, among other actions, order the Company to divest the subsidiary bank. Alternatively, the Company may elect to conform its activities to those permissible for a bank holding company that is not also a financial holding company. If any subsidiary bank of the Company receives a rating under the Community Reinvestment Act of 1977 of less than satisfactory, the Company will be prohibited from engaging in new activities or acquiring companies other than bank holding companies, banks or savings associations. The Company has not elected to become a financial holding company and has no current intention of making such an election.

Affiliate Transactions

Various governmental requirements, including Sections 23A and 23B of the Federal Reserve Act, limit borrowings by holding companies and non-bank subsidiaries from affiliated insured depository institutions, and also limit various other transactions between holding companies and their non-bank subsidiaries, on the one hand, and their affiliated insured depository institutions on the other. Section 23A of the Federal Reserve Act also generally requires that an insured depository institution s loan to its non-bank affiliates be secured, and Section 23B of the Federal Reserve Act generally requires that an insured depository institution s transactions with its non-bank affiliates be on arms-length terms.

Interstate Banking and Branching

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act (Riegle-Neal), subject to certain concentration limits and other requirements, adequately capitalized bank holding companies such as the Company are permitted to acquire banks and bank holding companies located in any state. Any bank that is a subsidiary of a bank holding company is permitted to receive deposits, renew time deposits, close loans, service loans and receive loan payments as an agent for any other bank subsidiary of that bank holding company. Banks are permitted to acquire branch offices outside their home states by merging with out-of-state banks, purchasing branches in other states and establishing de novo branch offices in other states. The ability of banks to acquire branch offices is contingent, however, on the host state having adopted legislation opting in to those provisions of Riegle-Neal. In addition, the ability of a bank to merge with a bank located in another state is contingent on the host state not having adopted legislation opting out of that provision of Riegle-Neal. The Company could from time to time use Riegle-Neal to acquire banks in additional states.

Control Acquisitions

The Change in Bank Control Act prohibits a person or group of persons from acquiring control of a bank holding company, unless the Federal Reserve Board has been notified and has not objected to the transaction. Under the rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act, such as the Company, would, under the circumstances set forth in the presumption, constitute acquisition of control of the bank holding company. In addition, a company is required to obtain the approval of the Federal Reserve Board under the Bank Holding Company Act before acquiring 25% (5% in the case of an acquirer that is a bank holding company) or more of any class of outstanding voting stock of a bank holding company, or otherwise obtaining control or a controlling influence over that bank holding company.

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Liability for Banking Subsidiaries

Under the current Federal Reserve Board policy, a bank holding company is expected to act as a source of financial and managerial strength to each of its subsidiary banks and to maintain resources adequate to support each subsidiary bank. This support may be required at times when the bank holding company may not have the resources to provide it. In the event of a bank holding company s bankruptcy, any commitment by the bank holding company to a U.S. federal bank regulatory agency to maintain the capital of a subsidiary bank would be assumed by the bankruptcy trustee and entitled to priority of payment. Any depository institution insured by the FDIC can be held liable for any loss incurred, or reasonably expected to be incurred, by the FDIC in connection with (1) the default of a commonly controlled FDIC-insured depository institution; or (2) any assistance provided by the FDIC to both a commonly controlled FDIC-insured depository institution in danger of default. The Company s subsidiary bank is an FDIC-insured depository institution. If a default occurred with respect to the Bank, any capital loans to the Bank from its parent holding company would be subordinate in right of payment to payment of the Bank s depositors and certain of its other obligations.

Regulatory Capital Requirements

The Company is required by the various regulatory authorities to maintain certain capital levels. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve Board capital adequacy guidelines. If capital falls below minimum guideline levels, a bank holding company, among other things, may be denied approval to acquire or establish additional banks or non-bank businesses. The required capital levels and the Company s capital position at December 31, 2011, 2012 are summarized in the table included in Note 14 to the consolidated financial statements.

FDICIA

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), and the regulations promulgated under FDICIA, among other things, established five capital categories for insured depository institutions-well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized-and requires U.S. federal bank regulatory agencies to implement systems for prompt corrective action for insured depository institutions that do not meet minimum capital requirements based on these categories. Unless a bank is well capitalized, it is subject to restrictions on its ability to offer brokered deposits and on certain other aspects of its operations. An undercapitalized bank must develop a capital restoration plan and its parent bank holding company must guarantee the bank s compliance with the plan up to the lesser of 5% of the banks or thrift s assets at the time it became undercapitalized and the amount needed to comply with the plan. As of December 31, 2012 the Company s banking subsidiary was well capitalized pursuant to these prompt corrective action guidelines.

Dividend Restrictions

The ability of the Company to obtain funds for the payment of dividends and for other cash requirements will be largely dependent on the amount of dividends which may be declared by its banking subsidiary. Various U.S. federal statutory provisions limit the amount of dividends the Company s banking subsidiary can pay to the Company without regulatory approval. Dividend payments by the Bank are limited to its retained earnings during the current year and its prior two years. See Note 15 to the consolidated financial statements for the actual amount.

Deposit Insurance Assessments

The deposits of the Company s banking subsidiary are insured up to the regulatory limits set by the FDIC. Prior to April 1, 2011, deposits were subject to deposit insurance assessments based on the Federal Deposit Insurance Reform Act of 2005 which was effective on April 21, 2006. The FDIC maintains the Deposit Insurance Fund (DIF) by assessing depository institutions an insurance premium (assessment). The amount assessed to each institution was based on statutory factors that included the balance of insured deposits, as well as the degree of risk the institution posed to the DIF. The FDIC assessed higher rates to those institutions that posed greater risks to the insurance fund.

In order to recapitalize and restore the DIF, the FDIC initially established a Restoration Plan in October 2008 to return the DIF to the statutorily mandated minimum reserve ratio of 1.15 percent within five years. Since 2008 and due to the extraordinary circumstances facing the banking industry, the FDIC imposed an emergency special assessment in 2009 and continued to make further amendments to its Restoration Plan by extending the restoration period for the DIF, increasing the premium assessments, and changing how regular deposit insurance premiums are assessed.

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The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) revised the statutory authorities governing the FDIC s management of the DIF. Key requirement from the Dodd-Frank Act resulted in the FDIC s adoption of new rules in February 2011 regarding Assessments, Dividends, Assessment Base, and Large Bank Pricing. The new rules implemented the following changes: (1) redefined the definition of an institution s deposit insurance assessment base from one based on domestic deposits to one based on assets now defined as average consolidated total assets minus average tangible equity ; (2) changed the assessment rate adjustments to better account for risk based on an institution s funding sources; (3) revised the deposit insurance assessment rate schedule in light of the new assessment base and assessment rate adjustments; (4) implemented Dodd-Frank Act dividend provisions; (5) revised the large insured depository institution assessment system to better differentiate for risk and to take into account losses the FDIC may incur from large institution failures; and (6) provided technical and other changes to the FDIC s assessment rules. Though deposit insurance assessments maintain a risk-based approach, the FDIC imposed a more extensive risk-based assessment system on large insured depository institutions with at least $10 billion in total assets since they are more complex in nature and could pose greater risk. The rules became effective April 1, 2011 implementing the revised assessment rate schedule for the quarter beginning April 1, 2011. The revised assessment rate schedule was used to calculate the June 30, 2011 assessments which were due September 30, 2011 and subsequent quarterly assessments thereafter.

Due to the changes to the assessment base and assessment rates, as well as the DIF restoration time frame, the impact on the Company s future deposit insurance assessments has been and should continue to be favorable.

The Emergency Economic Stabilization Act of 2008 provided a temporary increase in deposit insurance coverage from $100,000 to $250,000 per depositor. This legislation was effective immediately upon the President s signature on October 3, 2008. The basic deposit insurance limit was set to return to $100,000 on January 1, 2010; however, on May 20, 2009 the temporary increase was extended through December 31, 2013.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) permanently raised the standard maximum deposit insurance coverage amount to $250,000 and made the increase retroactive to January 1, 2008. This was effective immediately upon the President s signature on July 21, 2010. The FDIC deposit insurance coverage limit applies per depositor, per insurance depository institution for each account ownership category.

The FDIC Board of Directors issued a final rule on November 9, 2010 implementing a provision of the Dodd-Frank Act which temporarily provided for separate deposit insurance coverage for noninterest-bearing transaction accounts. This temporary deposit insurance coverage became effective on December 31, 2010. Funds held in noninterest-bearing transaction accounts were fully insured, without limit, and the temporary unlimited coverage was separate from, and in addition to, the deposit insurance coverage provided to depositors with respect to other accounts held at an insured depository institution. A noninterest-bearing transaction account is a deposit account in which (1) interest is neither accrued nor paid; (2) depositors are permitted to make an unlimited number of transfers and withdrawals; and (3) the insured depository institution does not reserve the right to require advance notice of an intended withdrawal. The Dodd-Frank Act provision did not include low-interest NOW (Negotiable Order of Withdrawal) Accounts or Interest on Lawyer Trust Accounts (IOLTAs) within the definition of noninterest-bearing transaction accounts. On December 29, 2010, the FDIC Board of Directors issued a final rule amending the Federal Deposit Insurance Act (FDI Act) to include IOLTAs within the definition of a noninterest-bearing transaction account thereby providing such accounts with temporary, unlimited deposit insurance coverage. The temporary unlimited deposit insurance coverage for noninterest-bearing transaction accounts terminated on December 31, 2012. As of January 1, 2013, noninterest-bearing transaction accounts are insured up to the standard maximum deposit insurance coverage amount of $250,000 per depositor under the FDIC s general deposit insurance coverage rules.

Depositor Preference Statute

In the liquidation or other resolution of an institution by any receiver, U.S. federal legislation provides that deposits and certain claims for administrative expenses and employee compensation against the insured depository institution would be afforded a priority over general unsecured claims against that institution, including federal funds and letters of credit.

Government Monetary Policy

The earnings of the Company are affected primarily by general economic conditions and to a lesser extent by the fiscal and monetary policies of the federal government and its agencies, particularly the Federal Reserve. Its policies influence, to some degree, the volume of bank loans and deposits, and interest rates charged and paid thereon, and thus have an effect on the earnings of the Company s subsidiary Bank.

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Capital Purchase Program

In response to the financial crisis affecting the banking system and financial markets, the Emergency Economic Stabilization Act of 2008 (the EESA) was signed into law on October 3, 2008 creating the Troubled Assets Relief Program (TARP). As part of TARP, the U.S. Treasury established the Capital Purchase Program to provide up to $700 billion of funding to eligible financial institutions through the purchase of capital stock and other financial institutions for the purpose of stabilizing and providing liquidity to the United States financial markets. The Company did not participate in the TARP Capital Purchase Program. In connection with the EESA, there have been numerous actions by the Federal Reserve Board, the United States Congress, the U.S. Treasury, the FDIC, the SEC and others to further the economic and banking industry stabilization efforts under the EESA. It remains unclear at this time what further legislative and regulatory measures will be implemented under the EESA that affect the Company.

Additional Regulation

The Bank is also subject to federal regulation as to such matters as required reserves, limitation as to the nature and amount of its loans and investments, regulatory approval of any merger or consolidation, issuance or retirement of their own securities, limitations upon the payment of dividends and other aspects of banking operations. In addition, the activities and operations of the Bank are subject to a number of additional detailed, complex and sometimes overlapping laws and regulations. These include state usury and consumer credit laws, state laws relating to fiduciaries, the federal Equal Credit Opportunity Act and Regulation B, the Fair Credit Reporting Act, the federal Home Mortgage Disclosure Act and Regulation C, the federal Electronic Funds Transfer Act and Regulation E, the Real Estate Settlement Act (RESPA) and Regulation X, the federal Truth in Lending Act and Regulation Z, the federal Truth in Savings Act and Regulation DD, the Bank Secrecy Act, the federal Community Reinvestment Act, anti-discrimination laws and legislation, and antitrust laws.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) signed by the President on July 21, 2010 posed a significant impact on financial regulations. Certain provisions such as the permanent increase in deposit insurance coverage had an immediate effective date. Provisions regarding rules for interchanges fees on electronic debit transactions became effective on October 1, 2011. Other provisions intended to provide regulatory relief to community banks, may require time and further analysis to evaluate the actual consequences once final implementing regulations are issued. Implementation of the Dodd-Frank Act provisions, which are conservatively estimated at more than 5,000 pages of new or expanded regulations for banks, will result in new rulemaking by the federal regulatory agencies over the next several years. Fully implementing the new and expanded regulation will involve ensuring compliance with extensive new disclosure and reporting requirements.

The Dodd-Frank Act created an independent regulatory body, the Bureau of Consumer Financial Protection (Bureau), with authority and responsibility to set rules and regulations for most consumer protection laws applicable to all banks large and small adds another regulator to scrutinize and police financial activities. Transfer to the Bureau of all consumer financial protection functions for designated laws by the other federal agencies was completed on July 21, 2011. The Bureau has responsibility for mortgage reform and enforcement, as well as broad new powers over consumer financial activities which could impact what consumer financial services would be available and how they are provided. The following consumer protection laws are the designated laws that will fall under the Bureau s rulemaking authority: the Alternative Mortgage Transactions Parity Act of 1928, the Consumer Leasing Act of 1976, the Electronic Fund Transfers Act, the Equal Credit Opportunity Act, the Fair Credit Billing Act, the Fair Credit Reporting Act subject to certain exclusions, the Fair Debt Collection Practices Act, the Home Owners Protection Act, certain privacy provisions of the Gramm-Leach-Bliley Act, the Home Mortgage Disclosure Act (HMDA), the Home Ownership and Equity Protection Act of 1994, the Real Estate Settlement Procedures Act (RESPA), the S.A.F.E. Mortgage Licensing Act of 2008 (SAFE Act), the Truth in Lending Act, and the Truth in Savings Act.

Since assuming authority and responsibility for most consumer financial protection laws, the Bureau has republished and reissued the regulations implementing the consumer financial protection laws. Interim final rules for each regulation were issued along with a request for public comment regarding technical and conforming changes to reflect the transfer of authority and certain other non-substantive changes to the regulations made by the Dodd-Frank Act. Issuance of interim final rules did not impose any substantive obligations on parties subject to existing

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regulations. In February 2012, the Bureau issued a final rule to the Electronic Fund Transfer Act and Regulation E which implemented Dodd-Frank Act provisions regarding remittance transfers. These final rules provided new protections, including new disclosures and error resolution and cancellation rights, to consumers sending remittance transfers to other consumers or businesses in a foreign country. Further additional rulemaking in August 2012 supplemented these final rules. Though originally scheduled to take effect on February 7, 2013, the Bureau proposed a temporary delay of the final remittance transfer rules to address additional changes regarding disclosure of foreign taxes and institution fees, disclosure of subnational taxes in a foreign country, and errors from incorrect account information. The effective date is now delayed until 90 days after finalizing the amendments.

A proposed Ability-to-Repay mortgage rule originally issued by the Federal Reserve System in May 2011 was not finalized prior to the transfer of the authority for consumer financial protection laws. The Bureau assumed the authority to finalize the Truth in Lending Act (Regulation Z) with regard to Dodd-Frank Act provisions on consumer ability to repay requirements for a mortgage loan that generally apply to most consumer credit transactions secured by a dwelling, including standards for complying by making a qualified mortgage which needed further definition. This matter was re-opened for further public comment in June 2012. Final rules issued in January 2013 established presumed compliance with the Ability-to-Repay rule if lenders issue a qualified mortgage . Certain requirements which prohibit or limit risky features must be met for a mortgage loan to be a qualified mortgage . Features of a qualified mortgage include: (1) no excess upfront points and fees; (2) no toxic loan features, such as interest-only loans, negative-amortization loans, or loans with terms longer than 30 years; (3) a general cap on how much income can go toward debt; and (4) no balloon payment loans, except those made by smaller creditors in rural or underserved areas. In addition, two types of qualified mortgages were defined: those with rebuttable presumption which involve higher-priced loans typically given to consumers with insufficient or weak credit history and those with safe harbor which are lower-priced loans typically made to low-risk borrowers.

Proposed rules were issued regarding other mortgage-related provisions addressed in the Dodd-Frank Act. The following significant mortgage-related proposals which provide for implementation of provisions in the Dodd-Frank Act were issued in 2012: (1) propose to amend the Truth in Lending Act (Regulation Z) and expand the types of mortgage loans subject to the Home Ownership and Equity Protection Act of 1994 (HOEPA) and impose additional restrictions on HOEPA mortgage loans, and amend both the Truth in Lending Act (Regulation Z) and the Real Estate Settlement Procedures Act (Regulation X) to require distribution of a list of homeownership counselors or counseling organizations within a few days after a mortgage loan request and in some instances would require pre-loan homeownership counseling for potential borrowers; (2) propose to amend both the Truth in Lending Act (Regulation Z) and the Real Estate Settlement Procedures Act (Regulation X) to combine and simplify certain disclosures that consumers receive when applying for a mortgage loan (early Truth in Lending disclosure and Good Faith Estimate form) and at closing of a mortgage loan (final Truth in Lending disclosure and HUD Settlement Statement form), as well as provide disclosures on cancellation of escrow accounts, a consumer s liability for debt payment after foreclosure, and on the creditor s policy for accepting partial payments along with an expanded definition of the types of charges that are treated as a loan finance charge; (3) propose to amend the Real Estate Settlement Procedures Act (Regulation X) regarding mortgage loan servicer obligations to correct errors asserted by borrowers, to ensure a reasonable basis exists to obtain force-place insurance, to establish reasonable information management policies and procedures, to provide information about mortgage loss mitigation options to delinquent borrowers, to provide delinquent borrowers access to and continuity of contact with servicer personnel, and to evaluate a borrowers application for available loss mitigation options; (4) propose to amend the Truth in Lending Act (Regulation Z) regarding mortgage loan servicing to address initial rate adjustment notices for adjustable rate mortgage loans, periodic statements for residential mortgage loans, prompt credit of mortgage payments when received, and timely response to requests for mortgage payoff amounts; (5) propose to amend the Truth in Lending Act (Regulation Z) to clarify and further address mortgage loan origination standards for mortgage loan originators in regard to compensation, qualifications, training requirements, and recordkeeping; and (6) propose to amend the Truth in Lending Act (Regulation Z) to implement new requirements regarding appraisals for Higher-Risk Mortgage Loans by ensuring appraisals meet certain specified standards, providing applicants a notification regarding the use of the appraisals, and giving applicants a copy of the appraised used. In November 2012, the Bureau subsequently postponed plans to issue final rules which would implement the combined disclosures consumers receive when applying for a mortgage loans and at closing of a mortgage loan. There was a Dodd-Frank Act mandated effective date of January 21, 2013, however, the Bureau determined it wise to give the industry more time and to allow for better integration with the mortgage disclosures required by other proposed mortgage rules. Most of the remaining proposed mortgage-related rules will likely result in issuance of final implementing rules in January 2013, with final effective dates within the next 12 months if not as soon as possible.

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In late 2012, a Community Bank Advisory Council was formed. Representatives were drawn from small-to-medium-sized community banks to engage in discussions on how smaller institutions help level the playing field for consumers experiencing difficulty in managing their money and what opportunities and challenges exist in mortgage lending for small institutions. The Bureau has developed prototype designs for various disclosures and agreements and invited the public and financial industry to review and comments on what works. Their website (www.consumerfinance.gov) serves as a public information resource laws and regulations, assistance with financial questions, participation with projects or initiatives, and submission of complaints. The CFPB has positioned itself to serve as a resource for submission of complaints and to provide help to consumers with complaints regarding credit cards, mortgages, student loans, checking accounts, savings accounts, credit reporting, bank services, and other consumer loans. Guidance and consumer tips on various financial topics were issued throughout 2012 in a Blog on the Bureau s website.

Issuance of a final rule on Procedures Relating to Rulemaking in December 2012 defined events that constitute issuance of Bureau rules. The earliest of the following events are deemed the date of issuance for Bureau rules: 1) when a final rule is posted on the Bureau s website, or 2) when a final rule is published in the Federal Register. Since the date of issuance of a rule can have legal consequences, clarification on this matter eliminates any uncertainty. Due to the significance of the changes and the complexity of the requirements, review and implementation of final rules addressing Dodd-Frank Act provisions, once issued, will initially heighten the regulatory compliance burden and increase litigation risk for the banking industry.

Future Legislation

Changes to the laws and regulations, both at the federal and state levels, can affect the operating environment of the Company and its subsidiary in substantial and unpredictable ways. The Company cannot accurately predict whether those changes in laws and regulations will occur, and, if those changes occur, the ultimate effect they would have upon the financial condition or results of operations of the Company or its subsidiary.

Available Information

The Company maintains an Internet web site at the following internet address: www.fm-bank.com. The Company files reports with the Securities and Exchange Commission (SEC). Copies of all filings made with the SEC may be read and copied at the SEC s Public Reference Room, 450 Fifth Street, Washington, DC, 20549. You may obtain information about the SEC s Public Reference Room by calling (800/SEC-0330). Because the Company makes its filing with the SEC electronically, you may access such reports at the SEC s website, www.sec.gov. The Company makes available, free of charge through its internet address, copies of its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to these reports as soon as reasonably practical after such materials have been filed with or furnished to the SEC. Copies of these documents may also be obtained, either in electronic or paper form, by contacting Barbara J. Britenriker, Chief Financial Officer of the Company at (419) 446-2501.

Please see the Consolidated Financial Statements provided under Part II, Item 8 of this Form 10-K for information regarding the Company s revenues from external customers, profits, and total assets for and as of, respectively, the fiscal year ended December 31, 2011 and 2012.

ITEM 1a. RISK FACTORS

Significant Competition from an Array of Financial Service Providers

Our ability to achieve strong financial performance and a satisfactory return on investment to shareholders will depend in part on our ability to expand our available financial services. In addition to the challenge of attracting and retaining customers for traditional banking services, our competitors now include securities dealers, brokers, mortgage bankers, investment advisors and finance and insurance companies who seek to offer one-stop financial services to their customers that may include services that banks have not been able or allowed to offer to their customers in the past. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems and the accelerating pace of consolidation among financial services providers. If we fail to adequately address each of the competitive pressures in the banking industry, our financial condition and results of operations could be adversely affected.

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Credit Risk

The risk of nonpayment of loans is inherent in commercial banking. Such nonpayment could have an adverse effect on the Company s earnings and our overall financial condition as well as the value of our common stock. Management attempts to reduce the Bank s credit exposure by carefully monitoring the concentration of its loans within specific industries and through the loan approval process. However, there can be no assurance that such monitoring and procedures will totally mitigate the risks. Credit losses can cause insolvency and failure of a financial institution and, in such event, its shareholders could lose their entire investment. For more information on the exposure of the Company and the Bank to credit risk, see the section under Part II, Item 7 of this Form 10-K captioned Loan Portfolio.

Susceptibility to Changes in Regulation

Any changes to state and federal banking laws and regulations may negatively impact our ability to expand services and to increase the value of our business. We are subject to extensive state and federal regulation, supervision, and legislation that govern almost all aspects of our operations. These laws may change from time to time and are primarily intended for the protection of consumers, depositors and the deposit insurance funds. In addition, the Company s earnings are affected by the monetary policies of the Board of Governors of the Federal Reserve. These policies, which include regulating the national supply of bank reserves and bank credit, can have a major effect upon the source and cost of funds and the rates of return earned on loans and investments. The Federal Reserve influences the size and distribution of bank reserves through its open market operations and changes in cash reserve requirements against member bank deposits. The Gramm-Leach-Bliley Act regarding financial modernization that became effective in November, 1999 removed many of the barriers to the integration of the banking, securities and insurance industries and is likely to increase the competitive pressures upon the Bank. We cannot predict what effect such Act and any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, but such changes could be materially adverse to our financial performance. For more information on this subject, see the section under Part I, Item 1 of this Form 10-K captioned Supervision and Regulation.

Interest Rate Risk

Changes in interest rates affect our operating performance and financial condition in diverse ways. Our profitability depends in substantial part on our net interest spread, which is the difference between the rates we receive on loans and investments and the rates we pay for deposits and other sources of funds. Our net interest spread will depend on many factors that are partly or entirely outside our control, including competition, federal economic, monetary and fiscal policies, and economic conditions generally. Historically, net interest spreads for other financial institutions have widened and narrowed in response to these and other factors, which are often collectively referred to as interest rate risk. Over the last few years, the Bank, along with most other financial institutions, has experienced a margin squeeze as drastic interest rate decreases have made it difficult to maintain a more favorable net interest spread. During 2012, the Bank s margin and spread tightened slightly as the rate environment remained low and flat. Maturities of higher rate deposits aided the decrease in cost of funds.

The Bank manages interest rate risk within an overall asset/liability framework. The principal objectives of asset/liability management are to manage sensitivity of net interest spreads and net interest income to potential changes in interest rates. Funding positions are kept within predetermined limits designed to ensure that risk-taking is not excessive and that liquidity is properly managed. In the event that our asset/liabilities management strategies are unsuccessful, our profitability may be adversely affected. For more information regarding the Company s exposure to interest rate risk, see Part II, Item 7A of this Form 10-K.

Attraction and Retention of Key Personnel

Our success depends upon the continued service of our senior management team and upon our ability to attract and retain qualified financial services personnel. Competition for qualified employees is intense. In our experience, it can take a significant period of time to identify and hire personnel with the combination of skills and attributes required in carrying out our strategy. If we lose the services of our key personnel, or are unable to attract additional qualified personnel, our business, financial condition, results of operations and cash flows could be materially adversely affected.

A key component of employee retention is providing a fair compensation base combined with the opportunity for additional compensation for above average performance. In this regard, the Company and the Bank use two incentive programs. The Company uses a stock award program to recognize and incent officers of the Bank. Under the long-term incentive compensation plan, restricted stock awards may be granted to officers. The amount of shares to be granted each year is determined by the Board Compensation Committee and may vary each year in its amount of shares and the number of recipients. The Compensation Committee determines the number of shares to be awarded overall and to the Chief Executive Officer (CEO). The CEO then makes recommendations to the committee as to the recipients of the remaining shares. The full Board of Directors approves the action of the Committee. Since the plan s inception in 2005, all granted stock awards have utilized a three year cliff vesting feature. This is viewed as a retention aid as the awards may be forfeited should an officer leave employment during the vesting period.

A second incentive program of the Bank is based on cash compensation of which almost all employees participate (excluding commission based employees and other employees paid for specific higher paid positions, such as peak time.) A discussion of executive officer pay is incorporated within the proxy and as such, this discussion will pertain to all other employees. Non-officer employees are paid a cash incentive based on the projected overall performance of the Bank in terms of Return of Average Assets (ROA). The Compensation Committee determines the target performance levels on which the percentage of pay will be based. The Committee takes into account the five and ten year trend of ROA along with budget forecasted for the next year and the Bank s past year performance. The Committee also considers the predicted banking environment under which the Bank will be operating. Non-officers receive incentive pay in December of the same year based on the year-to-date base compensation through the last pay received in November.

Officers, other than executive, receive incentive pay based on additional criterion. The officers are rewarded based on overall ROA of the Bank along with individual pre-established goals. Officers, therefore, have incentive pay at risk for individual performance. The individualized goals are recommended by each officer s supervisor and are approved by an incentive committee of the Bank. The goals are designed to improve the performance of the Bank while also limiting the risk of a short-term performance focus. For example, a lending officer may be given two goals of which one is to grow loans within specific targets and another is tied to a specific level of past dues and charge-offs. The second goal limits the ability to be rewarded for growth at all costs along with the specific target levels within the growth goal itself. Officers in a support department may be given goals which create efficiencies, ensure compliance with procedures, or generate new fee or product opportunities. An average of four goals was given to each officer in 2012. Officers are paid cash incentives based on the year end ROA of the Bank and receive it within the first quarter of the following year. Should the ROA be forecasted to be positive but below the base target set by the Board, the officers are paid an incentive under the same basis and timing as non-officers disclosed above.

The percentages of base pay on which the incentive is calculated graduates higher as does the responsibility level of the employee and their ability to impact the financial performance of the Bank. These percentages are recommended by management to the Compensation Committee and Board for approval. The cash incentive plan along with its targets and goals are subject to modification at the Compensation Committee and Board s discretion throughout each year.

Dividend Payout Restrictions

We currently pay a quarterly dividend on our common shares. However, there is no assurance that we will be able to pay dividends in the future. Dividends are subject to determination and declaration by our board of directors, which takes into account many factors. The declaration of dividends by us on our common stock is subject to the discretion of our board and to applicable state and federal regulatory limitations. The Company s ability to pay dividends on its common stock depends on its receipt of dividends from the Bank. The Bank is subject to restrictions and limitations in the amount and timing of the dividends it may pay to the Company.

Anti-Takeover Provisions

Provisions of our Articles of Incorporation and Ohio law could have the effect of discouraging takeover attempts which certain stockholders might deem to be in their interest. These anti-takeover provisions may make us a less attractive target for a takeover bid or merger, potentially depriving shareholders of an opportunity to sell their shares of common stock at a premium over prevailing market prices as a result of a takeover bid or merger.

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Operational Risks

We are subject to certain operational risks, including, but not limited to, data processing system failures and errors, customer or employee fraud and catastrophic failures resulting from terrorist acts or natural disasters. We maintain a system of internal controls to mitigate against such occurrences and maintain insurance coverage for such risks that are insurable, but should such an event occur that is not prevented or detected by our internal controls, uninsured or in excess of applicable insurance limits, it could have a significant adverse impact on our business, financial condition or results of operations.

Limited Trading Market

Our common stock is not listed on any exchange or The NASDAQ Stock Market. Our stock is currently quoted in the over-the-counter markets.

ITEM 1b. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal office is located in Archbold, Ohio.

The Bank operates from the facilities at 307 North Defiance Street. In addition, the Bank owns the property from 200 to 208 Ditto Street, Archbold, Ohio, which it uses for Bank parking and a community mini-park area. The Bank owns real estate at two locations, 207 Ditto Street and 209 Ditto Street in Archbold, Ohio upon which the bank built a commercial building to be used for storage, and a parking lot for company vehicles and employee parking. The Bank also owns real estate across from the main facilities to provide for parking.

The Bank occupies an Operations Center at 622 Clydes Way in Archbold, Ohio to accommodate our growth over the years. The bank owns a parking lot in downtown Montpelier which is provided for community use. The bank owns a property at 204 Washington Street, St Joe, Indiana at which an ATM is located.

The Bank owns all of its office locations, with the exception of Angola, Indiana. The Angola office location is leased. Current locations of retail banking services are:

Office	Location
Archbold, Ohio	1313 S Defiance Street
Wauseon, Ohio	1130 N Shoop Avenue
	119 N Fulton Street
Stryker, Ohio	300 S Defiance Street
West Unity, Ohio	200 W Jackson Street
Bryan, Ohio	929 E High Street
	1000 S Main Street
Delta, Ohio	101 Main Street
Montpelier, Ohio	1150 E Main Street
Napoleon, Ohio	2255 Scott Street
Swanton, Ohio	7 Turtle Creek Circle
Defiance, Ohio	1175 Hotel Drive

Perrysburg, Ohio	7001 Lighthouse Way
Butler, Indiana	200 S Broadway
Auburn, Indiana	403 Erie Pass
Angola, Indiana	2310 N Wayne Street
Hicksville, Ohio	100 N. Main Street

All but one of the above locations has drive-up service facilities and an ATM.

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ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings, other than ordinary routine proceedings incidental to the business of the Bank or the Company, to which we are a party or of which any of our properties are the subject.

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II.

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is not listed on the NASDAQ stock market or any other stock exchange. While there is no established public trading market for our common stock, our shares are currently dually-quoted by various market makers on the Over the Counter Bulletin Board and the OTCQB tier of the quotation service operated by the OTC Markets Group, which are both over-the-counter quotation services for participant broker-dealers. The Company s trading symbols is FMAO.

There are market makers that set a price for our stock; however, private sales continue to occur. The high and low sale prices were from sales of which we have been made aware by researching daily on Bloomberg.com. The high and low sale prices known to our management are as follows:

Stock Prices 2012

Quarter	Low	High
1st	$ 18.00	$ 21.00
2nd	19.50	22.00
3rd	19.80	21.50
4th	19.80	21.00

Stock Prices 2011

Quarter	Low	High
1st	$ 17.65	$ 19.00
2nd	17.45	18.75
3rd	17.25	18.74
4th	17.11	17.96

The Company utilizes Registrar and Transfer Company as its transfer agent.

As of January 24, 2013 there were 2,018 record holders of our common stock of which 22.46% of the outstanding shares are being held in brokerage accounts or street name and only considered as one record holder.

Below is a line-graph presentation comparing the cumulative total shareholder returns for the Corporation, an index for NASDAQ Stock Market (U.S. Companies) comprised of all domestic common shares traded on the NASDAQ National Market System and the NASDAQ Bank Index for the five-year period ended December 31, 2012. The chart compares the value of $100 invested in the Corporation and each of the indices and assumes investment on December 31, 2007 with all dividends reinvested.

The Board of Directors recognizes that the market price of stock is influenced by many factors, only one of which is performance. The stock price performance shown on the graph is not necessarily indicative of future performance.

	2007	2008	2009	2010	2011	2012
FMSB	100.00	102.12	87.51	99.41	100.99	116.89
NASDAQ COMPOSITE	100.00	60.20	87.33	103.05	102.26	120.36
NASDAQ-BANK INDEX	100.00	78.80	65.86	75.08	67.22	79.73

Dividends are declared and paid quarterly. Per share dividends declared for the years ended 2012 and 2011 are as follows:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
2012	$ 0.19	$ 0.19	$ 0.20	$ 0.20	$ 0.78
2011	$ 0.19	$ 0.19	$ 0.19	$ 0.19	$ 0.76

The ability of the Company to pay dividends is limited by the dividend that the Company receives from the Bank. The Bank may pay as dividends to the Company its retained earnings during the current year and its prior two years. Currently, such limitation on the payment of dividends from the Bank to the Company does not materially restrict the Company s ability to pay dividends to its shareholders.

Dividends declared during 2012 were $0.78 per share totaling $3.64 million, 2.63% higher than 2011 declared dividends of $0.76 per share. During 2012, the Company purchased 42,144 shares and awarded 11,000 shares to 54 employees and 1,135 shares were forfeited under its long term incentive plan. At year end, 2012, the Company held 515,942 shares in Treasury stock and 30,670 in unearned stock awards.

Dividends declared during 2011 were $0.76 per share totaling $3.56 million, 4.11% higher than 2010 declared dividends of $0.73 per share. During 2011, the Company purchased 16,779 shares and awarded 11,000 restricted shares to 56 employees under its long term incentive plan. 778 shares were forfeited during 2011. At year end 2011, the Company held 483,663 shares in Treasury stock and 29,715 in unearned stock awards.

The Company continues to have a strong capital base and to maintain regulatory capital ratios that are significantly above the defined regulatory capital ratios. On January 18, 2013, the Company announced the authorization by its Board of Directors for the Company s repurchase, either on the open market, or in privately negotiated transactions, of up to 200,000 shares of its outstanding common stock commencing January 18, 2013 and ending December 31, 2013.

	2012	2011
Primary Ratio	11.18%	10.80%
Tier I Leverage Ratio	10.67%	10.25%
Risk Based Capital Tier I	16.45%	15.66%
Total Risk Based Capital	17.35%	16.54%
Stockholders Equity/Total Assets	11.65%	11.39%

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ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Remaining Share Repurchase Authorization
10/1/2012 to 10/31/2012			36,944	163,056
11/1/2012 to 11/30/2012			36,944	163,056
12/1/2012 to 12/31/2012	5,200	$ 21.16	42,144	157,856
Total (1)	5,200	$ 21.16	42,144	157,856

(1) The Company purchased shares in the market pursuant to stock repurchase program publicly announced on January 20, 2012. On that date, the Board of Directors authorized the repurchase of 200,000 common shares between January 20, 2012 and December 31, 2012. 5,200 shares were repurchased in the fourth quarter. In total for 2012, 42,144 shares were repurchased.

Reclassification

Certain amounts in the 2011 and 2010 consolidated financial statements have been reclassified to conform with the 2012 presentation.

ITEM 6. SELECTED FINANCIAL DATA

SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA

	(In Thousands, except share data)				
	2012	2011	2010	2009	2008
Summary of Income:					
Interest income	$ 33,273	$ 36,660	$ 39,893	$ 41,114	$ 43,824
Interest expense	6,250	8,156	10,863	13,220	18,101
Net Interest Income	27,023	28,504	29,030	27,894	25,723
Provision for loan loss	738	1,715	5,325	3,558	1,787
Net interest income after provision for loan loss	26,285	26,789	23,705	24,336	23,936
Other income (expense), net	(12,593)	(15,382)	(14,342)	(15,256)	(14,763)
Net income before income taxes	13,692	11,407	9,363	9,080	9,173
Income taxes	3,904	2,893	2,382	2,475	2,450
Net income	$ 9,788	$ 8,514	$ 6,981	$ 6,605	$ 6,723
Per Share of Common Stock:					
Earnings per common share outstanding *					
Net income	$ 2.08	$ 1.82	$ 1.48	$ 1.39	$ 1.39

Dividends	$ 0.78	$ 0.76	$ 0.73	$ 0.72	$ 0.68
Weighted average number of shares outstanding	4,695,876	4,689,021	4,721,235	4,741,392	4,846,310

* Based on weighted average number of shares outstanding

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Summary of Consolidated Balance Sheet UNAUDITED

	(In Thousands)				
	2012	2011	2010	2009	2008
Total assets	$ 946,660	$ 922,993	$ 906,363	$ 853,860	$ 805,729
Loans	496,178	501,124	521,883	563,911	562,336
Total Deposits	763,252	739,382	724,513	676,444	615,732
Stockholders equity	110,240	105,091	94,403	93,584	90,547
Key Ratios					
Return on average equity	9.08%	8.56%	7.38%	7.19%	7.51%
Return on average assets	1.05%	0.93%	0.80%	0.80%	0.84%
Loans to deposits	65.01%	67.78%	72.03%	83.36%	91.33%
Capital to assets	11.65%	11.39%	10.42%	10.96%	11.24%
Dividend payout	37.15%	41.85%	49.33%	51.66%	48.77%

ITEM 7. MANAGEMENTS DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Critical Accounting Policy and Estimates

The Company s consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, and the Company follows general practices within the financial services industry in which it operates. At times the application of these principles requires management to make assumptions, estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. These assumptions, estimates and judgments are based on information available as of the date of the financial statements. As this information changes, the financial statements could reflect different assumptions, estimates and judgments. Certain policies inherently have a greater reliance on assumptions, estimates and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Examples of critical assumptions, estimates and judgments are when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not required to be recorded at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability must be recorded contingent upon a future event.

All significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the notes to the consolidated financial statements and in the management discussion and analysis of financial condition and results of operations, provide information on how significant assets and liabilities are valued and how those values are determined for the financial statements. Based on the valuation techniques used and the sensitivity of financial statement amounts to assumptions, estimates and judgments underlying those amounts, management has identified the determination of the Allowance for Loan and Lease Losses (ALLL) and the valuation of its Mortgage Servicing Rights and Other Real Estate Owned (OREO) as the accounting areas that requires the most subjective or complex judgments, and as such could be the most subject to revision as new information becomes available.

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the lower of fair value or the loan carrying amount at the date of foreclosure. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell.

The ALLL represents management s estimate of credit losses inherent in the Bank s loan portfolio at the report date. The estimate is a composite of a variety of factors including experience, collateral value, and the general economy. ALLL includes a specific portion, a formula driven portion, and a general nonspecific portion. The collection and ultimate recovery of the book value of the collateral, in most cases, is beyond our control.

The Company is also required to estimate the value of its Mortgage Servicing Rights. The Company recognizes as separate assets rights to service fixed rate single-family mortgage loans that it has sold without recourse but services for others for a fee. Mortgage servicing assets are initially recorded at cost, based upon pricing multiples as determined by the purchaser, when the loans are sold. Mortgage servicing assets are carried at the lower of the initial carrying value, adjusted for amortization, or estimated fair value. Amortization is determined in proportion to and over the period of estimated net servicing income using the level yield method. For purposes of determining impairment, the mortgage servicing assets are stratified into like groups based on loan type, term, new versus seasoned and interest rate. The valuation is completed by an independent third party.

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The expected and actual rates of mortgage loan prepayments are the most significant factors driving the potential for the impairment of the value of mortgage servicing assets. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced.

The Company s mortgage servicing rights relating to loans serviced for others represent an asset of the Company. This asset is initially capitalized and included in other assets on the Company s consolidated balance sheet. The mortgage servicing rights are then amortized against noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying mortgage servicing rights. There are a number of factors, however, that can affect the ultimate value of the mortgage servicing rights to the Company, including the estimated prepayment speed of the loan and the discount rate used to present value the servicing right. For example, if the mortgage loan is prepaid, the Company will receive fewer servicing fees, meaning that the present value of the mortgage servicing rights is less than the carrying value of those rights on the Company s balance sheet. Therefore, in an attempt to reflect an accurate expected value to the Company of the mortgage servicing rights, the Company receives a valuation of its mortgage servicing rights from an independent third party. The independent third party s valuation of the mortgage servicing rights is based on relevant characteristics of the Company s loan servicing portfolio, such as loan terms, interest rates and recent national prepayment experience, as well as current national market interest rate levels, market forecasts and other economic conditions. Management, with the advice from its third party valuation firm, review the assumptions related to prepayment speeds, discount rates, and capitalized mortgage servicing income on a quarterly basis. Changes are reflected in the following quarter s analysis related to the mortgage servicing asset. In addition, based upon the independent third party s valuation of the Company s mortgage servicing rights, management then establishes a valuation allowance by each strata, if necessary, to quantify the likely impairment of the value of the mortgage servicing rights to the Company. The estimates of prepayment speeds and discount rates are inherently uncertain, and different estimates could have a material impact on the Company s net income and results of operations. The valuation allowance is evaluated and adjusted quarterly by management to reflect changes in the fair value of the underlying mortgage servicing rights based on market conditions. The accuracy of these estimates and assumptions by management and its third party can be directly tied back to the fact that management has not been required to record a valuation allowance through its income statement based upon the valuation of each stratum of serving rights.

For more information regarding the estimates and calculations used to establish the ALLL and the value of Mortgage Servicing Rights, please see Note 1 to the consolidated financial statements provided herewith.

2012 in Review

The Company s 2012 performance was bolstered by the gains on sales from real estate loans. Due to the continued low rate environment, the Company s customers were able to refinance their loans and lower their payments and/or reduce the term of the loan. This activity occurred in both the home loan and agricultural real estate markets. It accounts for a significant portion of the improvement in the noninterest income segment of the income statement. The net interest margin continued to tighten through the year as evidenced by the lower net interest income on the income statement. Negative loan growth was a contributing factor along with loss on yield from investments due to maturities and calls and lower reinvestment rate opportunities.

Profitability was boosted in 2011 by the collection of two large nonaccrual loans. Both relationships were agricultural based. One collection occurred in the first quarter with the process taking three years to complete. The second relationship was placed on non-accrual in the second quarter with all funds collected in the fourth quarter. All legal fees associated with the collection process were also reimbursed to the Company. Further discussion of the impact of these collections is included in net interest income section along with the noninterest expense section. As was expected, 2012 numbers as they relate to interest earnings were lower in yield than 2011 without the additional large influx of nonaccrual interest collection.

Lower charge-off activity combined with negative loan growth, decreased the necessity of provisions for loan losses. The provision for loan loss during 2012 was $738 thousand and was the lowest provision in many years. Provision expense was $1.7 and $5.3 million were the provision for loan loss during 2011 and 2010 respectively. While the Company would prefer to add to the provision for loan growth, the low net charge-off level of 2012 attests to the improved asset quality of the Bank. Other Real Estate Owned (OREO) decreased in number of properties and in dollar amounts; at the same time the net loss on sale of other assets of $634 thousand in 2012 was significantly lower than 2011 s loss of almost $1.2 million. This was another positive improvement contributing to the improved bottom line of the Company.

All rates remain low and are expected to remain low throughout 2013. This has enabled the Company to continue to sell investment securities and recognize a gain without compromising the yield. The transactions have modestly extended the duration of the investment portfolio. For 2012, the recognized gain was $852 thousand, higher than 2011 s $504 thousand while lower than 2010 s $956 thousand. Most of the securities sold were agencies maturing in a shorter time period than the securities that were purchased to replace them. The Bank was able to continue to capitalize on the steepness of the yield curve and the unrealized markets gain position the last three years. The market value of the security portfolio remains high as evidenced by the high comprehensive income reported on the income statement. Additional opportunity remains to sell investment securities for a gain.

Overall, the increased profitability of 2012, stemmed from the improvement in noninterest income. Noninterest income was up 60.3% over 2011 and 33.8% over 2010. Net income was up 15.0% and 40.2% compared to 2011 and 2010, respectively. The Company has done an exceptional job of recognizing opportunities to provide services and products that the low rate environment made possible. These opportunities are further discussed in the Material Changes in Results of Operations. The Company remains strong, stable and well capitalized and has the capacity to continue to cover the increased costs of doing business in a tough economy while seeking good loans to improve profitability. The Company continues to look for new opportunities to generate and protect revenue and provide additional channels through which to serve our customers and maintain our high level of customer satisfaction.

Material Changes in Results of Operations

The discussion now turns to more financial based results and trends as a result of 2012 operations. In comparing line items of the consolidated statement of income for years ended 2010 through 2012, it is easily seen where the Company has been spending its time and the impact of the recession. Decreasing interest income and expense are obviously large factors relating to the profitability of the Company for 2012; however, that discussion can be found in the net interest income section. This discussion will focus on the significant noninterest items that impacted the operations of the Company.

The Company has concerns with the cost of regulation and possible loss of revenue from new regulations stemming from Dodd-Frank. One area of revenue impact was in overdraft fees. Updated Regulation E guidelines were implemented on August 15, 2010 and the Bank ended 2010 with a lower revenue stream by $22 thousand than 2009. This occurred even with the addition of the Hicksville office in July of 2010. 2011 also ended the year $20.8 thousand lower than in 2010 even though every office recorded an increase in the number of checking accounts and balances at yearend were $23 million higher than yearend 2010. At yearend 2012, the number of checking accounts increased along with the balances by $23.2 million; however collected overdraft fees decreased $28.3 thousand as compared to 2011. Overdraft fees in 2012 accounted for $2.4 million in noninterest income. This represents 46.2% of the line item service charges and fees on the income statement. The Bank has made this an area of focus for 2013 as this revenue stream remains under intense regulator review.

While the Bank did experience a heightened level of debit card fraud during 2012 and 2011, overall, revenue improved $580 and $239 thousand from ATM/debit card usage as compared to 2011 and 2010 respectively. The Bank receives interchange revenue from each swipe of the card. Both increases are attributed to the growth and popularity of the Bank s Reward checking product which migrated to KASASA in 2010. One of the criteria for the payment of high interest on the account is utilizing the debit card at least twelve times per statement cycle. The Bank s Reward & KASASA Checking customers averaged 30 and 29 transactions per statement during 2012 and 2011 respectively, surpassing the 10 transactions average of our Free Checking customers. The additional revenue from debit card usage offsets the interest expense, creating a win-win situation for the customers and the Bank. In 2011, this revenue stream was at risk of being reduced by the Federal Reserve regulation of the interchange fee. The establishment of a tiered pricing for banks under $10 billion has helped to protect the profitability though the concern remains as to how long this tiered pricing will remain in effect. All of the KASASA products have a debit card usage qualification; however, interest income is not the customer benefit for all accounts. As an alternative to receiving interest on their deposits, customers may choose to receive credit towards iTunes downloads or donate earnings to charity.

As discussed in the 2012 In Review , the largest positive impact on the income statement was derived from sales activity; including net loss on sale of other assets owned, net gain on sale of loans, and net gain on sale of securities. During 2012, the net gain on sale of loans, which is derived from sales of real estate loans into the secondary market,

was the most significant factor for this category, and was $1.2 million higher than 2011 and $646 thousand higher than 2010. The gain on residential real estate loans accounted for $1.3 million and $725 thousand was derived from gain on sales of agricultural real estate. Both of these programs are offered to our customers to enable them to have a fixed rate loan and the Bank limiting its interest rate risk exposure. Of these loan types, the Bank sells 100% of the residential loans and 90% of the agricultural loans into the secondary market. In 2011, $387.6 and $28.4 thousand were the gains recorded for the sales of residential and agricultural real estate, respectively. In conjunction with these sales, the Bank maintains servicing and those income amounts also increased during 2012 and are included in the customer service fees line item. 2012 recognized servicing income of $1.2 million which was $309.9 thousand higher than 2011.

While net loss on sale of other assets owned, mainly OREO property, does not represent income for 2012, the decrease in the amount of the loss for 2012, as compared to 2011, does account for improved profitability. The loss of $634 thousand for 2012, $1.2 million for 2011 and $109 thousand for 2010 stems not only from sales but also from write-downs in the carrying value of those properties still held. The number of properties decreased and the carrying value declined in 2012 to $2.3 million from $3.6 million in 2011 and from $4.5 million in 2010. OREO is the last step in the loan collection process.

The last line item in the noninterest income section as was discussed previously is the net gain on sale of investments. The Bank has taken advantage of this opportunity the last three years and expects to continue as long as the rates remain low and the yield curve is favorable to the transaction. The Bank will not increase short-term gain at the sacrifice of long-term profitability.

Overall, noninterest income increased $4.1 million in 2012 following a year where it had decreased $1.4 million. Some of the additional revenue may not be easily duplicated as it is dependent on economic and market conditions to provide the opportunity. However, the increased revenue from deposit and loan services should continue to provide improved profitability in the future. Gains on sales should also continue in the near term though when it will change is unknown at this time.

Moving to the expense side, overall, non-interest expense increased 6.0% in 2012 as compared to 2011 and decreased 1.4% in comparing 2011 to 2010. The largest factor behind the higher 2012 level was the summation line of employee benefit on the income statement. Employee benefits increased $453 thousand in 2012 over 2011; they decreased $74 thousand in 2011 over 2010. Three main components flow into employee benefits: payroll taxes, group health insurance, and pension expense. The Bank is partially self-insured and fluctuations to costs are therefore caused by fluctuations in claims made by employees along with the cost of insurance premiums. Employee s group insurance costs were higher in 2012 than 2011 by $314.1 thousand and were down $161 thousand for 2011 over 2010. The Bank offers a Health Savings Account (HSA) option. The Bank makes a contribution to the employees HSA along with a limited matching contribution to employee contributions. A higher profit-sharing contribution to the employees 401K along with the matching contribution increased this expense by $88.5 thousand in 2012 over 2011. 2011 s 401K expenses were $149.3 thousand higher than 2010. The profit-sharing percentages were 5% for 2012 and 4.5% for 2011 and 3% for 2010. (For further discussion on incentive pay, see note 11 of the consolidated financial statements.)

Mentioned previously was the mortgage refinancing activity of the last three years. A correlating expense to that activity is the amortization of mortgage servicing rights. The income was discussed previously; the amortization is the expense that offsets the income recognized. These remain large line items on both the income and expense classification in the income statement. Income is recorded when the mortgage loan is first sold with servicing retained and is therefore recognized within one year. The amortization, however, is calculated over the life of the loan and accelerated as loans are paid off early. An increase in this expense can be driven by two activities: an increase in the number of sold loans and/or by the acceleration of the expense from payoff and refinance activity. The best picture of the bottom line impact is achieved by netting the income with the expense each year. 2010 had net income of only $1 thousand, 2011 had a net expense of $107 thousand and 2012 had net expense of $7 thousand. Of course, the value (or income) of the mortgage servicing right when sold also impacts the net position. In 2010, the income barely offset the amortization expense. With the much slower activity in 2011, the amortization expense was higher than the new rights being capitalized. While gain on sale of these loans was high in 2012, the net position was an expense indicating the activity was mainly refinance. The number of loans and balances also indicates this as the levels have remained fairly constant. As of December 2012, there were 3,674 loans serviced with balances of $280.4 million. As of December 2011, there were 3,632 loans serviced with outstanding balance of $273.1 million for 2010 there were 3,647 loans serviced with outstanding balances of $275.7 million. Returning to the expense only portion, expense for 2012 was $270 thousand higher than 2011 and 2011 was $185 thousand lower than 2010.

The impact of mortgage servicing rights to both noninterest income and expense is shown in the following table:

	(In Thousands)	
	2012	2011
Beginning Year	$ 2,071	$ 2,178
Capitalized Additions	761	391
Amortization	(769)	(498)
Valuation Allowance		
End of Year	$ 2,063	$ 2,071

Salaries and wages decreased $173 thousand in 2012 as compared to 2011. 2011 had increased over 2010 by $439 thousand. Base salary, incentive, deferred costs from loans and restricted stock awards are compiled in this line item. One similarity between 2012 and 2011 is the increase in the incentive pay for the past two years and is reflective of the Company outperforming its budget and performing better than the peer average. Base salaries decreased all three years even with the addition of the Hicksville office in July of 2010. Lower loan activity, continued increase in volume of transactions processed electronically, and a continuing decrease in lobby traffic allowed the Company to decrease the workforce through attrition. Deferred costs from loans, which is an offset to salary expense, was larger in 2012 by $474 thousand than 2011 and 2011 was smaller by $201.7 thousand than 2010. Again, 2012 is reflective of large refinancing activity of which 2011 experienced lower levels.

Occupancy expense decreased by $82 thousand in 2012 as compared to 2011. Although real estate taxes and building repairs were higher, these were offset by lower insurance and utilities costs. Occupancy expense increased by $45 thousand in 2011 as compared to 2010. The largest expense increase in 2011 occupancy expense was utilities, which was driven by the additional office added in July 2010.

Data processing expense increased $141 thousand during 2012 and by only $25 thousand in 2011. A positive reduction in data processing expense of $183 thousand occurred in 2010. The larger reduction in 2010 was mainly due to the reduction of costs as the Bank switched its core service provider in February. The Company continues to investigate ways to reduce this expense. The pricing on many services, however, is based on number of accounts and the Bank fully expects those to increase with the addition of the Waterville office and overall Bank growth.

The FDIC assessment continues to decrease as new regulation changed the method of calculation in the summer of 2011. 2012 represented the first full year under the new method. As can be seen, the change to calculations based on asset size rather than deposits has been very beneficial to F&M.

The last line item in the noninterest expense is other general and administrative. While it is higher by $944 thousand in 2012 following a decrease of $176 thousand in 2011 over 2010 s $4.3 million, the fluctuation is not isolated to a single source. The largest fluctuation relates to legal and loan collection expenses. 2011 included a reimbursement of over $300 thousand in costs with the collection of one relationship that took three years to complete. ATM expense, consulting and state taxes continue to trend upwards.

The largest cost decrease of $3.6 million to the Bank in 2011 was the Provision for Loan Losses and it was the largest increase in 2010. In 2012, it decreased another $977 thousand as compared to 2011. A tough economic environment existed for most businesses in our primary market area during 2007 through 2010. Gross charge-offs were $6.4 million for 2010 and $2.7 million for 2011, and $891 thousand for 2012. Recoveries were $286, $351, and $795 thousand for 2012, 2011, and 2010, respectively. For all three years, activity was mainly commercial and commercial real estate driven in the provision allocation with charge-off activity related to consumer portfolios, including real estate, in 2012. Further analysis by loan type is presented in the discussion of the allowance for credit losses.

Net Interest Income

The primary source of the Company s traditional banking revenue is net interest income. Net interest income is the difference between interest income on interest earning assets, such as loans and securities, and interest expense on liabilities used to fund those assets, such as interest bearing deposits and other borrowings. Net interest income is

affected by changes in both interest rates and the amount and composition of earning assets and liabilities. The change in net interest income is most often measured as a result of two statistics interest spread and net interest margin. The difference between the yields on earning assets and the rates paid for interest bearing liabilities supporting those funds represents the interest spread. Because noninterest bearing sources of funds such as demand deposits and stockholders equity also support earning assets, the net interest margin exceeds the interest spread.

Overall, we continue to see compression in the net interest margin and spread with the risk remaining fairly constant. The net interest margin decreased by 26 basis points and the net interest spread decreased by 24 basis points in comparing 2012 to 2011, with both sides of the equation having lower yields. Major improvement occurred in the decrease of nonaccrual and watch list loans in 2011 with a slight uptick in 2012 due to one commercial relationship. Nonaccruals had increased during the first part of 2010 and decreased due to charge-off and payoff during the second half, specifically the fourth quarter. In first quarter of 2011, the Bank collected $640 thousand of nonaccured interest from a large agricultural loan that took three years to collect. During the fourth quarter 2011, the Bank again collected on a large agricultural loan that was in nonaccrual though the collection period was all in 2011. This was why the loan yield only decreased 4 basis points from 2010. During third quarter 2012, a commercial relationship caused the nonaccrual and impaired loan totals to increase over 2011 yearend levels. Short term rates remained flat throughout the years and long term rates lowered during the year 2012.

Earning assets increased during the year in actual and average balance. The interest collected on the earning assets decreased; the yield decreasing for 2012 as compared to 2011 and 2010 in all portfolios. The largest decrease in yield occurred in the loans. As a reminder, 2011 included a collection of over $600 thousand in nonaccrual interest which aided the yield. 2012 was hampered by negative loan growth, lower variable loan repricing and overall loan refinancing. Investment securities had lower yields due to the large amount of calls on government sponsored agencies and the yield on new purchases as the growth in the portfolio was over $38.2 million in average. It was not unusual for a called security to be replaced with a new security with a yield lower by 50 basis points or more. Overall, this portfolio s yield was 23 basis points lower in 2012 than in 2011, preceded by a 87 basis points drop in 2011 as compared to 2010.

Loans which have the highest earning asset yield decreased in average by $11.4 million when comparing 2012 to 2011 average balance and having decreased $46.6 million in average balance between 2011 and 2010. While the overall change in yield in the loan portfolio for 2011 was due mainly to the change in balance rather than to the change in rate, the 2012 yield was impacted more by rate decrease than the change in balance. Given that the loan portfolio represented only 56% of the earning assets in 2012 as compared to 59% in 2011 and 67% in 2010, it stands to reason that the overall asset yield decreased in every year since 2009. Coupling this with the growth in earning assets being invested in securities and Federal Funds Sold and interest bearing bank balances, the overall yield on earning assets decreased 50 basis points as compared to 2011 and 108 basis points lower than 2010.

Spread is the difference between what the Company earns on its assets and what it pays on its liabilities. It is on this spread that the Company must fund its operations and generate profit. When the asset yield decreases so must the cost of funds to maintain profitability. It becomes increasingly challenging as the asset yield gets closer to the prime lending rate, or the break-even point, of operations.

Looking at the other side of the balance sheet and the interest cost of funds, a decrease in the cost is apparent for 2012 as compared to both 2011 and 2010. Unfortunately, in the three years presented the asset yield decreased more than the cost of funds decreased and the net interest margin and spread decreased as compared to 2009.

The impact of the change in the portfolio mix was a factor in the liabilities as it was in the assets. All portfolios decreased in cost of funds in comparing 2012 to 2011and 2011 to 2010. The growth in balances was related to the growth in the new KASASA product offerings which rewarded customers by paying a higher interest rate for deposits which was offset by noninterest related Bank earnings and savings. By participating in the KASASA Saver product, a customer may have earned as much as 135 basis points more than the Bank s basic savings account. Even with the increased interest cost to the Bank for offering these products, the Bank was still able to decrease its cost of funds by 26 basis points. Time deposits and other borrowed money both decreased in cost and balances. The Bank borrowed funds from the Federal Home Loan Bank in the first quarter of 2010, to lock in lower rates to replace maturities coming due in the second through fourth quarter of the year. The Bank did not borrow any additional funds in 2011 or 2012, and the cost of those funds was again lower in 2012 since the associated expense of the matured advances was gone for a full year. The Bank paid off $5.1 and $3.2 million of FHLB borrowings during 2012 and 2011 respectively. The average balance of other borrowed money was lower by $10.1 and $12.1 million at December 31, 2012 and 2011, respectively.

The following tables present net interest income, interest spread and net interest margin for the three years 2010 through 2012, comparing average outstanding balances of earning assets and interest bearing liabilities with the associated interest income and expense. The tables show their corresponding average rates of interest earned and paid. The tax-exempt asset yields have been tax adjusted to reflect a marginal corporate tax rate of 34%. Average outstanding loan balances include non-performing loans and mortgage loans held for sale. Average outstanding security balances are computed based on carrying values including unrealized gains and losses on available-for-sale securities.

The percentage of interest earning assets to total assets increased in 2012 over 2011 and 2011 over 2010 and remained above 90% at a respectable 94% and 93.9% for 2012 and 2011, respectively.

As stated previously, the decreased yield on the assets was greater than the decreased cost of funds during all presented years. While the average balance on interest bearing liabilities increased, the costs on those funds were significantly lower. The average cost for 2012 was .86% compared to 2011 s 1.12% and 2010 s 1.53%. The balances in noninterest bearing liabilities also increased during the last three years.

The largest fluctuation in the cost of funds was in the other time deposits. The cost on savings decreased 10 basis points while on time deposits the cost decreased 33 basis points. The Bank has focused on increasing its core deposit base to lessen the dependency on higher cost time deposits. The Bank has also attempted to increase the duration of the time deposits; however, customers have maintained a short-term, twelve month focus.

The yield on Tax-Exempt investment securities shown in the following charts were computed on a tax equivalent basis. The yield on Loans has been tax adjusted for the portion of tax-exempt IDB loans included in the total. Total Interest Earning Assets is therefore also reflecting a tax equivalent yield in both line items, also with the Net Interest Spread and Margin. The adjustments were based on a 34% tax rate.

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	2012		
	(In Thousands)		
	Average Balance	Interest/ Dividends	Yield/Rate
ASSETS			
Interest Earning Assets:			
Loans (1)	$ 492,697	$ 26,489	5.41%
Taxable investment securities	289,864	4,802	1.66%
Tax-exempt investment securities	65,330	1,936	4.49%
Federal funds sold & interest bearing deposits	32,068	46	0.14%
Total Interest Earning Assets	$ 879,959	$ 33,273	3.92%
Non-Interest Earning Assets:			
Cash and cash equivalents	16,814		
Other assets	39,342		
Total Assets	$ 936,115		
LIABILITIES AND SHAREHOLDERS EQUITY			
Interest Bearing Liabilities:			
Savings deposits	$ 372,997	$ 1,982	0.53%
Other time deposits	285,214	3,592	1.26%
Other borrowed money	15,333	434	2.83%
Federal funds purchased and securties sold under agreement to repurchase	54,776	242	0.44%
Total Interest Bearing Liabilities	$ 728,320	$ 6,250	0.86%
Non-Interest Bearing Liabilities:			
Non-interest bearing demand deposits	88,588		
Other	11,458		
Total Liabilities	828,366		
Shareholders Equity	107,749		
Total Liabilities and Shareholders Equity	$ 936,115		
Interest/Dividend income/yield		$ 33,273	3.92%
Interest Expense / yield		6,250	0.86%
Net Interest Spread		$ 27,023	3.06%
Net Interest Margin			3.21%

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	2011 (In Thousands)		
	Average Balance	Interest/ Dividends	Yield/Rate
ASSETS			
Interest Earning Assets:			
Loans (1)	$ 504,058	$ 29,840	5.96%
Taxable investment securities	255,627	4,793	1.87%
Tax-exempt investment securities	61,366	1,956	4.83%
Federal funds sold & interest bearing deposits	35,436	71	0.20%
Total Interest Earning Assets	$ 856,487	$ 36,660	4.42%
Non-Interest Earning Assets:			
Cash and cash equivalents	15,218		
Other assets	40,648		
Total Assets	$ 912,353		
LIABILITIES AND SHAREHOLDERS EQUITY			
Interest Bearing Liabilities:			
Savings deposits	$ 349,816	$ 2,201	0.63%
Other time deposits	301,394	4,778	1.59%
Other borrowed money	25,465	883	3.47%
Federal funds purchased and securties sold under agreement to repurchase	51,576	294	0.57%
Total Interest Bearing Liabilities	$ 728,251	$ 8,156	1.12%
Non-Interest Bearing Liabilities:			
Non-interest bearing demand deposits	73,996		
Other	10,678		
Total Liabilities	812,925		
Shareholders Equity	99,428		
Total Liabilities and Shareholders Equity	$ 912,353		
Interest/Dividend income/yield		$ 36,660	4.42%
Interest Expense / yield		$ 8,156	1.12%
Net Interest Spread		$ 28,504	3.30%
Net Interest Margin			3.47%

	2010 (In Thousands) Average Balance	Interest/ Dividends	Yield/Rate
ASSETS			
Interest Earning Assets:			
Loans (1)	$ 550,698	$ 32,860	6.00%
Taxable investment securities	176,885	4,847	2.74%
Tax-exempt investment securities	59,537	2,091	5.32%
Federal funds sold & interest bearing deposits	35,195	95	0.27%
Total Interest Earning Assets	822,315	$ 39,893	5.00%
Non-Interest Earning Assets:			
Cash and cash equivalents	14,046		
Other assets	42,096		
Total Assets	$ 878,457		
LIABILITIES AND SHAREHOLDERS EQUITY			
Interest Bearing Liabilities:			
Savings deposits	$ 305,426	$ 2,190	0.72%
Other time deposits	321,018	6,936	2.16%
Other borrowed money	37,517	1,459	3.89%
Federal funds purchased and securties sold under agreement to repurchase	46,530	278	0.60%
Total Interest Bearing Liabilities	710,491	$ 10,863	1.53%
Non-Interest Bearing Liabilities:			
Non-interest bearing demand deposits	63,108		
Other	10,207		
Total Liabilities	783,806		
Shareholders Equity	94,651		
Total Liabilities and Shareholders Equity	$ 878,457		
Interest/Dividend income/yield		$ 39,893	5.00%
Interest Expense / yield		$ 10,863	1.53%
Net Interest Spread		$ 29,030	3.47%
Net Interest Margin			3.68%

The following tables show changes in interest income, interest expense and net interest resulting from changes in volume and rate variances for major categories of earnings assets and interest bearing liabilities.

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	2012 vs 2011 (In Thousands)		
	Net Change	Due to change in Volume	Rate
Interest Earning Assets:			
Loans	$		