FARMERS & MERCHANTS BANCORP INC
Form 10-Q
October 30, 2013
Table of Contents

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period September 30, 2013

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.

(Exact name of registrant as specified in its charter)

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

(419) 446-2501

Registrant s telephone number, including area code

(Former name, former address and former fiscal year, if changed since last report.)

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 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.

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

Indicate the number of shares of each of the issuers classes of common stock, as of the latest practicable date:

Common Stock, No Par Value	**4,660,938**
Class	**Outstanding as of October 30, 2013**

Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10Q

FARMERS & MERCHANTS BANCORP, INC.

INDEX

101.DEF	XBRL Taxonomy Extension Definition Linkbase Document (1)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document (1)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document (1)

(1) Pursuant to Rule 406T of Regulation S-T, the interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

Table of Contents

ITEM 1 FINANCIAL STATEMENTS
FARMERS & MERCHANTS BANCORP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

Farmers & Merchants Bancorp, Inc. and Subsidiary

	Condensed Consolidated Balance Sheets (in thousands of dollars)	
	September 30, 2013	December 31, 2012
Assets		
Cash and due from banks	$ 15,928	$ 25,620
Interest bearing deposits with banks	5,101	11,941
Federal Funds Sold	506	6,531
Total cash and cash equivalents	21,535	44,092
Securities - available for sale (Note 2)	337,298	355,905
Other Securities, at cost	4,216	4,365
Loans, net (Note 4)	518,296	496,178
Bank premises and equipment	18,452	17,599
Goodwill	4,074	4,074
Mortgage Servicing Rights	2,084	2,063
Other Real Estate Owned	2,361	2,310
Accrued interest and other assets	19,842	20,074
Total Assets	$ 928,158	$ 946,660
Liabilities and Stockholders Equity		
Liabilities		
Deposits		
Noninterest-bearing	$ 103,535	$ 103,966
Interest-bearing		
NOW accounts	199,090	196,971
Savings	201,568	192,808
Time	241,375	269,507
Total deposits	745,568	763,252
Federal funds purchased and securities sold under agreement to repurchase	61,322	51,312
FHLB Advances	7,100	11,600
Dividend payable	928	931
Accrued expenses and other liabilities	5,459	9,326
Total liabilities	820,377	836,421

Stockholders Equity				
Common stock - No par value - authorized 6,500,000 shares; issued & outstanding 5,200,000 shares		12,677		12,677
Treasury Stock - 539,062 shares 2013, 510,742 shares 2012		(11,108)		(10,588)
Unearned Stock Awards - 32,040 shares 2013, 30,670 shares 2012		(645)		(584)
Retained earnings		106,589		102,641
Accumulated other comprehensive income		268		6,093
Total stockholders equity		107,781		110,239
Total Liabilities and Stockholders Equity	$	928,158	$	946,660

See Notes to Condensed Consolidated Unaudited Financial Statements.

Note: The December 31, 2012 Balance Sheet has been derived from the audited financial statements of that date.

3

Table of Contents

FARMERS & MERCHANTS BANCORP, INC.

CONDENSED CONSOLIDATED STATEMENT OF INCOME & COMPREHENSIVE INCOME

(Unaudited)

Farmers & Merchants Bancorp, Inc. and Subsidiary

	Condensed Consolidated Statement of Income & Comprehensive Income (in thousands of dollars, except per share data)			
	Three Months Ended		Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Interest Income				
Loans, including fees	$ 6,244	$ 6,564	$ 18,411	$ 20,165
Debt securities:				
U.S. Treasury securities	64	93	189	266
Securities of U.S. Government Agencies	971	1,012	2,979	3,092
Municipalities	513	555	1,562	1,583
Dividends	47	46	141	141
Federal funds sold		2	11	13
Other	5	6	18	19
Total interest income	7,844	8,278	23,311	25,279
Interest Expense				
Deposits	1,023	1,345	3,229	4,254
Federal funds purchased and securities sold under agreements to repurchase	62	63	184	184
Borrowed funds	44	124	133	371
Total interest expense	1,129	1,532	3,546	4,809
Net Interest Income - Before provision for loan losses	6,715	6,746	19,765	20,470
Provision for Loan Losses (Note 4)	303	236	582	442
Net Interest Income After Provision For Loan Losses	6,412	6,510	19,183	20,028
Noninterest Income				
Customer service fees	1,252	1,239	3,869	3,808
Other service charges and fees	995	943	2,824	2,561
Net gain (loss) on sale of other assets owned	(21)	(209)	(147)	(486)
Net gain on sale of loans	176	602	978	1,385
Net gain on sale of securities	134	30	732	199
Total noninterest income	2,536	2,605	8,256	7,467
Noninterest Expenses				

Salaries and Wages	2,460	2,303	7,156	6,782
Pension and other employee benefits	819	713	2,273	2,285
Occupancy expense (net)	291	268	909	1,059
Furniture and equipment	350	371	1,057	1,072
Data processing	301	292	911	843
Franchise taxes	255	237	765	710
FDIC Assessment	146	126	406	345
Mortgage servicing rights amortization	88	177	345	549
Other general and administrative	1,382	1,240	4,165	3,690
Total Noninterest Expense	6,092	5,727	17,987	17,335
Income Before Federal Income Taxes	2,856	3,388	9,452	10,160
Federal Income Taxes	791	947	2,732	2,897
Net Income	$ 2,065	$ 2,441	$ 6,720	$ 7,263
Other Comprehensive Income (Net of Tax):				
Unrealized gains (loss) on securities	$ (159)	$ 589	$ (5,825)	$ 7,353
Comprehensive Income	$ 1,906	$ 3,030	$ 895	$ 14,616
Net Income Per Share	$ 0.45	$ 0.52	$ 1.44	$ 1.55
Weighted Average Shares Outstanding	4,682,655	4,685,879	4,682,092	4,698,364
Dividends Declared	$ 0.20	$ 0.20	$ 0.60	$ 0.58

See Notes to Condensed Consolidated Unaudited Financial Statements

Table of Contents

FARMERS & MERCHANTS BANCORP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Condensed Consolidated Statements of Cash Flows (in thousands of dollars) Nine Months Ended September 30, 2013	September 30, 2012
Cash Flows from Operating Activities		
Net income	$ 6,720	$ 7,263
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	916	899
Accretion and amortization of securities	1,714	2,346
Amortization of servicing rights	345	549
Amortization of core deposit intangible	234	234
Stock Based Compensation	(202)	(123)
Provision for loan loss	582	442
Gain on sale of loans held for sale	(978)	(1,385)
Originations of loans held for sale	(54,874)	(100,759)
Proceeds from sale of loans held for sale	57,957	104,147
Loss on sale of other assets	147	486
Gain on sales of investment securities	(732)	(199)
Change in operating assets and other liabilities, net	(117)	(682)
Net cash provided by operating activities	11,712	13,218
Cash Flows from Investing Activities		
Activity in securities:		
Maturities, prepayments and calls	28,722	30,404
Securities	63,570	29,084
Purchases	(83,310)	(86,101)
Proceeds from sales of assets	35	2
Additions to premises and equipment	(1,804)	(597)
Loan originations and principal collections, net	(25,783)	11,124
Net cash used in investing activities	(18,570)	(16,084)
Cash Flows from Financing Activities		
Net decrease in deposits	(17,684)	(4,551)
Net change in short-term debt	10,010	2,407
Repayments of long-term debt	(4,500)	(5,051)
Purchase of Treasury Stock	(734)	(789)
Cash dividends paid on common stock	(2,791)	(2,664)
Net cash used in financing activities	(15,699)	(10,648)

Decrease in Cash and Cash Equivalents		(22,557)		(13,514)
Cash and Cash Equivalents - Beginning of Year		44,092		43,143
Cash and Cash Equivalents - End of Period	$	21,535	$	29,629
RECONCILIATION OF CASH AND CASH EQUIVALENTS:				
Cash and cash due from banks	$	15,928	$	13,994
Interest bearing deposits with banks		5,101		10,561
Federal funds sold		506		5,074
Cash at end of period	$	21,535	$	29,629
Supplemental Information				
Cash paid during the year for:				
Interest	$	3,689	$	4,833
Income taxes	$	2,690	$	3,386
Noncash investing activities:				
Transfer of loans to other real estate owned	$	945	$	334

See Notes to Condensed Consolidated Unaudited Financial Statements

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10Q and Rule 10-01 of Regulation S-X; accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2013 are not necessarily indicative of the results that are expected for the year ended December 31, 2013. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2012.

NOTE 2 FAIR VALUE OF INSTRUMENTS

FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair values of financial instruments are management s estimate of the values at which the instruments could be exchanged in a transaction between willing parties. These estimates are subjective and may vary significantly from amounts that would be realized in actual transactions. In addition, other significant assets are not considered financial assets including deferred tax assets, premises, equipment and intangibles. Further, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered in any of the estimates.

The following assumptions and methods were used in estimating the fair value for financial instruments.

Cash and Cash Equivalents

The carrying amounts reported in the balance sheet for cash, cash equivalents and federal funds sold approximate their fair values. Also included in this line item are the carrying amounts of interest-bearing deposits maturing within ninety days which approximate their fair values. Fair values of other interest-bearing deposits are estimated using discounted cash flow analyses based on current rates for similar types of deposits.

Securities

Fair values for securities, excluding Federal Home Loan Bank stock, are based on quoted market price, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Other Securities

The carrying value of Federal Home Loan Bank stock, listed as other securities , approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

Loans

For those variable-rate loans that re-price frequently, and with no significant change in credit risk, fair values are based on carrying values. The fair values of the fixed rate and all other loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers with similar credit quality.

Deposits Interest Bearing, Non-interest Bearing and Time

The fair values disclosed for deposits with no defined maturities are equal to their carrying amounts, which represent the amount payable on demand. The carrying amounts for variable-rate, fixed term money market accounts and certificates of deposit approximate their fair value at the reporting date. Fair value for fixed-rate certificates of deposit are estimated using a discounted cash flow analysis that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Short-Term Borrowings

The carrying value of short-term borrowings approximates fair values.

FHLB Advances

Fair values of FHLB advances are estimated using discounted cash flow analysis based on the Company s current incremental borrowing rates for similar types or borrowing arrangements.

Accrued Interest Receivable and Payable

The carrying amounts of accrued interest approximate their fair values.

Dividends Payable

The carrying amounts of dividends payable approximate their fair values and are generally paid within forty days of declaration.

Off Balance Sheet Financial Instruments

Fair values for off-balance sheet, credit related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counter-parties credit standing.

The estimated fair values, and related carrying or notional amounts, for on and off-balance sheet financial instruments as of September 30, 2013 and December 31, 2012 are reflected below.

	(In Thousands) September 2013				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and Cash Equivalents	$ 21,535	$ 21,535	$ 21,535	$	$
Securities - available for sale	337,298	337,298	25,392	299,864	12,042
Other Securities	4,216	4,216			4,216
Loans, net	518,296	527,219			527,219
Interest receivable	4,289	4,289			4,289
Total Assets	$ 885,634	$ 894,557	$ 46,927	$ 299,864	$ 547,766
Financial Liabilities:					
Interest bearing Deposits	$ 400,658	$ 403,031	$	$	$ 403,031

Non-interest bearing Deposits	103,535	103,896		103,896	
Time Deposits	241,375	241,155			241,155
Total Deposits	$ 745,568	$ 748,082	$	$ 103,896	$ 644,186
Short-term debt	61,322	61,322			61,322
Federal Home Loan Bank advances	7,100	8,487			8,487
Interest payable	238	238			238
Dividends payable	928	928		928	
Total Liabilities	$ 815,156	$ 819,057	$	$ 104,824	$ 714,233

7

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

	(In Thousands) December 2012				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and Cash Equivalents	$ 44,092	$ 44,092	$ 44,092	$	$
Securities - available for sale	355,905	355,905	10,568	328,929	16,408
Other Securities	4,365	4,365			4,365
Loans, net	496,178	502,125			502,125
Interest receivable	3,603	3,603			3,603
Total Assets	$ 904,143	$ 910,090	$ 54,660	$ 328,929	$ 526,501
Financial Liabilities:					
Interest bearing Deposits	$ 389,779	$ 390,066	$	$	$ 390,066
Non-interest bearing Deposits	103,966	104,529		104,529	
Time Deposits	269,507	272,591			272,591
Total Deposits	$ 763,252	$ 767,186	$	$ 104,529	$ 662,657
Short-term debt	51,312	51,312			51,312
Federal Home Loan Bank advances	11,600	11,012			11,012
Interest payable	288	288			288
Dividends payable	931	931		931	
Total Liabilities	$ 827,383	$ 830,729	$	$ 105,460	$ 725,269

Fair Value Measurements

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities in active markets that the Company has the ability to access.

Available-for-sale securities, when quoted prices are available in an active market, securities are valued using the quoted price and are classified as Level 1. The quoted prices are not adjusted.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Available-for-sale securities classified as Level 2 are valued using the prices obtained from an independent pricing service. The prices are not adjusted. Securities of obligations of state and political subdivisions are valued using a type of matrix, or grid, pricing in which securities are benchmarked against the treasury rate based on credit rating. Substantially all assumptions used by the independent pricing service are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the market place.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability. Local municipals have been purchased that the Bank evaluates based on the credit strength of the underlying project such as the hospital or retirement home. The fair value is determined by valuing similar credit payment streams at similar rates.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company s assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

8

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Fair Value Measurements (Continued)

The following summarizes financial assets measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012, segregated by level or the valuation inputs within the fair value hierarchy utilized to measure fair value:

Assets and Liabilities Measured at Fair Value on a Recurring Basis

September 30, 2013 (In Thousands)	Quoted Prices in Active Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Observable Inputs (Level 3)
Assets-(Securities Available for Sale)			
U.S. Treasury	$ 25,392	$	$
U.S. Government agency		197,533	
Mortgage-backed securities		42,103	
State and local governments		60,228	12,042
Total Securities Available for Sale	$ 25,392	$ 299,864	$ 12,042

December 31, 2012 (In Thousands)	Quoted Prices in Active Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Observable Inputs (Level 3)
Assets-(Securities Available for Sale)			
U.S. Treasury	$ 10,568	$	$
U.S. Government agency		220,200	
Mortgage-backed securities		53,006	
State and local governments		55,723	16,408
Total Securities Available for Sale	$ 10,568	$ 328,929	$ 16,408

Most of the Company s available for sale securities, including any bonds issued by local municipalities, have CUSIP numbers or have similar characteristics of those in the municipal markets, making them marketable and comparable as Level 2.

The Company also has assets that, under certain conditions, are subject to measurement at fair value on a non-recurring basis. At September 30, 2013 and December 31, 2012, such assets consist primarily of impaired loans.

Impaired loans categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired. The Company estimates the fair value of the loans based on the present value of expected future cash flows using management s best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals.)

At September 30, 2013 and December 31, 2012, impaired loans categorized as Level 3 were $1.6 and $4.6 million, respectively. The specific allocation for impaired loans was $423 and $865 thousand as of September 30, 2013 and December 31, 2012, respectively, which are accounted for in the allowance for loan losses (see Note 4).

Other real estate is reported at either the lower of the fair value of the real estate minus the estimated costs to sell the asset or the cost of the asset. The determination of fair value of the real estate relies primarily on appraisals from third parties. If the fair value of the real estate, minus the estimated costs to sell the asset, is less than the asset s cost, the deficiency is recognized as a valuation allowance against the asset through a charge to expense. The valuation allowance is therefore increased or decreased, through charges or credits to expense, for changes in the asset s fair value or estimated selling costs.

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The following table presents impaired loans and other real estate owned as recorded at fair value on September 30, 2013 and December 31, 2012:

	Assets Measured at Fair Value on a Nonrecurring Basis at September 30, 2013				
(In Thousands)	Balance at September 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Change in fair value for Nine-month period ended September 30, 2013
Impaired loans	$ 1,562	$	$	$ 1,562	$
Other real estate owned residential mortgages	$ 886	$	$	$ 886	$ (16)
Other real estate owned commercial	$ 1,475	$	$	$ 1,475	$ (64)
					$ (80)

	Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2012				
(In Thousands)	Balance at December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Change in fair value for twelve-month period ended Dec. 31, 2012
Impaired loans	$ 4,591	$	$	$ 4,591	$ (76)
Other real estate owned residential mortgages	$ 783	$	$	$ 783	$ (62)
Other real estate owned commercial	$ 1,526	$	$	$ 1,526	$ (214)
					$ (352)

The Company also has other assets, which under certain conditions, are subject to measurement at fair value. These assets include loans held for sale, bank owned life insurance, and mortgage servicing rights. The Company estimated the fair values of these assets utilizing Level 3 inputs, including, the discounted present value of expected future cash flows. At September 30, 2013 and December 31, 2012, the Company estimates that there is no impairment of these assets, with the exception of mortgage servicing rights. Mortgage servicing rights recognized impairment in one stratum with a charge of $16 thousand in 2012 to expense. The impairment however was eliminated, as of June 30, 2013. Therefore, no impairment charge to other expense was required to adjust these assets to their estimated fair values.

NOTE 3 ASSET PURCHASES

In connection with a December 31, 2007 Knisely acquisition, the Company recognized a core deposit intangible asset of $1.1 million, which is being amortized on a straight line basis over 7 years, which represents the estimated remaining economic useful life of the deposits.

The Company also recognized core deposit intangible assets of $1.09 million with the purchase of the Hicksville office on July 9, 2010. These are being amortized over an estimated remaining economic useful life of the deposits of 7 years on a straight line basis.

The amortization expense for the year ended December 31, 2012 was $312 thousand. Of the $312 thousand to be expensed in 2013, $234 thousand has been expensed as of September 30, 2013.

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 3 ASSET PURCHASES (Continued)

	(In Thousands)		
	Knisley	Hicksville	Total
2013	$ 157	$ 155	$ 312
2014	157	155	312
2015		155	155
2016		155	155
2017		79	79

NOTE 4 LOANS

The Company had $689 thousand in loans held for sale as of September 30, 2013 as compared to $2.5 million in loans held for sale on December 31, 2012. Due to lack of materiality, these loans are included in the Consumer Real Estate loans below.

Loan balances as of September 30, 2013 and December 31, 2012:

	(In Thousands)	
Loans:	September 30, 2013	December 31, 2012
Commercial real estate	$ 232,104	$ 199,999
Agricultural real estate	37,758	40,143
Consumer real estate	79,268	80,287
Commercial and industrial	92,340	101,624
Agricultural	56,752	57,770
Consumer	21,002	20,413
Industrial Development Bonds	4,303	1,299
	523,527	501,535
Less: Net deferred loan fees and costs	(201)	(133)
	523,326	501,402
Less: Allowance for loan losses	(5,030)	(5,224)
Loans - Net	$ 518,296	$ 496,178

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 4 LOANS (Continued)

The following is a maturity schedule by major category of loans as of September 30, 2013:

	Maturities (In Thousands)		
	Within One Year	After One Year Within Five Years	After Five Years
Commercial Real Estate	$ 36,687	$ 100,596	$ 94,821
Agricultural Real Estate	1,987	10,068	25,703
Consumer Real Estate	10,208	12,796	56,264
Commercial/Industrial	58,743	26,504	7,093
Agricultural	31,918	21,995	2,839
Consumer	4,956	12,966	2,879
Industrial Development Bonds	1,900	490	1,913

The distribution of fixed rate loans and variable rate loans by major loan category is as follows as of September 30, 2013. Variable rate loans whose current rates are equal to their floor or ceiling are classified as fixed in this table.

	(In Thousands)	
	Fixed Rate	Variable Rate
Commercial Real Estate	$ 141,991	$ 90,113
Agricultural Real Estate	$ 28,277	$ 9,481
Consumer Real Estate	$ 66,464	$ 12,804
Commercial/Industrial	$ 72,385	$ 19,955
Agricultural	$ 51,662	$ 5,090
Consumer	$ 16,686	$ 4,115
Industrial Development Bonds	$ 4,303	$

As of September 30, 2013 and December 31, 2012 one to four family residential mortgage loans amounting to $25.3 and $26.8 million, respectively, have been pledged as security for loans the Bank has received from the Federal Home Loan Bank.

The percentage of delinquent loans has trended downward since the beginning of January 2010 from a high of 2.85% of total loans to a low of ..62% as of September 30, 2013. These percentages do not include nonaccrual loans which are not past due (nonaccruals are not considered past due if current). This level of delinquency is due in part to an adherence to sound underwriting practices over the course of time, an improvement in the financial status of companies to which the Bank extends credit, continued financial stability in the agricultural loan portfolio, and the writing down of uncollectable credits in a timely manner.

Industrial Development Bonds are included in the commercial and industrial category for the remainder of the tables in this Note 4.

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 4 LOANS (Continued)

The following table represents the contractual aging of the recorded investment in past due loans by portfolio segment of loans as of September 30, 2013 and December 31, 2012, net of deferred fees:

(In Thousands)

September 30, 2013	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
Residential	$ 847	$ 106	$ 339	$ 1,292	$ 77,976	$ 79,268	$
Ag Real Estate	$	$ 88	$	88	37,670	$ 37,758	$
Ag	$	$	$		56,752	$ 56,752	$
Commercial Real Estate	$	$ 975	$ 571	1,546	230,558	$ 232,104	$
Commercial and Industrial	$ 228	$	$ 50	278	96,365	$ 96,643	$
Consumer	$ 14	$ 18	$	32	20,769	$ 20,801	$
Total	$ 1,089	$ 1,187	$ 960	$ 3,236	$ 520,090	$ 523,326	$

December 31, 2012	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
Residential	$ 575	$	$ 648	$ 1,223	$ 79,064	$ 80,287	$
Ag Real Estate					40,143	40,143	
Ag	11			11	57,759	57,770	
Commercial Real Estate			877	877	199,122	199,999	
Commercial and Industrial	78		2,567	2,645	100,278	102,923	
Consumer	65	7		72	20,208	20,280	1
Total	$ 729	$ 7	$ 4,092	$ 4,828	$ 496,574	$ 501,402	$ 1

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 4 LOANS (Continued)

The following table presents the recorded investment in nonaccrual loans by class of loans as of September 30, 2013 and December 31, 2012:

	(In Thousands) September 30 2013	December 31 2012
Consumer Real Estate	$ 635	$ 964
Agricultural Real Estate	88	
Agriculture		
Commercial Real Estate	1,751	877
Commercial and Industrial	434	2,987
Consumer		
Total	$ 2,908	$ 4,828

The Bank uses a nine tier risk rating system to grade its loans. The grade of a loan may change during the life of the loan.

The risk ratings are described as follows.

1. Zero (0) Unclassified. Any loan which has not been assigned a classification.

2. One (1) Excellent. Credit to premier customers having the highest credit rating based on an extremely strong financial condition, which compares favorably with industry standards (upper quartile of Risk Management Association ratios). Financial statements indicate a sound earnings and financial ratio trend for several years with satisfactory profit margins and excellent liquidity exhibited. Prime credits may also be borrowers with loans fully secured by highly liquid collateral such as traded stocks, bonds, certificates of deposit, savings account, etc. No credit or collateral exceptions exist and the loan adheres to the Bank s loan policy in every respect. Financing alternatives would be readily available and would qualify for unsecured credit. This grade is summarized by high liquidity, minimum risk, strong ratios, and low handling costs.

3. Two (2) Good. Desirable loans of somewhat less stature than Grade 1, but with strong financial statements. Loan supported by financial statements containing strong balance sheets, generally with a leverage position less than 1.50, and a history of profitability. Probability of serious financial deterioration is unlikely. Possessing a sound repayment source (and a secondary source),

which would allow repayment in a reasonable period of time. Individual loans backed by liquid personal assets, established history and unquestionable character.

4. Three (3) Satisfactory. Satisfactory loans of average or slightly above average risk having some deficiency or vulnerability to changing economic conditions, but still fully collectible. Projects should normally demonstrate acceptable debt service coverage. Generally, customers should have a leverage position less than 2.00. May be some weakness but with offsetting features of other support readily available. Loans that are meeting the terms of repayment.

   Loans may be graded 3 when there is no recent information on which to base a current risk evaluation and the following conditions apply:

   At inception, the loan was properly underwritten and did not possess an unwarranted level of credit risk:

   a. At inception, the loan was secured with collateral possessing a loan value adequate to protect the Bank from loss;

   b. The loan exhibited two or more years of satisfactory repayment with a reasonable reduction of the principal balance;

   c. During the period that the loan has been outstanding, there has been no evidence of any credit weakness. Some examples of weakness include slow payment, lack of cooperation by the borrower, breach of loan covenants, or the business is in an industry which is known to be experiencing problems. If any of the credit weaknesses is observed, a lower risk grade is warranted.

5. Four (4) Satisfactory / Monitored. A 4 (Satisfactory/Monitored) risk grade may be established for a loan considered satisfactory but which is of average credit risk due to financial weakness or

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 4 LOANS (Continued)

uncertainty. The loans warrant a higher than average level of monitoring to ensure that weaknesses do not advance. The level of risk in Satisfactory/Monitored classification is considered acceptable and within normal underwriting guidelines, so long as the loan is given management supervision.

6. Five (5) Special Mention. Loans that possess some credit deficiency or potential weakness which deserves close attention, but which do not yet warrant substandard classification. Such loans pose unwarranted financial risk that, if not corrected, could weaken the loan and increase risk in the future. The key distinctions of a 5 (Special Mention) classification are that (1) it is indicative of an unwarranted level of risk, and (2) weaknesses are considered potential , versus defined , impairments to the primary source of loan repayment and collateral.

7. Six (6) Substandard. One or more of the following characteristics may be exhibited in loans classified substandard:

   a. Loans, which possess a defined credit weakness and the likelihood that a loan will be paid from the primary source, are uncertain. Financial deterioration is underway and very close attention is warranted to ensure that the loan is collected without loss.

   b. Loans are inadequately protected by the current net worth and paying capacity of the borrower.

   c. The primary source of repayment is weakened, and the Bank is forced to rely on a secondary source of repayment such as collateral liquidation or guarantees.

   d. Loans are characterized by the distinct possibility that the Bank will sustain some loss if deficiencies are not corrected.

   e. Unusual courses of action are needed to maintain a high probability of repayment.

   f. The borrower is not generating enough cash flow to repay loan principal; however, continues to make interest payments.

   g.

The lender is forced into a subordinate position or unsecured collateral position due to flaws in documentation.

h. Loans have been restructured so that payment schedules, terms and collateral represent concessions to the borrower when compared to the normal loan terms.

i. The lender is seriously contemplating foreclosure or legal action due to the apparent deterioration in the loan.

j. There is significant deterioration in the market conditions and the borrower is highly vulnerable to these conditions.

8. Seven (7) Doubtful. One or more of the following characteristics may be exhibited in loans classified Doubtful:

   a. Loans have all of the weaknesses of those classified as Substandard. Additionally, however, these weaknesses make collection or liquidation in full based on existing conditions improbable.

   b. The primary source of repayment is gone, and there is considerable doubt as to the quality of the secondary source of repayment.

   c. The possibility of loss is high, but, because of certain important pending factors which may strengthen the loan, loss classification is deferred until its exact status is known. A Doubtful classification is established deferring the realization of the loss.

9. Eight (8) Loss. Loans are considered uncollectable and of such little value that continuing to carry them as assets on the institution s financial statements is not feasible. Loans will be classified Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 4 LOANS (Continued)

The following table represents the risk category of loans by class based on the most recent analysis performed as of September 30, 2013 and December 31, 2012:

(In Thousands

	Agriculture Real Estate	Agriculture	Commercial Real Estate	Commercial and Industrial	Industrial Development Bonds
September 30, 2013					
1-2	$ 3,620	$ 5,792	$ 2,506	$ 2,234	$
3	13,749	23,382	56,952	22,392	3,959
4	19,523	27,578	161,927	64,002	344
5	743		5,065	2,142	
6	35		5,184	1,143	
7	88		470	427	
8					
Total	$ 37,758	$ 56,752	$ 232,104	$ 92,340	$ 4,303

	Agriculture Real Estate	Agriculture	Commercial Real Estate	Commercial and Industrial	Industrial Development Bonds
December 31, 2012					
1-2	$ 2,719	$ 5,022	$ 4,046	$ 750	$ 97
3	15,111	23,525	42,467	21,750	859
4	21,481	29,188	137,537	71,228	343
5	794	35	8,984	3,385	
6	38		6,295	2,202	
7			670	2,309	
8					
Total	$ 40,143	$ 57,770	$ 199,999	$ 101,624	$ 1,299

16

Table of Contents

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 4 LOANS (Continued)

For consumer residential real estate, and other, the Company also evaluates credit quality based on the aging status of the loan, which was previously stated, and by payment activity. The following tables present the recorded investment in those classes based on payment activity and assigned risk grading as of September 30, 2013 and December 31, 2012.

	(In Thousands)	
	Consumer Real Estate September 30 2013	Consumer Real Estate December 31 2012
Grade		
Pass	$ 78,767	$ 79,766
Special Mention (5)		
Substandard (6)	216	110
Doubtful (7)	285	411
Total	$ 79,268	$ 80,287

	(In Thousands)			
	Consumer - Credit		Consumer - Other	
	September 30 2013	December 31 2012	September 30 2013	December 31 2012
Performing	$ 3,412	$ 3,470	$ 17,364	$ 16,775
Nonperforming		3	25	32
Total	$ 3,412	$ 3,473	$ 17,389	$ 16,807

Information about impaired loans as of September 30, 2013, December 31, 2012 and September 30, 2012 are as follows:

	(In Thousands)		
	September 30, 2013	December 31, 2012	September 30, 2012
Impaired loans without a valuation allowance	$ 253	$ 730	$ 1,145
Impaired loans with a valuation allowance	1,308	3,861	3,371

Total impaired loans	$	1,561	$	4,591	$	4,516
Valuation allowance related to impaired loans	$	423	$	865	$	453
Total non-accrual loans	$	2,908	$	4,828	$	5,260
Total loans past-due ninety days or more and still accruing	$		$	1	$	
Quarter ended average investment in impaired loans	$	1,879	$	4,468	$	4,548
Year to date average investment in impaired loans	$	3,521	$	3,436	$	3,091

No additional funds are committed to be advanced in connection with impaired loans.

The Bank had approximately $378 thousand of its impaired loans classified as troubled debt restructured as of September 30, 2013, $627.3 thousand as of December 31, 2012 and as of September 30, 2012.

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 4 LOAN