FARMERS & MERCHANTS BANCORP
Form 10-Q
August 10, 2009

UNITED STATES
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 ended June 30, 2009
or

o 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: 000-26099

FARMERS & MERCHANTS BANCORP
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	94-3327828 (I.R.S. Employer Identification No.)
111 W. Pine Street, Lodi, California (Address of principal Executive offices)	95240 (Zip Code)

Registrant's telephone number, including area code (209) 367-2300

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 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 T 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes T 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 definition 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 T Non-accelerated filer £ Smaller Reporting Company £
(Do not check if a smaller reporting company)

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

Number of shares of common stock of the registrant: Par value $0.01, authorized 20,000,000 shares; issued and outstanding 782,155 as of July 31, 2009.

FARMERS & MERCHANTS BANCORP

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PART I. - FINANCIAL INFORMATION

Item 1 - Financial Statements

FARMERS & MERCHANTS BANCORP
Consolidated Balance Sheets (Unaudited)

(in thousands) Assets	June 30, 2009	December 31, 2008	June 30, 2008
Cash and Cash Equivalents:			
Cash and Due From Banks	$36,984	$ 46,774	$53,733
Federal Funds Sold	575	14,000	27,700
Total Cash and Cash Equivalents	37,559	60,774	81,433
Investment Securities:			
Available-for-Sale	375,060	291,839	204,135
Held-to-Maturity	70,589	71,890	106,418
Total Investment Securities	445,649	363,729	310,553
Loans	1,191,138	1,177,364	1,121,865
Less: Allowance for Loan Losses	25,454	20,034	18,682
Loans, Net	1,165,684	1,157,330	1,103,183
Premises and Equipment, Net	23,572	21,653	22,101
Bank Owned Life Insurance	42,873	41,965	41,072
Interest Receivable and Other Assets	45,687	38,986	50,454
Total Assets	$1,761,024	$ 1,684,437	$1,608,796
Liabilities			
Deposits:			
Demand	$279,619	$ 319,318	$274,306
Interest Bearing Transaction	152,651	146,879	127,295
Savings	386,608	353,055	334,649
Time	687,529	613,450	626,492
Total Deposits	1,506,407	1,432,702	1,362,742
Securities Sold Under Agreement to Repurchase	60,000	60,000	60,000
Federal Home Loan Bank Advances	676	703	729
Subordinated Debentures	10,310	10,310	10,310
Interest Payable and Other Liabilities	25,466	24,177	28,050
Total Liabilities	1,602,859	1,527,892	1,461,831
Shareholders' Equity			
Common Stock	8	8	8
Additional Paid-In Capital	76,679	78,527	81,642
Retained Earnings	77,371	72,350	65,864
Accumulated Other Comprehensive Income (Loss)	4,107	5,660	(549)
Total Shareholders' Equity	158,165	156,545	146,965
Total Liabilities & Shareholders' Equity	$1,761,024	$ 1,684,437	$1,608,796

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

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FARMERS & MERCHANTS BANCORP
Consolidated Statements of Income (Unaudited)

(in thousands except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Interest Income				
Interest and Fees on Loans	$ 18,646	$ 18,986	$ 37,307	$ 39,543
Interest on Federal Funds Sold and Securities Purchased Under Agreements to Resell	35	38	68	44
Interest on Investment Securities:				
Taxable	3,470	2,892	6,961	5,312
Tax-Exempt	736	762	1,479	1,536
Total Interest Income	22,887	22,678	45,815	46,435
Interest Expense				
Deposits	4,041	5,450	8,272	12,192
Borrowed Funds	546	436	1,085	667
Subordinated Debentures	106	147	225	342
Total Interest Expense	4,693	6,033	9,582	13,201
Net Interest Income	18,194	16,645	36,233	33,234
Provision for Loan Losses	7,260	4,035	8,130	4,605
Net Interest Income After Provision for Loan Losses	10,934	12,610	28,103	28,629
Non-Interest Income				
Service Charges on Deposit Accounts	1,731	1,797	3,343	3,515
Net Gain on Investment Securities	1,452	674	2,472	535
Credit Card Merchant Fees	-	555	-	1,089
Increase in Cash Surrender Value of Life Insurance	455	453	908	892
ATM Fees	419	390	786	751
Net Gain (Loss) on Deferred Compensation Investments	458	429	407	(203)
Other	574	3,552	1,331	4,248
Total Non-Interest Income	5,089	7,850	9,247	10,827
Non-Interest Expense				
Salaries & Employee Benefits	7,096	6,688	14,400	13,806
Net Gain (Loss) on Deferred Compensation Investments	458	429	407	(203)
Occupancy	670	686	1,379	1,344
Equipment	651	627	1,350	1,123
Credit Card Merchant Expense	-	421	-	828
ORE Holding Costs	161	19	666	19
FDIC Insurance	675	130	1,801	257
Other	1,807	1,874	3,490	3,466
Total Non-Interest Expense	11,518	10,874	23,493	20,640

Income Before Income Taxes	4,505	9,586	13,857	18,816
Provision for Income Taxes	1,429	3,624	4,847	7,090
Net Income	$ 3,076	$ 5,962	$ 9,010	$ 11,726
Earnings Per Share	$ 3.93	$ 7.50	$ 11.48	$ 14.71

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

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FARMERS & MERCHANTS BANCORP
Consolidated Statements of Comprehensive Income (Unaudited)
(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net Income	$3,076	$5,962	$9,010	$11,726
Other Comprehensive Loss -				
Unrealized Losses on Securities:				
Unrealized holding losses arising during the period, net of income tax benefit of $(1,018) and $(2,017) for the quarters ended June 30, 2009 and 2008, respectively, and of $(87) and $(887)for the six months ended June 30, 2009 and 2008, respectively.	(1,403)	(2,778)	(120)	(1,222)
Less: Reclassification adjustment for realized losses included in net income, net of related income tax effects of $(610) and $(283)for the quarters ended June 30, 2009 and 2008, respectively, and of $(1,039) and $(225) for the six months ended June 30, 2009 and 2008, respectively.	(842)	(391)	(1,433)	(310)
Total Other Comprehensive Loss	(2,245)	(3,169)	(1,553)	(1,532)
Comprehensive Income	$831	$2,793	$7,457	$10,194

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

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FARMERS & MERCHANTS BANCORP
Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
(in thousands except share data)

	Common Shares Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2007	800,112	$8	$84,437	$57,990	$ 983	$ 143,418
Net Income		-	-	11,726	-	11,726
Cash Dividends Declared on Common Stock		-	-	(3,852)	-	(3,852)
Repurchase of Stock	(6,076)	-	(2,795)	-	-	(2,795)
Change in Net Unrealized Loss on Securities Available for Sale		-	-	-	(1,532)	(1,532)
Balance, June 30, 2008	794,036	$8	$81,642	$65,864	$ (549)	$ 146,965
Balance, December 31, 2008	786,960	$8	$78,527	$72,350	$ 5,660	$ 156,545
Net Income		-	-	9,010	-	9,010
Cash Dividends Declared on Common Stock		-	-	(3,989)	-	(3,989)
Repurchase of Stock	(4,805)	-	(1,848)	-	-	(1,848)
Change in Net Unrealized Gain on Securities Available for Sale		-	-	-	(1,553)	(1,553)
Balance, June 30, 2009	782,155	$8	$76,679	$77,371	$ 4,107	$ 158,165

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

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FARMERS & MERCHANTS BANCORP
Consolidated Statements of Cash Flows (Unaudited)
(in thousands)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Operating Activities:		
Net Income	$ 9,010	$ 11,726
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Loan Losses	8,130	4,605
Depreciation and Amortization	932	886
Net (Accretion) Amortization of Investment Security Discounts & Premium	(2,564)	64
Net Gain on Investment Securities	(2,472)	(535)
Net Gain on Sale of Property & Equipment	(10)	(8)
Net Change in Operating Assets & Liabilities:		
Net Increase in Interest Receivable and Other Assets	(6,483)	(12,943)
Net Increase in Interest Payable and Other Liabilities	1,289	2,350
Net Cash Provided by Operating Activities	7,832	6,145
Investing Activities:		
Securities Available-for-Sale:		
Purchased	(179,869)	(119,742)
Sold, Matured or Called	99,015	55,532
Securities Held-to-Maturity:		
Purchased	(50)	(2,500)
Matured or Called	1,341	1,621
Net Loans Originated or Acquired	(16,603)	14,464
Principal Collected on Loans Previously Charged Off	119	234
Net Additions to Premises and Equipment	(2,854)	(2,799)
Proceeds from Disposition of Property & Equipment	13	8
Net Cash Used by Investing Activities	(98,888)	(53,182)
Financing Activities:		
Net Decrease in Demand, Interest-Bearing Transaction, and Savings Accounts	(374)	(11,392)
Increase in Time Deposits	74,079	63,344
Net Increase in Securities Sold Under Agreement to Repurchase	-	60,000
Net Decrease in Federal Home Loan Bank Advances	(27)	(28,225)
Cash Dividends	(3,989)	(3,852)
Stock Repurchases	(1,848)	(2,795)
Net Cash Provided by Financing Activities	67,841	77,080
(Decrease) Increase in Cash and Cash Equivalents	(23,215)	30,043
Cash and Cash Equivalents at Beginning of Year	60,774	51,390
Cash and Cash Equivalents as of June 30, 2009 and June 30, 2008	$ 37,559	$ 81,433

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

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FARMERS & MERCHANTS BANCORP
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Significant Accounting Policies

Farmers & Merchants Bancorp (the Company) was organized March 10, 1999. Primary operations are related to traditional banking activities through its subsidiary Farmers & Merchants Bank of Central California (the Bank) which was established in 1916. The Bank's wholly owned subsidiaries include Farmers & Merchants Investment Corporation and Farmers/Merchants Corp. Farmers & Merchants Investment Corporation has been dormant since 1991. Farmers/Merchants Corp. acts as trustee on deeds of trust originated by the Bank.

The Company's other subsidiaries include F & M Bancorp, Inc. and FMCB Statutory Trust I. F & M Bancorp, Inc. was created in March 2002 to protect the name F & M Bank. During 2002 the Company completed a fictitious name filing in California to begin using the streamlined name "F & M Bank" as part of a larger effort to enhance the Company's image and build brand name recognition. In December 2003 the Company formed a wholly owned subsidiary, FMCB Statutory Trust I. FMCB Statutory Trust I is a non-consolidated subsidiary per generally accepted accounting principles (GAAP) and was formed for the sole purpose of issuing Trust Preferred Securities. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and prevailing practice within the banking industry. The following is a summary of the significant accounting and reporting policies used in preparing the consolidated financial statements.

Basis of Presentation
The accompanying unaudited consolidated interim financial statements and notes thereto have been prepared in accordance with accounting principles generally accepted in the United States of America for financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X.

The accompanying unaudited consolidated interim financial statements include the accounts of the Company and the Company's wholly owned subsidiaries, F & M Bancorp, Inc. and the Bank, along with the Bank's wholly owned subsidiaries, Farmers & Merchants Investment Corporation and Farmers/Merchants Corp. Significant inter-company transactions have been eliminated in consolidation.

The preparation of unaudited consolidated interim financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. We have evaluated subsequent events for potential recognition and/or disclosure through August 10, 2009, the date the consolidated financial statements were issued.

Certain amounts in the prior periods' unaudited consolidated interim financial statements and related footnote disclosures have been reclassified to conform to the current-year presentation. These reclassifications have no effect on previously reported income.

2. Fair Value Disclosures

Effective January 1, 2008, the Company adopted SFAS No. 157 (SFAS 157), "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 applies whenever other standards require, or permit, assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, the FASB clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, SFAS 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy is as follows:

Level 1 inputs – Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

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Level 2 inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Securities classified as available-for-sale are reported at fair value on a recurring basis utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, "Accounting by Creditors for Impairment of a Loan." The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2008, substantially all impaired loans were evaluated based on the fair value of the collateral. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value which uses observable data, the Company records the impaired loan as nonrecurring Level 2. Otherwise, the Company records the impaired loan as nonrecurring Level 3.

Other Real Estate ("ORE") is reported at fair value on a non-recurring basis. When the fair value of the ORE is based on an observable market price or a current appraised value which uses observable data, the Company records the ORE as nonrecurring Level 2. Otherwise, the Company records the ORE as nonrecurring Level 3. Other real estate is reported in Interest Receivable and Other Assets on the Company's Consolidated Balance Sheets.

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

		Fair Value Measurements At June 30, 2009, Using		
(in thousands)	Fair Value June 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-Sale Securities	$375,060	$-	$375,060	$ -
Total Assets Measured at Fair Value On a Recurring Basis	$375,060	$-	$375,060	$ -

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The following table presents information about the Company's assets and liabilities measured at fair value on a non-recurring basis and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

		Fair Value Measurements At June 30, 2009, Using		
(in thousands)	Fair Value June 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans	$9,966	$-	$9,966	$ -
Other Real Estate	4,322	-	4,322	-
Total Assets Measured at Fair Value On a Non-Recurring Basis	$14,288	$-	$14,288	$ -

Impaired loans and ORE are measured for impairment using the fair value of the collateral because the loans/ORE are considered to be collateral dependent. Impaired loans were $11.4 million with an allowance for loan losses of $1.5 million and ORE was $6.9 million with a valuation allowance of $2.6 million.

Fair Value of Financial Instruments

Generally accepted accounting principles require disclosure of fair value information about financial instruments, whether or not recognized on the balance sheet, for which it is practical to estimate that value. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. The use of assumptions and various valuation techniques, as well as the absence of secondary markets for certain financial instruments, will likely reduce the comparability of fair value disclosures between financial institutions. In some cases, book value is a reasonable estimate of fair value due to the relatively short period of time between origination of the instrument and its expected realization.

A summary of the carrying amounts and estimated fair value of financial instruments is as follows:

	June 30, 2009		December 31, 2008	
(in thousands)	Carrying	Estimated	Carrying	Estimated
ASSETS:	Amount	Fair Value	Amount	Fair Value
Cash and Cash Equivalents	$37,559	$37,559	$60,774	$60,774
Investment Securities Held-to-Maturity	70,589	69,739	71,890	71,454
Investment Securities Available-for-Sale	375,060	375,060	291,839	291,839
Loans, Net of Deferred Loan Origination Fees	1,191,138	1,208,326	1,177,364	1,192,946
Cash Surrender Value of Life Insurance Policies	42,873	42,873	41,965	41,965
Accrued Interest Receivable	7,963	7,963	7,250	7,250
LIABILITIES:				
Deposits:				
Non-Interest Bearing	279,619	279,619	319,318	319,318
Interest-Bearing	1,226,788	1,229,091	1,113,384	1,116,389
FHLB Advances & Securities Sold Under Agreement to Repurchase	60,676	63,809	60,703	62,434
Subordinated Debentures	10,310	5,406	10,310	7,441

Accrued Interest Payable	2,972	2,972	3,067	3,067

The methods and assumptions used to estimate the fair value of each class of financial instrument listed in the table above are explained below.

Cash and Cash Equivalents: The carrying amounts reported in the balance sheet for cash and due from banks, federal funds sold, and securities purchased under agreements to resell are a reasonable estimate of fair value.

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Investment Securities: Fair values for investment securities are based on quoted market prices or dealer quotes, where available. If quoted market prices or dealer quotes are not available, fair values are based on quoted market prices of comparable instruments.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for fixed-rate loans are estimated using discounted cash flow analyses using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of accrued interest receivable approximates its fair value.

Cash Surrender Value of Life Insurance Policies: The fair value of life insurance policies are based on cash surrender values at each reporting date as provided by the insurers.

Deposit Liabilities: The fair value of demand deposits, interest bearing transaction accounts, and savings accounts is the amount payable on demand. The fair value of fixed-maturity certificates of deposit is estimated by discounting expected future cash flows utilizing interest rates currently being offered for deposits of similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

Borrowings: The fair value for Federal Home Loan Bank borrowings and securities sold under agreement to repurchase are determined using discounted future cash flows.

Subordinated Debentures: Fair values of subordinated debentures were determined based on the current market value of like-kind instruments of a similar maturity and structure.

Limitations: Fair value estimates presented herein are based on pertinent information available to management as of June 30, 2009. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date, and; therefore, current estimates of fair value may differ significantly from the amounts presented above.

3. Dividends and Earnings Per Share

Farmers & Merchants Bancorp common stock is not traded on any exchange. The shares are primarily held by local residents and are not actively traded. On May 5, 2009, the Board of Directors of Farmers & Merchants Bancorp declared a mid-year cash dividend of $5.10 per share, a 5.2% increase over the $4.85 per share paid on July 1, 2008. The cash dividend was paid on July 1, 2009, to shareholders of record on June 5, 2009.

Earnings per share amounts are computed by dividing net income by the weighted average number of common shares outstanding for the period. The following table calculates the earnings per share for the three and six months ended June 30, 2009 and 2008.

	Three Months Ended June 30,		Six Months Ended June 30,	
(net income in thousands)	2009	2008	2009	2008
Net Income	$3,076	$5,962	$9,010	$11,726
Average Number of Common Shares Outstanding	782,403	795,204	784,020	797,093
Per Share Amount	$3.93	$7.50	$11.48	$14.71

4. Recent Accounting Pronouncements

On June 29, 2009, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 168, The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles– –– a replacement of FASB Statement No. 162 ("SFAS 168"). SFAS 168 establishes the FASB Accounting Standards CodificationTM as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with US GAAP. SFAS 168 will be effective for financial statements issued for interim and annual periods ending after September 15, 2009, for most entities. On the effective date, all non-SEC accounting and reporting standards will be superseded. The Company will adopt SFAS 168 for the quarterly period ended September 30, 2009, as required, and adoption is not expected to have a material impact on the Company's financial statements.

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SFAS No. 165, "Subsequent Events" ("SFAS 165") established general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. SFAS 165 defines (i) the period after the balance sheet date during which a reporting entity's management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and (iii) the disclosures an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 became effective for periods ending after June 15, 2009, and its adoption did not have a significant impact on the Company's financial statements.

On April 9, 2009, the FASB issued three final Staff Positions intended to provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities. FASB Staff Position No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly ("FSP 157-4"), provides guidelines for making fair value measurements more consistent with the principles presented in FASB SFAS No. 157, Fair Value Measurements, when the volume and level of activity for the asset or liability have decreased significantly. FASB Staff Position No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments, ("FSP 107-1") enhances consistency in financial reporting by increasing the frequency of fair value disclosures. FASB Staff Position No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments, ("FSP 115-2") provides additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities.

All three Staff Positions were effective for interim and annual periods ending after June 15, 2009. Entities were permitted to early adopt these Staff Positions for interim and annual periods ending after March 15, 2009, but had to adopt all three Staff Positions concurrently. The Company adopted these Staff Positions for the quarterly period ending June 30, 2009, as required. The adoption of FSP 157-4, FSP 107-1, and FSP 115-2 did not have a material impact on the Company's financial statements.

On April 1, 2009, the FASB issued FASB Staff Position No. FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies ("FSP 141(R)-1"). FSP 141(R)-1 provides additional guidance regarding the recognition, measurement and disclosure of assets and liabilities arising from contingencies in a business combination. FSP 141(R)-1 is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The impact of the Company's adopting FSP 141(R)-1 will depend on the timing of future acquisitions, as well as the nature and existence of contingencies associated with such acquisitions.

Item 2. Management's Discussion And Analysis Of Financial Condition And Results Of Operations

The following is management's discussion and analysis of the major factors that influenced our financial performance for the three and six months ended June 30, 2009. This analysis should be read in conjunction with our 2008 Annual Report to Shareholders on Form 10-K, and with the unaudited financial statements and notes as set forth in this report.

Forward–Looking Statements

This Form 10-Q contains various forward-looking statements, usually containing the words "estimate," "project," "expect," "objective," "goal," or similar expressions and includes assumptions concerning the Company's operations, future results, and prospects. These forward-looking statements are based upon current expectations and are subject to risks and uncertainties. In connection with the "safe-harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Company provides the following cautionary statement identifying important factors which could cause the actual results of events to differ materially from those set forth in or implied by the forward-looking statements and related assumptions.

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Such factors include the following: (i) the current economic downturn and turmoil in financial markets and the response of federal and state regulators thereto; (ii) the effect of changing regional and national economic conditions including in the housing market in the Central Valley of California; (iii) significant changes in interest rates and prepayment speeds; (iv) credit risks of lending and investment activities; (v) changes in federal and state banking laws or regulations; (vi) competitive pressure in the banking industry; (vii) changes in governmental fiscal or monetary policies; (viii) uncertainty regarding the economic outlook resulting from the continuing war on terrorism, as well as actions taken or to be taken by the U.S. or other governments as a result of further acts or threats of terrorism; and (ix) other factors discussed in Item 1A. Risk Factors located in the Company’s 2008 Annual Report on Form 10-K.

Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. The Company undertakes no obligation to update any forward-looking statements to reflect events or circumstances arising after the date on which they are made.

Introduction

Farmers & Merchants Bancorp, or the Company, is a bank holding company formed March 10, 1999. Its subsidiary, Farmers & Merchants Bank of Central California, or the Bank, is a California state-chartered bank formed in 1916. The Bank serves the northern Central Valley of California through twenty-two banking offices and two stand-alone ATM’s. The service area includes Sacramento, San Joaquin, Stanislaus and Merced Counties with branches in Sacramento, Elk Grove, Galt, Lodi, Stockton, Linden, Modesto, Turlock, Hilmar, and Merced. Substantially all of the Company’s business activities are conducted within its market area.

As a bank holding company, the Company is subject to regulation and examination by the Board of Governors of the Federal Reserve System (“FRB”). As a California, state-chartered, non-fed member bank, the Bank is subject to regulation and examination by the California Department of Financial Institutions (“DFI”) and the Federal Deposit Insurance Corporation (“FDIC”).

Overview

The Company’s primary service area encompasses the northern Central Valley of California, a region that can be significantly impacted by the seasonal and cyclical operations of the agricultural industry. Accordingly, discussion of the Company’s Financial Condition and Results of Operations can be influenced by the banking needs of its agricultural customers (e.g., generally speaking during the spring and summer customers draw down their deposit balances and increase loan borrowing to fund the purchase of equipment and planting of crops. Correspondingly, deposit balances are replenished and loans repaid in fall and winter as crops are harvested and sold).

The Central Valley of California has been one of the hardest hit areas in the country during the current recession. Housing prices in many areas are down over 60% and the economic stress has spread from residential real estate to other industry segments such as autos and commercial real estate. Unemployment levels are well above 10% in some areas. Although, in management’s opinion, the Company’s credit quality performance over the past eighteen months has compared favorably to our peers, we believe that it is possible that any significant recovery in our local markets will not occur until 2010 or later and this may result in: (1) additional borrower stress in the coming quarters; and (2) continuing modest levels of loan growth over the near term.

Another factor that has adversely impacted the Company’s financial results for the first six months of 2009 has been significantly higher deposit insurance premiums and special assessments. The FDIC has levied these additional costs on all banks to help replenish a deposit insurance fund that has been depleted by the large number of bank failures across the nation. For the first six months of 2009 the Company’s total FDIC insurance costs exceeded the same period in 2008 by $1.5 million, a 600% increase. The FDIC has indicated that additional special assessments may be required during the remainder of 2009 and/or future years.

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For the three and six months ended June 30, 2009, Farmers & Merchants Bancorp reported net income of $3,076,000 and $9,010,000, earnings per share of $3.93 and $11.48 and return on average assets of 0.71% and 1.06%, respectively. Return on average shareholders' equity was 7.55% and 11.237% for the three and six months ended June 30, 2009.

For the three and six months ended June 30, 2008, Farmers & Merchants Bancorp reported net income of $5,962,000 and $11,726,000, earnings per share of $7.50 and $14.71 and return on average assets of 1.54% and 1.54%, respectively. Return on average shareholders' equity was 15.93% and 15.90% for the three and six months ended June 30, 2008.

Factors impacting the Company's earnings performance in the first six months of 2009 as compared to the same period last year were: (1) a $4.2 million increase in loan loss provisions and ORE holding costs as a result of the continuing economic problems in the Company's local markets; and (2) a $1.5 million increase in FDIC deposit insurance costs as a result of the FDIC's need to increase premiums and levy special assessments on all banks in order to replenish the deposit insurance fund that has been depleted from bank failures nationwide. These factors were partially offset by: (3) a $3.0 million increase in net interest income due to a 12.6% increase in average earning assets; and (4) a $1.9 million increase in gain on sale of investment securities.

The following is a summary of the financial results for the six month period ended June 30, 2009 compared to June 30, 2008.

- Net income decreased 23.2% to $9.0 million from $11.7 million.
- Earnings per share decreased 21.9% to $11.48 from $14.71.
- Total assets increased 9.5% to $1.8 billion.
- Total loans increased 6.2% to $1.2 billion.
- Allowance for loan losses increased 36.2% to $25.5 million.
- Total deposits increased 10.5% to $1.5 billion.
- Net interest income increased 9.0% to $36.2 million from $33.2 million.

Results of Operations

Net Interest Income / Net Interest Margin
The tables on the following pages reflect the Company's average balance sheets and volume and rate analysis for the three and six month periods ended June 30, 2009 and 2008.

The average yields on earning assets and average rates paid on interest-bearing liabilities have been computed on an annualized basis for purposes of comparability with full year data. Average balance amounts for assets and liabilities are the computed average of daily balances.

Net interest income is the amount by which the interest and fees on loans and other interest earning assets exceed the interest paid on interest bearing sources of funds. For the purpose of analysis, the interest earned on tax-exempt investments and municipal loans is adjusted to an amount comparable to interest subject to normal income taxes. This adjustment is referred to as "taxable equivalent" and is noted wherever applicable.

The Volume and Rate Analysis of Net Interest Income summarizes the changes in interest income and interest expense based on changes in average asset and liability balances (volume) and changes in average rates (rate). For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to: (1) changes in volume (change in volume multiplied by initial rate); (2) changes in rate (change in rate multiplied by initial volume); and (3) changes in rate/volume (allocated in proportion to the respective volume and rate components).

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Farmers & Merchants Bancorp
Quarterly Average Balances and Interest Rates
(Interest and Rates on a Taxable Equivalent Basis)
(in thousands)

	Three Months Ended June 30, 2009			Three Months Ended June 30, 2008		
Assets	Balance	Interest	Rate	Balance	Interest	Rate
Federal Funds Sold	$ 57,085	$ 35	0.25 %	$ 7,360	$ 38	2.07 %
Investment Securities Available-for-Sale:						
Municipals - Non-Taxable	9,673	183	7.56 %	8,451	160	7.57 %
Mortgage Backed Securities	264,012	3,310	5.01 %	180,190	2,425	5.38 %
Other	10,736	5	0.19 %	3,335	79	9.48 %
Total Investment Securities Available-for-Sale	307,808	3,594	4.67 %	191,976	2,664	5.55 %
Investment Securities Held-to-Maturity:						
U.S. Agencies	0	0	0.00 %	30,399	317	4.17 %
Municipals - Non-Taxable	64,253	921	5.74 %	66,096	967	5.85 %
Mortgage Backed Securities	4,549	43	3.78 %	6,123	59	3.85 %
Other	1,991	15	3.01 %	1,992	13	2.61 %
Total Investment Securities Held-to-Maturity	70,793	979	5.53 %	104,610	1,356	5.18 %
Loans:						
Real Estate	687,081	11,157	6.51 %	664,933	11,004	6.64 %
Home Equity	65,896	991	6.03 %	66,719	1,070	6.43 %
Agricultural	211,364	3,223	6.12 %	177,357	3,178	7.19 %
Commercial	200,341	3,073	6.15 %	198,748	3,332	6.72 %
Consumer	10,862	199	7.35 %	12,669	272	8.61 %
Credit Card	0	0	0.00 %	5,192	127	9.81 %
Municipal	1,075	3	1.12 %	1,168	3	1.03 %
Total Loans	1,176,619	18,646	6.36 %	1,126,786	18,986	6.76 %
Total Earning Assets	1,612,305	$ 23,254	5.79 %	1,430,732	$ 23,044	6.46 %
Unrealized Gain/(Loss) on Securities Available-for-Sale	10,318			3,018		
Allowance for Loan Losses	(20,833)			(19,217)		
	31,719			36,703		

Cash and Due From Banks													
All Other Assets		103,702						101,527					
Total Assets	$	1,737,211					$	1,552,763					
Liabilities & Shareholders' Equity													
Interest Bearing Deposits:													
Interest Bearing DDA	$	149,413	$	87	0.23	%	$	129,699	$	31		0.10	%
Savings		368,048		660	0.72	%		318,553		761		0.96	%
Time Deposits		694,724		3,295	1.90	%		598,741		4,658		3.12	%
Total Interest Bearing Deposits		1,212,185		4,042	1.34	%		1,046,993		5,450		2.09	%
Securities Sold Under Agreement to Repurchase		60,000		535	3.58	%		45,778		378		3.31	%
Other Borrowed Funds		1,660		10	2.42	%		9,158		58		2.54	%
Subordinated Debentures		10,310		106	4.12	%		10,310		147		5.72	%
Total Interest Bearing Liabilities		1,284,155	$	4,693	1.47	%		1,112,239	$	6,033		2.18	%
Interest Rate Spread					4.32	%						4.28	%
Demand Deposits (Non-Interest Bearing)		265,466						263,102					
All Other Liabilities		24,543						27,696					
Total Liabilities		1,574,164						1,403,037					
Shareholders' Equity		163,047						149,726					
Total Liabilities & Shareholders' Equity	$	1,737,211					$	1,552,763					
Impact of Non-Interest Bearing Deposits and Other Liabilities					0.30	%						0.48	%
Net Interest Income and Margin on Total Earning Assets				18,561	4.62	%				17,011		4.77	%
Tax Equivalent Adjustment				(367	)					(366	)		
Net Interest Income			$	18,194	4.53	%			$	16,645		4.67	%

Notes: Yields on municipal securities have been calculated on a fully taxable equivalent basis. Loan interest income includes fee income and unearned discount in the amount of $446,000 and $490,000 for the quarters ended June 30, 2009 and 2008, respectively. Yields on securities available-for-sale are based on historical cost.

Farmers & Merchants Bancorp
Year-to-Date Average Balances and Interest Rates
(Interest and Rates on a Taxable Equivalent Basis)
(in thousands)

	Six Months Ended June 30, 2009			Six Months Ended June 30, 2008		
Assets	Balance	Interest	Rate	Balance	Interest	Rate
Federal Funds Sold	$ 54,700	$ 68	0.25 %	$ 4,060	$ 44	2.17 %
Investment Securities Available-for-Sale:						
Municipals - Non-Taxable	9,940	373	7.51 %	8,956	336	7.50 %
Mortgage Backed Securities	256,795	6,737	5.25 %	163,405	4,377	5.36 %
Other	7,167	9	0.25 %	3,546	152	8.57 %
Total Investment Securities Available-for-Sale	285,660	7,215	5.05 %	175,907	4,865	5.53 %
Investment Securities Held-to-Maturity:						
U.S. Agencies	0	0	0.00 %	30,412	635	4.18 %
Municipals - Non-Taxable	64,420	1,843	5.72 %	66,096	1,937	5.86 %
Mortgage Backed Securities	4,755	91	3.83 %	6,334	122	3.85 %
Other	1,991	28	2.81 %	2,002	26	2.60 %
Total Investment Securities Held-to-Maturity	71,166	1,962	5.51 %	104,844	2,720	5.19 %
Loans:						
Real Estate	681,745	22,399	6.63 %	658,119	22,859	6.97 %
Home Equity	66,031	1,997	6.10 %	64,929	2,223	6.87 %
Agricultural	206,503	6,331	6.18 %	180,728	6,756	7.50 %
Commercial	202,957	6,177	6.14 %	196,851	6,901	7.03 %
Consumer	11,027	396	7.24 %	12,657		