# SECURITIES AND EXCHANGE COMMISSION
**WASHINGTON, D.C. 20549**

# FORM 10-Q

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period March 31, 2014**

**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**<br>**(State or other jurisdiction of incorporation or organization)** | **34-1469491**<br>**(IRS Employer Identification No.)** |
| **307 North Defiance Street, Archbold, Ohio**<br>**(Address of principal executive offices)** | **43502**<br>**(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 ☒ 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 ☒ 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 | ☒ |
| 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 ☒

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 April 28, 2014 |

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10Q

FARMERS & MERCHANTS BANCORP, INC.
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(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.

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) March 31, 2014 | December 31, 2013 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | $ 20,670 | $ 15,376 |
| Interest bearing deposits with banks | 6,313 | 2,889 |
| Federal Funds Sold | 601 | 998 |
| Total cash and cash equivalents | 27,584 | 19,263 |
| Securities - available for sale (Note 3) | 307,725 | 324,509 |
| Other Securities, at cost | 3,717 | 4,216 |
| Loans, net (Note 4) | 577,547 | 570,919 |
| Bank premises and equipment | 18,540 | 18,709 |
| Goodwill | 4,074 | 4,074 |
| Mortgage Servicing Rights | 2,025 | 2,066 |
| Other Real Estate Owned | 1,844 | 2,091 |
| Accrued interest and other assets | 21,611 | 20,091 |
| **Total Assets** | $ 964,667 | $ 965,938 |
| **Liabilities and Stockholders' Equity** | | |
| **Liabilities** | | |
| Deposits | | |
| Noninterest-bearing | $ 115,404 | $ 110,452 |
| Interest-bearing | | |
| NOW accounts | 227,308 | 215,185 |
| Savings | 220,446 | 214,467 |
| Time | 227,106 | 236,360 |
| Total deposits | 790,264 | 776,464 |
| Federal funds purchased and securities sold under agreement to repurchase | 58,775 | 69,756 |
| FHLB Advances | — | 4,500 |
| Dividend payable | 967 | 967 |
| Accrued expenses and other liabilities | 6,099 | 5,911 |
| Total liabilities | 856,105 | 857,598 |
| **Stockholders' Equity** | | |
| Common stock - No par value - authorized 6,500,000 shares; issued & outstanding 5,200,000 shares | 12,677 | 12,677 |
| Treasury Stock - 565,902 shares 2014, 561,562 shares 2013 | (11,714) | (11,611) |
| Unearned Stock Awards - 31,260 shares 2014, 31,890 shares 2013 | (630) | (642) |
| Retained earnings | 108,898 | 107,910 |
| Accumulated other comprehensive income (loss) | (669) | 6 |
| Total stockholders' equity | 108,562 | 108,340 |
| **Total Liabilities and Stockholders' Equity** | $ 964,667 | $ 965,938 |

See Notes to Condensed Consolidated Unaudited Financial Statements.

Note: The December 31, 2013 Balance Sheet has been derived from the audited financial statements of that date.

FARMERS & MERCHANTS BANCORP, INC.
CONDENSED CONSOLIDATED STATEMENT OF INCOME & COMPREHENSIVE INCOME
(Unaudited)

**Farmers & Merchants Bancorp, Inc. and Subsidiary**

| | (in thousands of dollars, except per share data) Three Months Ended March 31, 2014 | March 31, 2013 |
|---|---|---|
| **Interest Income** | | |
| Loans, including fees | $ 6,676 | $ 6,078 |
| Debt securities: | | |
| U.S. Treasury securities | 63 | 61 |
| Securities of U.S. Government Agencies | 849 | 992 |
| Municipalites Municipalities | 525 | 508 |
| Dividends | 43 | 49 |
| Federal funds sold | — | 7 |
| Other | 3 | 7 |
| Total interest income | 8,159 | 7,702 |
| **Interest Expense** | | |
| Deposits | 878 | 1,127 |
| Federal funds purchased and securities sold under agreements to repurchase | 62 | 60 |
| Borrowed funds | 4 | 46 |
| Total interest expense | 944 | 1,233 |
| **Net Interest Income - Before provision for loan losses** | 7,215 | 6,469 |
| **Provision for Loan Losses (Note 4)** | 428 | 167 |
| **Net Interest Income After Provision For Loan Losses** | 6,787 | 6,302 |
| **Noninterest Income** | | |
| Customer service fees | 1,246 | 1,361 |
| Other service charges and fees | 792 | 862 |
| Net loss on sale of other assets owned | (39) | (16) |
| Net gain on sale of loans | 89 | 480 |
| Net gain on sale of securities - available for sale | 122 | 221 |
| Total noninterest income | 2,210 | 2,908 |
| **Noninterest Expenses** | | |
| Salaries and Wages | 2,434 | 2,437 |
| Pension and other employee benefits | 845 | 844 |
| Occupancy expense (net) | 303 | 330 |
| Furniture and equipment | 394 | 349 |
| Data processing | 314 | 310 |
| Franchise taxes | 195 | 255 |
| FDIC Assessment | 132 | 119 |
| Mortgage servicing rights amortization | 82 | 137 |
| Other general and administrative | 1,466 | 1,345 |
| Total Noninterest Expense | 6,165 | 6,126 |
| **Income Before Federal Income Taxes** | 2,832 | 3,084 |
| **Federal Income Taxes** | 874 | 932 |
| **Net Income** | 1,958 | 2,152 |
| **Other Comprehensive Income (Net of Tax):** | | |
| Unrealized loss on securities, net of tax benefit of $348 and $387 respectively | (675) | (750) |
| **Comprehensive Income** | $ 1,283 | $ 1,402 |
| **Basic Earnings Per Share** | $ 0.42 | $ 0.46 |
| **Weighted Average Shares Outstanding** | 4,637,172 | 4,683,659 |
| **Dividends Declared** | $ 0.21 | $ 0.20 |

FARMERS & MERCHANTS BANCORP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

**Farmers & Merchants Bancorp, Inc. and Subsidiary**

| | Condensed Consolidated Statements of Cash Flows (in thousands of dollars) Three Months Ended | |
|---|---|---|
| | March 31, 2014 | March 31, 2013 |
| **Cash Flows from Operating Activities** | | |
| Net income | $ 1,958 | $ 2,152 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 361 | 304 |
| Accretion and amortization of securities, net | 419 | 635 |
| Amortization of servicing rights | 82 | 137 |
| Amortization of core deposit intangible | 120 | 78 |
| Compensation expense related to stock awards | (61) | 46 |
| Provision for loan loss | 428 | 167 |
| Gain on sale of loans | (89) | (480) |
| Originations of loans held for sale | (4,523) | (24,051) |
| Proceeds from sale of loans held for sale | 4,942 | 27,412 |
| Loss on sale of other assets | 39 | 16 |
| Gain on sales of securities available for sale | (122) | (221) |
| Change in other assets and other liabilities, net | (877) | (641) |
| Net cash provided by operating activities | 2,677 | 5,554 |
| **Cash Flows from Investing Activities** | | |
| Activity in securities: | | |
| Maturities, prepayments and calls | 6,799 | 13,402 |
| Securities | 9,169 | 35,131 |
| Purchases | — | (54,850) |
| Additions to premises and equipment | (192) | (427) |
| Loan originations and principal collections, net | (7,386) | 13,166 |
| Net cash provided by investing activities | 8,390 | 6,422 |
| **Cash Flows from Financing Activities** | | |
| Net increase in deposits | 13,800 | 9,194 |
| Net change in short-term debt | (10,981) | (2,225) |
| Repayments of FHLB advances | (4,500) | (4,500) |
| Purchase of Treasury Stock | (98) | (77) |
| Cash dividends paid on common stock | (967) | (931) |
| Net cash provided by (used in) financing activities | (2,746) | 1,461 |
| Increase in Cash and Cash Equivalents | 8,321 | 13,437 |
| Cash and cash equivalents - Beginning of year | 19,263 | 44,092 |
| Cash and cash equivalents - End of period | $ 27,584 | $ 57,529 |
| **Supplemental Information** | | |
| Cash paid during the year for: | | |
| Interest | $ 1,034 | $ 1,212 |
| Income taxes | $ 77 | $ — |
| Noncash investing activities: | | |
| Transfer of loans to other real estate owned | $ 110 | $ 75 |

See 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 three months ended March 31, 2014 are not necessarily indicative of the results that are expected for the year ended December 31, 2014. 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, 2013.

## NOTE 2 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.

An office was purchased on December 13, 2013 in Custar, Ohio. Core deposit intangible assets of $1.17 million were recognized and are being amortized over its remaining economic useful life of the deposits of 7 years on a straight line basis.

The amortization expense for the year ended December 31, 2013 was $319 thousand. Of the $480 thousand to be expensed in 2014, $120 thousand has been expensed as of March 31, 2014.

| | (In Thousands) | | | |
|---|---|---|---|---|
| | Knisley | Hicksville | Custar | Total |
| 2014 | $ 157 | $ 156 | $ 167 | $ 480 |
| 2015 | — | 155 | 167 | 322 |
| 2016 | — | 155 | 167 | 322 |
| 2017 | — | 77 | 167 | 244 |
| 2018 | — | — | 167 | 167 |
| Thereafter | — | — | 330 | 330 |
| | $ 157 | $ 543 | $1,165 | $1,865 |

NOTE 3 SECURITIES

The amortized cost and fair value of securities, with gross unrealized gains and losses, follows:

| | (In Thousands) March 31, 2014 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Market Value |
| Available-for-Sale: | | | | |
| U.S. Treasury | $ 26,009 | $ — | $ (780) | $ 25,229 |
| U.S. Government agency | 161,535 | 1,098 | (2,767) | 159,866 |
| Mortgage-backed securities | 42,478 | 661 | (324) | 42,815 |
| State and local governments | 78,717 | 1,745 | (647) | 79,815 |
| | $308,739 | $ 3,504 | $ (4,518) | $307,725 |

| | (In Thousands) December 31, 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Market Value |
| Available-for-Sale: | | | | |
| U.S. Treasury | $ 26,067 | $ — | $ (795) | $ 25,272 |
| U.S. Government agency | 174,772 | 1,386 | (3,186) | 172,972 |
| Mortgage-backed securities | 44,638 | 728 | (574) | 44,792 |
| State and local governments | 79,023 | 2,909 | (459) | 81,473 |
| | $324,500 | $ 5,023 | $ (5,014) | $324,509 |

Investment securities will at times depreciate to an unrealized loss position. The Bank utilizes the following criteria to assess whether impairment is other than temporary. No one item by itself will necessarily signal that a security should be recognized as an other than temporary impairment.

1. The fair value of the security has significantly declined from book value.
2. A downgrade has occurred that lowered the credit rating to below investment grade (below Baa3 by Moody and BBB – by Standard and Poors.)
3. Dividends have been reduced or eliminated or scheduled interest payments have not been made.
4. The underwater security has longer than 10 years to maturity and the loss position had existed for more than 3 years.
5. Management does not possess both the intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

If the impairment is judged to be other than temporary, the cost basis of the individual security shall be written down to fair value, thereby establishing a new cost basis. The new cost basis shall not be changed for subsequent recoveries in fair value. The amount of the write down shall be included in current earnings as a realized loss. The recovery in fair value, if any, shall be recognized in earnings when the security is sold. The table below is presented by category of security and length of time in a continuous loss position. The Bank currently does not hold any securities with other than temporary impairment.

Information pertaining to securities with gross unrealized losses at March 31, 2014 and December 31, 2013, aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

NOTE 3 SECURITIES (Continued)

| | (In Thousands) March 31, 2014 | | | |
|---|---|---|---|---|
| | Less Than Twelve Months | | Twelve Months & Over | |
| | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |
| U.S. Treasury | $ (780) | $ 25,229 | $ — | $ — |
| U.S. Government agency | (2,412) | 92,561 | (355) | 4,646 |
| Mortgage-backed securities | (324) | 20,008 | — | — |
| State and local governments | (626) | 22,847 | (21) | 389 |
| Total available-for-sale securities | $ (4,142) | $160,645 | $ (376) | $5,035 |

| | (In Thousands) December 31, 2013 | | | |
|---|---|---|---|---|
| | Less Than Twelve Months | | Twelve Months & Over | |
| | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |
| U.S. Treasury | $ (795) | $ 25,272 | $ — | $ — |
| U.S. Government agency | (2,783) | 96,241 | (403) | 4,598 |
| Mortgage-backed securities | (574) | 23,171 | — | — |
| State and local governments | (459) | 19,594 | — | — |
| Total available-for-sale securities | $ (4,611) | $164,278 | $ (403) | $4,598 |

Unrealized losses on securities have not been recognized into income because the issuers' bonds are of high credit quality and the Bank has the intent and ability to hold the securities for the foreseeable future. The fair value is *ex*pected to recover as the bonds approach the maturity date.

Below are the gross realized gains and losses as of March 31 for each of the years presented.

| | (In Thousands) 2014 | 2013 |
|---|---|---|
| Gross realized gains | $ 122 | $ 224 |
| Gross realized losses | — | (3) |
| Net realized gains | $ 122 | $ 221 |
| Tax expense related to net realized gains | $ 42 | $ 75 |

The net realized gain on sales and related tax expense is a reclassification out of accumulated other comprehensive income. The net realized gain is included in net gain on sale of securities available for sale and the related tax expense is included in income tax expense in the condensed consolidated statements of income and comprehensive income.

The amortized cost and fair value of debt securities at March 31, 2014, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

NOTE 3 SECURITIES (Continued)

| | (In Thousands) Amortized Cost | Fair Value |
|---|---|---|
| One year or less | $ 13,677 | $ 13,924 |
| After one year through five years | 169,784 | 170,039 |
| After five years through ten years | 74,346 | 72,885 |
| After ten years | 8,454 | 8,062 |
| Total | $266,261 | $264,910 |
| Mortgage-backed securities | 42,478 | 42,815 |
| Total | $308,739 | $307,725 |

Investments with a carrying value and fair value of $216.1 million at March 31, 2014 and $205.2 million at December 31, 2013 were pledged to secure public deposits and securities sold under repurchase agreements.

Other securities include Federal Home Loan Bank of Cincinnati and Farmer Mac stock as of March 31, 2014. Federal Home Loan Bank of Indianapolis stock which was acquired in the Knisely acquisition, completely redeemed in early 2013. The stock acquired had a five-year redemption period. The stock is carried at cost, which approximates fair value.

NOTE 4 LOANS

The Company had $226 thousand in loans held for sale as of March 31, 2014 as compared to $556 thousand in loans held for sale on December 31, 2013. Due to lack of materiality, these loans are included in the Consumer Real Estate loans below.

Loan balances as of March 31, 2014 and December 31, 2013:

| Loans: | (In Thousands) March 31, 2014 | December 31, 2013 |
|---|---|---|
| Commercial real estate | $ 261,634 | $ 248,893 |
| Agricultural real estate | 49,629 | 44,301 |
| Consumer real estate | 91,368 | 92,438 |
| Commercial and industrial | 90,024 | 99,498 |
| Agricultural | 64,859 | 65,449 |
| Consumer | 21,322 | 21,406 |
| Industrial Development Bonds | 4,334 | 4,358 |
| | 583,170 | 576,343 |
| Less: Net deferred loan fees and costs | (298) | (230) |
| | 582,872 | 576,113 |
| Less: Allowance for loan losses | (5,325) | (5,194) |
| Loans - Net | $ 577,547 | $ 570,919 |

NOTE 4 LOANS (Continued)

The following is a maturity schedule by major category of loans as of March 31, 2014:

| | Maturities (In Thousands) | | |
|---|---|---|---|
| | Within One Year | After One Year Within Five Years | After Five Years |
| Commercial Real Estate | $46,874 | $ 98,903 | $115,857 |
| Agricultural Real Estate | 2,986 | 15,099 | 31,544 |
| Consumer Real Estate | 9,786 | 16,834 | 64,748 |
| Commercial/Industrial | 49,684 | 34,923 | 5,417 |
| Agricultural | 40,408 | 20,987 | 3,464 |
| Consumer | 5,316 | 12,318 | 3,688 |
| Industrial Development Bonds | 1,933 | 542 | 1,859 |

The distribution of fixed rate loans and variable rate loans by major loan category is as follows as of March 31, 2014. 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 | $170,058 | $91,576 |
| Agricultural Real Estate | 35,240 | 14,389 |
| Consumer Real Estate | 74,606 | 16,762 |
| Commercial/Industrial | 68,909 | 21,115 |
| Agricultural | 60,876 | 3,983 |
| Consumer | 17,194 | 4,128 |
| Industrial Development Bonds | 4,137 | 197 |

As of March 31, 2014 and December 31, 2013 one to four family residential mortgage loans amounting to $22.9 and $24.2 million, respectively, have been pledged as security for loans the Bank has received from the Federal Home Loan Bank.

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

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 March 31, 2014 and December 31, 2013, net of deferred fees:

(In Thousands)

| March 31, 2014 | 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 |
|---|---|---|---|---|---|---|---|
| Consumer Real Estate | $ 784 | $ — | $ 116 | $ 900 | $ 90,468 | $ 91,368 | $ — |
| Agricultural Real Estate | — | — | — | — | 49,629 | 49,629 | — |
| Agricultural | — | 5 | — | 5 | 64,854 | 64,859 | — |
| Commercial Real Estate | 1,102 | 94 | 32 | 1,228 | 260,406 | 261,634 | — |
| Commercial and Industrial | 62 | 41 | — | 103 | 94,255 | 94,358 | — |
| Consumer | 32 | — | — | 32 | 20,992 | 21,024 | — |
| Total | $ 1,980 | $ 140 | $ 148 | $ 2,268 | $ 580,604 | $ 582,872 | $ — |

| December 31, 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 |
|---|---|---|---|---|---|---|---|
| Consumer Real Estate | $ 778 | $ — | $ 234 | $ 1,012 | $ 91,426 | $ 92,438 | $ — |
| Agricultural Real Estate | — | — | — | — | 44,301 | 44,301 | — |
| Agricultural | — | — | — | — | 65,449 | 65,449 | — |
| Commercial Real Estate | — | — | 373 | 373 | 248,520 | 248,893 | — |
| Commercial and Industrial | — | — | 26 | 26 | 103,830 | 103,856 | — |
| Consumer | 28 | 2 | — | 30 | 21,146 | 21,176 | — |
| Total | $ 806 | $ 2 | $ 633 | $ 1,441 | $ 574,672 | $ 576,113 | $ — |

NOTE 4 LOANS (Continued)

The following table presents the recorded investment in nonaccrual loans by class of loans as of March 31, 2014 and December 31, 2013:

| | (In Thousands) March 31 2014 | (In Thousands) December 31 2013 |
|---|---|---|
| Consumer Real Estate | $ 379 | $ 483 |
| Agricultural Real Estate | — | — |
| Agricultural | — | — |
| Commercial Real Estate | 1,875 | 2,436 |
| Commercial and Industrial | 361 | 410 |
| Consumer | — | — |
| Total | $ 2,615 | $ 3,329 |

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

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.

NOTE 4 LOANS (Continued)

The following table represents the risk category of loans by class based on the most recent analysis performed as of March 31, 2014 and December 31, 2013:

| | (In Thousands) | | | | |
|---|---|---|---|---|---|
| | Agricultural Real Estate | Agricultural | Commercial Real Estate | Commercial and Industrial | Industrial Development Bonds |
| March 31, 2014 | | | | | |
| 1-2 | $ 3,510 | $ 6,803 | $ 1,113 | $ 1,817 | $ — |
| 3 | 15,139 | 25,732 | 53,771 | 20,615 | 3,845 |
| 4 | 30,363 | 32,304 | 199,701 | 64,399 | 489 |
| 5 | 584 | 20 | 1,978 | 2,074 | — |
| 6 | 33 | — | 5,039 | 717 | — |
| 7 | | — | 32 | 402 | — |
| 8 | — | — | — | — | — |
| Total | $ 49,629 | $ 64,859 | $ 261,634 | $ 90,024 | $ 4,334 |

| | Agricultural Real Estate | Agricultural | Commercial Real Estate | Commercial and Industrial | Industrial Development Bonds |
|---|---|---|---|---|---|
| December 31, 2013 | | | | | |
| 1-2 | $ 3,764 | $ 9,263 | $ 1,104 | $ 2,525 | $ — |
| 3 | 14,588 | 27,212 | 55,060 | 21,610 | 3,869 |
| 4 | 25,186 | 28,974 | 182,277 | 72,059 | 489 |
| 5 | 729 | — | 4,987 | 2,119 | — |
| 6 | 34 | — | 5,092 | 758 | — |
| 7 | — | — | 373 | 427 | — |
| 8 | — | — | — | — | — |
| Total | $ 44,301 | $ 65,449 | $ 248,893 | $ 99,498 | $ 4,358 |

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 March 31, 2014 and December 31, 2013.

| | (In Thousands) Consumer Real Estate March 31 2014 | Consumer Real Estate December 31 2013 |
|---|---|---|
| Grade | | |
| Pass | $ 91,178 | $ 92,226 |
| Special Mention (5) | — | — |
| Substandard (6) | 81 | 18 |
| Doubtful (7) | 109 | 194 |
| Total | $ 91,368 | $ 92,438 |

| | (In Thousands) | | | |
|---|---|---|---|---|
| | Consumer - Credit | | Consumer - Other | |
| | March 31 2014 | December 31 2013 | March 31 2014 | December 31 2013 |
| Performing | $ 3,497 | $ 3,721 | $17,507 | $ 17,425 |
| Nonperforming | — | — | 20 | 30 |
| Total | $ 3,497 | $ 3,721 | $17,527 | $ 17,455 |

Information about impaired loans as of March 31, 2014, December 31, 2013 and March 31, 2013 are as follows:

| | (In Thousands) | | |
|---|---|---|---|
| | March 31, 2014 | December 31, 2013 | March 31, 2013 |
| Impaired loans without a valuation allowance | $ 1,116 | $ 924 | $ 1,119 |
| Impaired loans with a valuation allowance | 943 | 1,516 | 3,025 |
| Total impaired loans | $ 2,059 | $ 2,440 | $ 4,144 |
| Valuation allowance related to impaired loans | $ 261 | $ 516 | $ 860 |
| Total non-accrual loans | $ 2,615 | $ 3,329 | $ 4,582 |
| Total loans past-due ninety days or more and still accruing | $ — | $ — | $ 3 |
| Quarter ended average investment in impaired loans | $ 2,312 | $ 2,532 | $ 4,321 |
| Year to date average investment in impaired loans | $ 2,312 | $ 3,274 | $ 4,321 |

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

The Bank had approximately $974 thousand of its impaired loans classified as troubled debt restructured as of March 31, 2014, $861.2 thousand as of December 31, 2013 and $670 thousand as of March 31, 2013.

NOTE 4 LOANS (Continued)

The following table represents three months ended March 31, 2014.

| March 31, 2014<br>Troubled Debt Restructurings | Number of Contracts Modified in the Last 3 Months | (In Thousands)<br>Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Ag Real Estate | 2 | $ 153 | $ 141 |

| Troubled Debt Restructurings That Subsequently Defaulted | Number of Contracts Modified in the Last 3 Months | Recorded Investment |
|---|---|---|
| Commercial Real Estate | — | $ — |
| Ag Real Estate | — | $ — |
| Commercial and Industrial | — | $ — |

The following table represents three months ended March 31, 2013.

| March 31, 2013<br>Troubled Debt Restructurings | Number of Contracts Modified in the Last 3 Months | (In Thousands)<br>Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Commercial and Industrial | 1 | $ 81 | $ 43 |

| Troubled Debt Restructurings That Subsequently Defaulted | Number of Contracts Modified in the Last 3 Months | Recorded Investment |
|---|---|---|
| Commercial Real Estate | — | $ — |
| Ag Real Estate | — | $ — |
| Commercial and Industrial | — | $ — |

NOTE 4 LOANS (Continued)

For the majority of the Bank's impaired loans, the Bank will apply the observable market price methodology. However, the Bank may also utilize a measurement incorporating the present value of expected future cash flows discounted at the loan's effective rate of interest. To determine observable market price, collateral asset values securing an impaired loan are periodically evaluated. Maximum time for re-evaluation is every 12 months for chattels and titled vehicles and every two years for real estate. In this process, third party evaluations are obtained and heavily relied upon. Until such time that updated appraisals are received, the Bank may discount the collateral value used.

The Bank uses the following guidelines as stated in policy to determine when to realize a charge-off, whether a partial or full loan balance. A charge-off in whole or in part is realized when unsecured consumer loans, credit card credits and overdraft lines of credit reach 90 days delinquency. At 120 days delinquent, secured consumer loans are charged down to the value of the collateral, if repossession of the collateral is assured and/or in the process of repossession. Consumer mortgage loan deficiencies are charged down upon the sale of the collateral or sooner upon the recognition of collateral deficiency. Commercial and agricultural credits are charged down at 120 days delinquency, unless an established and approved work-out plan is in place or litigation of the credit will likely result in recovery of the loan balance. Upon notification of bankruptcy, unsecured debt is charged off. Additional charge-off may be realized as further unsecured positions are recognized.

The following table presents loans individually evaluated for impairment by class of loans for three months ended March 31, 2014

| Three Months Ended March 31, 2013 | (In Thousands) Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Consumer real estate | $ 72 | $ 72 | $ — | $ 145 | $ — |
| Agricultural real estate | 141 | 141 | — | 328 | — |
| Agricultural | — | — | — | — | — |
| Commercial real estate | 904 | 904 | — | 2,112 | 14 |
| Commercial and industrial | — | — | — | 25 | 9 |
| Consumer | — | — | — | — | — |
| With a specific allowance recorded: | | | | | |
| Consumer real estate | 109 | 109 | 44 | 523 | 1 |
| Agricultural real estate | — | — | — | 177 | — |
| Agricultural | — | — | — | — | — |
| Commercial real estate | 481 | 481 | 107 | 284 | — |
| Commercial and industrial | 352 | 352 | 110 | 1,968 | 7 |
| Consumer | — | — | — | — | — |
| Totals: | | | | | |
| Consumer real estate | $ 181 | $ 181 | $ 44 | $ 668 | $ 1 |
| Agricultural real estate | $ 141 | $ 141 | $ — | $ 505 | $ — |
| Agricultural | $ — | $ — | $ — | $ — | $ — |
| Commercial real estate | $ 1,385 | $ 1,385 | $ 107 | $ 2,396 | $ 14 |
| Commercial and industrial | $ 352 | $ 352 | $ 110 | $ 1,993 | $ 16 |
| Consumer | $ — | $ — | $ — | $ — | $ — |

NOTE 4 LOANS (Continued)

| Three Months Ended March 31, 2013 | Recorded Investment (In Thousands) | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Consumer real estate | $ 33 | $ 33 | $ — | $ 60 | $ 1 |
| Agricultural real estate | — | — | — | — | — |
| Agricultural | — | — | — | — | — |
| Commercial real estate | 801 | 1,225 | — | 207 | — |
| Commercial and industrial | 285 | 285 | — | 286 | — |
| Consumer | — | — | — | — | — |
| With a specific allowance recorded: | | | | — | |
| Consumer real estate | 277 | 349 | 79 | 131 | 3 |
| Agricultural real estate | — | — | — | — | — |
| Agricultural | — | — | — | — | — |
| Commercial real estate | 44 | 64 | 29 | 650 | — |
| Commercial and industrial | 2,704 | 2,704 | 751 | 2,743 | — |
| Consumer | — | — | — | — | — |
| Totals: | | | | | |
| Consumer real estate | $ 310 | $ 382 | $ 79 | $ 191 | $ 4 |
| Agricultural real estate | $ — | $ — | $ — | $ — | $ — |
| Agricultural | $ — | $ — | $ — | $ — | $ — |
| Commercial real estate | $ 845 | $ 1,289 | $ 29 | $ 857 | $ — |
| Commercial and industrial | $ 2,989 | $ 2,989 | $ 751 | $ 3,029 | $ — |
| Consumer | $ — | $ — | $ — | $ — | $ — |

The ALLL has a direct impact on the provision expense. An increase in the ALLL is funded through recoveries and provision expense. The following tables summarize the activities in the allowance for credit losses.

| | Three Months Ended March 31, 2014 (In Thousands) | Twelve Months Ended December 31, 2013 |
|---|---|---|
| Allowance for Loan Losses | | |
| Balance at beginning of year | $ 5,194 | $ 5,224 |
| Provision for loan loss | 428 | 858 |
| Loans charged off | (366) | (1,262) |
| Recoveries | 69 | 374 |
| Allowance for Loan & Lease Losses | $ 5,325 | $ 5,194 |
| Allowance for Unfunded Loan Commitments & Letters of Credit | $ 180 | $ 163 |
| Total Allowance for Credit Losses | $ 5,505 | $ 5,357 |

The Company segregates its Allowance for Loan and Lease Losses (ALLL) into two reserves: The ALLL and the Allowance for Unfunded Loan Commitments and Letters of Credit (AULC). When combined, these reserves constitute the total Allowance for Credit Losses (ACL).

The AULC is reported within other liabilities on the balance sheet while the ALLL is netted within the loans, net asset line. The ACL presented above represents the full amount of reserves available to absorb possible credit losses.

NOTE 4 LOANS (Continued)

The following table breaks down the activity within ACL for each loan portfolio segment and shows the contribution provided by both the recoveries and the provision along with the reduction of the allowance caused by charge-offs.

Additional analysis related to the allowance for credit losses for three months ended March 31, 2014 is as follows:

| | (In Thousands) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Consumer Real Estate | Agricultural Real Estate | Agricultural | Commercial Real Estate | Commercial and Industrial | Consumer | Unfunded Loan Commitment & Letters of Credit | Unallocated | Total |
| **Three Months Ended March 31, 2014** | | | | | | | | | |
| **ALLOWANCE FOR CREDIT LOSSES:** | | | | | | | | | |
| Beginning balance | $ 257 | $ 131 | $ 326 | $ 2,107 | $ 1,359 | $ 292 | $ 163 | $ 722 | $ 5,357 |
| Charge Offs | (64) | — | — | (201) | — | (101) | — | — | $ (366) |
| Recoveries | 10 | — | 1 | 2 | 5 | 51 | — | — | $ 69 |
| Provision (Credit) | 199 | — | (3) | 50 | (34) | 28 | — | 188 | $ 428 |
| Other Non-interest expense related to unfunded | — | — | — | — | — | — | 17 | — | $ 17 |
| Ending Balance | $ 402 | $ 131 | $ 324 | $ 1,958 | $ 1,330 | $ 270 | $ 180 | $ 910 | $ 5,505 |
| Ending balance: individually evaluated for impairment | $ 44 | $ — | $ — | $ 107 | $ 110 | $ — | $ — | $ — | $ 261 |
| Ending balance: collectively evaluated for impairment | $ 358 | $ 131 | $ 324 | $ 1,851 | $ 1,220 | $ 270 | $ 180 | $ 910 | $ 5,244 |
| Ending balance: loans acquired with deteriorated credit quality | $ 2 | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 2 |
| **FINANCING RECEIVABLES:** | | | | | | | | | |
| Ending balance | $ 91,368 | $ 49,629 | $ 64,859 | $ 261,634 | $ 94,358 | $ 21,024 | $ — | $ — | $582,872 |
| Ending balance: individually evaluated for impairment | $ 181 | $ 141 | $ — | $ 1,385 | $ 352 | $ — | $ — | $ — | $ 2,059 |
| Ending balance: collectively evaluated for impairment | $ 91,187 | $ 49,488 | $ 64,859 | $ 260,249 | $ 94,006 | $ 21,024 | $ — | $ — | $580,813 |
| Ending balance: loans acquired with deteriorated credit quality | $ 536 | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 536 |

NOTE 4 LOANS (Continued)

| (In Thousands) | Consumer Real Estate | Agricultural Real Estate | Agricultural | Commercial Real Estate | Commercial and Industrial | Consumer | Unfunded Loan Commitment & Letters of Credit | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Three Months Ended March 31, 2013** | | | | | | | | | |
| **ALLOWANCE FOR CREDIT LOSSES:** | | | | | | | | | |
| Beginning balance | $ 368 | $ 113 | $ 290 | $ 1,749 | $ 2,183 | $ 268 | $ 162 | $ 253 | $ 5,386 |
| Charge Offs | (10) | — | — | (20) | — | (86) | — | — | $ (116) |
| Recoveries | 4 | — | 1 | — | 15 | 49 | — | — | $ 69 |
| Provision (Credit) | 101 | (8) | (31) | (163) | (226) | 25 | — | 469 | $ 167 |
| Other Non-interest expense related to unfunded | — | — | — | — | — | — | 10 | — | $ 10 |
| Ending Balance | $ 463 | $ 105 | $ 260 | $ 1,566 | $ 1,972 | $ 256 | $ 172 | $ 722 | $ 5,516 |
| Ending balance: individually evaluated for impairment | $ 79 | $ — | $ — | $ 29 | $ 752 | $ — | $ — | $ — | $ 860 |
| Ending balance: collectively evaluated for impairment | $ 384 | $ 105 | $ 260 | $ 1,537 | $ 1,220 | $ 256 | $ 172 | $ 722 | $ 4,656 |
| Ending balance: loans acquired with deteriorated credit quality | $ 2 | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 2 |
| **FINANCING RECEIVABLES:** | | | | | | | | | |
| Ending balance | $ 77,160 | $ 35,898 | $ 51,896 | $ 209,601 | $ 90,981 | $ 19,292 | $ — | $ — | $484,828 |
| Ending balance: individually evaluated for impairment | $ 310 | $ — | $ — | $ 845 | $ 2,990 | $ — | $ — | $ — | $ 4,145 |
| Ending balance: collectively evaluated for impairment | $ 76,850 | $ 35,898 | $ 51,896 | $ 208,756 | $ 87,991 | $ 19,292 | $ — | $ — | $480,683 |
| Ending balance: loans acquired with deteriorated credit quality | $ 556 | $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ 556 |

## NOTE 5 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.

#### 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 March 31, 2014 and December 31, 2013 are reflected below.

| | (In Thousands) March 2014 | | | | |
|---|---|---|---|---|---|
| | Carrying Amount | Fair Value | Level 1 | Level 2 | Level 3 |
| Financial Assets: | | | | | |
| Cash and Cash Equivalents | $ 27,584 | $ 27,584 | $27,584 | $ — | $ — |
| Securities - available for sale | 307,725 | 307,725 | 25,229 | 273,840 | 8,656 |
| Other Securities | 3,717 | 3,717 | — | — | 3,717 |
| Loans, net | 577,547 | 587,274 | — | — | 587,274 |
| Interest receivable | 4,117 | 4,117 | — | — | 4,117 |
| Total Assets | $920,690 | $930,417 | $52,813 | $273,840 | $603,764 |
| Financial Liabilities: | | | | | |
| Interest bearing Deposits | $447,754 | $448,888 | $ — | $ — | $448,888 |
| Non-interest bearing Deposits | 115,404 | 114,877 | — | 114,877 | — |
| Time Deposits | 227,106 | 241,322 | — | — | 241,322 |
| Total Deposits | $790,264 | $805,087 | $ — | $114,877 | $690,210 |
| Short-term debt | 58,775 | 58,775 | — | — | 58,775 |
| Interest payable | 216 | 216 | — | — | 216 |
| Dividends payable | 967 | 967 | — | 967 | — |
| Total Liabilities | $850,222 | $865,045 | $ — | $115,844 | $749,201 |

NOTE 5 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

| | (In Thousands) December 2013 | | | | |
|---|---|---|---|---|---|
| | Carrying Amount | Fair Value | Level 1 | Level 2 | Level 3 |
| Financial Assets: | | | | | |
| Cash and Cash Equivalents | $ 19,263 | $ 19,263 | $19,263 | $ — | $ — |
| Securities - available for sale | 324,509 | 324,509 | 25,272 | 288,891 | 10,346 |
| Other Securities | 4,216 | 4,216 | — | — | 4,216 |
| Loans, net | 570,919 | 579,992 | — | — | 579,992 |
| Interest receivable | 3,694 | 3,694 | — | — | 3,694 |
| Total Assets | $922,601 | $931,674 | $44,535 | $288,891 | $598,248 |
| Financial Liabilities: | | | | | |
| Interest bearing Deposits | $429,652 | $429,750 | $ — | $ — | $429,750 |
| Non-interest bearing Deposits | 110,452 | 111,239 | — | 111,239 | — |
| Time Deposits | 236,360 | 236,027 | — | — | 236,027 |
| Total Deposits | $776,464 | $777,016 | $ — | $111,239 | $665,777 |
| Short-term debt | 69,756 | 69,756 | — | — | 69,756 |
| Federal Home Loan Bank advances | 4,500 | 4,570 | — | — | 4,570 |
| Interest payable | 223 | 223 | — | — | 223 |
| Dividends payable | 967 | 967 | — | 967 | — |
| Total Liabilities | $851,910 | $852,532 | $ — | $112,206 | $740,326 |

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.

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. The Bank holds some local municipals that the Bank evaluates based on the credit strength of the underlying project such as hospital or retirement housing. 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.

NOTE 5 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 March 31, 2014 and December 31, 2013, 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 (In Thousands)

| March 31, 2014 | 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 | $ 25,229 | $ — | $ — |
| U.S. Government agency | | 159,866 | — |
| Mortgage-backed securities | | 42,815 | — |
| State and local governments | — | 71,159 | 8,656 |
| Total Securities Available for Sale | $ 25,229 | $273,840 | $ 8,656 |

| December 31, 2013 | 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 | $ 25,272 | $ — | $ — |
| U.S. Government agency | — | 172,972 | |
| Mortgage-backed securities | — | 44,792 | — |
| State and local governments | — | 71,127 | 10,346 |
| Total Securities Available for Sale | $ 25,272 | $288,891 | $ 10,346 |

NOTE 5 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The following table represents the changes in the Level 3 fair-value category of which unobservable inputs are relied upon as of March 31, 2014 and March 31, 2013.

| | (In Thousands) Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | | |
|---|---|---|---|
| | State and Local Governments Tax-Exempt | State and Local Governments Taxable | State and Local Governments Total |
| Balance at January 1, 2014 | $ 8,802 | $ 1,544 | $ 10,346 |
| Change in Market Value | (1,121) | (369) | (1,490) |
| Payments & Maturities | (200) | — | (200) |
| Balance at March 31, 2014 | $ 7,481 | $ 1,175 | $ 8,656 |

| | (In Thousands) Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | | |
|---|---|---|---|
| | State and Local Governments Tax-Exempt | State and Local Governments Taxable | State and Local Governments Total |
| Balance at January 1, 2013 | $ 14,863 | $ 1,545 | $ 16,408 |
| Change in Market Value | (504) | (26) | (530) |
| Purchases | 519 | — | 519 |
| Payments & Maturities | (4,388) | — | (4,388) |
| Balance at March 31, 2013 | $ 10,490 | $ 1,519 | $ 12,009 |

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 March 31, 2014 and December 31, 2013, 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.)

NOTE 5 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The following table presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements:

| | Fair Value at March 31, 2014 | Valuation Technique | Unobservable Inputs | Range (Weighted Average) |
|---|---|---|---|---|
| State and political subdivision securities | $ 8,656 | Discounted Cash Flow | Credit strength of underlying project or entity / Discount rate | 0-5% |
| Impaired Loans | 1,798 | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 0-50% |
| Other real estate owned - residential | 933 | Appraisals | Discount to reflect current market | 0-20% |
| Other real estate owned - commercial | 911 | Appraisals | Discount to reflect current market | 0-20% |

| | Fair Value at December 31, 2013 | Valuation Technique | Unobservable Inputs | Range (Weighted Average) |
|---|---|---|---|---|
| State and political subdivision securities | $ 10,346 | Discounted Cash Flow | Credit strength of underlying project or entity / Discount rate | 0-5% |
| Impaired Loans | 1,924 | Collateral based measurements | Discount to reflect current market conditions and ultimate collectability | 0-50% |
| Other real estate owned - residential | 964 | Appraisals | Discount to reflect current market | 0-20% |
| Other real estate owned - commercial | 1,127 | Appraisals | Discount to reflect current market | 0-20% |

At March 31, 2014 and December 31, 2013, impaired loans categorized as Level 3 were $1.8 and $1.9 million, respectively. The specific allocation for impaired loans was $261 and $516 thousand as of March 31, 2014 and December 31, 2013, 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.

NOTE 5 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The following table presents impaired loans and other real estate owned as recorded at fair value on March 31, 2014 and December 31, 2013:

| | Assets Measured at Fair Value on a Nonrecurring Basis at March 31, 2014 | | | |
|---|---|---|---|---|
| (In Thousands) | Balance at March 31, 2014 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Impaired loans | $ 1,798 | $ — | $ — | $ 1,798 |
| Other real estate owned residential mortgages | $ 933 | $ — | $ — | $ 933 |
| Other real estate owned commercial | $ 911 | $ — | $ — | $ 911 |

| | Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2013 | | | |
|---|---|---|---|---|
| (In Thousands) | Balance at December 31, 2013 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Impaired loans | $ 1,924 | $ — | $ — | $ 1,924 |
| Other real estate owned residential mortgages | $ 964 | $ — | $ — | $ 964 |
| Other real estate owned commercial | $ 1,127 | $ — | $ — | $ 1,127 |

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 March 31, 2014 and December 31, 2013, the Company estimates that there is no impairment of these assets.

## ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### INTRODUCTION

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 2014, please see the portion of Management's Discussion and Analysis of Financial Condition and Results of Operations captioned "2014 in Review".

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NATURE OF ACTIVITIES

The Bank's primary service area, Northwest Ohio and Northeast Indiana, continue to experience a higher level of unemployment as compared to the national average. However, both local and national averages are showing a slight downward trend. The agricultural industry continued its strong performance in 2013 as evidenced by strengthened financial statements. The automotive sector showed improvement with car dealers in our marketing area ending with more profitable numbers than in recent years. Overall, business profits are improving. Loan growth occurred during the fourth quarter of 2013 and first quarter 2014 and the Bank finally surpassed the loan balances of yearend 2012 along with first quarter 2013 and yearend 2013. New 1-4 family residential and construction remain weak and refinancing activity is also below the level of same period 2013.

The Bank acquired its 21st office during the fourth quarter of 2013. The office is located in Custar, Ohio and was a natural extension of the Bank's market area. The office provides the full range of services discussed below.

The Farmers & Merchants State Bank engages in general commercial banking and savings business including 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 the purchase of autos, trucks, recreational vehicles, motorcycles, and other consumer goods.

The Bank also provides checking account services, as well as savings and time deposit services such as certificates of deposits. In addition ATMs (Automated Teller Machines) are provided at most branch locations along with other independent locations such as major employers and hospitals in the market area. The Bank has custodial services for IRAs (Individual Retirement Accounts) and HSAs (Health Savings Accounts). The Bank provides on-line banking access for consumer and business customers. For consumers, this includes bill-pay, on-line statement opportunities and mobile banking. 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 and merchant credit card services. Mobile banking was added in 2012 and has been widely accepted and used by consumers.

The Bank has established underwriting policies and procedures which 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 not to promote innovative, unproven credit products which will not be in the best interest of the Bank or its customers. The Bank does offer a hybrid mortgage loan. Hybrid loans are loans that start out 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 normally retains the servicing rights 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. In addition, the Bank does sell some of its longer term fixed rate agricultural mortgages into the secondary market with the aid of a broker.

The Bank does not have a program to fund sub-prime loans. Sub-prime loans are characterized as a lending program or strategy that targets 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.

NATURE OF ACTIVITIES (Continued)

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 and 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 the 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.

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 wage 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.
The Bank will only make Qualified Mortgages as defined by the Truth in Lending Act and Regulation Z.
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 to 80% LTV.

NATURE OF ACTIVITIES (Continued)

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 up to 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, ATMs are provided at all of our Ohio and Indiana banking 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 in the town of 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 smaller communities located in the Ohio counties of Defiance, Fulton, Henry, Lucas, Williams and Wood and in the Indiana counties of DeKalb and Steuben. 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 and farm credit services and savings and loan institutions in each of their operating localities. In a number of 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 service 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 offices. The Bank opened an office in Waterville, Lucas County, Ohio in second quarter 2013 providing growth opportunity and extension of the market area. An additional office in Wood County was opened in fourth quarter 2013. The office was added through a single office acquisition and is located in Custar, Ohio.

At March 31, 2014, 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.

## FIRST Q 2014 IN REVIEW

Loan growth continued in the first quarter of 2014 even with the expected pay down of seasonal borrowings after yearend. This loan growth was preceded by a strong fourth quarter which included an office acquisition and increased borrowings in the commercial and agricultural real estate portfolios. This growth is important to the Company as a step in the right direction to improve its net interest income and margin.

FIRST Q 2014 IN REVIEW (Continued)

Net interest income improved during the first quarter of 2014 as compared to the first quarter of 2013 by $746 thousand. This was accomplished due to increased loan balances and lower borrowing levels for the quarter. Loan income was up $598 thousand and total interest expense down $289 thousand.

Offsetting the improvement in net interest income was a decrease in noninterest income. Loan sales in both the agricultural and 1-4 family portfolios decreased significantly in comparison to previous year, down almost $21 million. Net gain on sales of loans was therefore also down $391 thousand. In fact, in comparing first quarter 2014 to first quarter 2013, 2013 outperformed 2014 in all areas of noninterest income, ending the quarter with a total difference of $698 thousand. This was not an unexpected turn of events and is why loan growth is so vital to the Company going forward.

Total allowance provision for loan losses was $261 thousand higher than 2013. Loan growth and charge-offs warranted additional provision expense be taken in the first quarter. Impaired loans decreased $381 thousand from December 31, 2013 levels and down $2.1 million from March 31, 2013. The same comparison applied for nonaccrual loans, showing an improvement in lower balances by $714 thousand than December 31, 2013. Past due loans increased by $827 thousand in comparing March 31, 2014 to December 31, 2013 balances, with the majority in the first past due bucket of 30-59 days. Overall past dues remain at extremely low levels. In 2014, the Company continues to work on the collection of these loans and looks forward to maintaining the low exposure during 2014.

All rates remain low and are expected to remain low throughout 2014. This has enabled the Company to continue to sell investment securities and recognize a gain without compromising the yield. In 2013, the transactions had modestly extended the duration of the investment portfolio. Sales in 2014 have so far been used to fund loan growth and reinvestment into securities has not been necessary. For all of 2013, the recognized gain was $775 thousand, of which $221 thousand was recognized in the first quarter. For first quarter 2014, the Company has recognized gains of $122 thousand. Most of the securities sold were agencies maturing in a short time period. The Bank was able to continue to capitalize on the steepness of the yield curve and the unrealized market gain position the last three years. Additional sales throughout 2014 may be executed as needed to fund loan growth, which management expects to continue. The market value of the security portfolio has declined as evidenced by the high other comprehensive loss reported on the income statement and statement of comprehensive income. Additional opportunity to se1l investment securities for a gain may be limited for the remainder of 2014.

The majority of the Bank’s commercial borrowers have experienced slight improvement, although a few still lag. As the economic recovery remains fragile and consumer confidence still remains at lower levels, consumer sensitive industries and the retail sector may continue to experience pressures as well. The Company has seen improvement in unemployment levels throughout its market area. Announcement of employment expansions by local businesses have also improved the outlook for 2014.

Agriculture remained strong in 2013 and farmers have begun to protect their revenues for 2014 through hedges and the purchase of crop insurance. Prices have come down in commodities and farmers work to structure inputs to offset.

Overall, profitability in the first quarter of 2014 was down as compared to the same quarter last year. In comparisons, net income is down 9% or $194 thousand. Net interest income was up 11.5% over the same period 2013. The Company has done an exceptional job of growing loans while keeping past dues low. 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.

The Bank has been attentive to the significant final mortgage rules and additional guidance issued by the Consumer Financial Protection Bureau to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act provisions. Effective in January 2014, these rules are a game-changer which impacts the entire mortgage lending industry, as well as the Bank’s perspective on its mortgage lending business. The Bank continues to work toward fulfillment of applicable requirements for these new mortgage rules, as it gains further understanding of the complexities and inter-related nature of these rules, makes strategic decisions, and addresses key considerations necessary for implementation of each rule. The Company is also preparing for the implementation of Basel III capital rules which will begin phase in for the Company on January 1, 2015. These rules may impact the ability of some financial institutions to pay dividends, though the Company believes itself to be able to maintain its strong capital position and not be limited in that regard. Larger institutions, which the rule was designed for, were required to begin reporting as of January 1, 2014.

## 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.

These policies, along with the disclosures presented in the notes to the condensed consolidated financial statements and in the management discussion and analysis of the 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 require 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 fair value 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.

Foreclosed real estate for sale is carried at the lower of fair value minus estimated costs to sell, or cost. Costs of holding foreclosed real estate are charged to expense in the current period, except for significant property improvements, which are capitalized. Valuations are periodically performed by management and a write-down is recorded by a charge to non-interest expense if the carrying value exceeds the fair value minus estimated costs to sell. Foreclosed real estate is classified as other real estate owned. The net income from operations of foreclosed real estate held for sale is reported in non-interest income. At March 31, 2014, holdings were $1.8 million and were $2.1 million as of December 31, 2013 and $2.2 million as of March 31, 2013.

The ALLL represents management's estimate of probable credit losses inherent in the Bank's loan portfolio, unfunded loan commitments, and letters of credit at the report date. The ALLL methodology is regularly reviewed for its appropriateness and is approved annually by the Board of Directors. This written methodology is consistent with Generally Accepted Accounting Principles which provides for a consistently applied analysis.

The Bank's methodology provides an estimate of the probable credit losses either by calculating a specific loss per credit or by applying a composite of historical factors over a relevant period of time with current internal and external factors which may affect credit collectability. Such factors which may influence estimated losses are the conditions of the local and national economy, local unemployment trends, abilities of lending staff, valuation trends of fixed assets, and trends in credit delinquency, classified credits, and credit losses.

Inherent in most estimates is an imprecision. The Bank's ALLL provides a margin for imprecision with an unallocated amount.

CRITICAL ACCOUNTING POLICY AND ESTIMATES (Continued)

Bank regulatory agencies and external auditors periodically review the Bank's methodology and adequacy of the ALLL. Any required changes in the ALLL or loan charge-offs by these agencies or auditors may have a material effect on the ALLL.

The Company is 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.

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 effect 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, reviewed 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 valuation specialist can be directly tied back to the fact that management has only been required to record minor valuation allowances through its income statement over time based upon the valuation of each stratum of servicing 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.

## MATERIAL CHANGES IN FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

In comparing the balance sheet of March 31, 2014 to that of December 31, 2013, the cash equivalent liquidity of the Bank has increased by approximately $8.3 million and still remains strong. The increase in liquidity was facilitated by the office acquisition in the fourth quarter of 2013 of which deposits account for $29.5 million and loans only $11.4 million. During the three months of 2014, net loans have increased $6.6 million even with a $10 million decrease stemming from the repayment on a line of credit by a single borrowing relationship which was expected and which happens each year at this time. The fact that loan levels increased in light of the anticipated yearly reduction is a positive factor towards future improvement to profitability.

MATERIAL CHANGES IN FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES (Continued)

The Company's decrease in total assets of just $1.3 million was due to lower balances within securities on the asset side of $17.3 million and FHLB borrowings of $4.5 million. The Company has an unsecured borrowing capacity of $105.3 million through correspondent banks and over $76.6 million of unpledged securities which may be sold or used as collateral. The strength of the security portfolio is shown in the tables to follow. With the exception of stock, all of the Bank's security portfolio is categorized as available for sale and as such is recorded at market value.

A large fluctuation in the market value of the securities occurred during the first quarter causing the unrealized gain position to decrease significantly. Management recognized the change in the market early and was quick to capture a portion of the gain before it fluctuated to an unrealized loss position. Management feels confident that liquidity needs can easily be funded from an orderly runoff of the investment portfolio, along with other sources of funding.

As previously stated, net loans show an increase for the three months ended March 31, 2014, which reverses the trend in declining loan balances which the Bank had experienced all throughout fiscal year 2012 and up through the second quarter 2013. Growth came within commercial and agricultural real estate portfolios with the remaining portfolios showing decreases as comparing to yearend 2013. The balance of the decrease in the other loan portfolios was due to the pay down, payoff or refinancing of loans. Loan sales into the secondary market have also impacted the consumer and agricultural real estate portfolios though on a much smaller basis than in 2013. Year to date, the Bank has sold approximately $6.7 million of loans into the secondary market, while originating only $4.7 million of the loans during the same three-month period as demonstrated in the cash flow statement for the period. The majority of the activity stemmed from within the 1-4 family portfolio. The trend of decreasing loan balances is not unique to this year as the chart to follow shows the decreasing 2012-2013 trend and shows a large uptick for March 2014 as compared to March 2013. The Bank is also starting to generate a positive trend of increasing loan balances after our first quarter activity when comparing to yearend. The Bank's pipeline of loans has increased, driven by opportunities for new relationships as business activity begins to reflect a more optimistic opinion of the economy and large financial institutions downsize certain portfolios.

The chart below shows the breakdown of the loan portfolio by category as of March 31 for the last three years.

| | (In Thousands) | | |
|---|---|---|---|
| | March-14 Amount | March-13 Amount | March-12 Amount |
| Commercial Real Estate | $261,634 | $209,601 | $200,865 |
| Agricultural Real Estate | 49,629 | 35,898 | 31,814 |
| Consumer Real Estate | 91,368 | 77,160 | 79,716 |
| Commercial and Industrial | 90,024 | 89,779 | 103,915 |
| Agricultural | 64,859 | 51,896 | 54,084 |
| Consumer, Overdrafts and other loans | 21,322 | 19,292 | 21,652 |
| Industrial Development Bonds | 4,334 | 1,202 | 1,196 |
| Total Loans | $583,170 | $484,828 | $493,242 |

On a year to year comparison basis, the Commercial real estate portfolio shows the largest increase of $52.0 million in balance as of March 31, 2014 compared to March 31, 2013. Agricultural real estate shows an increase of $13.7 million. Consumer real estate showed the largest improvement in the consumer balances of $14.2 million. Overall, all categories of loans increased. Loans increased $98.3 million as compared to the same period last year and increased $89.9 million as compared to March 31, 2012.

Overall, total assets of the Company remained equivalent decreasing just $1.3 million from December 31, 2013 to March 31, 2014.

MATERIAL CHANGES IN FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES (Continued)

Deposits increased $13.8 million with the largest increase in the deposit portfolio of $12.1 million in the interest-bearing transaction portfolio due to the continuing popularity of the KASASA program. The largest decrease of $9.3 million was in the time deposits. The mix of the portfolio continued to transition to a higher level of core deposits as a result primarily of the Bank's offering of a high interest bearing transaction account along with an increase in health savings accounts.

The Certificate of Deposit (COD) portfolio has decreased $9.3 million during the first three months of 2014, which is part of the reason why the Bank continues to decrease the cost of funds. Through its pricing, the Bank has limited its attractiveness to short-term rate shoppers and foresees continuing this strategy through the 2014. This is demonstrated below in the section of this MD&A captioned "MATERIAL CHANGES IN RESULTS OF OPERATIONS - Interest Expense".

The Bank paid off $4.5 million in FHLB advances which had matured during 2014. This too should lower the cost of funds. Securities sold under agreement to repurchase decreased $11.0 million during the first three months of 2014 as compared to yearend.

Capital increased a modest $222 thousand from year-end during the three months of 2014. Positive earnings offset by a decrease in accumulated other comprehensive income and a dividend declaration are the factors behind the capital remaining basically equal to yearend. Comprehensive loss decreased $675 thousand which encompassed the shift of $122 thousand from unrealized gain to realized gain with the sale of securities. Dividends paid year-to-date were $36 thousand higher than the same period last year with a one cent increase per share being the reason.

The Company continues to be well-capitalized in accordance with Federal regulatory capital requirements as the capital ratios below show:

| | |
|---|---|
| Primary Ratio | 11.28% |
| Tier I Leverage Ratio | 10.78% |
| Risk Based Capital Tier I | 15.59% |
| Total Risk Based Capital | 16.42% |
| Stockholders' Equity/Total Assets | 11.25% |

MATERIAL CHANGES IN RESULTS OF OPERATIONS

Comparison of Results of Operation for three month periods ended March 31, 2014 and 2013.

Improvement in net interest income for the first quarter 2014 was not high enough to offset the loss of noninterest income. As a result, net income was $194 thousand lower than 2013's first quarter. The $598 thousand higher balance in interest and fees from loans was generated from the increase loan balances of fourth quarter 2013 and first quarter 2014. Noninterest income for 2014 was impacted in all areas driven primarily by (i) a decrease in the gain on sale of securities of $99 thousand, (ii) a $391 thousand decrease on gain of sale of loans and (iii) lower levels of collection of customer service fees and charges by $185 thousand.

Net interest income after the provision for loan expense for the quarter ended March 31, 2014 was up $485 thousand from the three-month period ended March 31, 2013. The increase in total interest income for the comparison of the two periods was $457 thousand and the decrease in total interest expense was $289 thousand, making it the principal driver behind the overall increase. The provision for loan loss expense was approximately $261 thousand higher than same period 2013. The provision was needed for loan growth and replacement for the net charge-offs of $297 thousand that occurred during the period and was based on Management's quarterly analysis of the adequacy of the allowance for loan losses.

Noninterest expense was higher by $39 thousand in comparison largely due to the addition of the Waterville and Custar offices. The number of full time equivalent employees was 246 as of March 31, 2013 compared to 248 as of March 31, 2014.

MATERIAL CHANGES IN RESULTS OF OPERATIONS (Continued)

The low balances in past dues, nonaccruals, OREO and troubled loans, all contributed to lower levels of expense in legal fees as relate to collections along with appraisal expense. A change to the calculation of Ohio state tax was also favorable for the Company in 2014.

Overall, the performance for the year-to-date comparison had lower bottom line income of $194 thousand caused by the reduced level of noninterest income generation.

The Company predicted the lower noninterest income position and is focused on continuing to strengthen our core earnings through loan growth and improvement to the net interest margin. New products and services will be introduced in 2014 to create additional revenue opportunities.

Interest Income

Annualized interest income and yield on earning assets is up 13 basis points in 2014 as compared to March 31, 2013. While the average total earning assets were only higher by less than 1% or $7.3 million than the prior year, the increase in interest income resulted primarily from the increased growth of the Company's earning assets. As the table that follows confirms, the increase in the amount of the interest earning portfolios from investments to loans caused a higher March 2014 earnings in loans and securities thereby and caused higher combined yields. The increased volume in the loan portfolio did offset the loss in interest income due to rate changes. The security portfolio will continue to be utilized to fund loan growth. Prepayment speeds remain high on mortgage-backed securities, though these may slow as the Bank's refinancing activity has and long term rates inch higher.

Rates on the loan portfolio are lower as compared to the previous year due to the change in the composition of the overall portfolio. An emphasis on building spreads and margins on existing loans remains intact. Funding the loans with excess security holdings has been beneficial in the first quarter of 2014. Overall loans are up in average $84.5 million and the security portfolio down $42.0 million on average from the previous year. Deposit generation in the two new offices are the factors behind the discrepancy of balances.

The yields on tax-exempt securities and the portion of tax-exempt IDB loans included in loans have been tax adjusted based on a 34% tax rate in the charts to follow.

| | (In Thousands) March 31, 2014 | | Yield/Rate | |
|---|---|---|---|---|
| | Average Balance | Interest/Dividends | March 31, 2014 | March 31, 2013 |
| Interest Earning Assets: | | | | |
| Loans | $ 569,081 | $ 6,676 | 4.69% | 5.02% |
| Taxable Investment Securities | 247,097 | 1,017 | 1.65% | 1.56% |
| Tax-exempt Investment Securities | 69,000 | 463 | 4.07% | 4.39% |
| Fed Funds Sold & Interest Bearing Deposits | 8,841 | 3 | 0.14% | 0.17% |
| Total Interest Earning Assets | $ 894,019 | $ 8,159 | 3.76% | 3.63% |

**Change in March 31, 2014 Interest Income Compared to March 31, 2013**

| | Change | Due to Volume | Due to Rate |
|---|---|---|---|
| Interest Earning Assets: | | | |
| Loans | $ 598 | $ 1,996 | $ (1,398) |
| Taxable Investment Securities | (133) | (389) | 256 |
| Tax-exempt Investment Securities | 3 | 111 | (108) |
| Fed Funds Sold & Interest Bearing Deposits | (11) | (17) | 6 |
| Total Interest Earning Assets | $ 457 | $ 1,701 | $ (1,244) |

Interest Expense

Interest expense continued to be lower than the comparable three months of 2013. Interest expense related to deposits was down $249 thousand while the average interest-bearing deposit balance decreased by $1.5 million in comparing the balances of each three month period. Time deposits continue to reprice down and the Bank continues to try and lengthen the duration of the portfolio with specials offered in terms longer than thirty-six months. However, depositors continue to place more funds in shorter term deposits while they wait for rates to rise or move funds elsewhere. KASASA Cash and Saver along with HSA's helped to increase the savings average deposit balances by $37.3 million.

Interest on borrowed funds was $42 thousand lower for the three month period ended March 31, 2014 than 2013. More borrowings from Federal Home Loan Bank were paid off during 2013 and 2014, making the average balance in other borrowed money considerably lower by $7.2 million in 2014 in comparison. Thus the largest decrease in cost of funds for other borrowed money was due to the decreased volume which also impacted the rate of the remaining borrowings portfolio. During the first quarter of 2014, all borrowings from the FHLB were paid off. Fed Funds Purchased and Securities Sold under Agreement to Repurchase had a larger average balance in 2014 of $7.8 million of whose cost was offset by lower rates making the fluctuation cost a minimal $2 thousand.

Asset yield increased 13 basis points while cost of funds decreased 16 basis points. The main focus is to continue to increase asset yield by using excess cash and the liquidation of lower yielding investments to fund loan growth.

| | (In Thousands) March 31, 2014 | | Yield/Rate | |
|---|---|---|---|---|
| | Average Balance | Interest/Dividends | March 31, 2014 | March 31, 2013 |
| Interest Bearing Liabilities: | | | | |
| Savings Deposits | $ 432,927 | $ 349 | 0.32% | 0.39% |
| Other Time Deposits | 229,734 | 529 | 0.92% | 1.11% |
| Other Borrowed Money | 581 | 4 | 2.75% | 2.37% |
| Fed Funds Purchased & Securities Sold under Agreement to Repurch. | 59,738 | 62 | 0.42% | 0.46% |
| Total Interest Bearing Liabilities | $ 722,980 | $ 944 | 0.52% | 0.68% |

**Change in March 31, 2014 Interest Expense Compared to March 31, 2013**

| | Change | Due to Volume | Due to Rate |
|---|---|---|---|
| Interest Bearing Liabilities: | | | |
| Savings Deposits | $ (41) | $ 60 | $ (101) |
| Other Time Deposits | (208) | (165) | (43) |
| Other Borrowed Money | (42) | (99) | 57 |
| Fed Funds Purchased & Securities Sold under Agreement to Repurch. | 2 | 16 | (14) |
| Total Interest Bearing Liabilities | $ (289) | $ (188) | $ (101) |

Net Interest Income

Net interest income is higher in the three month comparison, which is the opposite position as yearend 2013's comparison to yearend 2012. The issue of earning less per earning asset dollar was reversed as evidenced by a 27 basis point higher net interest margin ratio when comparing year-to-date 2014 to 2013. The tables above demonstrate that the improvements in net interest income is primarily a result of a continued shift in balance sheet composition with the benefits hampered by the extended low rate environment.

Management expects the current interest rate environment to continue to further hamper the Company's progress on improving interest margins throughout the remainder of the fiscal year. As a result, interest income, in comparison

MATERIAL CHANGES IN RESULTS OF OPERATIONS (Continued)

to 2013 should increase throughout the year with a higher level of loan growth. The Bank continues to attempt to add spread on renewing loans while loan growth is needed to improve the overall numbers. Interest expense on time deposits may start to show an increase as depositors begin to transition back into longer-term deposits. The portfolio has very limited potential for large fluctuations in rates due to the duration of this low rate environment. Should rates begin to rise; the challenge will be to delay the upward pricing of deposits in order to allow the Bank to generate a greater spread from the increased yield on its earning assets.

Provision Expense

Provision for loan loss was $261 thousand higher for the three months ended March 31, 2014 as compared to the same 2013 period. A higher net charge-off position in 2014 than in 2013 along with fourth quarter 2013 and 2014 first quarter loan growth warranted the increased provision to the loan loss reserve. The balance in nonaccrual loans decreased $714 thousand along with a decrease of $381 thousand in impaired loan balances as of March 31, 2014 as compared to the balances as of December 31, 2013. In comparing to March 31, 2013, nonaccrual balances decreased $2.0 million and impaired loan balances decreased $2.1 million. Provision expense related to those increased balances was recognized in the later time periods of 2012. The overall loan portfolio was also $98.1 million higher as of March 31, 2014 compared to March 31, 2013. The Bank continues to focus on the commercial and commercial real estate portfolios for both asset quality and growth. As the charts further below will show for 2013 and 2012, a large portion of the provision was also to replace the reserve balance depleted from the net charge-offs during the period and 2014 had a larger net charge-off position than 2013.

Should the recovery stop or continue to slow even further, it is more likely additional credits may encounter cash flow problems and the Bank remains diligent in providing funds to offset future losses. In the immediate future, the Bank would expect to fund the loan loss reserve for any loan growth that may occur.

The Bank uses the following guidelines as stated in policy to determine when to realize a charge-off, whether a partial or full loan balance. A charge down in whole or in part is realized when unsecured consumer loans, credit card credits and overdraft lines of credit reach 90 days delinquency. At 120 days delinquent, secured consumer loans are charged down to the value of the collateral, if repossession of the collateral is assured and/or in the process of repossession. Consumer mortgage loan deficiencies are charged down upon the sale of the collateral or sooner upon the recognition of collateral deficiency. Commercial and agricultural credits are charged down at 120 days delinquency, unless an established and approved work-out plan is in place or litigation of the credit will likely result in recovery of the loan balance. Upon notification of bankruptcy, unsecured debt is charged off. Additional charge-off may be realized as further unsecured positions are recognized.

The Bank has recognized a significant decrease in the overall balance of impaired loans when looking at March 2014 compared to March 2013. A positive factor can also be seen in the decrease in the current average balance for the quarter during 2014 as compared to first and fourth quarter 2013. This is due mainly to the collection of principal from the sale of collateral from borrowers and continual collection of payments on these borrowers classified as impaired.

The Bank had $974 thousand of its impaired loans classified as troubled debt restructured "TDR" as of March 31, 2014. One new TDR impaired relationship was added during the first quarter however, when combined with pay downs, the change resulted in $381 thousand less in impaired balances and the specific allocation balance was decreased by $255 thousand.

In determining the allocation for impaired loans the Bank applies the observable market price of the collateral securing the asset, reduced by applying a discount for estimated costs of collateral liquidation. In some instances where the discounted market value is less than the loan amount, a specific impairment allocation is assigned, which may be reduced or eliminated by the write down of the credit's active principal outstanding balance.

For the majority of the Bank's impaired loans, the Bank will apply the observable market price methodology. However, the Bank may also utilize a measurement incorporating the present value of expected future cash flows discounted at the loan's effective rate of interest. To determine observable market price, collateral asset values securing an impaired loan are periodically evaluated. Maximum time of re-evaluation is every 12 months for chattels and titled vehicles and every two years for real estate. In this process, third party evaluations are obtained and heavily relied upon. Until such time that updated appraisals are received, the Bank may discount the collateral value used.

The ALLL has a direct impact on the provision expense. The increase in the ALLL is funded through recoveries and provision expense. The following tables both deal with the allowance for credit losses. The first table breaks down the activity within ALLL for each loan portfolio segment and shows the contribution provided by both the recoveries and the provision along with the reduction of the allowance caused by charge-offs. The second table discloses how much of the ALLL is attributed to each segment of the loan portfolio, as well as the percent that each particular segment of the loan portfolio represents to the entire loan portfolio in the aggregate. Commercial real estate loans accounted for the largest component of charge-offs and consumer loan activity has accounted for the largest component of recoveries in first quarter 2014 as compared to 2013. As was mentioned in previous discussion, the commercial real estate portfolio is currently having a major impact on the ALLL, both through charge-off activity and due to growth of balances.

The following table presents activities for the allowance for loan losses by loan type for three months ended March 31, 2014, 2013, and 2012.

| | (In Thousands) | | |
|---|---|---|---|
| | Three Months Ended March-14 | Three Months Ended March-13 | Three Months Ended March-12 |
| Loans | $582,872 | $484,828 | $493,242 |
| Daily average of outstanding loans | $569,081 | $484,590 | $491,969 |
| Allowance for Loan Losses - January 1 | $ 5,194 | $ 5,224 | $ 5,091 |
| Loans Charged off: | | | |
| Commercial Real Estate | 201 | 20 | — |
| Agricultural Real Estate | — | — | — |
| Consumer Real Estate | 64 | 10 | 40 |
| Commercial and Industrial | — | — | — |
| Agricultural | — | — | — |
| Consumer & other loans | 101 | 86 | 86 |
| | 366 | 116 | 126 |
| Loan Recoveries | | | |
| Commercial Real Estate | 2 | — | 4 |
| Agricultural Real Estate | — | — | — |
| Consumer Real Estate | 10 | 4 | 3 |
| Commercial and Industrial | 5 | 15 | 15 |
| Agricultural | 1 | 1 | 7 |
| Consumer & other loans | 51 | 49 | 30 |
| | 69 | 69 | 59 |
| Net Charge Offs | 297 | 47 | 67 |
| Provision for loan loss | 428 | 167 | 128 |
| Acquisition provision for loan loss | — | — | — |
| Allowance for Loan & Lease Losses - March 31 | $ 5,325 | $ 5,344 | $ 5,152 |
| Allowance for Unfunded Loan Commitments & Letters of Credit - March 31 | 180 | 172 | 140 |
| Total Allowance for Credit Losses - March 31 | $ 5,505 | $ 5,516 | $ 5,292 |
| Ratio of net charge-offs to average Loans outstanding | 0.05% | 0.01% | 0.01% |
| Ratio of Allowance for Loan Loss to Nonperforming Loans | 203.68% | 128.42% | 170.43% |

MATERIAL CHANGES IN RESULTS OF OPERATIONS (Continued)

The following table presents the balances for allowance of loan losses by loan type for three months ended March 31, 2014 and March 31, 2013.

| | (In Thousands March-2014 | | (In Thousands) March-2013 | |
|---|---|---|---|---|
| | Amount | % of Porfolio | Amount | % of Porfolio |
| Balance at End of Period Applicable To: | | | | |
| Commercial Real Estate | $1,958 | 44.89 | $1,566 | 43.24 |
| Agricultural Real Estate | 131 | 8.51 | 105 | 7.40 |
| Consumer Real Estate | 402 | 15.68 | 463 | 15.91 |
| Commercial and Industrial | 1,330 | 15.44 | 1,972 | 18.52 |
| Agricultural | 324 | 11.13 | 260 | 10.70 |
| Consumer, Overdrafts and other loans | 270 | 3.61 | 256 | 3.98 |
| Unallocated | 910 | 0.74 | 722 | 0.25 |
| Allowance for Loan & Lease Losses | 5,325 | | 5,344 | |
| Off Balance Sheet Commitments | 180 | | 172 | |
| Total Allowance for Credit Losses | $5,505 | | $5,516 | |

The percentage of delinquent loans has trended downward since the beginning of 2010 from a high of 2.85% of total loans in January to .25% as of the end of December 2013. March 2014 increased slightly to .39% though any percentage under 1% is considered low. These percentages do not include nonaccrual loans which are not past due. 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 write down of uncollectable credits in a timely manner.

Non-interest Income

Overall, noninterest income for first quarter 2014 was $698 thousand below the same time period of 2013. As has been expected, revenue from gains on sales of loans, investment securities and other assets owned diminished compared to prior periods. The Bank was able to capitalize on those opportunities; however, current increases in the long term market rates has slowed the progress. All categories of noninterest income decreased as compared to first quarter 2013. The Bank does not expect a significant change in the opportunity for gains for the remainder of 2014.

$9 million in sales of investment securities were conducted in first quarter 2014 to fund loan growth and capture some additional revenue. The sales resulted in a gain of $122 thousand. First quarter 2013 had sales of $35 million resulting in gains of $221 thousand. The difference between 2014 and 2013 sales was the utilization of the funds. 2014 went to fund loan growth while 2013 was reinvested in securities.

This does not mean that some avenues were not available for improvement. With the percentage of core deposits, specifically checking accounts, increasing throughout the Bank's market area, debit card usage was higher. Corresponding interchange income increased to over $500 thousand for the quarter, outperforming first quarter 2013 by $55 thousand. The same held true for credit card fees which had increased revenue of $22.5 thousand.

Overdraft and return check fees were lower by $55.9 thousand in comparing the quarters, even though the number of accounts increased by almost 2 thousand.

The Bank is in the early stages of designing new (while revamping older) products and services to capture additional revenue. More importantly, to also add value to our customer experience and meet new service demands.

MATERIAL CHANGES IN RESULTS OF OPERATIONS (Continued)

The impact of mortgage servicing rights, both to income and expense, is shown in the following table which reconciles the value of mortgage servicing rights. The capitalization runs through non-interest income while the amortization thereof is included in non-interest expense. A slight impairment in the valuation of the thirty year segment occurred in the fourth quarter of 2012 and was reversed in the second quarter of 2013, eliminating all impairment. Therefore, first quarter 2013 includes a slight valuation allowance of which there is not any in 2014. For 2014, mortgage servicing rights caused $36 thousand more in expense than for first quarter 2013.

| | (In Thousands) 2014 | 2013 |
|---|---|---|
| Beginning Balance, January 1 | $2,066 | $2,063 |
| Capitalized Additions | 41 | 132 |
| Amortization | (82) | (137) |
| Ending Balance, March 31 | 2,025 | 2,058 |
| Valuation Allowance | — | (16) |
| Mortgage Servicing Rights, net March 31 | $2,025 | $2,042 |

Loss on sale of other assets owned was higher by $23 thousand as of first quarter end 2014 as compared to same period 2013. This represents an additional expense or a decrease in non-interest income for the period. This line item includes losses from sales of assets, losses from write-downs to the Bank's Other Real Estate Owned (ORE) and losses resulting from the loss or disposal of fixed assets, though the fixed asset sales are inconsequential. Holdings in ORE decreased to $1.8 million as of March 31, 2014 compared to holdings of $2.2 million as of March 31. 2013. Activity on sales of ORE has increased in 2014 with four sales compared to only one sale in first quarter 2013 and the Bank expects this to continue throughout the remainder of 2014. The Bank also wrote down the value on four properties due to updated appraisals and expects holdings to decrease even further.

The movement of income from comprehensive income to realized gain on sale of securities is disclosed in the table to follow. Since the Bank classifies its entire investment portfolio, with the exception of stock, as available for sale, the majority of any gain/loss on the sale is a direct shift of funds from unrealized gain to realized gain. Since the purchase of additional or replacement securities occurs at the same time, those new securities immediately impact the other comprehensive loss.

| | (In Thousands) Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Net Unrealized gain (loss) on available-for-sale securities | $ (901) | $ (916) |
| Less reclassification adjustment for gain on sale of available-for-sale securities | 122 | 221 |
| Net unrealized losses | (1,023) | (1,137) |
| Tax Effect | 348 | 387 |
| Other comprehensive loss | $ (675) | $ (750) |

Non-Interest Expense

Non-interest expense for the three months ended March 31, 2014 was only $39 thousand higher than for the same period of 2013. Salaries and wages were almost equal to 2013, being $3 thousand less than the same three month time frame. The number of full time equivalent employees increased from 246 as of March 31, 2013 to 248 as of March 31, 2014. This occurred even with the addition of two offices in 2014's numbers.

MATERIAL CHANGES IN RESULTS OF OPERATIONS (Continued)

Non-Interest Expense (Continued)

Medical costs show a $93 thousand decrease in comparing year-to-date 2014 to 2013. The Bank instituted a change to how a HSA contribution per employee was given. Instead of depositing all at once at the start of the year as was done in 2013, the contribution is distributed through the year. The Bank also switched medical providers at yearend 2013, which resulted in claims which would have normally been covered in 2014 being expensed in 2013. Health insurance costs have increased for the Bank in 2014, though it is not clearly evident in looking at the line items.

An incentive accrual is also lower in 2014 than in 2013 by $72 thousand. This is due to the lower net income of the Bank for the period on which the incentive is calculated. The Bank continues to reward employees for performance and the accrual reflects this.

A decrease occurred of $55 thousand in the amortization expense of mortgage servicing rights. When a mortgage is refinanced, any unamortized servicing right is fully expensed and therefore, drives the amortization expense higher within that period. Of the sales and originations shown in the cash flow, $4.5 million were originated and $4.9 million sold from the 1-4 family portfolio which had mortgage servicing rights attached. These were down from $16.0 million in originations and $18.1 million in sales from the same portfolio as of first quarter 2013. Therefore, amortization expense from refinancing activity would be expected to be lower, which it is.

Other general and administrative expenses were higher during the three months for 2014 by $121 thousand; as compared to the same three months 2013. The amortization expense of the core deposit intangible was $14.8 thousand higher in 2014 than in 2013 due to the Custar office acquisition in December 2013. General legal fees were $37 thousand higher in first quarter 2014 as compared to same time frame of 2013. Legal fees as related to collection of problem loans were down $38.5 thousand in the same comparison. Improvement in past dues, nonaccruals, OREO and troubled loans were behind the lower expense. Other expenses related to these areas were also down $85.5 thousand form the previous year.

Additional decreases in general and administrative noninterest expense were lower taxes for the State of Ohio as a revised tax code became effective in 2014, resulting in a Company savings of $59.8 thousand for the first quarter on a consolidated basis. An adjustment for force placed property insurance that was over expensed resulted in a one-time decrease for general insurance expense in 2014.

The second largest increase in the line item general and administrative expense is in NSF checks and other losses stemming from the Bank's deposit accounts. In comparing the first quarter of 2014 to 2013, the increase amounted to $45.6 thousand more expense in 2014. This represents an area of great concern to the Bank as the failures of other organizations to protect customer's information hurts the Bank's bottom line. This exposure to risk continues to increase as our society adopts and utilizes more technology than ever before.

Overall non-interest expense was just $39 thousand higher in 2014 than in 2013. The Company continues to monitor costs to safeguard profitability.

Net Income

Overall, net income was down $194 thousand for the three months ended March 31, 2014, compared to the same period of 2013. The improvement in asset quality that has occurred over the last two years along with lower loan balances enabled the Company to have low levels of provision expense until third quarter 2013. Provision was increased during the quarter due to charge-offs and loan growth and was $261 thousand higher than 2013 on a comparable year-to-date. This coupled with the decreases in gain/loss on sale of other assets owned, gain on sale of investments, and gain on sales of loans are the largest factors behind the decrease.

The importance of a higher loan to asset percentage was evidenced by the improvement in interest income and yield. With the decrease in noninterest income, it becomes essential that the Bank continue to build on the growth in loans of the last two quarters. The ability to fund that loan growth with a growth in core deposits is another strength of the Company which should continue with the addition of new offices.

MATERIAL CHANGES IN RESULTS OF OPERATIONS (Continued)

The Bank also has the ability to borrow funds or sell securities and best of all, the option to choose which source correlates to be the most profitable.

The effective tax rate for the Bank increased during the first quarter as stock was redeemed by the Federal Home Loan Bank for the first time. Stock dividends, that were previously tax deferred, were currently taxed. This resulted in additional provision of $100 thousand for 2014 as compared to 2013. Offsetting this tax effect is the holdings of tax exempt municipal securities at the holding company level.

The Company is positioned for improvement in the net interest margin while rates remain low, provided there is an increase in loan demand. It will be a challenge to maintain the margin once short term rates begin to rise. However, the Bank remains focused on improving the asset yield through improved asset quality and added spread to prime on variable and adjustable rate loans. As with the rest of the banking industry, the Company is also limited from achieving higher profitability by the cost of increased regulatory requirements such as Regulation E, Dodd-Frank Wall Street Reform and Consumer Protection Act and any other additional regulations that may be enacted during 2014 and their corresponding cost of compliance. The Company will continue to seek to enhance existing products and services to increase revenue, improve efficiency and increase customer satisfaction.

Overall, the Bank is working to offset the probable loss of noninterest income streaming from sales by increasing the loan balances. Possible improvement in the net interest margin appears attainable with the loan increases shown in the quarterly comparisons.

## FORWARD LOOKING STATEMENTS

Statements contained in this portion of the Company's 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 words such 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 differ from those projected in the forward-looking statements.

## ITEM 3 QUALITATIVE AND QUANTITATIVE DISCOLSURES ABOUT MARKET RISK

Market risk is the exposure to loss resulting from changes in interest rates and equity prices. The primary market risk to which the Company is subject is interest rate risk. The majority of our interest rate risk arises from the instruments, positions and transactions entered into for purposes, other than trading such as loans, available for sale securities, interest bearing deposits, short term borrowings and long term borrowings. Interest rate risk occurs when interest bearing assets and liabilities re-price at different times as market interest rates change. For example, if fixed rate assets are funded with variable rate debt, the spread between asset and liability rates will decline or turn negative if rates increase.

Interest rate risk is managed within an overall asset/liability framework. The principal objectives of asset/liability management are to manage sensitivity of net interest spreads and net 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 profitably may be adversely affected. The Company employs a sensitivity analysis utilizing interest rate shocks to help in this analysis.

The Company also reviews shocks with a 4.0% fluctuation with a delayed time frame of 10 months. The shocks presented below assume an immediate change of rate in the percentages and directions shown covering a twelve month period:

| Interest Rate Shock on Net Interest Margin | | | Interest Rate Shock on Net Interest Income | | |
|---|---|---|---|---|---|
| Net Interest Margin (Ratio) | % Change to Flat Rate | Rate Direction | Rate Changes by | Cumulative Total ($000) | % Change to Flat Rate |
| 3.47% | 6.06% | Rising | 3.00% | 31,761 | 7.17% |
| 3.45% | 5.44% | Rising | 2.00% | 31,347 | 5.77% |
| 3.34% | 2.13% | Rising | 1.00% | 30,367 | 2.47% |
| 3.27% | 0.00% | Flat | 0.00% | 29,636 | 0.00% |
| 2.98% | -9.09% | Falling | -1.00% | 27,393 | -7.57% |
| 2.73% | -16.48% | Falling | -2.00% | 25,511 | -13.92% |
| 2.46% | -19.68% | Falling | -3.00% | 23,375 | -21.13% |

The net interest margin represents the forecasted twelve month margin. The Company also reviews a 24 month forecast period. It also shows what effect rate changes will have on both the margin and net interest income. The goal of the Company is to lengthen some of the liabilities or sources of funds to decrease the exposure to a rising rate environment. The Bank has offered higher rates on certificates of deposits for longer periods since 2011. Of course, customer desires also drive the ability to capture longer term deposits. Currently, the customer looks for terms twelve months and under while the Bank would prefer 24 months and longer. It is often a meeting in the middle that satisfies both. What the Bank has experienced is a decrease in the time balances of our deposit portfolio, therefore a loss of term funding. Over the last three years, other borrowings that had matured were not replaced which thus eliminated a category of what historically was longer term liability. A high level of liquidity negated the need to re-borrow.

The shock chart currently shows a tightening in net interest margin over the next twelve months in a decreasing rate environment while an improvement is forecasted in a rising rate environment. Due to the length and existence of such a low rate environment, the model does not predict expansion of net income margin in any falling category. Cost of funds are below .75% so at even the lowest shock of 100 basis points, the Bank cannot take full advantage and reprice funds to match the level of shock. The positive impact in a rising rate environment is partially caused by a large core deposit base that should not reprice as quickly as the assets. The average duration of the majority of the assets is outside the 12 month shock period. The Bank enhanced its use of the software model during 2012 by including decay rates and key rate ties on certain deposit accounts. Both enhancements were based on historical performance data of the Bank. Both directional changes are within risk exposure guidelines at the 200 basis point level. The effect of the rate shocks may be mitigated to the extent that not all lines of business are directly tied to an external index and actual balance sheet composition may differ from prediction.

Overall, what the chart shows is that the Company cannot remain stagnant in its choices. Changes in portfolio and/or balance sheet composition are needed for the margin to improve regardless of any rate shock.

## ITEM 4 CONTROLS AND PROCEDURES

As of March 31, 2014, an evaluation was performed under the supervision and with the participation of the Company’s management including the CEO and CFO, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures. Based on that evaluation, the Company’s management, including the CEO and CFO, concluded that the Company’s disclosure controls and procedures were effective as of March 31, 2014. There have been no changes in the Company’s internal control over financial reporting that occurred during the quarter ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, the registrant’s internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

None

ITEM 1A RISK FACTORS

There have been no material changes in the risk factors disclosed by Registrant in its Report on Form 10-K for the fiscal year ended December 31, 2013.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Treasury stock repurchase for quarter ended March 31, 2014.

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plan or Programs | (d) Maximum Number of Shares that may yet be purchased under the Plans or Programs |
|---|---|---|---|---|
| 1/1/2014 to 1/31/124 | — | — | — | 200,000 |
| 2/1/2014 to 2/28/2014 | — | — | — | 200,000 |
| 3/1/2014 to 3/31/2014 | 4,070 | $ 24.08 | 4,070 | 195,930 |
| Total | 4,070 | $ 24.08 | 4,070 | 195,930 |

(1) The Company purchased shares in the market pursuant to a stock repurchase program publicly announced on January 18, 2014. On that date, the Board of Directors authorized the repurchase of 200,000 common shares between January 18, 2014 and December 31, 2014.

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 MINE SAFETY DISCLOSURES

Not applicable

ITEM 5 OTHER INFORMATION

ITEM 6 EXHIBITS

| | |
|---|---|
| 3.1 | Amended Articles of Incorporation of the Registrant (incorporated by reference to Registrant's Quarterly Report on Form 10-Q filed with the Commission on August 1, 2006) |
| 3.2 | Code of Regulations of the Registrant (incorporated by reference to Registrant's Quarterly Report on Form 10-Q filed with the Commission on May 10, 2004) |
| 31.1 | Rule 13-a-14(a) Certification -CEO |
| 31.2 | Rule 13-a-14(a) Certification -CFO |
| 32.1 | Section 1350 Certification - CEO |
| 32.2 | Section 1350 Certification - CFO |
| 101.INS | XBRL Instance Document (1) |
| 101.SCH | XBRL Taxonomy Extension Schema Document (1) |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document (1) |
| 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) |

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Farmers & Merchants Bancorp, Inc.,

| | |
|---|---|
| Date: April 28, 2014 | By: /s/ Paul S. Siebenmorgen<br>Paul S. Siebenmorgen<br>President and CEO |
| Date: April 28, 2014 | By: /s/ Barbara J. Britenriker<br>Barbara J. Britenriker<br>Exec. Vice-President and CFO |

Exhibit 31.1

**CERTIFICATIONS**

I, Paul S. Siebenmorgen, President and CEO of Farmers & Merchants Bancorp, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Farmers & Merchants Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
   a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 28, 2014

/s/ Paul S. Siebenmorgen

Paul S. Siebenmorgen
President and Chief Executive Officer

Exhibit 31.2

**CERTIFICATIONS**

I, Barbara J. Britenriker, Executive Vice-President and CFO of Farmers & Merchants Bancorp, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Farmers & Merchants Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
    a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 28, 2014

/s/ Barbara J. Britenriker
Barbara J Britenriker
Executive Vice President and
Chief Financial Officer

Exhibit 32.1

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**
**PURSUANT TO 18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Farmers & Merchants Bancorp, Inc. on Form 10-Q for the period ending March 31, 2014 as filed with the Securities and Exchange Commission (“the report”), I, Paul S. Siebenmorgen, President and Chief Executive Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Farmers & Merchants Bancorp, Inc. as of the dates and for the periods expressed in the Report.

Date:April 28, 2014

/s/ Paul S. Siebenmorgen
Paul S. Siebenmorgen, President and
Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to Farmers & Merchants Bancorp, Inc. and will be retained by Farmers & Merchants Bancorp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

**Exhibit 32.2**

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER**
**PURSUANT TO 18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Farmers & Merchants Bancorp, Inc. on Form 10-Q for the period ending March 31, 2014, as filed with the Securities and Exchange Commission ("the report"), I, Barbara J. Britenriker, Exec. Vice-President and Chief Financial Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Farmers & Merchants Bancorp, Inc. as of the dates and for the periods expressed in the Report.

Date: April 28, 2014

/s/ Barbara J. Britenriker
Barbara J. Britenriker, Exec.
Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Farmers & Merchants Bancorp, Inc. and will be retained by Farmers & Merchants Bancorp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.