UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K-A

(Amendment No. 1)

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

For the fiscal year ended December 31, 2009

or

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

For the transition period from __________ to __________

Commission File Number 0-14492

FARMERS & MERCHANTS BANCORP, INC.

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

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

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

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

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

Common shares without par value
(Title of class)

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

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

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 o

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 o No o

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

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

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

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

As of June 30, 2009, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $96,949,092.00

As of February 24, 2010, the Registrant had 5,200,000 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of Form 10-K — Portions of the definitive Proxy Statement for the 2009 Annual Meeting of Shareholders of Farmers & Merchants Bancorp, Inc.

FARMERS & MERCHANTS BANCORP, INC.

TABLE OF CONTENTS

Form 10-K Items		PAGE
Item 1.	Business	4-12
Item 1a.	Risk Factors	12-14
Item 1b.	Unresolved Staff Comments	15
Item 2.	Properties	15
Item 3.	Legal Proceedings	15
Item 4.	Market for Registrant's Common Equity and Related Stockholder Matters	16-18
Item 5.	Selected Financial Data	18
Item 6.	Management Discussion and Analysis of Financial Condition and Results of Operations	19-41
Item 6a.	Quantitative and Qualitative Disclosures About Market Risk	41-42
Item 7.	Financial Statements and Supplementary Data	42-73
Item 8.	Disagreements on Accounting and Financial Disclosure	73
Item 8a.	Controls and Procedures	74
Item 8b.	Other Information	74
Item 9.	Directors and Executive Officers of the Registrant	75-76
Item 10.	Executive Compensation	77
Item 11.	Security Ownership of Certain Beneficial Owners and Management	77
Item 12.	Certain Relationships and Related Transactions	77
Item 13.	Principal Accountant Fees and Services	77
Item 14.	Exhibits, Financial Schedules and Reports on Form 8-K	78-79
Signatures & Certifications		80-84
Total Pages:		84

EXPLANATORY NOTE

Farmers & Merchants Bancorp, Inc, (the "Company") is filing this Amendment No. 1 on Form 10-K/A (the "Amendment") with the Securities and Exchange Commission (the "SEC") to amend its Annual Report on Form 10-K for the fiscal year ended December 21, 2009 as filed with the SEC on February 26, 2010 (the "Original Report"). The Amendment amends and restates the following sections to the Company's Original Report: (1) Part I, Item 1; (2) Part II, Item 6; (3) the Notes to the Company's financial statements provided under Part II, Item7; and (4) Part III, Item 10. This Amendment is being filed to enhance the Company's disclosures under the above-referenced items in response to comments from the Staff of the SEC given in connection with its review of the Company's recent filings under the Securities Exchange Act of 1934. In addition, new certifications by our principal executive officer and principal financial officer are being filed under Part IV, Item 15 as exhibits to this Amendment.

Except as described above, the Original Report has not been amended, updated or otherwise modified. The Original Report, as amended by this Amendment, continues to speak as of the date of the Original Report and does not reflect events occurring after the filing of the Original Report or update or otherwise modify any related or other disclosures, including forward-looking statements. Accordingly, this Amendment should be read in conjunction with the Company's other filings made with the SEC subsequent to the filing of the Original Report.

FORWARD LOOKING STATEMENTS

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

PART 1.

ITEM 1. BUSINESS:

General

Farmers & Merchants Bancorp, Inc. (Company) is a bank holding company incorporated under the laws of Ohio in 1985. Our primary subsidiary, The Farmers & Merchants State Bank (Bank) is a community bank operating in Northwest Ohio since 1897. Our only other subsidiary, Farmers & Merchants Life Insurance Company, a reinsurance company for life, accident and health insurance for the Bank's consumer credits,

was formed in 1992. Farmers & Merchants Life Insurance Company was dissolved during 2007. 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 2009, please see the portion of Management's Discussion and Analysis of Financial Condition and Results of Operations captioned "2009 in Review".

Nature Of Activities

The Bank's local service area has experienced high unemployment rates at year end 2009. The bio-diesel industry will be pressured, as Congressional support for this industry is still pending approval. As consumer confidence remains at lower levels, consumer sensitive industries such as the hotel/motel industry and the retail sector may experience pressures as well.

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

The Bank also provides checking account services, as well as savings and time deposit services such as certificates of deposits. In addition ATM's (automated teller machines) are provided at most branch locations along with other independent locations such as major employers and hospitals in the market area. The Bank has custodial services for IRA's (Individual Retirement Accounts) and HSA's (Health Savings Accounts).

The Bank's underwriting policies exercised through established procedures facilitates 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 loan. Hybrid loans are loans that start out as a fixed rate mortgage but after a set number of years they 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 does also retain the servicing on these partially or 100% sold loans. In order for the customer to participate in these programs they must meet the requirements established by these agencies.

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

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

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

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

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

Commercial/Industrial: Loans to proprietorships, partnerships, or corporations to provide temporary working capital and seasonal loans as well as acquisition of capital assets such as plant and equipment. 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 using 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 be lower than what is acceptable under the Bank’s Loan Policy.

The below listing has been updated as of this amended filing. Loan to values represent maximums as stated in policy. Future filings may include additional information on underwriting requirements as deemed necessary.

The following table is intended as a quick reference only. Advance rates indicated should be considered maximums and are subject to applicable policy provisions.

Consumer Loans	Max LTV
Cars/Vans/Light Trucks	
All years	
Purchases/retail value (fees & tax)	110%
Indirect/retail value (fees & taxes)	110%
Indirect with Add-ons	130%
Vehicles secured /retail value	65%
Boats/Campers/Motorcycles/RV's/Motor Coach	
< 2 Years	90%
≥ 3 Years	80%
Snowmobiles/Four Wheelers/Jet Skies/Mowers	
New	85%
Used	80%
1-4 Family Residential Properties	
In-House	90%*
Rental	75%**
Secondary (See Terms of Secondary Market Program)	
Home Equity/Jr. Liens credit score 720 and higher	80%
Home Equity credit score less than 720	75%
Home Equity/Jr. Liens (non-F&M priority lien)	75%
Home Equity/Jr. Liens (manufactured home/condo)	N/A
Bridge Loan	80%
Construction — The lesser of 80% of fair market value or 90% of hard cost.	
Raw Land / Lot Improved	75%
Raw Land / Lot Unimproved	65%
Non-Conforming Property	N/A
Jumbo Loan	75%
Refer to Secondary Market Guidelines	
State of Michigan Property	75%
State of Michigan Property with PMI	90%
State of Indiana Property	80%
State of Indiana Property with PMI	90%

* PMI Insurance **Required** if LTV Exceeds 80%.

** Not to exceed the lower of cost or appraisal.

Commercial / Agriculture Real Estate	
Commercial Real Estate	80%
Agriculture Real Estate	70*
Construction — The lesser of 80% of fair market value or 90% of hard cost.	
Secondary (See Terms of Secondary Market)	
Single Purpose Real Estate	70%

* On all appraisals completed in 2008. 80% on appraisals completed prior to 2008.

Commercial / Agriculture Accounts Receivable	
A/R 90 days with aging	up to 80%
(Eligible — see procedures for definition)	
A/R without aging	up to 35%

Inventory	
Inventory	up to 50%
(Eligible — see procedures for definition)	
Inventory Raw Material	50%
WIP (Work in Process)	0%
Finished Goods	50%
Stored Grain	80%
Warehouse Receipts of Grain	87% or max. Established by the Reg.
Assigned Insured Growing Crops	75% of input cost
Feeder Livestock (Purchase or Existing)	80% of FMV
Breeding Livestock	50%
Floor Plan Used Vehicles	80% of wholesale
Floor Plan New RV's/Campers	80% of wholesale
Floor Plan Manufactured Homes	80% of wholesale

Equipment	
New Equipment	up to 80% of invoice
Existing Equipment	up to 50% of listed equipment
Appraisal of existing	up to 75% of market value
Restaurant / Bar	up to 35% of market value
Heavy Trucks	up to 75% of market value
Titled Trailers	up to 75% of market value
Aircraft	up to 75% of appraised fair market value

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

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

Farmers & Merchants Life Insurance Company was established to provide services to our customers through the issuance of life and disability insurance policies. Our Bank's lending officers were the selling agents of the policies to customers. The activities of Farmers & Merchants Life Insurance Co. were not significant to the consolidated company. The Company dissolved the Farmers & Merchants Life Insurance Company subsidiary as the Bank discontinued offering the credit life, accident and health insurance to its customers. The Bank continues to offer credit insurance related products to our residential real estate customers; however, it is through an unrelated third party vendor.

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 is participating in the expanded FDIC limits through all of 2013 and utilizing the additional insurance coverage provided in the Temporary Liquidity Guarantee Program (TAG) through June 2010. The FDIC increased the insurance level for deposits from $100,000 to $250,000 on interest bearing accounts and unlimited FDIC insurance on non-interest bearing accounts. We believe the cost for this coverage is offset by the benefit to our depositors. The material cost of FDIC insurance is the assessments for the base program and not TAG.

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

acquired the Knisely Bank of Indiana, expanding its market with the addition of offices in Butler and Auburn, Indiana, both located in DeKalb County. An additional office was opened in the summer of 2008 in Angola, Indiana, located in Steuben County.

At December 31, 2009, we had 251 full time equivalent employees. The employees are not represented by a collective bargaining unit. We provide our employees with a comprehensive benefit program, some of which are contributory. We consider our employee relations to be excellent.

Supervision and Regulation

General

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

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

Regulatory Agencies

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

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

Holding Company Activities

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

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

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

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

Affiliate Transactions

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

Interstate Banking and Branching

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

Control Acquisitions

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

Liability for Banking Subsidiaries

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

Regulatory Capital Requirements

The Company is required by the various regulatory authorities to maintain certain capital levels. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines. If capital falls below minimum guideline levels, a bank holding company, among other things, may be denied approval to acquire or establish additional banks or non-bank businesses. The required capital levels and the Company's capital position at December 31, 2009 are summarized in the table included in Note 14 to the consolidated financial statements.

FDICIA

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), and the regulations promulgated under FDICIA, among other things, established five capital categories for insured depository institutions-well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized-and requires U.S. federal bank regulatory agencies to implement systems for "prompt corrective action" for insured depository institutions that do not meet minimum capital requirements based on these categories. Unless a bank is well capitalized, it is subject to restrictions on its ability to offer brokered deposits and on certain other aspects of its operations. An undercapitalized bank must develop a capital restoration plan and its parent bank holding company must guarantee the bank's compliance with the plan up to the lesser of 5% of the banks or thrift's assets at the time it became undercapitalized and the amount needed to comply with the plan. As of December 31, 2009, the Company's banking subsidiary was well capitalized pursuant to these prompt corrective action guidelines.

Dividend Restrictions

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

Deposit Insurance Assessments

The deposits of the Company's banking subsidiary are insured up to regulatory limits by the FDIC, and, accordingly, are subject to deposit insurance assessments based on the Federal Deposit Insurance Reform Act of 2005, as adopted and took effect on April 21, 2006.

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

Depositor Preference Statute

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

Government Monetary Policy

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

Capital Purchase Program

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

Additional Regulation

The Bank is also subject to federal regulation as to such matters as required reserves, limitation as to the nature and amount of its loans and investments, regulatory approval of any merger or consolidation, issuance or retirement of their own securities, limitations upon the payment of dividends and other aspects

of banking operations. In addition, the activities and operations of the Bank are subject to a number of additional detailed, complex and sometimes overlapping laws and regulations. These include state usury and consumer credit laws, state laws relating to fiduciaries, the Federal Truth-in-Lending Act and Regulation Z, the Federal Equal Credit Opportunity Act and Regulation B, the Fair Credit Reporting Act, the Electronic Funds Transfer Act and Regulation E, the Truth in Savings Act and Regulation DD, the Bank Secrecy Act, the Community Reinvestment Act, HUD's RESPA regulations, anti-discrimination laws and legislation, and antitrust laws.

Future Legislation

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

Available Information:

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

Please see the Consolidated Financial Statements provided under Part II, Item 8 of this Form 10-K for information regarding the Company's revenues from external customers, profits, and total assets for and as of, respectively, the fiscal year ended December 31, 2009.

ITEM 1a. RISK FACTORS

Significant Competition from an Array of Financial Service Providers

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

Credit Risk

The risk of nonpayment of loans is inherent in commercial banking. Such nonpayment could have an adverse effect on the Company's earnings and our overall financial condition as well as the value of our common stock. Management attempts to reduce the Bank's credit exposure by carefully monitoring the

concentration of its loans within specific industries and through loan application and approval procedures. However, there can be no assurance that such monitoring and procedures will reduce such lending risks. Credit losses can cause insolvency and failure of a financial institution and, in such event, its shareholders could lose their entire investment. For more information on the exposure of the Company and the Bank to credit risk, see the section under Part II, Item 7 of this Form 10-K captioned “Loan Portfolio.”

Susceptibility to Changes in Regulation

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

Interest Rate Risk

Changes in interest rates affect our operating performance and financial condition in diverse ways. Our profitability depends in substantial part on our “net interest spread,” which is the difference between the rates we receive on loans and investments and the rates we pay for deposits and other sources of funds. Our net interest spread will depend on many factors that are partly or entirely outside our control, including competition, federal economic, monetary and fiscal policies, and economic conditions generally. Historically, net interest spreads for other financial institutions have widened and narrowed in response to these and other factors, which are often collectively referred to as “interest rate risk.” Over the last few years, the Bank, along with most other financial institutions, has experienced a “margin squeeze” as drastic interest rate fluctuations have made it difficult to maintain a more favorable net interest spread. During 2009, the Bank was able to improve its margin and spread slightly as the rate environment remained low and flat. Maturities of higher rate deposits aided the decrease in cost of funds.

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

Attraction and Retention of Key Personnel

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

unable to attract additional qualified personnel, our business, financial condition, results of operations and cash flows could be materially adversely affected.

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

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

Officers, other than executive, receive incentive pay based on additional criterion. The officers are rewarded based on overall ROA of the Bank along with individual pre-established goals. Officers, therefore, have incentive pay at risk for individual performance. The individualized goals are recommended by each officer’s supervisor and are approved by an incentive committee of the Bank. The goals are designed to improve the performance of the Bank while also limiting the risk of a short-term performance focus. For example, a lending officer may be given two goals of which one is to grow loans within specific targets and another is tied to a specific level of past dues and charge-offs. The second goal limits the ability to be rewarded for growth at all costs along with the specific target levels within the growth goal itself. Officers in a support department may be given goals which create efficiencies, ensure compliance with procedures, or generate new fee or product opportunities. An average of four goals were given to each officer in 2009. Officers are paid cash incentives based on the year end ROA of the Bank and receive it within the first quarter of the following year. Should the ROA be forecasted to be positive but below the base target set by the Board, the officers are paid an incentive under the same basis and timing as non-officers disclosed above.

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

Dividend Payout Restrictions

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

The Bank is subject to restrictions and limitations in the amount and timing of the dividends it may pay to the Company.

Anti-Takeover Provisions

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

Operational Risks

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

Limited Trading Market

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

ITEM 1b. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal office is located in Archbold, Ohio.

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

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

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

Office	Location
Archbold, Ohio	1313 S Defiance Street
Wauseon, Ohio	1130 N Shoop Avenue
	119 N Fulton Street
Stryker, Ohio	300 S Defiance Street
West Unity, Ohio	200 W Jackson Street
Bryan, Ohio	929 E High Street
	1000 S Main Street
Delta, Ohio	101 Main Street
Montpelier, Ohio	1150 E Main Street
Napoleon, Ohio	2255 Scott Street
Swanton, Ohio	7 Turtle Creek Circle
Defiance, Ohio	1175 Hotel Drive
Perrysburg, Ohio	7001 Lighthouse Way
Butler, Indiana	200 S Broadway
Auburn, Indiana	403 Erie Pass
Angola, Indiana	2310 N Wayne Street

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

ITEM 3. LEGAL PROCEEDINGS

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

PART II.

ITEM 4. MARKET FOR REGISTRANT’S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is not listed on the NASDAQ stock market or any other stock exchange. While there is no established public trading market for our common stock, our shares are currently dually-quoted by various market makers on the Pink Sheets and the Over the Counter Bulletin Board, which are both over-the-counter quotation services for participant broker-dealers.

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

2009 — quarter	Quarter	Stock Prices Low	High
	1st	$17.60	$20.00
	2nd	17.55	20.50
	3rd	19.25	20.99
	4th	15.20	19.00

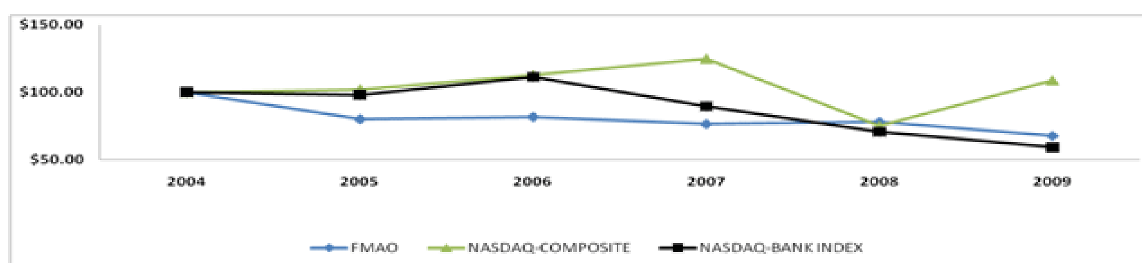
2008 — quarter	Quarter	Low	High
	1st	$18.00	$20.25
	2nd	19.05	22.80
	3rd	20.05	22.25
	4th	19.00	21.35

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

As of January 27, 2010 there were 2,052 record holders of our common stock.

Below is a line-graph presentation comparing the cumulative total shareholder returns for the Corporation, an index for NASDAQ Stock Market (U.S. Companies) comprised of all domestic common shares traded on the NASDAQ National Market System and the NASDAQ Bank Index for the five-year period ended December 31, 2009. The chart compares the value of $100 invested in the Corporation and each of the indices and assumes investment on December 31, 2004 with all dividends reinvested.

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



1. Year 2004 as the Base

	2004	2005	2006	2007	2008	2009
FMAO	$ 100.00	$ 80.00	$ 81.65	$ 76.40	$ 77.90	$ 67.60
NASDAQ-COMPOSITE	$ 100.00	$ 102.09	$ 112.64	$ 124.61	$ 75.02	$ 108.82
NASDAQ-BANK INDEX	$ 100.00	$ 98.02	$ 111.40	$ 89.54	$ 70.55	$ 58.97

Dividends are declared and paid quarterly. Per share dividends declared for the years ended 2009 and 2008 are as follows:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
2009	$.18	$.18	$.18	$.18	$.72
2008	$.16	$.16	$.18	$.18	$.68

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

Dividends declared during 2009 were $0.72 per share totaling $3.41 million, 5.88 percent higher than 2008 declared dividends of $0.68 per share. During 2009, the Company purchased 28,907 shares and awarded 10,000 restricted shares to 49 employees under its long term incentive plan. 350 shares were forfeited during 2009. At year end 2009, the Company held 437,551 shares in Treasury stock and 27,775 in unearned stock awards. The Company purchased 171,889 shares throughout 2008. 10,000 shares were awarded to 51 employees in 2008. 245 restricted shares were forfeited during 2008. At December 31, 2008, the Company held 418,294 shares in Treasury stock and 23,575 in unearned stock awards. The Company continues to have a strong capital base and to maintain regulatory capital ratios that are significantly above the defined regulatory capital ratios. On December 18, 2009, the Company announced the authorization by its Board of Directors for the Company's repurchase, either on the open market, or in privately negotiated transactions, of up to 200,000 shares of its outstanding common stock commencing January 1, 2010 and ending December 31, 2010.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Remaining Share Repurchase Authorization
10/1/2009 to 10/31/2009	—	—	—	196,093
11/1/2009 to 11/30/2009	—	—	—	196,093
12/1/2009 to 12/31/2009	—	—	—	196,093
Total	—	—	—	196,093

(1) On January 16, 2009, the Company announced the authorization by its Board of Directors for the Company's repurchase, either on the open market, or in privately negotiated transactions, of up to 225,000 shares of its outstanding common stock commencing on January 16, 2009 and ending December 31, 2009.

Reclassification

Certain amounts in the 2008 and 2007 consolidated financial statements have been reclassified to conform with the 2009 presentation.

ITEM 5. SELECTED FINANCIAL DATA

SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA

Summary of Consolidated Statement of Income — UNAUDITED

	(In Thousands, except share data)				
	2009	2008	2007	2006	2005
Summary of Income:					
Interest income	$ 41,114	$ 43,824	$ 45,424	$ 42,269	$ 38,101
Interest expense	13,220	18,101	21,722	18,535	13,539
Net Interest Income	27,894	25,723	23,702	23,734	24,562
Provision for loan loss	3,558	1,787	871	525	(425)
Net interest income after provision for loan loss	24,336	23,936	22,831	23,209	24,987
Other income (expense), net	(15,256)	(14,763)	(12,269)	(11,966)	(13,209)
Net income before income taxes	9,080	9,173	10,562	11,243	11,778
Income taxes	2,475	2,450	2,828	3,107	3,202
Net income	$ 6,605	$ 6,723	$ 7,734	$ 8,136	$ 8,576
Per Share of Common Stock:					
Earnings per common share outstanding *					
Net income	$ 1.39	$ 1.39	$ 1.52	$ 1.57	$ 1.65
Dividends	$ 0.720	$ 0.680	$ 0.640	$ 0.575	$ 0.500
Weighted average number of shares outstanding	4,741,392	4,846,310	5,097,636	5,186,329	5,198,728

* Based on weighted average number of shares outstanding

Summary of Consolidated Balance Sheet — UNAUDITED

	(In Thousands)				
	2009	2008	2007	2006	2005
Total assets	$853,860	$805,729	$803,974	$737,096	$720,945
Loans	563,911	562,336	523,474	498,580	458,704
Total Deposits	676,444	615,732	634,593	585,409	576,297
Stockholders' equity	93,584	90,547	89,375	87,732	82,588
Key Ratios					
Return on average equity	7.19%	7.51%	8.71%	9.64%	10.62%
Return on average assets	0.80%	0.84%	1.06%	1.14%	1.22%
Loans to deposits	83.36%	91.33%	82.49%	85.17%	79.65%
Capital to assets	10.96%	11.24%	11.12%	11.90%	11.46%
Dividend payout	51.66%	48.77%	42.00%	36.63%	30.31%

ITEM 6. MANAGEMENTS DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Critical Accounting Policy and Estimates

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

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

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

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

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

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

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

2009 in Review

2009 proved to be a tough year in which businesses had to operate. This was especially true in banking as negative press continued throughout the year and all banks were painted with the same brush. Increased FDIC assessments along with a special mid-year assessment impacted the bottom line with over $1.2 million additional expense recorded for 2009 as compared to 2008. This increased level of cost is forecasted to continue as the Bank has prepaid over $3.5 million for the next three years. While funds were available for the prepayment, it still represents a cost in terms of lost opportunity for earnings on the $3.5 million.

The Bank was not hit with the cost of failures in just our own industry, but rather from almost all industries as charge-offs and watch list loans increased also. Much of our lenders' time was spent working delinquencies and the one bright spot of the low rate environment, refinancing mortgages. Fortunately, many of our customers were able to refinance their mortgages to lower rates and payments even though their house values had declined. The financial impact of both these scenarios will be further discussed in the material changes in operations to follow.

The Bank launched a new product offering in March 2008: Reward Checking. The product is a free checking account which pays a high rate of interest to customers who agree to three qualifications each statement cycle. The three qualifications to be met each statement cycle are: 1.) the depositor agrees to

receive their checking statement electronically, 2.) receive one deposit or make one payment electronically to the account, for example, utilize direct deposit, and 3.) use the debit card tied to the account a specific number of times each statement cycle. The three qualifications enable the Bank to deliver the high interest rate as they create efficiencies or increase non-interest revenue to the Bank. As will be shown later, the success of this product grew throughout 2009 and is the reason for the increase in interest bearing liabilities. It has been extremely well received by customers and embraced by the Bank's employees. It has exceeded expectations at this point and continues to be the product of choice for a new checking customer. At year end 2009, it had the highest balance at over $49 million within the business and consumer checking portfolio. The Bank looks forward to further development of the product line in 2010 with the introduction of KASASA™. KASASA is the first national brand of the most innovative checking accounts available today. KASASA is a new word that was created to capture consumers' attention and awaken them to a new way of banking. These accounts are designed to be the first and only accounts that actually take an interest in their accountholders by paying them to use their account with what interests them most. More discussion will be focused on this product with the tables to follow.

The Company is proud of its results for 2009. Increased regulatory demands and high unemployment in the communities we serve impacted the level of profitability; however, the Company has remained in the black throughout the year. Using the Bank Holding Company and Uniform Bank Performance Report compiled by the Federal Reserve system as a reference, the Company was seven times more profitable than its national peer and the Bank twice its peers as of end of third quarter 2009.

Material Changes in Results of Operations

The discussion now turns to more financial based results and trends as a result of 2009 operations. In comparing line items of the consolidated statement of income for years ended 2007 through 2009, it is easily seen where the Company has been spending its time and the impact of the recession. Decreasing interest income and expense are obvious large factors on the profitability of the Company for 2009; however, that discussion can be found in the net interest income section. This discussion will focus on the significant non-interest items that impacted the operations of the Company.

Looking at the positive items first; overall, non-interest income shows a trend of improvement. A modest improvement of $94 thousand in 2008 over 2007 was followed by a more significant gain of over $1.3 million in 2009 as compared to 2008. Accounting for over $1 million of the gain was the revenue generated from mortgage loan activity through establishing mortgage servicing rights and gain on the sale of loans into the secondary market. As mentioned earlier, our loan officers and supporting departments were very busy in 2009 handling refinance activity for mortgages. It was a much needed, but unexpected source of increased revenue.

The second largest increase to non-interest income was derived from increased debit card usage. As the Bank receives interchange revenue from each "swipe" of the card, usage increased thereby increasing revenue over $126.5 thousand in 2009 over 2008. 2008's increase was $218.5 thousand over 2007. Both increases are attributed to the growth and popularity of the Bank's Reward checking product. One of the criteria for the payment of high interest on the account is utilizing the debit card at least twelve times per statement cycle. The Bank's Reward Checking customers average 25 transactions per statement, surpassing the 9 transactions average of our Free Checking customers. The additional revenue from debit card usage offsets the interest expense, creating a win-win situation for the customers and the Bank. In 2010, this revenue stream will be further enhanced with the addition of KASASA. All of the KASASA products will have a debit card usage qualification; however, interest income will not be the customer win for all accounts. Customers may choose to receive credit towards iTunes downloads or donate earnings to charity.

One additional non-interest income item to mention is overdraft and return check fee income. This revenue source decreased 6.5%, or $176 thousand, during 2009 even though the number of checking accounts increased 4.16% and the portfolio year end balance was $23.6 million higher in 2009 than 2008. Overdraft fees had been higher in 2008 than in 2007; however 2008's income fee was lower than in 2007. 2008 was higher due to the volume of checking accounts added from the Knisely acquisition. The average overdraft fee paid per account was $6.77 less in 2008 than in 2007. This revenue source is under intense regulatory review and proposed changes are predicted to decrease this line item by as much as 30% in 2010.

Service charge income remained virtually unchanged from 2008 even with the increase in accounts. Most of the new accounts added either don't have service fee charges and/or the balances are high enough to offset any charges. Both the OD and return check and service charge income from checking accounts are included in the customer service fees line item on the income statement.

Lastly, the Bank was able to take advantage of the ability to book some gains on the sale of securities. This opportunity presented itself in the first and last quarter of 2009. The Bank did not sacrifice long term profitability for short term gains as the yields of the portfolio were not negatively impacted by the sales. The discussion on causes for changes to yields follows in the interest section. The Bank did recognize a loss of just over $50 thousand on an equity security of a Banker's Bank. The entity had been taken over by the FDIC with its assets and deposits being bought by another financial institution.

Overall, non-interest expense increased 8.6% or $1.8 million in 2009 over 2008. This has proved to be an increasing trend as 2008 was 13.9% over 2007, or $2.6 million higher. The causes behind the increases; however, are different. The largest factor behind the 2009 increase was FDIC assessment, which was broken out as its own line item on the statement of income due to its significance. Of the $1.8 million increase in 2009 non-interest expense, $1.2 million is attributed to the cost of FDIC insurance.

Also mentioned previously was the mortgage refinancing activity of 2009. A correlating expense to that activity is the amortization of mortgage servicing rights. The income was discussed previously; the amortization is the offset to the income recognized. This increase occurred in both 2008 and 2009. Income is recorded when the mortgage loan is first sold with servicing retained and is therefore recognized within one year. The amortization, however, is calculated over the life of the loan and accelerated when paid off early. An increase in this expense can be driven by two activities: an increase in the number of sold loans and/or by the acceleration of the expense from payoff and refinance activity. The best picture of the bottom line impact is achieved by netting the income with the expense each year. 2007 had net income from mortgage servicing rights of $95 thousand, 2008 had net income of $77 thousand, and 2009 had net income of $225 thousand. Of course, the value (or income) of the mortgage servicing right when sold also impacts the net position. The reason for 2009's larger net position is due to the increase in the number of loans being serviced; thereby new rights are being established without having been offset by accelerated expense. This is evidenced by the year end number of loans and balances being up significantly. As of December 31 of each year, there were 3,571 loans serviced with outstanding balances of $267.8 million for 2009, 3,190 loans with balances of $233.9 million for 2008, and 3,178 loans with balances of $235.2 million for 2007. Returning to the expense only portion, expense for 2009 was $563 thousand higher than expense for 2008 and $676 thousand higher than 2007. As seen above, the increased expense was offset by a higher increase in income.

The impact of mortgage servicing rights, both income and expense is shown in the following table which reconciles the value of mortgage servicing rights which is another asset on the balance sheet. The capitalization runs through non-interest income while the amortization thereof is included in non-interest expense.

(In Thousands)	December 31, 2009	December 31, 2008
Beginning Balance, January 1	$ 1,970	$ 1,893
Capitalized Additions	1,158	447
Amortizations	(933)	(370)
Valuation Allowance	0	0
Ending Balance, December 31, 2009	$ 2,195	$ 1,970

During the first part of 2009, some of the Bank's lending officers were also very busy in auto loan financing. This activity was spurred by government and auto manufacturer incentives along with large banks exiting the market in the first half of the year. The consumer loan portfolio grew by 26%, or almost $6 million. This increased activity offset the increased salary expense as deferred costs from these loans are recorded as a deduction to the salary expense when the loans are made. While salaries and wages decreased in 2009 as compared to 2008, it was this component that made it possible. Base salary expense increased just over $400 thousand with the deferred costs offsetting with a $50 thousand increase for 2009. In 2008, as compared to 2007, base salary increased by $835 thousand, but was offset by a $98 thousand increase in deferred costs. The increases in base salary have been driven by additional offices being opened and increase in revenue generating positions, such as additional staff in the Bank's financial planning division.

Employee benefits ended 2009 at $185 less than (or basically even) 2008's and again it was for different reasons than the fluctuation of $214 thousand between 2008 and 2007. Employees group insurance costs were up $224 for 2009 over 2008 and 2008 costs were $51 thousand lower than 2007. The Bank is partially self-insured and fluctuations to costs are therefore caused by fluctuations in claims made by employees. In 2008, the Bank offered a Health Savings Account (HSA) option, along with offering its traditional medical plans. 70% of employees chose the HSA high deductible plan. Both options were available in 2009 and the decision was made to implement the HSA plan only bank-wide for 2010. The increase in medical expense was offset by a decrease of $201.5 thousand in miscellaneous personnel expense and in the BOLI retirement expense for 2009 as compared to 2008. Miscellaneous personnel expense includes such items as employee outings and the use of employment and executive search agencies. Bank Owned Life Insurance (BOLI) retirement expense represents the yearly cost to fund the liability of post retirement officers upon which the Bank has an insurance policy of which the Bank is the beneficiary. The total of these two expenses increased $216 thousand in 2008 as compared to 2007 and as stated previously was opposite of the movement in 2009 as compared to 2008.

Occupancy expense increased $84 thousand over 2008 with the largest impact stemming from the costs associated with holding Other Real Estate Owned (OREO). The balance in OREO increased from $426.7 thousand as of December 31, 2008 to $1.4 million as of December 31, 2009. The largest expense increase in occupancy was real estate taxes, which was driven by the additional holding of OREO and had increased $82.9 thousand. The larger increase of $465 thousand in occupancy expense in 2008 over 2007 was based on the increase in the number of offices and a decrease in the amount of building rent received from the Bank's brokerage division, FM Investments. The building rent received in 2009 was just 2% higher than in 2008, therefore it was not a factor in the increase for 2009.

As is often the case, an increase in technology costs is offset by efficiencies or cost savings found elsewhere on the statements of income. During 2008, the increase in furniture and equipment was caused by the increase in the number of offices and a new telephone system. The phone system utilizes the Bank's wide area data network, or VOIP (Voice Over Internet Protocol). The depreciation cost of which is offset by a reduction in long distance and line usage. In 2009, the increase in the furniture and equipment line item of $61 thousand over 2008 comes mainly from an increase in the expense of maintenance contracts. The majority of software utilized by the Bank includes an annual maintenance cost. This cost accounts for over 85% of the line item increase. It is an area that is closely monitored; however, not easily contained. Generally, to have additional revenue generated or expense decreased from new efficiencies, an additional expense will be incurred in furniture and equipment.

A positive reduction in data processing expense of $98 thousand occurred in 2009. This decrease is not attributable to just one vendor, but rather a negotiation with multiple vendors. This reduction is hoped to begin a trend of declining costs as the Bank plans to switch service providers in February 2010 at a cost savings. The pricing on many services, however, is based on number of accounts and the Bank fully expects those to increase with the KASASA additions and an improving economy.

It was mentioned earlier that much of the lenders' time was spent on mortgage refinancing and collections. The collection expense is included in the general and administrative expense. The collection expense increase of $92 thousand in 2008 as compared to 2007 has been followed by an additional $251 thousand increase in 2009 over 2008. A more positive comparison is the reduction by just under $74 thousand in 2009 of the expense associated with miscellaneous NSF (non-sufficient funds) and return checks. 2008 had seen an increase of $137 thousand over 2007 in this area where often the issue stems from fraudulent activity attempted on our customer accounts. This is often a reflection of a tough economy and the Bank worked hard to educate our customers and create an awareness to stop the losses. There are always a few that slip through the cracks but it is a credit to the Bank's front line personnel that a decrease to the expense took place.

The largest cost increase to the Bank in 2009 was the Provision for Loan Losses. A tough economic environment existed for most businesses in our primary market area during 2007 through 2009. In 2009, the provision expense was $1.8 million higher than 2008 and $2.7 million over 2007. Gross charge-offs were $3.3 million for 2009, as compared to 2008's $2.6 million and 2007's $1.6 million. Recoveries were $242, $348, and $732 thousand for 2009, 2008, and 2007, respectively. Unfortunately, 2009 had the highest charge-off and lowest recovery amounts, making the net charge-offs the highest at $3 million. 2008 had a net charge-off position of $2.2 million and 2007 had a position of less than $1 million. 2008 was impacted by mostly agricultural business and 2009 activity was mainly commercial driven. Further analysis by loan type is presented in the discussion of the allowance for credit losses.

Overall, the Company is proud to have another solid, positive year of performance during tough times. The Bank remains well capitalized and focused on how best to weather the economic climate. Some positive signs are beginning to show in our markets; however, the heavy burden of regulation is not easily overcome. FDIC assessments will be a way of life for the next three years. The Company forecasts moderate expansion while seeking opportunities to improve earnings and lower costs.

Net Interest Income

The net interest margin improved during 2009 as the Bank was able to adjust the majority of its deposit liabilities by a larger percentage down than which the loans were pricing down. A decrease occurred in both interest income and interest expense for the second straight year, however, the $4.2 million decrease in deposit interest expense alone outpaced the $2.7 million decrease in all interest income. Net interest income was $2.2 million higher than 2008 and 2008 was $2.0 million higher than 2007. As a percentage, net interest income was 17.7% higher than 2007, while the average balance on earning assets was only 5% higher for the same time period.

The following table presents net interest income, interest spread and net interest margin for the three years 2007 through 2009, comparing average outstanding balances of earning assets and interest bearing liabilities with the associated interest income and expense. The table also shows their corresponding average rates of interest earned and paid. The tax-exempt asset yields have been tax affected to reflect a marginal corporate tax rate of 34%. Average outstanding loan balances include non-performing loans and mortgage loans held for sale. Average outstanding security balances are computed based on carrying values including unrealized gains and losses on available-for-sale securities.

As the charts indicate, the Company experienced significant increased growth on an average basis for year 2008 compared to 2007 at 9.54%. 2009 had an increase of average assets of 3.13%. Interest earning assets average balance increased during all periods. The biggest component of the interest earning assets was loans. The decrease on yields is more pronounced on the other earning assets. Specifically, the largest fluctuation is in short-term funds, Federal Funds Sold. In 2007, the yield on Federal Funds was 4.67%, 2008 was 2.90%, and in 2009 it was 0.38%.

While the loan portfolio size has remained fairly constant in 2009, the yield, or income, generated has decreased for the second straight year. This is due to the low interest rate environment, with the lending prime rate within 26 basis points of the Company's net interest spread. Spread is the difference between what the Company earns on its assets and pays on its liabilities. It is on this spread that the Company must fund its operations and generate profit. When the asset yield decreases, so must the cost of funds to maintain profitability. It becomes increasingly challenging as the asset yield gets closer to the prime lending rate, or the break-even point, of operations. To mitigate the low rate environment, the Bank placed rate floors on most variable loans during 2009, which were typically 125 basis points over the current prime rate. This protected the Bank during a flat rate environment. The challenge will come when rates start to rise and the Bank will be affected by the index spreads also placed on the loans. An increased prime rate will not directly correlate to an increased yield on loans.

Overall, the tax equivalent yield on interest earning assets decreased to 5.52% for 2009 compared to 6.03% and 6.81% for 2008 and 2007 respectively. The percentage of interest earning assets to total assets increased slightly in 2009 over 2008 and remained above 90% at a respectable 93.55% for 2009.

As stated previously, the decreased yield on the assets was fortunately outpaced by the decreased cost of funds. The average balances for interest bearing liabilities increased only $17.4 million compared to 2008 and $83.5 million as compared to 2007. While the balance increased, the costs on those funds were significantly lower. The average cost for 2009 was 2.00% compared to 2008's 2.82% and 2007's 3.77%. The balances in non-interest bearing liabilities also increased during the last three years.

As with the yields on assets, the largest fluctuation in the cost of funds is in the shorter term liabilities, savings deposits. The cost on savings decreased 66% while on time deposits the cost decreased 38%. The Bank has focused on increasing its core deposit base to lessen the dependency on higher cost time deposits. The Bank has also attempted to increase the duration of the time deposits; however, customers have maintained a short-term, twelve month focus.

As stated previously, the charts show the improvement of the net interest margin from 2008 to 2009. A slight tightening occurred during 2008. Net interest spread increased 17 basis points during 2008 and 30 basis points during 2009. Net interest margin dropped 2 basis points in 2008 compared to 2007 and a 19 basis point increase from 2008 to 2009. Competition played a major role in the pressure applied on these margins along with the fluctuating rate environment and the slope of the yield curve during 2007 through 2009. The ability to grow loans was directly impacted by the ability to aggressively price the loans and finding borrowers wishing to borrow. The continued decrease in the prime lending rate and deterioration of the economy made any improvement in interest income very difficult. The two biggest factors in the decrease of interest expense in the liabilities were the volume of other time deposits that re-priced to a significantly lower rate during 2008 and 2009 and the large drop in the Federal Funds rate which directly

impacted the Federal funds purchased and securities sold under agreement to repurchase. The acquisition had a major impact on the average balances in 2008 as compared to 2007.

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

	2009 (In Thousands)		
	Average Balance	Interest/ Dividends	Yield/Rate
ASSETS			
Interest Earning Assets:			
Loans (1)	$558,869	$33,585	6.04%
Taxable investment securities	146,872	5,798	3.95%
Tax exempt investment securities	46,736	1,686	5.47%
Interest bearing deposits	—	—	0.00%
Federal funds sold	11,937	45	0.38%
Total Interest Earning Assets	764,414	$41,114	5.52%
Non-Interest Earning Assets:			
Cash and cash equivalents	19,209		
Other assets	39,007		
Total Assets	$822,630		
LIABILITIES AND SHAREHOLDERS' EQUITY			
Interest Bearing Liabilities:			
Savings deposits	$257,345	$ 1,755	0.68%
Other time deposits	317,619	9,252	2.91%
Other borrowed money	38,498	1,727	4.49%
Federal funds purchased and securities sold under agreement to repurchase	45,920	486	1.06%
Total Interest Bearing Liabilities	659,382	$13,220	2.00%
Non-Interest Bearing Liabilities:			
Non-interest bearing demand deposits	57,630		
Other	13,778		
Total Liabilities	730,790		
Shareholders' Equity	91,840		
Total Liabilities and Shareholders' Equity	$822,630		
Interest/Dividend income/yield		$41,114	5.52%
Interest Expense / yield		13,220	2.00%
Net Interest Spread		$27,894	3.51%
Net Interest Margin			3.79%

	2008 (In Thousands)		
	Average Balance	Interest/ Dividends	Yield/Rate
ASSETS			
Interest Earning Assets:			
Loans (1)	$544,310	$34,994	6.46%
Taxable investment securities	146,877	6,963	4.74%
Tax exempt investment securities	42,361	1,594	5.70%
Interest bearing deposits	—	—	0.00%
Federal funds sold	9,423	273	2.90%
Total Interest Earning Assets	742,971	$43,824	6.03%
Non-Interest Earning Assets:			
Cash and cash equivalents	19,399		
Other assets	35,317		
Total Assets	$797,687		
LIABILITIES AND SHAREHOLDERS' EQUITY			
Interest Bearing Liabilities:			
Savings deposits	$240,880	$ 2,760	1.15%
Other time deposits	314,005	12,467	3.97%
Other borrowed money	38,110	1,747	4.58%
Federal funds purchased and securities sold under agreement to repurchase	49,014	1,127	2.30%
Total Interest Bearing Liabilities	642,009	$18,101	2.82%
Non-Interest Bearing Liabilities:			
Non-interest bearing demand deposits	53,208		
Other	12,928		
Total Liabilities	708,145		
Shareholders' Equity	89,542		
Total Liabilities and Shareholders' Equity	$797,687		
Interest/Dividend income/yield		$43,824	6.03%
Interest Expense / yield		18,101	2.82%
Net Interest Spread		$25,723	3.21%
Net Interest Margin			3.60%

	2007 (In Thousands)		
	Average Balance	Interest/ Dividends	Yield/Rate
ASSETS			
Interest Earning Assets:			
Loans (1)	$502,815	$37,429	7.48%
Taxable investment securities	132,047	6,181	4.68%
Tax exempt investment securities	40,433	1,533	5.74%
Interest bearing deposits	286	17	5.94%
Federal funds sold	5,658	264	4.67%
Total Interest Earning Assets	681,239	$45,424	6.81%
Non-Interest Earning Assets:			
Cash and cash equivalents	17,318		
Other assets	29,684		
Total Assets	$728,241		
LIABILITIES AND SHAREHOLDERS' EQUITY			
Interest Bearing Liabilities:			
Savings deposits	$193,539	$ 3,978	2.06%
Other time deposits	312,515	14,424	4.62%
Other borrowed money	28,233	1,317	4.66%
Federal funds purchased and securities sold under agreement to repurchase	41,549	2,003	4.82%
Total Interest Bearing Liabilities	575,836	$21,722	3.77%
Non-Interest Bearing Liabilities:			
Non-interest bearing demand deposits	44,553		
Other	19,029		
Total Liabilities	639,418		
Shareholders' Equity	88,823		
Total Liabilities and Shareholders' Equity	$728,241		
Interest/Dividend income/yield		$45,424	6.81%
Interest Expense / yield		21,722	3.77%
Net Interest Spread		$23,702	3.04%
Net Interest Margin			3.62%

(1) For purposes of these computations, non-accruing loans are included in the daily average outstanding loan amounts.

The primary source of the Company's traditional banking revenue is net interest income. Net interest income is the difference between interest income on interest earning assets, such as loans and securities, and interest expense on liabilities used to fund those assets, such as interest bearing deposits and other borrowings. Net interest income is affected by changes in both interest rates and the amount and composition of earning assets and liabilities. The change in net interest income is most often measured as a result of two statistics — interest spread and net interest margin. The difference between the yields on earning assets and the rates paid for interest bearing liabilities supporting those funds represents the interest spread. Because non-interest bearing sources of funds such as demand deposits and stockholders' equity also support earning assets, the net interest margin exceeds the interest spread.

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

	2009 vs 2008 (In Thousands)		
	Net	Due to Change in	
	Change	Volume	Rate
Interest Earned On:			
Loans	$ (1,409)	$ 941	$ (2,350)
Taxable investment securities	(1,165)	—	(1,165)
Tax-exempt investment securities	92	249	(157)
Interest bearing deposits	—	—	—
Federal funds sold	(228)	73	(301)
Total Interest Earning Assets	$ (2,710)	$ 1,263	$ (3,973)
Interest Paid On:			
Savings deposits	$ (1,005)	$ 189	$ (1,194)
Other time deposits	(3,215)	143	(3,358)
Other borrowed money	(20)	18	(38)
Federal funds purchased and securties sold under agreement to repurchase	(641)	(71)	(570)
Total Interest Bearing Liabilities	$ (4,881)	$ 279	$ (5,160)

	2008 vs 2007 (In Thousands)		
	Net	Due to Change in	
	Change	Volume	Rate
Interest Earned On:			
Loans	$ (2,435)	$ 3,104	$ (5,539)
Taxable investment securities	782	694	88
Tax-exempt investment securities	61	111	(50)
Interest bearing deposits	(17)	(17)	—
Federal funds sold	9	176	(167)
Total Interest Earning Assets	$ (1,600)	$ 4,068	$ (5,668)
Interest Paid On:			
Savings deposits	$ (1,218)	$ 973	$ (2,191)
Other time deposits	(1,957)	69	(2,026)
Other borrowed money	430	460	(30)
Federal funds purchased and securties sold under agreement to repurchase	(876)	360	(1,236)
Total Interest Bearing Liabilities	$ (3,621)	$ 1,862	$ (5,483)

Interest rates began to drop at the end of third quarter 2007 and continued that course throughout 2008. With the increase in average balances during 2008, the significant increase in interest was to be expected due to change in volume. The difference in the two comparisons is the amount of change due to interest rates remaining low through the two periods. What did remain the same in the two comparisons is that the change in interest expense outpaced the change in interest income. In the early part of 2007, the Bank employed a strategy to keep time deposit "specials" to shorter terms (12 to 15 months). As rates continued to decline in 2008 and remain low throughout 2009, this strategy accomplished its goal of significantly lowering the cost of time deposits during 2008 and 2009. The strategy currently is to extend the maturities of "specials" to over 24 months to prepare for rising rates. The other strategy employed during 2008 and 2009 was to increase core deposits by offering innovative products focused on customer needs: higher interest rates. In exchange for a high interest-bearing checking account, customers were asked to utilize services that benefited both the Bank and themselves. Smaller time deposit rate shoppers had an option to perhaps change their behavior of banking or those deposits were allowed to run off. The new core deposit products were indeed embraced by our customers and have helped to reach the deposit portfolio mix the Bank was after. The improved net interest margin played a large role in offsetting the increased operating costs of credit.

Allowance for Credit Losses

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 Bank's ALLL methodology captures trends in leading, current, and lagging indicators which will directly affect the Bank's allocation amount. Trends in such leading indicators as delinquency, unemployment changes in the Bank's service area, experience and ability of staff, regulatory trends, and credit concentrations are referenced. A current indicator such as the total watch list loan amount to Capital, and a lagging indicator such as the charge off amount are referenced as well. A matrix is formed by loan type from these indicators that is responsive in making ALLL adjustments.

The Bank experienced a less than 1% uptick in Special Mention and Substandard loans as compared to total loans outstanding in 2009 as compared to year-end December 31, 2008. As a group, the Special Mention and Substandard loans increased 16.8% or $5.4 million in comparing yearend balances December 31, 2009 to December 31, 2008. In response to this increase, the Bank's ALLL to outstanding loans coverage percentage increased from .97% as of December 31, 2008 to 1.05% as of December 31, 2009.

The above indicators are reviewed quarterly. Some of the indicators are quantifiable and as such will automatically adjust the ALLL once calculated. These indicators include the ratio of past due loans to total loans, loans past due greater than 30 days, and watch list to capital ratios with the watch list made up of loans graded 5,6 or 7 on a 1 to 7 scale, 1 being the best rating. Both of these indicators caused the ALLL to increase during 2009. Other indicators use more subjective data to the extent possible to evaluate the potential for inherent losses in the Bank's loan portfolio. For example, the economic indicator uses the unemployment statistics from the communities in our market area to help determine whether the ALLL should be adjusted. At the end of 2009, a slight improvement was noted in unemployment figures and several local firms were calling a small number of employees back from layoff. During 2009 however, both of these trends were in the opposite direction and as such the ALLL was strengthened. The current recalls do not begin to approximate the number of positions lost.

All aggregate commercial and agricultural credits include real estate loans of $250,000 and over are reviewed annually by both credit committees and the internal loan review to look for early signs of deterioration.

To establish the specific reserve allocation in the instance of real estate, a discount to the market value is established to account for liquidation expenses. The discounting percentage used for real estate mirrors the discounting of real estate as provided in the guidance of the Bank’s Loan Policy. However, unique or unusual circumstances may be present which will affect the real estate value and, when appropriately identified, can adjust the discounting percentage at the discretion of management.

The ACL increased during 2009 as compared to 2008 as net charge-offs and past due loans had increased during 2009. The increase takes into account the high level of nonaccruals and watch list loans and the extended time period it may involve for resolution. $3.3 million in loans were charged off in 2009 compared to $2.6 million for 2008 and $1.6 million for 2007. The Company increased the allowance for credit losses for 2007 as $301 thousand of the increase was the allowance that came across from the acquisition. The allowance stands at $6.2 million for 2009 compared to $5.7 million for 2008 and $6.1 million for 2007. Provision expense was up $1.8 million for 2009 and $916 thousand for 2008, bringing the total expense to $3.6 million for 2009 compared to $1.8 million for 2008 and $871 thousand for 2007. The AULC remained almost equal to 2008, ending at $156 thousand for 2007, increased to $225 thousand for 2008, and ended 2009 at $227 thousand. Historical factors along with current economic conditions are part of the calculation to determine the adequacy of the allowance.

Non-interest Income

Non-interest income of $7.8 million is an increase of $982 thousand over 2008, while 2008 and 2007 were within $94 thousand of each other at $6.5 and $6.4 million, respectively. The largest fluctuations in non-interest income were impacted with the residential mortgage loan activity and sale of securities. Both of these were opportunities created from the low interest rate environment and may not be repeated in 2010.

Non-interest Expense

The increase of $1.8 million in non-interest expense for 2009 as compared to 2008 was mainly the increased FDIC assessment cost of $1.2 million and the $563 thousand of mortgage servicing rights amortization. The FDIC is a result of funding the insurance reserve for the increased number of failed banks the last two years and this cost will continue for the next few years to come. The mortgage servicing rights amortization came from the same residential mortgage activity as did the income; however, it was limited to the refinancing portion.

The difference in 2008 and 2007 was for entirely different reasons. Salaries and wages increased in 2008 as compared to 2007. Full time equivalent numbers of employees for December 2008 compared to September 2007 increased by seventeen with the addition of new offices. The incentive paid based on performance for 2008 was lower than 2007 as the overall performance of the Bank was lower. Employee benefits were lower as the Bank’s cost for medical insurance decreased during 2008 with lower claims and 401(k) expense was lower due to performance. This impact was discussed earlier.

Federal Income Taxes

Effective tax rates were 27.26%, 26.71%, and 26.78%, for 2009, 2008, and 2007, respectively. The effect of tax-exempt interest from holding tax-exempt securities and Industrial Development Bonds (IDBs) was $629, $654, and $650 thousand for 2009, 2008, and 2007, respectively.

Financial Condition

Average earning assets increased $21.4 million during 2009 over 2008 and were higher by $83.2 million as compared to 2007. The main cause of fluctuation was caused by the acquisition and repositioning the balance sheet. Average interest bearing liabilities increased $17.4 million over 2008 and $83.5 million from 2007. The increase in 2009 over 2008 was due to the success of the Reward Checking product to attract funds into the savings deposit bucket. The increase in 2008 over 2007 was from the acquisition and to fund the increase in loans.

Securities

The investment portfolio is first used mainly to provide overall liquidity for the Bank. It is also used to provide collateral for pledging to the Bank's Ohio public depositors for amounts on deposit over the FDIC coverage, as required by the State of Ohio. It may also be used to pledge for additional borrowings from third parties. Investments are made with the above criteria in mind while still seeking a fair market value of return, and looking for maturities that fall within the projected overall strategy of the Bank and the possible need to fund growth.

All of the Bank's security portfolio is categorized as available for sale with the exception of stock and as such is recorded at market value.

Security balances as of December 31 are summarized below:

	(In Thousands)		
	2009	2008	2007
U.S. Treasury	$ 5,219	$ —	$ —
U.S. Government agency	104,676	82,675	104,737
Mortgage-backed securities	36,848	51,826	39,367
State and local governments	60,538	43,160	41,467
	$207,281	$177,661	$185,571

The following table sets forth (dollars in thousands) the maturities of investment securities as of December 31, 2009 and the weighted average yields of such securities calculated on the basis of cost and effective yields weighted for the scheduled maturity of each security. Tax-equivalent adjustments, using a thirty-four percent rate have been made in yields on obligations of state and political subdivisions. Stocks of domestic corporations have not been included.

	Maturities (Amounts in Thousands)			
	Within One Year		After One Year Within Five Years	
	Amount	Yield	Amount	Yield
U.S. Treasury	$ —	0.00%	$ 5,219	1.26%
U.S. Government agency	31,037	2.90%	63,947	3.05%
Mortgage-backed securities	4,846	3.77%	32,002	4.91%
State and local governments	15,095	3.93%	18,578	3.40%
Taxable state and local governments	—	0.00%	2,089	3.50%

	Maturities (Amounts in Thousands)			
	After Five Years Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield
U.S. Treasury	$ —	0.00%	$ —	0.00%
U.S. Government agency	9,692	5.33%	—	0.00%
Mortgage-backed securities	—	0.00%	—	0.00%
State and local governments	22,281	3.67%	2,495	3.78%
Taxable state and local governments	—	0.00%	—	0.00%

As of December 31, 2009 the Bank did not hold a large block of any one investment security, except for U.S. Government agencies. The Bank also holds stock in the Federal Home Loan Bank of Cincinnati at a cost of $4.2 million. This is required in order to obtain Federal Home Loan Bank Loans. The Bank also acquired stock in the Federal Home Loan Bank of Indianapolis at a cost of $231.4 thousand and Banker's Bancorp, Inc at a cost of $50.8 thousand through its acquisition of Knisely Bank. There were no borrowings at the time of acquisition associated with Federal Home Loan Bank of Indianapolis. The value of the stock in Banker's Bancorp, Inc was written down to zero at the end of 2009 as the institution was taken over by its regulators. The Bank also owns stock of Farmer Mac with a carrying value of $27.4 thousand which is required to participate loans in the program.

Loan Portfolio

The Bank's various loan portfolios are subject to varying levels of credit risk. Management mitigates these risks through portfolio diversification and through standardization of lending policies and procedures.

Risks are mitigated through an adherence to Loan Policy with any exception being recorded and approved by Senior Management or committees comprised of Senior Management. Loan Policy defines parameters to essential underwriting guidelines such as loan-to-value ratio, cash flow and debt-to-income ratio, loan requirements and covenants, financial information tracking, collection practice and others. Limitation to any one borrower is defined by the Bank's legal lending limits and is stated in policy. On a broader basis, the Bank restricts total aggregate funding in comparison to Bank capital to any one business or agricultural sector by an approved sector percentage to capital limitation.

The following table shows the Bank's loan portfolio by category of loan as of December 31st of each year, including loans held for sale:

	(In Thousands)				
	2009	2008	2007	2006	2005
Loans:					
Commercial Real Estate	$214,849	$226,761	$181,340	$162,363	$113,283
Agricultural Real Estate	41,045	48,607	45,518	49,564	50,777
Consumer Real Estate	98,599	89,773	102,660	86,688	115,831
Commercial/industrial	120,543	112,526	104,188	101,788	81,893
Agricultural	59,813	56,322	58,809	69,301	61,502
Consumer	32,581	26,469	27,796	27,388	31,935
Industrial Development Bonds	2,552	7,572	9,289	7,335	9,237
Total Loans	$569,982	$568,030	$529,600	$504,427	$464,458

The following table shows the maturity of loans as of December 31, 2009:

	Maturities (In Thousands)			
	Within One Year	After One Year Within Five Years	After Five Years	Total
Commercial Real Estate	$12,811	$157,856	$44,182	$214,849
Agricultural Real Estate	1,410	14,450	25,185	$ 41,045
Consumer Real Estate	8,035	23,915	66,649	$ 98,599
Commercial and Industrial Loans	78,939	32,898	8,706	$120,543
Agricultural	43,253	13,861	2,699	$ 59,813
Consumer, Master Card and Overdrafts	5,882	19,741	6,958	$ 32,581
Industrial Development Bonds	862	639	1,051	$ 2,552

The following table presents the total of loans due after one year which has 1) predetermined interest rates and 2) floating or adjustable interest rates:

	(In Thousands)	
	Fixed Rate	Variable Rate
Commercial Real Estate	$26,398	$175,640
Agricultural Real Estate	4,337	35,298
Consumer Real Estate	20,069	70,495
Commercial and Industrial	15,924	25,680
Agricultural	9,508	7,052
Consumer, Overdrafts and other loans	26,696	3
Industrial Development Bonds	1,690	—

The following table summarizes the Company’s non-accrual and past due loans as of December 31 for each of the last five years:

	(In Thousands)				
	2009	2008	2007	2006	2005
Non-accrual loans	$ 14,054	$ 13,575	$ 4,918	$ 4,254	$ 4,663
Accruing loans past due 90 days or more	69	2,524	—	—	—
Total	$ 14,123	$ 16,099	$ 4,918	$ 4,254	$ 4,663

Although loans may be classified as non-performing, some pay on a regular basis, many continue to pay interest irregularly or at less than original contractual rates. Interest income that would have been recorded under the original terms of these loans was $2.0 million for 2009, $1.4 for 2008, and $313 thousand for 2007. Any collections of interest on non-accrual loans are included in interest income when collected unless it is on an impaired loan with a specific allocation. A collection of interest on an impaired loan with a specific allocation is applied to the loan balance to decrease the allocation needed. Total interest collections amounted to $290 thousand for 2009, $332 thousand for 2008, and $161 thousand for 2007. $6 thousand of interest collected in 2009 was applied to reduce the specific allocations, $20 thousand of interest collected in 2008 was applied to reduce the specific allocations, and $40 thousand of the interest collected in 2007 was applied to reduce the specific allocations for 2007.

Loans are placed on non-accrual status in the event that the loan is in past due status for more than 90 days or payment in full of principal and interest is not expected. The $14.1 million of non-accrual loans as of December 31, 2009 are secured. The loss of interest of $2 million on these non-accruals has significantly impacted the yield on loans.

As of December 31, 2009 the Bank has $25.6 million of loans which it considers to be potential problem loans in that the borrowers are experiencing financial difficulties. These loans are subject to constant management attention and are reviewed at least monthly.

The amount of the potential problem loans was considered in management's review of the loan loss reserve required at December 31, 2009.

In extending credit to families, businesses and governments, banks accept a measure of risk against which an allowance for possible loan loss is established by way of expense charges to earnings. This expense, used to enlarge a bank's allowance for loan losses, is determined by management based on a detailed monthly review of the risk factors affecting the loan portfolio, including general economic conditions, changes in the portfolio mix, past due loan-loss experience and the financial condition of the bank's borrowers.

As of December 31, 2009, the Bank had loans outstanding to individuals and firms engaged in the various fields of agriculture in the amount of $59.8 million with an additional $41 million in agricultural real estate loans. The ratio of this segment of loans to the total loan portfolio is not considered unusual for a bank engaged in and servicing rural communities.

Modifications granted are typically for seasonality issues where cash flow is decreased. The time period involved is generally quite short in relation to the loan term, for example, this may be interest only payments for 90 days. We consider this treatment of interest only payments for a short time as an insignificant delay in payment; consequently, we do not consider these occurrences as troubled debt restructurings. Interest rate modification to reflect a decrease in market interest rates or maintain a relationship with the debtor, where the debtor is not experiencing financial difficulty and can obtain funding from other sources, is not considered a troubled debt restructuring under FASB 15. The Bank has not used modifications to non-standard rates and terms to make a borrower cash flow their debt as a workout option. The Bank is occasionally ordered by the courts to give terms to a borrower that are better than what the Bank would like for the risk associated with that credit but not below or beyond rates and terms available for better credits in our market. Therefore, the Bank has not done any modifications that it would classify as "troubled debt restructurings."

Updated appraisals are required on all collateral dependent loans once they are deemed impaired. The Bank may also require an updated appraisal of a watch list loan which the Bank monitors under their loan policy. On a quarterly basis, Bank management reviews properties supporting asset dependent loans to consider market events indicating a change in value has occurred.

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.

Performing non-watch list customers secured in whole or in part by real estate do not require an updated appraisal unless the loan is rewritten and additional funds advanced. Watch List customers secured in whole or in part by real estate require updated appraisals every two years. All loans are subject to loan to values as found in Loan Policy no matter what their grade. Our watch list is reviewed on a quarterly basis by management and any questions to value are addressed at that time. All watch list accounts are to have real estate appraisals that are less than two years of age.

The majority of the Bank's loans are made in market by lenders that live and work in the market. Thus, their evaluation of the independent valuation is also valuable and serves as a double check.

On extremely rare occasions, the Bank will make adjustments to the recorded values of collateral securing commercial real estate loans without acquiring an updated appraisal for the subject property. The Bank has no formalized policy for determining when collateral value adjustments between regularly scheduled appraisals are necessary, nor does it use any specific methodology for applying such adjustments. However, on a quarterly basis as part of its normal operations, the Bank's senior management and the Loan Review Committee will meet to review all commercial credits either deemed to be impaired or on the Bank's Watch List. In addition to analyzing the recent performance of these loans, management and the Loan Review Committee will also consider any general market conditions that might warrant adjustments to the value of particular real estate collateralizing commercial loans. In addition, management conducts annual reviews of all commercial loans exceeding certain outstanding balance thresholds. In each of these situations, any information available to management regarding market conditions impacting a specific property or other relevant factors is considered, and lenders familiar with a particular commercial real estate loan and the underlying collateral may be present to provide their opinion on such factors. If the available information leads management to conclude a valuation adjustment is warranted, such an adjustment may be applied on the basis of the information available. If management concludes that an adjustment is warranted but lacks the specific information needed to reasonably quantify the adjustment, management will order a new appraisal on the subject property even though one may not be required under the Bank's general policies for updating appraisal.

ALLL is evaluated based on an assessment of the losses inherent in the loan portfolio. This assessment results in an allowance consisting of two components, allocated and unallocated.

Management considers several different risk assessments in determining ALLL. The allocated component of ALLL reflects expected losses resulting from an analysis of individual loans, developed through specific credit allocations for individual loans and historical loss experience for each loan category. For those loans where the internal credit rating is at or below a predetermined classification and management can reasonably estimate the loss that will be sustained based upon collateral, the borrowers operating activity and economic conditions in which the borrower operates, a specific allocation is made. For those borrowers that are not currently behind in their payment, but for which management believes based on economic conditions and operating activities of the borrower, the possibility exists for future collection problems, a reserve is established. The amount of reserve allocated to each loan portfolio is based on past loss experiences and the different levels of risk within each loan portfolio. The historical loan loss portion is determined using a historical loss analysis by loan category.

The unallocated portion of the reserve for loan losses is determined based on management's assessment of general economic conditions as well as specific economic factors in the Bank's marketing area. This assessment inherently involves a higher degree of uncertainty. It represents estimated inherent but undetected losses within the portfolio that are probable due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition and other current risk factors that may not have yet manifested themselves in the Bank's historical loss factors used to determine the allocated component of the allowance.

Actual charge-off of loan balances is based upon periodic evaluations of the loan portfolio by management. These evaluations consider several factors, including, but not limited to, general economic conditions, financial condition of the borrower, and collateral.

As presented below, charge-offs increased to $3.3 million for 2009, and the provision was $3.6 million. An additional $301 thousand is showing in the provision line for 2007 which represents ALLL that was carried over from the acquisition. The Commercial and Industrial portfolio was the only segment in a net recovery for 2008 and 2007, however it had the largest net charge-off position in 2009. The negative provision of 2005 was necessary to decrease the allowance because of the overall decrease of the loan portfolio and the

improved asset quality position. The decrease in the total allowance for credit losses for 2006 was due to the continued improvement in the asset quality position and reassessment of the risk existent in the unfunded loan commitments. The improvement in the ratio of net charge offs to average loans outstanding is evidence of the improved asset quality during that period.

The increase in net charge-offs and past due loans along with the loan growth were the reasons for the increase in the ALLL for 2007. The decrease in the ALLL for 2008 was due to the large level of charge-offs taken. With the charge-offs going higher in 2009, it became prudent to increase the ALLL for 2009. The increase provides for the high level of non-accrual and watch list loans and recognizes the extended time period with which it has taken to achieve resolution and/or collection of these loans.

The following table presents a reconciliation of the allowance for credit losses:

	(In Thousands)				
	2009	2008	2007	2006	2005
Loans	$569,982	$568,030	$529,600	$504,427	$464,488
Daily average of outstanding loans	$559,261	$544,859	$503,296	$484,663	$469,326
Allowance for Loan Losses-Jan 1	$ 5,496	$ 5,922	$ 5,594	$ 5,388	$ 6,814
Loans Charged off:					
Commercial Real Estate	—	—	376	214	82

	2009	2008	2007	2006	2005
	(In Thousands)				
Ag Real Estate	—	—	—	—	—
Consumer Real Estate	452	194	252	167	347
Commercial and Industrial	2,235	71	538	282	933
Agricultural	230	1,912	42	—	12
Consumer & other loans	371	384	368	322	722
	3,288	2,561	1,576	983	2,096
Loan Recoveries:					
Commercial Real Estate	—	—	25	2	—
Ag Real Estate	—	—	—	214	20
Consumer Real Estate	11	87	5	24	52
Commercial and Industrial	72	78	359	—	580
Agricultural	6	4	103	74	31
Consumer & other loans	153	179	240	352	412
	242	348	732	666	1,095
Net Charge Offs	3,047	2,213	844	319	1,001
Provision for loan loss	3,558	1,787	871	525	(425)
Acquisition provision for loan loss	—	—	301	—	—
Allowance for Loan & Lease Losses — Dec 31	$ 6,008	$ 5,496	$ 5,922	$ 5,594	$ 5,388
Allowance for Unfunded Loan Commitments & Letters of Credit Dec 31	$ 227	$ 226	$ 156	$ 168	$ 841
Total Allowance for Credit Losses — Dec 31	$ 6,235	$ 5,722	$ 6,078	$ 5,762	$ 6,229
Ratio of net charge-offs to average Loans outstanding	0.54%	0.41%	0.17%	0.07%	0.21%
Ratio of the Allowance for Loan Loss to Nonperforming Loans*	42.75%	40.48%	106.44%	N/A	N/A

* Nonperforming loans are defined as all loans on nonaccrual, plus any loans past due 90 days not on nonaccrual.

Allocation of ALLL per Loan Category in terms of dollars and percentage of loans in each category to total loans is as follows:

	2009 Amount (000's)	%	2008 Amount (000's)	%	2007 Amount (000's)	%	2006 Amount (000's)	%	2005 Amount (000's)	%
Balance at End of Period Applicable To:										
Commercial Real Estate	$1,810	37.69%	$1,810	39.92%	$1,358	34.24%	$1,221	32.19%	$ 756	24.39%
Agricultural Real Estate	120	7.20%	130	8.56%	117	8.60%	162	9.82%	88	10.93%
Consumer Real Estate	439	17.30%	386	15.80%	381	19.39%	288	17.19%	719	24.95%
Commercial & Industrial	2,494	21.14%	2,278	19.81%	1,859	19.67%	2,721	20.18%	2,246	17.63%
Agricultural	647	10.49%	413	9.92%	1,676	11.10%	250	13.74%	275	13.24%
Consumer, Overdrafts and other loans	498	5.72%	479	5.99%	531	7.00%	634	6.88%	526	8.86%
Unallocated	—		—		—		318		778	
Allowance for Loan & Lease Losses	$6,008	100.00%	$5,496	100.00%	$5,922	100.00%	$5,594	100.00%	$5,388	100.00%
Off Balance Sheet Commitments	$ 227		$ 226		$ 156		$ 168		$ 841	
Total Allowance for Credit Losses	$6,235		$5,722		$6,078		$5,762		$6,229	

Deposits

The amount of outstanding time certificates of deposits and other time deposits in amounts of $100,000 or more by maturity as of December 31, 2009 are as follows:

	(In Thousands)			
	Under Three Months	Over Three Months Less than Six Months	Over Six Months Less Than One Year	Over One Year
Time Deposits	$28,631	$22,205	$31,901	$31,922

The following table presents the average amount of and average rate paid on each deposit category:

	(In Thousands)			
	Non-Interest DDAs	Interest DDAs	Savings Accounts	Time Accounts
December 31, 2009:				
Average balance	$ 55,793	$145,259	$112,086	$317,619
Average rate	0.00%	1.02%	0.24%	2.91%
December 31, 2008:				
Average balance	$ 52,152	$130,887	$109,993	$314,005
Average rate	0.00%	1.46%	0.77%	3.97%
December 31, 2007:				
Average balance	$ 44,331	$ 84,674	$108,864	$312,515
Average rate	0.00%	2.30%	1.87%	4.58%

Liquidity

Liquidity remains high with the Bank also having access to $27 million of unsecured borrowings through correspondent banks and $34 million of unpledged securities which may be sold or used as collateral. An additional $7.1 million is also available from the Federal Home Loan Bank based on current collateral pledging with up to $114 million available provided adequate collateral is pledged.

Maintaining sufficient funds to meet depositor and borrower needs on a daily basis continues to be among our management's top priorities. This is accomplished not only by the immediately liquid resources of cash, due from banks and federal funds sold, but also by the Bank's available for sale securities portfolio. The average aggregate balance of these assets was $216 million for 2009, compared to $220 million for 2008, and $196 million for 2007. This represented 26.3 percent, 28.0 percent, and 26.9 percent of total average assets, respectively. Of the almost $208 million of debt securities in the company's portfolio as of December 31, 2009, $51 million or 24.6 percent of the portfolio is expected to mature in 2010. Taking into consideration possible calls of the debt securities, the amount climbs to $104.2 million or 50.3 percent of the portfolio becomes a source of funds. The availability of the funds may be reduced by the need to utilize securities for pledging purposes on public deposits. This liquidity provides the opportunity to fund loan growth without having to over aggressively price deposits.

Historically, the primary source of liquidity has been core deposits that include non-interest bearing and interest bearing demand deposits, savings, money market accounts and time deposits of individuals. Core deposits increased as of year end balances in 2009, in all categories. Overall deposits increased an average of $29.3 million during 2009 compared to 2008's increase over 2007 of $53.4 million in average deposits. These represent changes of 4.8 percent and 9.5 percent in average total deposits, respectively. The Bank also utilized Federal Funds purchased at times during 2009. The average balance for 2009 was $5 thousand.

Again, historically, the primary use of new funds is placing the funds back into the community through loans for the acquisition of new homes, consumer products and for business development. The use of new funds for loans is measured by the loan to deposit ratio. The Company's average loan to deposit ratio for 2009 was 85.95 percent, 2008 was 87.81percent, and 2007 was 88.82 percent. The lower ratio in 2009 was due to the success of the deposit gathering function and the residential mortgage loans being sold in the secondary market. The lower ratio in 2008 is due to the lower loan to deposit ratio of the acquisition and utilizing excess funds to grow loans. 2007 represented the increased loan growth outpacing deposit growth. The Company's goal is for this ratio to be higher with loan growth the driver; however, this was difficult to achieve in 2009 with borrowers taking a conservative approach to increasing their liabilities.

Short-term debt such as federal funds purchased and securities sold under agreement to repurchase also provides the Company with liquidity. Short-term debt for both federal funds purchased and securities sold under agreement to repurchase amounted to $43.3 million at the end of 2009 compared to $48.2 million at the end of 2008 and to $41.3 million at the end of 2007. Though no federal funds were purchased at year end, the Bank does have arrangements with correspondent Banks that can be utilized when necessary. Following is a table showing the daily securities sold under agreement to repurchase activity for 2009, 2008, and 2007. These accounts are used to provide a sweep product to the Bank's commercial customers. The decrease in balances during 2009 was due to business' discontinuing the sweep as the cost of fees were higher than the interest benefit on lower balance accounts. These funds may return in the future when short-term rates increase.

	Daily Securities Sold Under Agreement to Repurchase				
	Amount Oustanding at End of Period (000'S)	Weighted Average Rate End of Period	Maximum Amount Borrowings Outstanding Month End (000's)	Approximate Average Outstanding in Period (000's)	Approximate Weighted Average Interest Rate For the Period
2009	$33,457	0.42%	$40,530	$37,696	0.48%
2008	$40,014	0.50%	$47,644	$40,113	1.96%
2007	$35,059	3.72%	$39,205	$31,513	4.64%

Other borrowings are also a source of funds. Other borrowings consist of loans from the Federal Home Loan Bank of Cincinnati. These funds are then used to provide fixed rate mortgage loans secured by homes in our

community. Borrowings from this source decreased by $11.4 million to $34.2 million at December 31, 2009. This compares to increased borrowings during 2008 of $13.8 million to $45.6 million at December 31, 2008 and increased borrowings during 2007 of $8.6 million to $31.8 million to end at December 31, 2007. The increased borrowings in 2008 and 2007 were used to fund loan growth and were a cheaper source of funds than certificate of deposits. The decreased borrowings were payoffs of matured notes in 2009. Sufficient funds were available to fund growth so new advances were not needed in 2009.

Asset/Liability Management

The primary functions of asset/liability management are to assure adequate liquidity and maintain an appropriate balance between interest earning assets and interest bearing liabilities. It involves the management of the balance sheet mix, maturities, re-pricing characteristics and pricing components to provide an adequate and stable net interest margin with an acceptable level of risk. Interest rate sensitivity management seeks to avoid fluctuating net interest margins and to enhance consistent growth of net interest income through periods of changing interest rates.

Changes in net income, other than those related to volume arise when interest rates on assets re-price in a time frame or interest rate environment that is different from that of the re-pricing period for liabilities. Changes in net interest income also arise from changes in the mix of interest-earning assets and interest-bearing liabilities.

Historically, the Bank has maintained liquidity through cash flows generated in the normal course of business, loan repayments, maturing earning assets, the acquisition of new deposits, and borrowings. The Bank’s asset and liability management program is designed to maximize net interest income over the long term while taking into consideration both credit and interest rate risk. Interest rate sensitivity varies with different types of interest-earning assets and interest-bearing liabilities. Overnight federal funds on which rates change daily and loans that are tied to the market rate differ considerably from long-term investment securities and fixed rate loans. Similarly, time deposits over $100,000 and money market certificates are much more interest rate sensitive than passbook savings accounts. The Bank utilizes shock analysis to examine the amount of exposure an instant rate change of 100, 200, and 300 basis points in both increasing and decreasing directions would have on the financials. Acceptable ranges of earnings and equity at risk are established and decisions are made to maintain those levels based on the shock results.

Impact of Inflation And Changing Prices

The consolidated financial statements and notes thereto presented herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of the Company’s operations. Unlike most industrial companies, nearly all the assets and liabilities of the Company are monetary in nature. As a result, interest rates have a greater impact on the Company’s performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and service.

Contractual Obligations

Contractual Obligations of the Company totaled $405.3 million as of December 31, 2009. Time deposits represent contractual agreements for certificates of deposits held by its customers. Long term debt represents the borrowings with the Federal Home Loan Bank and is further defined in Note 4 and 9 of the Consolidated Financial Statements.

Contractual Obligations	Total	Payment Due by Period (In Thousands) Less than 1 year	1-3 Years	3-5 Years	More than 5 years
Securities sold under agreement to repurchase	$ 43,257	$ 43,257			
Time Deposits	326,957	221,435	89,100	14,977	1,445
Dividends Payable	853	853			
Long Term Debt	34,199	13,325	18,274	2,600	
Total	$405,266	$278,870	$107,374	$17,577	$ 1,445

Capital Resources

Stockholders' equity was $93.6 million as of December 31, 2009 compared to $90.5 million at December 31, 2008. Dividends declared during 2009 were $0.72 per share totaling $3.41 million, 5.88 percent higher than 2008's declared dividends of $0.68 per share. During 2009, the Company purchased 28,907 shares and awarded 10,000 restricted shares to 49 employees under its long term incentive plan. 350 shares were forfeited during 2009. At year end 2009, the Company held 437,551 shares in Treasury stock and 27,775 in unearned stock awards. The Company purchased 171,889 shares throughout 2008. 10,000 shares were awarded to 51 employees in 2008. 245 restricted shares were forfeited during 2008. At December 31, 2008, the Company held 418,294 shares in Treasury stock and 23,575 in unearned stock awards. The Company continues to have a strong capital base and to maintain regulatory capital ratios that are significantly above the defined regulatory capital ratios. On December 18, 2009, the Company announced the authorization by its Board of Directors for the Company's repurchase, either on the open market, or in privately negotiated transactions, of up to 200,000 shares of its outstanding common stock commencing January 01, 2010 and ending December 31, 2010.

At December 31, 2009, The Farmers & Merchants State Bank and Farmers & Merchants Bancorp, Inc had total risk-based capital ratios of 14.10% and 14.14%, respectively. Core capital to risk-based asset ratios of 10.85% and 13.19% are well in excess of regulatory guidelines. The Bank's leverage ratio of 8.5% is also substantially in excess of regulatory guidelines as is the Company's at 10.3%.

The Company's subsidiaries are restricted by regulations from making dividend distributions in excess of certain prescribed amounts.

ITEM 6a. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

Market risk is the exposure to loss resulting from changes in interest rates and equity prices. The primary market risk to which we are 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 profitability may be adversely affected. The Company employs a sensitivity analysis utilizing interest rate shocks to help in this analysis.

The shocks presented below assume an immediate change of rate in the percentages and directions shown:

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
2.77%	-10.98%	Rising	3.00%	23,220	-10.43%
2.88%	-7.27%	Rising	2.00%	24,127	-6.93%
2.99%	-3.61%	Rising	1.00%	25,028	-3.46%
3.11%	0.00%	Flat	0	25,924	0.00%
3.20%	3.12%	Falling	-1.00%	26,874	3.66%
3.27%	5.42%	Falling	-2.00%	27,487	6.03%
3.32%	7.02%	Falling	-3.00%	27,977	7.92%

The shock chart currently shows a tightening in net interest margin over the next twelve months in a rising rate environment. It shows expansion of net interest margin should rates fall. Both directional changes are well within risk exposure guidelines. 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.

ITEM 7. FINANCIAL STATEMENTS

Index To Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheet at December 31, 2009 and 2008
Consolidated Statements of Income for the years ended December 31, 2009, 2008 and 2007
Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2009, 2008 and 2007
Consolidated Statements of Cash Flow for the years ended December 31, 2009, 2008 and 2007
Notes to Consolidated Financial Statements

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Farmers & Merchants Bancorp, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Farmers & Merchants Bancorp, Inc. and Subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2009. We also have audited the Company's internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying financial statements. Our responsibility is to express an opinion on these financial statements and an opinion on the company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately

and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Farmers & Merchants Bancorp, Inc. and Subsidiaries as of December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Farmers & Merchants Bancorp, Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ Plante & Moran, PLLC
Plante & Moran, PLLC

February 24, 2010
Columbus, Ohio

Farmers & Merchants Bancorp, Inc and Subsidiaries

Consolidated Balance Sheet
December 31, 2009 and 2008
(000's Omitted, Except Per Share Data)

	2009	2008
Assets		
Assets		
Cash and due from banks (Note 1)	$ 28,691	$ 19,148
Federal Funds Sold	4,957	1,739
Total cash and cash equivalents	33,648	20,887
Securities — available for sale (Note 3)	207,281	177,661
Other Securities, at cost (Note 3)	4,448	4,498
Loans, net (Note 4)	563,911	562,336
Premises and equipment (Note 5)	16,053	16,806
Goodwill (Note 2)	4,074	4,074
Other assets (Note 2 & 6)	24,445	19,467
Total Assets	$853,860	$805,729
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing	$ 65,302	$ 62,582
Interest-bearing		
NOW accounts	160,432	136,760
Savings	123,753	122,482
Time (Note 7)	326,957	293,908
Total deposits	676,444	615,732
Securities sold under agreement to repurchase (Note 8)	43,257	48,214
FHLB Advances (Note 9)	34,199	45,635
Dividend payable	853	857
Accrued expenses and other liabilities (Note 10)	5,523	4,744
Total liabilities	760,276	715,182
Stockholders' Equity (Note 14 and 15)		
Common stock — No par value — 6,500,000 shares authorized; 5,200,000 shares issued & outstanding	12,677	12,677
Treasury Stock — 437,551 Shares 2009, 418,294 Shares 2008	(9,082)	(8,727)
Unearned Stock Awards — 27,775 Shares 2009, 23,575 Shares 2008	(573)	(503)
Retained earnings	88,048	84,864
Accumulated other comprehensive income	2,514	2,236
Total stockholders' equity	93,584	90,547
Total Liabilities and Stockholders' Equity	$853,860	$805,729

See Notes to Consolidated Financial Statements

Farmers & Merchants Bancorp, Inc and Subsidiaries

Consolidated Statement of Income
Years Ended December 31, 2009, 2008 and 2007
(000's Omitted, Except Per Share Data)

	2009	2008	2007
Interest Income			
Loans, including fees	$ 33,585	$ 34,994	$ 37,429
Debt securities:			
U.S. Treasury and government agency	5,496	6,634	5,813
Municipalities	1,788	1,697	1,635
Dividends	200	226	266
Federal funds sold	19	273	264
Other	26	—	17
Total interest income	41,114	43,824	45,424
Interest Expense			
Deposits	11,007	15,227	18,402
Federal funds purchased and securities sold under agreements to repurchase	486	1,127	2,003
Borrowed funds	1,727	1,747	1,317
Total interest expense	13,220	18,101	21,722
Net Interest Income — Before provision for loan losses	27,894	25,723	23,702
Provision for Loan Losses (Note 4)	3,558	1,787	871
Net Interest Income After Provision For Loan Losses	24,336	23,936	22,831
Noninterest Income			
Customer service fees	3,276	3,436	3,201
Other service charges and fees	2,541	2,322	2,569
Net gain on sale of loans	1,776	708	617
Net gain on sale of securities	230	15	—
Total noninterest income	7,823	6,481	6,387
Noninterest Expenses			
Salaries and Wages	8,601	8,715	8,084
Employee benefits (Note 11)	3,018	3,018	2,804
Occupancy expense	1,113	1,029	564
Furniture and equipment	1,504	1,443	1,321
Data processing	1,136	1,234	1,019
Franchise taxes	914	863	873
FDIC Assessment	1,306	151	67
Mortgage servicing rights amortization (Note 6)	933	370	257
Other general and administrative	4,554	4,421	3,667
Total other operating expenses	23,079	21,244	18,656
Income Before Income Taxes	9,080	9,173	10,562
Income Taxes (Note 10)	2,475	2,450	2,828
Net Income	$ 6,605	$ 6,723	$ 7,734
Earnings Per Share — Basic and Diluted	$ 1.39	$ 1.39	$ 1.52
Weighted Average Shares Outstanding	4,741,392	4,846,310	5,097,636

See Notes to Consolidated Financial Statements

Farmers & Merchants Bancorp, Inc. and Subsidiaries

Consolidated Statement of Changes in Shareholders Equity
For the Years Ended December 31, 2009, 2008, and 2007
(000's Omitted, Except per Share Data)

	Shares of Common Stock	Common Stock	Treasury Stock	Unearned Stock Awards	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance — January 01, 2007	5,163,820	12,677	(816)	(244)	77,089	(974)	87,732
Comprehensive income (Note 1):							
Net income					7,734		7,734
Change in net unrealized gain on securities available for sale, net of reclassification adjustment and tax effects						1,854	1,854
Total comprehensive income							9,588
Purchase of Treasury Stock	(228,000)		(4,710)				(4,710)
Shares issued for vested stock awards				13			13
Grant of Restricted Stock Awards-8760 shares (Net of Forfeiture — 740)	8,020		160	(160)			
Cash dividends declared — $0.64 per share					(3,248)		(3,248)
Balance — December 31, 2007	4,943,840	12,677	(5,366)	(391)	81,575	880	89,375
Cumulative effect of adoption of EITF 06-4 for post retirement liability					(152)		(152)
Comprehensive income (Note 1):							
Net income					6,723		6,723
Change in net unrealized gain on securities sale, net of reclassification adjustment and tax						1,356	1,356
Total comprehensive income							8,079
Purchase of Treasury Stock	(171,889)		(3,576)				(3,576)
Shares issued for vested stock awards				98			98
Grant of Restricted Stock Awards-10,000 shares (Net of Forfeiture — 245)	9,755		215	(210)			5
Cash dividends declared — $0.68 per share					(3,282)		(3,282)
Balance — December 31, 2008	4,781,706	$12,677	$ (8,727)	$ (503)	$84,864	$ 2,236	$ 90,547
Comprehensive income (Note 1):							
Net income					6,605		6,605
Change in net unrealized gain on securities sale, net of reclassification adjustment and tax						278	278
Total comprehensive income							6,883
Purchase of Treasury Stock	(28,907)		(555)				(555)
Shares issued for vested stock awards							
Grant of Restricted Stock Awards-10,000 shares				123	(8)		115
(Net of Forfeiture — 350)	9,650		200	(193)			7
Cash dividends declared — $0.72 per share					(3,413)		(3,413)
Balance — December 31, 2009	4,762,449	$12,677	$ (9,082)	$ (573)	$88,048	$ 2,514	$ 93,584

See notes to Consolidated Financial Statements

Farmers & Merchants Bancorp, Inc and Subsidiaries

Consolidated Statement of Cash Flows
Years Ended December 31, 2009, 2008 and 2007
(000's Omitted)

	2009	2008	2007
Cash Flows from Operating Activities			
Net income	$ 6,605	$ 6,723	$ 7,734
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation	1,171	1,132	1,059
Amortization of servicing rights	933	370	257
Amortization of Core Deposit Intangible	157	157	—
Provision for loan loss	3,558	1,787	871
Accretion and amortization of securities	809	300	131
Deferred income taxes (benefit)	142	(39)	(170)
(Gain) loss on sale of other assets	75	194	4
Realized (gain) loss on sales of securities, net	(230)	(15)	—
Change in other assets and other liabilities, net	(6,026)	(1,943)	(1,343)
Net cash provided by operating activities	7,194	8,666	8,543
Cash Flows from Investing Activities			
Activity in securities:			
Sales	16,333	25	215
Maturities, prepayments and calls	78,292	75,084	80,876
Purchases	(124,354)	(65,580)	(95,804)
Loan and lease originations and principal collections, net	(5,133)	(41,266)	6,620
Proceeds from sales of assets	494	1,102	—
Additions to premises and equipment	(412)	(1,081)	(2,675)
Purchase of Bank Owned Life Insurance	—	—	(3,000)
Net cash paid for acquisition	—	—	(2,400)
Net cash used in investing activities	(34,780)	(31,716)	(16,168)
Cash Flows from Financing Activities			
Net increase (decrease) in deposits	60,712	(18,861)	12,108
Net change in federal funds purchased and securities sold under agreements to repurchase	(4,957)	6,885	6,511
Proceeds from issuance of long-term debt	—	19,600	15,000
Repayment of long-term debt	(11,436)	(5,781)	(6,417)
Purchase of Treasury Stock	(555)	(3,576)	(4,710)
Cash dividends paid on common stock	(3,417)	(3,217)	(3,227)
Net cash provided (used) by financing activities	40,347	(4,950)	19,265
Net Increase (Decrease) in Cash and Cash Equivalents	12,761	(28,000)	11,640
Cash and Cash Equivalents — Beginning of Year	20,887	48,887	37,247
Cash and Cash Equivalents — End of Year	**$ 33,648**	**$ 20,887**	**$ 48,887**
Supplemental Information			
Cash paid during the year for:			
Interest	**$ 13,275**	**$ 18,756**	**$ 21,721**
Income taxes	**$ 2,725**	**$ 2,445**	**$ 3,120**

See Notes to Consolidated Financial Statements

Note 1 — Summary of Significant Accounting Policies

Nature of Operations

The Farmers & Merchants Bancorp, Inc. (the Company) through its bank subsidiary, The Farmers & Merchants State Bank (the Bank) provides a variety of financial services to individuals and small businesses through its offices in Northwest Ohio and Northeast Indiana.

Consolidation Policy

The consolidated financial statements include the accounts of Farmers & Merchants Bancorp, Inc. and its wholly-owned subsidiaries, The Farmers & Merchants State Bank (the Bank), a commercial banking institution, and the Farmers & Merchants Life Insurance Company, a reinsurance company for life, accident and health insurance for the Bank's consumer credits. The Farmers & Merchants Life Insurance Company was dissolved during 2007 with the Bank no longer offering the insurance product to its non-residential real estate consumers. The Bank continues to offer credit insurance related products to our residential real estate customers; however, it is through an unrelated third party vendor. All significant inter-company balances and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of mortgage servicing rights. Actual results could differ from those estimates.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

The Bank's loans are generally secured by specific items of collateral including real property, consumer assets, and business assets. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions in the agricultural industry.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Cash and Cash Equivalents

For purposes of the consolidated statement of cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. This includes cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold for one day periods.

Note 1 — Summary of Significant Accounting Policies (Continued)

Restrictions on Cash and Amounts Due from Banks

The Bank is required to maintain average balances on hand with the Federal Reserve Bank. The aggregate reserve was $4.0 million for December 31, 2009 and it was $3.0 million for December 31, 2008.

The Company and its subsidiaries maintain cash balances with high quality credit institutions. At times such balances may be in excess of the federally insured limits.

Securities

Debt securities are classified as available-for-sale. Securities available-for-sale are carried at fair value with unrealized gains and losses reported in other comprehensive income. Realized gains and losses on securities available for sale are included in other income (expense) and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. Gains and losses on sales of securities are determined on the specific-identification method.

Declines in the fair value of securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The related write-downs are included in earnings as realized losses.

Other Securities

Other Securities consists of Federal Home Loan Bank of Cincinnati and Indianapolis stock, Bankers Bank stock, and Farmer Mac stock. These stocks are carried at cost and are held to enable the Bank to conduct business with the entities. The Federal Home Loan Banks sell and purchase their stock at par; therefore cost approximates market value. The Federal Home Loan Bank of Cincinnati stock is held as collateral security for all indebtedness of the Bank to the Federal Home Loan Bank.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at the amount of unpaid principal, reduced by unearned discounts and deferred loan fees and costs, as well as, by the allowance for loan losses. Interest income is accrued on a daily basis based on the principal outstanding.

Generally, a loan is classified as nonaccrual and the accrual of interest income is generally discontinued when a loan becomes ninety days past due as to principal or interest and these loans are placed on a “cash basis” for purposes of income recognition. Management may elect to continue the accrual of interest when the estimated net realizable value of collateral is sufficient to cover the principal and accrued interest, and the loan is in the process of collection. When a loan is placed on nonaccrual status, all previously accrued and unpaid interest receivable is charged against income.

Loan origination and commitment fees and certain direct loan origination costs are deferred and amortized as a net adjustment to the related loan’s yield. The Bank is generally amortizing these costs over the contractual life of such loans.

Note 1 — Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses charged to income. Loans deemed to be uncollectable and changes in the allowance relating to loans are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based on management's periodic review of the collectability of the loans in light of historical experiences, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are subject to revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. The unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and agricultural loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

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.

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.

Large groups of homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer loans for impairment disclosures.

Note 1 — Summary of Significant Accounting Policies (Continued)

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized in a valuation allowance by charges to income.

Servicing Assets

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into noninterest expense in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum. Fees received for servicing loans owned by investors are based on a percentage of the outstanding monthly principal balance of such loans and are included in operating income as loan payments are received. Costs of servicing loans are charged to expense as incurred.

Goodwill and other Intangible Assets

Goodwill results from business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment is recognized in the period identified.

Other intangible assets consist of core deposit intangible assets arising from business acquisitions. They are initially measured at fair value and then are amortized on a straight line method over their estimated useful lives.

Off Balance Sheet Instruments

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

Bank Premises and Equipment

Land is carried at cost. Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is based on the estimated useful lives of the various properties and is computed using straight line and accelerated methods. Costs for maintenance and repairs are charged to operations as incurred. Gains and losses on dispositions are included in current operations.

Federal Income Tax

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

Note 1 — Summary of Significant Accounting Policies (Continued)

Earnings Per Share

Basic earnings per share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Basic and dilutive earnings per share are the same as the restricted stock grants are primarily anti-dilutive.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet. Such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

	(In Thousands)		
	2009	2008	2007
Net Unrealized gain on available-for-sale securities	$ 701	$2,055	$2,810
Reclassification adjustment for gain on sale of available-for-sale securities	$(281)	$ —	$ —
Net unrealized gains	$ 420	$2,055	$2,810
Tax Effect	$ 142	$ 699	$ 956
Other comprehensive income	$ 278	$1,356	$1,854

Other securities, not classified as available for sale, had a realized loss of $51 thousand for 2009 and a $15 thousand gain in 2008. Those amounts are not included in the above table.

Post Retirement Liability

In September 2006, the accounting for deferred compensation and postretirement benefit aspects of endorsement split-dollar life insurance arrangements was changed. Effective in 2008, liability and related compensation costs are recognized for endorsement split-dollar life insurance policies that provide a benefit to an employee extending to postretirement periods. This accounting pronouncement was applied as a change in accounting principle through a cumulative-effect adjustment to retained earnings as of January 01, 2008 approximating $152,000.

Reclassification

Certain amounts in the 2008 and 2007 consolidated financial statements have been reclassified to conform with the 2009 presentation.

Note 2 — Business Combination

On December 31, 2007, the Bank acquired 100% of the outstanding shares of Knisely Bank. Knisely Bank was merged with and into the Bank, and the Knisely Bank offices now operate as branches of the Bank. The merger enabled the Company to increase its market share in a community contiguous to its existing markets.

The aggregate acquisition cost of Knisely Bank was $10.4 million, which was all paid in cash. Direct acquisition costs approximated $222 thousand. The acquisition cost in excess of the net assets and identifiable intangible assets acquired, has been recorded as goodwill of $4 million. Goodwill that is deductible for tax purposes is approximately $3.85 million.

Note 2 — Business Combination (Continued)

In connection with the acquisition, the Company recognized core deposit intangible assets of $1.1 million, which are being amortized on a straight line basis over the estimated remaining economic useful life of the deposits of 7 years. There was no amortization of the core deposit intangibles for the year ended December 31, 2007, but $157,000 was amortized in 2008 and 2009. Amortization of the core deposit intangibles remaining is scheduled to be as follows:

	(In Thousands)
2010	157
2011	157
2012	157
2013	157
2014	158
	$ 786

Note 3 — Securities

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

	(In Thousands) 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available-for-Sale:				
U.S. Treasury	$ 5,244	$ —	$ (25)	$ 5,219
U.S. Government agency	103,311	1,501	(136)	104,676
Mortgage-backed securities	35,209	1,639	—	36,848
State and local governments	59,708	1,009	(179)	60,538
	$203,472	$ 4,149	$ (340)	$207,281

	(In Thousands) 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available-for-Sale:				
U.S. Treasury	$ —	$ —	$ —	$ —
U.S. Government agency	80,477	2,198	—	82,675
Mortgage-backed securities	50,831	1,052	57	51,826
State and local governments	42,964	561	365	43,160
	$174,272	$ 3,811	$ 422	$177,661

Note 3 — Securities (Continued)

Information pertaining to securities with gross unrealized losses at December 31, 2009 and 2008, aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

	2009			
	(In Thousands) Less Than Twelve Months		(In Thousands) Twelve Months & Over	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. Treasury	$ 25	$ 5,219	$ —	$ —
U.S. Government agency	136	14,355	—	—
Mortgage-backed securities	—	—	—	—
State and local governments	179	15,754	—	—

	2008			
	(In Thousands) Less Than Twelve Months		(In Thousands) Twelve Months & Over	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. Treasury	$ —	$ —	$ —	$ —
U.S. Government agency	—	—	—	—
Mortgage-backed securities	46	4,390	11	1,822
State and local governments	326	11,899	39	482

Unrealized losses on securities have not been recognized into income because the issuers' bonds are of high credit quality, the Bank has the intent and ability to hold the securities for the foreseeable future, and the decline in fair value is primarily due to increased market interest rates. The fair value is expected to recover as the bonds approach the maturity date.

The gross realized gains and losses for the years ended December 31, are presented below:

	(In Thousands)		
	2009	2008	2007
Gross realized gains	$ 281	$ 15	$ —
Gross realized losses	(51)	—	—
	$ —	$ —	
Net Realized Gains	$ 230	$ 15	$ —
Tax expense related to net realized gains	$ 78	$ 5	$ —

Note 3 — Securities (Continued)

The amortized cost and fair value of debt securities at December 31, 2009, 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.

	(In Thousands)	
	Amortized Cost	Fair Value
One year or less	$ 13,335	$ 13,631
After one year through five years	80,554	81,402
After five years through ten years	56,302	57,221
After ten years	18,072	18,179
Subtotal	$168,263	$170,433
Mortgage Backed Securities	35,209	36,848
Total	$203,472	$207,281

Investments with a carrying value and fair value of $167.3 million at December 31, 2009 and $155.9 million at December 31, 2008 were pledged to secure public deposits and securities sold under repurchase agreements.

Other securities include Federal Home Loan Bank of Cincinnati and Indianapolis stock, Bankers Bank stock, and Farmer Mac stock. Bankers Bank was written down to a carrying value of zero in December 2009 at a loss of $51 thousand.

Note 4 — Loans

Loans at December 31 are summarized below:

	(In Thousands)	
	2009	2008
Loans:		
Commercial Real Estate	$214,849	$226,761
Agricultural Real Estate	41,045	48,607
Consumer Real Estate	98,599	89,773
Commercial and industrial	120,543	112,526
Agricultural	59,813	56,322
Consumer, Overdrafts and other loans	32,581	26,469
Industrial Development Bonds	2,552	7,572
	569,982	568,030
Less: Deferred loan fees and costs	(63)	(198)
	569,919	567,832
Less: Allowance for loan losses	(6,008)	(5,496)
Loans — Net	$563,911	$562,336

The following is a maturity schedule by major category of loans:

	(In Thousands) Principal Payments Due Within		
	One Year	Two to Five Years	After Five Years
Commercial Real Estate	$12,811	$157,856	$44,182
Agricultural Real Estate	1,410	14,450	25,185
Consumer Real Estate	8,035	23,915	66,649
Commercial and industrial loans	78,939	32,898	8,706
Agricultural	43,253	13,861	2,699
Consumer, Master Card and Overdrafts	5,882	19,741	6,958
Industrial Development Bonds	862	639	1,051

Note 4 — Loans (Continued)

The distribution of fixed rate loans and variable rate loans by major loan category is as follows as of December 31, 2009:

	(In Thousands)	
	Fixed Rate	Variable Rate
Commercial Real Estate	$31,218	$183,631
Agricultural Real Estate	4,902	36,143
Consumer Real Estate	23,153	75,446
Commercial and industrial loans	26,412	94,131
Agricultural	14,538	45,275
Consumer, Master Card and Overdrafts	27,677	4,904
Industrial Development Bonds	2,552	—

As of December 31, 2009, one to four family residential mortgage loans amounting to $73.1 million and $72.1 million, respectively, have been pledged as security for loans the Bank has received from the Federal Home Loan Bank.

The following is an analysis of the allowance for credit losses:

	(In Thousands)		
	2009	2008	2007
Allowance for Loan Losses			
Balance at beginning of year	$ 5,496	$ 5,922	$ 5,594
Provision for loan loss	3,558	1,787	871
Loans charged off	(3,288)	(2,561)	(1,576)
Recoveries	242	348	732
Acquisition allowance for loan loss	—	—	301
Allowance for Loan & Leases Losses	$ 6,008	$ 5,496	$ 5,922
Allowance for Unfunded Loan Commitments & Letters of Credit	$ 227	$ 226	$ 156
Total Allowance for Credit Losses	$ 6,235	$ 5,722	$ 6,078

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 is a summary of information pertaining to impaired loans:

	(In Thousands)	
	2009	2008
Impaired loans without a valuation allowance	$ 10,804	$ 9,582
Impaired loans with a valuation allowance	1,385	2,095
Total impaired loans	$ 12,189	$ 11,677
Valuation allowance related to impaired loans	$ 353	$ 466
Total non-accrual loans	$ 14,054	$ 13,575
Total loans past-due ninety days or more and still accruing	$ 69	$ 2,524

	(In Thousands)		
	2009	2008	2007
Average investment in impaired loans	$ 13,643	$ 10,767	$ 6,975
Interest income recognized on impaired loans	$ 290	$ 341	$ 592
Interest income recognized on a cash basis on impaired loans	$ 290	$ 332	$ 161

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

For the majority of the Bank's impaired loans, the Bank will apply the observable market price methodology, but reserves the right to use a measurement of impairment based on the present value of expected future cash flows discounted at the loan's effective rate of interest as an acceptable alternative method. As of yearend, the majority of the Bank's impaired loans had adequate collateral coverage so that an allocation was not warranted.

In determination of observable market price, collateral asset values securing an impaired loan are periodically evaluated. Maximum time of reevaluation is every 12 months for chattels and titled vehicles and every two years for real estate. In this process, third party evaluations are obtained or heavily relied upon.

Note 5 — Premises and Equipment

The major categories of banking premises and equipment and accumulated depreciation at December 31 are summarized below:

	(In Thousands)	
	2009	2008
Land	$ 3,510	$ 3,510
Buildings (useful life 15-39 years)	17,200	17,133
Furnishings (useful life 3-15 years)	9,435	10,226
	30,145	30,869
Less: Accumulated depreciation	(14,092)	(14,063)
Premises and Equipment (Net)	$ 16,053	$ 16,806

Note 6 — Servicing

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of loans serviced for others were $267 and $251 million at December 31, 2009 and 2008, respectively.

The balance of capitalized servicing rights included in other assets at December 31, 2009 and 2008, was $2.2 and $2.0 million, respectively. The capitalized addition of servicing rights is included in net gain on sale of loans on the consolidated statement of income. The capitalized additions are as shown in the table following.

Note 6 — Servicing (Continued)

The fair market value of the capitalized servicing rights as of December 31, 2009 and 2008 was $3.0 million and $2.7 million, respectively. The valuations were completed by stratifying the loans into like groups based on loan type, term and new versus seasoned. Impairment was measured by estimating the fair value of each stratum, taking into consideration an estimated level of prepayment based upon current market conditions. An average constant prepayment rate of 11.3 and 7.7 were utilized for 2009 and 2008, respectively. All stratums showed positive values compared to carrying value using a discount yield of 7.75% for 2009 and 8.0% for 2008.

The following summarizes mortgage servicing rights capitalized and amortized during each year:

	(In Thousands)	
	2009	2008
Beginning Year	$ 1,970	$ 1,893
Capitalized Additions	1,158	447
Amortization	(933)	(370)
Valuation Allowance	—	—
End of Year	$ 2,195	$ 1,970

Note 7 — Deposits

Time deposits at December 31 consist of the following:

	(In Thousands)	
	2009	2008
Time deposits under $100,000	$212,298	$216,824
Time deposits of $100,000 or more	114,659	77,084
	$326,957	$293,908

At December 31, 2009 the scheduled maturities for time deposits are as follows:

	(In Thousands)
2010	221,435
2011	65,217
2012	23,883
2013	10,204
2014	4,773
thereafter	1,445
	$ 326,957

Note 8 — Securities Sold Under Agreement to Repurchase

The Bank's policy requires qualifying securities to be used as collateral for the underlying repurchase agreements. As of December 31, 2009 and 2008 securities with a book value of $55.9 million and $58.5 million, respectively, were underlying the repurchase agreements and were under the Bank's control.

	Daily Securities Sold Under Agreement to Repurchase				
	Amount Outstanding at End of Period (000's)	Weighted Average Rate End of Period	Maximum Amount Borrowings Outstanding Month End (000's)	Approximate Average Outstanding in Period (000's)	Approximate Weighted Average Interest Rate for the Period
2009	$33,457	0.42%	$40,530	$37,696	0.48%
2008	$40,014	0.50%	$47,644	$40,113	1.96%
2007	$35,059	3.72%	$39,205	$31,513	4.64%

Note 9 — Federal Home Loan Bank Advances

Long term debt consists of various loans from the Federal Home Loan Bank. Repayment structures vary, ranging from monthly installments, annual payments or upon maturity. Interest payments are due monthly with interest rates on the loans varying from 2.70% to 7.05%. Total borrowings were $34.1 million and $45.6 million for 2009 and 2008, respectively. Notes are secured by a blanket lien on the one to four family residential mortgage loan portfolios (Note 4).

The following is a schedule by years of future minimum principal payments:

	(In Thousands)
2010	13,325
2011	13,212
2012	5,062
2013	2,600
	$ 34,199

Note 10 — Federal Income Taxes

The components of income tax expense for the years ended December 31 are as follows:

	(In Thousands)		
	2009	2008	2007
Current:			
Federal	$ 2,333	$ 2,489	$ 2,998
Deferred:			
Federal	142	(39)	(170)
	$ 2,475	$ 2,450	$ 2,828

Note 10 — Federal Income Taxes (Continued)

The following is a reconciliation of the statutory federal income tax rate to the effective tax rate:

	(In Thousands)		
	2009	2008	2007
Income tax at statutory rates	$ 3,087	$ 3,119	$ 3,591
Increase(decrease) resulting from:			
Tax exempt interest	(629)	(654)	(650)
Change in prior estimates and other	17	(15)	(113)
	$ 2,475	$ 2,450	$ 2,828

Deferred tax assets and liabilities at December 31 are comprised of the following:

	(In Thousands)	
	2009	2008
Deferred Tax Assets:		
Allowance for loan losses	$ 2,042	$ 1,869
Other	650	751
Total deferred tax assets	2,692	2,620
Deferred Tax Liabilities:		
Accreted discounts on bonds	56	55
FHLB stock dividends	862	862
Mortgage servicing rights	740	667
Other	700	560
Net unrealized gain on available-for-sale securities	1,295	1,153
Total deferred tax liabilities	3,653	3,297
Net Deferred Tax Liability	$ (961)	$ (677)

Note 11 — Employee Benefit Plan

The Bank has established a 401(k) profit sharing plan, which allows eligible employees to save at a minimum one percent of eligible compensation on a pre-tax basis, subject to certain Internal Revenue Service limitations. The Bank will match 50% of employee 401(k) contributions up to four percent of total eligible compensation. In addition, the Bank may make a discretionary contribution from time to time. A participant is 100% vested in the participant's deferral contributions and employer matching contributions. A six-year vesting schedule applies to employer discretionary contributions. Contributions to the 401(k) profit sharing plan for both the employer matching contribution and the discretionary contribution were $570, $524, and $575 thousand for 2009, 2008 and 2007, respectively.

The Company has a Long-Term Stock Incentive Plan under which 10,000 shares of restricted stock were issued to 49 and 51 employees during 2009 and 2008, respectively. 8,760 shares were issued to 46 employees during 2007. Under the plan, the shares vest 100% in three years. Due to employee termination, there were 350 and 245 shares forfeited during 2009 and 2008, respectively, 740 shares forfeited during 2007. During 2009, 5,450 shares awarded in 2006 were vested 100%. 36 employees were still employed and received the stock. During 2007, 600 shares had vesting accelerated and were paid to a retiring officer. Compensation expense applicable to the restricted stock totaled $190, $155, and $104 thousand for the year ending December 31, 2009, 2008 and 2007, respectively.

Note 12 — Related Party Transactions

In the ordinary course of business, the Bank has granted loans to senior officers and directors and their affiliated companies amounting to $9.5 and $11.3 million at December 31, 2009 and 2008, respectively. Loans made during 2009 were $67 thousand and repayments were $1.8 million. The difference in related borrowings amounted to $7.6 million, net reduction. Deposits of directors, executive officers and companies in which they have a direct or indirect ownership as of December 31, 2009 and 2008 amounted to $2.4 million and $4.8 million, respectively.

There was one director added to the Board during 2009. In 2008, one director retired from the Board and one was appointed. An executive officer was hired also during the year of 2008.

Note 13 — Off Balance Sheet Activities

Credit Related Financial Instruments

The Bank is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing need of its customer. These financial instruments include commitments to extend credit, Standby Letters of Credit, and Commercial Letters of Credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policies in making commitments as it does for on-balance-sheet instruments. The allowance for credit losses as it relates to unfunded loan commitments (AULC) is included under other liabilities. The AULC as of December 31, 2009 and 2008 was $227 thousand and $226 thousand, respectively. At December 31, 2009 and 2008, the following financial instruments were outstanding whose contract amounts represent credit risk:

	(In Thousands)	
	2009	2008
Commitments to extend credit	$151,696	$156,575
Credit card arrangements	16,569	15,840
Standby letters of credit	18,085	20,418

Commitments to extend credit, credit card arrangements and Standby Letters of Credit all include exposure to some credit loss in the event of nonperformance of the customer. The Bank's credit policies and procedures for credit commitments and financial guarantees are the same as those for extensions of credit that are recorded in the financial statements. Due to the fact that these instruments have fixed maturity dates, and because many of them expire without being drawn upon, they generally do not present any significant liquidity risk to the Bank.

Collateral Requirements

To reduce credit risk related to the use of credit-related financial instruments, the Bank might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Bank's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant, and real estate.

Legal Contingencies

Various legal claims also arise from time to time in the normal course of business, which, in the opinion of management, will have no material effect on the Company's consolidated financial statements.

Note 14 — Minimum Regulatory Capital Requirements

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off balance-sheet items as calculated under regulatory accounting practices.

The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of: total risk-based capital and Tier I capital to risk-weighted assets (as defined in the regulations), and Tier I capital to adjusted total assets (as defined). Management believes, as of December 31, 2009, that the Bank meets all the capital adequacy requirements to which it is subject.

As of December 31, 2009 the most recent notification from the FDIC indicated the Bank was categorized as well capitalized under the regulatory framework for prompt corrective action. To remain categorized as well capitalized, the Bank will have to maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as disclosed in the table to follow. There are no conditions or events since the most recent notification that management believes have changed the Bank's prompt corrective action category.

The Company and the Bank's actual and required capital amounts and ratios as of December 31, 2009 and 2008 are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under the Prompt Corrective Action Provisions	
As of December 31, 2009	(000's) Amount	Ratio	(000's) Amount	Ratio	(000's) Amount	Ratio
Total Risk-Based Capital (to Risk Weighted Assets)						
Consolidated	$92,447	14.14%	$52,294	8.00%	N/A	N/A
Farmers & Merchants State Bank	92,184	14.10%	52,305	8.00%	$65,382	10.00%
Tier 1 Capital (to Risk Weighted Assets)						
Consolidated	86,212	13.19%	26,147	4.00%	N/A	N/A
Farmers & Merchants State Bank	70,949	10.85%	26,153	4.00%	39,229	6.00%
Tier 1 Capital (to Adjusted Total Assets)						
Consolidated	86,212	10.33%	33,393	4.00%	N/A	N/A
Farmers & Merchants State Bank	70,949	8.47%	33,487	4.00%	41,858	5.00%

Note 14 — Minimum Regulatory Capital Requirements (Continued)

As of December 31, 2008	Actual (000's) Amount	Ratio	For Capital Adequacy Purposes (000's) Amount	Ratio	To Be Well Capitalized Under the Prompt Corrective Action Provisions (000's) Amount	Ratio
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-Based Capital (to Risk Weighted Assets) Consolidated	$89,017	13.95%	$51,036	8.00%	N/A	N/A
Farmers & Merchants State Bank	88,941	13.94%	51,048	8.00%	$63,810	10.00%
Tier 1 Capital (to Risk Weighted Assets) Consolidated	83,294	13.06%	25,518	4.00%	N/A	N/A
Farmers & Merchants State Bank	68,218	10.69%	25,524	4.00%	38,286	6.00%
Tier 1 Capital (to Adjusted Total Assets) Consolidated	83,294	10.50%	31,716	4.00%	N/A	N/A
Farmers & Merchants State Bank	68,218	8.59%	31,766	4.00%	39,708	5.00%

Note 15 — Restrictions of Dividends & Inter-company Borrowings

The Bank is restricted as to the amount of dividends that can be paid. Dividends declared by the Bank that exceed the net income for the current year plus retained income for the preceding two years must be approved by federal and state regulatory agencies. Under this formula dividends of $3.6 million may be paid without prior regulatory approval. Regardless of formal regulatory restrictions, the Bank may not pay dividends that would result in its capital levels being reduced below the minimum requirements shown above. Under current Federal Reserve regulations, the Bank is limited as to the amount and type of loans it may make to the Company and its non-bank subsidiary. These loans are subject to qualifying collateral requirements on which the amount of the loan may be based.

Note 16 — 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.

Note 16 — Fair Value of Financial Instruments (Continued)

Securities and Other Securities

Fair values for securities, excluding Federal Home Loan Bank stock and Federal Reserve Bank stock, are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The carrying value of Federal Home Loan Bank and Federal Reserve Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank and the Federal Reserve Bank.

Loans

Most commercial and real estate mortgage loans are made on a variable rate basis. 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

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.

Borrowings

Short-term borrowings are carried at cost that approximates fair value. Other long-term debt was generally valued using a discounted cash flow analysis with a discounted rate based on current incremental borrowing rates for similar types of arrangements, or if not available, based on an approach similar to that used for loans and deposits.

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 counterparties' credit standing.

The estimated fair values, and related carrying or notional amounts, for on and off-balance sheet financial instruments as of December 31, 2009 and 2008, are reflected below.

Note 16 — Fair Value of Financial Instruments (Continued)

	(In Thousands)			
	2009		2008	
	Carrying	Fair	Carrying	Fair
Financial Assets:				
Cash and Cash Equivalents	$ 33,648	$ 33,648	$ 20,887	$ 20,887
Securities — available for sale	207,281	207,281	177,661	177,661
Other Securities	4,448	4,448	4,498	4,498
Loans, net	563,911	563,532	562,336	562,049
Interest receivable	3,693	3,693	4,048	4,048
Financial Liabilities:				
Deposits	$676,444	$672,963	$615,732	$614,495
Short-term debt				
Repurchase agreement sold	43,257	43,257	48,214	48,214
Long term debt	34,199	34,947	45,635	44,940
Interest payable	852	852	907	907
Dividends payable	853	853	857	857
Off-Balance Sheet Financial Instruments Commitments to extend credit	$ —	$ —	$ —	$ —
Standby letters of credit	—	—	—	—

Fair Value Measurements

The following table presents information about the Company’s assets and liabilities measured at fair value on a recurring basis at December 31, 2009 and 2008, and the valuation techniques used by the Company to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or 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- When quoted prices are available in an active market, securities are valued using the quoted price and are classified as Level 1. The quoted prices are not adjusted.

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

Available-for-sale securities classified as Level 2 are valued using the prices obtained from an independent pricing service. The prices are not adjusted. The independent pricing service uses industry standard models to price U.S. Government agencies and mortgage backed securities that consider various assumptions, including time value, yield curves, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. 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 marketplace.

Note 16 — Fair Value of Financial Instruments (Continued)

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.

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 or liability.

Disclosures concerning assets and liabilities measured at fair value are as follows:

Assets and Liabilities Measured at Fair Value on a Recurring Basis at December 31, 2009 and December 31, 2008:

Assets and Liabilities Measured at Fair Value on a Recurring Basis

($ in Thousands) Significant Unobservable Inputs 12/31/2009	Significant Markets for Identical Assets (Level 1)	Quoted Prices in Active Observable Inputs (Level 2)	(Level 3)
Assets — Securities Available for Sale			
U.S. Treasury	$ 5,219		
U.S. Government agency	$104,675		
Mortgage-backed securities	$ 36,848		
State and local governments	$ 0	$ 60,539	$ 0
Total Securities Available for Sale	$ 0	$146,742	$60,539
Liabilities	$ 0	$ 0	$ 0
12/31/2008	Assets (Level 1)	(Level 2)	(Level 3)
Assets — Securities Available for Sale			
U.S. Treasury	$ 0		
U.S. Government agency	$82,674		
Mortgage-backed securities	$51,827		
State and local governments	$ 0	$ 43,160	$ 0
Total Securities Available for Sale	$ 0	$134,501	$43,160
Liabilities	$ 0	$ 0	$ 0

Note 16 — Fair Value of Financial Instruments (Continued)

All 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 December 31, 2009 and 2008, such assets consist primarily of impaired loans. Impaired loans categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired. The Company estimates the fair value of the loans based on the present value of expected future cash flows using management's best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals).

At December 31, 2009 and 2008, impaired loans categorized as Level 3 were $12.2 and $11.7 million, respectively. The change in fair value of impaired loans of $353 and $466 thousand for 2009 and 2008, respectively, is accounted for in the allowance for loan losses (see Note 4).

Other real estate is reported at either the fair value of the real estate, minus the estimated costs to sell the asset, or the cost of the asset. The determination of the 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.

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 December 31, 2009, the Company estimates that there is no impairment of these assets and therefore, no impairment charge to other expense was required to adjust these assets to their estimated fair values.

Note 16 — Fair Value of Financial Instruments (Continued)

		Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2009			
($ in Thousands)	Balance at 12/31/09	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Change in fair value for twelve-month period ended Dec. 31, 2009
Impaired loans	$12,189			$ 12,189	$ 113
Other real estate owned — residential mortgages	$ 964			$ 964	$ (19)
Other real estate owned commercial	$ 475			$ 475	$ (40)
Total change in fair value					$ 54

	Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2008				
($ in Thousands)	Balance at 12/31/08	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Change in fair value for twelve-month period ended Dec. 31, 2008
Impaired loans	$11,677			$ 11,677	$ 1,176
Other real estate owned - residential mortgages	$ 427			$ 427	$ (22)
Other real estate owned commercial	$ —			$ —	$ —
Total change in fair value					$ 1,154

Note 17 — Condensed Financial Statements of Parent Company

Balance Sheet

	(In Thousands)	
	2009	2008
Assets		
Cash	$ 471	$ 315
Related party receivables:		
Dividends & Accounts receivable from subsidiaries	1,060	963
Note receivable from Bank subsidiary	15,000	15,000
Investment in subsidiaries	78,322	75,471
Total Assets	$ 94,853	$ 91,749
Liabilities		
Accrued expenses	$ 416	$ 345
Dividends payable	853	857
Total Liabilities	1,269	1,202
Stockholders' Equity		
Total Stockholders' Equity	$ 93,584	$ 90,547
Total Liabilities and Stockholders' Equity	$ 94,853	$ 91,749

Statement of Income

	(In Thousands)		
	2009	2008	2007
Income			
Dividends from subsidiaries	$ 3,940	$ 6,708	$ 6,238
Interest	713	717	712
Total Income	4,653	7,425	6,950
Operating Expenses	460	364	383
Income Before Income Taxes and Equity in Undistributed Earnings (Distributions in excess of earnings) and Subsidiaries	4,193	7,061	6,567
Income Taxes	161	167	105
	4,032	6,894	6,462
Equity in undistributed earnings (Distributions in excess of earnings) of subsidiaries	2,573	(171)	1,272
Net Income	$ 6,605	$ 6,723	$ 7,734

Note 17 — Condensed Financial Statements of Parent Company (Continued)

Statements of Cashflows

	(In Thousands)		
	2009	2008	2007
Cash Flows from Operating Activities			
Net income	$ 6,605	$ 6,723	$ 7,734
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Equity in undistributed net income (Distributions in excess earnings) of subsidiaries	(2,573)	171	(1,272)
Changes in Assets and Liabilities:			
Account receivable	—	—	35
Dividends receivable	(97)	(162)	(26)
Other Liabilities	193	(228)	428
Net Cash Provided by Operating Activities	4,128	6,504	6,899
Cash Flows from Investing Activities			
Return of Capital from Investment in Subsidiary	—	—	725
Cash Flows from Financing Activities			
Payment of dividends	(3,417)	(3,217)	(3,227)
Purchase of Treasury Stock	(555)	(3,575)	(4,710)
Net Change in Cash and Cash Equivalents	156	(288)	(313)
Cash and Cash Equivalents			
Beginning of year	315	603	916
Cash and Cash Equivalents			
End of year	$ 471	$ 315	$ 603

Note 18 — Quarterly Financial Data

(000s omitted except per share data)

Quarterly Financial Data — UNAUDITED

	Quarter Ended in 2009			
	Mar 31	June 30	Sep 30	Dec 31
Summary of Income:				
Interest income	$ 10,376	$ 10,459	$ 10,081	$ 10,198
Interest expense	3,474	3,427	3,220	3,099
Net Interest Income	6,902	7,032	6,861	7,099
Provision for loan loss	659	1,079	1,432	388
Net interest income after provision for loan loss	6,243	5,953	5,429	6,711
Other income (expense)	(3,880)	(4,016)	(3,739)	(3,621)
Net income before income taxes	2,363	1,937	1,690	3,090
Income taxes	633	536	414	892
Net income	$ 1,730	$ 1,401	$ 1,276	$ 2,198
Earnings per Common Share	$ 0.36	$ 0.30	$ 0.27	$ 0.46
Average common shares outstanding	4,756,389	4,742,910	4,731,841	4,734,674

	Quarter Ended in 2008			
	Mar 31	June 30	Sep 30	Dec 31
Summary of Income:				
Interest income	$ 11,211	$ 11,134	$ 10,816	$ 10,663
Interest expense	5,254	4,659	4,431	3,757
Net Interest Income	5,957	6,475	6,385	6,906
Provision for loan loss	269	180	33	1,305
Net interest income after provision for loan loss	5,688	6,295	6,352	5,601
Other income (expense)	(3,539)	(3,474)	(3,910)	(3,840)
Net income before income taxes	2,149	2,821	2,442	1,761
Income taxes	581	782	659	428
Net income	$ 1,568	$ 2,039	$ 1,783	$ 1,333
Earnings per common share	$ 0.32	$ 0.42	$ 0.37	$ 0.28
Average common shares outstanding	4,917,707	4,867,824	4,822,467	4,778,681

ITEM 8. CHANGE IN AND DISAGREEMENTS WITH ACCOUNTING AND FINANCIAL DISCLOSURE

No disagreements exist on accounting and financial disclosures or related matter.

ITEM 8a. CONTROLS AND PROCEDURES

Management Report Regarding Disclosure Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2009, pursuant to Exchange Act 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2009, in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

MANAGEMENT REPORT REGARDING INTERNAL CONTROL AND COMPLIANCE WITH DESIGNATED LAWS AND REGULATIONS

Management of Farmers & Merchants Bancorp, Inc. and Subsidiaries is responsible for preparing the Bank's annual financial statements. Management is also responsible for establishing and maintaining internal control over financial reporting presented in conformity with both generally accepted accounting principles and regulatory reporting in conformity with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (call report instructions). The Bank's internal control contains monitoring mechanisms, and actions are taken to correct deficiencies identified.

There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal control can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

It is also management's responsibility to ensure satisfactory compliance with all designated laws and regulations and in particular, those laws and regulations concerning loans to insiders. The federal laws concerning loans to insiders are codified at 12 USC 375a and 375b, and the federal regulations are set forth at 12 CFR 23.5, 31, and 215.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control — Integrated Framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2009. The registered public accounting firm that audited the financial statements included in this annual report has issued an attestation report on the Company's internal control over financial reporting which can be found under Item 8 of this form 10-K.

There was no change in the company's internal control over financial reporting that occurred during the Company's fiscal quarter ended December 31, 2009 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 8b. OTHER INFORMATION

None.

PART III

ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

BOARD OF DIRECTORS

The information called for herein is presented below:

Name	Age	Principal Occupation or Employment for Past Five Years	Year First Became Director
Dexter L. Benecke	67	President, Freedom Ridge, Inc.	1999
Steven A. Everhart	55	Secretary/Treasurer, MBC Holdings, Inc.	2003
Robert G. Frey	69	President, E.H. Frey & Sons, Inc.	1987
Jack C. Johnson	57	President, Hawk's Clothing, Inc.	1991
Marcia S. Latta[1]	48	Vice President, BGSU Foundation	2009
Steven J. Planson	50	Self-Employed Farmer	2008
Anthony J. Rupp	60	President, Rupp Furniture Co.	2000
David P. Rupp, Jr.[2]	68	Attorney	2001
James C. Saneholtz	63	President, Saneholtz-McKarns, Inc.	1995
Kevin J. Sauder	49	President/CEO, Sauder Woodworking Co.	2004
Merle J. Short	69	Chairman, ProMow, Inc.	1987
Paul S. Siebenmorgen	60	President/CEO of the Corporation and The Farmers & Merchants State Bank	2005
Steven J. Wyse	65	Private Investor	1991

Directors are elected annually at the annual meeting of shareholders

1 Ms. Latta was appointed to the Board of Directors of the Company and The Farmers & Merchants State Bank on January 16, 2009.

2 David P. Rupp, Jr. is an attorney with membership in the law firm of Plassman, Rupp, Short & Hagans of Archbold, Ohio. The law firm has been retained by the Corporation, and its subsidiaries, during the past twenty years and is to be retained currently.

EXECUTIVE OFFICERS

Name	Age	Principal Occupation & Offices Held with Corporation & Bank for Past Five Years
David P. Rupp, Jr.	68	Chairman
Paul S. Siebenmorgen	60	President & Chief Executive Officer
Barbara J. Britenriker	48	Executive Vice President Chief Financial Officer
Todd A. Graham	59	Executive Vice President Chief Lending Officer
Edward A. Leininger	53	Executive Vice President Chief Operating Officer
Rex D. Rice	51	Executive Vice President Senior Commercial Banking Director

Any remaining information required by Item 401 of Regulation S-K is presented in the proxy statement to be furnished in connection with the solicitation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held on April 15, 2010, and is incorporated herein by reference. The information called for under Item 405 of Regulation S-K regarding compliance with Section 16(a) and called for under Item 407(d)(5) regarding the existence of a Financial Expert on the Audit Committee of the Company's Board of Directors is presented in the proxy statement to be furnished in connection with the solicitation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held on April 15, 2010, and is incorporated herein by reference.

The Board of Directors of the Company adopted a Code of Business Conduct and Ethics (the "Code") at its meeting on February 13, 2004. While the Sarbanes-Oxley Act of 2002 mandates the adoption of a code of ethics for the most senior executive officers of all public companies, the Code adopted by the Corporation's Board of Directors is broader in the activities covered and applies to all officers, directors and employees of the Corporation and the Bank, including the chief executive officer, chief financial officer, principal accounting officer and other senior officers performing accounting, auditing, financial management or similar functions. The administration of the Code has been delegated to the Audit Committee of the Board of Directors, a Committee comprised entirely of "independent directors." The Code addresses topics such as compliance with laws and regulations, honest and ethical conduct, conflicts of interest, confidentiality and protection of Corporation assets, fair dealing and accurate and timely periodic reports, and also provides for enforcement mechanisms. The Board and management of the Corporation intends to continue to monitor not only the developing legal requirements in this area, but also the best practices of comparable companies, to assure that the Corporation maintains sound corporate governance practices in the future.

A copy of the Corporation's Code is available on the website of the Bank (www.fm-bank.com). In addition, a copy of the Code is available to any shareholder free of charge upon request. Shareholders desiring a copy of the Code should address written requests to Mr. Paul S. Siebenmorgen, President, Chief Executive Officer and Treasurer of Farmers & Merchants Bancorp, Inc., 307North Defiance Street, Archbold, Ohio 43502, and are asked to mark Code of Business Conduct and Ethics on the outside of the envelope containing the request.

ITEM 10. EXECUTIVE COMPENSATION

The information called for herein is presented in the proxy statement to be furnished in connection with the solicitation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held on April 15, 2010, and is incorporated herein by reference.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information called for by Item 403 of Regulation S-K is presented in the proxy statement to be furnished in connection with the solicitation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held Thursday, April 15, 2010 and is incorporated herein by reference.

On April 23, 2005 the Company's shareholders approved the Farmers & Merchants Bancorp, Inc. 2005 Long-Term Stock Incentive Plan. The plan authorizes the issuance of up to 800,000 of the Company's common shares in the form of stock options, restricted stock, performance shares, and unrestricted stock to employees of the Company and its subsidiaries. During 2005, 4,000 shares of restricted stock were issued under the plan to 38 employees of the Bank. Due to employee termination, there were 80 shares forfeited during 2005. During 2006, the Company purchased 42,000 shares and awarded 6,100 restricted shares to 41 employees. 200 shares were forfeited during 2006. 8,760 shares of restricted stock were issued to 46 employees during 2007. Due to employee termination, 740 shares were forfeited during 2007. 600 shares had vesting accelerated and were paid to a retiring officer. 228,000 shares were purchased in 2007. In 2008, 171,889 shares were purchased with 10,000 shares being awarded to 51 employees. 245 shares were forfeited in 2008. 2009 had purchases of 28,907 shares with awards of 10,000 shares to 49 employees. 350 shares were forfeited during the year. At year end, the Company held 437,551 shares in Treasury stock and 27,775 in unearned stock awards.

	Equity Compensation Plan Information		
	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	0	$0.00	762,755
Equity compensation plans not approved by security holders	0	$0.00	0
Total	0	$0.00	762,755

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information called for herein is presented in the proxy statement to be furnished in connection with the solicitation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held on April 15, 2010, and is incorporated herein by reference.

ITEM 13. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information called for by this Item is presented in the proxy statement to be furnished in connection with the solicitation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held on April 15, 2010, and is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS AND FINANCIAL STATEMENTS SCHEDULES

a. The Following documents are filed as part of this report.

(1) Financial Statements (included in this 10-K under Item 8)
Report of Independent Accountants
Consolidated Balance Sheets
Consolidated Statements of Income
Consolidated Statements of Changes in Shareholders' Equity
Consolidated Statements of Cash Flows
Note to Consolidated Financial Statements

(2) Financial Statement Schedules
Five Year Summary of Operations

b. Exhibits Required by Item 601 of Regulation S-K

(3) a. Articles of Incorporation are incorporated by reference to the Company's Quarterly Report on Form 10-Q that was filed with the Commission on May 10, 2004.

b. Certificate of Amendment to the Company's Articles of Incorporation is incorporated by reference to the Company's Current Report on Form 8-K that was filed with the Commission on April 26, 2006.

(3.1) Code of Regulations are incorporated by reference to the Company's Quarterly Report on Form 10-Q that was filed with the Commission on May 10, 2004.

(10.1) Change in Control Agreement executed by and between the Company and Paul S. Siebenmorgen on November 27, 2007 (incorporated by reference to the Current Report on Form 8-K filed with the Commission on November 30, 2007).

(10.2) Change in Control Agreement executed by and between the Company and Barbara J. Britenriker on November 27, 2007 (incorporated by reference to the Current Report on Form 8-K filed with the Commission on November 30, 2007).

(10.3) Change in Control Agreement executed by and between the Company and Edward A. Leininger on November 27, 2007 (incorporated by reference to the Current Report on Form 8-K filed with the Commission on November 30, 2007).

(10.4) Change in Control Agreement executed by and between the Company and Rex D. Rice on November 27, 2007 (incorporated by reference to the Current Report on Form 8-K filed with the Commission on November 30, 2007).

(10.5) 2005 Long-Term Stock Incentive Plan (incorporated by reference to the Quarterly Report on Form 10-Q filed with the Commission on October 27, 2005).

(10.6) Form on Restricted Stock Agreement (incorporated by reference to the Quarterly Report on Form 10-Q filed with the Commission on October 27, 2005).

ITEM 14. EXHIBITS AND FINANCIAL STATEMENTS SCHEDULES (Continued)

(21) Subsidiaries of Farmers & Merchants Bancorp, Inc.

(31.1) Certification of the Chief Executive Officer Required under Rule 13(a)-14(a)/15d-14(a)

(31.2) Certification of the Chief Financial Officer Required under Rule 13(a)-14(a)/15d-14(a)

(32.1) Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(32.2) Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

FARMERS & MERCHANTS BANCORP, INC

Signatures

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934. The registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized

By: /s/ Paul S. Siebenmorgen Date: December 29, 2010
Paul S. Siebenmorgen
Chief Executive Officer
Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Paul S. Siebenmorgen Date: December 29, 2010
Paul S Siebenmorgen
Chief Executive Officer (Principal Executive Officer)

/s/ Dexter L. Benecke Date: December 29, 2010
Dexter L. Benecke, Director

/s/ Robert G. Frey Date: December 29, 2010
Robert G. Frey, Director

/s/ Marcia S. Latta Date: December 29, 2010
Marcia S. Latta, Director

/s/ Anthony J. Rupp Date: December 29, 2010
Anthony J. Rupp, Director

/s/ James C. Saneholtz Date: December 29, 2010
James C. Saneholtz, Director

/s/ Merle J. Short Date: December 29, 2010
Merle J. Short, Director

/s/ Barbara J. Britenriker Date: December 29, 2010
Barbara J. Britenriker
Chief Financial Officer
(Principal Financial Officer/Principal Accounting Officer)

/s/ Steven A. Everhart Date: December 29, 2010
Steven A. Everhart, Director

/s/ Jack C. Johnson Date: December 29, 2010
Jack C. Johnson, Director

/s/ Steven J. Planson Date: December 29, 2010
Steven J. Planson, Director

/s/ David P. Rupp, Jr Date: December 29, 2010
David P. Rupp, Jr., Director

/s/ Kevin J. Sauder Date: December 29, 2010
Kevin J. Sauder, Director

/s/ Steven J. Wyse Date: December 29, 2010
Steven J. Wyse, Director

Exhibit 21

SUBSIDIAIRIES OF FARMERS & MERCHANTS BANCORP, INC

FARMERS & MERCHANTS STATE BANK

Exhibit 31.1

CERTIFICATIONS

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

1. I have reviewed this annual report on Form 10-K 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 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 Exchange Act 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 the 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 control 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: December 29, 2010

/s/ Paul S. Siebenmorgen
Paul S. Siebenmorgen, President and CEO

Exhibit 31.2

CERTIFICATIONS

I, Barbara J. Britenriker, Chief Financial Officer of Farmers & Merchants Bancorp, Inc., certify that:

1. I have reviewed this annual report on Form 10-K 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 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 Exchange Act 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 the 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 control 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: December 29, 2010

/s/ Barbara J. Britenriker
Barbara J. Britenriker, Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ENACTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

FARMERS & MERCHANTS BANCORP, INC

In connection with the Annual Report on Form 10-K of Farmers & Merchants Bancorp, Inc. for the year ended December 31, 2009, as filed with the Securities and Exchange Commission (the “Report”), I, Paul S. Siebenmorgen, Chief Executive Officer, of the Company, certify, pursuant to 18 U.S.C. 1350, as added by 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirement 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 the Company.

Date: December 29, 2010

/s/ Paul S. Siebenmorgen
Paul S. Siebenmorgen
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 PURSUANT TO
18 U.S.C. SECTION 1350,
AS ENACTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

FARMERS & MERCHANTS BANCORP, INC

In connection with the Annual Report on Form 10-K of Farmers & Merchants Bancorp, Inc. for the year ended December 31, 2009, as filed with the Securities and Exchange Commission (the "Report"), I, Paul S. Siebenmorgen, Chief Executive Officer, of the Company, certify, pursuant to 18 U.S.C. 1350, as added by 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirement 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 the Company.

Date: December 29, 2010

/s/ Barbara J. Britenriker
Barbara J. Britenriker
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.