

Annual Report 2018



Farmers and Merchants Bancshares, Inc.

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President's Message



Farmers and Merchants Bancshares, Inc. (Company) had a challenging 2018. We were on target to meet budget until December 2018 when an asset quality concern was discovered. Consolidated earnings were hindered primarily by the provision for loan losses of \$1,115,034 to cover the asset quality issues. As a result, the Company reported a net loss of \$50,071. As you will see from the financials later in this report, the Company continues to control our cost of funds and operating expenses with interest expense and non-interest expense remaining consistent year over year.

The Brokerage (Four Points Financial) and Trust Services area of the bank, under the umbrella of Integrated Financial Resources (IFR), had another good year and once again contributed significantly to the bottom line of the Bank with \$262,676 of net income. Unfortunately, with the Fourth Quarter 2018 market conditions and all major indexes being down, Assets under Management (AUM) decreased for the first time since 2008 and finished at \$216.3 million. However, IFR margins remained very strong at 28%.

In 2018, total assets remained in line with our strategic goals at \$187,430,483. Total loan portfolio balances at year-end 2018 were \$133,273,617, an increase of 2.9% year over year, with most of this growth occurring in the 4th Quarter. The trend continued into the first four months of 2019 as we recorded loan growth of almost 2% or \$2,375,642 from year-end 2018. We are proud of our continued efforts to support the credit needs of our clients and community. Total deposits declined 2.01% to \$162,620,612 year over year. Although the Bank has a good deposit market share, we continue to seek growth opportunities with existing and new clients. In 2019, we have introduced a more robust and simplified set of deposit products that will reward our clients' relationships with F&M Bank & Trust.

Stockholders' equity was \$13,134,024 at year-end 2018 with a Book Value per Share of \$49.54. We were able to return value to you, our shareholders, through two cash dividends of \$0.50 per share or \$1.00 per share in total in 2018.

Our capital ratios continue to exceed "Well Capitalized" levels with the Company's Tier 1 Leverage Ratio at 9.6% and Total Risk-Based Capital Ratio at 15.3% as of December 31, 2018. In addition, the Company's liquidity position remains favorable due to our strong core deposit base and investment portfolio.

As I look back on 2018, I take great pride in being part of the only real community bank in Burlington, Iowa, servicing it along with the surrounding towns in our market area. Being part of our community is what sets us apart from the bigger banks. We love to get someone started in their new business, help someone purchase a new home or educate our children through our financial literacy programs. We have established deep roots in the community and helped to build this strong community. Faces may have changed through the years but our core values have stayed the same. We will continue to be a real community bank, dedicated to the place that we call home.

Highlights of 2018 include the following:

- The Bank partnered with many nonprofit organizations by donating \$86,720 in 2018 and our employees donated an additional \$12,199 through a payroll deduction program. We are proud to be the first sponsor of the Youth for Quality Care of Animals (YQCA) program in which we underwrite the \$10 cost per child in Des Moines County to take the classroom certification course they must take in order to show livestock through 4-H. The farm community has been especially appreciative of this sponsorship. Beyond the financial contributions, F&M employees gave over 3,300 hours of volunteer work in our community during 2018. Some of the volunteerism included cooking meals for families with loved ones in Great River Hospice, serving on Boards of non-profit organizations and mentoring elementary students in the local school system.
- The F&M Community Foundation complemented these community efforts by raising more than \$21,375 and collecting school supplies that benefit Burlington, West Burlington and Mediapolis teachers and their students.
- The 2018 F&M Bank & Trust Navigator Lunch & Learn year was fun and productive and hosted two great programs. In January a presentation was given by Mike Naig, Secretary of Agriculture, also an Iowa born and raised farmer. He updated our guests on the importance of agriculture to our state. Colin Westencamp, Chief Executive Officer for the Mississippi River Cities and Town Initiatives (MRCTI) shared the mission of the MRCTI in November. Their coalition of Mayors is dedicated to preserving and protecting the great waterway, its culture and its heritage, while promoting growth within their regions.
- The Financial Literacy Department operated Kids Banks in eight schools, Teen Banks in four schools, the After School Program and the Summer Enrichment Program. We honored the 20th anniversary of our Kids Bank Program with a celebration at each of our Kids Bank schools in April 2018, Financial Literacy Month. In 2019, we will begin a weekly F&M Kids Homeschool Bank, staffed with homeschooled students at our West Burlington location.
- The Bank continually provides innovative products and services to our clients. In 2018, the Bank added Positive Pay, a safe easy way for our business clients to track both checks and ACH transactions and to reconcile their accounts. The system verifies checks or ACH transactions going through the Bank and checks for discrepancies, helping to prevent fraud. We also began offering instant issue and chip-enabled debit cards, which allows our clients to obtain their debit card the same day it is ordered. Instant issue debit cards are not only convenient, but also offer a fun feature – the chance to choose the picture printed on the card for a small fee. In addition, the Bank added a 15-year balloon mortgage product to our lending portfolio. On the technology front, we updated all of our ATMs to deposit automation, featuring envelope free deposits.

We will stay the course with optimism in 2019. We are more than just numbers and we look forward to many more years supporting and making a positive impact on our community. On behalf of our team, thank you for your continued support and being a part of our history!

I look forward to seeing you at our annual meeting in May.

Sincerely,



Charles E. Walsh
President

Financials

Balance Sheets

Assets	12/31/2018	12/31/2017
Cash	\$6,972	\$7,105
Investments	33,123	39,331
Net Loans	131,517	128,204
All Other Assets	15,818	17,056
TOTAL ASSETS	\$187,430	\$191,696
Liabilities		
Total Deposits	\$162,620	\$165,951
All Other Liabilities	11,676	11,840
TOTAL LIABILITIES	\$174,296	\$177,791
Capital		
Total Capital Accounts	13,134	13,905
TOTAL LIABILITIES AND CAPITAL	\$187,430	\$191,696

Income Statements

Total Interest and Dividend Income	\$6,776	\$6,825
Total Interest Expense	(596)	(474)
Provision for Loan Losses	(1,115)	(600)
Net Interest Income After Provision for Loan Losses	\$5,065	\$5,751
Total Non-Interest Income	2,715	2,896
Total Non-Interest Expense	(7,901)	(7,729)
Income (Loss) Before Income Taxes	\$(121)	\$918
Income Tax Benefit (Expense)	71	(603)
NET INCOME (LOSS)	\$(50)	\$315

These summary financial statements are derived from the Company's audited consolidated financial statements, which are prepared in accordance with auditing standards generally accepted in the United States of America.

Crowe LLP is the Company's independent auditor. The Company's audited consolidated financial statements are available upon written request to Farmers and Merchants Bancshares, Inc., P.O. Box 928, Burlington, Iowa 52601.

Organizational Chart

Farmers and Merchants Bancshares, Inc.

Established in 1993, is a Holding Company consisting of 190 shareholders representing 265,131 shares owning 100% of Farmers & Merchants Bank & Trust, Burlington, Iowa

Farmers & Merchants Bank & Trust

Established in 1916, is a financial institution whose primary market area is Des Moines and Louisa Counties, Iowa

Farmers and Merchants Building Corporation Burlington, Iowa

Owned 100% by Farmers & Merchants Bank & Trust, Burlington, Iowa
The building corporation is the Bank's real estate management company.

Farmers and Merchants Community Foundation

A separate entity founded and organized by Bank employees in 2008.

The Foundation's purpose is to obtain donations of school supplies and funds to help area teachers in Des Moines County, Iowa; to provide scholarships for post-secondary education to graduates of Des Moines County schools and to participate in fundraising efforts with other charitable organizations.

Monetary donations can be sent to:
Farmers and Merchants Community Foundation, Inc.
PO Box 928
Burlington, IA 52601



Farmers and Merchants Bancshares, Inc.
221 Jefferson Street
P.O. Box 928
Burlington, Iowa 52601

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