

Annual Report 2017



Farmers and Merchants Bancshares, Inc.

Contents

3-4	Message from the President
5	Report of the Audit Committee
6	Financials
7	Organizational Chart
8	Contact Information

President's Message



President's Message

Farmers and Merchants Bancshares, Inc. (Company) was headed for another profitable year in 2017. On December 22, 2017, the U.S. Government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act introduced tax reform that reduced the current corporate federal income tax rate to 21%, among other changes. The corporate tax rate reduction was effective January 1, 2018. The Company performed an analysis and determined that the value of the deferred tax assets had declined by \$421,000. To reflect the decline in value of the deferred tax assets, Farmers & Merchants Bank & Trust (Bank) recorded additional tax expense of \$421,000 in December 2017. As a result, earnings reported for the Company on a consolidated basis for 2017 were \$315,131 compared to \$731,633 for 2016. The Bank utilized tax planning strategies in December 2017 to reduce future tax bills and going forward, the Tax Act is expected to be an ongoing benefit to the Bank.

The Company and the Bank continue to control their cost of funds. Interest expense is down slightly year over year by \$11,045 or 2.3%. Interest and dividend income remained steady in 2017 at \$6,825,332, a slight increase of 1.5% over 2016. There was a Provision for Loan Losses of \$600,000 in 2017; this resulted in net interest income of \$5,751,196. Non-interest income improved 6.6% or \$179,419. This improvement is primarily due to improved trust income and other income. Integrated Financial Resources (IFR) had another outstanding year with both Trust Services and Four Points Financial (brokerage) exceeding budget goals. The combined IFR unit grew from \$215.7 million to \$231.8 million in Assets under Management while adding 140 new accounts in the process. Net IFR operating income finished the year at \$543,133, which was 48.59% over budget for 2017. Non-interest expense was basically flat year over year.

In 2017, total assets remained in line with our strategic goals at \$191,695,733. Total loan portfolio balances at year-end 2017 were \$129,569,918, a slight growth over the previous year. Past due loans and non-performing assets continued to decrease from 2.57% in 2016 to 1.90% in 2017. Total deposits declined 8.3% to \$165,950,742 year over year mainly due to a decline in public fund deposits.

Stockholders' equity grew \$438,587 due to earnings and the increase of our investment portfolio market value minus dividends paid to shareholders. Earnings per share were \$1.19 for the Company in 2017. Book value per share was \$52.61 at year-end 2017. 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 2017.

The Bank capital ratios continue to exceed "Well Capitalized" levels with the Bank's Tier 1 Leverage Ratio at 9.1% and Total Risk-Based Capital Ratio at 15.0% as of December 31, 2017.

We are about more than just numbers. We have established deep roots in the community and helped to build a strong community. Through the years, faces may have changed 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.

Some additional highlights of 2017 were:

- Farmers & Merchants Bank & Trust donated \$92,697 to various community organizations in 2017 and our employees donated an additional \$7,650 through a payroll deduction program. Fortunately, we were not satisfied with just handing over checks. Beyond the financial contributions, F&M employees gave over 4,200 hours of volunteer work in our community during 2017. 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 \$21,800 and collecting school supplies that benefit Burlington, West Burlington and Mediapolis teachers and their students.
- The F&M Bank & Trust Navigators hosted three events this past year. The events were a Film Night at Burlington Art Center concluding at the Capitol Theatre. The film was a documentary by the University of Iowa titled "My Mural." We held two lunch and learn events at the Bank with local speakers - Lisa Louck, District Forester for the Iowa Department of Natural Resources and Jerry Miller presented on the history of land surveying and how it has changed. We are always looking for new programs and new members. If you are interested in joining F&M Navigators or have a topic you would like to hear about, feel free to contact Lisa Walsh at ltw@fmbanktrust.com or (319) 850-1950.
- The Bank added an ATM to their fleet at the Notre Dame School. In an effort to operate more efficiently, the Financial Literacy Department added technology in the form of Chromebooks used by Kids Bank staff to input client deposit information. This school year also brings with it the 20th Anniversary of our Kids Bank program. We honored this monumental milestone with a celebration at each of our Kids Bank schools in April 2018, Financial Literacy Month. We also held a ribbon cutting at North Hill Elementary to commemorate our first Kids Bank.

We look forward to many more years in helping and serving our community. It all starts with our F&M team including the Board of Directors, employees, and shareholders and I would like to thank them for their hard work and dedication. 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

Audit Committee Report

The Audit Committee assists the Board in its oversight of the integrity of the financial statements of the Company, the qualifications, independence and performance of the Company's independent registered public accounting firm, the performance of the Company's internal audit function and compliance by the Company with legal and regulatory requirements. As permitted by law, the Audit Committee has not, nor has the Board, chosen to designate any one of the committee members as an "Audit Committee Financial Expert" as defined by the Rules of the Securities and Exchange Commission. The Board has determined such designation is not necessary. The Board believes the committee members possess the financial literacy and business experience to qualify them to serve on the Audit Committee. During the year, the Committee met five (5) times.

The Committee has received from the independent registered public accounting firm, Crowe Horwath LLP, a written statement describing all relationships between Crowe Horwath LLP and the Company that might bear on the Crowe Horwath LLP's independence consistent with Independence Standards Board Standard No. 1, "Independence Discussions with Audit Committees,"; it has discussed with Crowe Horwath LLP any relationships that may impact their objectivity and independence, and satisfied itself as to Crowe Horwath LLP's independence. The Committee discussed with management, the internal auditors and Crowe Horwath LLP the quality and adequacy of the Company's internal controls and the internal audit functions. The Committee also reviewed with both management and the independent registered public accounting firm their audit plans, audit scope, and identification of audit risks.

The Committee discussed and reviewed with Crowe Horwath LLP all communications required by generally accepted accounting standards and, with and without management present, discussed and reviewed the results of Crowe Horwath LLP's examination of the financial statements. The Committee also discussed the results of the internal audit examinations.

The Committee reviewed and discussed the audited financial statements of the Company for the fiscal year ended December 31, 2017, with management and Crowe Horwath LLP. Management has the responsibility for the preparation of the Company's financial statements and the independent registered public accounting firm has the responsibility for the examination of those statements.

Based on the above review and discussions with management and the independent registered public accounting firm, the Committee recommended to the Board of Directors that the Company's audited financial statements be included in its Annual Report for the last fiscal year. The Company also recommended the reappointment of the independent registered public accounting firm.

Submitted by the Fiscal 2017 Audit Committee of the Company's Board of Directors:

Mark R. Hagerla, Chair
Brian K. Readinger
William J. Kuepper

Financials

Balance Sheets

Assets	12/31/2017	12/31/2016
Cash	\$7,105	\$11,797
Investments	39,331	48,543
Net Loans	128,204	126,642
All Other Assets	17,056	15,427
TOTAL ASSETS	\$191,696	\$202,409
Liabilities		
Total Deposits	\$165,951	\$181,038
All Other Liabilities	11,840	7,905
TOTAL LIABILITIES	\$177,791	\$188,943
Capital		
Total Capital Accounts	13,905	13,466
TOTAL LIABILITIES AND CAPITAL	\$191,696	\$202,409

Income Statements

Total Interest and Dividend Income	\$6,825	\$6,721
Total Interest Expense	(474)	(485)
Provision for Loan Losses	(600)	(200)
Net Interest Income After Provision for Loan Losses	\$5,751	\$6,036
Total Non-Interest Income	2,896	2,716
Total Non-Interest Expense	(7,729)	(7,724)
Income Before Income Taxes	\$918	\$1,028
Income Tax Provision	(603)	(296)
NET INCOME	\$315	\$732

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 Horwath 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 184 shareholders representing 264,291 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

319-754-BANK or 888-331-BANK
fmbanktrust.com