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FARMERS & MERCHANTS BANCORP INC
Form 10-Q
April 27, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from _____ to _____

Commission File Number 0-14492

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

OHIO
(State or other jurisdiction of
incorporation or organization)

34-1469491
(I.R.S Employer
Identification No.)

307-11 North Defiance Street, Archbold, Ohio
(Address of principal executive offices)

43502
(Zip Code)

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

(Former name, former address and former fiscal year,
if changed since last report.)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer Accelerated filer Non-accelerated filer

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

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Indicate the number of shares of each of the issuers classes of common stock, as of the latest practicable date:

Common Stock, No Par Value	5,136,545
-----	-----
Class	Outstanding as of April 19, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10Q

FARMERS & MERCHANTS BANCORP, INC.
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ITEM 1 FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands of dollars)

	Mar 31, 2007	Dec 31, 2006
	-----	-----
ASSETS:		
Cash and due from banks	\$ 14,969	\$ 23,583
Interest bearing deposits with banks	318	311
Federal funds sold	7,998	13,353
Investment Securities:		
U.S. Treasury	388	388
U.S. Government	119,012	122,231
State & political obligations	42,740	45,495
All others	4,064	4,063
Loans and leases (Net of reserve for loan losses of \$5,476 & \$5,594 respectively)	508,280	498,580
Bank premises and equipment-net	14,602	14,189
Accrued interest and other assets	19,164	14,903
	-----	-----
TOTAL ASSETS	\$731,535	\$737,096
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY LIABILITIES:		
Deposits:		
Noninterest bearing	\$ 49,428	\$ 60,211
Interest bearing	528,188	525,198
Federal funds purchased and securities sold under agreement to repurchase	36,512	34,818
Other borrowed money	23,051	23,233
Accrued interest and other liabilities	5,474	5,904
	-----	-----
Total Liabilities	642,653	649,364
SHAREHOLDERS' EQUITY:		
Common stock, no par value - authorized 6,500,000 shares; issued 5,136,555 shares	12,677	12,677
Treasury Stock - 53,625 shares, Unearned stock awards 9,720 shares and for Dec. 31, 2006 - Unearned stock 9,720 shares	(1,455)	(1,060)
Undivided profits	78,343	77,089
Accumulated other comprehensive income (expense)	(683)	(974)
	-----	-----
Total Shareholders' Equity	88,882	87,732
	-----	-----
LIABILITIES AND SHAREHOLDERS' EQUITY	\$731,535	\$737,096
	=====	=====

See Notes to Condensed Consolidated Unaudited Financial Statements.

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Note: The December 31, 2006 Balance Sheet has been derived from the audited financial statements of that date.

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FARMERS & MERCHANTS BANCORP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(in thousands of dollars, except per share data)

	Three Months Ended	
	Mar 31, 2007	Mar 31, 2006
INTEREST INCOME:		
Loans and leases	\$ 9,499	\$ 8,088
Investment Securities:		
U.S. Treasury securities	4	18
Securities of U.S. Government agencies	1,324	1,250
Obligations of states and political subdivisions	422	581
Other	63	58
Federal funds	51	69
Deposits in banks	26	3
	11,389	10,067
INTEREST EXPENSE:		
Deposits	4,396	3,569
Borrowed funds	779	591
	5,175	4,160
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	6,214	5,907
PROVISION FOR LOAN LOSSES	(19)	(50)
	6,233	5,957
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,233	5,957
OTHER INCOME:		
Service charges	760	794
Other	615	610
Net securities gains (losses)	--	20
	1,375	1,424
OTHER EXPENSES:		
Salaries and wages	2,090	2,000
Pension and other employee benefits	817	629
Occupancy expense (net)	149	135
Other operating expenses	1,661	1,852
	4,717	4,616
INCOME BEFORE FEDERAL INCOME TAX	2,891	2,765
FEDERAL INCOME TAXES	815	747

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NET INCOME	----- 2,076 =====	----- 2,018 =====
OTHER COMPREHENSIVE INCOME (NET OF TAX):		
Unrealized gains (losses) on securities	----- 291	----- (150)
COMPREHENSIVE INCOME (EXPENSE)	\$ 2,367	\$ 1,868
NET INCOME PER SHARE	\$ 0.40	\$ 0.39
Based upon average weighted shares		
outstanding of:	5,149,967	5,195,920
DIVIDENDS DECLARED	\$ 0.16	\$ 0.125

No disclosure of diluted earnings per share is required as shares are antidiluted as of quarter end.

See Notes to Condensed Consolidated Unaudited Financial Statements.

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

	Three Months Ended	
	----- Mar 31, 2007	----- Mar 31, 2006
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,076	\$ 2,018
Adjustments to Reconcile Net Income to Net		
Cash Provided by Operating Activities:		
Depreciation and amortization	297	276
Premium amortization	92	228
Discount amortization	(64)	(81)
Provision for loan losses	(19)	(50)
Provision (Benefit) for deferred income		
taxes	(1)	77
(Gain) Loss on sale of fixed assets	1	(32)
(Gain) Loss on sale of investment		
securities	--	(20)
Changes in Operating Assets and		
Liabilities:		
Accrued interest receivable and		
other assets	(1,410)	1,452
Accrued interest payable and other		
liabilities	(479)	(413)
Net Cash Provided by Operating Activities	----- 493	----- 3,455
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(711)	(27)
Net (increase) decrease in Federal Funds Sold	5,355	(1,682)
Proceeds from sale of fixed assets	--	
Proceeds from maturities of investment		

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securities:	22,836	14,106
Proceeds from sale of investment securities:	--	4,777
Purchase of investment securities	(16,449)	(5,114)
Purchase of Bank Owned Life Insurance	(3,000)	
Net (increase) decrease in loans and leases	(9,681)	(14,077)
	-----	-----
Net Cash Provided (Used) by Investing Activities	(1,650)	(2,017)
 CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	(7,793)	(12,814)
Net change in short-term borrowings	1,694	4,278
Increase in long-term borrowings	--	--
Payments on long-term borrowings	(182)	(194)
Purchase of Treasury stock	(395)	(33)
Payments of dividends	(774)	(844)
	-----	-----
Net Cash Provided (Used) by Financing Activities	(7,450)	(9,607)
	-----	-----
Net change in cash and cash equivalents	(8,607)	(8,169)
Cash and cash equivalents - Beginning of year	23,894	22,589
	-----	-----
CASH AND CASH EQUIVALENTS - END OF THE YEAR	\$ 15,287	\$ 14,420
	=====	=====
 RECONCILIATION OF CASH AND CASH EQUIVALENTS:		
Cash and cash due from banks	\$ 14,969	\$ 14,123
Interest bearing deposits	318	297
	-----	-----
	\$ 15,287	\$ 14,420
	=====	=====

See Notes to Condensed Consolidated Unaudited Financial Statements.

FARMERS & MERCHANTS BANCORP, INC.

Notes to Condensed Consolidated Unaudited Financial Statements

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10Q and Rule 10-01 of Regulation S-X; accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that are expected for the year ended December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2006.

The Company's Board of Directors declared a 4 for 1 stock split effective May 12, 2006. Therefore, all references in the financial statements and other disclosures related to the number of shares and per share amounts of

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the Company's stock have been retroactively restated to reflect the increased number of shares outstanding.

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

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

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 industries 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. 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.

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

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS (Continued)

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of its Mortgage Servicing Rights as the accounting areas that requires the most subjective or complex judgments, and as such have the highest possibility of being subject to revision as 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 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.

Farmers & Merchants Bancorp, Inc. was incorporated on February 25, 1985, under the laws of the State of Ohio. Farmers & Merchants Bancorp, Inc., and its subsidiaries The Farmers & Merchants State Bank and Farmers & Merchants Life Insurance Company are engaged in commercial banking and life and disability insurance, respectively. The executive offices of Farmers & Merchants Bancorp, Inc. are located at 307-11 North Defiance Street, Archbold, Ohio 43502.

LIQUIDITY, CAPITAL RESOURCES AND MATERIAL CHANGES IN FINANCIAL CONDITION

Loan growth during the quarter totaled just over \$9.5 million. The largest growth of over \$5.5 million occurred in the commercial real estate portfolio. This was coupled with \$2.5 million increase in commercial loans and a \$400 thousand increase in the home equity portfolio. The overall growth was funded from the asset side of the balance sheet. A decrease in cash and federal funds sold of almost \$14 million. Also decreasing was the rest of the loan portfolio and the investment portfolio contained runoff of approximately \$6 million which wasn't reinvested in the first quarter. Other assets increased by \$4.26 million mainly due to an additional BOLI (Bank Owned Life Insurance) purchase of \$3 million in January 2007. This BOLI purchase was completed for asset yield improvement to fund the ever increasing employee medical costs of the Bank. The Bank also completed the purchase of land for its next branch location in Perrysburg, Ohio. Overall, the Company's assets decreased \$5.56 million to end the quarter at \$731.54 million. Liquidity remained strong with loans to assets hovering around seventy percent, up just slightly from December 31, 2006's sixty eight percent. The Bank is currently at the low end of the target range for this ratio.

Loans past due 30 days or more as a percentage of total loans as of December 31, 2006 were .31% compared to March 31, 2007's .53%. The largest increase in the comparison was located in the 1-4 family real estate portfolio. The real estate and overall percentages, however, still remain below the target percentage. Asset quality remains strong with net charge-off activity for the quarter below \$100,000.

Total deposit footings decreased just under \$8 million as of quarter end compared to year end. Growth occurred in time deposits of over \$5 million while the footings decreased in checking and savings accounts by a combined total of \$13 million. The Bank continues to offer higher rates for short-term CD's with an incentive rate for continuing or establishing a relationship (checking) account with the Bank. To encourage core deposit growth, the Bank is also running a "refer a friend" deposit promotion. The number of accounts being opened continues to improve with the decrease in footings being linked to commercial and public fund accounts. The Bank has also begun offering Health Savings Accounts (HSA) and while building the portfolio will take time, it is encouraged by the success achieved within the first quarter bringing in \$198 thousand on deposit.

The Company purchased 17,445 shares of Treasury stock during March for an outlay of nearly \$400 thousand for the transactions. These transactions are

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a continuation of the buyback agreement authorized in the fourth quarter of 2006 and may continue throughout 2007.

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ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS (Continued)

MATERIAL CHANGES IN RESULTS OF OPERATIONS

The income statement shows improvement in net interest income as comparing quarter end March 2007 to March 2006. As the Federal Reserve has left rates unchanged since June 2006, improvement has been seen in the net interest margin. Interest income and interest expense are both higher given the higher rate environment compared to a year ago and a higher asset size of the Company. Borrowed funds interest expense is higher due to the Bank being in a net Federal Funds Purchase position for much of the quarter. This is also confirmed with the lower interest income reported in Federal Funds. More discussion on the net interest margin is included with the interest rate shock on net interest margin report under Market Risk. Overall net interest income improved by 5.2% over 2006 with the asset size growing by less than 3.5%.

The non interest components of the statement of income show a slight decrease of \$49 thousand in income and a slight increase of \$101 thousand in expense. As stated previously, asset quality remained strong and the provision for loan losses posted a slight income position of \$19 thousand compared to \$50 thousand in 2006. Expenses related to personnel were responsible for the increase in non interest expense with the largest increase in the employee benefits as medical claims increased during 2007. Other operating expense actually decreased as compared to March 2006 by over \$190 thousand. A \$45 thousand decrease is attributable to lower audit and exam fees due to being an accelerated filer and adjusting audit procedures to better incorporate SOX control issues with general audit. The Bank has renewed contracts and/or vendors with more favorable terms such as the savings attributive to ATM processing of \$30 thousand and discontinuing some consulting fees saving almost \$61 thousand as compared to first quarter last year. Cost savings continues to be a focus for the Company. Increased use of imaging technology is being implemented during 2007 with efficiency and improved customer service the planned outcomes.

Overall net income improved by 3% as compared to quarter end 2006 and net income per share improved to \$.40 as of March 31, 2007 compared to March 31, 2006's \$.39 per share. Comprehensive income shows the unrealized gain (loss) position on securities continuing to improve due to the maturing and reinvesting activities over the last year.

The company continues to be well-capitalized as the capital ratios below show:

Primary Ratio	12.96%
Tier I Leverage Ratio	12.20%
Risk Based Capital Tier 1	16.07%
Total Risk Based Capital	17.08%
Stockholders' Equity/Total Assets	12.15%

ITEM 3 QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the exposure to loss resulting from changes in interest rates and equity prices. The primary market risk to which the Company is subject is interest rate risk. The majority of the Company's interest rate risk arises from the instruments, positions and transactions entered into for purposes, other than trading, such as lending, investing and securing sources of funds. Interest rate risk occurs when interest bearing assets and liabilities reprice 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 for the Company. 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. The Company employs a sensitivity analysis in the form of a net interest rate shock as shown in the table following.

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
2.94%	-15.463%	Rising	3.000%	5,531	-15.741%
3.12%	-10.245%	Rising	2.000%	5,879	-10.436%
3.30%	-5.091%	Rising	1.000%	6,224	-5.189%
3.48%	0.000%	Flat	0.000%	6,564	0.000%
3.65%	5.005%	Falling	-1.000%	6,900	5.107%
3.85%	10.607%	Falling	-2.000%	7,262	10.629%
3.90%	12.070%	Falling	-3.000%	7,347	11.924%

The net interest margin represents the forecasted twelve month margin. The predicted margin is lower than the Bank's current net interest margin. This is due mainly to the shortened duration of the certificate of deposit portfolio and correlates into the scenario of higher rates representing a loss of margin as compared to the repricing of those CDs in a falling rate environment. The uncertainty of the direction of any rate movements and the flat and inverted yield curve have facilitated the Bank taking the position it has. The range of the fluctuation of the percentage change is 10% higher than a year ago with last year's ranging from 2 to 6%. The positive effect of a falling rate environment at all rate shock levels is also an improvement from a year ago.

The Bank will continue to focus on controlling the cost of funds through deposit promotions aimed at gaining more relationships per customer. Improving the overall asset yield is the other side of the equation that needs to be addressed. Fierce competition continues to pressure the yield and the Bank has focused on using a combination of rate and fees to attract new business. The addition of another banking location will help the

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expansion of the market though its completion will be late 2007.

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ITEM 4 CONTROLS AND PROCEDURES

As of March 31, 2007, an evaluation was performed under the supervision and with the participation of the Company's management including the CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of March 31, 2007. There have been no significant changes in the Company's internal controls that occurred for the quarter ended March 31, 2007.

PART II

ITEM 1 LEGAL PROCEEDINGS

None

ITEM 1A RISK FACTORS

There have been no material changes in the risk factors disclosed by Registrant in its Report on Form 10-K for the fiscal year ended December 31, 2006.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plan or Programs	(d) Maxim that may ye the Pl
-----	-----	-----	-----	-----
1/1/2007				
to				
1/31/2007				
2/1/2007				
to				
2/28/2007				
3/1/2007				
to	17,445	\$22.67	17,445	
3/31/2007				
	-----	-----	-----	
Total	17,445 =====	\$22.67 =====	17,445 (1) =====	

- (1) The Company purchased these shares in the market pursuant to a stock repurchase program publicly announced on October 20, 2006. On that date, the Board of Directors authorized the repurchase of 250,000 common shares between October 20, 2006 and December 31, 2007.

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

None

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ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

None

ITEM 5 OTHER INFORMATION

ITEM 6 EXHIBITS

- 3.1 Amended Articles of Incorporation of the Registrant (incorporated by reference to Registrant's Quarterly Report on Form 10-Q filed with the Commission on August 1, 2006)
- 3.2 Code of Regulations of the Registrant (incorporated by reference to Registrant's Quarterly Report on Form 10-Q filed with the Commission on May 10, 2004)
- 31.1 Rule 13-a-14(a) Certification -CEO
- 31.2 Rule 13-a-14(a) Certification -CFO
- 32.1 Section 1350 Certification - CEO
- 32.2 Section 1350 Certification - CFO

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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, thereunto duly authorized.

Farmers & Merchants Bancorp, Inc.,

Date: April 25, 2007

By: /s/ Paul S. Siebenmorgen

Paul S. Siebenmorgen
President and CEO

Date: April 25, 2007

By: /s/ Barbara J. Britenriker

Barbara J. Britenriker
Exec. Vice-President and CFO

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