

F&M BANK CORP
Form 10-Q
August 08, 2018

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

FORM 10-Q

Quarterly report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2018.

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

Commission File Number: 000-13273

F & M BANK CORP.

Virginia
(State or Other Jurisdiction of Incorporation or Organization) 54-1280811
(I.R.S. Employer Identification No.)

P. O. Box 1111
Timberville, Virginia 22853
(Address of Principal Executive Offices) (Zip Code)

(540) 896-8941
(Registrant's Telephone Number, Including Area Code)

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 has submitted electronically and posted on its website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

State the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Class	Outstanding at August 6, 2018
Common Stock, par value - \$5	3,228,984 shares

F & M BANK CORP.

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Part I Financial Information
Item 1 Financial Statements

F & M BANK CORP.
Consolidated Balance Sheets
(Dollars in thousands, except per share data)

	June 30,	December 31,
	2018	2017*
	(Unaudited)	
Assets		
Cash and due from banks	\$9,735	\$10,622
Money market funds	1,565	1,285
Federal funds sold	2,064	-
Cash and cash equivalents	13,364	11,907
Securities:		
Held to maturity – fair value of \$122 and \$125 in 2018 and 2017, respectively	122	125
Available for sale	8,263	28,615
Other investments	14,771	12,503
Loans held for sale	49,821	39,775
Loans held for investment	634,122	616,974
Less: allowance for loan losses	(7,105)	(6,044)
Net loans held for investment	627,017	610,930
Other real estate owned, net	2,034	1,984
Bank premises and equipment, net	17,487	15,894
Interest receivable	1,983	2,007
Goodwill	2,956	2,881
Bank owned life insurance	19,166	13,950
Other assets	13,684	12,699
Total assets	\$770,668	\$753,270
Liabilities		
Deposits:		
Noninterest bearing	\$163,809	\$162,233
Interest bearing	404,757	406,944
Total deposits	568,566	569,177
Short-term debt	46,000	25,296
Accrued liabilities	16,904	17,789
Long-term debt	47,434	49,733
Total liabilities	678,904	661,995

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Stockholders' Equity		
Preferred Stock \$25 par value, 400,000 shares authorized, 322,510 and 324,150 issued and outstanding for June 30, 2018 and December 31, 2017, respectively	\$7,488	\$7,529
Common stock, \$5 par value, 6,000,000 shares authorized, 3,242,462 and 3,255,036 shares issued and outstanding for June 30, 2018 and December 31, 2017, respectively.	16,212	16,275
Additional paid in capital – common stock	9,796	10,225
Retained earnings	61,989	60,814
Non-controlling interest in consolidated subsidiaries	554	574
Accumulated other comprehensive loss	(4,275)	(4,142)
Total stockholders' equity	\$91,764	\$91,275
Total liabilities and stockholders' equity	\$770,668	\$753,270

*2017 derived from audited consolidated financial statements.

See notes to unaudited consolidated financial statements

F & M BANK CORP.
Consolidated Statements of Income
(Dollars in thousands)
(Unaudited)

	Three Months Ended	
	June 30,	
	2018	2017
Interest and Dividend income		
Interest and fees on loans held for investment	\$8,529	\$7,906
Interest and fees on loans held for sale	308	271
Interest from money market funds and federal funds sold	5	18
Interest on debt securities – taxable	120	61
Total interest and dividend income	8,962	8,256
Interest expense		
Total interest on deposits	766	633
Interest from short-term debt	126	24
Interest from long-term debt	223	268
Total interest expense	1,115	925
Net interest income	7,847	7,331
Provision for Loan Losses	1,350	-
Net Interest Income After Provision for Loan Losses	6,497	7,331
Noninterest income		
Service charges on deposit accounts	358	335
Investment services and insurance income, net	223	187
Mortgage banking income, net	615	613
Title insurance income	306	355
Income on bank owned life insurance	112	112
Low income housing partnership losses	(192)	(201)
ATM and check card fees	388	351
Other operating income	189	130
Total noninterest income	1,999	1,882
Noninterest expense		
Salaries	3,047	2,628
Employee benefits	953	852
Occupancy expense	286	254
Equipment expense	259	207
FDIC insurance assessment	48	90

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Other real estate owned, net	17	12
Marketing expense	129	122
Legal and professional fees	95	79
ATM and check card fees	195	178
Telecommunication and data processing expense	417	352
Directors fees	114	116
Bank franchise tax	146	164
Other operating expenses	927	963
Total noninterest expense	6,633	6,017
Income before income taxes	1,863	3,196
Income tax expense	159	809
Net Income	1,704	2,387
Net income attributable to non-controlling interest	16	59
Net Income attributable to F & M Bank Corp.	\$1,688	\$2,328
Dividends paid/accumulated on preferred stock	104	105
Net income available to common stockholders	\$1,584	\$2,223

Per Common Share Data

Net income – basic	\$.49	\$.68
Net income – diluted	\$.47	\$.64
Cash dividends on common stock	\$.25	\$.23
Weighted average common shares outstanding – basic	3,250,749	3,272,352
Weighted average common shares outstanding – diluted	3,609,812	3,637,030

See notes to unaudited consolidated financial statements

F & M BANK CORP.
Consolidated Statements of Income
(Dollars in thousands)
(Unaudited)

Six Months Ended

June 30,

	2018	2017
Interest and Dividend income		
Interest and fees on loans held for investment	\$17,010	\$15,609
Interest and fees on loans held for sale	458	445
Interest from money market funds and federal funds sold	25	75
Interest on debt securities – taxable	212	137
Total interest and dividend income	17,705	16,266
Interest expense		
Total interest on deposits	1,505	1,249
Interest from short-term debt	136	32
Interest from long-term debt	453	550
Total interest expense	2,094	1,831
Net interest income	15,611	14,435
Provision for Loan Losses	2,030	-
Net Interest Income After Provision for Loan Losses	13,581	14,435
Noninterest income		
Service charges on deposit accounts	724	651
Investment services and insurance income	420	361
Mortgage banking income, net	1,135	1,113
Title insurance income	562	554
Income on bank owned life insurance	222	224
Low income housing partnership losses	(384)	(386)
ATM and check card fees	735	681
Gain on prepayment of long-term debt	-	504
Loss on sale of other investments	-	(42)
Other operating income	318	268
Total noninterest income	3,732	3,928
Noninterest expense		
Salaries	6,147	5,362
Employee benefits	1,876	1,805
Occupancy expense	537	503
Equipment expense	517	393

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FDIC insurance assessment	96	180
Other real estate owned, net	2	26
Marketing expense	231	257
Legal and professional fees	199	175
ATM and check card fees	356	346
Telecommunication and data processing expense	751	675
Directors fees	228	243
Bank franchise tax	312	324
Other operating expenses	1,858	1,683
Total noninterest expense	13,110	11,972
Income before income taxes	4,203	6,391
Income tax expense	538	1,686
Net Income	3,665	4,705
Net income attributable to non-controlling interest	5	32
Net Income attributable to F & M Bank Corp.	\$3,660	\$4,673
Dividends paid/accumulated on preferred stock	207	209
Net income available to common stockholders	\$3,453	\$4,464
Per Common Share Data		
Net income – basic	\$1.06	\$1.36
Net income – diluted	\$1.01	\$1.29
Cash dividends on common stock	.70	\$.45
Weighted average common shares outstanding – basic	3,253,007	3,272,318
Weighted average common shares outstanding – diluted	3,612,601	3,635,999

See notes to unaudited consolidated financial statements

F & M BANK CORP.
Consolidated Statements of Comprehensive Income
(Dollars in thousands)
(Unaudited)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2018	2017	2018	2017
Net Income	\$3,660	\$4,673	\$1,688	\$2,328
Other comprehensive (loss):				
Unrealized holding (losses) on available-for-sale securities	(168)	(2)	(22)	(1)
Tax effect	35	1	4	-
Unrealized holding (losses), net of tax	(133)	(1)	(18)	(1)
Total other comprehensive (loss)	(133)	(1)	(18)	(1)
Total comprehensive income	\$3,527	\$4,672	\$1,670	\$2,327
Comprehensive income attributable to noncontrolling interests	\$5	\$32	\$16	\$59
Comprehensive income attributable to F&M Bank Corp.	\$3,532	\$4,704	\$1,686	\$2,386

See notes to unaudited consolidated financial statements

F & M BANK CORP.

Condensed Consolidated Statements of Changes in Stockholders' Equity

(Dollars in thousands)

(Unaudited)

Six Months Ended

June 30,

2018 2017

Balance, beginning of period	\$91,275	\$86,682
Comprehensive income		
Net income – F & M Bank Corp	3,660	4,673
Net income attributable to non-controlling interest	5	32
Other comprehensive (loss)	(133)	(1)
Total comprehensive income	3,532	4,704
Minority interest capital distributions	(25)	(150)
Issuance of common stock	154	105
Repurchase of common stock	(624)	-
Repurchase of preferred stock	(63)	(24)
Dividends paid	(2,485)	(1,644)
Balance, end of period	\$91,764	\$89,673

See notes to unaudited consolidated financial statements

F & M BANK CORP.
Consolidated Statements of Cash Flows
(Dollars in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities		
Net income	\$3,660	\$4,673
Reconcile net income to net cash provided by operating activities:		
Depreciation	563	430
Amortization of intangibles	33	-
Amortization of securities	3	2
Proceeds from loans held for sale originated	22,918	38,767
Loans held for sale originated	(21,813)	(37,445)
Gain on sale of loans held for sale originated	(1,105)	(1,138)
Gain on prepayment of long-term debt	-	(504)
Provision for loan losses	2,030	-
Decrease (increase) in interest receivable	24	(110)
Increase in other assets	(566)	(435)
Decrease in accrued liabilities	(1,317)	(1,421)
Amortization of limited partnership investments	384	386
Income from life insurance investment	(222)	(224)
Gain on the sale of fixed assets	(9)	-
Loss on sale of investments	-	42
Gain on sale and valuation adjustments for other real estate owned	(30)	-
Net cash provided by operating activities	4,553	3,023
Cash flows from investing activities		
Purchase of investments available for sale and other investments	(3,361)	(41,436)
Purchase of title insurance company	(75)	(304)
Proceeds from maturity of investments available for sale	20,893	41,316
Proceeds from the sale of investments	-	55
Net increase in loans held for investment	(18,137)	(12,132)
Net (increase) decrease in loans held for sale participations	(10,046)	10,784
Purchase of bank owned life insurance	(5,000)	-
Proceeds from the sale of fixed assets	9	-
Proceeds from the sale of other real estate owned	-	74
Net purchase of property and equipment	(2,156)	(2,114)
Net cash used in investing activities	(17,873)	(3,757)
Cash flows from financing activities		

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Net change in deposits	(611)	(599)
Net change in short-term debt	20,704	10,000
Dividends paid in cash	(2,485)	(1,644)
Proceeds from issuance of common stock	154	105
Repurchase of preferred stock	(63)	(24)
Repurchase of common stock	(624)	-
Repayments of long-term debt	(2,298)	(11,795)
Net cash provided by (used in) financing activities	14,777	(3,957)
Net (decrease) increase in Cash and Cash Equivalents	1,457	(4,691)
Cash and cash equivalents, beginning of period	11,907	16,355
Cash and cash equivalents, end of period	\$13,364	\$11,664
Supplemental Cash Flow information:		
Cash paid for:		
Interest	\$2,087	\$1,836
Taxes	1,357	2,530
Supplemental non-cash disclosures:		
Transfer from loans to other real estate owned	20	6
Change in unrealized gain (loss) on securities available for sale	(168)	(2)

See notes to unaudited consolidated financial statements

Note 1.

Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying unaudited consolidated financial statements including the accounts of Farmers & Merchants Bank, TEB Life Insurance Company, Farmers & Merchants Financial Services, Inc., VBS Mortgage, LLC (dba F&M Mortgage), (net of non-controlling interest) and VSTitle, LLC and in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for the interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (“SEC”). Accordingly, these financial statements do not include all of the information and footnotes required by U. S. GAAP for complete financial statements. Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (the “2017 Form 10-K”).

The accompanying unaudited consolidated financial statements include the accounts of the Company, the Bank and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Nature of Operations

The Company, through its subsidiary Farmers & Merchants Bank (the “Bank”), operates under a charter issued by the Commonwealth of Virginia and provides commercial banking services. As a state chartered bank, the Bank is subject to regulation by the Virginia Bureau of Financial Institutions and the Federal Reserve Bank. The Bank provides services to customers primarily located in Rockingham, Shenandoah, Page and Augusta Counties in Virginia. Services are provided at thirteen branch offices and a Dealer Finance Division. The Company offers insurance, mortgage lending, title insurance and financial services through its subsidiaries, TEB Life Insurance, Inc., Farmers & Merchants Financial Services, Inc. (FMFS), F&M Mortgage, and VSTitle, LLC (VST). The Company purchased VSTitle, a title company headquartered in Harrisonburg, VA with offices in Harrisonburg, Fishersville and Charlottesville, VA on January 1, 2017.

Basis of Presentation

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that effect 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. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, goodwill and intangibles, fair value, the valuation of deferred tax assets and liabilities, pension accounting and the valuation of foreclosed real estate. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, which are necessary for fair presentation of the results of operations in these financial statements, have been made.

Reclassification

Certain reclassifications have been made to prior period amounts to conform to current period presentation. None of these reclassifications are considered material and have no impact on net income.

Note 1.

Summary of Significant Accounting Policies, continued

Earnings per Share

Accounting guidance specifies the computation, presentation and disclosure requirements for earnings per share (“EPS”) for entities with publicly held common stock or potential common stock such as options, warrants, convertible securities or contingent stock agreements if those securities trade in a public market. Basic EPS is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding. In calculating diluted EPS net income available to common stockholders is used as the numerator and the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive common shares had been issued. The dilutive effect of conversion of preferred stock is reflected in the diluted earnings per share calculation.

Net income available to common stockholders represents consolidated net income adjusted for preferred dividends declared.

The following table provides a reconciliation of net income to net income available to common stockholders for the periods presented:

(dollars in thousands)	For the Six months ended	For the Three months ended	For the Six months ended	For the Three months ended
	June 30, 2018	June 30, 2018	June 30, 2017	June 30, 2017

Earnings available to common stockholders:

Net income	\$3,665	\$1,704	\$4,705	\$2,387
Non-controlling interest income	5	16	32	59
Preferred stock dividends	207	104	209	105
Net income available to common stockholders	\$3,453	\$1,584	\$4,464	\$2,223

The following table shows the effect of dilutive preferred stock conversion on the Company's earnings per share for the periods indicated:

	Six months ended June 30, 2018			Six months ended June 30, 2017		
	Income	Weighted Average Shares	Per Share Amounts	Income	Weighted Average Shares	Per Share Amounts
Basic EPS	\$3,453	3,253,007	\$1.06	\$4,464	3,272,318	\$1.36

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Effect of Dilutive Securities:

Convertible Preferred Stock	207	359,594	(.05)	209	363,681	(0.07)
Diluted EPS	\$3,660	3,612,601	\$1.01	\$4,673	3,635,999	\$1.29

Three months ended
June 30, 2018

Three months ended
June 30, 2017

	Income	Weighted Average Shares	Per Share Amounts	Income	Weighted Average Shares	Per Share Amounts
Basic EPS	\$1,584	3,250,749	\$.49	\$2,223	3,273,352	\$.68
Effect of Dilutive Securities:						
Convertible Preferred Stock	104	359,063	(.02)	105	363,678	(0.04)
Diluted EPS	\$1,688	3,609,812	\$.47	\$2,328	3,637,030	\$.64

Note 2.

Investment Securities

Investment securities available for sale are carried in the consolidated balance sheets at their approximate fair value. Investment securities held to maturity are carried in the consolidated balance sheets at their amortized cost at June 30, 2018 and December 31, 2017 are as follows:

	Amortized Cost	Gross Gains	Gross Unrealized Losses	Fair Value
June 30, 2018				
U. S. Treasuries	\$122	\$-	\$-	\$122
December 31, 2017				
U. S. Treasuries	\$125	\$-	\$-	\$125

The amortized cost and fair value of securities available for sale are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2018				
U. S. Government sponsored enterprises	\$7,999	\$-	\$183	\$7,816
Mortgage-backed obligations of federal agencies	457	-	10	447
Total Securities Available for Sale	\$8,456	\$-	\$193	\$8,263
December 31, 2017				
U. S. Treasuries	\$19,998	\$-	\$-	\$19,998
U.S. Government sponsored enterprises	7,999	-	19	7,980
Mortgage-backed obligations of federal agencies	508	-	6	502
Equity securities ¹	135	-	-	135
Total Securities Available for Sale	\$28,640	\$-	\$25	\$28,615
1 Transferred to other investments on January 1, 2018 upon adoption of ASU 2016-01				

The amortized cost and fair value of securities at June 30, 2018, 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.

(dollars in thousands)	Securities Held to Maturity		Securities Available for Sale	
	Amortized	Fair	Amortized	Fair
	Cost	Value	Cost	Value
Due in one year or less	\$-	\$-	\$-	\$-
Due after one year through five years	122	122	7,999	7,816
Due after five years	-	-	457	447
Due after ten years	-	-	-	-
Total	\$122	\$122	\$8,456	\$8,263

There were no gains or losses on sales of available for sale securities in the three or six month periods ended June 30, 2018 or 2017. There were also no securities with other than temporary impairment and no securities that had been in a continues loss position in excess of twelve months as of June 30, 2018 and December 31, 2017.

Note 2. Investment Securities, continued

A summary of unrealized losses (in thousands) and the length of time in a continuous loss position, by security type of June 30, 2018 and December 31, 2017 were as follows:

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2018						
U. S. Government sponsored enterprises	\$7,816	\$(183)	\$-	\$-	\$7,816	\$(183)
Mortgage-backed obligations of federal agencies	447	(10)	-	-	447	(10)
Total	\$8,263	\$(193)	\$-	\$-	\$8,263	\$(193)

	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2017						
U. S. Government sponsored enterprises	\$3,981	\$(19)	\$-	\$-	\$3,981	\$(19)
Mortgage-backed obligations of federal agencies	502	(6)	-	-	502	(6)
Total	\$4,483	\$(25)	\$-	\$-	\$4,483	\$(25)

Other investments consist of investments in twenty low-income housing and historic equity partnerships (carrying basis of \$8,523), stock in the Federal Home Loan Bank (carrying basis \$4,644) and various other investments (carrying basis \$1,604). The interests in low-income housing and historic equity partnerships have limited transferability and the interests in the other stocks are restricted as to sales. The fair values of these securities are estimated to approximate their carrying value as of June 30, 2018. At June 30, 2018, the Company was committed to invest an additional \$4,398 in seven low-income housing limited partnerships. These funds will be paid as requested by the general partner to complete the projects. This additional investment has been reflected in the above carrying basis and in accrued liabilities on the consolidated balance sheet. During the first quarter of 2017, both Farmers & Merchants Financial Services and F&M Mortgage ended their relationship with Bankers Title Virginia resulting in a consolidated loss of \$42.

Note 3.

Loans

Loans held for investment outstanding at June 30, 2018 and December 31, 2017 are summarized as follows:

(dollars in thousands)	2018	2017
Construction/Land Development	\$67,079	\$71,620
Farmland	16,500	13,606
Real Estate	184,674	184,546
Multi-Family	9,829	10,298
Commercial Real Estate	156,041	148,906
Home Equity – closed end	10,742	11,606
Home Equity – open end	55,837	54,739
Commercial & Industrial – Non-Real Estate	41,275	36,912
Consumer	5,216	6,633
Dealer Finance	83,962	75,169
Credit Cards	2,967	2,939
Total	\$634,122	\$616,974

The Company has pledged loans held for investment as collateral for borrowings with the Federal Home Loan Bank of Atlanta totaling \$182,373 and \$218,523 as of June 30, 2018 and December 31, 2017, respectively. The Company maintains a blanket lien on its entire residential real estate portfolio and certain commercial and home equity loans.

Note 3.

Loans, continued

The following is a summary of information pertaining to impaired loans (dollars in thousand):

	June 30, 2018			December 31, 2017		
	Unpaid			Unpaid		
	Recorded	Principal	Related	Recorded	Principal	Related
	Investment	Balance	Allowance	Investment	Balance	Allowance
Impaired loans without a valuation allowance:						
Construction/Land Development	\$4,478	\$4,478	\$-	\$4,352	\$5,269	\$-
Farmland	1,984	1,984	-	1,984	1,984	-
Real Estate	1,688	1,688	-	1,273	1,273	-
Multi-Family	-	-	-	-	-	-
Commercial Real Estate	291	291	-	6,229	6,229	-
Home Equity – closed end	-	-	-	-	-	-
Home Equity – open end	-	-	-	-	347	-
Commercial & Industrial – Non-Real Estate	-	-	-	-	-	-
Consumer	-	-	-	8	8	-
Credit cards	-	-	-	-	-	-
Dealer Finance	33	33	-	31	31	-
	8,474	8,474	-	13,877	15,141	-
Impaired loans with a valuation allowance						
Construction/Land Development	7,463	8,023	2,154	4,998	4,998	1,661
Farmland	-	-	-	-	-	-
Real Estate	110	110	7	1,188	1,188	209
Multi-Family	-	-	-	-	-	-
Commercial Real Estate	5,898	5,898	1,586	-	-	-
Home Equity – closed end	-	-	-	-	-	-
Home Equity – open end	-	-	-	-	-	-
Commercial & Industrial – Non-Real Estate	-	-	-	-	-	-
Consumer	11	11	2	-	-	-
Credit cards	-	-	-	-	-	-
Dealer Finance	229	229	7	47	47	12
	13,711	14,271	3,756	6,233	6,233	1,882
Total impaired loans	\$22,185	\$22,745	\$3,756	\$20,110	\$21,374	\$1,882

The Recorded Investment is defined as the original principal balance less principal payments, charge-offs and nonaccrual payments applied to principal.

Loans held for sale consists of loans originated by F&M Mortgage for sale in the secondary market, and the Bank's commitment to purchase residential mortgage loan participations from Northpointe Bank. The volume of loans purchased from Northpointe fluctuates due to a number of factors including changes in secondary market rates, which affects demand for mortgage loans; the number of participating banks involved in the program; the number of mortgage loan originators selling loans to the lead bank and the funding capabilities of the lead bank. Loans held for sale as of June 30, 2018 and December 31, 2017 were \$49,821 and \$39,775, respectively.

Note 3.

Loans Held for Investment, continued

The following is a summary of the average investment and interest income recognized for impaired loans (dollars in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2018		2017		2018		2017	
	Average Recorded	Interest Income	Average Recorded	Interest Income	Average Recorded	Interest Income	Average Recorded	Interest Income
	Investment Recognized	Investment Recognized	Investment Recognized	Investment Recognized	Investment Recognized	Investment Recognized	Investment Recognized	Investment Recognized
Impaired loans without a valuation allowance:								
Construction/Land Development	\$4,759	\$45	\$4,734	\$47	\$4,929	\$79	\$4,374	\$50
Farmland	1,984	62	1,858	-	1,984	62	1,239	-
Real Estate	837	(6)	750	14	982	11	756	17
Multi-Family	-	-	-	-	-	-	-	-
Commercial Real Estate	797	4	100	2	2,608	9	719	3
Home Equity – closed end	-	-	-	-	-	-	-	-
Home Equity – open end	-	-	347	6	116	-	347	-
Commercial & Industrial – Non-Real Estate	-	-	166	-	-	-	167	6
Consumer and credit cards	-	-	11	-	3	-	12	-
Dealer Finance	33	-	20	1	32	1	13	1
	8,410	105	7,986	70	10,654	162	7,627	77
Impaired loans with a valuation allowance:								
Construction/Land Development	\$7,417	\$64	\$6,512	\$97	\$6,610	\$98	\$6,539	\$140
Farmland	-	-	-	-	-	-	-	-
Real Estate	1,283	9	1,199	31	1,251	27	1,201	31
Multi-Family	-	-	-	-	-	-	-	-
Commercial Real Estate	5,407	73	-	-	3,605	141	317	-

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Home Equity – closed end	-	-	-	-	-	-	-	-
Home Equity – open end	-	-	-	-	-	-	-	-
Commercial & Industrial – Non-Real Estate	-	-	-	-	-	-	-	-
Consumer and credit card	12	-	-	-	8	1	-	-
Dealer Finance	198	4	65	-	148	8	72	1
	14,317	150	7,776	128	11,622	275	8,129	172
Total Impaired Loans	\$22,727	\$255	\$15,762	\$198	\$22,276	\$437	\$15,756	\$249

Note 3.

Loans, continued

The following table presents the aging of the recorded investment of past due loans (dollars in thousands) as of June 30, 2018 and December 31, 2017:

	30-59 Days Past due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loan Receivable	Non-Accrual Loans	Recorded Investment >90 days & accruing
June 30, 2018								
Construction/Land Development	\$1,465	\$52	\$5,367	\$6,884	\$60,195	\$67,079	\$5,927	\$-
Farmland	-	-	-	-	16,500	16,500	-	-
Real Estate	1,772	1,215	1,496	4,483	180,191	184,674	1,345	899
Multi-Family	174	-	-	174	9,655	9,829	-	-
Commercial Real Estate	4,153	4,895	218	9,266	146,775	156,041	6,460	-
Home Equity – closed end	-	15	-	15	10,727	10,742	-	-
Home Equity – open end	539	258	158	955	54,882	55,837	133	26
Commercial & Industrial – Non- Real Estate	201	150	-	351	40,924	41,275	-	-
Consumer	117	15	10	142	5,074	5,216	-	10
Dealer Finance	1,066	262	93	1,421	82,541	83,962	161	-
Credit Cards	30	5	16	51	2,916	2,967	-	16
Total	\$9,517	\$6,867	\$7,358	\$23,742	\$610,380	\$634,122	\$14,026	\$951
December 31, 2017								
Construction/Land Development	\$167	\$5,459	\$3,908	\$9,534	\$62,086	\$71,620	\$3,908	\$-
Farmland	-	-	-	-	13,606	13,606	-	-
Real Estate	2,858	1,954	560	5,372	179,174	184,546	1,720	143
Multi-Family	179	-	-	179	10,119	10,298	-	-
	544	-	-	544	148,362	148,906	-	-

Commercial Real Estate								
Home Equity – closed end	-	25	-	25	11,581	11,606	3	-
Home Equity – open end	454	165	268	887	53,852	54,739	448	-
Commercial & Industrial – Non- Real Estate	108	36	595	739	36,173	36,912	599	-
Consumer	43	5	-	48	6,585	6,633	-	-
Dealer Finance	1,300	252	189	1,741	73,428	75,169	226	54
Credit Cards	30	8	1	39	2,900	2,939	-	1
Total	\$5,683	\$7,904	\$5,521	\$19,108	\$597,866	\$616,974	\$6,904	\$198

At June 30, 2018 and December 31, 2017, other real estate owned included \$177 and \$207 of foreclosed residential real estate. The Company has \$465 of consumer mortgages for which foreclosure is in process at June 30, 2018 and \$103 at December 31, 2017.

Nonaccrual loans at June 30, 2018 and June 30, 2017, would have earned approximately \$252 and \$42, respectively, in interest income had they been accruing loans.

Note 4.

Allowance for Loan Losses

A summary of changes in the allowance for loan losses (dollars in thousands) for June 30, 2018 and December 31, 2017 is as follows:

June 30, 2018	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Allowance for loan losses:							
Construction/Land Development	\$2,547	\$47	\$122	\$167	\$2,789	\$2,154	\$635
Farmland	25	-	-	-	25	-	25
Real Estate	719	53	12	(261)	417	7	410
Multi-Family	19	-	-	(2)	17	-	17
Commercial Real Estate	482	-	1	1,366	1,849	1,586	263
Home Equity – closed end	66	3	3	(17)	49	-	49
Home Equity – open end	209	-	3	(42)	170	-	170
Commercial & Industrial – Non-Real Estate	337	544	57	425	275	-	275
Consumer	148	13	5	(75)	65	2	63
Dealer Finance	1,440	1,036	528	471	1,403	7	1,396
Credit Cards	52	21	17	(2)	46	-	46
Total	\$6,044	\$1,717	\$748	\$2,030	\$7,105	\$3,756	\$3,349
December 31, 2017	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Allowance for loan losses:							
Construction/Land Development	\$3,381	\$620	\$-	\$(214)	\$2,547	\$1,661	\$886
Farmland	34	-	-	(9)	25	-	25
Real Estate	843	-	2	(126)	719	209	510
Multi-Family	23	-	-	(6)	19	-	19
Commercial Real Estate	705	-	13	(236)	482	-	482
Home Equity – closed end	75	7	25	(27)	66	-	66

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Home Equity – open end 470	26	53	(288)	209	-	209	
Commercial & Industrial – Non-Real Estate	586	179	72	(142)	337	-	337
Consumer	78	136	28	178	148	-	148
Dealer Finance	1,289	1,806	1,143	814	1,440	12	1,428
Credit Cards	59	98	37	54	52	-	52
Total	\$7,543	\$2,872	\$1,373	\$-	\$6,044	\$1,882	\$4,162

Note 4.

Allowance for Loan Losses, continued

The following table presents the recorded investment in loans (dollars in thousands) based on impairment method as of June 30, 2018 and December 31, 2017:

June 30, 2018	Loan Receivable	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Construction/Land Development	\$67,079	\$11,941	\$55,138
Farmland	16,500	1,984	14,516
Real Estate	184,674	1,798	182,876
Multi-Family	9,829	-	9,829
Commercial Real Estate	156,041	6,189	149,853
Home Equity – closed end	10,742	-	10,742
Home Equity –open end	55,837	-	55,837
Commercial & Industrial – Non-Real Estate	41,275	-	41,275
Consumer	5,216	11	5,205
Dealer Finance	83,962	262	83,699
Credit Cards	2,967	-	2,967
	\$634,122	\$22,185	\$611,937
Total			
December 31, 2017	Loan Receivable	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Construction/Land Development	\$71,620	\$9,350	\$62,270
Farmland	13,606	1,984	11,622
Real Estate	184,546	2,461	182,085
Multi-Family	10,298	-	10,298
Commercial Real Estate	148,906	6,229	142,677
Home Equity – closed end	11,606	-	11,606
Home Equity –open end	54,739	-	54,739
Commercial & Industrial – Non-Real Estate	36,912	-	36,912
Consumer	6,633	8	6,625
Dealer Finance	75,169	78	75,091
Credit Cards	2,939	-	2,939
	\$616,974	\$20,110	\$596,864
Total			

Note 4.

Allowance for Loan Losses, continued

The following table shows the Company's loan portfolio broken down by internal loan grade (dollars in thousands) as of June 30, 2018 and December 31, 2017:

June 30, 2018	Grade 1 Minimal Risk	Grade 2 Modest Risk	Grade 3 Average Risk	Grade 4 Acceptable Risk	Grade 5 Marginally Acceptable	Grade 6 Watch	Grade 7 Substandard	Grade 8 Doubtful	Total
Construction/Land Development	\$-	\$1,657	\$15,517	\$32,841	\$7,011	\$113	\$9,940	\$-	\$67,079
Farmland	62	-	4,410	5,806	3,744	494	1,984	-	16,500
Real Estate	-	1,603	53,790	100,205	21,918	2,573	4,585	-	184,674
Multi-Family	-	185	2,757	6,713	174	-	-	-	9,829
Commercial Real Estate	-	3,064	45,988	89,682	8,203	2,545	6,559	-	156,041
Home Equity – closed end	-	-	3,346	5,432	1,949	15	-	-	10,742
Home Equity – open end	223	1,910	19,897	29,687	3,618	307	195	-	55,837
Commercial & Industrial (Non-Real Estate)	229	1,532	18,386	18,078	2,451	535	64	-	41,275
Consumer (excluding dealer)	30	274	3,057	906	910	19	20	-	5,216
Total	\$544	\$10,225	\$167,148	\$289,350	\$49,978	\$6,601	\$23,347	\$-	\$547,193

	Credit Cards	Dealer Finance
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Performing	\$2,951	\$83,801
Non-performing	16	161
Total	\$2,967	\$83,962

Note 4.

Allowance for Loan Losses, continued

December 31, 2017	Grade 1 Minimal Risk	Grade 2 Modest Risk	Grade 3 Average Risk	Grade 4 Acceptable Risk	Grade 5 Marginally Acceptable	Grade 6 Watch	Grade 7 Substandard	Grade 8 Doubtful	Total
Construction/Land Development	\$-	\$690	\$12,974	\$30,197	\$9,165	\$3,520	\$15,074	\$-	\$71,620
Farmland	63		3,153	4,120	3,793	494	1,983	-	13,606
Real Estate	-	1,512	53,764	101,606	19,734	4,660	3,270	-	184,546
Multi-Family	-	228	4,780	5,111	179	-	-	-	10,298
Commercial Real Estate	-	3,525	45,384	89,195	9,012	634	1,156	-	148,906
Home Equity – closed end	-	-	3,535	5,410	1,279	1,379	3	-	11,606
Home Equity – open end	235	1,598	17,383	30,888	3,945	176	514	-	54,739
Commercial & Industrial (Non-Real Estate)	262	1,595	13,297	19,442	1,480	207	629	-	36,912
Consumer (excluding dealer)	34	490	2,226	88	1,065	2,254	476	-	6,633
Total	\$594	\$9,638	\$156,496	\$286,057	\$49,652	\$13,324	\$23,105	\$-	\$538,866

	Credit Cards	Dealer Finance
Performing	\$2,938	\$75,116
Non-performing	1	53
Total	\$2,939	\$75,169

Description of internal loan grades:

Grade 1 – Minimal Risk: Excellent credit, superior asset quality, excellent debt capacity and coverage, and recognized management capabilities.

Grade 2 – Modest Risk: Borrower consistently generates sufficient cash flow to fund debt service, excellent credit, above average asset quality and liquidity.

Grade 3 – Average Risk: Borrower generates sufficient cash flow to fund debt service. Employment (or business) is stable with good future trends. Credit is very good.

Grade 4 – Acceptable Risk: Borrower's cash flow is adequate to cover debt service; however, unusual expenses or capital expenses must be covered through additional long term debt. Employment (or business) stability is reasonable, but future trends may exhibit slight weakness. Credit history is good. No unpaid judgments or collection items appearing on credit report.

Note 4.

Allowance for Loan Losses, continued

Grade 5 – Marginally acceptable: Credit to borrowers who may exhibit declining earnings, may have leverage that is materially above industry averages, liquidity may be marginally acceptable. Employment or business stability may be weak or deteriorating. May be currently performing as agreed, but would be adversely affected by developing factors such as layoffs, illness, reduced hours or declining business prospects. Credit history shows weaknesses, past dues, paid or disputed collections and judgments, but does not include borrowers that are currently past due on obligations or with unpaid, undisputed judgments.

Grade 6 – Watch: Loans are currently protected, but are weak due to negative balance sheet or income statement trends. There may be a lack of effective control over collateral or the existence of documentation deficiencies. These loans have potential weaknesses that deserve management’s close attention. Other reasons supporting this classification include adverse economic or market conditions, pending litigation or any other material weakness. Existing loans that become 60 or more days past due are placed in this category pending a return to current status.

Grade 7 – Substandard: Loans having well-defined weaknesses where a payment default and or loss is possible, but not yet probable. Cash flow is inadequate to service the debt under the current payment, or terms, with prospects that the condition is permanent. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the borrower and there is the likelihood that collateral will have to be liquidated and/or guarantor(s) called upon to repay the debt. Generally, the loan is considered collectible as to both principal and interest, primarily because of collateral coverage, however, if the deficiencies are not corrected quickly; there is a probability of loss.

Grade 8 – Doubtful: The loan has all the characteristics of a substandard credit, but available information indicates it is unlikely the loan will be repaid in its entirety. Cash flow is insufficient to service the debt. It may be difficult to project the exact amount of loss, but the probability of some loss is great. Loans are to be placed on non-accrual status when any portion is classified doubtful.

Credit card and dealer finance loans are classified as performing or nonperforming. A loan is nonperforming when payments of principal and interest are past due 90 days or more.

Note 5.

Employee Benefit Plan

The Bank has a qualified noncontributory defined benefit pension plan which covers substantially all of its full-time employees hired before April 1, 2012. The benefits are primarily based on years of service and earnings. The Company uses December 31st as the measurement date for the defined benefit pension plan. The Bank does not expect to contribute to the pension plan in 2018.

On January 1, 2018 the Company adopted ASU No. 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." Under the new guidance, employers are required to present the service cost component of the net periodic benefit cost in the same income statement line item (e.g., Salaries and Employee benefits) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components of net periodic benefit cost separately (e.g., Other Noninterest Expense) from the line item that includes the service cost. The Company adopted ASU No. 2017-07 on January 1, 2018 and re-classified non-servicing components of net periodic pension cost from compensation expense to other noninterest expense. ASU No. 2017-07 did not have a material impact on the Company's Consolidated Financial Statements.

The following is a summary of net periodic pension costs for the three and six month periods ended June 30, 2018 and 2017:

	Six Months Ended		Three Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Service cost	\$384	\$348	\$192	\$174
Interest cost	248	244	124	122
Expected return on plan assets	(462)	(426)	(231)	(213)
Amortization of prior service cost	(8)	(8)	(4)	(4)
Amortization of net loss	152	142	76	71
Net periodic pension cost	\$314	\$300	\$157	\$150

Note 6.

Fair Value

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques.

Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Accounting guidance for fair value excludes certain financial instruments and all nonfinancial instruments

from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The Company records fair value adjustments to certain assets and liabilities and determines fair value disclosures utilizing a definition of fair value of assets and liabilities that states that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Additional considerations are involved to determine the fair value of financial assets in markets that are not active.

The Company uses a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. The three levels of the fair value hierarchy based on these two types of inputs are as follows:

- Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.
- Level 2 – Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.
- Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

Note 6.

Fair Value, continued

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the financial statements:

Securities

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. The carrying value of restricted Federal Reserve Bank and Federal Home Loan Bank stock approximates fair value based upon the redemption provisions of each entity and is therefore excluded from the following table.

Derivatives

The Company's derivatives are recorded at fair value based on third party vendor supplied information using discounted cash flow analysis from observable-market based inputs, which are considered Level 2 inputs.

The following tables present the balances of financial assets measured at fair value on a recurring basis as of June 30, 2018 and December 31, 2017 (dollars in thousands):

June 30, 2018	Total	Level 1	Level 2	Level 3
U.S. Government sponsored enterprises	\$7,816	\$-	\$7,816	\$-
Mortgage-backed obligations of federal agencies	447	-	447	-
Total securities available for sale	\$8,263	\$-	\$8,263	\$-
December 31, 2017	Total	Level 1	Level 2	Level 3
U. S. Treasuries	\$19,998	\$19,998	\$-	\$-
U.S. Government sponsored enterprises	7,980	-	7,980	-
Mortgage-backed obligations of federal agencies	502	-	502	-
Equity securities ¹	135	-	135	-
Total securities available for sale	\$28,615	\$19,998	\$8,617	\$-

1 Transferred to other investments on January 1, 2018 upon adoption of ASU 2016-01

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain financial assets recorded at fair value on a nonrecurring basis in the financial statements:

Loans Held for Sale

Loans held for sale are short-term loans purchased at par for resale to investors at the par value of the loan and loans originated by F&M Mortgage for sale in the secondary market. Loan participations are generally repurchased within 15 days. Loans originated for sale by F&M Mortgage are recorded at lower of cost or market. No market adjustments were required at June 30, 2018 or December 31, 2017; therefore, loans held for sale were carried at cost. Because of the short-term nature and fixed repurchase price, the book value of these loans approximate fair value at June 30, 2018 and December 31, 2017.

Note 6.

Fair Value, continued

Impaired Loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due will not be collected according to the contractual terms of the loan agreement. Troubled debt restructurings are impaired loans. Impaired loans are measured at fair value on a nonrecurring basis. If an individually-evaluated impaired loan's balance exceeds fair value, the amount is allocated to the allowance for loan losses. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

The fair value of an impaired loan and measurement of associated loss is based on one of three methods: the observable market price of the loan, the present value of projected cash flows, or the fair value of the collateral. The observable market price of a loan is categorized as a Level 1 input. The present value of projected cash flows method results in a Level 3 categorization because the calculation relies on the Company's judgment to determine projected cash flows, which are then discounted at the current rate of the loan, or the rate prior to modification if the loan is a troubled debt restructure.

Loans measured using the fair value of collateral method are categorized in Level 3. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. Most collateral is real estate. The Company bases collateral method fair valuation upon the "as-is" value of independent appraisals or evaluations.

The value of real estate collateral is determined by an independent appraisal utilizing an income or market valuation approach. Appraisals conducted by an independent, licensed appraiser outside of the Company as observable market data is categorized as Level 3. The value of business equipment is based upon an outside appraisal (Level 3) if deemed significant, or the net book value on the applicable business' financial statements (Level 3) if not considered significant. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3).

As of June 30, 2018 and December 31, 2017, the fair value measurements for impaired loans with specific allocations were primarily based upon the fair value of the collateral.

The following table summarizes the Company's financial assets that were measured at fair value on a nonrecurring basis during the period (dollars in thousands):

June 30, 2018	Total	Level 1	Level 2	Level 3
Construction/Land Development	\$5,309	\$-	\$-	\$5,309
Real Estate	103	-	-	103
Commercial Real Estate	4,312	-	-	4,312
Consumer	9	-	-	9
Dealer Finance	222	-	-	222
Impaired loans	\$9,955	\$-	\$-	\$9,955

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December 31, 2017	Total	Level 1	Level 2	Level 3
Construction/Land Development	\$3,337	\$-	-	\$3,337
Real Estate	979	-	-	979
Dealer Finance	35	-	-	35
Impaired loans	\$4,351	\$-	\$-	\$4,351

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Note 6.

Fair Value, continued

The following table presents information about Level 3 Fair Value Measurements for June 30, 2018:

(dollars in thousands)	Fair Value at June 30, 2018	Valuation Technique	Significant Unobservable Inputs	Range
Impaired Loans	\$ 9,995	Discounted appraised value	Discount for selling costs and marketability	2%-19% (Average 4.9%)

The following table presents information about Level 3 Fair Value Measurements for December 31, 2017:

(dollars in thousands)	Fair Value at December 31, 2017	Valuation Technique	Significant Unobservable Inputs	Range
Impaired Loans	\$ 4,351	Discounted appraised value	Discount for selling costs and marketability	3%-19% (Average 5.5%)

Other Real Estate Owned

Certain assets such as other real estate owned (OREO) are measured at fair value less cost to sell. Valuation of other real estate owned is determined using current appraisals from independent parties, a level two input. If current appraisals cannot be obtained prior to reporting dates, or if declines in value are identified after a recent appraisal is received, appraisal values are discounted, resulting in Level 3 estimates. If the Company markets the property with a realtor, estimated selling costs reduce the fair value, resulting in a valuation based on Level 3 inputs.

The Company markets other real estate owned both independently and with local realtors. Properties marketed by realtors are discounted by selling costs. Properties that the Company markets independently are not discounted by selling costs.

The following table summarizes the Company's other real estate owned that were measured at fair value on a nonrecurring basis as of June 30, 2018 and December 31, 2017 (dollars in thousands).

June 30, 2018	Total	Level 1	Level 2	Level 3
Other real estate owned	\$2,034	-	-	\$2,034
December 31, 2017	Total	Level 1	Level 2	Level 3

Other real estate owned \$1,984 - - \$1,984

The following table presents information about Level 3 Fair Value Measurements for June 30, 2018:

(dollars in thousands)	Fair Value at June 30, 2018	Valuation Technique	Significant Unobservable Inputs	Range
Other real estate owned	\$ 2,034	Discounted appraised value	Discount for selling costs	2.5%-10% (Average 4%)

The following table presents information about Level 3 Fair Value Measurements for December 31, 2017:

(dollars in thousands)	Fair Value at December 31, 2017	Valuation Technique	Significant Unobservable Inputs	Range
Other real estate owned	\$ 1,984	Discounted appraised value	Discount for selling costs	5%-15% (Average 8%)

Note 7. Disclosures about Fair Value of Financial Instruments

The following presents the carrying amount, fair value and placement in the fair value hierarchy of the Company's financial instruments as of June 30, 2018 and December 31, 2017. For short-term financial assets such as cash and cash equivalents and short-term liabilities, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For financial liabilities such as noninterest bearing demand, interest bearing demand and savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity. Fair values for June 30, 2018 are estimated under the exit price notion in accordance with the prospective adoption of ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities." Fair values for December 31, 2017 are estimated under the guidance in effect for that period, which did not require use of the exit price notion.

The estimated fair values, and related carrying amounts (dollars in thousands), of the Company's financial instruments are as follows:

Fair Value Measurements at June 30, 2018 Using

(dollars in thousands)	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at June 30, 2018
Assets:					
Cash and cash equivalents	\$13,364	\$13,364	\$-	\$-	\$13,364
Securities	8,385	-	8,385	-	8,385
Loans held for sale	49,821	-	49,821	-	49,821
Loans held for investment, net	627,017	-	-	615,424	615,424
Interest receivable	1,983	-	1,983	-	1,983
Bank owned life insurance	19,166	-	19,166	-	19,166
Total	\$719,736	\$13,364	\$79,355	\$615,424	\$708,143
Liabilities:					
Deposits	\$568,566	\$-	\$406,830	\$163,871	\$570,701
Short-term debt	46,000	-	46,000	-	46,000
Long-term debt	47,434	-	-	47,524	47,524
Interest payable	267	-	267	-	267
Total	\$662,267	\$-	\$453,097	\$211,395	\$664,492

Note 7. Disclosures About Fair Value of Financial Instruments, continued

Fair Value Measurements at December 31, 2017 Using

(dollars in thousands)	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at December 31, 2017
Assets:					
Cash and cash equivalents	\$11,907	\$11,907	\$-	\$-	\$11,907
Securities	28,740	19,998	8,742	-	28,740
Loans held for sale	39,775	-	39,775	-	39,775
Loans held for investment, net	610,930	-	-	646,703	646,703
Interest receivable	2,007	-	2,007	-	2,007
Bank owned life insurance	13,950	-	13,950	-	13,950
Total	\$707,309	\$31,905	\$64,474	\$646,703	\$743,082
Liabilities:					
Deposits	\$569,177	\$-	\$403,907	\$167,210	\$571,117
Short-term debt	25,296	-	25,296	-	25,296
Long-term debt	49,733	-	-	49,869	49,869
Interest payable	260	-	260	-	260
Total	\$644,466	\$-	\$429,463	\$217,079	\$646,542

Note 8.

Troubled Debt Restructuring

In the determination of the allowance for loan losses, management considers troubled debt restructurings and subsequent defaults in these restructurings by adjusting the loan grades of such loans, which are considered in the qualitative factors within the allowance. Defaults resulting in charge-offs affect the historical loss experience ratios which are a component of the allowance for loan loss methodology. Additionally, specific reserves may be established on restructured loans which are evaluated individually for impairment.

During the six months ended June 30, 2018, there were sixteen loan modifications that were considered to be troubled debt restructurings. Six of these loans were modified during the three months ended June 30, 2018 and ten loan modifications that would be considered a troubled debt restructuring were modified during the first quarter of 2018. Modifications may have included rate adjustments, revisions to amortization schedules, suspension of principal payments for a temporary period, re-advancing funds to be applied as payments to bring the loan(s) current, or any combination thereof.

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June 30, 2018

		Pre-Modification	Post-Modification
(dollars in thousands)		Outstanding	Outstanding
Troubled Debt Restructurings	Number of Contracts	Recorded Investment	Recorded Investment
Commercial Real Estate	1	\$1,002	\$1,002
Real Estate	2	1,255	1,255
Consumer	13	196	196
Total	16	\$2,453	\$2,453

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Note 8.

Troubled Debt Restructuring, continued

At June 30, 2018, there were no loans restructured in the previous 12 months in default or on nonaccrual status. A restructured loan is considered in default when it becomes 90 days past due.

During the six months ended June 30, 2017, there was one loan modification that was considered to be a troubled debt restructuring. This loan was modified during the three months ended June 30, 2017, there were no loan modifications that would be considered a troubled debt restructuring during the second quarter of 2017.

Six Months ended June 30, 2017

		Pre-Modification	Post-Modification
(dollars in thousands)		Outstanding	Outstanding
	Number of Contracts	Recorded Investment	Recorded Investment
Troubled Debt Restructurings			
Consumer	1	\$20	\$20
Total	1	\$20	\$20

At June 30, 2017, there was one loan restructured in the previous 12 months in default or on nonaccrual status. A restructured loan is considered in default when it becomes 90 days past due.

June 30, 2017

		Pre-Modification	Post-Modification
		Outstanding	Outstanding
	Number of Contracts	Recorded Investment	Recorded Investment
Troubled Debt Restructurings			
Real Estate	1	\$67	\$67
Total	1	\$67	\$67

Note 9.

Accumulated Other Comprehensive Loss

The balances in accumulated other comprehensive loss are shown in the following tables for June 30, 2018 and 2017:

(dollars in thousands)	Unrealized Securities Gains (Losses)	Adjustments Related to Pension Plan	Accumulated Other Comprehensive Loss
Balance at December 31, 2017	\$(20)	\$(4,122)	\$(4,142)
Change in unrealized securities gains (losses), net of tax	(133)	-	(133)
Change in unfunded pension liability, net of tax	-	-	-
Balance at June 30, 2018	\$(153)	\$(4,122)	\$(4,275)

(dollars in thousands)	Unrealized Securities Gains (Losses)	Adjustments Related to Pension Plan	Accumulated Other Comprehensive Loss
Balance at December 31, 2016	\$6	\$(3,171)	\$(3,165)
Change in unrealized securities gains (losses), net of tax	(1)	-	(1)
Change in unfunded pension liability, net of tax	-	-	-
Balance at June 30, 2017	\$5	\$(3,171)	\$(3,166)

There were no reclassifications adjustments reported on the consolidated statements of income during the three or six months ended June 30, 2018 or 2017.

Note 10.

Business Segments

The Company utilizes its subsidiaries to provide multiple business segments including retail banking, mortgage banking, title insurance services, investment services and credit life and accident and health insurance products related to lending. Revenues from retail banking operations consist primarily of interest earned on loans and investment securities and service charges on deposit accounts. Mortgage banking operating revenues consist principally of gains on sales of loans in the secondary market, loan origination fee income and interest earned on mortgage loans held for sale. Revenues from title insurance services, investment services and insurance products consist of commissions on products provided.

Note 10.

Business Segments, continued

The following tables represent revenues and expenses by segment for the three and six months ended June 30, 2018 and June 30, 2017.

Six Months Ended
June 30, 2018

	F&M Bank	F&M Mortgage	TEB Life/FMFS	VS Title	Parent Only	Eliminations	F&M Bank Corp. Consolidated
Revenues:							
Interest Income	\$17,620	\$71	\$71	\$-	\$-	\$(57)	\$17,705
Service charges on deposits	724	-	-	-	-	-	724
Investment services and insurance income	-	-	431	-	-	(11)	420
Mortgage banking income, net	-	1,135	-	-	-	-	1,135
Title insurance income	-	109	-	453	-	-	562
Gain on prepayment of long-term debt	-	-	-	-	-	-	-
Loss on investments	-	-	-	-	-	-	-
Other operating income	843	48	-	-	-	-	891
Total income	19,187	1,363	502	453	-	(68)	21,437
Expenses:							
Interest Expense	2,097	54	-	-	-	(57)	2,094
Provision for loan losses	2,030	-	-	-	-	-	2,030
Salary and benefit expense	6,564	831	283	345	-	-	8,023
Other operating expenses	4,496	456	28	89	29	(11)	5,087
Total expense	15,187	1,341	311	434	29	(68)	17,234
Net income (loss) before taxes	4,000	22	191	19	(29)	-	4,203
Income tax expense	284	-	36	-	218	-	538
Net income (loss)	\$3,716	\$22	\$155	\$19	\$(247)	\$-	\$3,665
Net income attributable to non-controlling interest	-	5	-	-	-	-	5
Net Income attributable to F & M Bank Corp.	\$3,716	\$17	\$155	\$19	\$(247)	\$-	\$3,660
Total Assets	\$772,244	\$8,332	\$6,910	\$707	\$91,480	\$(109,005)	\$770,668
Goodwill	\$2,670	\$65	\$-	\$57	\$164	\$-	\$2,956

Note 10.

Business Segments, continued

Three months ended
June 30, 2018

	F&M Bank	F&M Mortgage	TEB Life/FMFS	VS Title	Parent Only	Eliminations	F&M Bank Corp. Consolidated
Revenues:							
Interest Income	\$8,916	\$42	\$36	\$-	\$-	\$(32)	\$8,962
Service charges on deposits	358	-	-	-	-	-	358
Investment services and insurance income	-	-	228	-	-	(5)	223
Mortgage banking income, net	-	615	-	-	-	-	615
Title insurance income	-	47	-	259	-	-	306
Gain on prepayment of long-term debt	-	-	-	-	-	-	-
Loss on investments	-	-	-	-	-	-	-
Other operating income	450	47	-	-	-	-	497
Total income	9,724	751	264	259	-	(37)	10,961
Expenses:							
Interest Expense	1,116	31	-	-	-	(32)	1,115
Provision for loan losses	1,350	-	-	-	-	-	1,350
Salary and benefit expense	3,268	416	137	179	-	-	4,000
Other operating expenses	2,317	246	18	42	15	(5)	2,633
Total expense	8,051	693	155	221	15	(37)	9,098
Net income (loss) before taxes	1,673	58	109	38	(15)	-	1,863
Income tax expense	144	-	21	-	(6)	-	159
Net income (loss)	\$1,529	\$58	\$88	\$38	\$(9)	\$-	\$1,704
Net income attributable to non-controlling interest	-	16	-	-	-	-	16
Net Income attributable to F & M Bank Corp.	\$1,529	\$42	\$88	\$38	\$(9)	\$-	\$1,688

Note 10.

Business Segments, continued

Six Months Ended
June 30, 2017

	F&M Bank	VBS Mortgage	TEB Life/FMFS	VS Title	Parent Only	Eliminations	F&M Bank Corp. Consolidated
Revenues:							
Interest Income	\$16,171	\$65	\$75	\$-	\$-	\$(45)	\$16,266
Service charges on deposits	651	-	-	-	-	-	651
Investment services and insurance income	1	-	360	-	-	-	361
Mortgage banking income, net	-	1,113	-	-	-	-	1,113
Title insurance income	-	-	-	554	-	-	554
Gain on prepayment of long-term debt	504	-	-	-	-	-	504
Loss on investments	-	(40)	(2)	-	-	-	(42)
Other operating income	787	-	-	-	-	-	787
Total income	18,114	1,138	433	554	-	(45)	20,194
Expenses:							
Interest Expense	1,834	42	-	-	-	(45)	1,831
Provision for loan losses	-	-	-	-	-	-	-
Salary expense	5,977	616	234	340	-	-	7,167
Other operating expenses	4,220	470	17	94	4	-	4,805
Total expense	12,031	1,128	251	434	4	(45)	13,803
Net income (loss) before taxes	6,083	10	182	120	(4)	-	6,391
Income tax expense	1,669	-	53	-	(36)	-	1,686
Net income (loss)	\$4,414	\$10	\$129	\$120	\$32	\$-	\$4,705
Net income attributable to non-controlling interest	-	3	-	29	-	-	32
Net Income attributable to F & M Bank Corp.	\$4,414	\$7	\$129	\$91	\$32	\$-	\$4,673
Total Assets	\$746,193	\$6,027	\$6,630	\$274	\$89,909	\$(104,770)	\$744,263
Goodwill	\$2,670	\$-	\$-	\$-	\$304	\$-	\$2,974

Note 10.

Business Segments, continued

	Three Months Ended June 30, 2017						F&M Bank Corp. Consolidated
	F&M Bank	VBS Mortgage	TEB Life/FMFS	VS Title	Parent Only	Eliminations	
Revenues:							
Interest Income	\$8,210	\$30	\$38	\$-	\$-	\$(22)	\$8,256
Service charges on deposits	335	-	-	-	-	-	335
Investment services and insurance income	-	-	187	-	-	-	187
Mortgage banking income, net	-	613	-	-	-	-	613
Title insurance income	-	-	-	355	-	-	355
Gain on prepayment of long-term debt	-	-	-	-	-	-	-
Loss on investments	-	-	-	-	-	-	-
Other operating income	392	-	-	-	-	-	392
Total income	8,937	643	225	355	-	(22)	10,138
Expenses:							
Interest Expense	927	20	-	-	-	(22)	925
Provision for loan losses	-	-	-	-	-	-	-
Salary and benefit expense	2,968	211	119	182	-	-	3,480
Other operating expenses	2,160	320	13	43	1	-	2,537
Total expense	6,055	551	132	225	1	(22)	6,942
Net income (loss) before taxes	2,882	92	93	130	(1)	-	3,196
Income tax expense	801	-	26	-	(18)	-	809
Net income (loss)	\$2,081	\$92	\$67	\$130	\$17	\$-	\$2,387
Net income attributable to non-controlling interest	-	28	-	31	-	-	59
Net Income attributable to F & M Bank Corp.	\$2,081	\$64	\$67	\$99	\$17	\$-	\$2,328

Note 11.

Debt

Short-term Debt

The Company utilizes short-term debt such as Federal funds purchased and Federal Home Loan Bank of Atlanta (FHLB) short term borrowings to support the loans held for sale participation program and provide liquidity. Federal

funds purchased are unsecured overnight borrowings from other financial institutions. FHLB short term debt, which is secured by the loan portfolio, can be a daily rate variable loan that acts as a line of credit or a fixed rate advance, depending on the need of the Company. Short-term debt totaled \$46 million at June 30, 2018 and has increased \$20.7 million from \$25.3 million at December 31, 2017 due to an increase in the loans held for sale as well as internal loan growth and a slight decline in deposits.

Long-term Debt

The Company utilizes the FHLB advance program to fund loan growth and provide liquidity. The interest rates on long-term debt are fixed at the time of the advance and range from 1.16% to 2.56%; the weighted average interest rate was 1.87% and 1.86% at June 30, 2018 and December 31, 2017, respectively. The balance of these obligations at June 30, 2018 and December 31, 2017 were \$47,339 and \$49,554 respectively. The Company recognized a gain of \$504 on prepayment of two FHLB advances totaling \$10,000 during the first quarter of 2017 and there were no additional borrowings in 2017 or 2018. FHLB advances include a \$5 million line of credit at FHLB that is pledged to the Commonwealth of Virginia to secure public funds.

In addition, the Company has a note payable to purchase a lot adjacent to one of the Bank branches for \$85 at June 30, 2018 that is payable in one annual payment on January 1, 2019. There was \$170 outstanding on this note at December 31, 2017. VS Title, LLC has a note payable for vehicle purchases with a balance of \$10 at June 30, 2018.

Note 12.

Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2014-09 “Revenue from Contracts with Customers” (Topic 606) and all subsequent ASUs that modified Topic 606. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees, merchant income, and annuity and insurance commissions. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company’s revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), overdraft fees, monthly service fees, check orders, and other deposit account related fees. The Company’s performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Company’s performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers’ accounts.

Investment Services and Insurance Income

Investment services and insurance income primarily consists of commissions received on mutual funds and other investment sales. Commissions from the sale of mutual funds and other investments are recognized on trade date, which is when the Company has satisfied its performance obligation.

Title Insurance Income

VSTitle provides title insurance and real estate settlement services. Revenue is recognized at the time the real estate transaction is completed.

ATM and Check Card Fees

ATM and Check Card Fees are primarily comprised of debit and credit card income, ATM fees, merchant services income, and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Company’s debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees.

Other

Other noninterest income consists of other recurring revenue streams such as safe deposit box rental fees, and other service charges. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation.

Other service charges include revenue from processing wire transfers, online payment fees, cashier's checks, mobile banking fees and other services. The Company's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

Note 12.

Revenue Recognition, continued

The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and six months ended June 30, 2018 and 2017. Noninterest income out-of-scope of Topic 606 in 2017 included onetime gains on prepayment of debt of \$504.

	Six Months Ended June 30,		Three Months Ended June 30,	
	2018	2017	2018	2017
Noninterest Income (in thousands)				
In-scope of Topic 606:				
Service Charges on Deposits	\$724	\$651	\$358	\$335
Investment Services and Insurance Income	420	361	223	187
Title Insurance Income	562	554	306	355
ATM and check card fees	735	681	388	351
Other	250	240	134	118
Noninterest Income (in-scope of Topic 606)	2,691	2,487	1,409	1,348
Noninterest Income (out-of-scope of Topic 606)	1,041	1,441	590	536
Total Noninterest Income	\$3,732	\$3,928	\$1,999	\$1,882

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's noninterest revenue streams are largely based on transactional activity. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of June 30, 2018 and December 31, 2017, the Company did not have any significant contract balances.

Contract Acquisition Costs

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer

that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Company did not capitalize any contract acquisition cost.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations

F & M Bank Corp. (Company), incorporated in Virginia in 1983, is a financial holding company pursuant to section 3(a)(1) of the Bank Holding Company Act of 1956, which provides financial services through its wholly-owned subsidiary Farmers & Merchants Bank (Bank), TEB Life Insurance Company (TEB) and Farmers & Merchants Financial Services (FMFS) are wholly-owned subsidiaries of the Bank. The Bank also holds a majority ownership in VBS Mortgage LLC (dba F&M Mortgage) and F & M Bank Corp. holds a majority ownership in VSTitle LLC (VST), with the remaining minority interest owned by F&M Mortgage.

The Bank is a full service commercial bank offering a wide range of banking and financial services through its thirteen branch offices as well as its loan production office located in Penn Laird, VA (which specializes in providing automobile financing through a network of automobile dealers). TEB reinsures credit life and accident and health insurance sold by the Bank in connection with its lending activities. FMFS provides, brokerage services and property/casualty insurance to customers of the Bank. F&M Mortgage originates conventional and government sponsored mortgages through their offices in Harrisonburg, Fishersville, and Woodstock, VA. VS Title provides title insurance services through their offices in Harrisonburg, Fishersville, and Charlottesville, VA.

The Company's primary trade area services customers in Rockingham County, Shenandoah County, Page County and Augusta County.

Management's discussion and analysis is presented to assist the reader in understanding and evaluating the financial condition and results of operations of the Company. The analysis focuses on the consolidated financial statements, footnotes, and other financial data presented. The discussion highlights material changes from prior reporting periods and any identifiable trends which may affect the Company. Amounts have been rounded for presentation purposes. This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and the Notes to the Consolidated Financial Statements presented in Item 1, Part 1 of this Form 10-Q and in conjunction with the audited Consolidated Financial Statements included in the Company's December 31, 2017 Form 10-K.

Forward-Looking Statements

Certain statements in this report may constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that include projections, predictions, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often characterized by the use of qualified words (and their derivatives) such as "expect," "believe," "estimate," "plan," "project," or other statements concerning opinions or judgment of the Company and its management about future events.

Although the Company believes that its expectations with respect to certain forward-looking statements are based upon reasonable assumptions within the bounds of its existing knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Actual future results and trends may differ materially from historical results or those anticipated depending on a variety of factors, including, but not limited to, the effects of and changes in: general economic conditions, the interest rate environment, legislative and regulatory requirements, competitive pressures, new products and delivery systems, inflation, changes in the stock and bond markets, technology, and consumer spending and savings habits.

We do not update any forward-looking statements that may be made from time to time by or on behalf of the Company.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Critical Accounting Policies

General

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within the statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. The Company's financial position and results of operations are affected by management's application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company's consolidated financial position and/or results of operations.

In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of these transactions would be the same, the timing of events that would impact these transactions could change. Following is a summary of the Company's significant accounting policies that are highly dependent on estimates, assumptions and judgments.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on two basic principles of accounting: (i) ASC 450 (formerly SFAS No. 5) "Contingencies", which requires that losses be accrued when they are probable of occurring and estimable and (ii) ASC 310 (formerly SFAS No. 114), "Receivables", which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance. The Company's allowance for loan losses is the accumulation of various components that are calculated based on independent methodologies. All components of the allowance represent an estimation performed pursuant to either ASC 450 or ASC 310. Management's estimate of each ASC 450 component is based on certain observable data that management believes are most reflective of the underlying credit losses being estimated. This evaluation includes credit quality trends; collateral values; loan volumes; geographic, borrower and industry concentrations; seasoning of the loan portfolio; the findings of internal credit quality assessments and results from external bank regulatory examinations. These factors, as well as historical losses and current economic and business conditions, are used in developing estimated loss factors used in the calculations.

Allowances for loans are determined by applying estimated loss factors to the portfolio based on management's evaluation and "risk grading" of the loan portfolio. Specific allowances are typically provided on all impaired loans in excess of a defined loan size threshold that are classified in the Substandard or Doubtful risk grades. The specific reserves are determined on a loan-by-loan basis based on management's evaluation of the Company's exposure for each credit, given the current payment status of the loan and the value of any underlying collateral.

While management uses the best information available to establish the allowance for loan and lease losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the valuations or, if required by regulators, based upon information available to them at the time of their examinations. Such adjustments to original estimates, as necessary, are made in the period in which these factors and other relevant considerations indicate that loss levels may vary from previous estimates.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Critical Accounting Policies (continued)

Goodwill and Intangibles

In June 2001, the Financial Accounting Standards Board issued ASC 805, Business Combinations and ASC 350, Intangibles. The provisions of ASC 350 discontinue the amortization of goodwill and intangible assets with indefinite lives. Instead, these assets are subject to an annual impairment review and more frequently if certain impairment indicators are in evidence. ASC 350 also requires that reporting units be identified for the purpose of assessing potential future impairments of goodwill. The Company adopted ASC 350 on January 1, 2002. Goodwill totaled \$2,639 at January 1, 2002. As of December 31, 2008, the Company recognized \$31 in additional goodwill related to the purchase of 70% ownership in F&M Mortgage. In 2017, the Company recognized \$211 in goodwill and \$285 in intangibles related to the purchase of VST. The goodwill is not amortized but is tested for impairment at least annually. Based on this testing, there were no impairment charges for 2017, 2016 or 2015. The intangibles related to the VST purchase are amortized over periods up to 15 years with \$33 and \$53 recorded in 2018 and 2017, respectively.

At June 30, 2018, a preliminary goodwill of \$75 was recorded for VSTitle's acquisition of a small title company in Harrisonburg. The amount is subject to change during the measurement period.

Income Tax

The determination of income taxes represents results in income and expense being recognized in different periods for financial reporting purposes versus for the purpose of computing income taxes currently payable. Deferred taxes are provided on such temporary differences and are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. Further, the Company seeks strategies that minimize the tax effect of implementing its business strategies. Management makes judgments regarding the ultimate consequence of long-term tax planning strategies, including the likelihood of future recognition of deferred tax benefits. As a result, it is considered a significant estimate.

Fair Value

The estimate of fair value involves the use of (1) quoted prices for identical instruments traded in active markets, (2) quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques using significant assumptions that are observable in the market or (3) model-based techniques that use significant assumptions not observable in the market. When observable market prices and parameters are not fully available, management's judgment is necessary to arrive at fair value including estimates of current market participant expectations of future cash flows, risk premiums, among other things. Additionally, significant judgment may be required to determine whether certain assets measured at fair value are classified within the fair value hierarchy as Level 2 or Level 3. The estimation process and the potential materiality of the amounts involved result in this item being identified as critical.

Pension Plan Accounting

The accounting guidance for the measurement and recognition of obligations and expense related to pension plans generally applies the concept that the cost of benefits provided during retirement should be recognized over the employees' active working life. Inherent in this concept is the requirement to use various actuarial assumptions to

predict and measure costs and obligations many years prior to the settlement date. Major actuarial assumptions that require significant management judgment and have a material impact on the measurement of benefits expense and accumulated obligation include discount rates, expected return on assets, mortality rates, and projected salary increases, among others. Changes in assumptions or judgments related to any of these variables could result in significant volatility in the Company's financial condition and results of operations. As a result, accounting for the Company's pension expense and obligation is considered a significant estimate. The estimation process and the potential materiality of the amounts involved result in this item being identified as critical.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Critical Accounting Policies (continued)

Other Real Estate Owned (OREO)

OREO is held for sale and represents real estate acquired through or in lieu of foreclosure. OREO is initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The Company's policy is to carry OREO on its balance sheet at the lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Overview

Net income for the six months ended June 30, 2018 was \$3,660 or \$1.01 per diluted share, compared to \$4,673 or \$1.29 in the same period in 2017, a decrease of 21.68%. During the six months ended June 30, 2018, noninterest income decreased 4.99% and noninterest expense increased 9.51% during the same period. Net income from Bank operations adjusted for income from Parent activities, is as follows:

In thousands	2018	2017
Net Income from Bank Operations	\$3,888	\$4,550
Income from Parent Company Activities	(228)	123
Net Income for the six months ended June 30	\$3,660	\$4,673

During the three months ended June 30, 2018, net income was \$1,688 or \$.47 per diluted share, compared to \$2,328 or \$.64 in the same period in 2017, a decrease of 27.49%. In the three months ended June 30, 2018, noninterest income increased 6.22% and noninterest expense increased 10.24%.

In thousands	2018	2017
Net Income from Bank Operations	\$1,659	\$2,212
Income from Parent Company Activities (2018)	29	116
Net Income for the three months ended June 30	\$1,688	\$2,328

As shown in Table I, the 2018 year to date tax equivalent net interest income increased \$1,147 or 7.91% compared to the same period in 2017. The tax equivalent adjustment to net interest income totaled \$41 for the first six months of 2018. The yield on earning assets increased .33%, while the cost of funds increased .13% compared to the same period in 2017.

The three months ended June 30, 2018 tax equivalent net interest income increased \$500 or 6.79% compared to the same period in 2017. The tax equivalent adjustment to net interest income totaled \$20 for the three months ended June 30, 2018.

Year to date, the combination of the increase in yield on assets and the increase in cost of funds coupled with changes in balance sheet leverage has resulted in the net interest margin increasing to 4.73% at June 30, 2018, an increase of 27 basis points when compared to the same period in 2017. A schedule of the net interest margin for the three and six month periods ended June 30, 2018 and 2017 can be found in Table I.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Results of Operations

The following table provides detail on the components of tax equivalent net interest income:

GAAP Financial Measurements: (Dollars in thousands).	June 30, 2018		June 30, 2017	
	Six Months	Three Months	Six Months	Three Months
Interest Income – Loans	\$17,468	\$8,837	\$16,054	\$8,177
Interest Income - Securities and Other Interest-Earnings Assets	237	125	212	79
Interest Expense – Deposits	1,505	766	1,249	633
Interest Expense - Other Borrowings	589	349	582	292
Total Net Interest Income	15,611	7,847	14,435	7,331
 Non-GAAP Financial Measurements:				
Add: Tax Benefit on Tax-Exempt Interest Income – Loans	41	20	70	36
Total Tax Benefit on Tax-Exempt Interest Income	41	20	70	36
Tax-Equivalent Net Interest Income	\$15,652	\$7,867	\$14,505	\$7,367

The Interest Sensitivity Analysis contained in Table II indicates the Company is in an asset sensitive position in the one year time horizon. As the notes to the table indicate, the data was based in part on assumptions as to when certain assets or liabilities would mature or reprice. Approximately 41.83% of rate sensitive assets and 36.63% of rate sensitive liabilities are subject to repricing within one year. Due to the relatively flat yield curve, management has kept deposit rates low. The growth in earning assets and the growth in noninterest bearing accounts has resulted in the decrease in the positive GAP position in the one year time period.

The decrease in noninterest income of \$196 for the six-month period June 30, 2018 is primarily due to the 2017 gain on prepayment of FHLB debt of \$504 in the first quarter of 2017. Exclusive of the FHLB debt gain, noninterest income increased 9%. Other areas of increase are service charges on deposits (\$73), ATM and check card fees (\$54) and investment services and insurance (\$59). The increase in noninterest income of \$117 for the three months ended June 30, 2018 is primarily due to growth in investment services and insurance (\$36) and ATM and check card fees (\$37). For the three months ended June 30, 2018 noninterest income increased 6.22%.

Noninterest expense for the six months ended June 30, 2018 increased \$1,138 as compared to 2017. Expenses increased in the areas of salaries and benefits (\$856), equipment expense (\$124) and telecommunications and data processing (\$76). For the three months ended June 30, 2018 noninterest expense increased \$616. Areas of increase were salary and benefits (\$520), equipment expense (\$52) and telecommunications and data processing (\$65). Increases in salaries and benefits relate to normal salary increases, additional staff to support new branch locations, employee increases at F&M Mortgage and VSTitle, and increased cost of insurance. Equipment and telecommunications and data processing also increased as a result of branching activities.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Balance Sheet

Federal Funds Sold and Interest Bearing Bank Deposits

The Company's subsidiary bank invests a portion of its excess liquidity in either federal funds sold or interest bearing bank deposits. Federal funds sold offer daily liquidity and pay market rates of interest that at quarter end were benchmarked at 1.75% to 2.00% by the Federal Reserve. Actual rates received vary slightly based upon money supply and demand among banks. Interest bearing bank deposits are held either in money market accounts or as short-term certificates of deposits. Balances in federal funds sold and interest bearing bank deposits have increased since year end due to changes in the composition of the balances sheet.

Securities

The Company's securities portfolio serves to assist the Company with asset liability management.

The securities portfolio consists of investment securities commonly referred to as securities held to maturity and securities available for sale. Securities are classified as Held to Maturity investment securities when management has the intent and ability to hold the securities to maturity. Held to Maturity Investment securities are carried at amortized cost. Securities available for sale include securities that may be sold in response to general market fluctuations, liquidity needs and other similar factors. Securities available for sale are recorded at fair value. Unrealized holding gains and losses on available for sale securities are excluded from earnings and reported (net of deferred income taxes) as a separate component of stockholders' equity. The low income housing projects included in other investments are held for the tax losses and credits that they provide.

As of June 30, 2018, the fair value of securities available for sale was below their cost by \$193. The portfolio is made up of primarily agency securities with an average portfolio life of just over three years. This short average life results in less portfolio volatility and positions the Bank to redeploy assets in response to rising rates. There are no securities that will mature in 2018.

In reviewing investments as of June 30, 2018, there were no securities which met the definition for other than temporary impairment. Management continues to re-evaluate the portfolio for impairment on a quarterly basis.

Loan Portfolio

The Company operates in a predominately rural area that includes the counties of Rockingham, Page, Shenandoah and Augusta in the western portion of Virginia. The local economy benefits from a variety of businesses including agri-business, manufacturing, service businesses and several universities and colleges. The Bank is an active residential mortgage and residential construction lender and generally makes commercial loans to small and mid-size businesses and farms within its primary service area. There are no loan concentrations as defined by regulatory guidelines.

Loans Held for Investment of \$634,122 increased \$17,148 at June 30, 2018 compared to December 31, 2017. The following categories experienced growth: farmland, real estate, commercial real estate, home equity-open end, commercial and industrial, credit cards and dealer finance.

Loans Held for Sale totaled \$49,821 at June 30, 2018, an increase of \$10,046 compared to December 31, 2017. The Northpointe participation loan program is typically subject to seasonal fluctuations.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Loan Portfolio (continued)

Nonperforming loans include nonaccrual loans and loans 90 days or more past due. Nonaccrual loans are loans on which interest accruals have been suspended or discontinued permanently. Nonperforming loans totaled \$14,977 at June 30, 2018 compared to \$7,102 at December 31, 2017. The increase in nonaccrual loans is primarily due to two commercial relationships which have been reviewed for impairment and properly provisioned at June 30, 2018. Although the potential exists for loan losses, management believes the bank is generally well secured and continues to actively work with its customers to effect payment. As of June 30, 2018 and December 31, 2017, the Company held \$2,034 and \$1,984 of real estate which was acquired through foreclosure, respectively.

The following is a summary of information pertaining to risk elements and nonperforming loans (in thousands):

	June 30, 2018	December 31, 2017
Nonaccrual Loans		
Real Estate	\$7,272	\$5,628
Commercial	6,460	599
Home Equity	133	451
Other	161	226
Loans past due 90 days or more (excluding nonaccrual)		
Real Estate	899	143
Commercial	-	-
Home Equity	26	-
Other	26	55
Total Nonperforming loans	\$14,977	\$7,102
Restructured Loans current and performing:		
Real Estate	7,486	7,710
Commercial	-	-
Home Equity	-	-
Other	268	78
Nonperforming loans as a percentage of loans held for investment	2.36%	1.15%
Net charge offs to total loans held for investment	.15%	.24%
Allowance for loan and lease losses to nonperforming loans	47.44%	85.10%

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Allowance for Loan Losses

The allowance for loan losses provides for the risk that borrowers will be unable to repay their obligations. The risk associated with real estate and installment notes to individuals is based upon employment, the local and national economies and consumer confidence. All of these affect the ability of borrowers to repay indebtedness. The risk associated with commercial lending is substantially based on the strength of the local and national economies.

Management evaluates the allowance for loan losses on a quarterly basis in light of national and local economic trends, changes in the nature and volume of the loan portfolio and trends in past due and criticized loans. Specific factors evaluated include internally generated loan review reports, past due reports, historical loan loss experience and changes in the financial strength of individual borrowers that have been included on the Bank's watch list or schedule of classified loans.

In evaluating the portfolio, loans are segregated into loans with identified potential losses, pools of loans by type, with separate weighting for past dues and a general allowance based on a variety of criteria. Loans with identified potential losses include examiner and bank classified loans. Classified relationships in excess of \$500,000 and loans identified as troubled debt restructurings are reviewed individually for impairment under ASC 310. A variety of factors are considered when reviewing these credits, including borrower cash flow, payment history, fair value of collateral, company management, industry and economic factors.

Loans that are not impaired are categorized by call report code into unimpaired and classified loans. For unimpaired loans an estimate is calculated based on actual loss experience over the last five years, for loans of that type. Dealer finance loans utilize a two-year loss history. The Company monitors the net losses for this division and adjusts based on how the portfolio performs since the department was established in 2012. For classified loans, loans are grouped by call code and past due or adverse risk rating. Loss rates are assigned based on actual loss experience over the last five years multiplied by a risk factor. The Dealer finance loans are given a higher risk factor for past due and adverse risk ratings based on back testing of the risk factors.

A general allowance for inherent losses has been established to reflect other unidentified losses within the portfolio. The general allowance is calculated using nine qualitative factors identified in the 2006 Interagency Policy Statement on the allowance for loan losses. The general allowance assists in managing recent changes in portfolio risk that may not be captured in individually impaired loans, or in the homogeneous pools based on loss histories. The Board approves the loan loss provision for each quarter based on this evaluation.

The allowance for loan losses of \$7,105 at June 30, 2018 is equal to 1.12% of loans held for investment. This compares to an allowance of \$6,044 (.98%) at December 31, 2017. The Company experienced an increase in nonperforming loans during the fourth quarter of 2017 and first half of 2018. As a result, the Bank has recorded a \$2,030 provision for loan losses in the first half of 2018. In addition, past due and adversely risk rated loans have higher allocation factors within the allowance for loan losses calculation. The increase in nonperforming loans is attributable to two relationships (\$8.1 million) that have been reviewed for impairment and have specific reserves of \$2.3 million in the allowance for loan losses. Management will continue to monitor nonperforming and past due loans and will make necessary adjustments to specific reserves and provision for loan losses should conditions change regarding collateral values or cash flow expectations.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Deposits and Other Borrowings

The Company's main source of funding is comprised of deposits received from individuals, governmental entities and businesses located within the Company's service area. Deposit accounts include demand deposits, savings, money market and certificates of deposit. Total deposits at June 30, 2018 have decreased \$611 since December 31, 2017. Noninterest bearing deposits increased \$1,576 while interest bearing decreased \$2,187. The decrease in deposits is consistent with the first half of 2017, commercial accounts decline due to tax and bonus payouts during this time of year. The Bank participates in the CDARS (Certificate of Deposit Account Registry Service) and ICS (Insured Cash Sweep) programs. These programs, CDARS for certificates of deposit and ICS for demand and savings, allow the Bank to accept customer deposits in excess of FDIC limits and through reciprocal agreements with other network participating banks by offering FDIC insurance up to as much as \$50 million in deposits. The Bank also has the ability to bid on One-Way buy deposits through the CDARS network and has participated in this program to supplement core deposits. At June 30, 2018 and December 31, 2017 the Company had a total of \$3.1 million and \$1.2 million in CDARS funding and \$16 million and \$16.7 million in ICS funding, respectively.

Short-term borrowings

Short-term debt consists of federal funds purchased, daily rate credit obtained from the Federal Home Loan Bank (FHLB), and short-term fixed rate FHLB borrowings. Federal funds purchased are overnight borrowings obtained from the Bank's primary correspondent bank to manage short-term liquidity needs. Borrowings from the FHLB have been used to finance loans held for sale and also to finance the increase in short-term residential and commercial construction loans. As of June 30, 2018, short-term debt consisted of \$40,000 in FHLB short-term borrowings and \$6,000 in FHLB daily rate credit. This compared to FHLB short-term borrowings of \$20,000 at December 31, 2017. There were no balances in Federal funds purchased at June 30, 2018 or December 31, 2017.

Long-term borrowings

Borrowings from the FHLB continue to be an important source of funding. The Company's subsidiary bank borrows funds on a fixed rate basis. These borrowings are used to fund loan growth and also assist the Bank in matching the maturity of its fixed rate real estate loan portfolio with the maturity of its debt and thus reduce its exposure to interest rate changes. There were no new borrowings in 2018. Long term FHLB borrowings totaled \$47,339 and \$49,554 at June 30, 2018 and December 31, 2017.

The Company also has a note payable on a lot adjacent to one of the branches in the amount of \$85 and \$170 at June 30, 2018 and December 31, 2017. VS Title, LLC has a vehicle loan with a balance of \$10 at June 30, 2018 and December 31, 2017.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Capital

The Company seeks to maintain a strong capital base to expand facilities, promote public confidence, support current operations and grow at a manageable level.

In March 2015, the Bank implemented the Basel III capital requirements, which introduced the Common Equity Tier I ratio in addition to the two previous capital guidelines of Tier I capital (referred to as core capital) and Tier II capital (referred to as supplementary capital). At June 30, 2018, the Bank had Common Equity Tier I capital of 13.84%, Tier I capital of 13.84% of risk weighted assets and combined Tier I and II capital of 14.92% of risk weighted assets. Regulatory minimums at this date were 4.5%, 6% and 8%, respectively. At December 30, 2017, the Bank had Common Equity Tier I capital of 13.86%, Tier I capital of 13.86% of risk weighted assets and combined Tier I and II capital of 15.08% of risk weighted assets. Regulatory minimums at this date were 4.5%, 6% and 8%, respectively. The Bank has maintained capital levels far above the minimum requirements throughout the year. In the unlikely event that such capital levels are not met, regulatory agencies are empowered to require the Bank to raise additional capital and/or reallocate present capital.

In addition, the regulatory agencies have issued guidelines requiring the maintenance of a capital leverage ratio. The leverage ratio is computed by dividing Tier I capital by average total assets. The regulators have established a minimum of 4% for this ratio but can increase the minimum requirement based upon an institution's overall financial condition. At June 30, 2018 and December 31, 2017, the Bank reported a leverage ratio of 12.24% and 11.83%, respectively, which was also substantially above the minimum. The Bank also reported a capital conservation buffer of 6.92% at June 30, 2018 and 7.41% at December 31, 2017. The capital conservation buffer is designed to strengthen an institution's financial resilience during economic cycles. Financial institutions are required to maintain a minimum buffer as required by the Basel III final rules in order to avoid restrictions on capital distributions and other payments. Beginning January 1, 2017, a capital conservation buffer of 0.625% became effective. The capital conservation buffer for 2018 is 1.25% and will gradually be increased through January 1, 2019 to 2.5%.

Liquidity

Liquidity is the ability to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest-bearing deposits with banks, federal funds sold, investments and loans maturing within one year. The Company's ability to obtain deposits and purchase funds at favorable rates determines its liquidity exposure. As a result of the Company's management of liquid assets and the ability to generate liquidity through liability funding, management believes that the Company maintains overall liquidity sufficient to satisfy its depositors' requirements and meet its customers' credit needs.

Additional sources of liquidity available to the Company include, but are not limited to, loan repayments, the ability to obtain deposits through the adjustment of interest rates and the purchasing of federal funds. To further meet its liquidity needs, the Company's subsidiary bank also maintains a line of credit with its primary correspondent financial institution, with Zions Bank and Pacific Coast Bankers Bank. The Bank also has a line of credit with the Federal Home Loan Bank of Atlanta that allows for secured borrowings.

Interest Rate Sensitivity

In conjunction with maintaining a satisfactory level of liquidity, management must also control the degree of interest rate risk assumed on the balance sheet. Managing this risk involves regular monitoring of interest sensitive assets relative to interest sensitive liabilities over specific time intervals. The Company monitors its interest rate sensitivity periodically and makes adjustments as needed. There are no off balance sheet items that will impair future liquidity.

As of June 30, 2018, the Company had a cumulative Gap Rate Sensitivity Ratio of 15.61% for the one year repricing period. This generally indicates that earnings would increase in an increasing interest rate environment as assets reprice more quickly than liabilities. However, in actual practice, this may not be the case as balance sheet leverage, funding needs and competitive factors within the market could dictate the need to raise deposit rates more quickly. Management constantly monitors the Company's interest rate risk and has decided the current position is acceptable for a well-capitalized community bank.

A summary of asset and liability repricing opportunities is shown in Table II.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Effect of Newly Issued Accounting Standards

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2017-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its consolidated financial statements by gathering data on current lease agreements and analyzing the capital impact of expected right of use assets that will be recorded. No changes are expected regarding total lease expense.

During June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements and has formed a Current Expected Credit Losses steering committee which has chosen a vendor and is in the beginning stages of set up.

During January 2017, the FASB issued ASU No. 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment". The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are U.S. Securities and Exchange Commission (SEC) filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Effect of Newly Issued Accounting Standards, continued

During March 2017, the FASB issued ASU 2017-08, "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities." The amendments in this ASU shorten the amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The Company does not expect this standard to have a material impact on the financial statements.

In February 2018, the FASB issued ASU 2018-03, "Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments provide targeted improvements to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Specifically, the amendments include clarifications related to: measurement elections, transition requirements, and adjustments associated with equity securities without readily determinable fair values; fair value measurement requirements for forward contracts and purchased options on equity securities; presentation requirements for hybrid financial liabilities for which the fair value option has been elected; and measurement requirements for liabilities denominated in a foreign currency for which the fair value option has been elected. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. Early adoption is permitted. The Company is currently assessing the impact that ASU 2018-03 will have on its consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, "Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting." The amendments expand the scope of Topic 718 to include share-based payments issued to non-employees for goods or services, which were previously excluded. The amendments will align the accounting for share-based payments to nonemployees and employees more similarly. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company does not have stock compensation and therefore this standard will have no material impact.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not expected to have a material effect on the Company's financial position, result of operations or cash flows.

Existence of Securities and Exchange Commission Web Site

The Securities and Exchange Commission maintains a Web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Commission, including F & M Bank Corp. and the address is (<http://www.sec.gov>).

TABLE I
F & M BANK CORP.
Net Interest Margin Analysis
(on a fully taxable equivalent basis)
(Dollar Amounts in Thousands)

	Six Months Ended			Six Months Ended			Three Months Ended			Three Months Ended		
	June 30, 2018			June 30, 2017			June 30, 2018			June 30, 2017		
Average	Income/	Average	Income/	Average	Income/	Average	Income/	Average	Income/	Average	Income/	
	Balance ^{2,4}	Expense	Rates	Balance ^{2,4}	Expense	Rates	Balance ^{2,4}	Expense	Rates	Balance ^{2,4}	Expense	
Interest income												
Loans held for investment ^{1,2}	\$624,278	\$17,051	5.51%	\$592,729	\$15,679	5.33%	\$628,381	\$8,549	5.46%	\$597,126	\$7,942	
Loans held for sale	26,226	458	3.52%	32,145	445	2.79%	38,602	308	3.20%	38,193	271	
Federal funds sold	2,676	18	1.36%	18,143	71	.79%	886	2	.91%	7,695	17	
Interest bearing deposits	1,087	7	1.30%	1,098	4	.73%	1,069	3	1.13%	670	1	
Investments												
Taxable ³	13,552	212	3.15%	11,194	137	2.47%	13,522	120	3.56%	11,022	61	
Partially taxable	124	-	-	125	-	-	124	-	-	125	-	
Total earning assets	\$667,943	\$17,746	5.36%	\$655,434	\$16,336	5.03%	\$682,584	\$8,982	5.28%	\$654,831	\$8,292	
Interest Expense												
Demand deposits	115,632	267	.47%	119,388	254	.43%	115,410	136	.47%	118,560	129	
Savings deposits	123,090	275	.45%	111,755	247	.45%	124,595	140	.45%	112,015	126	
Time deposits	164,141	963	1.18%	155,593	748	.97%	163,024	490	1.20%	154,971	378	
Short-term debt	13,945	136	1.98%	15,982	32	.42%	24,935	126	2.03%	18,688	24	
Long-term debt	48,291	453	1.89%	55,390	550	2.00%	47,731	223	1.87%	52,311	268	
Total interest	\$465,099	\$2,094	.91%	\$458,108	\$1,831	.81%	\$475,695	\$1,115	.94%	\$456,545	\$925	

bearing
liabilities

Tax equivalent net interest income	\$15,652	\$14,505	\$7,867	\$7,367
Net interest margin	4.73%	4.46%	4.62%	

1 Interest income on loans includes loan fees.

2 Loans held for investment include nonaccrual loans.

3 An incremental income tax rate of 21% was used to calculate the tax equivalent income on nontaxable and partially taxable investments and loans in 2018 and 34% was used in 2017.

4 Average balance information is reflective of historical cost and has not been adjusted for changes in market value annualized.

TABLE II

F & M BANK CORP.
Interest Sensitivity Analysis
June 30, 2018
(Dollars In Thousands)

The following table presents the Company's interest sensitivity.

	0 – 3	4 – 12	1 – 5	Over 5	Not	
	Months	Months	Years	Years	Classified	Total
Uses of funds						
Loans						
Commercial	\$38,292	\$37,062	\$118,281	\$30,010	\$-	\$223,645
Installment	3,870	2,330	66,273	16,705	-	89,178
Real estate loans for investments	94,715	58,442	155,413	9,762	-	318,332
Loans held for sale	49,821	-	-	-	-	49,821
Credit cards	2,967	-	-	-	-	2,967
Interest bearing bank deposits	1,565	-	-	-	-	1,565
Federal funds sold	2,064	-	-	-	-	2,064
Investment securities	-	-	7,938	447	-	8,385
Total	\$193,294	\$97,834	\$347,905	\$56,924	\$-	\$695,957
Sources of funds						
Interest bearing demand deposits	\$-	\$31,110	\$67,493	\$18,191	\$-	\$116,794
Savings deposits	-	25,246	75,736	25,245	-	126,227
Certificates of deposit \$100,000 and over	6,148	20,722	32,907	-	-	59,777
Other certificates of deposit	12,658	31,100	58,201	-	-	101,959
Short-term borrowings	46,000	-	-	-	-	46,000
Long-term borrowings	1,108	8,406	33,795	4,125	-	47,434
Total	\$65,914	\$116,584	\$268,132	\$47,561	\$-	\$498,191
Discrete Gap	\$127,380	\$(18,750)	\$79,773	\$9,363	\$-	\$197,766
Cumulative Gap	\$127,380	\$108,630	\$188,403	\$197,766	\$197,766	
Ratio of Cumulative Gap to Total Earning Assets	18.30%	15.61%	27.07%	28.42%	28.42%	

Table II reflects the earlier of the maturity or repricing dates for various assets and liabilities as of June 30, 2018. In preparing the above table, no assumptions were made with respect to loan prepayments. Loan principal payments are included in the earliest period in which the loan matures or can reprice. Investment securities included in the table consist of securities held to maturity and securities available for sale. Principal payments on installment loans scheduled prior to maturity are included in the period of maturity or repricing. Proceeds from the redemption of investments and deposits are included in the period of maturity. Estimated maturities of deposits, which have no stated maturity dates, were derived from guidance contained in FDICIA 305.

Item 3.

Quantitative and Qualitative Disclosures about Market Risk

The Company considers interest rate risk to be a significant market risk and has systems in place to measure the exposure of net interest income to adverse movement in interest rates. Interest rate shock analyses provide management with an indication of potential economic loss due to future rate changes. There have not been any changes which would significantly alter the results disclosed as of December 31, 2017 in the Company's 2017 Form 10-K, Item 7A or Part II.

Item 4.

Controls and Procedures

The Company's management evaluated, with the participation of the Company's principal executive officer and principal financial officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on that evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective as of June 30, 2018 to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the three months ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Because of the inherent limitations in all control systems, the Company believes that no system of controls, no matter how well designed and operated, can provide absolute assurance that all control issues have been detected.

Part II
Other Information

Item 1. Legal Proceedings

There are no material pending legal proceedings other than ordinary routine litigation incidental to its business, to which the Company is a party or of which the property of the Company is subject.

Item 1a. Risk Factors –

There have been no material changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds –None

Item 3. Defaults Upon Senior Securities – None

Item 4. Mine Safety Disclosures None

Item 5. Other Information – None

Item 6. Exhibits

(a)
Exhibits

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) (filed herewith).

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) (filed herewith).

32 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sabanes-Oxley Act of 2002 (filed herewith).

The following materials from F&M Bank Corp.'s Quarterly Report on Form 10Q for the period ended March 31, 2018, formatted in Extensible Business Reporting Language (XBRL), include: (i) Consolidated Balance Sheets, 101 (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Stockholders' Equity, (v) Consolidated Statements of Cash Flows and (vi) related notes (filed herewith).

Signatures

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

F & M BANK CORP.

By: /s/ Mark C. Hanna
Mark C. Hanna
President and Chief Executive Officer

By: /s/ Carrie A. Comer
Carrie A. Comer
Executive Vice President and Chief Financial Officer

August 8, 2018

Exhibit Index:

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