2009 • Annual Report

Farmers & Merchants Bank®

California's Strongest Bank®

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2009 Annual Report

Farmers & Merchants Bank®

California's Strongest Bank®


HAMILTON OHIO U S A

Dear Fellow Shareholders:

Farmers & Merchants Bank of Long Beach achieved solid financial results in 2009 by focusing on conservative lending practices and superior service.

We safely navigated through a challenging economic environment, while growing our core deposit accounts and maintaining capital ratios well above industry standards. The Bank's sound judgment, financial strength and established roots provided a platform to support our customer base and offer products that continue to position Farmers & Merchants as a leader in Southern California.

Interest income for the year ended December 31, 2009 was $189.6 million, compared with $182.3 million reported for the same period in 2008. At the same time, interest expense for the year totaled $18.4 million, compared with $35.5 million in 2008, primarily related to a lower interest rate environment.

Reflecting more stability in the economic environment when compared with the prior year, our provision for loan losses totaled $40.8 million in 2009 versus $53.0 million for 2008. Allowance for loan losses as a percentage of loans outstanding was 2.85% at December 31, 2009, compared with 2.69% at December 31, 2008.

While the economy began to show signs of improvement in 2009, we continued to closely monitor non-performing loans and control operating costs. Additionally, investments in our securities portfolio remained in good standing.

Non-interest expense for the year ended December 31, 2009 was $77.5 million, compared with $61.5 million during the same period in 2008. Reflecting the Bank's focus on controlling operating costs, Farmers & Merchants' overhead efficiency ratio was 41.26%, better than the industry's average.

Our ability to weather tough economic conditions ultimately improved profitability for the year. The Bank's net income for 2009 was $40.7 million, or $310.82 per diluted share, compared with $29.7 million, or $218.97 per diluted share, for 2008. As we continue to adjust to changing economic conditions, the Bank's core strength is well intact and guided by a tenured management team that is committed to our financial performance and shareholder value.

The strength of the Bank's balance sheet is a testament to our commitment.

Strong Balance Sheet

At December 31, 2009, net loans increased 1.1% to $1.97 billion from $1.95 billion at December 31, 2008. The Bank's deposits grew 6.3% to $2.84 billion at the end of 2009, compared with $2.68 billion at December 31, 2008. Non-interest bearing deposits represented 31.6% of total deposits at December 31, 2009, versus 30.3% of total deposits at December 31, 2008. Total assets increased to $3.98 billion at the close of 2009 from $3.64 billion at December 31, 2008.

At December 31, 2009, the Bank remained "well-capitalized" under all regulatory categories, with a total risk-based capital ratio of 26.39%, a Tier 1 risk-based capital ratio of 25.12%, and a Tier 1 leverage ratio of 14.29%. The minimum ratios for capital adequacy for a well-capitalized bank are 10.00%, 6.00% and 5.00%, respectively.

The strength of our balance sheet is particularly important at a time when depositors, borrowers and shareholders seek out relationships with banks that have a solid foundation.

Father and Sons, Third and Fourth Generation Bankers
(Pictured from Left to Right) Daniel K. Walker, Kenneth G. Walker, W. Henry Walker

Maintaining Our Strength

Farmers & Merchants has 22 branches throughout Southern California that cultivate longstanding relationships with the customers and communities served. Relationship banking is a priority for us, as well as providing our customers with the best products and services to help them achieve their goals.

Maintaining a strong capital position is critical as we continue to adapt to the changing times. Prudent lending practices and sound judgment are key ingredients to the Bank's success. These traits also translate to our newer offerings, including electronic statements. We believe applying Farmers & Merchants' core values to all aspects of our organization is what ultimately resonates with customers.

Moving Forward

Farmers & Merchants' 103-year-old heritage distinguishes the Bank from the competition. We plan to increase the presence of our brand in the year ahead, melding our decades of experience in Southern California with the entrepreneurial thinking that customers expect in a banking partner.

In 2009, we were honored with the Ernst & Young Entrepreneur of the Year Lifetime Achievement Award, and while we are proud of this accomplishment, it also speaks to the discipline, commitment and integrity that have been the hallmarks of the Bank since 1907.

As we move forward, Farmers & Merchants is focused on delivering the highest standards in banking, maintaining financial strength and contributing to the communities we serve. On behalf of our board of directors and management team, we thank our employees, customers and shareholders for their continued dedication to making Farmers & Merchants one of the strongest banks in the country.

Daniel K. Walker

Daniel K. Walker
Chairman of the Board and President

W. Henry Walker

W. Henry Walker
Chief Executive Officer

• Board of Directors •

Farmers & Merchants Bank of Long Beach thanks its board of directors for their continued loyalty and commitment to making F&M one of the strongest banks in the country.

Daniel K. Walker, Chairman of the Board

Richard W. Darling

Walter M. Florie

William G. Hayter

Timothy W. Jackert

Lawrence J. McLaughlin

Timothy M. Wilson

Farmers & Merchants Bank Board of Directors

(Pictured from Left to Right) William G. Hayter, Richard W. Darling, Timothy M. Wilson, Lawrence J. McLaughlin, Daniel K. Walker–Chairman of the Board, Timothy W. Jackert, Walter M. Florie

• Meet the Executives •

F&M launched an e-mail campaign for customers to become acquainted with the Bank's leadership titled "Meet the Executives." The program was kicked off on September 18, 2009 in honor of Kenneth Walker's 61st anniversary with the bank.

The "Meet the Executives" e-blasts marked the start of our electronic marketing efforts utilizing our new, industry-leading e-blast software. The intent was for customers to get accustomed to hearing from F&M via e-mail, before we began frequent e-blasts to customers on product offerings.

The "Meet the Executives" e-blasts were well received, with an overall average open rate of 28.22% versus a financial services industry standard open rate of 20.87%. The highest-performing e-blast of the Executive Series was that of Kenneth G. Walker, with an open rate of 32.69% versus the aforementioned industry standard of 20.87%. These results indicated a successful launch of this new medium of communication with our customers.

Meet Kenneth G. Walker

Grandson of founder C.J. Walker, Kenneth began working at F&M at age 11 as the elevator operator and grounds keeper of the Long Beach headquarters. He later served in the U.S. Navy, and then attended USC, where he studied finance, accounting, and economics. Following his military service and educational pursuits, he married and returned to work at F&M as a teller in 1948, and has worked in almost every conceivable banking capacity at F&M until becoming its executive vice president in 1965. Kenneth succeeded his father, Gus Walker, as president of the bank in 1979, a role he held for close to 30 years. He has been critical to the institution's success and at 82 years of age continues to serve as president of the Long Beach main office.

One of Kenneth's greatest accomplishments was seeing his sons, Daniel and Henry Walker, rise to executive-level roles in the bank.

• Meet the Executives •

Meet Daniel K. Walker

Daniel Walker has held virtually every job at the Bank, from teller to branch manager. Currently, Daniel holds the titles of president and chairman of the board for Farmers & Merchants Bank. He also serves as the president of Farmers & Merchants Trust Company. He is actively involved in the Long Beach Police Foundation.

Meet W. Henry Walker

W. Henry Walker started his career on the teller line and almost 30 years later stepped into the role of chief executive officer. This year, he successfully led the Bank to $4 billion in assets for the first time in the Bank's history. Henry has made it his mission to proactively serve the community and was honored by Big Brothers Big Sisters of Orange County at the annual Gourmet Dinner in November 2009. He also serves as a board member for the Pacific Symphony of Orange County and as a Pink Tie Guy for Susan G. Komen for the Cure.

Meet John W. H. Hinrichs

John Hinrichs has dedicated more than 46 years to Farmers & Merchants Bank, where he currently serves as chief financial officer. He has worked alongside three generations of F&M CEOs, striking a balance between revenues and expenses that has established tremendous financial stability for F&M, day in and day out. John's philanthropic spirit extends to several charities that include the Long Beach chapters of Goodwill Industries International, Inc., Family Services, St. Mary's Foundation, and Rotary Club.

• Meet the Managers •

F&M profiled the individual branch managers in an e-mail campaign titled “Meet the Managers.” The e-blast for each branch location was targeted to customers in close proximity to help them become better acquainted with the face of the bank in their specific area.

The e-blast campaign proved successful with an overall average open rate of 34.20%, versus a financial services industry standard open rate of 20.87%. The highest-performing e-blast of this series was that of our Rolling Hills branch manager, Jason Anderson, with a 39.72% open rate.

Each of the branch managers received a number of positive comments about their e-blasts from visiting customers.

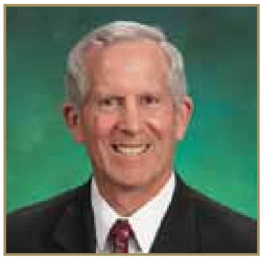
LOS ANGELES COUNTY OFFICES

Phil Sblendorio
Senior Vice President
Main

Serving F&M for more than 28 years.

Lorie Stack
Vice President
East Long Beach

Serving F&M for more than 42 years.



James Robison
Senior Vice President
Artesia

Serving F&M for more than 37 years.

Juan Arreola
First Vice President
Lakewood

Serving F&M for more than 19 years.

• Meet the Managers •

LOS ANGELES COUNTY OFFICES

Alex Bikov
Vice President
Bixby Knolls
Serving F&M for more than 3 years.

Bret Holloway
First Vice President
Belmont Shore
Serving F&M for more than 25 years.

Ed Herro
Vice President
Los Altos
Serving F&M for more than 4 years.

Wayne Hunter
Vice President
Memorial
Serving F&M for more than 14 years.

SOUTH BAY OFFICES

Jason Anderson
Vice President
Rolling Hills
Serving F&M for more than 14 years.

Ankit Shah
Vice President
Torrance
Serving F&M for more than 2 years.

• Meet the Managers •

ORANGE COUNTY OFFICES

Sandy Thomas
Vice President
Garden Grove

Serving F&M for more than 33 years.

Tom Sauchelli
Vice President
Lake Forest

Serving F&M for more than 12 years.

Robert Schoeffler
Vice President
Orange

Serving F&M for more than 8 years.

Scott Dowds
Senior Vice President
Fullerton

Serving F&M for more than 16 years.

Paula Garcia-Young
Vice President
Santa Ana

Serving F&M for more than 1 year.

OJ Gause
First Vice President
San Juan Capistrano

Serving F&M for more than 5 years.

Jeff Hagan
Vice President
Rossmoor

Serving F&M for more than 33 years.

Marty Hartsock
Vice President
Huntington Beach

Serving F&M for more than 7 years.

• Meet the Managers •

ORANGE COUNTY OFFICES

Matthew Walker
Vice President
Laguna Hills

Serving F&M for more than 13 years.

Robert Fish
Senior Vice President
Newport Beach

Serving F&M for more than 10 years.

Ada Baker
Vice President
San Clemente

Serving F&M for more than 11 years.

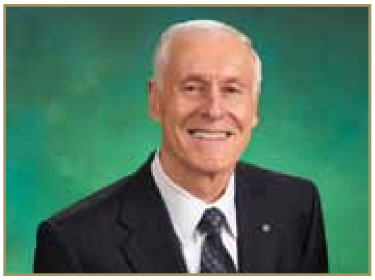
Marcia Evans
Vice President
Tustin

Serving F&M for more than 3 years.

• CFO of the Year—Lifetime Achievement Award •

John Hinrichs received the prestigious Lifetime Achievement Award at the CFO of the Year Awards on January 14, 2009 at the Hyatt Regency in Irvine.

The award was given on behalf of the *Orange County Business Journal* and the California Society of Certified Public Accountants.



• Ernst & Young Lifetime Achievement Award •

Kenneth, Daniel, and Henry Walker of Farmers & Merchants Bank were collectively honored with the Ernst & Young Entrepreneur of the Year 2009 Lifetime Achievement Award.

The Walkers received this prestigious, rarely given award at the yearly awards gala on June 11, 2009 at the Hyatt Regency in Irvine.

• Music for the Cure •

F&M was aligned with causes significant to the Orange County community through the creation of the first-ever "Music for the Cure" concert. This collaboration featured F&M CEO Henry Walker, who was both a Pink Tie Guy for Susan G. Komen for the Cure-OC and on the Pacific Symphony's board of directors, to address an audience of more than 7,000 at the Verizon Wireless Amphitheater in Irvine on September 12, 2009.

• Big Brothers Big Sisters of Orange County •

W. Henry Walker was honored by Big Brothers Big Sisters of Orange County at its 45th annual Gourmet Dinner at the Hyatt Regency Irvine on November 5, 2009. Serving as a board member for the past six years, Walker played an instrumental role in generating support and increasing involvement for the organization's programs.

• 2009 Women of Courage Program •

The first-ever "Women of Courage" program spotlighted customers in Orange County who have displayed courage, tenacity, and strength in business and the community.

F&M hosted an awards breakfast for the honorees on October 29, 2009 at Zov's Bistro in Tustin. The event was tied to F&M's philanthropy for the National Association of Women Business Owners, Orange County (NAWBO-OC).

F&M Executives Congratulate Sponsored NAWBO-OC's Remarkable Women "Courage" Honoree
(Pictured from Left to Right) W. Henry Walker, Cheryl Osborn of CASCO Contractors, Daniel K. Walker

• 2009 Women of Courage Honorees •

Agnes Green
Vernon's Enterprises, Inc.
Garden Grove
Customer Since 1983

Chosen by Garden Grove Branch Manager Sandy Thomas for the perseverance she displayed in keeping her business, Vernon's Enterprises, Inc., running despite the loss of her property to eminent domain.

Janet Ferguson
Newman Backhoe
Fullerton
Customer Since 1997

Chosen by Fullerton Branch Manager Scott Dowds for her resolve to take over the family business and grow it into a thriving company, even in the male-dominated construction industry.

Annette Derosa
Blenders & Softserve, Inc.
Santa Ana
Customer Since 1999

Chosen by Santa Ana Branch Manager Paula Garcia-Young for her resilience in continuing the business she founded with her closest friend, Terry Dreiswerd, who passed away suddenly. Annette keeps Terry's dream alive by continuing to grow Blenders & Softserve, Inc.

Robin Matherson
Mission Motorsports
San Juan Capistrano
Customer Since 1996

Chosen by San Juan Capistrano Branch Manager OJ Gause for her resilience and perseverance to continue growing the business her husband started, after he died in a motorcycle accident. She has also battled breast cancer, showing great courage in the face of adversity.

• 2009 Women of Courage Honorees •

Leslie Seigel

California Closet Co.

Rossmoor

Customer Since 1992

Chosen by Seal Beach Branch Manager Jeff Hagan for her strength to persevere as a wife, mother of two, and business owner while battling breast cancer.

Diane Adams-Rehrig

Farmers Insurance

Huntington Beach

Customer Since 2005

Chosen by Huntington Beach Branch Manager Marty Hartsock because of her mission to raise money and serve as an advocate for autism, inspired by her commitment to help her autistic son.

Renee Ramos-Hitzel

PMI

Laguna Hills

Customer Since 2009

Chosen by Laguna Hills Branch Manager Matthew Walker for her tenacity to grow her company, Program Management International (PMI), into the fastest-growing company in the protective clothing industry.

Katherine Litton

Real Estate Investor

Newport Beach

Customer Since 2006

Chosen by Newport Beach Branch Manager Robert Fish because of her commitment to maintain her mother's financial investments amidst the grief of her loss.

Jeanne Scott

"The Waffle Lady"

San Clemente

Customer Since 2001

Chosen by San Clemente Branch Manager Ada Baker for growing her business into a niche brand to become known as "The Waffle Lady," and for providing organic food to an orphanage in Uganda.

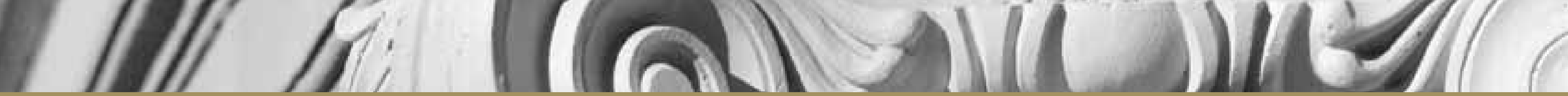
Jenny Rosoff

Village Green Foods

Tustin

Customer Since 2007

Chosen by Tustin Branch Manager Marcia Evans for her tenacity to continue her family's legacy in the food industry by expanding Village Green Foods into a thriving multimillion-dollar business.



2009 Financial Report

F&M

Farmers & Merchants Bank®

KPMG LLP
Suite 2000
355 South Grand Avenue
Los Angeles, CA 90071-1568

Independent Auditors' Report

The Board of Directors
Farmers & Merchants Bank of Long Beach:

We have audited the accompanying balance sheets of Farmers & Merchants Bank of Long Beach (the Bank) as of December 31, 2009 and 2008, and the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Farmers & Merchants Bank of Long Beach as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

We also have audited in accordance with attestation standards established by the American Institute of Certified Public Accountants, the Farmers & Merchants Bank of Long Beach's internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated April 7, 2010 expressed an unqualified opinion on the effectiveness of the Bank's internal control over financial reporting.

KPMG LLP

Los Angeles, California
April 7, 2010

Farmers & Merchants Bank of Long Beach
Balance Sheets

	December 31, 2009	December 31, 2008
Assets		
Cash and due from banks:		
Non-interest bearing balances	$ 46,401,558	$ 59,028,599
Interest bearing balances	123,490,990	150,668,294
Total cash and due from banks	169,892,548	209,696,893
Securities held-to-maturity (fair value of $1,282,767,107 and $991,583,907)	1,240,311,935	965,166,197
Securities available-for-sale (amortized cost of $453,963,087 and $404,653,584)	469,671,621	421,192,391
Loans, net	1,967,705,442	1,947,156,909
Bank premises and equipment, net	52,783,405	55,531,620
Other real estate owned	19,600,462	-
Accrued interest receivable	16,426,807	14,853,715
Other assets	44,377,233	23,674,204
Total assets	**$ 3,980,769,453**	**$ 3,637,271,929**
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Demand, non-interest bearing	$ 898,186,729	$ 809,671,161
Demand, interest bearing	254,904,882	225,485,095
Savings and money market savings	626,319,998	507,521,371
Time deposits	1,063,578,783	1,133,141,414
Total deposits	2,842,990,392	2,675,819,041
Securities sold under agreements to repurchase	544,565,850	393,201,735
Accrued interest payable and other liabilities	6,348,188	7,329,241
Total liabilities	3,393,904,430	3,076,350,017
Commitments and contingencies		
Stockholders' equity:		
Common stock, par value $20; authorized 250,000 shares; issued and outstanding 130,928 shares	2,618,560	2,618,560
Surplus	12,043,783	12,043,783
Retained earnings	563,098,956	536,674,669
Accumulated other comprehensive income	9,103,724	9,584,900
Total stockholders' equity	586,865,023	560,921,912
Total liabilities and stockholders' equity	**$ 3,980,769,453**	**$ 3,637,271,929**

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach
Statements of Income

	Years Ended December 31, 2009	2008
Interest income:		
Loans	$ 121,745,167	$ 115,050,129
Securities held-to-maturity	48,772,817	44,439,550
Securities available-for-sale	18,388,269	20,722,296
Federal funds sold	-	1,848,476
Deposits with banks	653,751	205,923
Total interest income	189,560,004	182,266,374
Interest expense:		
Deposits	15,706,936	27,605,714
Securities sold under agreements to repurchase	2,664,266	7,849,337
Total interest expense	18,371,202	35,455,051
Net interest income	171,188,802	146,811,323
Provision for loan losses	40,800,000	52,989,722
Net interest income after provision for loan losses	130,388,802	93,821,601
Non-interest income:		
Service charges on deposit accounts	5,771,560	6,031,132
Merchant bankcard fees	1,229,774	1,368,093
Escrow fees	672,782	1,183,167
Other	5,470,082	5,699,319
Total non-interest income	13,144,198	14,281,711
Non-interest expense:		
Salaries and employee benefits	38,834,421	38,590,068
FDIC and other insurance expense	6,211,412	1,612,793
Occupancy expense	6,038,150	5,747,933
Equipment expense	4,963,531	4,351,144
Other real estate owned expense, net	10,325,850	-
Legal and professional fees	2,290,754	2,409,215
Marketing and promotional expense	2,035,175	2,475,774
Printing and supplies	900,781	1,052,658
Postage and delivery	1,251,963	1,356,813
Other	4,677,563	3,950,746
Total non-interest expense	77,529,600	61,547,144
Income before income tax expense	66,003,400	46,556,168
Income tax expense	25,307,961	16,833,911
Net income	**$ 40,695,439**	**$ 29,722,257**
Basic and diluted earnings per common share	$ 310.82	$ 218.97

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach
Statements of Comprehensive Income

	Years Ended December 31, 2009	Years Ended December 31, 2008
Net income	$ 40,695,439	$ 29,722,257
Other comprehensive income, net of tax:		
Unrealized gains on securities:		
Unrealized holding (losses) gains arising during period	(481,176)	5,145,342
Other comprehensive (loss) income	(481,176)	5,145,342
Comprehensive Income	**$ 40,214,263**	**$ 34,867,599**

See accompanying notes to financial statements.

Farmers & Merchants Bank

Farmers & Merchants Bank of Long Beach

Statements of Changes in Stockholders' Equity

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stock-holders' Equity
Balance, December 31, 2007	**$ 3,029,500**	**12,043,783**	**671,114,844**	**4,439,558**	**$ 690,627,685**
Repurchase and retirement of common stock	(410,940)	-	(149,582,160)	-	(149,993,100)
Net income	-	-	29,722,257	-	29,722,257
Cash dividends	-	-	(14,580,272)	-	(14,580,272)
Other comprehensive income, net of tax expense	-	-	-	5,145,342	5,145,342
Balance, December 31, 2008	**$ 2,618,560**	**12,043,783**	**536,674,669**	**9,584,900**	**$ 560,921,912**
Net income	-	-	40,695,439	-	40,695,439
Cash dividends	-	-	(14,271,152)	-	(14,271,152)
Other comprehensive loss, net of tax benefit	-	-	-	(481,176)	(481,176)
Balance, December 31, 2009	**$ 2,618,560**	**12,043,783**	**563,098,956**	**9,103,724**	**$ 586,865,023**

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach

Statements of Cash Flows

	Years Ended December 31, 2009	Years Ended December 31, 2008
Cash flows from operating activities:		
Net income	$ 40,695,439	$ 29,722,257
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,208,689	2,919,893
Net amortization on securities	13,089,154	2,778,086
Provision for loan losses	40,800,000	52,989,722
Reduction of reserve for losses on unfunded commitments	(249,299)	(549,356)
Deferred income tax benefit	(7,210,724)	(7,170,597)
Gain on sale of other real estate owned	(859,137)	-
Provision for other real estate owned	8,179,881	-
(Increase) decrease in accrued interest receivable	(1,573,092)	2,140,876
Increase in other assets	(13,143,208)	(973,769)
(Decrease) increase in accrued interest payable and other liabilities	(731,754)	1,086,337
Total adjustments	42,510,510	53,221,192
Net cash provided by operating activities	83,205,949	82,943,449
Cash flows from investing activities:		
Proceeds from maturities of securities held-to-maturity	342,899,389	275,957,127
Purchases of securities held-to-maturity	(629,896,697)	(203,576,533)
Proceeds from maturities of securities available-for-sale	136,784,215	212,688,777
Purchases of securities available-for-sale	(187,331,302)	(192,446,286)
Net increase in loans	(105,352,635)	(470,248,108)
Purchases of bank premises and equipment	(1,460,473)	(23,505,911)
Proceeds from sale of other real estate owned	17,082,895	-
Net cash used in investing activities	(427,274,608)	(401,130,934)
Cash flows from financing activities:		
Net increase in deposits	167,171,351	663,817,993
Net increase (decrease) in securities sold under agreements to repurchase	151,364,115	(102,343,568)
Repurchase and retirement of common stock	-	(149,993,100)
Dividends paid	(14,271,152)	(14,580,272)
Net cash provided by financing activities	304,264,314	396,901,053
Net (decrease) increase in cash and cash equivalents	(39,804,345)	78,713,568
Cash and cash equivalents at beginning of year	209,696,893	130,983,325
Cash and cash equivalents at end of year	**$ 169,892,548**	**$ 209,696,893**
Supplemental disclosures of cash flow information:		
Interest paid (including interest credited during the year)	$ 18,762,338	$ 35,613,129
Cash paid during the year for income taxes	32,700,000	25,030,000

See accompanying notes to financial statements.

NOTE 1 – NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Farmers & Merchants Bank of Long Beach (the "Bank") is an FDIC-insured community bank offering a broad range of banking products and services to consumers and small to medium-sized businesses. As of December 31, 2009 the Bank operates 22 branches in California's South Los Angeles County and Orange County. The Bank accepts demand and time deposits, funds loans including real estate, construction, and SBA loans and offers other business-oriented banking products.

The Bank's operations, like those of other financial institutions operating in Southern California, are significantly influenced by economic conditions in Southern California, including local economies, the strength of the real estate market, and the fiscal and regulatory policies of the federal and state government and the regulatory authorities that govern financial institutions. No individual or single group of related accounts is considered material in relation to the total assets or deposits of the Bank. However, approximately 94% of the loan portfolio at December 31, 2009 consisted of real estate related loans, including commercial loans and construction loans secured by real estate. There has been a slow-down in the real estate market due to negative economic trends and credit market disruptions, the impact of which are not yet completely known or quantified. The Bank has observed tighter credit underwriting and higher premiums on liquidity, both of which may continue to place downward pressure on real estate values. Any further downturn in the real estate market could materially and adversely affect the business because a significant portion of the loan portfolio is secured by real estate. The ability to recover on defaulted loans by selling the real estate collateral would then be diminished and the Bank would be more likely to suffer losses on defaulted loans. Substantially all of the Bank's real property collateral is located in Southern California. Consequently, the results of operations and financial condition are dependent upon the general trends in the Southern California economies and, in particular, the commercial and residential real estate markets. If there is a further decline in real estate values, especially in Southern California, the collateral of the loans would provide less security. Real estate values could be affected by, among other things, a worsening of the economic conditions, an increase in foreclosures, a decline in home sale volumes, an increase in interest rates, earthquakes and other natural disasters particular to California. Further, the Bank may experience an increase in the number of borrowers who become delinquent, file for protection under bankruptcy laws or default on their loans or other obligations to the Bank given a sustained weakness or weakening in business and economic conditions generally in the principal markets in which the Bank does business. An increase in number of delinquencies, bankruptcies or defaults could result in higher level of nonperforming assets, net charge-offs and provision for loan losses.

Basis of Financial Statement Presentation

The accounting and reporting policies of Farmers & Merchants Bank of Long Beach are in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and conform to general practice within the banking industry. The policies that materially affect the determination of financial position, results of operations and cash flow are summarized below.

Use of Estimates

In preparing the financial statements, in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and income statement for the year. 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, the carrying value of securities available-for-sale and the valuation of other real estate owned.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents consist of cash and due from banks.

Securities Held-to-Maturity and Securities Available-for-Sale

The Bank classifies its securities into one of two categories: held-to-maturity and available-for-sale. Securities held-to-maturity are those for which the Bank has the ability and positive intent to hold until maturity. All other securities are classified as available-for-sale.

Securities held-to-maturity are recorded at cost, adjusted for the amortization of premiums and accretion of discounts on a level-yield basis. Securities available-for-sale are carried at fair value. Unrealized holding gains and losses, net of the related tax effect, on securities available-for-sale are excluded from income and reported as a separate component of stockholders' equity identified as accumulated other comprehensive income until realized. Transfers of securities between categories, if any, are recorded at fair value at the date of the transfer. Unrealized holding gains or losses included in the separate component of equity for securities transferred from available-for-sale to held-to-maturity would be maintained and amortized into income over the remaining life of the security as an adjustment to the yield in a manner consistent with the amortization of premium or accretion of discount on the associated security.

If a decline in market value of any held-to-maturity or available-for-sale security below cost is deemed other than temporary, the security is written down to its fair value which becomes the new cost basis and an impairment loss is recognized. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent of which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Any impairment on securities the Bank intends, or is more likely than not required to sell, is recognized in earnings as the entire difference between the amortized cost and its fair value. Any impairment on securities the Bank does not intend, or it is not more likely than not required to sell before recovery, is separated into an amount representing the credit loss, which is recognized in earnings and the amount related to all other factors, which is recognized in other comprehensive income. The new cost basis is not changed for subsequent recoveries in fair value.

Premiums and discounts are amortized and accreted over the life of the related securities available for sale and securities held-to-maturity as an adjustment to yield using the interest method. Realized gains and losses on the sale of securities available-for-sale and securities held-to-maturity are included in non-interest income as gain (loss) on sale of securities and are derived using the specific-identification method for determining the cost of securities sold.

Loans and Allowance for Loan Losses

Loans are reported at the principal amounts outstanding, net of unamortized non-refundable loan fees and related direct loan origination costs. Deferred net fees and costs are recognized in interest income on an effective yield basis over the contractual loan term. Interest on loans is accrued as earned.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Nonaccrual Loans

It is the Bank's general practice for interest accruals on loans to be discontinued whenever the payment of interest or principal is 90 days past due. Whenever the accrual of interest is discontinued, previously accrued but uncollected interest income is reversed. Accrual of interest is resumed only when principal and interest are brought fully current and when in management's judgment such loans are deemed fully collectible as to both principal and interest. The accrual of interest on loans that are more than 90 days past due may continue if the loans are well secured, in the process of collection, and management deems it appropriate.

Impaired Loans

The Bank considers a loan impaired when it is probable that the Bank will be unable to collect all amounts due according to its contractual terms. The amount of an impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or measured against the value of the loan's underlying collateral, if the loan is collateral dependent. Impairment losses are included in the allowance for loan losses through the provision for loan losses. Cash receipts on impaired loans receivable are applied to reduce the principal amount of such loans until the principal has been recovered and are recognized as income thereafter.

Restructured Loans

A loan is classified as a trouble debt restructured when a borrower is experiencing financial difficulties that lead to a restructuring of the loan, and the Bank grants concessions to the borrower in the restructuring that it would not otherwise consider. These concessions may include interest rate reductions, principal forgiveness, extension of maturity date and other actions intended to minimize potential losses. Loans restructured may be excluded from restructured loan disclosures in years subsequent to the restructuring if the loans are in compliance with their modified terms. Generally, a nonaccrual loan that is restructured remains on nonaccrual for a period of six months to demonstrate that the borrower can meet the restructured terms. However, the borrower's performance prior to restructuring, or other significant events at the time of restructuring may be considered in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status after a shorter performance period. If the borrower's performance under the new terms is not reasonably assured, the loan remains classified as a nonaccrual loan.

Allowance for Loan Losses

The Bank accounts for the credit risk associated with lending activities through its allowance for loan losses and provision for loan losses. The provision is the expense recognized in the statements of income to adjust the allowance to the levels deemed appropriate by management, as determined through application of the Bank's allowance methodology procedures. The provision for loan losses reflects management's judgment of the adequacy of the allowance for loan losses. It is determined through quarterly analytical reviews of the loan portfolios and consideration of such other factors as the Bank's loan loss experience, trends in problem loans, concentrations of credit risk, underlying collateral values, and current economic conditions, as well as the results of the Bank's ongoing credit review process. As conditions change, the level of provisioning and the allowance for loan losses may change. Loans which are deemed to be uncollectible are charged off and deducted from the allowance. The provision for loan losses and recoveries on loans previously charged off are added to the allowance.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Bank Premises and Equipment

Bank premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is computed on straight-line method based on the estimated useful lives of the assets:

Type	Estimated Useful Life
Buildings	20 to 30 years
Building improvements	20 to 30 years
Furniture, fixtures, and equipment	3 to 7 years

Leasehold improvements are capitalized and amortized on a straight-line basis over the term of the lease or the estimated useful lives of the improvements, whichever is shorter. Construction in process is carried at cost and includes land acquisition, architectural fees, general contractor fees, capitalized interest and other costs related directly to the construction of a property. Maintenance and repairs are charged to expense. Gains or losses on sale or retirement of assets are reported in equipment expense.

Other Real Estate Owned

Other real estate owned (OREO) represents the collateral acquired through foreclosure in full or partial satisfaction of the related loan and is recorded at fair value as established by a current appraisal, adjusted for estimated selling costs. The excess of the carrying amount of a loan over the fair value of real estate acquired less cost to sell is charged to the allowance for loan losses. OREO values are reviewed on an ongoing basis and any decline in value is charged against OREO expense and included in the allowance for OREO in the period in which they are identified. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in OREO expense, net.

Operating Leases

The Bank enters into a variety of lease contracts generally for premises and equipment. Lease contracts that do not transfer substantially all of the benefits and risks of ownership and do not meet the accounting requirements for capital lease classification are treated as operating leases. The Bank accounts for the payments of rent on these contracts on a straight-line basis over the lease term. At inception of the lease term, any periods for which no rents are paid and/or escalation clauses are stipulated in the lease contract are included in the determination of the rent expense and recognized ratably over the lease term.

Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, the deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

Reserve for Losses on Off-Balance Sheet Commitments

The Bank maintains a reserve for losses on off-balance sheet commitments to absorb losses inherent in those commitments upon funding. The commitments include unfunded loan commitments, standby letters of credit and commercial lines of credit. The Bank's methodology for assessing the appropriateness of this allowance is the same as that used for the allowance for loan losses and incorporates an assumption based upon historical information of likely utilization. See accounting policy *"Loans and Allowance for Loan Losses."* The reserve for losses on off-balance sheet commitments is classified as other liabilities and the change in this allowance is recognized in noninterest expense.

Comprehensive Income

Comprehensive income consists of net income and net unrealized gains (losses) on securities available-for-sale arising or reclassified during the period, and is presented in the statements of comprehensive income.

Earnings Per Share (EPS) Data

The table below is a reconciliation of the numerators and denominators used in the calculation of basic and diluted EPS for the years ended December 31, 2009 and 2008. Basic EPS is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock that then would share the earnings of the Bank.

	2009	2008
Basic and diluted earnings per share:		
Net income available to common stockholders	$ 40,695,439	$ 29,722,257
Weighted average number of common shares outstanding	130,928	135,737
Weighted basic and diluted earnings per common share	$ 310.82	$ 218.97

Recent Accounting Pronouncements

FASB Accounting Standards Codification

In June 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-01, *Topic-105-Generally Accepted Accounting Principles amendments based on Statement of Financial Accounting Standards No. 168-The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles.* The new guidance establishes the FASB Accounting Standards Codification (FASB ASC) as the single source of authoritative U.S. GAAP. The FASB ASC does not significantly change current U.S. GAAP and merely restructures the information in a topical format. The FASB ASC was effective July 1, 2009 and the technical references to U.S. GAAP included in these consolidated financial statements are provided under the new FASB ASC structure with the prior terminology included parenthetically within this note. At adoption, there was no impact from this change on the Bank's financial position or results of operations.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

***Recent Accounting Pronouncements,* continued**

Business Combinations

In December 2007, FASB issued new guidance impacting FASB ASC 805, *Business Combinations* (Formerly SFAS No. 141R, *Business Combinations*). This guidance establishes principles in which the acquirer in a business combination is required to recognize and measure in its financial statements all identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. As such, contingent consideration will need to be recognized based on estimated fair value at the date of acquisition. In addition, the costs related to the acquisition are to be recognized as incurred rather than allocated to the individual assets and liabilities. Also, if applicable, where the fair value of the assets acquired exceeded the acquisition cost, the excess asset value will be recognized as income. This guidance makes significant amendments to other statements and other authoritative guidance. The provisions of this guidance apply prospectively to business combinations with acquisition dates on or after January 1, 2009. The adoption of FASB ASC 805 has no impact on the Bank's financial statements.

Noncontrolling Interests in Consolidated Financial Statements

FASB ASC 810-10, *Consolidation-Overall* (Formerly FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements)* was issued in December 2007. This guidance clarifies that a noncontrolling interest (minority interest) in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Sufficient disclosure should be provided to identify and distinguish between the interests of the parents and the interest of the noncontrolling owners. This statement also establishes that purchases or sales of equity securities that do not result in a change in control will be accounted for as equity transactions. Upon loss of control, the interest sold, as well as any interest retained will be measured at fair value with any gain or loss recognized in earnings. This guidance was effective for the Bank on January 1, 2009. At adoption, there was no impact on the Bank's financial statements.

Recognition and Presentation of Other-Than-Temporary Impairments

In April 2009, the FASB issued new guidance impacting FASB ASC 320-10, *Investments-Debt and Equity Securities* (formerly FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*). The guidance amends the determination and recognition of other-than-temporary impairment criteria related to debt securities. The guidance establishes new criteria for determining whether impairment is other-than-temporary and what portion of any such impairment is recognized in earnings. A company is required to assert whether it intends or it is more likely than not that it will need to sell a security with an unrealized loss before full recovery of the amortized cost basis. If it is likely that security will be sold prior to full recovery, the security must be written down to its current fair value. However, in that case, only the credit loss component shall be recognized in earnings immediately with the remaining non-credit related loss portion recorded in other comprehensive income. The guidance was effective April 1, 2009. At adoption, there was no impact on the Bank's financial position or results of operations.

NOTE 1 – Nature of Operations and Summary of Significant Accounting Policies, continued

***Recent Accounting Pronouncements,* continued**

Subsequent Events

In May 2009, the FASB issued FASB ASC 855-10, *Subsequent Events* (formerly SFAS No. 165, *Subsequent Events*), which requires an evaluation of events or transactions that occur after the balance sheet date through the date that the financial statements are issued or available to be issued. The guidance also provides information about when such a subsequent event should be recognized in the financial statements and requires the disclosure of the date through which subsequent events were evaluated and whether that represents the date the financial statements were issued or available to be issued. The guidance was effective June 30, 2009. In February 2010, the FASB issued FASB ASU 2010-09, *Amendments to Certain Recognition and Disclosure Requirements,* which amends the above subsequent event guidance to remove the requirement to disclose the actual date through which subsequent events have been evaluated. This guidance was effective upon issuance. At adoption of both of the above guidance, there was no impact on the Bank's financial statements. The Bank evaluates the impact of subsequent events through the date that its financial statements are issued.

Accounting for Transfers of Financial Assets

In December 2009, the FASB issued ASU 2009-16, *Accounting for Transfers of Financial Assets*, which formally codifies SFAS No. 166, *Accounting for Transfers of Financial Assets-an amendment of FASB Statement 140,* which was issued in June 2009. The guidance eliminates the concept of qualifying special purpose entities (QSPEs) and modifies financial asset derecognition criteria. The elimination of the exception for QSPEs will likely result in many sponsors that transferred financial assets to such vehicles to consolidate them. The derecognition modifications require that companies consider all arrangements such that the transferred financial asset is legally isolated from the transferor and any of its consolidated affiliates when determining whether derecognition is appropriate for a transferred financial asset. For a transfer of a portion of a financial asset to be derecognized, it must meet the definition of a participating interest. The guidance also requires that all beneficial interests retained in transferred financial assets be initially measured at fair value. Disclosures are amended to require description of a company's continuing involvement with transferred financial assets and details regarding financial or other support provided. The guidance is effective January 1, 2010. Management believes that adopting this guidance will not have an impact on the Bank's financial position or results of operations.

Measuring Liabilities at Fair Value

In August 2009, the FASB issued ASU 2009-05, *Measuring Liabilities at Fair Value*. This guidance amends FASB ASC 820-10, *Fair Value Measurements and Disclosures* to clarify that, if available, an entity should measure the fair value of a liability using a quoted price in an active market. If such information is not available, an entity should use a valuation technique based on the quoted price when the liability or similar liabilities are traded as assets, if available, which should not be adjusted for any transfer restrictions. The guidance also emphasizes that an entity should maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The guidance was effective October 1, 2009. At adoption, there was no impact on the Bank's financial position or results of operations.

NOTE 2 – FAIR VALUE MEASUREMENTS

FASB ASC 820-10 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Bank adopted FASB ASC 820-10 on January 1, 2008, and determined the fair values of our financial instruments based on the three-level fair value hierarchy established in FASB ASC 820-10. The three-level inputs to measure the fair value of assets and liabilities are as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities.
Level 2 - Observable prices in active markets for similar assets or liabilities; prices for identical or similar assets or liabilities in markets that are not active; directly observable market inputs for substantially the full term of the asset and liability; market inputs that are not directly observable but are derived from or corroborated by observable market data.
Level 3 - Unobservable inputs based on the Bank's own judgments about the assumptions that a market participant would use.

The Bank uses the following methodologies to measure the fair value of its financial assets on a recurring basis:

Securities available-for-sale - The Bank measures all securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement. This category generally includes federal agency debt securities, state and municipal securities, mortgage-backed securities, asset-backed securities and corporate bonds.

Impaired loans - The Bank does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded based on either current appraised value of the collateral, a Level 2 measurement, or management's judgment and estimation of value reported on old appraisals which are then adjusted based on recent market trends, a Level 3 measurement.

Other real estate owned - The fair value of OREO is generally based on third-party appraisals, which are reviewed and approved by the Bank's Credit Administration Department. OREO measured at fair value based on third-party appraisals or observable market data is classified in Level 2 of the fair value hierarchy. In certain circumstances, fair value may be determined using a combination of inputs including appraised values, broker price opinions and recent market activity. The weighing of each input in the calculation of fair value is based on management's assumptions regarding market conditions. These assumptions cannot be observed in the market. OREO measured at fair value using non-observable inputs is classified in Level 3 of the fair value hierarchy.

The following table presents the Bank's hierarchy for its assets and liabilities measured at fair value on a recurring and non-recurring basis at December 31, 2009:

	Fair Value Measurements Using			Table at
	Level 1	Level 2	Level 3	Fair Value
Assets				
On a recurring basis:				
Securities available-for-sale	$ -	$ 469,671,621	$ -	$ 469,671,621
On a non-recurring basis:				
Impaired loans	-	29,641,752	20,564,344	50,206,096
Other real estate owned	-	7,959,123	11,641,339	19,600,462
Total assets	$ -	$ 507,272,496	$ 32,205,683	$ 539,478,179

NOTE 2 – Fair Value Measurements, continued

The following table presents the Bank's hierarchy for its assets and liabilities measured at fair value on a recurring and non-recurring basis at December 31, 2008:

	Fair Value Measurements Using			Table at
	Level 1	Level 2	Level 3	Fair Value
Assets				
On a recurring basis:				
Securities available-for-sale	$ -	$ 421,192,391	$ -	$ 421,192,391
On a non-recurring basis:				
Impaired loans	-	18,597,888	42,994,343	61,592,231
Total assets	$ -	$ 439,790,279	$ 42,994,343	$ 482,784,622

NOTE 3 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments are defined under FASB ASC 825-50, *Financial Instruments-Disclosures* (Formerly SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*), as cash, evidence of an ownership in an entity, or a contract that conveys or imposes on an entity the contractual right or obligation to either receive or deliver cash or another financial instrument. A significant portion of the Bank's assets and liabilities are financial instruments as defined under FASB ASC 825-50.

The following presents a description of the Bank's financial instruments and the methodologies and assumptions used to estimate their fair value. Much of the information used to determine fair value is highly subjective. When applicable, readily available market information has been utilized. However, for a significant portion of the Bank's financial instruments, active markets do not exist. Therefore, considerable judgments were required in estimating fair value of certain items. The subjective factors include, among other things, the estimated timing and amount of cash flows, risk characteristics, credit quality and interest rates, all of which are subject to change. Since the fair value is estimated as of December 31, 2009 and 2008, the amounts that will actually be realized could be significantly different.

Cash and Cash Equivalents

The carrying value of cash and cash equivalents approximates the fair value because of the short maturity of such assets.

Securities Held-to-Maturity and Securities Available-for-Sale

The Bank used market quotes for similar or identical securities in an actively traded market to determine the fair values of securities held-to-maturity and securities available-for-sale as disclosed in Notes 4 and 5, respectively.

Loans

Fair values were estimated for portfolios of loans with similar financial characteristics. Each loan category was further segmented into fixed and adjustable rate interest terms and by performing and nonperforming categories. The fair value of performing loans was calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The entire allowance for loan losses was applied to classified loans including nonaccruals. Accordingly, they are considered to be carried at fair value as the allowance for loan losses represents the estimated discount for credit risk for the applicable loans.

NOTE 3 – Fair Value of Financial Instruments, continued

Deposits

The fair value of demand deposits, savings and money market saving accounts was determined to approximate the carrying value as they are immediately withdrawable. For fixed maturity time deposits, the fair value was estimated by discounting expected cash flows by the current offering rates of term deposits with similar maturities. In accordance with FASB ASC 825-10, *Financial Instruments-Overall* no value has been assigned to the Bank's long-term relationship with its deposit customers (core deposit intangibles) since it is not a financial instrument as defined under FASB ASC 825-10.

Securities Sold Under Agreements to Repurchase

The fair value of securities sold under agreements to repurchase approximates their carrying value due to the terms and nature of the obligations.

Off-Balance Sheet Financial Instruments

As the standby letters of credit and commitments to lend have terms that are consistent with current market terms, the Bank estimates that the fair value of the fees charged to enter into such agreements to be nominal.

The following table presents estimated fair value information for the Bank's loans and deposits at December 31:

	2009	
	Carrying Value	Estimated Fair Value
Loans, net of allowance for loan losses	$ 1,967,705,442	$ 2,136,057,115
Deposits:		
Demand, non-interest bearing	$ 898,186,729	$ 898,186,729
Demand, interest bearing	254,904,882	254,904,882
Savings and money market savings	626,319,998	626,319,998
Time deposits	1,063,578,783	1,063,578,783
	$ 2,842,990,392	$ 2,842,990,392

	2008	
	Carrying Value	Estimated Fair Value
Loans, net of allowance for loan losses	$ 1,947,156,909	$ 2,421,088,904
Deposits:		
Demand, non-interest bearing	$ 809,671,161	$ 809,671,161
Demand, interest bearing	225,485,095	225,485,095
Savings and money market savings	507,521,371	507,521,371
Time deposits	1,133,141,414	1,134,931,438
	$ 2,675,819,041	$ 2,677,609,065

NOTE 4 – SECURITIES HELD-TO-MATURITY

The following is a summary of securities held-to-maturity:

	December 31, 2009	December 31, 2008
Carrying Value:		
Federal agency - Debt	$ 59,949,425	$ 24,342,791
State and municipal securities	146,875,806	139,089,960
Federal agency - MBS	897,135,972	686,078,782
CMOs - Federal agency	131,271,776	115,654,664
Corporate securities	5,078,956	-
	$ 1,240,311,935	$ 965,166,197
Approximate Fair Value:		
Federal agency - Debt	$ 59,987,057	$ 25,368,216
State and municipal securities	153,112,449	140,479,984
Federal agency - MBS	928,834,769	707,559,353
CMOs - Federal agency	135,596,385	118,176,354
Corporate securities	5,236,447	-
	$ 1,282,767,107	$ 991,583,907
Gross Unrealized Gains:		
Federal agency - Debt	$ 611,678	$ 1,025,425
State and municipal securities	6,347,282	1,774,353
Federal agency - MBS	31,763,835	21,483,469
CMOs - Federal agency	4,472,046	2,523,052
Corporate securities	172,288	-
	43,367,129	26,806,299
Gross Unrealized Losses:		
Federal agency - Debt	574,046	-
State and municipal securities	110,639	384,329
Federal agency - MBS	65,039	2,897
CMOs - Federal agency	147,436	1,363
Corporate securities	14,797	-
	911,957	388,589
Net Unrealized Gains	$ 42,455,172	$ 26,417,710

Maturities at December 31, 2009:

	Carrying Value	Estimated Fair Value
Due in 1 year or less	$ 16,523,901	$ 16,911,849
Due after 1 year through 5 years	91,811,990	95,900,004
Due after 5 years through 10 years	101,310,263	103,322,758
Due after 10 years	2,258,033	2,201,342
Federal agency - MBS	897,135,972	928,834,769
CMOs - Federal agency	131,271,776	135,596,385
	$ 1,240,311,935	$ 1,282,767,107

There were no sales of securities held-to-maturity in 2009 or 2008. There were no transfers of securities from held-to-maturity to available-for-sale in 2009 or 2008.

NOTE 4 – Securities Held-to-Maturity, continued

Gross unrealized losses on held-to-maturity securities and the fair value of the related held-to-maturity securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2009 were as follows:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Federal agency-Debt	$ 33,592,167	$ 574,046	$ -	$ -	$ 33,592,167	$ 574,046
State and municipal Securities	5,642,192	47,167	2,445,275	63,472	8,087,467	110,639
Federal agency - MBS	7,917,627	65,039	-	-	7,917,627	65,039
CMOs – Federal Agency	19,855,486	147,436	-	-	19,855,486	147,436
Corporate securities	915,142	14,797	-	-	915,142	14,797
Total temporarily impaired securities	$ 67,922,614	$ 848,485	$ 2,445,275	$ 63,472	$ 70,367,889	$ 911,957

The Bank's held-to-maturity portfolio is primarily comprised of mortgage-backed securities issued or guaranteed by FNMA (Fannie Mae) or GNMA (Ginnie Mae). The unrealized losses on mortgage-backed securities are primarily attributable to declining market prices caused by accelerated prepayments on the mortgages resulting from a lower interest rate environment. At December 31, 2009, there were 24 and 3 held-to-maturity securities with unrealized losses less than 12 months and 12 months or longer, respectively.

At December 31, 2009, management believes that held-to-maturity securities in an unrealized loss position were temporary in nature, and therefore no impairment losses were recognized in the statement of income. Because the Bank has the ability and intent to hold these investments until a market price recovery or maturity, these held-to-maturity securities are not considered other-than-temporarily impaired.

Total securities with a carrying value of approximately $976,802,072 and $695,464,944 at December 31, 2009 and December 31, 2008, respectively, were pledged to secure public deposits and for other purposes required by law.

Interest income on tax-exempt securities was $6,648,921 for the year ended December 31, 2009, and $5,696,594 for the year ended December 31, 2008.

NOTE 5 – SECURITIES AVAILABLE-FOR-SALE

The following is a summary of securities available-for-sale:

	December 31, 2009	December 31, 2008
Amortized Cost:		
Federal agency - Debt	$ 96,943,538	$ 153,115,436
State and municipal securities	125,204,008	37,717,608
Federal agency - MBS	216,521,713	197,916,356
CMOs - Federal agency	15,083,700	15,904,184
Corporate securities	210,128	-
	$ 453,963,087	$ 404,653,584
Approximate Fair Value:		
Federal agency - Debt	$ 101,446,198	$ 161,062,685
State and municipal securities	127,215,280	38,369,786
Federal agency - MBS	225,152,321	205,521,274
CMOs - Federal agency	15,643,000	16,238,646
Corporate securities	214,822	-
	$ 469,671,621	$ 421,192,391
Gross Unrealized Gains:		
Federal agency - Debt	$ 4,502,660	$ 7,947,249
State and municipal securities	2,172,239	700,394
Federal agency - MBS	9,078,514	7,604,917
CMOs - Federal agency	587,529	334,463
Corporate securities	4,694	-
	16,345,636	16,587,023
Gross Unrealized Losses:		
State and municipal securities	160,967	48,216
Federal agency - MBS	447,906	-
CMOs - Federal agency	28,229	-
	637,102	48,216
Net Unrealized Gains	$ 15,708,534	$ 16,538,807

Maturities at December 31, 2009:

	Carrying Value	Estimated Fair Value
Due in 1 year or less	$ 54,104,915	$ 54,811,548
Due after 1 year through 5 years	100,580,379	104,544,851
Due after 5 years through 10 years	59,884,566	61,752,160
Due after 10 years	7,787,814	7,767,741
Federal agency - MBS	216,521,713	225,152,321
CMOs - Federal agency	15,083,700	15,643,000
	$ 453,963,087	$ 469,671,621

NOTE 5 – Securities Available-for-Sale, continued

There were no sales of securities available-for-sale in 2009 or 2008.

Gross unrealized losses on available-for-sale securities and the fair value of the related available-for-sale securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2009 were as follows:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
State and municipal Securities	$ 48,284,997	$ 160,967	$ -	$ -	$ 48,284,997	$ 160,967
Federal agency - Debt	41,770,271	447,906	-	-	41,770,271	447,906
CMOs – Federal Agency	2,016,478	28,229	-	-	2,016,478	28,229
Total temporarily impaired securities	$ 92,071,746	$ 637,102	$ -	$ -	$ 92,071,746	$ 637,102

The unrealized losses on mortgage-backed securities are primarily attributable to declining market prices caused by accelerated prepayments on the mortgages resulting from a lower interest rate environment. At December 31, 2009, there were 88 available-for-sale securities with unrealized losses less than 12 months and no available-for-sale securities with unrealized losses 12 months or longer. Whenever the cost of an investment security exceeds its fair value, management evaluates, among other factors, general market conditions, the duration and extent to which cost is more than fair value.

At December 31, 2009, management believes that available-for-sale securities in an unrealized loss position were temporary in nature, and therefore no impairment losses were recognized in the income statement. Because the Bank has the ability and intent to hold these investments until a market price recovery or maturity, these available-for-sale securities are not considered other-than-temporarily impaired.

The following represents the related tax effect allocated to each component of other comprehensive income for the year ended December 31, 2009:

	Before-Tax Amount	Tax Benefit	Net-of-Tax Amount
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (830,273)	$ 349,097	$ (481,176)
Other comprehensive losses	$ (830,273)	$ 349,097	$ (481,176)

NOTE 5 – Securities Available-for-Sale, continued

The following represents the related tax effect allocated to each component of other comprehensive income for the year ended December 31, 2008:

	Before-Tax Amount	Tax Expense	Net-of-Tax Amount
Unrealized gains on securities:			
Unrealized holding gains arising during period	$ 8,878,321	$ (3,732,979)	$ 5,145,342
Other comprehensive gains	$ 8,878,321	$ (3,732,979)	$ 5,145,342

NOTE 6 – LOANS AND ALLOWANCE FOR LOAN LOSSES

The following is a summary of the major categories of loans:

	December 31, 2009	December 31, 2008
Commercial	$ 93,397,054	$ 135,113,415
Real estate	1,695,035,932	1,515,229,002
Construction	206,600,250	308,856,536
Consumer	30,423,657	41,752,300
	2,025,456,893	2,000,951,253
Less: Allowance for loan losses	(57,751,451)	(53,794,344)
Loans, net	$ 1,967,705,442	$ 1,947,156,909

Activities in the allowance for loan losses for the years ended December 31, 2009 and 2008 were as follows:

	2009	2008
Balance, beginning of year	$ 53,794,344	$ 27,229,882
Provision for loan losses	40,800,000	52,989,722
Charge-offs	(37,014,364)	(26,480,673)
Recoveries	171,471	55,413
Balance, end of year	$ 57,751,451	$ 53,794,344

The loan portfolio is composed mainly of credit extended to borrowers in Southern California with the majority of loans secured by real estate, even though a substantial amount of the Bank's loans are intended for business purposes. There is no concentration of loans to borrowers in a specific industry within the commercial loan portfolio.

Loans on which the accrual of interest has been discontinued amounted to $56,855,606 at December 31, 2009, and $85,383,313 at December 31, 2008. If interest on these loans had been accrued, interest income would have been increased by approximately $2,632,101 in 2009, and $3,402,349 in 2008.

During 2009 and 2008, the Bank recorded $359,753 and $17,008, respectively, in interest income recoveries on loans that had previously been on nonaccrual.

NOTE 6 – Loans and Allowance for Loan Losses, continued

Loans 90 days or more past due as to interest and/or principal which remain on accrual status approximated $13,171,245 at December 31, 2009 and $9,321,774 at December 31, 2008.

Included in the Bank's loan portfolio are restructured loans which are those loans whose terms have been modified because of a deterioration in the financial condition of the borrower. The total amount of restructured loans was $16,549,515 at December 31, 2009 and $1,973,339 at December 31, 2008.

At December 31, 2009 and 2008, the recorded investment in loans for which an impairment has been recognized was $61,592,706 and $54,321,922, respectively, and the related specific allowance for loan losses was $11,386,610 and $17,587,912, respectively. The recorded investment in loans considered impaired and for which no specific allowance has been recorded was $14,171,964 at December 31, 2009 and $24,858,221 at December 31, 2008. The average recorded investment in impaired loans during 2009 and 2008 was $62,953,917 and $49,979,425, respectively. Interest income recognized on impaired loans was $258,027 during 2009 and $11,684 during 2008.

The Bank had outstanding loan commitments of $339,552,575 and $407,880,260 at December 31, 2009 and 2008, respectively. Substantially, all of the Bank's loan commitments are on a variable rate basis and are comprised of real estate loan commitments. Activities in the reserve for unfunded commitments included in other liabilities in the accompanying balance sheet for the years ended December 31, 2009 and 2008 were as follows:

	2009	2008
Balance, beginning of year	$ 2,767,833	$ 3,317,189
Reduction of reserve for losses on unfunded commitments	(249,299)	(549,356)
Charge-offs	-	-
Recoveries	-	-
Balance, end of year	$ 2,518,534	$ 2,767,833

NOTE 7 – BANK PREMISES AND EQUIPMENT

The following is a summary of bank premises and equipment at December 31:

	2009	2008
Land	$ 19,173,291	$ 19,067,560
Buildings	36,406,858	36,092,672
Furniture, fixtures and equipment	24,414,558	23,576,929
Leasehold improvements	3,518,336	3,518,336
	83,513,043	82,255,497
Less accumulated depreciation and amortization	(30,729,638)	(26,723,877)
	$ 52,783,405	$ 55,531,620

Depreciation and amortization expense was $4,208,689 in 2009 and $2,919,893 in 2008.

NOTE 7 – Bank Premises and Equipment, continued

The Bank is committed under operating leases on certain premises and equipment. Certain leases require the Bank to pay property taxes and insurance. Rental expense was $1,210,258 in 2009 and $1,453,996 in 2008, net of sublease income of $512,436 and $326,374, respectively. Annual minimum lease commitments at December 31, 2009 were:

2010	$ 1,462,540
2011	1,248,719
2012	955,476
2013	969,238
2014	929,432
Thereafter	2,781,092

Management expects that in the normal course of business, leases that expire will be renewed or replaced by other leases.

NOTE 8 – OTHER REAL ESTATE OWNED

At December 31, 2009, other real estate owned was $19,600,462, net of reserve for OREO of $6,508,994. The components of OREO expense, net are as follows:

	2009
OREO operating and maintenance expense	$ 3,396,092
Provision for OREO	8,179,881
OREO income	(390,986)
Gain on sale of OREO	(859,137)
	$ 10,325,850

NOTE 9 – TIME DEPOSITS

The following is a summary of time deposits:

	December 31,	
	2009	2008
Time deposits less than $100,000	$ 303,059,677	$ 338,428,568
Time deposits of $100,000 and over	760,519,106	794,712,846
	$ 1,063,578,783	$ 1,113,141,414

Interest expense on time deposits of $100,000 and over totaled $10,041,457 and $16,500,579 for the years ended December 31, 2009, and 2008, respectively.

NOTE 9 – Time Deposits, continued

At December 31, 2009, the maturity distribution of the Bank's time deposits was as follows:

2010	$	968,292,734
2011		62,912,218
2012		13,493,798
2013		2,144,487
2014		16,735,546
	$	1,063,578,783

NOTE 10 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

At December 31, 2009 and 2008, securities sold under agreements to repurchase totaled $544,565,850 and $393,201,735 and carried weighted average interest rates of 0.44% and 0.68%, respectively. The securities underlying these agreements were U.S. Government agency obligations, state and municipal securities, and mortgage-backed securities with carrying values of $612,465,733 and $407,792,509 and fair values of $635,453,853 and $422,572,386, at December 31, 2009 and 2008, respectively. The securities underlying these agreements are held by a custodian bank until the maturity of the agreement. The identical securities will be repurchased by the Bank.

The average outstanding amounts of securities sold under agreements to repurchase (based upon daily balances) were $495,027,011 in 2009, and $466,870,029 in 2008. The weighted average interest rates were 0.54% in 2009 and 1.68% in 2008, and the maximum amounts outstanding during the periods were $571,005,362 and $545,603,418, respectively. All agreements in 2009 and 2008 are short term with maturities in a range of 6 to 8 weeks.

NOTE 11 – INCOME TAXES

The provision for income taxes for the years ended December 31, 2009 and 2008, is comprised of the following:

		2009		2008
Current:				
Federal	$	24,671,112	$	17,497,239
State		7,847,573		6,507,269
Total		32,518,685		24,004,508
Deferred:				
Federal		(5,553,404)		(4,933,451)
State		(1,657,320)		(2,237,146)
Total		(7,210,724)		(7,170,597)
Total income tax expense	$	25,307,961	$	16,833,911

NOTE 11 – Income Taxes, continued

Significant temporary differences that give rise to the deferred tax assets and liabilities as of December 31, 2009 are as follows:

	Assets	Liabilities
Allowance for loan losses	$ 27,627,761	$ -
Discount accretion income	-	35,495
State income taxes	-	120,480
Depreciation and amortization	1,213,724	-
Fair value adjustments on securities available-for-sale	-	6,604,808
Gain/loss on sale of OREO	3,488,905	-
Other, net	591,292	-
Total deferred taxes	$ 32,921,682	$ 6,760,783

Based on management's review of the recoverability of the net deferred tax asset above, no valuation allowance was considered necessary as of December 31, 2009. The net deferred tax asset is included in other assets in the accompanying balance sheets.

Significant temporary differences that give rise to the deferred tax assets and liabilities as of December 31, 2008 are as follows:

	Assets	Liabilities
Allowance for loan losses	$ 23,664,569	$ -
Discount accretion income	-	34,641
State income taxes	73,831	-
Depreciation and amortization	981,175	-
Fair value adjustments on securities available-for-sale	-	6,953,906
Other, net	215,035	-
Total deferred taxes	$ 24,934,610	$ 6,988,547

The Federal tax rate was 35% for 2009 and 2008. A reconciliation of income tax expense and the amount computed by applying the "expected" Federal income tax rate to income before income taxes follows:

	2009	2008
Federal income tax rate	35.0%	35.0%
State income taxes, net of Federal benefit	6.1%	6.0%
Tax exempt income	(3.5%)	(4.0%)
Other	0.7%	(0.8%)
	38.3%	36.2%

NOTE 12 – COMMITMENTS, CONTINGENCIES AND OFF-BALANCE SHEET RISK

In the normal course of business, there are various outstanding commitments and contingencies, such as financial instruments with off-balance sheet risk, which are not reflected in the accompanying financial statements. These financial instruments primarily consist of commitments to extend credit and standby letters of credit issued to meet the financing needs of the Bank's customers. Management does not anticipate any material losses as a result of these transactions.

Commitments to extend credit and standby letters of credit only represent exposure to risk in the event the contract is drawn upon and the other party to the contract defaults. The actual credit risk of these transactions depends upon the credit worthiness of the customer and on the value of any related collateral. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The Bank had outstanding loan commitments of $339,552,575 and $407,880,260 at December 31, 2009 and 2008, respectively. Substantially, all of the Bank's loan commitments are on a variable rate basis and are comprised of real estate loan commitments.

Standby letters of credit amounting to $41,916,859 and $49,549,574 were outstanding at December 31, 2009 and 2008, respectively. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Where appropriate, cash or other security support is held as collateral.

From time to time, the Bank is a defendant or plaintiff in various legal proceedings, including litigation arising in the ordinary course of its business. To date, none of these types of litigation has had a material effect on the Bank's financial position or results of operations and, as of December 31, 2009, the Bank is not a party to any material litigation.

NOTE 13 – RELATED PARTY TRANSACTIONS

At December 31, 2009, no loan was extended to an affiliated party. At December 31, 2008, there was one loan with remaining outstanding balance of $438,672 that the Bank has extended to an affiliated party. In the opinion of management, the terms of this loan were the same that would be offered to any other borrower of similar financial strength and collateral.

The Bank and Farmers & Merchants Trust Company of Long Beach (the "Trust Co.") are affiliated parties as a substantial percentage of the outstanding shares of the Bank and the parent company of the Trust Co. are held by common shareholders, which include Richard Darling, William Hayter, Lawrence McLaughlin, Daniel K. Walker, Kenneth G. Walker and W. Henry Walker, each of whom is either a director and/or an officer of the Bank. In addition, certain officers and/or directors of the Bank are also officers and/or directors of the parent company of the Trust Co. and its subsidiaries, including the Trust Co. The Bank provides administrative, accounting and data processing services as well as office space to the Trust Co. The Trust Co. provides trustee and financial management services to the Bank and maintains deposits with the Bank. The Bank and the Trust Co. have entered into an agreement for the exchange of services, which will result in a periodic settlement of amounts owed. This agreement was unanimously approved by their respective audit committee and Board of Directors. The Trust Co. paid the Bank $65,853 and $78,097, respectively, pursuant to the agreement for the exchange of services for each of the years ended December 31, 2009 and 2008.

NOTE 13 – Related Party Transactions, continued

The Bank leases a branch location from the Trust Co.'s parent corporation. The Bank paid $267,954 and $267,954, respectively, in rent pursuant to this lease for each of the years ended December 31, 2009 and 2008.

NOTE 14 – PROFIT-SHARING PLAN

The Bank has a noncontributory profit-sharing plan in which employees are eligible to participate at year-end if they have been employed for at least 1,000 hours during the year. The Bank contributed $3,322,742 and $3,191,908 to the profit-sharing plan in 2009 and 2008, respectively. At December 31, 2009 and December 31, 2008, no shares of the Bank's stock are held by the trust created by the plan.

NOTE 15 – REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the Federal and State banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly, additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2009, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2009, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual regulatory capital amounts and ratios are also presented in the table.

	Actual		For Capital Adequacy Purposes:		To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2009						
Total Capital (to Risk-Weighted Assets)	$606,895,048	26.39%	≥$183,965,099	≥8.0%	≥$229,956,373	≥10.0%
Tier 1 Capital (to Risk-Weighted Assets	$577,761,299	25.12%	≥$ 91,982,549	≥4.0%	≥$137,973,824	≥ 6.0%
Tier 1 Capital (to Average Assets)	$577,761,299	14.29%	≥$161,735,672	≥4.0%	≥$202,169,589	≥ 5.0%

NOTE 15 – Regulatory Matters, continued

	Actual		For Capital Adequacy Purposes:		To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2008						
Total Capital (to Risk-Weighted Assets)	$579,017,403	26.49%	≥$174,843,965	≥8.0%	≥$218,554,956	≥10.0%
Tier 1 Capital (to Risk-Weighted Assets	$551,337,011	25.23%	≥$ 87,421,982	≥4.0%	≥$131,132,974	≥ 6.0%
Tier 1 Capital (to Average Assets)	$551,337,011	15.22%	≥$144,936,578	≥4.0%	≥$181,170,723	≥ 5.0%

NOTE 16 – SUBSEQUENT EVENTS

The Bank has evaluated events that have occurred subsequent to December 31, 2009, and through April 7, 2010, the date that these financial statements were issued. There have been no subsequent events that have occurred during the period that would require recognition in the consolidated financial statements or its disclosure for 2009.

Farmers & Merchants Bank

Farmers & Merchants Bank of Long Beach
Corporate Information

Board of Directors
Daniel K. Walker, Chairman of the Board
Richard W. Darling
Walter M. Florie
William G. Hayter
Timothy W. Jackert
Lawrence J. McLaughlin
Timothy M. Wilson

Principal Officers
Daniel K. Walker, Chairman of the Board and President
W. Henry Walker, Chief Executive Officer
Kenneth G. Walker, President, Main Office
John W. H. Hinrichs, Chief Financial Officer

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Security Listing
Farmers & Merchants Bank's common stock is traded on the OTC Bulletin Board under the symbol FMBL.

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