2013 Annual Report

F&M BANK

Farmers & Merchants Bank®

F&M BANK
Farmers & Merchants Bank®

2010 · 2000 · 1990 · 1980 · 1970

2007

More than eight decades after its original construction, Main Office undergoes a thorough renovation.

1985

Bank monitors declare F&M Bank safest of 441 similar institutions in California.

2013

Farmers & Merchants Bank celebrates its 106th year of being *California's Strongest*.

THE FARMERS AND MERCHANTS BANK

1950 · 1940 · 1930 · 1920 · 1910

1955

The Garden Grove Office in Orange County opens as the first F&M branch outside of Long Beach.

1940

F&M Bank holds its first annual employee banquet to honor those who had served the bank for 20 years or more.

1923

On April 7th, the newly designed Main Office of F&M Bank opened.

1907

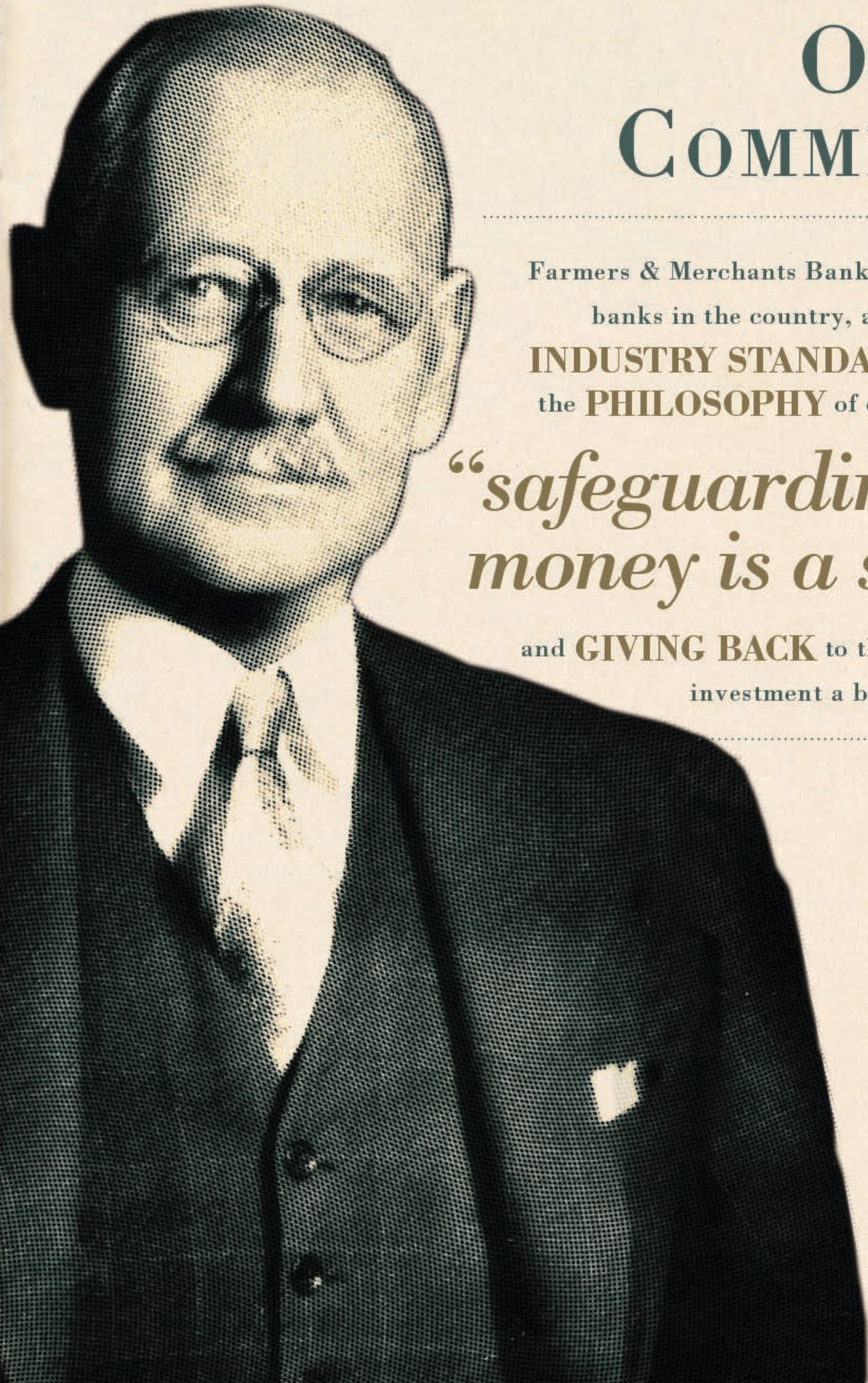
On November 23rd, Farmers & Merchants Bank of Long Beach is born.

Our Commitment

Farmers & Merchants Bank is one of the **STRONGEST** banks in the country, as measured by a variety of **INDUSTRY STANDARDS**, and continues to uphold the **PHILOSOPHY** of our founder, C.J. Walker, that

"safeguarding our clients' money is a sacred trust"

and **GIVING BACK** to the community is the **WISEST** investment a business can make.



C.J. Walker

Charles J. Walker, Founder

THE FARMERS AND MERCHANTS BANK

F AND M BANK

LONG BEACH, CAL.

Farmers & Merchants Bank

Long Beach, CA

Savings Department, In Account with:

C. J. Walker

No. 1

THIS BOOK MUST BE PRESENTED WHEN DEPOSITS OR WITHDRAWALS ARE MADE

DATE	DEPOSITS	WITHDRAWAL	BALANCE

Contents — Page

Corporate Profile

Farmers & Merchants Bank is a full-service, California-state-chartered bank with $5.21 billion in total assets at December 31, 2013. Founded in Long Beach in 1907 by C.J. Walker, the Bank specializes in commercial and small business banking, along with robust business loan programs and a wide array of consumer retail banking products, with 23 offices located throughout Los Angeles and Orange Counties. The Bank is one of California's strongest banks, as demonstrated by several characteristics, including financial performance, heritage, culture, longevity, character, values and customer service.

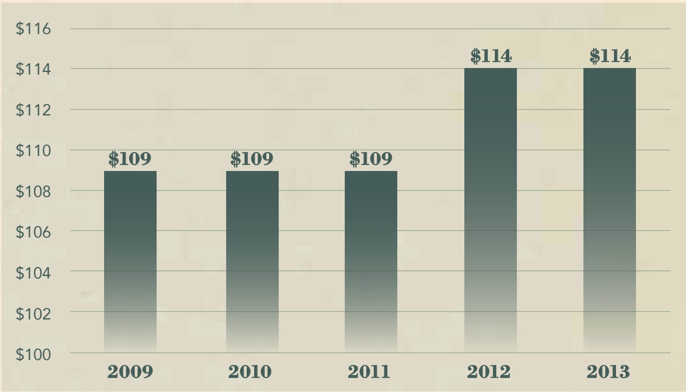
Our People

The theme for this year's Annual Report, "Our People," is a testament to the exceptional experience and driven dedication of those who work at Farmers & Merchants Bank. Our client base is comprised of some of the country's most innovative minds in retail, healthcare, real estate, education and the non-profit world – just a few of whom are profiled in this Annual Report. We are proud to serve our clients with the very best and brightest talent that define "Our People."

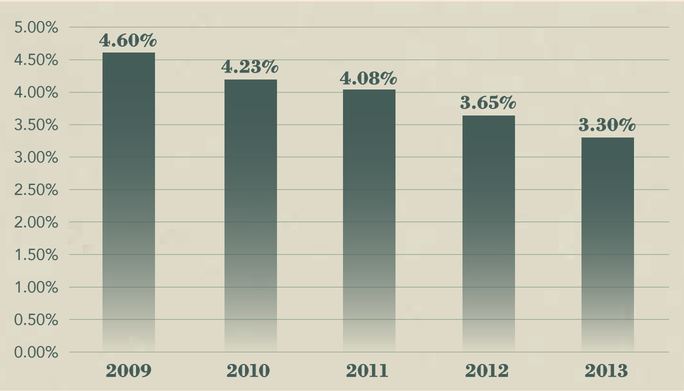
Farmers & Merchants Bank, Main Office ~ 1923

Diluted Earnings Per Common Share
(In Dollars)

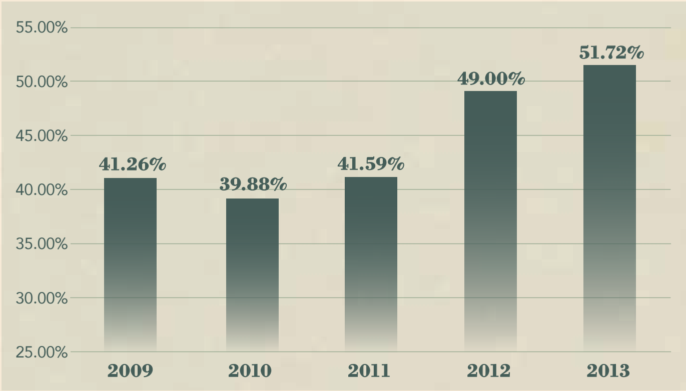
Dividends Declared Per Common Share
(In Dollars)



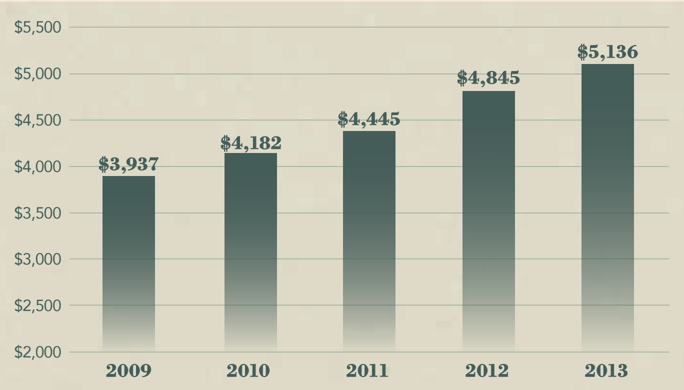
Net Interest Margin
(In Percents)



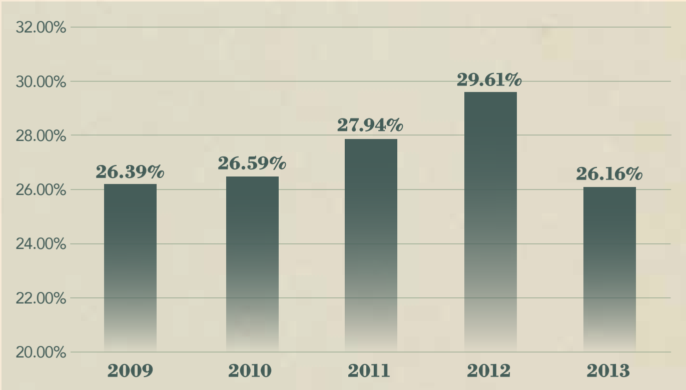
Overhead Efficiency Ratio
(In Percents)



Average Assets
(Dollars in Millions)



Total Risk-Based Capital
(In Percents)



A Letter to Our Shareholders

Dear Fellow Shareholders,

The banking landscape has changed significantly during the last several years, as the recovering economy and industry reforms continue to lay the groundwork for a new environment of growth and stability. Adapting to change has been integral to Farmers & Merchants Bank's success during the last 106 years of serving Southern California, and a key component of navigating the ups and downs of an economy in flux is the tenured experience of our people.

The wisdom, expertise and commitment that Farmers & Merchants' employees bring to their jobs are fundamental to the Bank's ongoing position of superior strength. While it is our fiduciary responsibility to report Farmers & Merchants' financial performance, we are happy to have the opportunity to shed light in this year's Annual Report on the people who maintain the Bank's vitality both in good, and bad, economic times.

Before discussing our 2013 financial results, we would like to highlight an individual who has contributed 50 years of superior service to the Bank.

John W. H. Hinrichs joined our organization on March 30, 1964 as a bank teller and worked his way up to become Chief Financial Officer and Executive Vice President. John's work ethic, financial acumen and balanced approach to managing Farmers & Merchants' finances are traits that have greatly benefited the Bank. His mentoring, impressive aptitude, and high-energy level dovetail with his fiscally responsible qualities, and his humble and frugal style can be seen in that he brings his lunch to work almost every day.

John was recognized in the community for his exceptional work when he received a Lifetime Achievement Award from the Orange County Business Journal and the California Society of Certified Public Accountants. As we move forward in 2014, we are grateful for John's outstanding service, his ongoing devotion to maintaining the Bank's strength and stability, and the role model that he continues to serve as, for all of us who are privileged to work with him.

Strong Growth in Net Loans

Farmers & Merchants' strong loan growth in 2013 is indicative of the hard work and results-driven resolve of our people. At December 31, 2013, net loans had grown 24 percent to $2.40 billion from $1.93 billion in 2012, thanks to the Bank's recently expanded lending team.

Interest income for the year ended December 31, 2013 was $163.2 million, compared with $171.1 million for the same period in 2012. Interest expense for the year declined to $6.2 million from $7.0 million in 2012, reflecting the prolonged low interest rate environment.

Net interest income for 2013 was $157.0 million, versus $164.1 million in 2012. Farmers & Merchants' net interest margin was 3.30% for the year ended December 31, 2013, compared with 3.65% in the previous year.

The Bank did not have a provision for loan losses in 2013, nor in 2012, amid continued strength in the quality of its loan portfolio. The Bank's allowance for loan losses as a percentage of loans outstanding was 2.09% at December 31, 2013, compared with 2.57% at December 31, 2012; the decrease being indicative of the 2013 loan growth coupled with strong loan quality.

Non-interest income for the full 2013 year totaled $37.8 million, versus $26.6 million for 2012. Non-interest expense for the year ended December 31, 2013 was $104.3 million, compared with $98.5 million last year.

The Bank's net income for 2013 was $62.2 million, or $474.80 per diluted share, compared with $63.4 million, or $484.14 per diluted share, for 2012.

Strong Numbers

Under the steadfast leadership of Chief Financial Officer John Hinrichs, we continued to maintain a strong balance sheet in 2013. The Bank's deposits grew to $3.83 billion at the end of 2013 from $3.69 billion at December 31, 2012. Non-interest bearing deposits represented 38.5% of total deposits at December 31, 2013, versus 40.0% of total deposits at December 31, 2012. Total assets increased to $5.21 billion at the close of 2013 from $4.99 billion at December 31, 2012.

While the minimum ratios for capital adequacy for a "well-capitalized" bank are 10.00% for total risk-based capital, 6.00% for Tier 1 risk-based capital and 5.00% for Tier 1 leverage, Farmers & Merchants exceeded these requirements under all regulatory categories at December 31, 2013 with ratios of 26.16%, 24.90% and 14.48%, respectively.

Strong in Our Community

With the Bank now in its 107th year of serving Southern California, one of our ongoing priorities is continuing to cultivate the multigenerational relationships that have been formed in the communities we serve. We opened two new branches in 2013, in Corona del Mar and Downey. Both branches represent important geographic footprints, as we expand our strong presence in Los Angeles and Orange Counties and welcome new clients to the Bank.

Volunteer work is another way our people continued to connect in 2013 with the communities we serve. Farmers & Merchants employees dedicated approximately 7,000 hours to community organizations during a two-year period that ended in 2013. A significant portion of that time was devoted to providing financial expertise to unemployed and low-income individuals.

We also invested in our people in 2013, welcoming Melissa Lanfre to our executive management team as Chief Operating Officer. Melissa has more than 30 years of experience in the banking industry and is overseeing operations for service and support departments. Her newly created position is reflective of our growth opportunities in the Southern California marketplace. You may recall we also named Phillip J. Bond, another seasoned banking industry expert, as Chief Credit Officer in 2012. With Phil and Melissa aboard, we now have a total of six principal officers on our strong executive management team.

Farmers & Merchants' client base is also a group comprised of some of the country's most innovative minds in retail, education, real estate, healthcare and the non-profit world – only some of whom are profiled in this Annual Report.

That's why we are so proud to serve these clients with a talented and experienced team, whether it's an executive who has been with the Bank for 50 years or a new member of management. At the end of the day, our people are *your* people. And it's Farmers & Merchants' job to ensure we have the very best and brightest to serve a dynamic and growing community.

This brings us full circle to the theme of this year's Annual Report: Our People. On behalf of our Board of Directors and management team, we thank our employees, clients and shareholders for their continued support in making Farmers & Merchants one of the strongest banks in California. We look forward to continuing to serve our client base with the unparalleled service and integrity that have been epitomizing our people since 1907.

Daniel K. Walker   W. Henry Walker

Daniel K. Walker
Chairman of the Board and CEO

W. Henry Walker
President

Body Glove International

Redondo Beach, California

F&M Bank Client Since 1964

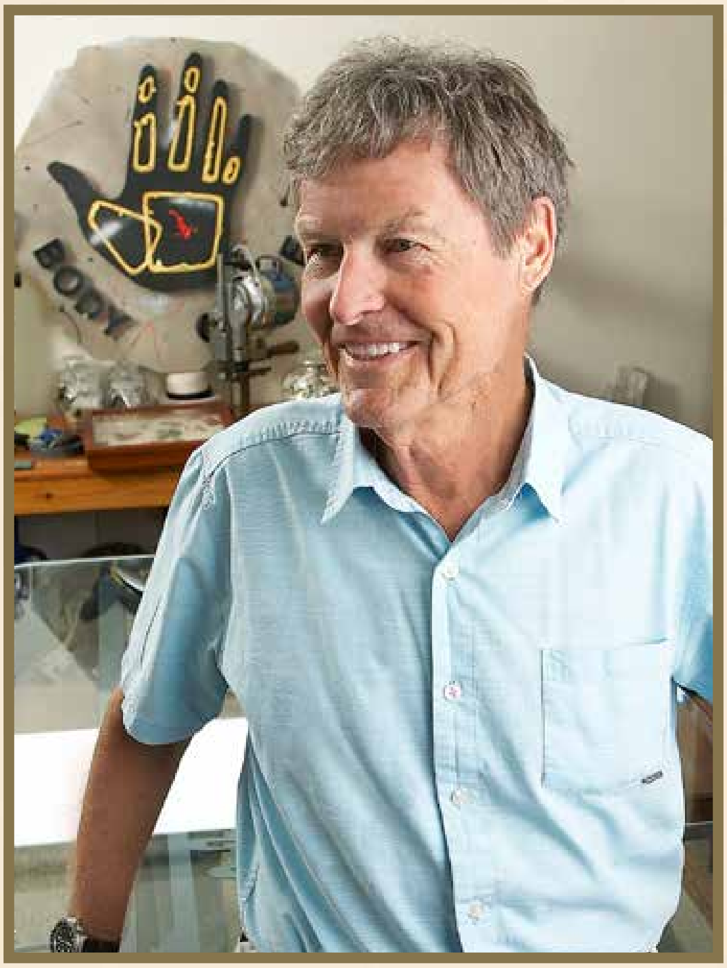
In the fall of 1964, Russ Lesser and his bride-to-be were in need of a refrigerator and bed to make a comfortable home. He also was in need of a checking account.

That's when Mr. Lesser met Ken Walker, then an officer of the Bank, who helped the young entrepreneur open a checking account.

"Ken asked me what else I needed, and I told him about needing a bed and a refrigerator. He asked me if I could pay him back, I said yes, and he said OK and loaned me $500," said Lesser, who is now President of iconic water sports brand Body Glove International, whose products are sold in approximately 50 countries internationally. "Banking with F&M is all about a personal relationship, which has grown substantially over the years."

In 2013, F&M provided Body Glove with $3 million in financing to convert the company's Dive n' Surf retail store in Redondo Beach into its corporate headquarters.

"F&M is big enough to handle anything a business may encounter, and at the same time, F&M has always been there for us like a family member," Lesser added.



Russ Lesser, President
Body Glove International

Discovery Science Center

Santa Ana, California

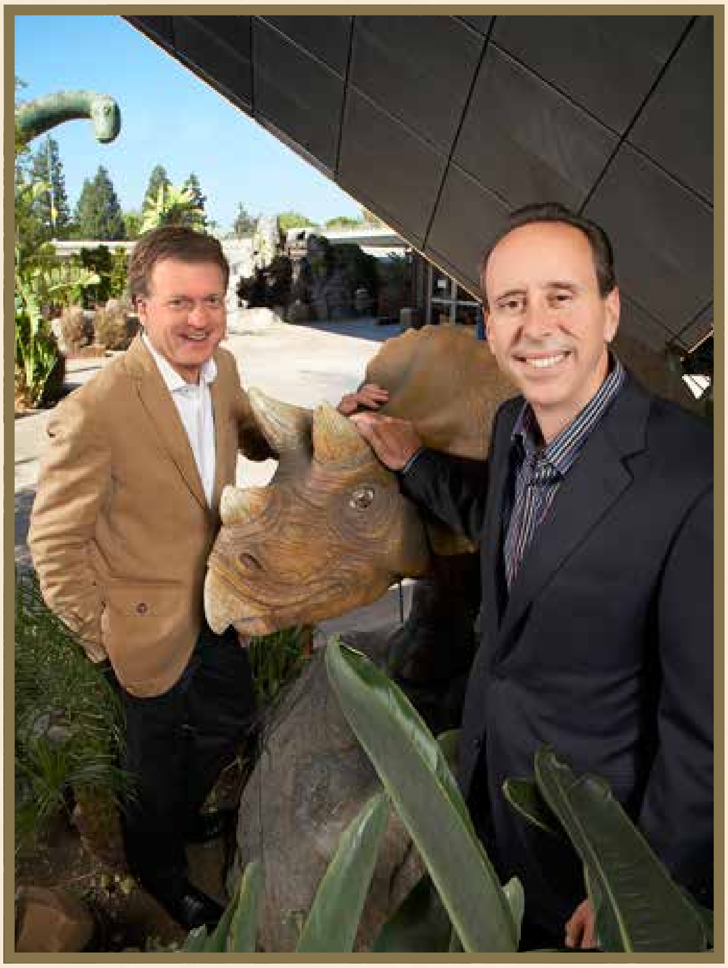
F&M Bank Client Since 2009

When the Discovery Science Center was in need of funding to double its size and increase the number of educational programs offered to local students and teachers, F&M was eager to partake in the project.

"F&M has always been involved with philanthropic projects in the Southern California community, so it was encouraging for us to work with them on this transaction," said Joe Adams, President of the Discovery Science Center, a leading family destination in Santa Ana known for hands-on science exhibits and its iconic solar cube.

As part of the Center's $22-million expansion, a new healthy living pavilion and test kitchen will provide live demonstrations teaching families the importance of nutrition, a new environmental education wing will teach guests about California's natural resources and how to be good environmental stewards, and a new showcase theater will house national blockbuster and world premier traveling exhibits such as "Mythbusters" and "Sherlock Holmes."

"The Walker Family cares about the community we serve, and that is an important value we have in common," said Mike McGee, Vice President of Finance of Discovery Science Center.



Joe Adams, President (left), and Mike McGee, Vice President of Finance (right)
Discovery Science Center

Hope International University

Fulton, California

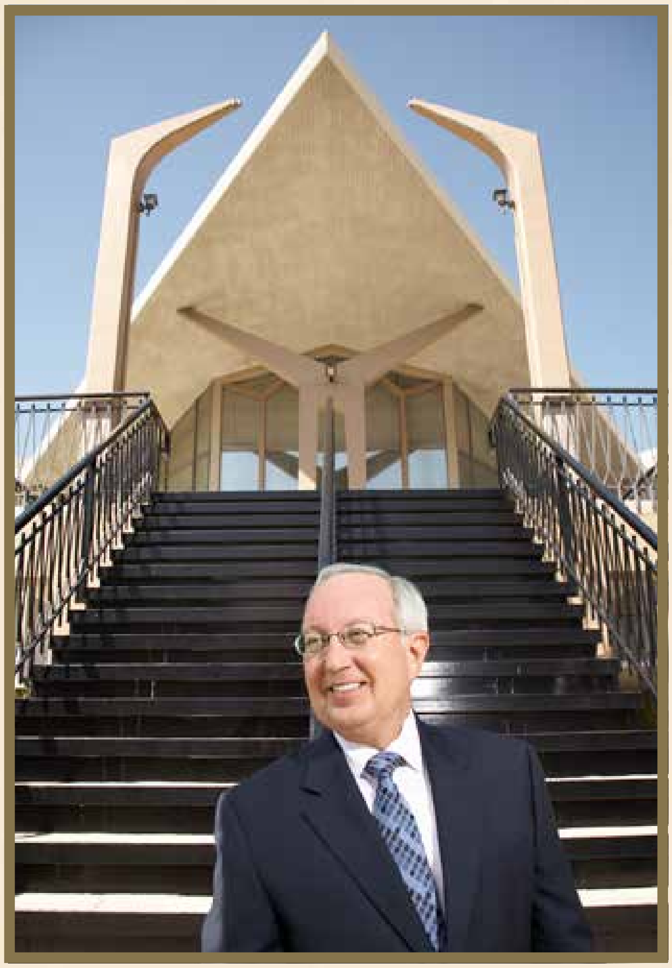
F&M Bank Client Since the 1960s

One word comes to mind when Dr. John Derry, President of Hope International University, describes his relationship with F&M: partnership.

"We're not just a client of the Bank. F&M has a genuine interest in the mission of our university to empower students to impact the world," Dr. Derry said. "We see each other as members of the community, and that serves as the foundation for our partnership with F&M."

Founded in 1928, HIU is regionally accredited and offers bachelor's degrees, master's degrees, certificate programs, and credential programs to more than 1,700 students worldwide. Dr. Derry said having a reliable banking partner is critical, as the university continues to grow and attract new students.

"F&M has been very generous in terms of financial support, including scholarships for our students," Dr. Derry said. "F&M truly sees us as a member of the community in which it wants to invest. And that has gone a long way in the several decades we've been a client."



Dr. John Derry, President
Hope International University

Dr. Hanna Alexander

Alexander Hearing Services

Torrance, California

F&M Bank Client Since 1979

Dr. Hanna Alexander was listening to the needs of business owners long before becoming a doctor of audiology. In fact, in the early 1970s, Dr. Alexander was a business checking supervisor at F&M Bank in Long Beach.

"I remember working for Gus Walker (then CEO of the Bank), and he would always listen to my recommendations for upgrading equipment, improving customer service and helping the less fortunate," Dr. Alexander said. "I learned a lot working for F&M, and many of the same values apply to my practice today."

Dr. Alexander began working as an audiologist in 1987, eventually completing her doctorate and opening her own practice in Torrance. Today, as a client of F&M's, she draws parallels between the Bank's superior customer service and how she treats her own patients.

"You never know what kind of situations people are facing, whether it is a financial problem or the start of hearing loss," she said. "Serving each patient with dignity and grace is one of the biggest lessons I learned at F&M."

Dr. Hanna Alexander
Alexander Hearing Services

Pacific Battleship Center

Home of the Battleship Iowa

San Pedro, California

F&M Bank Client Since 2013

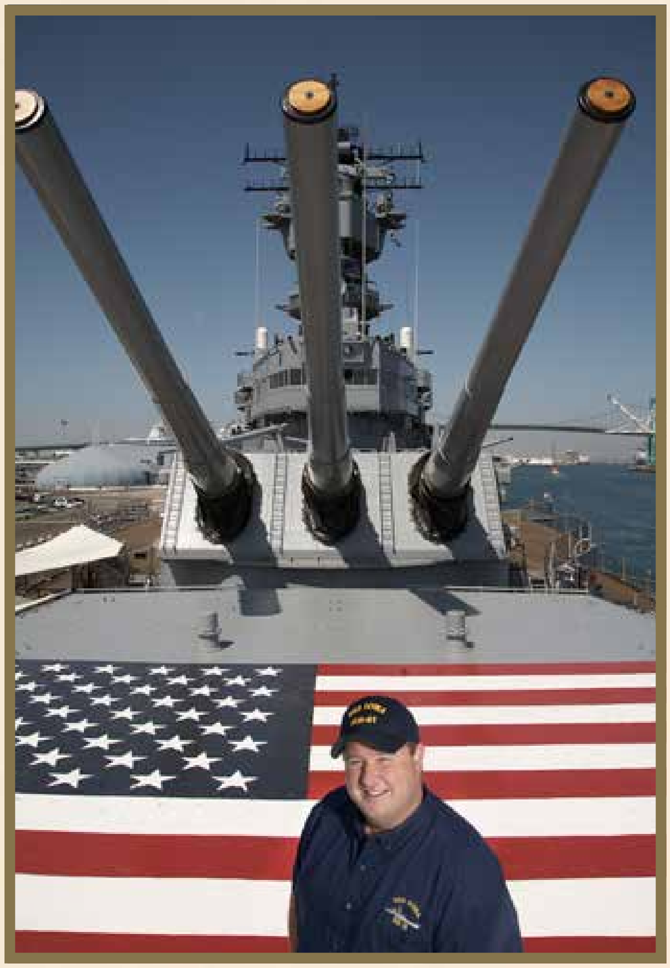
Battleships and banks have a lot in common. They both provide security, stability and firepower when needed.

So it is fitting that one of the Navy's strongest battleships and one of California's strongest banks would one day work together.

In 2011, the Battleship Iowa made the Port of Los Angeles its permanent home after a half-century of service that included a tour of duty during World War II. Today, the battleship is a museum and valued client of F&M's. It is also an educational platform dedicated to working with schools and businesses in the region to provide fun, exciting programs that focus on science, technology and naval history. Donations and grants are the fuel for these initiatives – as Iowa is no longer affiliated with any government agency.

"We wanted a banking partner that had strong ties to the community – a partner that would understand the cultural and historical significance of the battleship," said Jonathan Williams, President of the Pacific Battleship Center. "F&M has that personal touch. Our branch representative will actually visit the ship to pick up checks."

Strong relationships run deep for F&M – so we're proud to serve one of the world's most powerful battleships and an invaluable source of inspiration to the Southern California community.



Jonathan Williams, President
Pacific Battleship Center
Home of the Battleship Iowa

Board Member Profiles

Daniel K. Walker

Chairman of the Board since 2003. Mr. Walker is CEO of Farmers & Merchants Bank, where he has served in various positions since 1975.

Richard W. Darling

Board member since 2008. Mr. Darling, who also served as a board member between 1994 and 2007, is the retired president of Bremco Construction, a general contractor specializing in projects for major industrial and commercial corporations.

Walter M. Florie

Board member since 2007. Mr. Florie, who formerly held executive positions at Union Bank for almost three decades, is now president and chief executive officer of the Earl B. and Loraine H. Miller Foundation, an organization focused on children and their healthcare needs in the greater Long Beach community.

William G. Hayter

Board member since 1988. Mr. Hayter, who previously served as president of the Pacific Hospital Foundation, director of the Long Beach YMCA, and counsel for the Boy Scouts of America, is a practicing attorney specializing in business, estate planning and trust administration.

Timothy W. Jackert

Board member since 2008. Mr. Jackert served as chief financial officer at Memorial Medical Center Foundation in Long Beach for 38 years.

Lawrence J. McLaughlin

Board member since 1990. Mr. McLaughlin, who formerly was a principal and managing partner of a Los Angeles-based law firm for more than three decades, is now a principal at Megandrew Mineral Co., a Girard, Texas-based petroleum development company.

Timothy M. Wilson

Board member since 2005. Mr. Wilson is president of Mitchell Land & Improvement Co., a Southern California-based real estate development company where he previously served as executive vice president and chief operating officer.

SOUND FRIENDLY · BANKING SERVICE ·
STRONG
F&M
CONSERVATIVE

2013
Financial Report

F&M BANK

Farmers & Merchants Bank®

FARMERS & MERCHANTS BANK OF LONG BEACH
2013 ANNUAL REPORT

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KPMG LLP
Suite 700
20 Pacifica
Irvine, CA 92618-3391

Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of Farmers & Merchants Bank of Long Beach (the Bank), which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2013 and 2012, and the results of its operations and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

We also have examined in accordance with attestation standards established by the American Institute of Certified Public Accountants, the Bank's internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated April 23, 2014 expressed an unqualified opinion on the effectiveness of the Bank's internal control over financial reporting.

KPMG LLP

Irvine, California
April 23, 2014

FARMERS & MERCHANTS BANK OF LONG BEACH
BALANCE SHEETS

	December 31, 2013	December 31, 2012
	(In thousands, except share and per share data)	
Assets		
Cash and due from banks:		
Non-interest-bearing balances	$ 65,261	$ 60,914
Interest-bearing balances	20,755	253,087
Total cash and due from banks	86,016	314,001
Securities available-for-sale (amortized cost of $424,324 and $617,239)	427,942	630,055
Securities held-to-maturity (fair value of $2,144,536 and $2,015,916)	2,145,289	1,942,085
Loans held for sale	465	2,364
Loans, net	2,401,347	1,930,718
Other real estate owned, net	14,502	17,696
Public welfare investments	27,722	35,804
Bank premises and equipment, net	66,212	60,504
Net deferred tax assets	23,512	26,060
Other assets	21,579	29,674
Total assets	**$ 5,214,586**	**$ 4,988,961**
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest bearing deposits	$ 1,475,888	$ 1,474,215
Interest bearing deposits	2,355,554	2,211,651
Total deposits	3,831,442	3,685,866
Securities sold under repurchase agreements	595,991	551,293
Other liabilities	27,986	34,543
Total liabilities	4,455,419	4,271,702
Commitments and contingencies		
Stockholders' equity:		
Common stock, par value $20; authorized 250,000 shares; issued and outstanding 130,928 shares	2,619	2,619
Additional paid-in capital	12,044	12,044
Retained earnings	742,408	695,169
Accumulated other comprehensive income	2,096	7,427
Total stockholders' equity	759,167	717,259
Total liabilities and stockholders' equity	**$ 5,214,586**	**$ 4,988,961**

See accompanying notes to financial statements.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF INCOME

	Years Ended December 31, 2013	Years Ended December 31, 2012
	(In thousands, except per share data)	
Interest income:		
Loans	$ 105,163	$ 112,157
Securities available-for-sale	8,067	10,794
Securities held-to-maturity	49,441	47,112
Interest-bearing deposits in financial institutions	488	1,051
Total interest income	163,159	171,114
Interest expense:		
Deposits	5,049	5,840
Securities sold under repurchase agreements	1,116	1,147
Total interest expense	6,165	6,987
Net interest income	156,994	164,127
Provision for loan losses	-	-
Net interest income after provision for loan losses	156,994	164,127
Non-interest income:		
Service charges on deposit accounts	4,554	4,598
Gain on sale of securities available-for-sale	1,308	345
Other real estate owned income	3,757	2,797
Merchant bankcard income	9,358	8,822
Gain (Loss) on sale of bank premises and equipment	3,638	(166)
Other income	15,199	10,237
Total non-interest income	37,814	26,633
Non-interest expense:		
Salaries and employee benefits	55,986	48,271
FDIC and other insurance expense	4,825	6,479
Occupancy expense	6,987	6,500
Equipment expense	6,026	5,634
Other real estate owned expense	528	4,476
Amortization of public welfare investments	8,082	7,762
Merchant bankcard expense	7,493	6,821
Legal and professional services	3,604	2,882
Marketing expense	3,770	3,424
Other expense	6,961	6,268
Total non-interest expense	104,262	98,517
Income before income tax expense	90,546	92,243
Income tax expense	28,382	28,856
Net income	**$ 62,164**	**$ 63,387**
Basic and diluted earnings per common share	$ 474.80	$ 484.14

See accompanying notes to financial statements.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31, 2013	2012
	(In thousands)	
Net income	$ 62,164	$ 63,387
Other comprehensive loss, net of tax:		
Unrealized losses on securities:		
Unrealized holding losses arising during the period	(4,319)	(1,180)
Reclassification adjustment for net gains included in net income	(1,012)	(238)
Other comprehensive loss	(5,331)	(1,418)
Comprehensive income	**$ 56,833**	**$ 61,969**

See accompanying notes to financial statements.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(In thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance, December 31, 2011	**$ 2,619**	**$ 12,044**	**$ 646,708**	**$ 8,845**	**$ 670,216**
Net income	-	-	63,387	-	63,387
Cash dividends	-	-	(14,926)	-	(14,926)
Other comprehensive loss, net of tax	-	-	-	(1,418)	(1,418)
Balance, December 31, 2012	**$ 2,619**	**$ 12,044**	**$ 695,169**	**$ 7,427**	**$ 717,259**
Net income	-	-	62,164	-	62,164
Cash dividends	-	-	(14,925)	-	(14,925)
Other comprehensive loss, net of tax	-	-	-	(5,331)	(5,331)
Balance, December 31, 2013	**$ 2,619**	**$ 12,044**	**$ 742,408**	**$ 2,096**	**$ 759,167**

See accompanying notes to financial statements.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2013	2012
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 62,164	$ 63,387
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization on securities	32,794	28,655
Provision for loan losses	-	-
Gain on sale of securities available-for-sale	(1,308)	(345)
Gain on sale of other real estate owned	(2,788)	(2,195)
(Reduction) Addition of reserve for other real estate owned	(951)	938
Depreciation and amortization	4,800	4,191
Amortization of public welfare investments	8,082	7,762
Addition of reserve for losses on unfunded loan commitments	-	100
Deferred income tax expense	6,415	3,553
Decrease in other assets	8,095	1,774
Increase (Decrease) in other liabilities	4,276	(4,932)
Total adjustments	59,415	39,501
Net cash provided by operating activities	121,579	102,888
Cash flows from investing activities:		
Securities available-for-sale:		
Proceeds from maturities and paydowns	245,043	344,782
Proceeds from sales	55,294	7,642
Purchases	(103,659)	(444,242)
Securities held-to-maturity:		
Proceeds from maturities and paydowns	428,559	445,401
Purchases	(667,011)	(843,350)
Net (increase) decrease in loans	(469,448)	83,471
Purchases of bank premises and equipment	(10,508)	(9,540)
Proceeds from sale of other real estate owned	7,650	18,267
Increase in investments in low-income communities	(10,833)	-
Net cash used in investing activities	(524,913)	(397,569)
Cash flows from financing activities:		
Net increase in deposits	145,576	292,388
Net increase (decrease) in securities sold under repurchase agreements	44,698	(4,699)
Cash dividends paid	(14,925)	(14,926)
Net cash provided by financing activities	175,349	272,763
Net decrease in cash and due from banks	(227,985)	(21,918)
Cash and cash equivalents at beginning of year	314,001	335,919
Cash and cash equivalents at end of year	**$ 86,016**	**$ 314,001**

See accompanying notes to financial statements.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF CASH FLOWS, CONTINUED

	Years Ended December 31,	
	2013	2012
	(In thousands)	
Supplemental disclosures of cash flow information		
Cash paid during the year for:		
Interest	$ 6,177	$ 6,911
Income taxes	15,869	31,369
Non-cash investing and financing activities:		
Transfers of loans to other real estate owned	$ 717	$ 11,954
Loans to facilitate the sale of other real estate owned	-	1,753

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” or “FMB”) was founded in 1907 as a California state-chartered community bank that offers a broad range of banking products and services to individuals, professionals and small to medium-sized businesses. The Bank operates 23 branches in California’s South Los Angeles County and Orange County as of December 31, 2013.

As a full-service commercial bank, FMB offers a broad range of banking products and services including: accepting demand, money market, and time deposits; originating loans, including commercial real estate loans and commercial business loans; and providing other business-oriented banking products. The Bank also provides financing for residential loans including single-family and multifamily loans. To a lesser extent, the Bank also makes real estate construction and consumer loans.

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.

Basis of Financial Statement Presentation

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and conform to general practices 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, 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. 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, the valuation of other real estate owned and fair value disclosures. Actual results could differ from those estimates.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year’s presentation.

Cash and due from banks

Cash and cash equivalents consist of cash and due from banks.

Securities Available-for-sale and Securities Held-to-maturity

The Bank classifies its securities into one of two categories: available-for-sale and held-to-maturity.

All securities not identified as held-to-maturity are classified as available-for-sale. These 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.

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

Securities Available-for-sale and Securities Held-to-maturity, continued

Securities held-to-maturity are those for which the Bank has the ability and positive intent to hold until maturity. These securities are recorded at cost, adjusted for the amortization of premiums and accretion of discounts on a level-yield basis.

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 investment security as an adjustment to yield using the interest method. Unamortized premiums and unaccreted discounts are recognized as a component of gain or loss on sale upon disposition of the related security. Interest income is recognized when earned. Realized gains and losses on the sale of securities available-for-sale are included in non-interest income as gain (loss) on sale of securities using the specific-identification method.

Loans held for sale

Loans held for sale are carried at the lower of aggregate cost or fair value. Gain and losses are recorded in non-interest income based on the difference between sales proceeds, net of sales commissions, and carrying value.

Loans

Loans are reported at the principal amounts outstanding, net of the allowance for loan losses, 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.

Nonaccrual Loans

It is the Bank's general practice for interest accrual 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

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

Nonaccrual Loans, continued

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 impairment is measured either 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.

Troubled Debt Restructured Loans

A loan is classified as a troubled debt restructuring ("TDR") 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. TDR loans may be excluded from restructured loan disclosures in years subsequent to the restructuring if the loans are in compliance with their modified terms and the modification was made at market rates for a borrower with similar risk characteristics. 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. Loans classified as TDRs are reported as impaired loans.

Allowance for Loan Losses

The allowance for loan losses ("ALL") is maintained at a level deemed appropriate by the Bank to adequately provide for known and inherent risks in the loan portfolio at the balance sheet date. The allowance is based upon a continuing review of the portfolio, past loan loss experience, current economic conditions which may affect the borrowers' ability to pay, and the underlying collateral value of the loans. 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.

The allowance for loan losses consists of two components: specific allowances and general allowances. To determine the adequacy of the allowance in each of these two components, two primary methodologies are employed, the individual loan review analysis methodology and the classification migration methodology. These methodologies support the basis for determining allocations between the various loan segments and the overall adequacy of our allowance to provide for probable losses inherent in the loan portfolio. These methodologies are further supported by additional analysis of relevant factors such as the historical losses in the portfolio during the

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

Allowance for Loan Losses, continued

past 16 quarters, and environmental factors which include trends in delinquency and non-accrual, and other significant factors, such as the national and local economy, the volume and composition of the portfolio, strength of management and loan staff, underwriting standards, and the concentration of credit.

The Bank's management allocates a specific allowance for "Impaired Loans", in accordance with Accounting Standard Codification ("ASC") Section 310-10-35. For non-impaired loans, a general allowance is established for those loans internally classified and risk graded Pass, Special Mention, Substandard, or Doubtful based on historical losses in the specific loan portfolio and a reserve based on environmental factors determined for that loan group. The level of the general allowance is established to provide coverage for management's estimate of the credit risk in the loan portfolio by various loan segments not covered by the specific allowance.

The Bank's loan portfolio, excluding impaired loans which are evaluated individually, is categorized into several segments for purposes of determining allowance amounts by loan segment. The loan segments management currently evaluates are: commercial real estate, real estate construction, single-family residence, multi-family residence, equity lines, credit cards, commercial, consumer and farmland. Within these segments, management then evaluates loans not criticized, which are referred to as "pass" loans, separately from criticized loans. The criticized loans are further grouped into three credit risk rating categories: "special mention," "substandard" and "doubtful," which management defines as follows.

Special Mention: Loans classified as special mention have a potential weakness that requires management's attention. If not addressed, these potential weaknesses may result in further deterioration in the borrower's ability to repay the loan.

Substandard: Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the collection of the debt. They are characterized by the possibility that the Bank will sustain some loss if the weaknesses are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses as those classified as substandard, with the additional trait that the weaknesses make collection or repayment in full highly questionable and improbable.

In addition, management may refer to the loans classified as "substandard" and "doubtful" together as "classified loans." For additional information on classified loans, see Note 4, *Loans and Allowance for Loan Losses.*

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 the 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 at the date of transfer. OREO values are reviewed on an ongoing basis and any decline in value is charged against OREO expense, along with operating expense of such properties. Subsequent increases in the fair value of the asset less selling costs reduce the OREO valuation allowance, but not below zero, and are credited to noninterest expense. Income on OREO and gains and losses on their disposition are included in OREO income.

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

Public Welfare Investments

The Bank invests in limited liability companies and partnerships that make investments in commercial enterprises and affordable housing projects located in low income communities, which qualify for Federal or State income tax credits. The Bank's interests are accounted for utilizing the cost method of accounting and are being proportionately amortized over the life of the related tax credits. The investments are reviewed for impairment on an annual basis or on an interim basis if an event occurs that would trigger potential impairment.

Bank Premises and Equipment

Bank premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is computed on a 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	Shorter of useful lives or the terms of the lease

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.

The Bank reviews its long-lived assets for impairment annually or when events or circumstances indicate that the carrying amount of these assets may not be recoverable. When impairment is indicated for an asset, the amount of impairment loss is the excess of the net book value over its fair value.

Securities Sold Under Repurchase Agreements

The Bank sells certain securities under agreements to repurchase. The agreements are treated as collateralized financing transactions and the obligations to repurchase securities sold are reflected as a liability in the accompanying balance sheets. The securities underlying the agreements remain in the applicable asset accounts.

Operating Leases

The Bank enters into a variety of lease contracts, as lessee, 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.

The Bank also enters into a variety of lease contracts, as lessor, for Bank-owned properties or, as sublessee, for properties leased by the Bank. The Bank accounts for rental income on accrual basis.

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

Reserve for Losses on Unfunded Loan Commitments

The Bank maintains a reserve for losses on unfunded loan 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. The reserve for losses on unfunded loan commitments is classified as other liabilities and the change in this reserve is recognized in noninterest expense.

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 basis. 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.

The Bank has adopted the provisions of ASC 740-10, *Accounting for Uncertainty in Income Taxes,* which prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740-10 requires that the Bank recognize in the financial statements the impact of a tax position, if that position is more likely than not to be sustained, based on the technical merits of the position.

On an ongoing basis, management evaluates the deferred tax assets to determine if the tax benefits are expected to be realized in future periods. To the extent the benefit of a deferred tax asset is no longer expected to be realized, a valuation allowance is established with a corresponding charge through the provision for income taxes.

The Bank may, from time to time, be assessed interest or penalties by taxing authorities. In the event a reserve for interest and penalties is established pursuant to ASC 740-10, or, if any such interest and penalties are assessed by a tax authority, such amounts will be classified in the financial statements as income tax expense.

Comprehensive Income

Other comprehensive income refers to revenues, expenses, and gains and losses that are included in comprehensive income but are excluded from net income because they have been recorded directly in equity. The Bank’s comprehensive income consists of net income and net unrealized gains (losses) on securities available-for-sale, arising during the period and is presented in the statements of comprehensive income.

Earnings Per Share (EPS) Data

Basic EPS is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period.

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

Recent Accounting Standards

In April 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2011-02, *Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. ASU 2011-02 amends guidance for evaluating whether the restructuring of a receivable by a creditor is a TDR. In evaluating whether a restructuring constitutes a TDR, a creditor must separately conclude that both of the following exist:

- The restructuring constitutes a concession.
- The debtor is experiencing financial difficulties.

The amendments to Topic 310 clarify guidance on a creditor's evaluation of whether 1) it has granted a concession related to certain interest rate change scenarios and 2) a debtor is experiencing financial difficulties based on the probability of payment default in the foreseeable future without a modification. Nonpublic entities were required to adopt the ASU for annual periods ending on or after December 15, 2012. The adoption of this guidance did not have a material effect on the Bank's financial statements.

In February 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. With the issuance of ASU 2013-02, entities are now required to disclose:

- For items reclassified out of accumulated other comprehensive income ("AOCI") and into net income in their entirety, the effect of the reclassification on each affected net income line item; and
- For AOCI, reclassification items that are not reclassified in their entirety into net income, a cross reference to other required U.S. GAAP disclosures.

Although nonpublic entities are required to adopt the ASU for reporting periods beginning after December 31, 2013, the Bank elected early adoption. The adoption of this guidance did not have a material effect on the Bank's financial statements.

In July 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. This ASU requires an entity to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss ("NOL") carryforward, a similar tax loss, or a tax credit carryforward, rather than as a liability when (1) the uncertain tax position would reduce the NOL or other carryforward under the tax law of the applicable jurisdiction and (2) the entity intends to use the deferred tax asset for that purpose. The ASU does not require new recurring disclosures. For nonpublic entities, the guidance is effective prospectively for interim and annual periods beginning after December 15, 2014. The adoption of this guidance is not expected to have a material effect on the Bank's financial statements.

In January 2014, the FASB issued ASU 2014-01, *Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects*. ASU 2014-01 allows investors in low-income housing tax credit ("LIHTC") entities that meet certain conditions to present the net tax benefits (net of the amortization of the cost of the investment) within income tax expense. The cost of the investments that meets the conditions will be amortized in proportion to (and over the same period as) the total expected tax benefits, including tax credits and other tax benefits, as they are realized on the tax return. ASU 2014-01 is effective for the Bank on January 1, 2015 and is to be applied retrospectively if investors elect the proportional amortization

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

Recent Accounting Standards, continued

method. However, if investors have LIHTC investments accounted for under the effective yield method at adoption, they may continue to apply that method for those existing investments. Early adoption is permitted. The adoption of this guidance is not expected to have a material effect on the Bank's financial statements.

In January 2014, the FASB issued ASU 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. ASU 2014-04 clarifies when a creditor should reclassify mortgage loans collateralized by residential real estate from loans receivable to other real estate owned. ASU 2014-04 clarifies when an in-substance repossession or foreclosure has occurred and when a creditor is considered to have received physical possession of residential real estate collateralizing a mortgage loan. ASU 2014-04 is effective for the Bank on January 1, 2015 and can be applied either prospectively or using a modified retrospective transition method, and early adoption is permitted. The Bank is evaluating the impact this standard may have on its financial statements.

NOTE 2 – SECURITIES AVAILABLE-FOR-SALE

The following table presents an analysis of the securities available-for-sale portfolio:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In thousands)		
At December 31, 2013				
U.S. Treasury securities	$ -	$ -	$ -	$ -
U.S. Government agency and U.S. Government sponsored enterprise debt securities	37,461	51	14	37,498
Mortgage-backed securities	104,070	3,720	1,587	106,203
State and municipal securities	271,434	2,178	785	272,827
Collateralized mortgage obligations	9,199	105	50	9,254
Corporate debt securities	2,160	-	-	2,160
Total securities available-for-sale	$ 424,324	$ 6,054	$ 2,436	$ 427,942
At December 31, 2012				
U.S. Treasury securities	$ 100	$ -	$ -	$ 100
U.S. Government agency and U.S. Government sponsored enterprise debt securities	143,847	187	4	144,030
Mortgage-backed securities	123,987	8,104	-	132,091
State and municipal securities	326,280	4,458	233	330,505
Collateralized mortgage obligations	17,995	296	-	18,291
Corporate debt securities	5,030	8	-	5,038
Total securities available-for-sale	$ 617,239	$ 13,053	$ 237	$ 630,055

NOTE 2 – Securities Available-For-Sale, continued

The following table presents a summary of the estimated maturities of securities available-for-sale as of December 31, 2013:

	Amortized Cost	Fair Value
	(In thousands)	
Due in 1 year or less	$ 135,230	$ 135,422
Due after 1 year through 5 years	146,095	147,966
Due after 5 years through 10 years	53,324	55,321
Due after 10 years	89,675	89,233
	$ 424,324	$ 427,942

Proceeds from sales of securities available-for-sale were $55.29 million during 2013 and $7.64 million during 2012. Gross realized gains on sale of securities available-for-sale were $1.31 million in 2013 and $0.35 million in 2012 which $1.01 million and $0.24 million were reclassified out of accumulated other comprehensive income and into net income, respectively.

The following table shows the gross unrealized losses on available-for-sale securities and the related fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2013:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
U.S. Government agency and U.S. Government sponsored enterprise debt securities	$ 987	$ (14)	$ -	$ -	$ 987	$ (14)
Mortgage-backed securities	39,217	(1,587)	-	-	39,217	(1,587)
State and municipal securities	26,857	(454)	11,374	(331)	38,231	(785)
Collateralized mortgage obligations	5,525	(50)	-	-	5.525	(50)
Corporate debt securities	1,161	-	-	-	1,161	-
Total temporarily impaired securities	$ 73,747	$ (2,105)	$ 11,374	$ (331)	$ 85,121	$ (2,436)

The unrealized losses are primarily attributable to declining market prices caused by a rising interest rate environment. At December 31, 2013, there were 173 and 42 available-for-sale securities with unrealized losses less than 12 months and 12 months or longer, respectively. 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, 2013, management believes that available-for-sale securities in an unrealized loss position had a loss position that was temporary in nature, 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.

NOTE 2 – Securities Available-For-Sale, continued

The following represents the related tax effect allocated to each component of other comprehensive income at the dates indicated:

	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
		(In thousands)	
Year ended December 31, 2013			
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (7,453)	$ 3,134	$ (4,319)
Reclassification adjustment for net gains included in net income	(1,745)	733	(1,012)
Other comprehensive loss	$ (9,198)	$ 3,867	$ (5,331)
Year ended December 31, 2012			
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (2,036)	$ 856	$ (1,180)
Reclassification adjustment for net gains included in net income	(411)	173	(238)
Other comprehensive loss	$ (2,447)	$ 1,029	$ (1,418)

NOTE 3 – SECURITIES HELD-TO-MATURITY

The following table presents an analysis of the securities held-to-maturity portfolio:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In thousands)		
At December 31, 2013				
U.S. Government agency and U.S. Government sponsored enterprise debt securities	$ 15,759	$ 19	$ 506	$ 15,272
Mortgage-backed securities	1,644,496	24,531	30,736	1,638,291
State and municipal securities	438,024	11,332	5,109	444,247
Collateralized mortgage obligations	46,226	376	663	45,939
Corporate debt securities	784	3	-	787
Total securities held-to-maturity	$ 2,145,289	$ 36,261	$ 37,014	$ 2,144,536
At December 31, 2012				
U.S. Government agency and U.S. Government sponsored enterprise debt securities	$ 16,247	$ 59	$ 7	$ 16,299
Mortgage-backed securities	1,452,426	48,771	111	1,501,086
State and municipal securities	396,935	24,591	389	421,137
Collateralized mortgage obligations	71,010	846	55	71,801
Corporate debt securities	5,467	126	-	5,593
Total securities held-to-maturity	$ 1,942,085	$ 74,393	$ 562	$ 2,015,916

NOTE 3 – Securities Held-To-Maturity, continued

The following table is a summary of the estimated maturities of securities held-to-maturity as of December 31, 2013:

	Amortized Cost	Fair Value
	(In thousands)	
Due in 1 year or less	$ 26,356	$ 26,940
Due after 1 year through 5 years	133,690	139,514
Due after 5 years through 10 years	347,061	359,436
Due after 10 years	1,638,182	1,618,646
	$ 2,145,289	$ 2,144,536

There were no sales or transfers of securities held-to-maturity in 2013 or 2012.

The following table shows the gross unrealized losses on held-to-maturity securities and the related fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2013:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
U.S. Government agency and U.S. Government sponsored enterprise debt securities	$ 4,799	$ (200)	$ 3,438	$ (306)	$ 8,237	$ (506)
Mortgage-backed securities	1,030,614	(29,930)	16,461	(806)	1,047,075	(30,736)
State and municipal securities	106,159	(3,721)	20,149	(1,388)	126,308	(5,109)
Collateralized mortgage obligations	31,348	(663)	-	-	31,348	(663)
Total temporarily impaired securities	$ 1,172,920	$ (34,514)	$ 40,048	$ (2,500)	$ 1,212,968	$ (37,014)

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 are primarily attributable to declining market prices caused by accelerated prepayments on the mortgages resulting from a rising interest rate environment. At December 31, 2013, there were 364 and 362 held-to-maturity securities with unrealized losses less than 12 months and 12 months or longer, respectively.

At December 31, 2013, management believes that held-to-maturity securities in an unrealized loss position had a loss position that was 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 maturity, these held-to-maturity securities are not considered other-than-temporarily impaired.

Total securities with a carrying value of approximately $1.12 billion and $1.03 billion at December 31, 2013 and December 31, 2012, respectively, were pledged to secure securities sold under agreements to repurchase, public deposits and for other purposes required by law.

Interest income on tax-exempt securities was $12.6 million for the year ended December 31, 2013, and $11.7 million for the year ended December 31, 2012.

NOTE 4 – LOANS AND ALLOWANCE FOR LOAN LOSSES

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 loan portfolio. Loans are generally expected to be paid off from the operating cash flow of the borrowers, refinancing by another lender, or through sale by the borrowers of the secured collateral.

The following is the presentation of the loan portfolio by loan segment:

	December 31, 2013	December 31, 2012
	(In thousands)	
Commercial & industrial	$ 106,119	$ 154,477
Construction	71,340	36,535
Commercial real estate	1,612,810	1,250,534
Residential mortgage	537,566	393,275
Equity lines	108,529	123,972
Installment and other loans	17,973	23,283
Gross loans	2,454,337	1,982,076
Less: Allowance for loan losses	(51,251)	(50,994)
Unamortized deferred loan fees, net	(1,739)	(364)
Loans, net	$ 2,401,347	$ 1,930,718
Loans held for sale	465	2,364
Total loans receivable, net	$ 2,401,812	$ 1,933,082

Nonaccrual and Past Due

Loans are tracked by the numbers of days borrower payments are past due. The following tables present an aging analysis of nonaccrual and past due loans, segregated by loan segment:

	As of December 31, 2013					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days & Over Still Accruing	Non-accrual	Current	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	$ -	$ -	$ -	$ 95	$ 106,024	$ 106,119
Construction	-	-	-	1,115	70,225	71,340
Commercial real estate	1,608	785	-	25,735	1,584,682	1,612,810
Residential mortgage	-	408	-	1,084	536,074	537,566
Equity lines	171	-	-	1,165	107,193	108,529
Installment and other loans	121	49	32	-	17,771	17,973
Gross loans	**$ 1,900**	**$ 1,242**	**$ 32**	**$ 29,194**	**$ 2,421,969**	**$ 2,454,337**

NOTE 4 – Loans and Allowance for Loan Losses, continued

Nonaccrual and Past Due, continued

	As of December 31, 2012					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days & Over Still Accruing	Non-accrual	Current	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	$ 6,070	$ 521	$ -	$ 2,428	$ 145,458	$ 154,477
Construction	-	-	-	6,607	29,928	36,535
Commercial real estate	4,544	-	440	28,909	1,216,641	1,250,534
Residential mortgage	3,686	231	-	9,655	379,703	393,275
Equity lines	-	-	-	1,526	122,446	123,972
Installment and other loans	9	191	70	-	23,013	23,283
Gross loans	**$ 14,309**	**$ 943**	**$ 510**	**$ 49,125**	**$ 1,917,189**	**$ 1,982,076**

The following is a summary of non-accrual loans as of December 31, 2013 and 2012 and the related contractual interest income foregone for the years then ended:

	2013	2012
	(In thousands)	
Nonaccrual loans		
Outstanding balance	$ 29,194	$ 49,125
Average balance	38,577	79,801
Interest income recorded	308	217
Interest income foregone	1,708	3,144

Credit Quality

Loans are risk rated based on analysis of the current state of the borrower's credit quality. The analysis of credit quality includes review of all sources of repayment, the borrower's current payment performance/delinquency, the borrower's current financial and liquidity status, and all other relevant information.

The following tables present the credit risk rating categories for each loan segment as of the dates indicated. Nonclassified loans are those with a credit risk rating of either pass or special mention, while classified loans are those with a credit risk rating of either substandard or doubtful.

	December 31, 2013			December 31, 2012		
	Nonclassified	Classified	Total	Nonclassified	Classified	Total
	(In thousands)					
Commercial & industrial	$ 105,580	$ 539	$ 106,119	$ 151,088	$ 3,389	$ 154,477
Construction	69,858	1,482	71,340	29,457	7,078	36,535
Commercial real estate	1,570,312	42,498	1,612,810	1,167,266	83,268	1,250,534
Residential mortgage	532,991	4,575	537,566	378,179	15,096	393,275
Equity lines	103,439	5,090	108,529	116,826	7,146	123,972
Installment and other loans	17,973	-	17,973	23,283	-	23,283
Total	**$ 2,400,153**	**$ 54,184**	**$ 2,454,337**	**$ 1,866,099**	**$ 115,977**	**$ 1,982,076**

NOTE 4 – Loans and Allowance for Loan Losses, continued

Loan Impairment

Nonaccrual loans and performing restructured loans are considered impaired for reporting purposes. The following table segregates the major loan categories between those loans that were individually evaluated for impairment and those loans that were collectively evaluated for impairment.

	December 31, 2013			December 31, 2012		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	$ 237	$ 105,882	$ 106,119	$ 2,598	$ 151,879	$ 154,477
Construction	1,115	70,225	71,340	6,839	29,696	36,535
Commercial real estate	29,418	1,583,392	1,612,810	45,368	1,205,166	1,250,534
Residential mortgage	1,594	535,972	537,566	9,663	383,612	393,275
Equity lines	1,165	107,364	108,529	1,526	122,446	123,972
Installment and other loans	-	17,973	17,973	-	23,283	23,283
Total	**$ 33,529**	**$ 2,420,808**	**$ 2,454,337**	**$ 65,994**	**$ 1,916,082**	**$ 1,982,076**

For the indicated periods, the following tables contain an analysis of impaired loans by segment:

	As of December 31, 2013						
	Unpaid Principal Balance	Recorded Investment With No ALL	Recorded Investment With ALL	Related ALL	Total	Average Recorded Investment	Interest Income Recognized
	(In thousands)						
Loan Segment							
Commercial & industrial	$ 440	$ 223	$ 14	$ 1	$ 236	$ 957	$ 8
Construction	1,380	1,115	-	-	1,115	5,644	-
Commercial real estate	34,550	29,400	18	17	29,401	34,024	458
Residential mortgage	2,139	1,594	-	-	1,594	5,503	21
Equity lines	1,383	1,165	-	-	1,165	1,513	52
Installment and other loans	-	-	-	-	-	-	-
Total	**$ 39,892**	**$ 33,497**	**$ 32**	**$ 18**	**$ 33,511**	**$ 47,641**	**$ 539**

NOTE 4 – Loans and Allowance for Loan Losses, continued

Loan Impairment, continued

	As of December 31, 2012						
	Unpaid Principal Balance	Recorded Investment With No ALL	Recorded Investment With ALL	Related ALL	Total	Average Recorded Investment	Interest Income Recognized
				(In thousands)			
Loan Segment							
Commercial & industrial	$ 8,486	$ 2,395	$ 203	$ 36	$ 2,562	$ 6,913	$ 179
Construction	7,460	6,839	-	-	6,839	11,455	14
Commercial real estate	52,994	42,363	3,005	804	44,564	66,654	1,004
Residential mortgage	11,137	9,305	358	-	9,663	15,684	179
Equity lines	1,760	1,526	-	-	1,526	1,555	34
Installment and other loans	-	-	-	-	-	737	-
Total	**$ 81,837**	**$ 62,428**	**$ 3,566**	**$ 840**	**$ 65,154**	**$ 102,998**	**$ 1,410**

Troubled Debt Restructured Loans

Included in the Bank's loan portfolio are TDRs which are modified because of deterioration in the financial condition of the borrower. The total amount of TDRs was $32.6 million at December 31, 2013 and $57.0 million at December 31, 2012.

The following tables present TDRs as of each year end that were modified as TDRs during the year.

	For The Year Ended December 31, 2013						
						TDRs that Subsequently Defaulted	
	No. of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment	Charge-offs During Modification	Allocated Reserve	No. of Contracts	Recorded Investment
				(In thousands)			
Loan Segment							
Commercial & industrial	2	$ 183	$ 183	$ -	$ -	-	$ -
Construction	1	-	-	-	-	-	-
Commercial real estate	5	14,313	14,313	-	-	-	-
Residential mortgage	2	592	592	-	-	1	263
Equity lines	1	441	441	-	-	-	-
Total	**11**	**$ 15,529**	**$ 15,529**	**$ -**	**$ -**	**1**	**$ 263**

NOTE 4 – Loans and Allowance for Loan Losses, continued

Troubled Debt Restructured Loans, continued

	For The Year Ended December 31, 2012						
	No. of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment	Charge-offs During Modification	Allocated Reserve	TDRs that Subsequently Defaulted No. of Contracts	TDRs that Subsequently Defaulted Recorded Investment
	(In thousands)						
Loan Segment							
Commercial & industrial	4	$ 472	$ 472	$ -	$ 33	-	$ -
Construction	3	6,996	6,996	-	-	1	1,494
Commercial real estate	10	17,738	17,723	15	776	1	1,355
Residential mortgage	2	498	498	-	-	-	-
Equity lines	-	-	-	-	-	-	-
Total	**19**	**$ 25,704**	**$ 25,689**	**$ 15**	**$ 809**	**2**	**$ 2,849**

Accruing TDRs

A summary of accruing TDRs by concession type and by loan segment is shown below for each year end.

	As of December 31, 2013			
	Principal Deferral	Rate Reduction	Combination of such Concession	Total
	(In thousands)			
Loan Segment				
Commercial & industrial	$ 141	$ -	$ -	$ 141
Construction	-	-	-	-
Commercial real estate	263	-	3,420	3,683
Residential mortgage	218	-	292	510
Total loans	**$ 622**	**$ -**	**$ 3,712**	**$ 4,334**

	As of December 31, 2012			
	Principal Deferral	Rate Reduction	Combination of such Concession	Total
	(In thousands)			
Loan Segment				
Commercial & industrial	$ 170	$ -	$ -	$ 170
Construction	-	-	231	231
Commercial real estate	7,208	-	9,251	16,459
Residential mortgage	-	-	9	9
Total loans	**$ 7,378**	**$ -**	**$ 9,491**	**$ 16,869**

NOTE 4 – Loans and Allowance for Loan Losses, continued

Non-Accruing TDRs

A summary of non-accruing TDRs by concession type and by loan segment is shown below for each year end.

	As of December 31, 2013				
	Principal Deferral	Rate Reduction	Forgiveness of Principal	Combination of such concession	Total
			(In thousands)		
Loan Segment					
Commercial & industrial	$ 95	$ -	$ -	$ -	$ 95
Construction	1,115	-	-	-	1,115
Commercial real estate	16,561	-	-	8,987	25,548
Residential mortgage	-	-	-	1,084	1,084
Equity lines	395	-	-	-	395
Total loans	**$ 18,166**	**$ -**	**$ -**	**$ 10,071**	**$ 28,237**

	As of December 31, 2012				
	Principal Deferral	Rate Reduction	Forgiveness of Principal	Combination of such concession	Total
			(In thousands)		
Loan Segment					
Commercial & industrial	$ 222	$ -	$ -	$ -	$ 222
Construction	6,382	-	-	-	6,382
Commercial real estate	20,114	-	-	8,571	28,685
Residential mortgage	995	-	-	3,446	4,441
Equity lines	416	-	-	-	416
Total loans	**$ 28,129**	**$ -**	**$ -**	**$ 12,017**	**$ 40,146**

NOTE 4 – Loans and Allowance for Loan Losses, continued

Allowance for Loan Losses

The following table summarizes ALL activity by loan segment for each year ended:

	As of December 31, 2013						
	Commercial & Industrial	Construction	Commercial Real Estate	Residential Mortgage	Equity Lines	Installment and Other Loans	Total
				(In thousands)			
December 31, 2011	**$ 6,868**	**$ 8,340**	**$ 19,739**	**$ 18,852**	**$ 652**	**$ 4,012**	**$ 58,463**
Provision	348	(6,520)	4,960	(1,318)	544	1,986	-
Charge-Off	(6,028)	(1,274)	(1,082)	(817)	(125)	(892)	(10,218)
Recoveries	902	879	-	531	2	435	2,749
December 31, 2012	**$ 2,090**	**$ 1,425**	**$ 23,617**	**$ 17,248**	**$ 1,073**	**$ 5,541**	**$ 50,994**
Provision	(904)	4,649	(10,410)	6,790	(125)	-	-
Charge-Off	(399)	-	(644)	(249)	-	(564)	(1,856)
Recoveries	476	146	1,043	144	4	300	2,113
December 31, 2013	**$ 1,263**	**$ 6,220**	**$ 13,606**	**$ 23,933**	**$ 952**	**$ 5,277**	**$ 51,251**
The ending ALL balance is composed of amounts applicable to loans:							
Individually evaluated for impairment	$ 1	$ -	$ 17	$ -	$ -	$ -	$ 18
Collectively evaluated for impairment	$ 1,262	$ 6,220	$ 13,589	$ 23,933	$ 952	$ 5,277	$ 51,233

Reserve for Unfunded Loan Commitments

Activities in the reserve for unfunded loan commitments included in other liabilities in the accompanying balance sheets for the years ended December 31, 2013 and 2012 were as follows:

	December 31,	
	2013	2012
	(In thousands)	
Balance, beginning of year	$ 2,152	$ 2,052
Addition of reserve for losses on unfunded loan commitments	-	100
Balance, end of year	$ 2,152	$ 2,152

NOTE 5 – OTHER REAL ESTATE OWNED

At December 31, 2013 and 2012, OREO was $14.5 million, net of OREO reserve of $4.9 million and $17.7 million, net of OREO reserve of $11.7 million, respectively. The following tables summarize OREO by property type at the dates indicated:

	December 31,	
	2013	2012
	(In thousands)	
Commercial real estate	$ 461	$ 1,900
Construction	11,991	13,746
Farmland	1,065	1,065
Single family residence	985	985
Total OREO, net	$ 14,502	$ 17,696

The components of OREO operations for the years indicated are as follows:

	2013	2012
	(In thousands)	
Rental income	$ 969	$ 602
Net gain on sale	2,788	2,195
Total OREO income	3,757	2,797
Operating and maintenance expense	1,479	3,538
Provision for losses	(951)	938
Total OREO expense	528	4,476
OREO income (expense), net	$ 3,229	$ (1,679)

NOTE 6 – PUBLIC WELFARE INVESTMENTS

The Bank has invested in certain limited liability companies and partnerships that make investments in commercial enterprises and affordable housing projects located in low income communities. The Bank evaluates the investment in the fund to determine whether it meets the definition of variable interest entity (VIE) and whether the Bank is required to consolidate the fund. The Bank is not the primary beneficiary of any VIEs and is not under common control, therefore not required to consolidate these entities.

The Bank's investments totaled $27.7 million and $35.8 million at December 31, 2013 and December 31, 2012, respectively. Unfunded commitments related to these investments totaled $12.2 million and $23.0 million at December 31, 2013 and December 31, 2012, respectively, which were recorded under other liabilities.

The remaining Federal tax credits to be utilized over a multiple-year period are $30.7 million at December 31, 2013. The Bank's usage of tax credits approximated $8.9 million for 2013 and $8.9 million for 2012.

NOTE 7 – BANK PREMISES AND EQUIPMENT

The following is a summary of bank premises and equipment as of the dates indicated:

	December 31,	
	2013	2012
	(In thousands)	
Land	$ 25,580	$ 24,725
Buildings and building improvements	49,807	43,014
Furniture, fixtures and equipment	25,818	25,567
Leasehold improvements	4,232	3,780
Construction in progress	1,727	2,444
	$ 107,164	$ 99,530
Less accumulated depreciation and amortization	(40,952)	(39,026)
	$ 66,212	$ 60,504

Depreciation and amortization expense was $4.8 million in 2013 and $4.2 million in 2012.

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 $369,700 in 2013 and $518,000 in 2012, net of rental income of $1,144,000 and $1,012,700, respectively. Annual minimum lease commitments at December 31, 2013 were:

Year Ending December 31,	Commitments
	(In thousands)
2014	$ 1,322
2015	1,217
2016	961
2017	671
2018	240
Thereafter	$ 835

The following table shows future rental income payments to be received under operating leases with terms in excess of one year as of December 31, 2013:

Year Ending December 31,	Commitments
	(In thousands)
2014	$ 987
2015	769
2016	620
Thereafter	$ 835

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

NOTE 8 – DEPOSITS

The following table presents the components of deposits as of the dates indicated:

	December 31, 2013	December 31, 2012
	(In thousands)	
Non-interest bearing checking	$ 1,475,888	$ 1,474,215
Interest bearing checking	413,291	346,991
Money market accounts	531,196	468,650
Savings deposits	549,578	542,379
Total core deposits	$ 2,969,953	$ 2,832,235
Time deposits:		
Less than $100,000	$ 205,866	$ 227,521
$100,000 or greater	655,623	626,110
Total time deposits	861,489	853,631
Total deposits	$ 3,831,442	$ 3,685,866

Interest expense on time deposits of $100,000 and over totaled $3.0 million and $3.6 million for the years ended December 31, 2013, and 2012, respectively.

At December 31, 2013, the maturity distribution of the Bank's time deposits was as follows:

Year of Maturity	$100,000 or Greater	Less Than $100,000	Total
		(In thousands)	
2014	$ 513,998	$ 178,208	$ 692,206
2015	81,769	17,133	98,902
2016	20,197	5,585	25,782
2017	14,758	2,659	17,417
2018	24,901	2,281	27,182
	$ 655,623	$ 205,866	$ 861,489

NOTE 9 – SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

Substantially all repurchase agreements have open-ended maturities, but either the customer or the Bank may terminate a repurchase agreement at any time upon written notice. All outstanding balances and pledged securities will be rebalanced and interest rates will reset daily to reflect market movement.

NOTE 9 – Securities Sold under Repurchase Agreements, continued

The following table summarizes information about securities sold under repurchase agreements as of the periods indicated:

	2013	2012
Securities sold under repurchase agreements	$ 595,991	$ 551,293
Weighted average interest rate	0.19%	0.19%
Securities underlying repurchase agreements	$ 666,267	$ 630,657
Fair value	$ 670,508	$ 656,424

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 following summarizes the activity within the securities sold under repurchase agreements during the periods 2013 and 2012, respectively:

	2013	2012
Average outstanding	$ 578,651	$ 563,144
Weighted average interest rate	0.19%	0.20%
Maximum amounts outstanding	$ 664,329	$ 644,975

NOTE 10 – INCOME TAXES

The provision for income taxes for the years ended December 31, 2013 and 2012 is comprised of the following:

	2013	2012
	(In thousands)	
Current income taxes:		
Federal	$ 13,887	$ 17,120
State	8,080	8,183
Total current income tax expense	21,967	25,303
Deferred income taxes:		
Federal	4,457	2,709
State	1,958	844
Total deferred income tax expense	6,415	3,553
Total income tax expense	$ 28,382	$ 28,856

NOTE 10 – Income Taxes, continued

Significant temporary differences that give rise to the deferred tax assets and liabilities as of December 31, 2013 and December 31, 2012 are as follows:

	2013	2012
	(In thousands)	
Deferred tax assets		
Allowance for loan losses	$ 24,480	$ 24,362
State income taxes	864	-
Depreciation and amortization	-	1,445
Gain on sale of OREO	2,242	5,480
Other, net	825	885
Subtotal deferred tax assets	$ 28,411	$ 32,172
Valuation allowance	(2,151)	(658)
Total deferred tax assets	$ 26,260	$ 31,514
Deferred tax liabilities		
Discount accretion income	(35)	(35)
State income taxes	-	(31)
Depreciation and amortization	(1,191)	-
Fair value adjustments on securities available-for-sale	(1,522)	(5,388)
Total deferred tax liabilities	$ (2,748)	$ (5,454)
Net deferred tax assets	$ 23,512	$ 26,060

The Federal tax rate was 35% for 2013 and 2012. A reconciliation of income tax expense and the amount computed by applying the statutory Federal income tax rate to income before income taxes follows:

	2013	2012
Federal income tax rate	35.0%	35.0%
State income taxes, net of Federal benefit	6.3%	5.6%
Tax exempt income	(4.7%)	(4.3%)
Tax credit	(6.4%)	(5.5%)
Other	1.1%	0.4%
	31.3%	31.2%

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which those temporary differences become deductible.

Based upon our taxpaying history and estimates of taxable income over the years in which the items giving rise to the deferred tax assets are deductible, management believes it is more likely than not that the Bank will realize the benefits of these deductible differences (except to the extent of the recorded valuation allowance). A valuation allowance has been provided for expected capital losses in California since management believes it is probable that these losses may not be utilized.

The Bank has adopted the provisions of ASC 740-10, *Accounting for Uncertainty in Income Taxes*, which prescribes the requirements for financial statement recognition and measurement of a tax position taken or

NOTE 10 – Income Taxes, continued

expected to be taken in a tax return. The ASC 740-10 standard requires that all tax positions be assessed and to the extent the position is more likely than not to be sustained on its technical merits, a benefit be recognized based on the greatest amount that is more likely than not to be sustained.

Management's evaluation of tax positions was performed for those tax years which remain open to audit. As of December 31, 2013, all tax years subsequent to 2009 and 2008 for federal and state purposes respectively remain open to examination. The Bank may, from time to time, be assessed interest or penalties by taxing authorities, although any such assessments historically have been minimal and immaterial to our financial results. The Bank has concluded that there are no material uncertain tax positions as of December 31, 2013.

NOTE 11 – EARNINGS PER SHARE

As of December 31, 2013 and 2012, there were no securities or other contracts to issue common stock. 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, 2013 and 2012.

	2013	2012
	(In thousands, except share and per share data)	
Basic and diluted earnings per share:		
Net income available to common stockholders	$ 62,164	$ 63,387
Weighted average number of common shares outstanding	130,928	130,928
Weighted basic and diluted earnings per common share	$ 474.80	$ 484.14

NOTE 12 – COMMITMENTS AND CONTINGENCIES

Commitments to Extend Credit

In the normal course of business, the Bank has various outstanding commitments to extend credit that are not reflected in the accompanying financial statements. While the Bank does not anticipate material losses as a result of these transactions, commitments to extend credit are included in determining the appropriate level of the reserve for unfunded loan commitments.

Commitments to extend credit are agreements to lend to a customer, provided there is no violation of any condition established in the agreement. Substantially all of the Bank's commitments to extend credit are on a variable rate basis. Standby letters of credit are conditional commitments issued by the Bank to make payment on behalf of customers when certain specified future events occur. The customer is obligated to reimburse the Bank for any such payment. Most letters of credit expire within one year.

The Bank uses the same credit policies in making commitments to extend credit and in issuing standby letters of credit. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained is based on management's credit evaluation of the customer.

NOTE 12 – Commitments and Contingencies, continued

Commitments to Extend Credit, continued

The following table presents a summary of the Bank's commitments to extend credit as of the dates indicated:

	December 31, 2013	December 31, 2012
	(In thousands)	
Commitments to extend credit	$ 686,089	$ 463,074
Financial standby letters of credit	10,845	8,201
Performance standby letters of credit	7,389	7,871
	$ 704,323	$ 479,146

Legal Matters

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. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Bank's financial position or results of operations and, as of December 31, 2013, the Bank is not a party to any material litigation.

NOTE 13 – FAIR VALUE MEASUREMENTS

FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value including a three-level valuation hierarchy, and expands disclosures about fair value measurements. Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date reflecting assumptions that a market participant would use when pricing an asset or liability. The three-level inputs to measure the fair value of assets and liabilities are as follows:

- Level 1 - Quoted prices for identical instruments that are highly liquid, observable and actively traded in over-the-counter markets. Level 1 financial instrument typically includes U.S. Treasury securities.
- Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable and can be corroborated by market data. Level 2 financial instruments typically include U.S. Government debt and agency mortgage-backed securities, municipal securities, corporate debt securities, impaired loans and OREO.
- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category typically includes impaired loans and OREO.

NOTE 13 – Fair Value Measurements, continued

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

Securities available-for-sale – Other than U.S. Treasury securities, which is a Level 1 measurement, the Bank measures all other securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.

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 appraisals which are adjusted based on recent market trends, a Level 3 measurement. The impaired loans categorized as Level 3 also include loans whose fair values are based on unobservable inputs such as cash flows discounted at the effective loan rate, management's judgment or in the event when current appraised value was higher than the Bank's book balance.

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 accepted written offers is classified in Level 2 in 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. These assets and liabilities are reported on the balance sheets at their fair values as of December 31, 2013 and December 31, 2012, respectively:

	As of December 31, 2013			
	Fair Value Measurements Using			Total at
	Level 1	Level 2	Level 3	Fair Value
	(In thousands)			
Assets				
On a recurring basis:				
Securities available-for-sale	$ -	$ 427,942	$ -	$ 427,942
On a non-recurring basis:				
Impaired loans	-	5,497	-	5,497
Other real estate owned	-	5,106	-	5,106
Total assets	$ -	$ 438,545	$ -	$ 438,545

NOTE 13 – Fair Value Measurements, continued

	As of December 31, 2012			
	Fair Value Measurements Using			Total at
	Level 1	Level 2	Level 3	Fair Value
	(In thousands)			
Assets				
On a recurring basis:				
Securities available-for-sale	$ 100	$ 629,955	$ -	$ 630,055
On a non-recurring basis:				
Impaired loans	-	9,183	2,559	11,742
Other real estate owned	-	8,012	1,049	9,061
Total assets	$ 100	$ 647,150	$ 3,608	$ 650,858

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments are defined under FASB ASC 825-50, *Financial Instruments-Disclosures,* 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 may not exist. Therefore, considerable judgments are 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, 2013 and 2012, the amounts that will actually be realized could be significantly different.

Cash and due from banks

The carrying value of cash and due from banks approximates the fair value because of the short maturity of such assets.

Securities Available-for-sale and Securities Held-to-maturity

The Bank used market quotes for similar or identical securities in an actively traded market to determine the fair values of securities available-for-sale and securities held-to-maturity as disclosed in Notes 2 and 3, 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 14 – Fair Value of Financial Instruments, continued

Deposits

The fair value of demand deposits, savings and money market saving accounts represents the amount payable on demand at the reporting date. 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; However, since the bank's current interest rate is approximately at market, fixed maturity time deposits was determined to approximate the carrying value.

Securities Sold Under Repurchase Agreements

The fair value of securities sold under agreements to repurchase approximates carrying value due to the terms and nature of the obligations, where the interest rate will reset daily according to the market movement.

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 financial instruments at December 31:

	2013		2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
	(In thousands)			
Financial Assets:				
Cash and due from banks	$ 86,016	$ 86,016	$ 314,001	$ 314,001
Securities available-for-sale	427,942	427,942	630,055	630,055
Securities held-to-maturity	2,145,289	2,144,536	1,942,085	2,015,916
Loans, net of allowance for loan losses	2,401,812	2,456,743	1,933,082	1,944,257
Public welfare investments	27,722	27,722	35,804	35,804
Financial Liabilities:				
Deposits:				
Non-interest bearing checking	$ 1,475,888	$ 1,475,888	$ 1,474,215	$ 1,474,215
Interest bearing checking	413,291	413,291	346,991	346,991
Savings and money market deposits	1,080,774	1,080,774	1,011,029	1,011,029
Time deposits	861,489	861,489	853,631	853,631
Securities sold under repurchase agreements	595,991	595,991	551,293	551,293

NOTE 15 – RELATED PARTY TRANSACTIONS

The Bank and Queen City Investments, Inc. ("Queen City"), which is the parent company of the Farmers & Merchants Trust Company of Long Beach (the "Trust Company"), are considered affiliated parties as significant percentages of the outstanding shares of the Bank and Queen City are held by common shareholders, including

NOTE 15 – Related Party Transactions, continued

by certain directors and/or executive officers of the Bank. In addition, certain executive and other officers of the Bank serve as officers and/or directors of Queen City Investments and/or its subsidiaries, including the Trust Company.

The Bank and the Trust Company have entered into an Employee Leasing Agreement whereby the Bank provides the Trust Company with the services of various Bank employees and in return the Trust Company pays fees to the Bank for such employee services. In 2013 and 2012, the Trust Company paid the Bank $302,000 and $559,000, respectively, under this arrangement. In addition, the Bank and the Trust Company have entered into an Exchange of Services Agreement for the exchange of various other services, which agreement provides for the periodic settlement between the parties of the differences in the values of respective services provided by one party to the other. Under this arrangement, the Bank provides administrative, accounting and data processing services as well as office space to the Trust Company and the Trust Company provides trustee and financial management services to the Bank and maintains deposits with the Bank. In 2013 the Bank paid the Trust Company $30,000 for the difference between the values of services exchanged between the parties in 2012, and in 2012 the Trust Company paid the Bank $160,000 for the difference between the values of services exchanged between the parties in 2011.

The Bank has also leased two branch locations from Queen City. The Downey location was temporarily leased for $97,000 during 2012, pending purchase of the property by the Bank. The Torrance location is subject to an ongoing lease and the Bank paid $291,000 in rent for each of the years ended December 31, 2013 and 2012.

At December 31, 2013 and December 31, 2012, no loans were outstanding with any related party.

NOTE 16 – 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 $4.3 million and $3.9 million to the profit-sharing plan in 2013 and 2012, respectively. At December 31, 2013 and December 31, 2012, no shares of the Bank's stock are held by the trust created by the plan.

NOTE 17 – 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, 2013, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2013, the most recent notification from the Federal Reserve Bank categorized the Bank as

NOTE 17 – Regulatory Matters, continued

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 following 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	Rate	Amount	Rate	Amount	Rate
			(Dollars in thousands)			
As of December 31, 2013:						
Total Capital (to Risk-Weighted Assets)	$ 795,263	26.16%	≥ $ 243,219	≥ 8.0%	≥ $ 304,024	≥ 10.0%
Tier 1 Capital (to Risk-Weighted Assets)	$ 757,070	24.90%	≥ $ 121,609	≥ 4.0%	≥ $ 182,414	≥ 6.0%
Tier 1 Capital (to Average Assets)	$ 757,070	14.48%	≥ $ 209,122	≥ 4.0%	≥ $ 261,402	≥ 5.0%

	Actual		For Capital Adequacy Purposes:		To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Rate	Amount	Rate	Amount	Rate
			(Dollars in thousands)			
As of December 31, 2012:						
Total Capital (to Risk-Weighted Assets)	$ 741,402	29.61%	≥ $ 200,323	≥ 8.0%	≥ $ 250,404	≥ 10.0%
Tier 1 Capital (to Risk-Weighted Assets)	$ 709,832	28.35%	≥ $ 100,162	≥ 4.0%	≥ $ 150,242	≥ 6.0%
Tier 1 Capital (to Average Assets)	$ 709,832	14.24%	≥ $ 199,429	≥ 4.0%	≥ $ 249,286	≥ 5.0%

NOTE 18 – SUBSEQUENT EVENTS

The Bank has evaluated events that have occurred subsequent to December 31, 2013, and through April 23, 2014, the date that these financial statements were issued. On March 31, 2014, the Bank transferred $100.0 million from retained earnings to additional-paid-in capital with the approval of the Department of Business Oversight and the Board of Directors, and the concurrence of the Federal Reserve Bank. The transfer was completed for the purpose of complying with the limitation on investments in bank premises pursuant to the Federal Reserve Bank's Section 208.21(a) of Regulation H; it does not have an impact on total equity, capital ratios or net income.

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 CEO

W. Henry Walker, President

Kenneth G. Walker, President, Main Office

John W.H. Hinrichs, Chief Financial Officer

Phillip J. Bond, Chief Credit Officer

Melissa Lanfre, Chief Operating Officer

Independent Auditor

KPMG LLP

600 Anton Boulevard, Suite 700

Costa Mesa, CA 92626

Legal Counsel

Paul, Hastings, Janofsky & Walker LLP

695 Town Center Drive, 17th Floor

Costa Mesa, CA 92626

Investor Relations

PondelWilkinson Inc.

1880 Century Park East, Suite 350

Los Angeles, CA 90067

Transfer Agent

American Stock Transfer and Trust Company

6201 15th Avenue

Brooklyn, NY 11219

Securities Listing

Farmers & Merchants Bank's common stock is traded on the OTC Markets system (OTCQB) under the symbol FMBL.

Corporate Headquarters

302 Pine Avenue

Long Beach, CA 90802

Member FDIC

fmb.com

EQUAL HOUSING LENDER

Certain statements in this annual report may be forward-looking statements. Readers of this annual report should understand that all such forward-looking statements are inherently subject to risk and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by or underlying such forward-looking statements and the Bank's actual results or outcomes could differ materially from those anticipated.

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4545 California Ave.
Long Beach, CA 90807
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Corona del Mar*
2421 E. Coast Hwy.
Corona del Mar, CA 92625
(949) 723-1804

Downey*
9001 Firestone Blvd.
Downey, CA 90241
(562) 334-1836

East Long Beach
3140 E. Anaheim St.
Long Beach, CA 90804
(562) 621-1400

Fullerton*
315 N. Harbor Blvd.
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Garden Grove*
10422 Garden Grove Blvd.
Garden Grove, CA 92843
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Huntington Beach*
7125 Yorktown Ave.
Huntington Beach, CA 92648
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23772 Rockfield Blvd.
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621 N. El Camino Real
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Tustin*
2691 Park Ave.
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***Open Saturdays from 9:00 am to 12:00 pm**

F&M BANK

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