



2017 Annual Report



110 Years.

\$7 Billion in Assets.

4 Generations of Leadership.

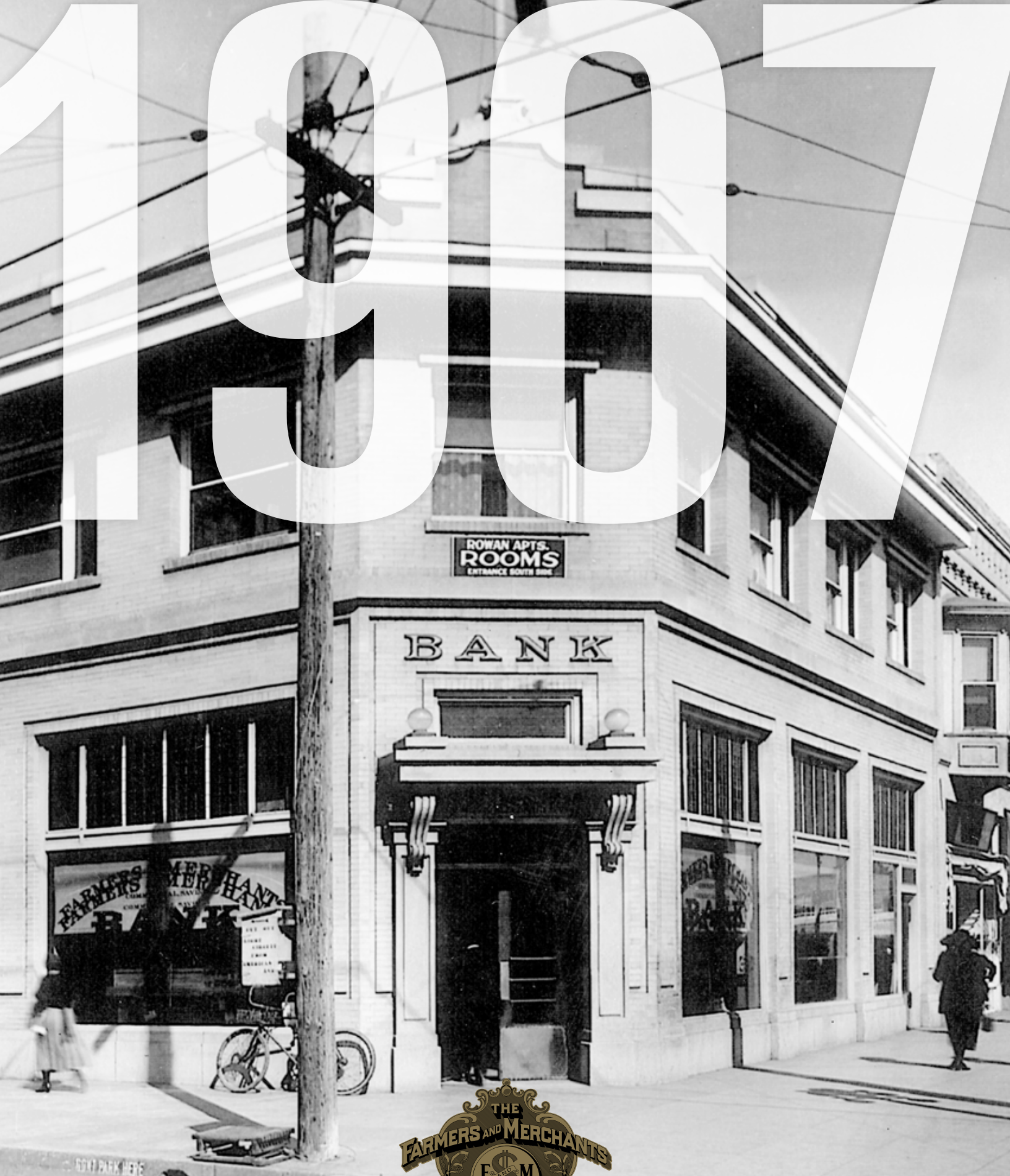
1 Steadfast Pillar in the Community.

California's Strongest, since 1907.

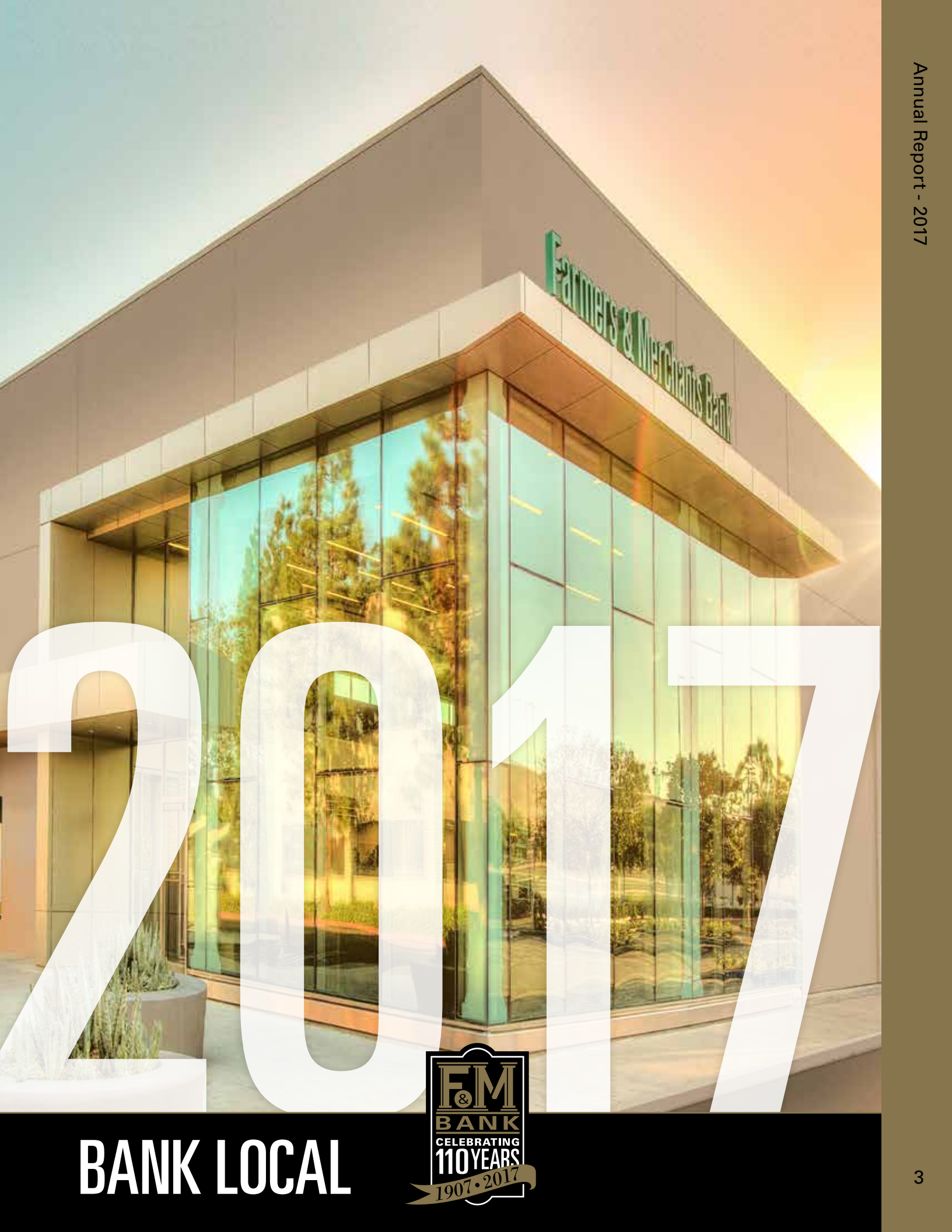


Farmers & Merchants Bank
2017 Annual Report

1907



BUILD LOCAL



2017

BANK LOCAL



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Financial Report



Today

Our Balance Sheet as of 12/31/2017

\$7.0 Billion

In Total Assets

\$5.4 Billion

In Total Deposits

\$3.8 Billion

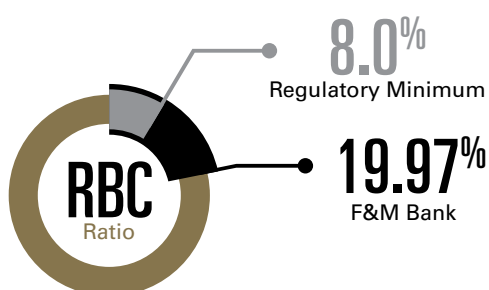
In Total Net Loans

\$959.1 Million

Total Stockholders' Equity

130,928

Total Shares Outstanding



F&M's total risk-based capital (RBC) was 19.97% on 12/31/17, over DOUBLE the federally mandated adequacy levels.

Our Stats

24 Offices

In Southern California

747

Employees

8.2 Years

Average Employee Tenure

30%

Of employees have been at F&M for over 10 years

1,799 Hours

Of community service time in 2017 by F&M employees



Facebook



Instagram



YouTube



Yelp

18.67 Million

Impressions in 2017 across F&M's four social media platforms.



Our Values for 110 Years

Honesty

Integrity

The Home

The Church

Service above Self



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BANK LOCAL



Board of Directors

Daniel K. Walker

Chairman of the Board

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

Timothy W. Jackert

Board Member

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

Richard W. Darling

Board Member

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.

Lawrence J. McLaughlin

Board Member

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 land leasing company.

Walter M. Florie

Board Member

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

Timothy M. Wilson

Board Member

From October, 2009 through December, 2017, Mr. Wilson served as President of Mitchell Land and Improvement Co., a commercial real estate development and investment company. He retired in January, 2018, and was elected to the company's Board of Directors where he now serves in that role.

William G. Hayter

Board Member

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.





California's



Strongest

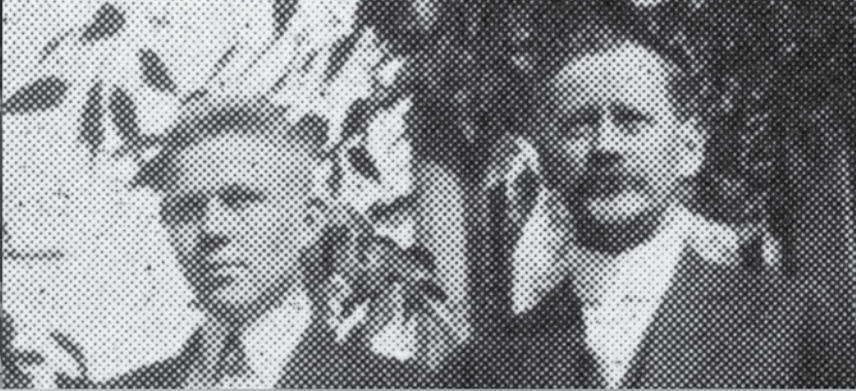
A black and white portrait of a man with a mustache, wearing a suit and tie. The portrait is enclosed in an oval frame with decorative flourishes at the top corners. The man is looking slightly to the left of the camera.

YOUNG MEN'S
CHRISTIAN
ASSOCIATION
A.D. 1921
TO THE GLORY OF GOD
IN SERVICE FOR MEN
AND BOYS



THE
FARMERS AND MERCHANTS





BANKER PROVES HE'S GOOD FIREFIGHTER

Gus Walker, president of the Farmers & Merchants Bank, proved yesterday that he is an able fireman as well as a good banker.

Last evening when the fire broke out in the building next to his bank, Walker grabbed a fire hose in the bank building, hauled it to the roof and proceeded to battle the blaze like a veteran fire-eater.



Banker Honored by Association

G. A. Walker, president of the Farmers & Merchants Bank, today was elected a member of the executive council of the California Bankers' Association for three years at

the closing session of the 56th anniversary convention of the Association at Hotel Del Coronado, Coronado.

William A. Marms, vice president of the American Trust Co., of San Francisco, was elected president, succeeding Mark G. McMahon, of Glendale.



G. A. WALKER



Gus Walker
President of F&M Bank from 1937-1979



Gus A. Walker Elected Head of Clearing House

GUS A. WALKER, president of the Farmers & Merchants Bank, was elected president of the Long Beach Clearing House Association last night, succeeding F. E. Hatch, dean of Long Beach bankers who had served as president of the Clearing House since its organization in 1910. Mr. Hatch recently retired from active banking.

J. R. Davis, vice president and manager of the Long Beach office of the Bank of America, was re-elected secretary and manager, a position that he has held for 13 years.

Members of the executive committee are Warren A. Harlan, president of the Western Bank; C. C. Jameson, vice president and

Middough Again Head of Crime Curb Committee

Lorne Middough, Long Beach representative to the State Assembly, was re-elected today to the chairmanship of the crime and correction committee of the Assembly; also he was assigned to a committee ordered to investigate charges of brutality at the Preston State School of Industry.

The investigation committee will open its inquiry at the school Monday. It will question O. B. Close, superintendent, suspended by Karl Helton, director of the State Youth Authority. A San Francisco Assemblyman, Edward F. O'Day, chairman of the committee, has said that he found three near-nude youths shivering in unheated cells at the school.

Fred Kraft (R-San Diego) was named chairman of the committee to handle Gov. Earl Warren's compulsory health insurance plan.

Walter Foster (R-Ventura) will be in charge of the Governor's program to maintain state tax rates at present levels.

C. Don Field (R-Glendale) will head the committee on government efficiency and economy.

Albert Woltersberg (R-San Francisco) heads the ways and means committee.



GUS A. WALKER

manager of the Security First National Bank, Mr. Walker and Mr. Davis.

The Clearing House Association, of all Long Beach bankers, has functioned for 35 years. It



CHAIRMAN OF THE BOARD STILL RUNNING THE BUSINESS F & M's Gus Walker Going Strong At 90

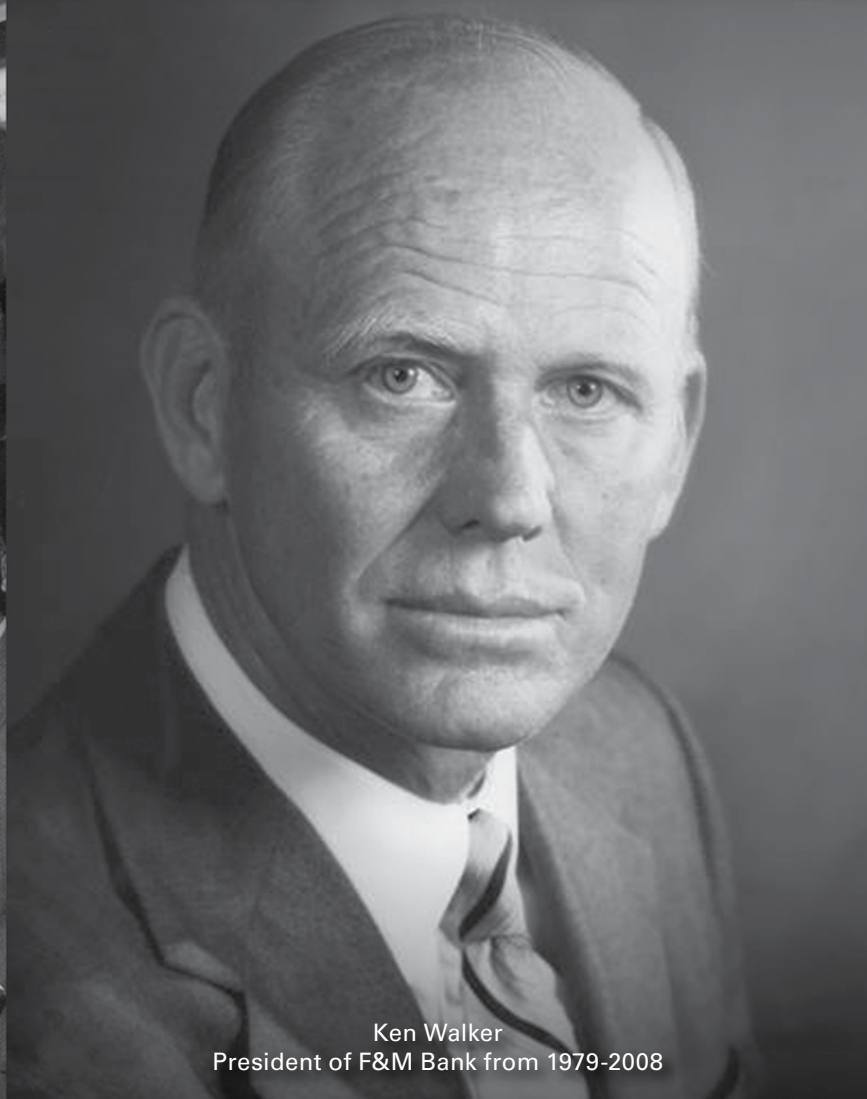
By Mike Fisher
Gus Walker is not retiring — not in any way. The chairman of the board of Farmers and Merchants (F&M) Bank of Long Beach continues his daily hands-on management from his balcony office, which overlooks the banking floor.



Walker spends a typical day at the 301 Pine Ave., F&M headquarters "teasing and selling securities," he said, "and changing the balances of correspondent banks so they don't get too high, and we can make them come to something."



BANK LOCAL



Ken Walker
President of F&M Bank from 1979-2008

CALIFORNIA'S STRONGEST BANK HAS FAMILY TIES

LONG BEACH'S F & M BANK

By William McElharry

With a net worth-to-asset ratio of 17 percent, almost three times the FDIC guidelines, and enough cash, government bonds, and high-grade municipal bonds to cover total deposits of \$587 million at the close of 1985, Farmers & Merchants Bank is considered one of California's strongest banks.

The Long Beach-based bank, which has seven branch offices in Orange County, is run by the father-and-son team of Gus Walker, chairman of the bank, and Kenneth Walker, president. They attribute the bank's strength — and longevity — to conservative practices.

"According to Kenneth Walker, 'When you realize that the size of the bank is related to the amount of deposits and these are liabilities, not assets, of the bank, the fiduciary responsibility of management is very clear. We are responsible first to our depositors, second to our stockholders and third to our employees — in that order of priority.'"

Though native to New York state, the sons of the Walker family began about 1890 when young C.J. Walker rode headback from Kansas City to California, following his father and eventually settling in the Long Beach area. Marrying a lady from the Fresno

bank moved into their present headquarters on Pine Street in Long Beach, a strikingly nostalgic building that transports the visitor back in time in spite of the obvious technology of a modern full service retail bank. Between Gus and Kenneth, they are celebrating a century in the banking business this year.

C.J. Walker's policy of capital accumulation to insure and protect the bank as well as its customers has been faithfully and consistently maintained by two succeeding generations and, according to Kenneth Walker, referring to his children and grandchildren, should they choose to stay in banking. "We're covered for the next two generations."

Fiduciary responsibility exists in all depository institutions — why then have others failed?

"Because they weren't good in their trust responsibilities," Kenneth Walker responded. As to how the bank avoided the bad energy and real estate loans that have crippled other banks, he continued, "You can learn from past experience and history. This bank has been associated with oil production back to the early 1920s, when they first hit oil on Signal Hill."

Most bank managers "grew up in the bank in Long Beach," and Garden Grove branch manager Melvin Markler

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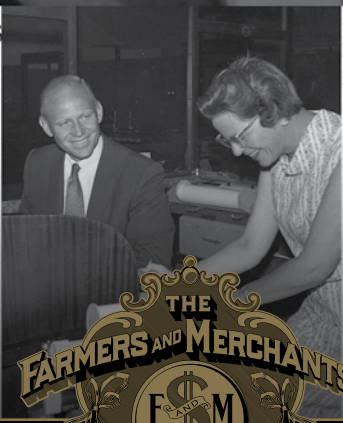
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Most bank managers "grew up in the bank in Long Beach," and Garden Grove branch manager Melvin Markler



Kenneth and Gus Walker carry on family banking traditions.



National Conference honorees



Ken Walker heads the family business, the Farmers and Merchants Bank. Throughout his career, he has been involved in numerous philanthropic activities.

Walking the philanthropic walk

Hospital Board Chief

Kenneth G. Walker, executive vice president of Farmers and Merchants Bank, has been elected president of the board of directors of Memorial Hospital of Long Beach.

He succeeds R.J. Munzer.

Walker has twice served terms as vice president on the board and has been a trustee and director for 12 years.

The new president said he will try to see that the hospital invests in the best medical care and that it attains quality patient care through a healthy financial organization.

He stressed, however, that the hospital must succeed as an efficient operation "without losing personal relationships."



KENNETH G. WALKER



Daniel K. Walker
Chairman of the Board & CEO

W. Henry Walker
President



California's



Strongest

Dear Fellow Shareholders

Farmers & Merchants Bank's independence and financial strength have remained constant since it was founded more than 110 years ago. The Bank is proud to have built relationships with its clients and community that span several generations.

F&M's deep roots are evident as soon as you walk into our main branch in Long Beach, which opened its doors in the 1920s. Robust technology back then consisted of a strong safe and a ventilation system to keep patrons and employees comfortable.

Fast forward more than nine decades later, and F&M is powered by technology that encompasses mobile banking, complete with a digital wallet offering and the highest standards in cybersecurity.

Keeping our clients' deposits safe has been a priority since C.J. Walker founded the Bank in 1907. We continued that tradition in 2017 by investing approximately \$7 million in F&M's infrastructure to further enhance the systems that are necessary for a bank of our size.

We strive to strike a balance between offering the latest conveniences and technology of a contemporary bank, while also retaining the personalized customer service that differentiates F&M from its competitors.

In this year's annual report, we are highlighting three client categories for which F&M has great passion and experience – healthcare, education and religious services. Each meaningful category exemplifies how F&M's relationships with its clients are more than simply transactional. Our clients are teachers who educate our families. They are doctors who care for our sick. And they are leaders of faith and places of worship that instill values in our community.

The valued work of these professionals parallels F&M's commitment to maintaining the financial health of the Bank. Perspective is hard to come by in an industry rife with consolidation and seemingly little differentiation. Fortunately for F&M, perspective and differentiation are characteristics in which we excel after more than a century of serving clients and navigating wide economic swings. All this, and more, are just part of what continues to make F&M Bank *California's Strongest*.

Profitable Since 1907

F&M has been profitable since it was founded, and we continued to achieve profitability in 2017, despite the protracted period of historically low interest rates.

Total interest and dividend income for the year ended December 31, 2017, was \$238.9 million, compared with \$222.9 million reported for 2016. Interest expense for the full 2017 year was \$14.4 million versus \$10.3 million in 2016.

Net interest income for 2017 was \$224.6 million, versus \$212.6 million in 2016. Farmers & Merchants' net interest margin was 3.43% for the year ended December 31, 2017, compared with 3.51% in the previous year.



BUILD LOCAL

The Bank's provision for loan losses was \$1.0 million for the year ended December 31, 2017, while the Bank did not record a provision for loan losses for the year ended December 31, 2016. The Bank's allowance for loan losses as a percentage of loans outstanding was 1.53% at December 31, 2017, compared with 1.64% at December 31, 2016.

Non-interest income for the full 2017 year totaled \$28.9 million, compared with \$25.2 million for the full 2016 year.

Non-interest expense for the year ended December 31, 2017, was \$161.8 million, compared with \$143.5 million last year.

The Bank's net income for 2017 was \$64.8 million, or \$494.65 per diluted share, compared with \$71.5 million, or \$546.16 per diluted share, for 2016. Net income for 2017 included \$6.8 million of additional income tax expense recognized, or \$52.30 per diluted share, related to the Tax Cuts and Jobs Act.

Solid Balance Sheet

F&M generated solid loan growth and maintained strong liquidity levels in 2017. At December 31, 2017, net loans totaled \$3.83 billion, compared with \$3.40 billion at December 31, 2016. Investment securities aggregated \$2.84 billion at December 31, 2017 versus \$2.95 billion at December 31, 2016.

Deposits, the Bank's primary funding source, grew to \$5.39 billion at the end of 2017, from \$5.12 billion at December 31, 2016. Non-interest-bearing deposits represented 37.6% of total deposits at December 31, 2017, versus 37.7% of total deposits at December 31, 2016. Total assets increased to \$6.99 billion at the close of 2017 from \$6.73 billion at December 31, 2016.

At December 31, 2017, Farmers & Merchants Bank remained "well-capitalized" under all regulatory categories, with a total risk-based capital ratio of 19.97%, a tier 1 risk-based capital ratio of 18.72%, a common equity tier 1 capital ratio of 18.72%, and a tier 1 leverage ratio of 13.45%. The minimum ratios for capital adequacy for a well-capitalized bank are 10.00%, 8.00%, 6.50% and 5.00%, respectively.

In a Position of Strength

F&M is in a position of strength, now in its 111th year of serving Southern California. We are focused on continuing to cultivate relationships with new and existing clients, demonstrating why banking with F&M provides a depth of knowledge and experience few other institutions can offer.

We also maintain our concentration on investing in the Bank's future, ensuring that F&M is prepared to continue to grow and provide high-quality services and products that appeal to a diverse client base. Specifically, we look forward to serving new clients this year with the opening of a branch in Santa Barbara.

None of this would be possible without the dedication of our talented employees, loyal trust of our clients, support from our shareholders, and guidance by our Maker. Thank you, as we continue to grow together and forge ahead in this exciting era for F&M.



Daniel K. Walker
Chairman of the Board & CEO



W. Henry Walker
President



BANK LOCAL

Financial Information

Diluted Earnings per Common Share (in Dollars)	2017 \$495	2016 \$546	2015 \$496	2014 \$477	2013 \$475
Dividends Declared per Common Share (in Dollars)	2017 \$119	2016 \$119	2015 \$119	2014 \$114	2013 \$114
Net Interest Margin (in Percents)	2017 3.43%	2016 3.51%	2015 3.63%	2014 3.50%	2013 3.30%
Overhead Efficiency Ratio (in Percents)	2017 62.08%	2016 58.80%	2015 56.62%	2014 55.21%	2013 51.72%
Average Assets (Dollars in Millions)	2017 \$6,942	2016 \$6,407	2015 \$5,804	2014 \$5,452	2013 \$5,136
Total Risk-Based Capital (in Percents)	2017 19.97%	2016 20.85%	2015 21.33%	2014 23.59%	2013 26.16%



Corporate Profile

Farmers & Merchants Bank is a full-service, California-state-chartered bank with \$6.99 billion in total assets at December 31, 2017. Founded in Long Beach in 1907 by C.J. Walker, the Bank specializes in commercial and small business banking, business loan programs, home loans, and a robust offering of consumer retail banking products, including checking, savings and youth accounts. Farmers & Merchants Bank is one of California's strongest banks, as demonstrated by several characteristics, including financial performance, heritage, culture, longevity, character, customer service and values.

Values in Our Community

This year's annual report highlights three prominent client categories for which Farmers & Merchants Bank has great passion and experience, including healthcare, education, and religious services. Each of these categories is indicative of the Bank's community, which is composed of teachers who educate our families, doctors who care for our sick, and leaders of faith and places of worship that instill values.



Daniel K. Walker

Chairman of the Board
Chief Executive Officer



W. Henry Walker

President



John W.H. Hinrichs

Executive Vice President,
Chief Financial Officer



Phillip J. Bond

Executive Vice President,
Chief Credit Officer



Melissa Lanfre

Executive Vice President,
Chief Operating Officer

California's



Strongest



Supporting Healthcare for 110 Years

Farmers & Merchants Bank has a long, storied history of serving the healthcare community that started at Seaside Hospital in Long Beach (pictured above and below) in 1907. F&M Bank financed the loan for the Hospital's current campus, since renamed Long Beach Memorial Medical Center/Miller Children's Hospital, and opened a branch there in 1980. Today, F&M Bank's Healthcare Client Services Center (HCSC) will make you feel confident in your banking partner.



BUILD LOCAL

The Children's Clinic, Serving Children & Their Families



"We take great pride in providing the very best services to our community and patients, and we share many of the same values at Farmers & Merchants Bank," said Dr. Elisa Nicholas, Chief Executive Officer of Long Beach, California-based The Children's Clinic (TCC), Serving Children & Their Families, which provides access to health and wellness services for all ages, particularly those who are from low-income families and who are at greatest risk for health problems. "Similar to our organization, F&M has extremely deep roots in the community and understands the importance of taking care of the people and families who live and work in Long Beach."

TCC CEO, Dr. Elisa Nicholas, MD, MSPH, with Sophia

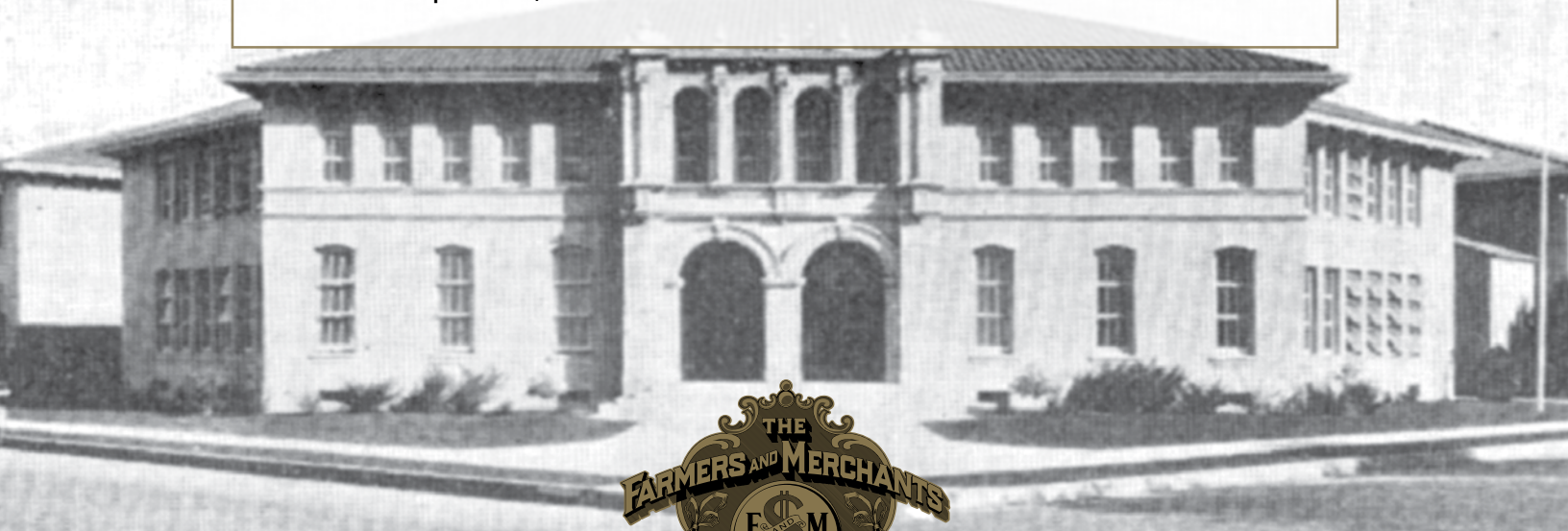
BANK LOCAL





Supporting Education for 110 Years

Farmers & Merchants Bank's emphasis on education predates the Bank's founding in 1907. Carrie Walker, wife of F&M founder C.J. Walker and graduate of what is today known as UCLA, began teaching children in Long Beach in 1894. After F&M financed the construction of Pine Avenue School (pictured above) and Theodore Roosevelt Elementary (pictured below), among others, second generation F&M Bank president, Gus Walker, continued that tradition by purchasing \$1.85 million in school bonds from the Long Beach Unified School District to support the construction of the much-needed Elizabeth Hudson Elementary. Even today, F&M Bank believes the funding of an academically sound public education system is not only an essential civic component, but also a wise investment.



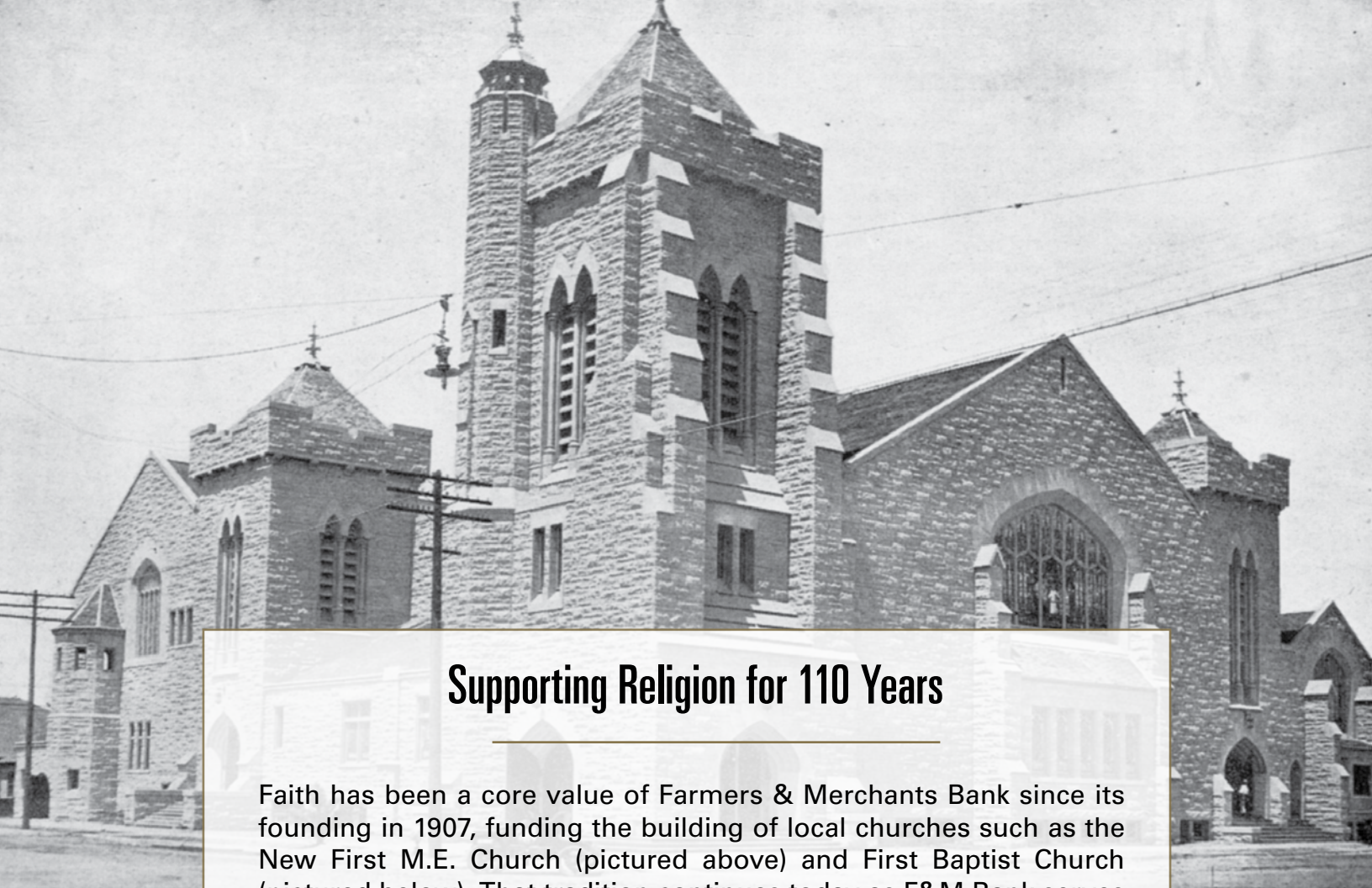
Minnie Gant Elementary School



"As a parent, it's important to feel like you have support at your kid's school, and the same goes for our PTA when choosing a banking partner," said Gennifer Billish, president of the Parent-Teacher Association at Minnie Gant Elementary School in Long Beach. "We maximize the funds we receive to help every student as much as possible, and we feel that F&M has the same values when helping its community," said Jessica Reed (pictured), treasurer of the Parent-Teacher Association at Minnie Gant. "Every time I walk into F&M's office, they know who I am immediately and clearly care deeply about our needs as a PTA."

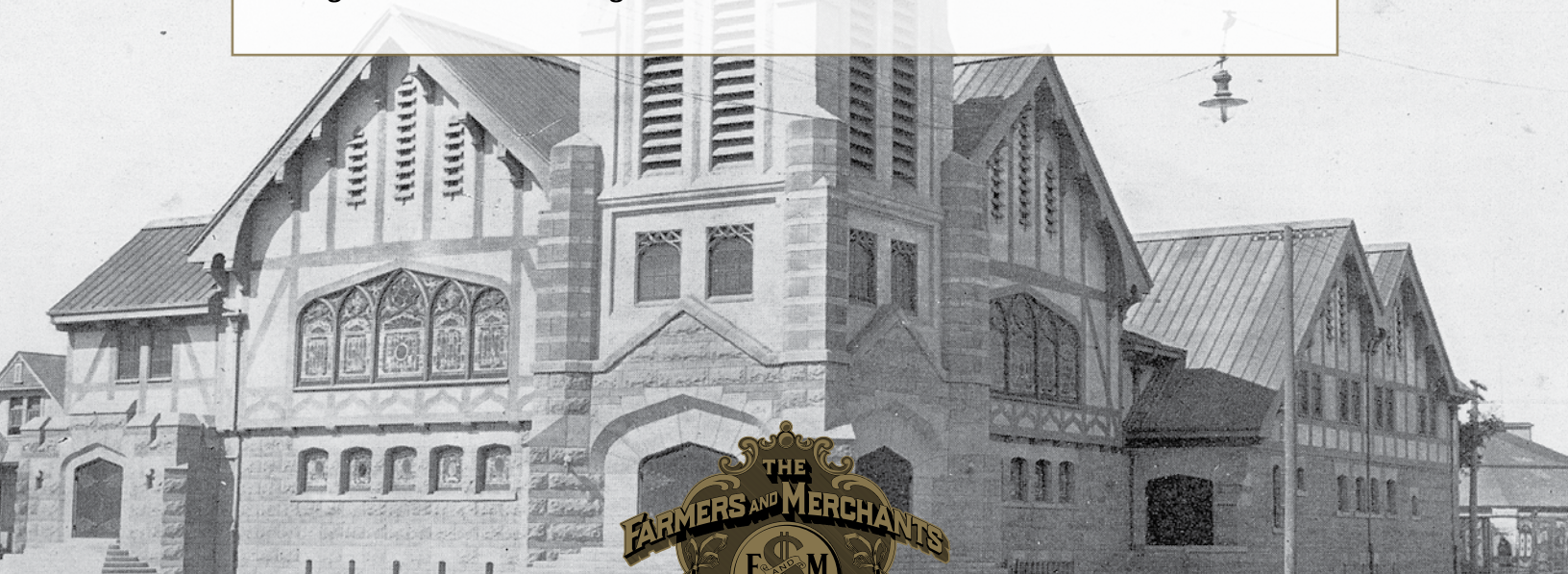
Minnie Gant PTA Treasurer Jessica Reed with Minnie Gant students





Supporting Religion for 110 Years

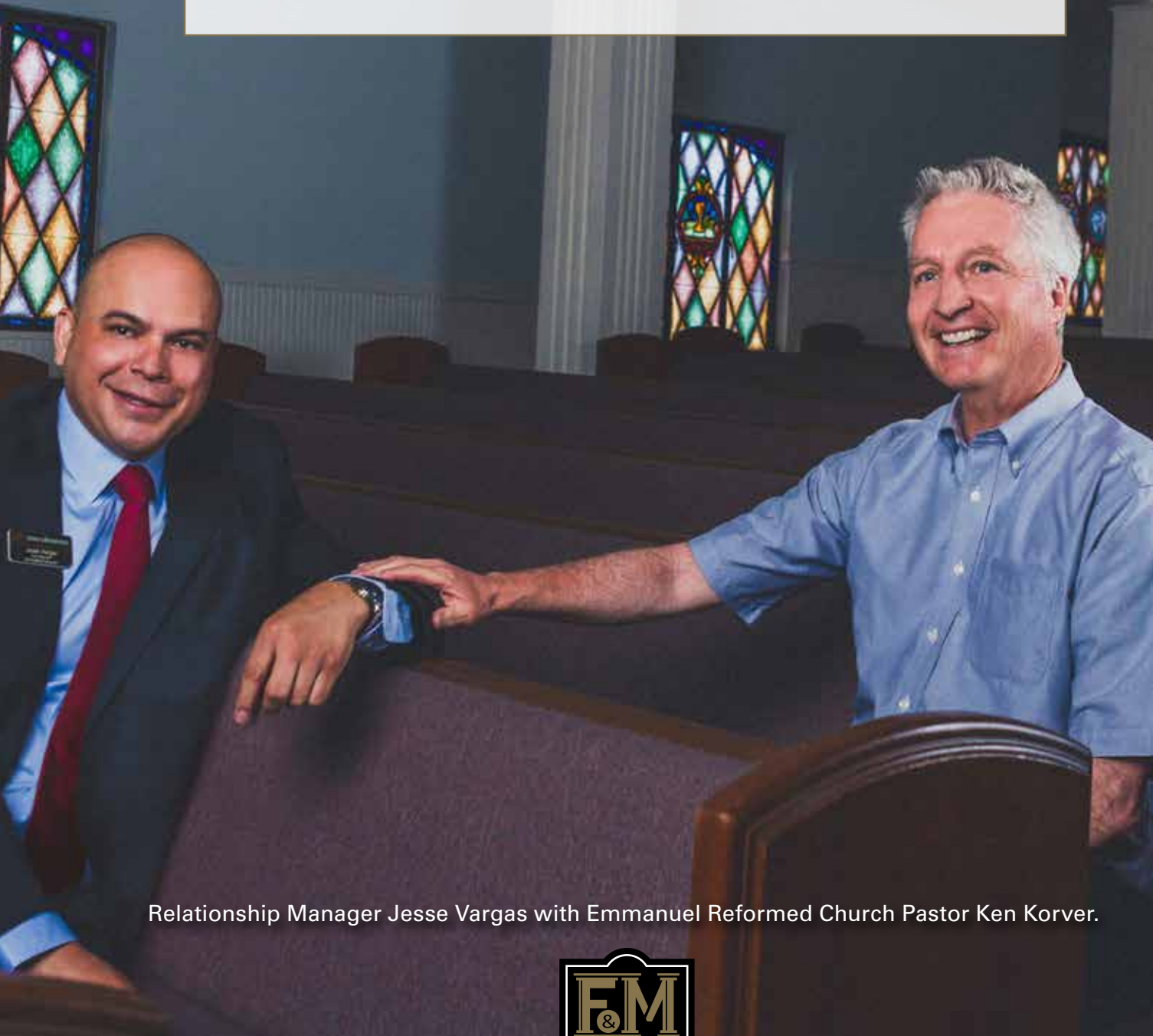
Faith has been a core value of Farmers & Merchants Bank since its founding in 1907, funding the building of local churches such as the New First M.E. Church (pictured above) and First Baptist Church (pictured below). That tradition continues today as F&M Bank serves a diverse clientele of religious organizations through the newly established Religious Client Services department. At F&M, faith-based organizations find a partner who not only understands the complexities of their business, but also supports local communities by donating over \$1 million each year to charities, nonprofit organizations and religious entities.



BUILD LOCAL

Emmanuel Reformed Church

"As Christians, we are servants looking to help people around us. We find the same values at F&M," said Pastor Ken Korver from Emmanuel Reformed Church in Paramount, California. "F&M has been serving the community for a long time, and you can see and feel how the Bank's values come from faith and heart."



Relationship Manager Jesse Vargas with Emmanuel Reformed Church Pastor Ken Korver.

BANK LOCAL







Mobile Check Deposit



Pin and Chip Credit Cards



Instant Issue Debit Cards



Touch ID

California's



Strongest

FARMERS & MERCHANTS BANK OF LONG BEACH
UNDIVIDED PROFITS --- 1978

EARNINGS

INTEREST ON LOANS	\$ 11,617,663.59
INTEREST ON INVESTMENTS	13,071,273.48
OTHER EARNINGS, FEES & SERVICE CHARGES	3,364,912.09
TOTAL GROSS EARNINGS	28,053,849.16

EXPENSES

SALARIES	\$ 3,319,130.39
INTEREST PAID ON SAVINGS	8,330,194.49
DEPRECIATION, TAXES & ASSESSMENTS	734,221.89
OTHER OPERATING EXPENSES	2,178,864.94
NONRECURRING SECURITY & LOAN RESERVE VALUATION	4,725,232.64
TAXES PAID (INCOME)	4,238,053.79
TOTAL EXPENSES	23,525,698.14
NET PROFIT AFTER TAXES	4,528,151.02
DIVIDENDS	1,200,000.00
NET ADDITION TO UNDIVIDED PROFITS	3,328,151.02
CAPITAL ACCOUNTS -12-31-77	31,813,564.83
CAPITAL ACCOUNTS -12-31-78	35,141,715.85

Chalkboard from the 1978 F&M Bank Shareholders Meeting

2017 Financial Report

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Statements of Cash Flows

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Notes to Financial Statements



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

Independent Auditors' Report

To 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, 2017 and 2016, and the related statements of income, comprehensive 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, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP is a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.



Report on Internal Control Over Financial Reporting

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the Bank's internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated April 23, 2018 expressed an unmodified opinion on the effectiveness of the Bank's internal control over financial reporting.

KPMG LLP

Irvine, California
April 23, 2018

Farmers & Merchants Bank of Long Beach

Balance Sheets

	December 31,	
	2017	2016
	(In thousands, except share and per share data)	
<u>Assets</u>		
Cash and due from banks:		
Non-interest bearing balances	\$ 56,604	\$ 63,797
Interest-bearing balances	43,512	84,918
Total cash and due from banks	100,116	148,715
Securities available-for-sale, at fair value	187,102	182,320
Securities held-to-maturity, at amortized cost	2,657,796	2,762,877
Loans held for sale	15,038	6,080
Gross loans	3,899,110	3,466,382
Allowance for loan losses	(59,502)	(56,867)
Unamortized deferred loan fees, net	(5,611)	(5,314)
Loans, net	3,833,997	3,404,201
Other real estate owned, net	-	791
Investments in FHLB and FRB stock, at cost	20,690	20,690
Premises and equipment, net	95,550	87,775
Deferred tax assets, net	20,726	30,281
Other assets	60,563	85,328
Total assets	<u>\$ 6,991,578</u>	<u>\$ 6,729,058</u>
<u>Liabilities and Stockholders' Equity</u>		
Liabilities:		
Deposits:		
Non-interest-bearing deposits	\$ 2,026,237	\$ 1,931,931
Interest-bearing deposits	3,364,874	3,191,026
Total deposits	5,391,111	5,122,957
Securities sold under repurchase agreements	614,410	540,035
Other borrowings	-	100,000
Other liabilities	26,937	55,753
Total liabilities	6,032,458	5,818,745
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	112,044	112,044
Retained earnings	844,370	795,187
Accumulated other comprehensive income	87	463
Total stockholders' equity	959,120	910,313
Total liabilities and stockholders' equity	<u>\$ 6,991,578</u>	<u>\$ 6,729,058</u>

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach

Statements of Income

	Years Ended December 31,	
	2017	2016
	(In thousands, except per share data)	
Interest and dividend income:		
Loans	\$ 172,772	\$ 161,799
Investment securities	63,155	57,823
Investments in FHLB and FRB stock	1,460	2,305
Interest-bearing deposits in financial institutions	1,550	963
Total interest and dividend income	238,937	222,890
Interest expense:		
Deposits	10,037	8,452
Securities sold under repurchase agreements	4,252	1,877
Other borrowings	66	5
Total interest expense	14,355	10,334
Net interest income	224,582	212,556
Provision for loan losses	1,000	-
Net interest income after provision for loan losses	223,582	212,556
Non-interest income:		
Service charges on deposit accounts	3,971	3,930
Other real estate owned income	17	27
Merchant bankcard income	10,773	10,298
Other income	14,162	10,976
Total non-interest income	28,923	25,231
Non-interest expense:		
Salaries and employee benefits	85,086	77,190
FDIC and other insurance expense	2,574	2,963
Occupancy expense	9,252	10,433
Software and equipment expense	9,380	7,337
Other real estate owned expense	(605)	(62)
Merchant bankcard expense	8,486	8,040
Professional and legal services	6,024	5,649
Marketing expense	5,307	6,396
Other expense	36,341	25,587
Total non-interest expense	161,845	143,533
Income before income tax expense	90,660	94,254
Income tax expense	25,896	22,746
Net income	\$ 64,764	\$ 71,508
Basic and diluted earnings per common share	\$ 494.65	\$ 546.16

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach

Statements of Comprehensive Income

	Years Ended December 31,	
	2017	2016
	(In thousands)	
Net income	<u>\$ 64,764</u>	<u>\$ 71,508</u>
Other comprehensive loss, net of tax:		
Unrealized losses on securities available-for-sale:		
Unrealized holding losses arising during the period	<u>(376)</u>	<u>(946)</u>
Other comprehensive loss	<u>(376)</u>	<u>(946)</u>
Comprehensive income	<u><u>\$ 64,388</u></u>	<u><u>\$ 70,562</u></u>

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach

Statements of Changes in Stockholders' Equity

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	(In thousands)				
Balance, December 31, 2015	\$ 2,619	\$ 112,044	\$ 739,259	\$ 1,409	\$ 855,331
Net income	-	-	71,508	-	71,508
Cash dividends	-	-	(15,580)	-	(15,580)
Other comprehensive loss, net of tax	-	-	-	(946)	(946)
Balance, December 31, 2016	\$ 2,619	\$ 112,044	\$ 795,187	\$ 463	\$ 910,313
Net income	-	-	64,764	-	64,764
Cash dividends	-	-	(15,581)	-	(15,581)
Other comprehensive loss, net of tax	-	-	-	(376)	(376)
Balance, December 31, 2017	\$ 2,619	\$ 112,044	\$ 844,370	\$ 87	\$ 959,120

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach

Statements of Cash Flows

	Years Ended December 31,	
	2017	2016
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 64,764	\$ 71,508
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization on securities	25,069	24,066
Provision for loan losses	1,000	-
Originations of loans held for sale	(75,212)	(93,115)
Proceeds from sale of loans held for sale	67,577	91,846
Gain on sale of loans held for sale	(1,323)	(1,643)
Gain on sale of other real estate owned	(9)	(15)
Amortization of tax credit investments	24,076	18,880
Gain on sale of bank premises	(2,815)	-
Depreciation of bank premises and equipment	6,968	7,148
Addition of reserve for losses on unfunded loan commitments	1,300	600
Decrease (increase) in deferred income tax benefit	9,936	(1,692)
Decrease (increase) in other assets	689	(11,456)
Decrease in other liabilities	(3,012)	(3,185)
Total adjustments	54,244	31,434
Net cash provided by operating activities	119,008	102,942
Cash flows from investing activities:		
Securities available-for-sale:		
Proceeds from maturities and pay downs	75,095	76,804
Purchases	(84,295)	(59,276)
Securities held-to-maturity:		
Proceeds from maturities and pay downs	404,186	405,833
Purchases	(320,405)	(824,224)
Net increase in loans held for investment	(430,796)	(186,158)
Proceeds from sale of other real estate owned	800	575
Increase of tax credit investments	(27,212)	(12,190)
Proceeds from sale of bank premises	2,937	-
Purchases of bank premises and equipment	(14,865)	(8,142)
Net cash used in investing activities	(394,555)	(606,778)

Farmers & Merchants Bank of Long Beach

Statements of Cash Flows

Statements of Cash Flows, continued

	Years Ended December 31,	
	2017	2016
	(In thousands)	
Cash flows from financing activities:		
Net increase in deposits	268,154	432,991
Net increase (decrease) in securities sold under repurchase agreements	74,375	(32,880)
Net (decrease) increase in other borrowings	(100,000)	100,000
Cash dividends paid	(15,581)	(15,580)
Net cash provided by financing activities	226,948	484,531
Net decrease in cash and due from banks	(48,599)	(19,305)
Cash and cash equivalents at beginning of year	148,715	168,020
Cash and cash equivalents at end of year	\$ 100,116	\$ 148,715
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest expense	\$ 10,006	\$ 8,524
Income taxes	13,540	29,719
Non-cash investing and financing activities		
New commitment to fund tax credit investments	\$ -	\$ 28,103

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach

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 bank that offers a broad range of banking products and services to individuals, professionals and small to medium-sized businesses. The Bank operates 24 branches in California’s Los Angeles County and Orange County as of December 31, 2017. As a full-service commercial bank, FMB offers a broad range of banking products and services including: accepting demand, money market, savings, and time deposits; originating loans, including commercial real estate loans, construction loans, and commercial business loans; and providing other business-oriented banking products and services. The Bank also provides financing for residential loans including single-family and multifamily 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 governments 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 balance sheets, statements of income, 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 fair value of securities available-for-sale, the reserve for other real estate owned, realization of deferred tax assets, and the fair value of financial instruments. Actual results could differ from those estimates.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year’s presentation. These reclassifications did not affect previously reported net income.

Cash and Due from Banks

For purposes of the statements of cash flows, cash and cash equivalents consist of cash and due from banks, which comprise non-interest-bearing balances and interest-bearing balances. Interest-bearing balances represent cash held at the Federal Reserve Bank of San Francisco (“FRBSF”), the majority of which is immediately available.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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

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

At the time of purchase, the Bank classifies its securities into one of two categories: available-for-sale and held-to-maturity. If the Bank has the ability and positive intent at the time of purchase to hold securities until maturity, they are classified as held-to-maturity. All securities not identified as held-to-maturity are classified as available-for-sale. Securities held-to-maturity are recorded at cost, adjusted for the amortization of premiums and accretion of discounts on a level-yield basis. Securities available-for-sale are carried at estimated fair value with unrealized holding gains and losses, net of the related tax effect, excluded from income and reported as a separate component of stockholders' equity identified as accumulated other comprehensive income until realized.

Transfers of securities between categories, if any, are recorded at fair value at the date of the transfer. Unrealized holding gains or losses included in the separate component of equity for securities transferred from available-for-sale to held-to-maturity would be maintained and amortized into income over the remaining life of the security as an adjustment to the yield in a manner consistent with the amortization of premium or accretion of discount on the associated security.

If a decline in market value of any security held-to-maturity or available-for-sale 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 is 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 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.

The Bank's security portfolio is managed to meet our liquidity needs through proceeds from scheduled maturities and is also utilized for pledging requirements for deposits of state and local subdivisions, securities sold under repurchase agreements, and Federal Reserve Bank ("FRB") Discount Window borrowings.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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

Loans Held for Sale

Loans held for sale are carried at the lower of cost or fair value. Origination fees on loans held for sale, net of certain costs of processing and closing the loans, are deferred until the time of sale and are included in the computation of the gain or loss from the sale of the related loans. Gains and losses are recorded in non-interest income based on the difference between sales proceeds, net of sales commissions, and carrying value.

The Bank will occasionally transfer loans from held for investment to held for sale. Upon transfer, any associated allowance for loan losses is charged off and the carrying value of the loan is adjusted to the lower of cost or estimated fair value. Gains or losses on the sale of these loans are recorded in non-interest income.

Loans

Loans that the Bank has the intent and ability to hold for the foreseeable future, or until maturity, are reported at the principal amounts outstanding, net of the allowance for loan losses and unamortized deferred net loan fees or costs. Nonrefundable fees and direct costs associated with the origination or purchase of loans are deferred and netted against outstanding loan balances. The deferred net loan fees and costs are recognized in interest income on an effective yield basis over the contractual loan term. Interest income on loans is recorded on an accrual basis in accordance with the terms of the respective loan.

Nonaccrual Loans

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when interest or principal payments are past due 90 days or when, in the opinion of management, there is a reasonable doubt as to collectability in the normal course of business. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income, and all interest received on nonaccrual loans will be applied to principal. Loans are restored to accrual status when principal and interest are brought fully current and when, in the opinion of management, 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.

Troubled Debt Restructured Loans

A loan is classified as a troubled debt restructured loan (“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 are not insignificant, or that it would not otherwise consider for market participants with similar risk characteristics. 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

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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

Troubled Debt Restructured Loans, continued

are in compliance with their modified terms and the modifications were made at market rates for borrowers 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.

Impaired Loans

Loans are considered impaired when it is probable that the Bank will be unable to collect all amounts due according to the original contractual terms. Impaired loans include loans on nonaccrual status and restructured 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 and external 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: a general allowance for loans not considered impaired and a specific allowance for loans determined to be impaired.

The methodology the Bank uses to estimate the general allowance component of our ALL is the classification migration methodology, which considers both objective and subjective criteria. The objective criteria uses the Bank's actual historical loan charge-off experience on pools of similar loans to establish loss rates that are applied to the Bank's current loan balances to estimate inherent credit losses. The estimation of the ALL at December 31, 2017 considered actual historical loan charge-off experience over a twelve-year period starting with the fourth quarter of 2005. The estimation of the ALL at December 31, 2016 considered actual historical loan charge-off experience over an eleven-year period starting with the fourth quarter of 2005. The increase in the historical look-back period from eleven years at December 31, 2016 to twelve years at December 31, 2017 was deemed prudent, in order to include loan charge-off experience during the most recent downward economic cycle in the estimation of the allowance for loan losses. This timeframe also provides a reasonable period for migration. The Bank recognizes that the estimation of the ALL is sensitive to the assigned credit risk ratings and loss rates at any given point in time. To ensure the accuracy of our credit risk ratings, an independent credit review function assesses the ratings assigned to loans on an ongoing basis.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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

Allowance for Loan Losses, continued

The subjective criteria considered when establishing the loss rates include, but are not limited to the following:

- current economic trends and forecasts;
- the loan portfolio composition and any loan concentrations;
- the Bank's current lending policies;
- the volume and nature of new loan originations; and
- the loan portfolio's credit performance trends.

The credit risk ratings assigned to every loan are either "pass", "special mention", "substandard", or "doubtful" and defined as follows:

Pass: Loans classified as pass are expected to be fully collected.

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*.

The methodology the Bank uses to estimate the specific allowance for loans determined to be impaired complies with the Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") Section 310-10-35. If the loan is collateral-dependent, the amount of impairment is measured against the estimated fair value of the loan's underlying collateral, less estimated selling costs, including senior obligations such as delinquent property taxes. If the loan is not collateral-dependent, the Bank measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate. The impairment amount on a collateral-dependent loan is charged-off to the allowance and the impairment amount of a loan that is not collateral-dependent is set up as a specific allowance.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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

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 expenses 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.

Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank (“FHLB”) of San Francisco, the Bank is required to own common stock in the FHLB of San Francisco, which is based upon the Bank’s membership asset value and/or borrowing levels. Investment in FHLB stock is carried at cost and is expected to be redeemed at par. Investment in FHLB stock is evaluated regularly for impairment. Cash dividends are accrued and reported as dividend income.

Investment in Federal Reserve Bank Stock

As a member of the FRBSF, the Bank is required to maintain stock in the FRBSF based on a specified ratio relative to our capital. FRB stock is carried at cost and may be sold back to the FRB at its carrying value. Investments in FRB stock is evaluated regularly for impairment. Cash dividends are accrued and reported as dividend income.

Tax Credit Investments

The Bank invests in limited liability companies and partnerships that make investments in affordable housing projects, renewable energy projects, and new market tax credits, which qualify for Federal income tax credits. The Bank’s interests are accounted for utilizing the cost method, the Hypothetical Liquidation at Book Value (“HLBV”) method, or the proportional amortization method. Investments accounted for using the cost method are being amortized over the life of the related tax credit investments as a component of noninterest expense. For investments accounted for using the HLBV method, a calculation is prepared at each balance sheet date to estimate the amount that the Bank would receive if the investment entity was to liquidate all of its assets and distribute that cash to the investors based on the contractually defined liquidation priorities. Meanwhile, those accounted for using the proportional amortization method are being amortized in proportion to the expected total tax benefits as a component of current tax expense. The investments are reviewed for impairment on an annual basis or on an interim basis if an event occurs that would trigger potential impairment.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization. Land is not depreciated. Depreciation is computed on a straight-line method based on the estimated useful lives of the assets:

<u>Type</u>	<u>Estimated Useful Life</u>
Buildings	20 to 39 years
Building improvements	15 to 39 years
Furniture, fixtures, and equipment	3 to 7 years
Leasehold improvements	Shorter of useful lives or the terms of the lease

Construction in progress is carried at cost and includes land acquisition, architectural fees, general contractor fees, 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.

Borrowings

The Bank utilizes repurchase agreements, federal funds' lines of credit, FRB discount window, and FHLB advances to manage its liquidity position. The repurchase 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 collateral securities underlying the agreements remain in the applicable asset accounts. The Bank has established unsecured federal funds lines of credit with several correspondent banks, as well as with the FHLB and FRB. These federal funds lines of credit generally mature within one business day. The Bank's available secured borrowing capacity from the FHLB is derived from the loans that are pledged to the FHLB.

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 sub-lessee, for properties leased by the Bank. The Bank accounts for lease income on an accrual basis.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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 ("DTA/DTL") 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. Deferred tax assets and liabilities in the same jurisdiction, are grouped together and reported net on the balance sheets.

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 that the benefit of a deferred tax asset is not more likely than not to be realized, a valuation allowance is established with a corresponding charge through the provision for income taxes. The Bank also evaluates existing valuation allowances periodically to determine if sufficient evidence exists to support an increase or reduction in the allowance. The Bank recognizes interest and penalties related to tax positions as part of its provision for income taxes.

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 Data

Basic earnings per share ("EPS") is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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

Recent Accounting Standards

In May 2014, the FASB issued Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The new guidance replaced existing revenue recognition guidance for contracts to provide goods or services to customers. ASU 2014-09 clarified the principles for recognizing revenue and replaces nearly all existing revenue recognition guidance in U.S. GAAP. Quantitative and qualitative disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers are also required. ASU 2014-09 as amended by ASU 2015-14, ASU 2016-08, ASU 2016-10 and ASU 2016-12, is effective for fiscal years beginning after December 15, 2018 and is applied on either a modified retrospective or full retrospective basis. The Bank’s revenue is mainly comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. The Bank’s implementation efforts included the identification of revenue streams within the scope of the guidance, evaluation of the revenue contracts, and existing revenue recognition policies. The Bank is evaluating the impact of this ASU on its financial statements and related disclosures.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 amended the guidance in U.S. GAAP on the accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements of financial instruments. ASU 2016-01 is effective for fiscal years beginning after December 15, 2018. The Bank does not expect the provisions of ASU 2016-01 to have a material impact on its financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires lessees to recognize all leases longer than twelve months on the balance sheet as lease assets and lease liabilities and provide quantitative and qualitative disclosures regarding key information about leasing arrangements. Lessor accounting remains substantially similar to current U.S. GAAP. ASU 2016-02 is effective for fiscal years beginning after December 15, 2019 and the guidance should be applied using modified retrospective transition method through a cumulative-effect adjustment. The Bank is in the process of reviewing its existing lease contracts and service contracts that may include embedded leases. The Bank expects the adoption of ASU 2016-02 to result in additional assets and liabilities, as the Bank will be required to recognize operating leases on the Balance Sheet. The Bank continues to evaluate the impact of this ASU on its financial statements and related disclosures.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 will significantly change the way entities recognize impairment of many financial assets, including available-for sale and held-to-maturity debt securities and loans. For available-for-sale debt securities with unrealized losses, ASU 2016-13 does not change the measurement method of credit losses, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. Currently, the impairment model is based on incurred losses, and investments are recognized as impaired when there is no longer an assumption that future cash flows will be collected in full under the originally contracted terms. Under the current expected credit loss (CECL) model, the new standard requires immediate recognition of estimated credit losses expected to occur over the remaining life of the asset. The Bank established a

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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

Recent Accounting Standards, continued

CECL Committee in 2017 to develop, implement and review the adoption of ASU 2016-13. ASU 2016-13 is effective for fiscal years beginning after December 15, 2020. The Bank is evaluating the impact of this ASU on its financial statements and related disclosures.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 provides guidance on the classification of certain cash receipts and payments on the statement of cash flows in order to reduce diversity in practice. ASU 2016-15 is effective for fiscal years beginning after December 15, 2018. The Bank does not expect the adoption of this guidance to have a material impact on its financial statements and related disclosures.

In February 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The amendments in ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (“Tax Reform Act”). ASU 2018-02 is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted and the proposed amendment should be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Reform Act is recognized. The Bank will adopt this ASU effective January 1, 2018 and does not expect to have a material impact on its financial statements and related disclosures.

NOTE 2 – SECURITIES AVAILABLE-FOR-SALE

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

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(In thousands)			
As of December 31, 2017				
Mortgage-backed securities	\$ 77,907	\$ 249	\$ (378)	\$ 77,778
State and municipal securities	109,045	620	(341)	109,324
Total securities available-for-sale	<u>\$ 186,952</u>	<u>\$ 869</u>	<u>\$ (719)</u>	<u>\$ 187,102</u>
As of December 31, 2016				
Mortgage-backed securities	\$ 24,192	\$ 517	\$ (136)	\$ 24,573
State and municipal securities	157,328	903	(484)	157,747
Total securities available-for-sale	<u>\$ 181,520</u>	<u>\$ 1,420</u>	<u>\$ (620)</u>	<u>\$ 182,320</u>

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 2 – Securities Available-for-Sale, continued

The following table presents a summary of the estimated maturities of securities available-for-sale based on amortized cost and estimated fair value:

	<u>Amortized Cost</u>	<u>Fair Value</u>
	(In thousands)	
As of December 31, 2017		
Due in 1 year or less	\$ 44,406	\$ 44,336
Due after 1 year through 5 years	56,355	56,759
Due after 5 years through 10 years	10,406	10,575
Due after 10 years	75,785	75,432
	<u>\$ 186,952</u>	<u>\$ 187,102</u>

	<u>Amortized Cost</u>	<u>Fair Value</u>
	(In thousands)	
As of December 31, 2016		
Due in 1 year or less	\$ 64,025	\$ 63,986
Due after 1 year through 5 years	82,205	82,603
Due after 5 years through 10 years	18,972	19,553
Due after 10 years	16,318	16,178
	<u>\$ 181,520</u>	<u>\$ 182,320</u>

The Bank did not sell any securities during 2017 and 2016.

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

	<u>Less than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
	(In thousands)					
As of December 31, 2017						
Mortgage-backed securities	\$ 54,409	\$ (378)	\$ -	\$ -	\$ 54,409	\$ (378)
State and municipal securities	55,006	(267)	16,785	(74)	71,791	(341)
Total temporarily impaired securities	<u>\$ 109,415</u>	<u>\$ (645)</u>	<u>\$ 16,785</u>	<u>\$ (74)</u>	<u>\$ 126,200</u>	<u>\$ (719)</u>

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 2 – Securities Available-for-Sale, continued

	<u>Less than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
	(In thousands)					
As of December 31, 2016						
Mortgage-backed securities	\$ 13,782	\$ (136)	\$ -	\$ -	\$ 13,782	\$ (136)
State and municipal securities	119,119	(481)	1,330	(3)	120,449	(484)
Total temporarily impaired securities	<u>\$ 132,901</u>	<u>\$ (617)</u>	<u>\$ 1,330</u>	<u>\$ (3)</u>	<u>\$ 134,231</u>	<u>\$ (620)</u>

The unrealized losses are primarily attributable to declining market prices caused by a rising interest rate environment. The number of securities available-for-sale with unrealized losses less than 12 months and 12 months or longer was 426 and 161, respectively, for the year ended December 31, 2017, and 1,123 and 8, respectively, for the year ended December 31, 2016. Whenever the cost of a 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. Management believes that securities available-for-sale in an unrealized loss position at December 31, 2017 and 2016, respectively, had a loss position that was temporary in nature, and therefore no impairment losses were recognized in the income statements. Because the Bank has the ability and intent to hold these investments until a market price recovery or maturity, these securities available-for-sale are not considered other-than-temporarily impaired.

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

	<u>Before-Tax Amount</u>	<u>Tax Benefit</u>	<u>Net-of-Tax Amount</u>
	(In thousands)		
Year ended December 31, 2017			
Unrealized losses on securities:			
Unrealized holding losses arising during period	\$ (649)	\$ 273	\$ (376)
Other comprehensive loss	<u>\$ (649)</u>	<u>\$ 273</u>	<u>\$ (376)</u>
Year ended December 31, 2016			
Unrealized losses on securities:			
Unrealized holding losses arising during period	\$ (1,632)	\$ 686	\$ (946)
Other comprehensive loss	<u>\$ (1,632)</u>	<u>\$ 686</u>	<u>\$ (946)</u>

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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)			
As of December 31, 2017				
U.S. Government agency and U.S. Government sponsored enterprise debt securities	\$ 13,008	\$ -	\$ (71)	\$ 12,937
Mortgage-backed securities	2,110,096	8,670	(17,099)	2,101,667
State and municipal securities	492,795	5,196	(1,449)	496,542
Collateralized mortgage obligations	41,175	106	(397)	40,884
Corporate debt securities	722	2	-	724
Total securities held-to-maturity	\$ 2,657,796	\$ 13,974	\$ (19,016)	\$ 2,652,754

As of December 31, 2016

U.S. Government agency and U.S. Government sponsored enterprise debt securities	\$ 13,941	\$ 33	\$ (43)	\$ 13,931
Mortgage-backed securities	2,174,471	13,993	(23,616)	2,164,848
State and municipal securities	533,537	8,607	(1,959)	540,185
Collateralized mortgage obligations	40,190	277	(287)	40,180
Corporate debt securities	738	11	-	749
Total securities held-to-maturity	<u>\$ 2,762,877</u>	<u>\$ 22,921</u>	<u>\$ (25,905)</u>	<u>\$ 2,759,893</u>

The following table is a summary of the estimated maturities of securities held-to-maturity based on amortized cost and estimated fair value:

	Amortized Cost	Fair Value
	(In thousands)	
As of December 31, 2017		
Due in 1 year or less	\$ 85,855	\$ 85,933
Due after 1 year through 5 years	342,620	346,110
Due after 5 years through 10 years	636,930	643,231
Due after 10 years	1,592,391	1,577,480
	<u>\$ 2,657,796</u>	<u>\$ 2,652,754</u>
As of December 31, 2016		
Due in 1 year or less	\$ 49,092	\$ 49,171
Due after 1 year through 5 years	374,460	380,431
Due after 5 years through 10 years	398,359	409,580
Due after 10 years	1,940,966	1,920,711
	<u>\$ 2,762,877</u>	<u>\$ 2,759,893</u>

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 3 – Securities Held-to-Maturity, continued

There were no sales or transfers of securities held-to-maturity in 2017 or 2016.

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

	<u>Less than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In thousands)						
As of December 31, 2017						
U.S. Government agency and U.S. Government sponsored enterprise debt securities	\$ 8,772	\$ (19)	\$ 4,164	\$ (52)	\$ 12,936	\$ (71)
Mortgage-backed securities	1,093,401	(7,943)	363,387	(9,156)	1,456,788	(17,099)
State and municipal securities	167,911	(1,009)	58,250	(440)	226,161	(1,449)
Collateralized mortgage obligations	29,715	(288)	3,431	(109)	33,146	(397)
Total temporarily impaired securities	<u>\$ 1,299,799</u>	<u>\$ (9,259)</u>	<u>\$ 429,232</u>	<u>\$ (9,757)</u>	<u>\$ 1,729,031</u>	<u>\$ (19,016)</u>

	<u>Less than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(In thousands)						
As of December 31, 2016						
U.S. Government agency and U.S. Government sponsored enterprise debt securities	\$ 4,737	\$ (43)	\$ -	\$ -	\$ 4,737	\$ (43)
Mortgage-backed securities	1,565,522	(23,616)	-	-	1,565,522	(23,616)
State and municipal securities	249,786	(1,944)	918	(15)	250,704	(1,959)
Collateralized mortgage obligations	27,582	(287)	-	-	27,582	(287)
Total temporarily impaired securities	<u>\$ 1,847,627</u>	<u>\$ (25,890)</u>	<u>\$ 918</u>	<u>\$ (15)</u>	<u>\$ 1,848,545</u>	<u>\$ (25,905)</u>

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 faster-than-expected prepayments and a rising interest rate environment. The number of securities held-to-maturity with unrealized losses less than 12 months and 12 months or longer was 556 and 202, respectively, for the year ended December 31, 2017, and 851 and 3, respectively, for the year ended December 31, 2016. Management believes that securities held-to-maturity in an unrealized loss position as December 31, 2017 and 2016, respectively, had a loss position that was temporary in nature, and therefore no impairment losses were recognized in the statements of income. Because the Bank has the ability and intent to hold these investments until maturity, these securities held-to-maturity are not considered other-than-temporarily impaired.

Total securities with a carrying value of approximately \$1.31 billion for December 31, 2017 and \$1.19 billion for December 31, 2016 were pledged to secure securities sold under repurchase agreements, public deposits, FRB's daylight overdraft, and for other purposes required by law.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 3 – Securities Held-to-Maturity, continued

Interest income on tax-exempt securities was \$10.8 million for the year ended December 31, 2017, and \$10.3 million for the year ended December 31, 2016.

NOTE 4 – LOANS AND ALLOWANCE FOR LOAN LOSSES

The loan portfolio is comprised 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, separated into the same loan segments utilized in the estimation of the ALL:

	December 31,	
	2017	2016
	(In thousands)	
Commercial & industrial	\$ 96,221	\$ 118,364
Construction	467,021	361,133
Commercial real estate	2,429,643	2,111,355
Residential mortgages	756,719	719,666
Equity lines	122,206	126,009
Installment and other loans	<u>\$ 27,300</u>	<u>\$ 29,855</u>
Gross loans	\$ 3,899,110	\$ 3,466,382
Less: Allowance for loan losses	(59,502)	(56,867)
Unamortized deferred loan fees, net	<u>(5,611)</u>	<u>(5,314)</u>
Loans, net	<u>\$ 3,833,997</u>	<u>\$ 3,404,201</u>
Loans held for sale	<u>15,038</u>	<u>6,080</u>
Total loans receivable, net	<u><u>\$ 3,849,035</u></u>	<u><u>\$ 3,410,281</u></u>

Total loans with a balance of \$689.6 million and \$673.1 million at December 31, 2017 and December 31, 2016, respectively, were pledged to secure the Bank's FHLB advance line.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

Nonaccrual and Past Due Loans

Loans are tracked by the numbers of days that borrower's 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, 2017						
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days & Over Still Accruing	Nonaccrual	Current	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	\$ 100	\$ -	\$ -	\$ -	\$ 96,121	\$ 96,221
Construction	63	-	-	1,750	465,208	467,021
Commercial real estate	1,141	218	-	679	2,427,605	2,429,643
Residential mortgages	4,135	-	-	11,977	740,607	756,719
Equity lines	116	-	-	516	121,574	122,206
Installment and other loans	-	27	16	-	27,257	27,300
Gross loans	\$ 5,555	\$ 245	\$ 16	\$ 14,922	\$ 3,878,372	\$ 3,899,110

As of December 31, 2016						
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days & Over Still Accruing	Nonaccrual	Current	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	\$ 80	\$ -	\$ -	\$ -	\$ 118,284	\$ 118,364
Construction	-	-	-	-	361,133	361,133
Commercial real estate	24	-	-	774	2,110,557	2,111,355
Residential mortgages	-	-	-	705	718,961	719,666
Equity lines	454	-	-	267	125,288	126,009
Installment and other loans	-	17	49	-	29,789	29,855
Gross loans	\$ 558	\$ 17	\$ 49	\$ 1,746	\$ 3,464,012	\$ 3,466,382

The following is a summary of selected information related to the nonaccrual loans outstanding as of December 31, 2017 and 2016, and the related contractual interest income foregone for the years indicated:

	2017	2016
	(In thousands)	
Nonaccrual loans		
Outstanding balance	\$ 14,922	\$ 1,746
Average balance	11,607	2,033
Interest income recorded	161	14
Interest income foregone	500	85

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

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, 2017			December 31, 2016		
	Nonclassified	Classified	Total	Nonclassified	Classified	Total
(In thousands)						
Loan Segment						
Commercial & industrial	\$ 93,267	\$ 2,954	\$ 96,221	\$ 115,723	\$ 2,641	\$ 118,364
Construction	462,871	4,150	467,021	358,733	2,400	361,133
Commercial real estate	2,406,741	22,902	2,429,643	2,101,519	9,836	2,111,355
Residential mortgages	741,894	14,825	756,719	714,599	5,067	719,666
Equity lines	119,760	2,446	122,206	124,800	1,209	126,009
Installment and other loans	27,300	-	27,300	29,855	-	29,855
Total	\$ 3,851,833	\$ 47,277	\$ 3,899,110	\$ 3,445,229	\$ 21,153	\$ 3,466,382

Troubled Debt Restructured Loans

Included in the Bank's loan portfolio are TDRs, which are loans that have been modified due to deterioration in the financial condition of the borrower, and the Bank has granted concessions to the borrower that it would not otherwise consider. The total amount of TDRs was \$14.7 million at December 31, 2017 and \$5.4 million at December 31, 2016.

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

	For The Year Ended December 31, 2017					
	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 Recorded Investment
(In thousands)						
Loan Segment						
Construction	-	\$ -	\$ -	\$ -	\$ -	- \$ -
Commercial real estate	6	8,590	8,590	-	-	- -
Residential mortgages	-	-	-	-	-	- -
Equity lines	1	346	346	-	-	- -
Total	7	\$ 8,936	\$ 8,936	\$ -	\$ -	- \$ -

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

Troubled Debt Restructured Loans, continued

	For The Year Ended December 31, 2016						
		Pre- modification Outstanding Recorded Investment	Post- modification Outstanding Recorded Investment	Charge-offs During Modification	Allocated Reserve	TDRs That Subsequently Defaulted	
	No. of Contracts					No. of Contracts	Recorded Investment
	(In thousands)						
Loan Segment							
Construction	1	\$ 1,900	\$ 1,900	\$ -	\$ -	-	\$ -
Commercial real estate	-	-	-	-	-	-	-
Residential mortgages	1	1,410	1,410	-	-	-	-
Equity lines	-	-	-	-	-	-	-
Total	2	\$ 3,310	\$ 3,310	\$ -	\$ -	-	\$ -

Accruing TDRs

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

	Principal Deferral	Rate Reduction	Combination of such Concession	Total
(In thousands)				
As of December 31, 2017				
Loan Segment				
Construction	\$ 2,400	\$ -	\$ -	\$ 2,400
Commercial real estate	10,639	-	758	11,397
Residential mortgages	-	-	-	-
Equity lines	347	-	-	347
Total loans	\$ 13,386	\$ -	\$ 758	\$ 14,144
As of December 31, 2016				
Loan Segment				
Construction	\$ 2,400	\$ -	\$ -	\$ 2,400.00
Commercial real estate	229	-	768	997
Residential mortgages	1,410	-	-	1,410
Equity lines	-	-	-	-
Total loans	\$ 4,039	\$ -	\$ 768	\$ 4,807

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

Nonaccrual TDRs

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

	Principal Deferral	Rate Reduction	Forgiveness of Principal (In thousands)	Combination of Such Concession	Total
As of December 31, 2017					
Loan Segment					
Commercial real estate	\$ -	\$ -	\$ -	\$ 547	\$ 547
Total loans	\$ -	\$ -	\$ -	\$ 547	\$ 547
As of December 31, 2016					
Loan Segment					
Commercial real estate	\$ -	\$ -	\$ -	\$ 617	\$ 617
Total loans	\$ -	\$ -	\$ -	\$ 617	\$ 617

Impaired Loans

Nonaccrual loans and performing restructured loans are considered impaired loans for reporting purposes. For the indicated periods, the following tables contain an analysis of impaired loans by segment:

As of December 31, 2017							
	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							
Construction	\$ 4,150	\$ 4,150	\$ -	\$ -	\$ 4,150	\$ 2,535	\$ 205
Commercial real estate	12,436	12,076	-	-	12,076	7,800	538
Residential mortgages	12,206	11,977	-	-	11,977	11,128	94
Equity lines	876	863	-	-	863	458	22
Total	\$ 29,668	\$ 29,066	\$ -	\$ -	\$ 29,066	\$ 21,921	\$ 859

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

Impaired Loans, continued

As of December 31, 2016							
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							
Construction	\$ 2,400	\$ 2,400	\$ -	\$ -	\$ 2,400	\$ 1,291	\$ 146
Commercial real estate	2,085	1,771	-	-	1,771	4,085	58
Residential mortgages	2,115	2,115	-	-	2,115	2,002	57
Equity lines	316	266	-	-	266	357	12
Total	\$ 6,916	\$ 6,552	\$ -	\$ -	\$ 6,552	\$ 7,735	\$ 273

The following table segregates the loan segments between those loans that were individually evaluated for impairment and those loans that were collectively evaluated for impairment.

December 31, 2017			December 31, 2016		
Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
(In thousands)					
Loan Segment					
Commercial & industrial	\$ -	\$ 96,221	\$ 96,221	\$ -	\$ 118,364
Construction	4,150	462,871	467,021	2,400	358,733
Commercial real estate	12,076	2,417,567	2,429,643	1,771	2,109,584
Residential mortgages	11,977	744,742	756,719	2,115	717,551
Equity lines	863	121,343	122,206	266	125,743
Installment and other loans	-	27,300	27,300	-	29,855
Total	\$ 29,066	\$ 3,870,044	\$ 3,899,110	\$ 6,552	\$ 3,459,830

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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:

				- 56	(97) 53		
	Commercial & Industrial	Construction	Commercial Real Estate	Residential Mortgages	Equity Lines	Installment and Other Loans	Total
	(In thousands)						
December 31, 2015	\$ 1,413	\$ 14,109	\$ 32,167	\$ 7,388	\$ 935	\$ 658	\$ 56,670
Provision	304	206	(84)	(481)	128	(73)	-
Charge-Offs	-	-	-	-	(142)	(206)	(348)
Recoveries	19	85	166	36	12	227	545
December 31, 2016	\$ 1,736	\$ 14,400	\$ 32,249	\$ 6,943	\$ 933	\$ 606	\$ 56,867
Provision	(63)	846	2,130	(1,282)	(550)	(81)	1,000
Charge-Offs	(250)	-	-	-	(97)	(234)	(581)
Recoveries	82	500	1,299	56	53	226	2,216
December 31, 2017	\$ 1,505	\$ 15,746	\$ 35,678	\$ 5,717	\$ 339	\$ 517	\$ 59,502

The ending ALL balance is composed of amounts applicable to loans:

Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	\$ 1,505	\$ 15,746	\$ 35,678	\$ 5,717	\$ 339	\$ 517	\$ 59,502

Reserve allocations for loan losses by loan category can shift year to year based on changes to outstanding loan balances, other factors such as charge-offs and recoveries, as well as enhancements to the ALL methodology.

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, 2017 and 2016 were as follows:

	December 31,	
	2017	2016
	(In thousands)	
Balance, beginning of year	\$ 4,000	\$ 3,400
Addition	1,300	600
Balance, end of year	<u>\$ 5,300</u>	<u>\$ 4,000</u>

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 5 – OTHER REAL ESTATE OWNED

As of December 31, 2017, the Bank had no OREO. At December 31, 2016, the carrying value of OREO was \$0.8 million, net of reserve for OREO of \$0.6 million. The following table summarizes the net carrying value of OREO by property type at the dates indicated:

	December 31,	
	2017	2016
	(In thousands)	
Construction and land development	\$ -	\$ 791
Total OREO, net	\$ -	\$ 791

The components of OREO income and expense for the years indicated are as follows:

	2017	2016
	(In thousands)	
Rental income	\$ 8	\$ 13
Net gain on sale	9	14
Total OREO income	17	27
Operating and maintenance (reimbursements), net	(605)	(62)
Total OREO expense	(605)	(62)
OREO income, net	\$ 622	\$ 89

NOTE 6 – TAX CREDIT INVESTMENTS

The Bank has invested in certain limited liability companies and partnerships that make investments in affordable housing projects, new market tax credits, and renewable energy projects for the purpose of utilizing the tax credits these investments generate. The Bank is not the primary beneficiary of these partnerships and has no control over the operations; therefore, the Bank is not required to consolidate these entities on its financial statements.

The Bank's tax credit investments totaled \$25.8 million and \$50.7 million at December 31, 2017 and December 31, 2016, respectively, and are included in other assets on the balance sheets. Unfunded commitments related to these tax credit investments totaled \$3.8 million and \$31.9 million at December 31, 2017 and December 31, 2016, respectively, and are included in other liabilities on the balance sheets.

The Bank's usage of federal tax credits totaled \$19.0 million for 2017 and \$20.4 million for 2016. The Bank's remaining tax credits to be utilized over a multiple-year period approximated \$16.9 million and \$36.3 million at December 31, 2017 and December 31, 2016, respectively. Under the proportional amortization method, the amortization of the investment recognized as a component of income tax expenses for the years ended December 31, 2017 and 2016 were \$2.7 million for both years.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 7 – PREMISES AND EQUIPMENT

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

	December 31,	
	2017	2016
	(In thousands)	
Land	\$ 38,083	\$ 35,625
Buildings and building improvements	74,253	65,231
Furniture, fixtures and equipment	37,259	29,480
Leasehold improvements	2,832	2,832
Construction in progress	3,064	8,953
	155,491	142,121
Less accumulated depreciation and amortization	(59,941)	(54,346)
	<u>\$ 95,550</u>	<u>\$ 87,775</u>

Depreciation and amortization expense was \$7.0 million in 2017 and \$7.1 million in 2016.

The Bank is committed under a number of operating leases for premises. Most of the leases require that the Bank pay property taxes, insurance and other operating expenses applicable to the leased premises in addition to the monthly lease payments. Lease expense for the years ended December 31, 2017 and 2016 was \$1.5 million and \$1.4 million, respectively. Total lease income for the years ended December 31, 2017 and 2016 was \$2.1 million for both years.

The following table presents future annual minimum lease commitments and lease income payments to be received under operating leases with terms in excess of one year as of December 31, 2017:

	Commitments	
	Expense	Income
	(In thousands)	
2018	\$ 1,609	\$ 2,030
2019	1,697	1,802
2020	1,741	1,545
2021	1,782	1,116
2022	1,834	674
Thereafter	\$ 4,683	\$ 79

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

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 8 – DEPOSITS

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

	December 31,	
	2017	2016
	(In thousands)	
Non-interest-bearing checking	\$ 2,026,237	\$ 1,931,931
Interest-bearing checking	925,308	868,380
Money market accounts	948,904	793,021
Savings deposits	694,955	667,648
Total core deposits	\$ 4,595,404	\$ 4,260,980
Time deposits:		
\$250,000 or less	\$ 429,910	\$ 441,120
Greater than \$250,000	365,797	420,857
Total time deposits	795,707	861,977
Total deposits	\$ 5,391,111	\$ 5,122,957

As of December 31, 2017, the maturity distribution of the Bank's time deposits was as follows:

	\$250,000 or Less	Greater Than \$250,000	Total
	(In thousands)		
2018	\$ 283,091	\$ 257,819	\$ 540,910
2019	33,779	30,987	64,766
2020	53,748	36,516	90,264
2021	38,149	22,919	61,068
2022	21,143	17,556	38,699
	\$ 429,910	\$ 365,797	\$ 795,707

NOTE 9 – SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

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

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 9 – Securities Sold Under Repurchase Agreements, continued

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

	December 31,	
	2017	2016
	(In thousands)	
Securities sold under repurchase agreements	\$ 614,410	\$ 540,035
Weighted average interest rate	0.89%	0.39%
Securities underlying repurchase agreements	\$ 765,050	\$ 647,808
Fair value of securities underlying repurchase agreements	\$ 764,546	\$ 651,434

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 table summarizes securities sold under repurchase agreements' activity during the periods 2017 and 2016, respectively:

	2017	2016
	(In thousands)	
Average outstanding	\$ 619,751	\$ 573,371
Weighted average interest rate	0.69%	0.33%
Maximum amounts outstanding	\$ 680,418	\$ 642,214

NOTE 10 – OTHER BORROWINGS

The Bank's available borrowing capacity from federal funds lines of credit and FRB discount window amounted to \$596.9 million and \$579.6 million as of December 31, 2017 and 2016, respectively. The Bank's available secured borrowing capacity for FHLB advances totaled \$538.0 million and \$394.1 million as of December 31, 2017 and 2016, respectively.

The following table summarizes information about FHLB advances as of the periods indicated:

	December 31,	
	2017	2016
	(In thousands)	
FHLB advances outstanding at year-end	\$ -	\$ 100,000
Weighted average rate on outstanding at year-end	-	0.55%
Highest month-end balance	\$ 150,000	\$ 100,000
Average amount outstanding	\$ 7,658	\$ 874
Weighted average rate	0.83%	0.59%

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 11 - INCOME TAXES

The income tax expense for the years ended December 31, 2017 and 2016 are comprised of the following:

	<u>2017</u>	<u>2016</u>
	(In thousands)	
Current income taxes:		
Federal	\$ 5,696	\$ 12,047
State	10,264	12,391
Total current income tax expense	<u>15,960</u>	<u>24,438</u>
Deferred income taxes:		
Federal	10,273	(343)
State	(337)	(1,349)
Total deferred income tax expense (benefit)	<u>9,936</u>	<u>(1,692)</u>
Total income tax expense	<u>\$ 25,896</u>	<u>\$ 22,746</u>

Significant temporary differences that give rise to the deferred tax assets and liabilities as of December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
	(In thousands)	
Deferred tax assets		
Allowance for loan losses	\$ 20,633	\$ 27,902
Reserve for OREO	-	261
Tax credit investments - state tax basis difference	5,943	5,473
Capital loss carry forward	914	687
State income taxes	272	1,116
Accrued employee compensation	415	1,664
Premises and equipment depreciation and amortization	597	1,935
Other, net	1,892	1,700
Gross Deferred tax assets	30,666	40,738
Valuation allowance	(4,829)	(4,721)
Deferred tax assets, net of valuation allowance	<u>\$ 25,837</u>	<u>\$ 36,017</u>
Deferred tax liabilities		
Net unrealized gain on securities available-for-sale	\$ 63	\$ 336
Tax credit investments - federal tax basis difference	2,739	5,365
Deferred loan origination costs	1,470	-
Other, net	839	35
Gross deferred tax liabilities	<u>5,111</u>	<u>5,736</u>
Net deferred tax assets	<u>\$ 20,726</u>	<u>\$ 30,281</u>

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 11 – Income Taxes, continued

The Federal tax rate was 35% for 2017 and 2016. The difference between the effective tax rate in the financial statements and the federal income tax rate is attributed to the following:

	2017	2016
Federal income tax rate	35.0%	35.0%
State income taxes, net of federal benefit	6.4%	6.9%
Tax-exempt interest income	(4.9%)	(4.2%)
Tax credits	(18.7%)	(16.6%)
Amortization – low-income housing investment	3.0%	2.8%
Write down of DTA/DTL due to tax rate change	7.6%	-
Other	0.2%	0.2%
	<u>28.6%</u>	<u>24.1%</u>

The higher effective tax rate during the year ended December 31, 2017 compared to the same period in 2016 was attributable to a one-time write down of deferred tax assets and liabilities as a result of the Tax Reform Act enacted into law on December 22, 2017. Beginning in 2018, the Tax Reform Act reduces the federal tax rate for corporations from 35% to 21%. As a result, the underlying deferred tax assets and liabilities must be revalued using the enacted tax laws and rates. In 2017, the Bank recognized \$6.8 million additional tax expense due to the revaluation. In addition, as of December 31, 2017, the Bank has federal tax credit carryforwards of \$1.4 million; the tax credit carryforwards will expire in 2037 if unused.

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, with the exception of the deferred tax assets related to certain state tax basis differences arising from new market tax credit investments and capital loss carry forward in California.

FASB ASC 740-10, *Accounting for Uncertainty in Income Taxes* 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, 2017, all tax years subsequent to 2013 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. Unrecognized tax benefit primarily includes state exposures from California Enterprise Zone net interest deduction. The Bank does not anticipate any material change in the total amount of unrecognized tax benefits to occur within the next twelve months.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 12 – EARNINGS PER SHARE

As of December 31, 2017 and 2016, 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, 2017 and 2016.

	<u>2017</u>	<u>2016</u>
	<u>(In thousands, except share and per share data)</u>	
Basic and diluted earnings per share:		
Net income available to common stockholders	\$ 64,764	\$ 71,508
Weighted average number of common shares outstanding	130,928	130,928
Weighted basic and diluted earnings per common share	\$ 494.65	\$ 546.16

NOTE 13 – 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.

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 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.

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

	<u>December 31,</u>	
	<u>2017</u>	<u>2016</u>
	<u>(In thousands)</u>	
Commitments to extend credit	\$1,459,527	\$1,230,452
Financial standby letters of credit	12,998	11,079
Performance standby letters of credit	6,971	5,949
	<u>\$1,479,496</u>	<u>\$1,247,480</u>

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 13 – Commitments and Contingencies, continued

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 our business. The outcome of such legal proceedings and the timing of ultimate resolution are inherently difficult to predict. In accordance with applicable accounting guidance, the Bank establishes an accrued liability for litigation when those matters present loss contingencies that are both probable and estimable. In such cases, there may be an exposure to loss in excess of any amounts accrued. As a matter develops, the Bank, in conjunction with any outside counsel handling the matter, evaluates on an ongoing basis whether such matter presents a loss contingency that is probable and estimable. Once the loss contingency is deemed to be both probable and estimable, the Bank will establish an accrued liability and record a corresponding amount of litigation-related expense. The Bank continues to monitor the matter for further developments that could affect the amount of the accrued liability that has been previously established. Based on current knowledge, management does not believe that loss contingencies arising from pending matters will have a material adverse effect on the financial position or liquidity of the Bank.

NOTE 14 – 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 instruments typically include 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, loans held for sale, 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.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 14 – 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, 2017 and 2016:

	As of December 31, 2017			
	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	\$ -	\$ 187,102	\$ -	\$ 187,102
On a non-recurring basis:				
Impaired loans	-	-	-	-
Other real estate owned	-	-	-	-
Total assets	\$ -	\$ 187,102	\$ -	\$ 187,102

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 14 – Fair Value Measurements, continued

	As of December 31, 2016			
	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	\$ -	\$ 182,320	\$ -	\$ 182,320
On a non-recurring basis:				
Impaired loans	-	-	-	-
Other real estate owned	-	-	-	-
Total assets	\$ -	\$ 182,320	\$ -	\$ 182,320

NOTE 15 – 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, 2017 and 2016, 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 or management's judgment and estimation to determine the fair values of securities available-for-sale and securities held-to-maturity as disclosed in Notes 2 and 3, respectively. Private Placement Bonds are evaluated with the same methodology that is used in loans.

Loans Held for Sale

Loans held for sale are carried at the lower of aggregate cost or fair value, and are short-term in nature. Fair values are based on quoted price for similar financial characteristics, commitments outstanding from investors, or book value.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 15 – Fair Value of Financial Instruments, continued

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, by performing and nonperforming categories, and credit quality. 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 deducted from the loan portfolio. 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. The fair value that has been determined by the Bank does not represent an exit price of the loan portfolio.

Investments in FHLB and FRB Stock

Investments in FHLB and FRB stock are carried at cost. Ownership of stock is restricted to member banks and the securities do not have a readily determinable market value. Purchases and sales of these securities are at par value with the issuers; hence, the fair value is equal to the carrying value.

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 were 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. Interest rates will reset daily according to the market movement.

Other Borrowings

The fair value of other borrowings approximates carrying value due to the terms and nature of the obligations. The borrowings are generally short term.

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.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 15 – Fair Value of Financial Instruments, continued

The following table presents the carrying and estimated fair value per the fair value hierarchy of certain financial instruments at the dates indicated

	<u>Carrying Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Estimated Fair Value</u>
			(In thousands)		
As of December 31, 2017					
Financial Assets:					
Cash and due from banks	\$ 100,116	\$ 100,116	\$ -	\$ -	\$ 100,116
Securities available-for-sale	187,102	-	187,102	-	187,102
Securities held-to-maturity	2,657,796	-	2,611,275	41,479	2,652,754
Loans held for sale	15,038	-	15,245	-	15,245
Loans, net of allowance for loan losses	3,833,997	-	-	3,909,583	3,909,583
Investments in FHLB and FRB stock	20,690	-	20,690	-	20,690
Financial Liabilities:					
Deposits:					
Non-interest-bearing deposits	\$ 2,026,237	\$ -	\$ 2,026,237	\$ -	\$ 2,026,237
Interest-bearing deposits	925,308	-	925,308	-	925,308
Savings and money market deposits	1,643,859	-	1,643,859	-	1,643,859
Time deposits	795,707	-	795,707	-	795,707
Securities sold under repurchase agreements	614,410	-	614,410	-	614,410
FHLB advances	-	-	-	-	-
As of December 31, 2016					
Financial Assets:					
Cash and due from banks	\$ 148,715	\$ 148,715	\$ -	\$ -	\$ 148,715
Securities available-for-sale	182,320	-	182,320	-	182,320
Securities held-to-maturity	2,762,877	-	2,718,818	41,075	2,759,893
Loans held for sale	6,080	-	6,217	-	6,217
Loans, net of allowance for loan losses	3,404,201	-	-	3,501,867	3,501,867
Investments in FHLB and FRB stock	20,690	-	20,690	-	20,690
Financial Liabilities:					
Deposits:					
Non-interest-bearing deposits	\$ 1,931,931	\$ -	\$ 1,931,931	\$ -	\$ 1,931,931
Interest-bearing deposits	868,380	-	868,380	-	868,380
Savings and money market deposits	1,460,669	-	1,460,669	-	1,460,669
Time deposits	861,977	-	861,977	-	861,977
Securities sold under repurchase agreements	540,035	-	540,035	-	540,035
FHLB advances	100,000	-	100,000	-	100,000

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 16 – RELATED PARTY TRANSACTIONS

The Bank and Queen City Investments, Inc. (“Queen City”), which is the parent company of 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 certain executive officers and/or directors of the Bank. In addition, certain executive and other officers of the Bank served as officers and/or directors of Queen City and/or its subsidiaries, including the Trust Company.

The Bank and the Trust Company have entered into an Employee Leasing agreement whereby the Bank and the Trust Company provide services of various employees between the parties, and will be reimbursed periodically. In 2017 and 2016, the Trust Company paid the Bank a net total of \$361,000 and \$341,000, respectively, under this agreement. In addition, the Bank and the Trust Company have entered into various agreements for the exchange of other services, which provide for the periodic settlement between the parties of the differences in the values of respective services provided between each other. Under this arrangement, the Bank provides human resources, payroll services, and IT support to the Trust Company, and the Trust Company provides financial services to the Bank and maintains deposits with the Bank. In 2017, the Trust Company paid the Bank a net total of \$56,000 for the difference between the values of services exchanged between the parties. Respectively, the Bank paid the Trust Company a net total of \$46,000 in 2016.

The Bank has leased the Torrance branch location from Queen City, which is subject to an ongoing lease agreement. The Bank paid \$276,000 and \$270,000, respectively, in lease expense for each of the years ended December 31, 2017 and 2016. The Trust Company also has leased office space from the Bank at the Long Beach Main and Laguna Hills branch locations, which are subject to ongoing lease agreements. The Trust Company paid \$63,000 in lease expense for the year ended December 31, 2017.

At December 31, 2017 and 2016, no loans were outstanding with any related party. At December 31, 2017 and 2016, related-party deposits were \$98 million and \$143 million, respectively, of which, \$89 million and \$134 million, respectively, were attributable to Queen City and its subsidiaries.

NOTE 17 – 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 accrued expense of \$6.9 million and \$6.2 million for the profit-sharing plan in 2017 and 2016, respectively. At December 31, 2017 and 2016, no shares of the Bank’s stock are held by the trust created by the plan.

NOTE 18 – 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

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 18 – Regulatory Matters, continued

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, common equity, and other factors.

As of December 31, 2017, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, Tier 1 common equity, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the institution's category.

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

	<u>Actual</u>		<u>Minimum Capital Requirements</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>
(Dollars in thousands)						
As of December 31, 2017:						
Total risk-based capital ratio	\$ 1,023,091	19.97% ≥	\$ 409,913	≥ 8.00%	\$ 512,391	≥ 10.00%
Tier 1 risk-based capital ratio	959,033	18.72% ≥	307,432	≥ 6.00%	409,909	≥ 8.00%
Common equity tier 1 capital ratio	959,033	18.72% ≥	230,574	≥ 4.50%	333,051	≥ 6.50%
Tier 1 leverage ratio	959,033	13.45% ≥	285,172	≥ 4.00%	356,465	≥ 5.00%

	<u>Actual</u>		<u>Minimum Capital Requirements</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>
(Dollars in thousands)						
As of December 31, 2016:						
Total risk-based capital ratio	\$ 967,919	20.85% ≥	\$ 371,420	≥ 8.00%	\$ 464,275	≥ 10.00%
Tier 1 risk-based capital ratio	909,850	19.60% ≥	278,565	≥ 6.00%	371,420	≥ 8.00%
Common equity tier 1 capital ratio	909,850	19.60% ≥	208,924	≥ 4.50%	301,779	≥ 6.50%
Tier 1 leverage ratio	909,850	13.62% ≥	267,307	≥ 4.00%	334,133	≥ 5.00%

NOTE 19 – SUBSEQUENT EVENTS

The Bank has evaluated events that have occurred subsequent to December 31, 2017, and through April 23, 2018, the date that these financial statements were issued. There have been no subsequent events that have occurred during the period that would require recognition in the financial statements or its disclosure in 2017.

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 & 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

Auditor

KPMG LLP
 20 Pacifica, Suite 700
 Irvine, CA 92618

Legal Counsel

Paul Hastings 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 & Trust Company
 6201 15th Ave.
 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 Ave.
 Long Beach, CA 90802

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.

Office Locations

Main — Long Beach

302 Pine Ave.
Long Beach, CA 90802
(562) 437-0011
Since 1907

Belmont Shore

4827 E. Second St.
Long Beach, CA 90803
(562) 621-1430
Since 1971

Bixby Knolls

4545 California Ave.
Long Beach, CA 90807
(562) 984-3600
Since 1970

Corona del Mar

2421 E. Coast Hwy.
Corona del Mar, CA 92625
(949) 723-1804
Since 2013

Downey

9001 Firestone Blvd.
Downey, CA 90241
(562) 334-1836
Since 2013

East Long Beach

3140 E. Anaheim St.
Long Beach, CA 90804
(562) 621-1400
Since 1921

Fullerton

315 N. Harbor Blvd.
Fullerton, CA 92832
(714) 578-1945
Since 1985

Garden Grove

10422 Garden Grove Blvd.
Garden Grove, CA 92843
(714) 590-3880
Since 1955

Huntington Beach

7125 Yorktown Ave.
Huntington Beach, CA 92648
(714) 465-3131
Since 2004

Laguna Hills

24300 Paseo de Valencia
Laguna Hills, CA 92653
(949) 340-3150
Since 2004

Lake Forest

23772 Rockfield Blvd.
Lake Forest, CA 92630
(949) 460-7900
Since 1981

Lakewood

5101 Lakewood Blvd.
Lakewood, CA 90712
(562) 602-8378
Since 1966

Los Altos

2302 Bellflower Blvd.
Long Beach, CA 90815
(562) 799-7271
Since 1973

Memorial Hospital

2801 Atlantic Ave.
Long Beach, CA 90806
(562) 989-7862
Since 1981

Newport Beach

4695 MacArthur Ct., Ste. 130
Newport Beach, CA 92660
(949) 241-8280
Since 2006

Orange

1220 E. Katella Ave.
Orange, CA 92867
(714) 288-8450
Since 1981

Redondo Beach

1304 S. Pacific Coast Hwy.
Redondo Beach, CA 90277
(310) 802-7560
Since 2015

Rolling Hills Estates

27525 Indian Peak Road
Rolling Hills Estates, CA 90274
(310) 491-1711
Since 2001

Rossmoor

12535 Seal Beach Blvd.
Seal Beach, CA 90740
(562) 799-2002
Since 1985

San Clemente

621 N. El Camino Real
San Clemente, CA 92672
(949) 373-2470
Since 2006

San Juan Capistrano

31873 Del Obispo St.
San Juan Capistrano, CA 92675
(949) 488-8550
Since 1985

Santa Ana

1750 E. 17th St.
Santa Ana, CA 92705
(714) 564-1750
Since 1985

Torrance

22400 Hawthorne Blvd.
Torrance, CA 90505
(310) 265-3200
Since 2003

Tustin

2691 Park Ave.
Tustin, CA 92782
(714) 824-3070
Since 2007

Specialized Client Services

Home Loan Center

12515 Seal Beach Blvd.
Seal Beach, CA 90740
(866) 649-3863
Since 2015

Healthcare Client Services

2801 Atlantic Ave.
Long Beach, CA 90806
(562) 989-7862
Since 2017

Religious Client Services

12535 Seal Beach Blvd.
Seal Beach, CA 90740
(562) 344-4070
Since 2017



Main (1907)



East Long Beach (1921)



Garden Grove (1955)



Lakewood (1966)



Bixby Knolls (1970)



Belmont Shore (1971)



Los Altos (1973)



Memorial Hospital (1981)



Lake Forest (1981)



Orange (1981)



Fullerton (1985)



Santa Ana (1985)



San Juan Capistrano (1985)



Rossmoor (1985)



Rolling Hills Estates (2001)



Torrance (2003)



Huntington Beach (2004)



Laguna Hills (2004)



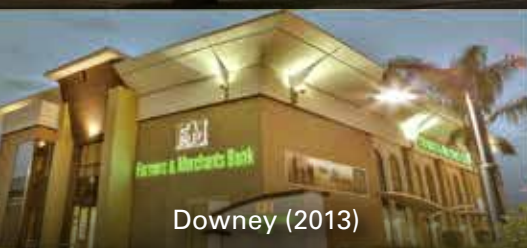
Newport Beach (2006)



San Clemente (2006)



Tustin (2007)



Downey (2013)



Corona del Mar (2013)



Redondo Beach (2018)





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