





Today

Our Balance Sheet as of 12/31/2018

\$7.3 Billion

In Total Assets

\$5.6 Billion

In Total Deposits

\$4.2 Billion

In Total Net Loans

\$1.0 Billion

Total Stockholders' Equity

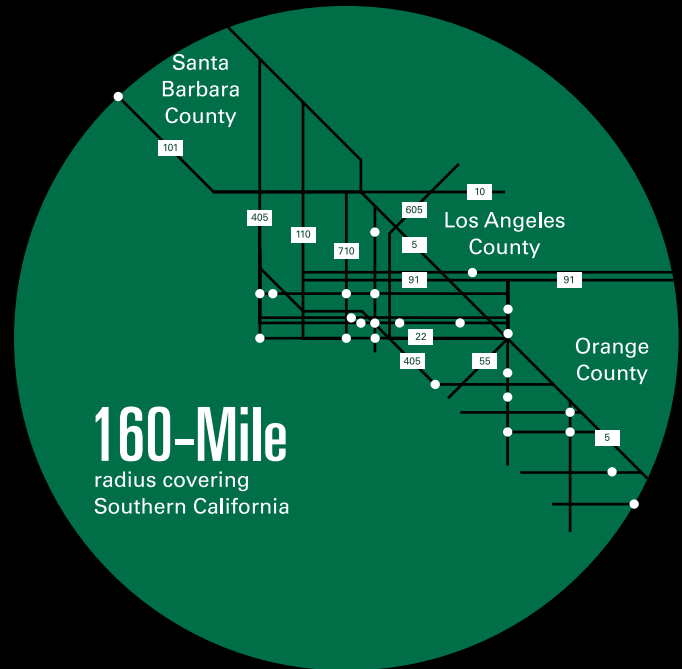
130,928

Total Shares Outstanding

Our Locations

25 Offices

As of 12/31/2018



Our Services



Personal Banking



Business Banking



Credit & Loans



Commercial Real Estate

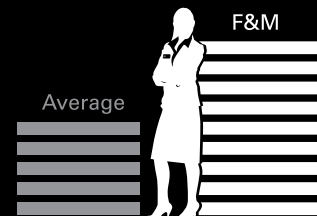
Our Key Facts



F&M's total risk-based capital (RBC) was 19.89% on 12/31/18, more than DOUBLE the federally mandated adequacy levels.

Our Employees

Median
Tenure
in Years



F&M's employee tenure averages more than eight years, which is nearly DOUBLE the median employee tenure.

FMB.com

2018

Capital & Reserves as of 12/31/2018



**CAPITAL & RESERVES
OVER \$1 BILLION**

Our Board of Directors

DIRECTORS

DANIEL K. WALKER
CHAIRMAN OF THE BOARD

JoANN M. BOURNE

RICHARD W. DARLING

WALTER M. FLORIE

LAWRENCE J. McLAUGHLIN

CHRISTINE A. SCHEUNEMAN

TIMOTHY M. WILSON

* New Board Members

Our Year Highlights



500th

Consecutive Dividend Paid



September 2018

OC Regional Headquarters Renovation Completed



May 2018

Rossmoor Office Grand Reopening



October 2018

Redondo Beach Office Construction Completed
Santa Barbara Office Grand Opening

Our Technology



Digital Wallet



Positive Pay



Mobile Check Deposit



Touch ID®

Touch ID® is a trademark of Apple, Inc.
registered in the U.S. and other countries.



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Honesty

Integrity

The Home

The Church

Service Above Self



Thank You

Farmers & Merchants Bank of Long Beach would like to acknowledge and thank two of its Directors, William G. Hayter and Timothy W. Jackert, who both retired from the Board at the end of 2018.

William G. Hayter

Board Member 1988-2018

Mr. Hayter served as a Director of Farmers & Merchants Bank of Long Beach since 1988. He has a deep breadth of experience serving additional community-oriented organizations. Mr. Hayter was President of the Pacific Hospital Foundation, Director of the Long Beach YMCA, and Counsel for the Boy Scouts of America.



Timothy W. Jackert

Board Member 2008-2018



Mr. Jackert served as a Director of F&M since July 2008. His deep roots in the community include his expert experience as the Chief Financial Officer of the Memorial Medical Center Foundation for 38 years. He also was Chairman of the Board of Allied Healthcare Federal Credit Union for 25 years.

Welcome

In January 2019, Farmers & Merchants Bank of Long Beach appointed business leaders JoAnn M. Bourne and Christine A. Scheuneman to its Board of Directors.

Christine A. Scheuneman

Ms. Scheuneman, who became a member of the Bank's Risk and Compliance Committee, is a recently retired partner with the law firm Pillsbury Winthrop Shaw Pittman LLP. She is skilled in national and international retail, as well as commercial and consumer product matters. Ms. Scheuneman is a published author on corporate governance and finance issues and is a Governance Fellow with the National Association of Corporate Directors.



JoAnn M. Bourne



Ms. Bourne, who became a member of the Bank's Audit Committee, is a retired Senior Executive Vice President at MUFG Union Bank. She served on the Executive Management Committee and the US Management Committee in the Americas, and has extensive executive experience in governance and risk management, global treasury management, product management, technology, global trading and trust custody services.



Timothy M. Wilson

Richard W. Darling

Lawrence J. McLaughlin

JoAnn M. Bourne

Daniel K. Walker
Chairman of the Board

Christine A. Scheuneman

Walter M. Florie

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.

JoAnn M. Bourne

Ms. Bourne is a retired Senior Executive Vice President at MUFG Union Bank. She served on the Executive Management Committee and the US Management Committee in the Americas.

Richard W. Darling

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

Walter M. Florie

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 in the greater Long Beach community and their healthcare needs.

Lawrence J. McLaughlin

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

Christine A. Scheuneman

Ms. Scheuneman, who became a member of the Bank's Risk and Compliance Committee, is a recently retired partner with the law firm Pillsbury Winthrop Shaw Pittman LLP. She is skilled in national and international retail, as well as commercial and consumer product matters.

Timothy M. Wilson

Mr. Wilson was the President of Mitchell Land & Improvement Co., a Southern California-based real estate development company where he previously served as Executive Vice President and Chief Operating Officer.





**F&M
BANK**
Farmers & Merchants Bank®
California's Strongest, since 1907.

FMB.com

Our Technology

Central to our FMB mission is our mantra to provide “...an unparalleled commitment to excellence to our customers,” which extends to FMB’s long-term technology investments and updated digital experience.

To ensure that FMB’s technology remains strong and resilient, we have invested substantially in updating our technology with **state-of the-art infrastructure**; from our data centers to each of our 25 branches, and to all administrative locations.

Clients are increasingly focused on ensuring the **safe and secure protection of their personal and financial data**, and so is F&M. As we have developed and launched new digital products and services, FMB has maintained a focus on balancing client expectations for convenience with the need to ensure that funds and data are always protected.

Our investments also include visible upgrades in **new employee technology and equipment**. For example, new video conference rooms are now standardized and available in many of our branches, which enable faster collaboration within FMB to be even more responsive to client needs.

In support of our technology enhancements, **we are investing in our technology support team**. We are hiring IT business analysts and application developers, and empowering our employees by offering training and certification in specific technology tracks. Enterprise software platforms, infrastructure hardware, virtualized machines and cloud-based technologies are part of the rapidly changing technology ecosystem in which FMB is investing.

These foundational **technology investments are yielding new competitive products and services** for our clients. Our recently launched online banking platform merges the FMB mobile, tablet, and online interface into one unified experience. With one scalable platform, we can now launch new products that work seamlessly across all digital experiences. The new Direct Connect for Quicken and QuickBooks and Centrix Positive Pay are examples of how we can develop new services that extend across digital platforms.

In 2019 and 2020, we look forward to releasing even more digital services that will further enable FMB’s retail and commercial clients to work more closely with our FMB bankers and specialists across the region.



Dear Fellow Shareholders

We live in a world that changes quickly, and most of that change is brought about by technology. A key objective for Farmers & Merchants Bank is incorporating new technologies without sacrificing the human touch that is fundamental to our success.

We work diligently to ensure that the safety and convenience of online banking elicit the same sense of well-being as meeting in person with our branch managers, as we strive to provide stellar experiences in both settings.

After 111 years of serving clients throughout Southern California, we understand that it is imperative to adapt to the needs and wants of a region that is often a trendsetter for the rest of the world. To do that, we must make investments today that will continue to serve us and our clients well beyond tomorrow.

In 2018, F&M invested approximately \$6 million in technology, which includes infrastructure to serve and protect the Bank as we continue to grow. Whether F&M is offering peer-to-peer (P2P) banking, mobile banking, or digital wallets, the strength of each application is tied to the quality and depth of the Bank's technology infrastructure.

We are confident that the vision outlined in our strategic plan related to technology and associated investments will prepare the Bank for the continued growth and stability that make F&M *California's Strongest, since 1907*.

Profitable for 111 Years

F&M has been profitable since it was founded, and we continued to achieve profitability in 2018, even amid heightened competition and the continuation of a historically low interest rate environment.

Total interest and dividend income for the year ended December 31, 2018, was \$261.0 million, compared with \$238.9 million reported for 2017. Interest expense for the full 2018 year was \$21.9 million, versus \$14.4 million in 2017.

Net interest income for 2018 was \$239.1 million, versus \$224.6 million in 2017. Farmers & Merchants' net interest margin was 3.45% for the year ended December 31, 2018, compared with 3.43% in the previous year.

The Bank's provision for loan losses was \$2.5 million for the year ended December 31, 2018, compared with a loan loss provision of \$1.0 million for the year ended December 31, 2017. The Bank's allowance for loan losses as a percentage of loans outstanding was 1.47% as of December 31, 2018, compared with 1.53% as of December 31, 2017.

Non-interest income for the full 2018 year totaled \$18.2 million, compared with \$28.9 million for the full 2017 year. Non-interest expense for the year ended December 31, 2018, was \$146.1 million, compared with \$161.8 million last year.

The Bank's net income for 2018 was \$85.6 million, or \$654.07 per diluted share, compared with \$64.8 million, or \$494.65 per diluted share, for 2017.

Solid Balance Sheet

F&M recorded strong loan growth and maintained robust liquidity in 2018. As of December 31, 2018, net loans totaled \$4.19 billion, compared with \$3.83 billion as of December 31, 2017. Investment securities aggregated \$2.78 billion as of December 31, 2018, versus \$2.84 billion as of December 31, 2017.

Deposits, the Bank's primary funding source, grew to \$5.58 billion at the end of 2018, from \$5.39 billion as of December 31, 2017. Non-interest-bearing deposits represented 37.6% of total deposits as of December 31, 2018, essentially in line with non-interest-bearing deposits a year ago. Total assets increased to \$7.31 billion at the close of 2018 from \$6.99 billion as of December 31, 2017.

As of December 31, 2018, Farmers & Merchants Bank remained “well-capitalized” under all regulatory categories, with a total risk-based capital ratio of 19.89%, a tier 1 risk-based capital ratio of 18.66%, a common equity tier 1 capital ratio of 18.66%, and a tier 1 leverage ratio of 14.04%. The minimum ratios for capital adequacy for a well-capitalized bank are 10.00%, 8.00%, 6.50% and 5.00%, respectively.

A New Presence

Our financial strength, coupled with new technology to protect and power F&M in the future, are characteristics that speak to the Bank’s core values. In an industry rife with consolidation, we pride ourselves on distinguishing F&M as a leading independent Bank that prioritizes the safety of its depositors.

We also care about providing a client-centric experience where multigenerational relationships form a bond between F&M and its community.

In 2018, we completed the modern transformation of the 30-year-old Rossmoor Office with a grand reopening. Improvements to the office include a redesigned teller line, allowing employees to promptly greet clients upon arrival and invite them to sit down instead of standing in line. We also opened a branch in Santa Barbara, our 25th location.

At the beginning of 2019, F&M announced that business leaders JoAnn M. Bourne and Christine A. Scheuneman were elected to its Board of Directors. They succeeded William G. Hayter and Timothy W. Jackert, who retired from the Board after serving for 31 years and 13 years, respectively.

We are grateful for our departing Board Members’ guidance and leadership, and welcome the expertise and acumen of our new Board Members.

Investing in Our Communities

As you can see, 2018 ushered in several changes and opportunities that we believe further enhance the strength of the Bank and its ability to serve our customers and our communities.

In 2018, we also announced a \$1 million extension of credit to the Anaheim Family YMCA for completion of phase one of a new facility; we partnered with the Compton Initiative to work alongside hundreds of volunteers to help restore and beautify the city of Compton; and we generated grants to help fund the Thomas House Family Shelter and Second Chance Orange County.

Additionally, we donated more than \$1.6 million to charities in 2018, including Big Brothers Big Sisters of Orange County, the Diocese of Orange, Aquarium of the Pacific, Pathways to Independence, YMCA of Greater Long Beach, and Orangewood Foundation, among others.

Participating in these activities is part of the culture at F&M. We are passionate about the work we do, and we are thankful for our talented employees who make it happen. On behalf of our valued F&M team and board of directors, we express gratitude for our loyal clients, supportive shareholders, and, as always, the guidance from our Maker.



Daniel K. Walker
Chairman of the Board & CEO



W. Henry Walker
President



Financial Information

Diluted Earnings per Common Share	2018 \$654	2017 \$495	2016 \$546	2015 \$496	2014 \$477
Dividends Declared per Common Share	2018 \$121	2017 \$119	2016 \$119	2015 \$119	2014 \$114
Net Interest Margin	2018 3.45%	2017 3.43%	2016 3.51%	2015 3.63%	2014 3.50%
Overhead Efficiency Ratio	2018 55.98%	2017 62.08%	2016 58.80%	2015 56.62%	2014 55.21%
Average Assets (In Millions)	2018 \$7,222	2017 \$6,942	2016 \$6,407	2015 \$5,804	2014 \$5,452
Total Risk-Based Capital	2018 19.89%	2017 19.97%	2016 20.85%	2015 21.33%	2014 23.59%

Corporate Profile

Farmers & Merchants Bank is a 112-year-old regional bank with 25 offices offering high-touch, white glove service and top technology...just some of what makes us California's Strongest. 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.

Building Tomorrow Today

This year's annual report highlights four F&M clients who are key mentors in developing future leaders and greater citizenry of tomorrow. These clients embody the values of the Bank, and Farmers & Merchants Bank is honored to partner with these pillars of their communities, establishing a strong foundation together to build tomorrow, today.



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



Comprehensive Child Development Services Long Beach

"We want to do business with organizations that have a sense of responsibility for their community, and that is why we do business with F&M. The Bank is a pillar in the community and understands the concept of stewardship," said Dora Jacildo, Executive Director of Comprehensive Child Development Services, which serves nearly 7,000 children a day through its early care and education program and nutrition program. "We also have a mutually beneficial relationship with the Bank for networking and meeting people who want to advance our mission."

"The Bank is a pillar in the community and understands the concept of stewardship."

Dora Jacildo – Executive Director of Comprehensive Child Development Services

Dora Jacildo – People You Can Bank On

Recipient of F&M's People You Can Bank On Award for 2018, Dora Jacildo has worked to provide crucial care and resources to some of the most vulnerable within the greater Long Beach area. As Executive Director at Comprehensive Child Development Services, Dora's 25 years of service and impact on young children are instrumental in improving access to quality child care programs in Los Angeles County.

With a caring heart, irrepressible creativity and an unyielding commitment to service, Dora is a powerful advocate for a group of children whose well-being and long-term vitality depend on the support she champions.



Marisela Cristich
Vice President/Relationship Manager
Main Office



Dora Jacildo
Executive Director
Comprehensive Child Development Services

Mariners Christian School

Nationally recognized as a Blue Ribbon School, Mariners Christian School is a coeducational independent Christian school of over 680 students located in Costa Mesa, California. Established in 1987, the school's mission is "building a firm foundation through Christ-centered education" in the heart and mind of each child. Each student's development is nurtured in an academically rigorous and Christ-centered environment.

"It's beautiful to see that F&M conducts its business with the same values we find in scripture," said Troy Moore, Head of Mariners Christian School. "The word integrity comes to mind when I think about what characterizes F&M. And because I know the Bank operates with Godly principles, I know we're in good hands."

"The word integrity comes to mind when I think about what characterizes F&M."

Troy Moore – Head of School at Mariners Christian School

F&M OC Regional Headquarters

Farmers & Merchants Bank OC Regional Headquarters underwent extensive renovation in Newport Beach, with completion of all upgrades in September of 2018. F&M OC Regional Headquarters is now an innovative and architectural pillar in the beachside Orange County community. With Branch Manager Bob Martinez at the helm, local decisions can be made immediately to cater to the business and personal banking needs of greater Orange County and surrounding areas.



Troy Moore
Head of School
Mariners Christian School

Bob Martinez
Branch Manager
OC Regional Headquarters

Redondo Beach Unified School District

The Redondo Beach Unified School District (RBUSD), located in Redondo Beach, consists of eight elementary schools, two middle schools, one high school, one continuation school, and one adult school, serving almost 10,000 students. The ongoing goal of RBUSD is to strive for excellence in education through partnership, past traditions and communication, with teachers, staff, parents, community members and, most importantly, the children of the city of Redondo Beach.

"F&M is a great corporate citizen, and that resonates strongly with us," said Dr. Steven E. Keller, Superintendent of Schools for RBUSD. "The Bank participates in our events and donate generously, and they also value investing in people, not just capitalistic endeavors. Shout out to Faisal Hashmi, Branch Manager in Redondo Beach!"

"F&M is a great corporate citizen, and that resonates strongly with us."

Dr. Steven E. Keller – Superintendent of Schools for Redondo Beach Unified School District

F&M Redondo Beach Office

The Farmers & Merchants Bank Redondo Beach Office opened in June of 2015. After several years of renovation at the permanent facility, F&M Redondo Beach is now an unprecedented mainstay in the city of Redondo Beach. Under Branch Manager Faisal Hashmi's leadership, F&M now has the modern facility to better serve the business and personal banking needs of the South Bay.



Dr. Steven Keller
Superintendent of Schools
Redondo Beach Unified School District



Faisal Hashmi
Branch Manager
Redondo Beach Office

RiteCare Program – Santa Barbara

Farmers & Merchants Bank is honored to serve Santa Barbara RiteCare, a nonprofit center that provides screenings, evaluations, and therapy services to preschool-aged children. In operation since 1984, the center is a philanthropy of the Scottish Rite, a concordant body of the Freemasons. One of 170 RiteCare Centers across the U.S., the Center is located in downtown Santa Barbara on the fourth floor of the Masonic Center.

“F&M provides friendly service and takes an active interest in our involvement helping children in need of speech and language therapy at RiteCare,” said Maurice Sourmany, personal representative of the RiteCare program in Santa Barbara. “We share the same philosophy with F&M, prioritizing our community. That’s the most important trait for us.”

**“We share the same philosophy with F&M,
prioritizing our community.”**

Maurice Sourmany – Personal Representative of the RiteCare Program

F&M Santa Barbara Office

Farmers & Merchants Bank Santa Barbara Office opened its doors in October 2018. After months of planning and extensive overhaul of the iconic downtown facility, F&M Santa Barbara Office now has formidable outreach in the greater Santa Barbara community. Branch Manager Nolan Nicholson, the fifth generation of Walker family leadership, guides the team that can provide the expert level of F&M’s white-glove service and top-tier technology to the community of Santa Barbara for the first time.



Maurice Sourmany

Personal Representative of the Language Center
Santa Barbara RiteCare

Nolan Nicholson

Branch Manager
Santa Barbara Office



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Irvine, CA 92618-3391

Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of Farmers & Merchants Bank of Long Beach (the Bank), which comprise the balance sheets as of December 31, 2018 and 2017, 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, 2018 and 2017, 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, 2018, 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, 2019 expressed an unmodified opinion on the effectiveness of the Bank's internal control over financial reporting.

KPMG LLP

Irvine, California
April 23, 2019



Farmers & Merchants Bank of Long Beach

Balance Sheets

	December 31,	
	2018	2017
	(In thousands, except share and per share data)	
<u>Assets</u>		
Cash and due from banks:		
Non-interest-bearing balances	\$ 69,486	\$ 56,604
Interest-bearing balances	17,661	43,512
Total cash and due from banks	87,147	100,116
Securities available-for-sale, at fair value	134,008	187,102
Securities held-to-maturity, at amortized cost	2,649,460	2,657,796
Loans held for sale	20,718	15,038
Gross loans	4,260,093	3,899,110
Allowance for loan losses	(62,450)	(59,502)
Unamortized deferred loan fees, net	(5,973)	(5,611)
Loans, net	4,191,670	3,833,997
Other real estate owned, net	1,724	-
Investments in FHLB and FRB stock, at cost	20,690	20,690
Premises and equipment, net	100,478	95,550
Deferred tax assets, net	19,680	20,726
Other assets	82,661	60,563
Total assets	\$ 7,308,236	\$ 6,991,578
<u>Liabilities and Stockholders' Equity</u>		
Liabilities:		
Deposits:		
Non-interest-bearing deposits	\$ 2,098,097	\$ 2,026,237
Interest-bearing deposits	3,486,369	3,364,874
Total deposits	5,584,466	5,391,111
Securities sold under repurchase agreements	609,791	614,410
Other borrowings	30,000	-
Other liabilities	56,106	26,937
Total liabilities	6,280,363	6,032,458
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	914,164	844,370
Accumulated other comprehensive (loss) income	(954)	87
Total stockholders' equity	1,027,873	959,120
Total liabilities and stockholders' equity	\$ 7,308,236	\$ 6,991,578

See accompanying notes to financial statements.

Farmers & Merchants Bank of Long Beach

Statements of Income

	Years Ended December 31,	
	2018	2017
	(In thousands, except per share data)	
Interest and dividend income:		
Loans	\$ 190,234	\$ 172,772
Investment securities	67,034	63,155
Investments in FHLB and FRB stock	1,694	1,460
Interest-bearing deposits in financial institutions	2,035	1,550
Total interest and dividend income	260,997	238,937
Interest expense:		
Deposits	14,202	10,037
Securities sold under repurchase agreements	7,698	4,252
Other borrowings	41	66
Total interest expense	21,941	14,355
Net interest income	239,056	224,582
Provision for loan losses	2,500	1,000
Net interest income after provision for loan losses	236,556	223,582
Non-interest income:		
Service charges on deposit accounts	5,650	3,971
Card income	3,877	-
Merchant bankcard income	-	10,773
Other real estate owned income	-	17
Other income	8,639	14,162
Total non-interest income	18,166	28,923
Non-interest expense:		
Salaries and employee benefits	88,463	85,086
FDIC and other insurance expense	2,593	2,574
Occupancy expense	10,195	9,252
Software and equipment expense	10,879	9,380
Other real estate owned expense	139	(605)
Merchant bankcard expense	-	8,486
Professional and legal services	5,803	6,024
Marketing expense	5,950	5,307
Other expense	22,076	36,341
Total non-interest expense	146,098	161,845
Income before income tax expense	108,624	90,660
Income tax expense	22,988	25,896
Net income	\$ 85,636	\$ 64,764
Basic and diluted earnings per common share	\$ 654.07	\$ 494.65

See accompanying notes to financial statements.



Farmers & Merchants Bank of Long Beach

Statements of Comprehensive Income

	<u>Years Ended December 31,</u>	
	<u>2018</u>	<u>2017</u>
	<u>(In thousands)</u>	
Net income	<u>\$ 85,636</u>	<u>\$ 64,764</u>
Other comprehensive loss, net of tax:		
Unrealized losses on securities available-for-sale:		
Unrealized holding losses arising during the period	<u>(1,041)</u>	<u>(376)</u>
Other comprehensive loss	<u>(1,041)</u>	<u>(376)</u>
Comprehensive income	<u>\$ 84,595</u>	<u>\$ 64,388</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 (Loss)	Total Stockholders' Equity
			(In thousands)		
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
Net income	-	-	85,636	-	85,636
Cash dividends	-	-	(15,842)	-	(15,842)
Other comprehensive loss, net of tax	-	-	-	(1,041)	(1,041)
Balance, December 31, 2018	\$ 2,619	\$ 112,044	\$ 914,164	\$ (954)	\$ 1,027,873

See accompanying notes to financial statements.



Farmers & Merchants Bank of Long Beach

Statements of Cash Flows

	Years Ended December 31,	
	2018	2017
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 85,636	\$ 64,764
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization on securities	19,634	25,069
Provision for loan losses	2,500	1,000
Originations of loans held for sale	(55,552)	(75,212)
Proceeds from sale of loans held for sale	50,808	67,577
Gain on sale of loans held for sale	(936)	(1,323)
Gain on sale of other real estate owned	-	(9)
Amortization of tax credit investments	11,582	24,076
Gain on sale of bank premises	(22)	(2,815)
Depreciation of bank premises and equipment	7,700	6,968
Addition of reserve for losses on unfunded loan commitments	400	1,300
Decrease in deferred income tax benefit	1,334	9,936
Decrease in other assets	3,875	689
Increase (decrease) in other liabilities	2,119	(3,012)
Total adjustments	43,442	54,244
Net cash provided by operating activities	129,078	119,008
Cash flows from investing activities:		
Securities available-for-sale:		
Proceeds from maturities and pay downs	55,802	75,095
Purchases	(6,338)	(84,295)
Securities held-to-maturity:		
Proceeds from maturities and pay downs	477,514	404,186
Purchases	(486,686)	(320,405)
Net increase in loans held for investment	(361,897)	(430,796)
Proceeds from sale of other real estate owned	-	800
Increase of tax credit investments	(10,730)	(27,212)
Proceeds from sale of bank premises	93	2,937
Purchases of bank premises and equipment	(12,699)	(14,865)
Net cash used in investing activities	(344,941)	(394,555)

Farmers & Merchants Bank of Long Beach

Statements of Cash Flows

Statements of Cash Flows, continued

	Years Ended December 31,	
	2018	2017
	(In thousands)	
Cash flows from financing activities:		
Net increase in deposits	193,355	268,154
Net (decrease) increase in securities sold under repurchase agreements	(4,619)	74,375
Net increase (decrease) in other borrowings	30,000	(100,000)
Cash dividends paid	(15,842)	(15,581)
Net cash provided by financing activities	202,894	226,948
Net decrease in cash and due from banks	(12,969)	(48,599)
Cash and cash equivalents at beginning of year	100,116	148,715
Cash and cash equivalents at end of year	\$ 87,147	\$ 100,116
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest expense	\$ 22,140	\$ 10,006
Income taxes	15,821	13,540
Non-cash investing and financing activities		
Transfers of loans to other real estate owned	\$ 1,724	\$ -
New commitment to fund tax credit investments	37,556	-

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 25 branches in California’s Los Angeles County, Orange County and Santa Barbara County as of December 31, 2018. 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 are in compliance with their modified terms and the modifications were made at market rates for borrowers with similar risk characteristics.

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

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 ALL is based upon a continuing review of the portfolio, past loan loss experience, current economic conditions and external conditions that may affect the borrowers' ability to pay and the underlying collateral value of the loans. Loans that are deemed to be uncollectible are charged off and deducted from the ALL. The provision for loan losses and recoveries on loans previously charged off are added to the ALL.

The ALL 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, 2018, considered actual historical loan charge-off experience over a 13-year period starting with the fourth quarter of 2005. The estimation of the ALL at December 31, 2017, considered actual historical loan charge-off experience over a 12-year period starting with the fourth quarter of 2005. The increase in the historical look-back period from 12 years at December 31, 2017, to 13 years at December 31, 2018, was deemed prudent in order to include loan charge-off experience during the most recent downward economic cycle in the estimation of the ALL. This time frame 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 are 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 costs to sell is charged to the ALL 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 FRB stock 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. Investment 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 Hypothetical Liquidation at Book Value (“HLBV”) method or the proportional amortization method. 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. Investments accounted for using the proportional amortization method are 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 sublessee, 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 ALL 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.

Tax positions that are uncertain but meet a more-likely-than-not recognition threshold are initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position meets the more likely than not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. 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.



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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

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.

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, 2017, and is applied on either a modified retrospective or full retrospective basis. The Bank’s revenue is mainly composed 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. Accordingly, the majority of the Bank’s revenues was not affected. In addition, the new standard did not materially impact the timing or measurement of the Bank’s revenue recognition, as it is consistent with the Bank’s existing accounting for contracts within the scope of the new standard. The Bank adopted this guidance as of January 1, 2018, using the modified retrospective method where there was no cumulative effect adjustment to retained earnings as a result of adopting this new standard. In addition, the standard did not have a material impact on the Bank’s financial statements. See Note 19 – Revenue from Contracts with Customers for additional information.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which requires an entity to disclose the fair value of financial instruments measured at amortized cost on the balance sheet and to measure that fair value using the exit price option. The Bank adopted this guidance as of January 1, 2018, and has adopted the exit price notion on fair value measurement of its loan portfolio. As a result of this fair value change, the prior-year figures shown for loans in Note 15 – Fair Value of Financial Instruments for comparative purposes will no longer be comparable.

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 allow 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 adopted this ASU effective January 1, 2018, which did not have any material impact on its financial statements and related disclosures.

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

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires lessees to recognize all leases longer than 12 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, 2018, and the guidance should be applied using the modified retrospective transition method through a cumulative-effect adjustment. The new standard provides a number of optional practical expedients in transition. The Bank expects to elect the “package of practical expedients,” which permits us not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. The Bank will adopt the new standard on January 1, 2019, and expects to recognize additional Right of Use (ROU) assets of \$10.1 million and lease liabilities of \$10.4 million, based on the present value of the remaining minimum rental payments under current leasing standards for existing operating leases.

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 CECL Committee in 2017 to develop, implement and review the adoption of ASU 2016-13. In 2018, the Bank established an implementation plan, selected a software solution, reached preliminary accounting decisions on various matters and is engaged in the implementation phase of the project. The Bank continues to develop and document the new expected loss model with supportable assumptions and address data and reporting requirements. The Bank expects to begin parallel calculations, testing, and sensitivity analysis on its initial modeling assumptions and results in the fourth quarter of 2019. 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 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This update targets improvements in the effectiveness of disclosure requirements for recurring and nonrecurring fair value measurements. The standard removes, modifies, and adds certain disclosure requirements, and is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Adoption of ASU 2018-13 is not expected to have a significant impact on the Bank’s financial statements and related disclosures.



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

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, 2018				
SBA pool securities	\$ 5,027	\$ 117	\$ -	\$ 5,144
Mortgage-backed securities	66,980	82	(1,604)	65,458
State and municipal securities	63,355	291	(240)	63,406
Total securities available-for-sale	<u>\$ 135,362</u>	<u>\$ 490</u>	<u>\$ (1,844)</u>	<u>\$ 134,008</u>
As of December 31, 2017				
SBA pool securities	\$ -	\$ -	\$ -	\$ -
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>

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, 2018		
Due in 1 year or less	\$ 24,744	\$ 24,723
Due after 1 year through 5 years	30,889	31,125
Due after 5 years through 10 years	15,186	15,026
Due after 10 years	64,543	63,134
	<u>\$ 135,362</u>	<u>\$ 134,008</u>
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>

The Bank did not sell any securities during 2018 and 2017.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 2 – Securities Available-for-Sale, continued

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, 2018						
Mortgage-backed securities	\$ 14,723	\$ (320)	\$ 46,715	\$ (1,284)	\$ 61,438	\$ (1,604)
State and municipal securities	8,713	(29)	29,885	(211)	38,598	(240)
Total temporarily impaired securities	<u>\$ 23,436</u>	<u>\$ (349)</u>	<u>\$ 76,600</u>	<u>\$ (1,495)</u>	<u>\$ 100,036</u>	<u>\$ (1,844)</u>
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>

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 50 and 230, respectively, for the year ended December 31, 2018, and 426 and 161, respectively, for the year ended December 31, 2017. 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, 2018 and 2017, 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, 2018			
Unrealized losses on securities:			
Unrealized holding losses arising during period	\$ (1,504)	\$ 463	\$ (1,041)
Other comprehensive loss	<u>\$ (1,504)</u>	<u>\$ 463</u>	<u>\$ (1,041)</u>



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 2 – Securities Available-for-Sale, continued

	Before- Tax Amount	Tax Benefit (In thousands)	Net-of-Tax Amount
Year ended December 31, 2017			
Unrealized losses on securities:			
Unrealized holding losses arising during period	\$ (649)	\$ 273	\$ (376)
Other comprehensive loss	\$ (649)	\$ 273	\$ (376)

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, 2018				
SBA pool securities	\$ 80,263	\$ 1,332	\$ (140)	\$ 81,455
Mortgage-backed securities	2,041,099	3,045	(45,318)	1,998,826
State and municipal securities	381,797	2,108	(1,244)	382,661
Collateralized mortgage obligations	146,301	2,444	(681)	148,064
Total securities held-to-maturity	\$ 2,649,460	\$ 8,929	\$ (47,383)	\$ 2,611,006
As of December 31, 2017				
SBA pool 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

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 3 – Securities Held-to-Maturity, continued

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

	<u>Amortized Cost</u>	<u>Fair Value</u>
	(In thousands)	
As of December 31, 2018		
Due in 1 year or less	\$ 163,460	\$ 163,585
Due after 1 year through 5 years	192,036	193,355
Due after 5 years through 10 years	683,002	678,452
Due after 10 years	1,610,962	1,575,614
	<u>\$ 2,649,460</u>	<u>\$ 2,611,006</u>
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>

There were no sales or transfers of securities held-to-maturity in 2018 or 2017.

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>	
	<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, 2018						
SBA pool securities	\$ -	\$ -	\$ 10,458	\$ (140)	\$ 10,458	\$ (140)
Mortgage-backed securities	509,841	(6,692)	1,225,080	(38,626)	1,734,921	(45,318)
State and municipal securities	42,838	(220)	128,969	(1,023)	171,807	(1,243)
Collateralized mortgage obligations	9,431	(115)	26,885	(567)	36,316	(682)
Total temporarily impaired securities	<u>\$ 562,110</u>	<u>\$ (7,027)</u>	<u>\$ 1,391,392</u>	<u>\$ (40,356)</u>	<u>\$ 1,953,502</u>	<u>\$ (47,383)</u>



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 3 – Securities Held-to-Maturity, 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, 2017						
SBA pool 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>

The Bank's held-to-maturity portfolio is primarily composed 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 372 and 610, respectively, for the year ended December 31, 2018, and 556 and 202, respectively, for the year ended December 31, 2017. Management believes that securities held-to-maturity in an unrealized loss position as December 31, 2018 and 2017, 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 \$1.38 billion for December 31, 2018, and \$1.31 billion for December 31, 2017, were pledged to secure securities sold under repurchase agreements, public deposits, FRB's daylight overdraft, and for other purposes required by law.

Interest income on tax-exempt securities was \$9.8 million for the year ended December 31, 2018, and \$10.8 million for the year ended December 31, 2017.

NOTE 4 – LOANS AND ALLOWANCE FOR LOAN LOSSES

The loan portfolio is composed mainly of credit extended to borrowers in Southern California with the majority of loans secured by real estate, even though a substantial amount of the Bank's loans are intended for business purposes. There is no concentration of loans to borrowers in a specific industry within the loan portfolio. Loans are generally expected to be paid off from the operating cash flow of the borrowers, refinancing by another lender, or through sale by the borrowers of the secured collateral.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

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

	December 31,	
	2018	2017
	(In thousands)	
Commercial & industrial	\$ 139,376	\$ 96,221
Construction	526,011	467,021
Commercial real estate	2,712,210	2,429,643
Residential mortgages	761,669	756,719
Equity lines	92,639	122,206
Installment and other loans	28,188	27,300
Gross loans	\$ 4,260,093	\$ 3,899,110
Less: Allowance for loan losses	(62,450)	(59,502)
Unamortized deferred loan fees, net	(5,973)	(5,611)
Loans, net	\$ 4,191,670	\$ 3,833,997
Loans held for sale	20,718	15,038
Total loans receivable, net	\$ 4,212,388	\$ 3,849,035

Total loans with a balance of \$714.2 million and \$689.6 million at December 31, 2018, and December 31, 2017, respectively, were pledged to secure the Bank's FHLB advance line.

Nonaccrual and Past Due Loans

Loans are tracked by the numbers of days that the 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, 2018					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days & Over Still Accruing	Nonaccrual	Current	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	\$ 1,776	\$ -	\$ -	\$ -	\$ 137,600	\$ 139,376
Construction	-	-	-	1,609	524,402	526,011
Commercial real estate	475	-	-	897	2,710,838	2,712,210
Residential mortgages	5,092	849	-	10,847	744,881	761,669
Equity lines	996	-	-	875	90,768	92,639
Installment and other loans	-	33	3	-	28,152	28,188
Gross loans	\$ 8,339	\$ 882	\$ 3	\$ 14,228	\$ 4,236,641	\$ 4,260,093



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

Nonaccrual and Past Due Loans, continued

	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

The following is a summary of selected information related to the nonaccrual loans outstanding as of December 31, 2018 and 2017, and the related contractual interest income foregone for the years indicated:

	2018	2017
	(In thousands)	
Nonaccrual loans		
Outstanding balance	\$ 14,228	\$ 14,922
Average balance	14,428	11,607
Interest income recorded	55	161
Interest income foregone	712	500

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, 2018			December 31, 2017		
	Nonclassified	Classified	Total	Nonclassified	Classified	Total
	(In thousands)					
Loan Segment						
Commercial & industrial	\$ 136,963	\$ 2,413	\$ 139,376	\$ 93,267	\$ 2,954	\$ 96,221
Construction	515,486	10,525	526,011	462,871	4,150	467,021
Commercial real estate	2,696,181	16,029	2,712,210	2,406,741	22,902	2,429,643
Residential mortgages	743,304	18,365	761,669	741,894	14,825	756,719
Equity lines	89,926	2,713	92,639	119,760	2,446	122,206
Installment and other loans	28,188	-	28,188	27,300	-	27,300
Total	<u>\$ 4,210,048</u>	<u>\$ 50,045</u>	<u>\$ 4,260,093</u>	<u>\$ 3,851,833</u>	<u>\$ 47,277</u>	<u>\$ 3,899,110</u>

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

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 \$4.3 million at December 31, 2018, and \$14.7 million at December 31, 2017.

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

	No. of <u>Contracts</u>	Pre- modification Outstanding Recorded <u>Investment</u>	Post- modification Outstanding Recorded <u>Investment</u>	Charge-offs During <u>Modification</u>	Allocated <u>Reserve</u>	TDRs That Subsequently Defaulted	
						No. of <u>Contracts</u>	Recorded <u>Investment</u>
(In thousands, except number of contracts)							
As of December 31, 2018							
Loan Segment							
Commercial real estate	1	\$ 905	\$ 905	\$ -	\$ -	-	\$ -
Equity lines	1	395	395	-	-	-	-
Total	2	\$ 1,300	\$ 1,300	\$ -	\$ -	-	\$ -

As of December 31, 2017

Loan Segment							
Commercial real estate	6	\$ 8,590	\$ 8,590	\$ -	\$ -	-	\$ -
Equity lines	1	346	346	-	-	-	-
Total	7	\$ 8,936	\$ 8,936	\$ -	\$ -	-	\$ -

Accruing TDRs

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

	<u>Principal Deferral</u>	<u>Rate Reduction</u>	<u>Combination of Such Concession</u>	<u>Total</u>
	(In thousands)			
As of December 31, 2018				
Loan Segment				
Construction	\$ 2,200	\$ -	\$ -	\$ 2,200
Commercial real estate	-	-	733	733
Residential mortgages	-	-	-	-
Equity lines	105	-	-	105
Total loans	<u>\$ 2,305</u>	<u>\$ -</u>	<u>\$ 733</u>	<u>\$ 3,038</u>



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

Accruing TDRs, continued

	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
Equity lines	347	-	-	347
Total loans	\$ 13,386	\$ -	\$ 758	\$ 14,144

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, 2018					
Loan Segment					
Commercial real estate	\$ 897	\$ -	\$ -	\$ -	\$ 897
Equity lines	388	-	-	-	388
Total loans	<u>\$ 1,285</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,285</u>
As of December 31, 2017					
Loan Segment					
Commercial real estate	\$ -	\$ -	\$ -	\$ 547	\$ 547
Equity lines	-	-	-	-	-
Total loans	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 547</u>	<u>\$ 547</u>

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 4 – Loans and Allowance for Loan Losses, continued

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:

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment with No ALL</u>	<u>Recorded Investment with ALL</u>	<u>Related ALL</u>	<u>Total</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
(In thousands)							
As of December 31, 2018							
Loan Segment							
Construction	\$ 3,950	\$ 3,809	\$ -	\$ -	\$ 3,809	\$ 3,980	\$ 141
Commercial real estate	1,634	1,630	-	-	1,630	1,315	76
Residential mortgages	11,075	10,847	-	-	10,847	11,552	-
Equity lines	1,027	980	-	-	980	851	27
Total	<u>\$ 17,686</u>	<u>\$ 17,266</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 17,266</u>	<u>\$ 17,698</u>	<u>\$ 244</u>

As of December 31, 2017

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	<u>\$ 29,668</u>	<u>\$ 29,066</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 29,066</u>	<u>\$ 21,921</u>	<u>\$ 859</u>

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.

	<u>December 31, 2018</u>			<u>December 31, 2017</u>		
	<u>Individually Evaluated for Impairment</u>	<u>Collectively Evaluated for Impairment</u>	<u>Total</u>	<u>Individually Evaluated for Impairment</u>	<u>Collectively Evaluated for Impairment</u>	<u>Total</u>
(In thousands)						
Loan Segment						
Commercial & industrial	\$ -	\$ 139,376	\$ 139,376	\$ -	\$ 96,221	\$ 96,221
Construction	3,809	522,202	526,011	4,150	462,871	467,021
Commercial real estate	1,630	2,710,580	2,712,210	12,076	2,417,567	2,429,643
Residential mortgages	10,847	750,822	761,669	11,977	744,742	756,719
Equity lines	980	91,659	92,639	863	121,343	122,206
Installment and other loans	-	28,188	28,188	-	27,300	27,300
Total	<u>\$ 17,266</u>	<u>\$ 4,242,827</u>	<u>\$ 4,260,093</u>	<u>\$ 29,066</u>	<u>\$ 3,870,044</u>	<u>\$ 3,899,110</u>



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:

	Commercial & Industrial	Construction	Commercial Real Estate	Residential Mortgages	Equity Lines	Installment and Other Loans	Total
	(In thousands)						
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
Provision	130	1,229	2,157	(645)	(304)	(67)	2,500
Charge-Offs	-	-	-	-	(10)	(165)	(175)
Recoveries	259	-	-	3	210	151	623
December 31, 2018	<u>\$ 1,894</u>	<u>\$ 16,975</u>	<u>\$ 37,835</u>	<u>\$ 5,075</u>	<u>\$ 235</u>	<u>\$ 436</u>	<u>\$ 62,450</u>

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

Individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Collectively evaluated for impairment	<u>\$ 1,894</u>	<u>\$ 16,975</u>	<u>\$ 37,835</u>	<u>\$ 5,075</u>	<u>\$ 235</u>	<u>\$ 436</u>	<u>\$ 62,450</u>

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, 2018 and 2017, were as follows:

	December 31,	
	2018	2017
	(In thousands)	
Balance, beginning of year	\$ 5,300	\$ 4,000
Addition	400	1,300
Balance, end of year	<u>\$ 5,700</u>	<u>\$ 5,300</u>

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 5 – OTHER REAL ESTATE OWNED

At December 31, 2018, the Bank had two OREO properties with a carrying value of \$1.7 million and no reserve. At December 31, 2017, the Bank had no OREO. The following table summarizes the net carrying value of OREO by property type at the dates indicated:

	December 31,	
	2018	2017
	(In thousands)	
Commercial real estate	\$ 1,019	\$ -
Single-family residence	705	-
Total OREO, net	<u>\$ 1,724</u>	<u>\$ -</u>

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

	2018	2017
	(In thousands)	
Rental income	\$ -	\$ 8
Net gain on sale	-	9
Total OREO income	<u>-</u>	<u>17</u>
Operating and maintenance (reimbursements), net	139	(605)
Total OREO expense	<u>139</u>	<u>(605)</u>
OREO (expense) income, net	<u>\$ (139)</u>	<u>\$ 622</u>

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 \$51.9 million and \$25.8 million at December 31, 2018 and December 31, 2017, respectively, and are included in other assets on the balance sheets. Unfunded commitments related to these tax credit investments totaled \$30.7 million and \$3.8 million at December 31, 2018 and December 31, 2017, respectively, and are included in other liabilities on the balance sheets.

The Bank's usage of federal tax credits totaled \$13.1 million for 2018 and \$19.0 million for 2017. The Bank's remaining tax credits to be utilized over a multiple-year period approximated \$45.0 million and \$16.9 million at December 31, 2018 and December 31, 2017, respectively. Under the proportional amortization method, the amortization of the investments recognized as a component of income tax expenses for the years ended December 31, 2018 and 2017, were \$2.8 million and \$2.7 million, respectively.



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,	
	2018	2017
	(In thousands)	
Land	\$ 38,083	\$ 38,083
Buildings and building improvements	79,685	74,253
Furniture, fixtures and equipment	41,802	37,259
Leasehold improvements	4,467	2,832
Construction in progress	2,577	3,064
	166,614	155,491
Less accumulated depreciation and amortization	(66,136)	(59,941)
Total premises and equipment, net	<u>\$ 100,478</u>	<u>\$ 95,550</u>

Depreciation and amortization expense was \$7.7 million in 2018 and \$7.0 million in 2017.

The Bank is obligated 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, 2018 and 2017, was \$2.1 million and \$1.5 million, respectively. Total lease income for the years ended December 31, 2018 and 2017, was \$2.3 million and \$2.1 million, respectively.

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, 2018:

	Commitments	
	Expense	Income
	(In thousands)	
2019	\$ 1,721	\$ 2,075
2020	1,765	1,925
2021	1,807	1,498
2022	1,860	945
2023	1,471	291
Thereafter	3,212	213

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,	
	2018	2017
	(In thousands)	
Non-interest-bearing checking	\$ 2,098,097	\$ 2,026,237
Interest-bearing checking	1,178,886	925,308
Money market accounts	890,327	948,904
Savings deposits	676,119	694,955
Total core deposits	<u>\$ 4,843,429</u>	<u>\$ 4,595,404</u>
Time deposits:		
\$250,000 or less	\$ 402,776	\$ 429,910
Greater than \$250,000	338,261	365,797
Total time deposits	<u>741,037</u>	<u>795,707</u>
Total deposits	<u><u>\$ 5,584,466</u></u>	<u><u>\$ 5,391,111</u></u>

As of December 31, 2018, the maturity distribution of the Bank's time deposits was as follows:

	\$250,000 or Less	Greater Than \$250,000 (In thousands)	Total
2019	\$ 255,431	\$ 219,316	\$ 474,747
2020	69,184	59,893	129,077
2021	39,014	30,653	69,667
2022	20,736	13,876	34,612
2023	18,411	14,523	32,934
	<u>\$ 402,776</u>	<u>\$ 338,261</u>	<u>\$ 741,037</u>

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,	
	2018	2017
	(In thousands)	
Securities sold under repurchase agreements	\$ 609,791	\$ 614,410
Weighted average interest rate	1.63%	0.89%
Securities underlying repurchase agreements	\$ 738,955	\$ 765,050
Fair value of securities underlying repurchase agreements	\$ 723,794	\$ 764,546

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 2018 and 2017, respectively:

	2018	2017
	(In thousands)	
Average outstanding	\$ 637,228	\$ 619,751
Weighted average interest rate	1.21%	0.69%
Maximum amounts outstanding	\$ 727,885	\$ 680,418

NOTE 10 – OTHER BORROWINGS

The Bank's available borrowing capacity from federal funds lines of credit and FRB discount window amounted to \$616.5 million and \$596.9 million as of December 31, 2018 and 2017, respectively. The Bank's available secured borrowing capacity for FHLB advances totaled \$481.8 million and \$538.0 million as of December 31, 2018 and 2017, respectively.

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

	December 31,	
	2018	2017
	(In thousands)	
FHLB advances outstanding at year-end	\$ 30,000	\$ -
Weighted average rate on outstanding at year-end	2.56%	-
Highest month-end balance	\$ 30,000	\$ 150,000
Average amount outstanding	\$ 1,740	\$ 7,658
Weighted average rate	2.37%	0.83%

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 11 – INCOME TAXES

The income tax expense for the years ended December 31, 2018 and 2017, are composed of the following:

	<u>2018</u>	<u>2017</u>
	<u>(In thousands)</u>	
Current income taxes:		
Federal	\$ 10,706	\$ 5,696
State	10,948	10,264
Total current income tax expense	<u>21,654</u>	<u>15,960</u>
Deferred income taxes:		
Federal	(312)	10,273
State	1,646	(337)
Total deferred income tax expense	<u>1,334</u>	<u>9,936</u>
Total income tax expense	<u><u>\$ 22,988</u></u>	<u><u>\$ 25,896</u></u>

Significant temporary differences that give rise to the deferred tax assets and liabilities as of December 31, 2018 and 2017, are as follows:

	<u>2018</u>	<u>2017</u>
	<u>(In thousands)</u>	
Deferred tax assets		
Allowance for loan losses	\$ 21,699	\$ 20,633
Tax credit investments — state tax basis difference	4,785	5,943
Capital loss carry forward	959	914
State income taxes	763	272
Accrued employee compensation	478	415
Premises and equipment depreciation and amortization	147	597
Other, net	614	1,892
Gross deferred tax assets	<u>29,445</u>	<u>30,666</u>
Valuation allowance	<u>(5,671)</u>	<u>(4,829)</u>
Deferred tax assets, net of valuation allowance	<u><u>\$ 23,774</u></u>	<u><u>\$ 25,837</u></u>
Deferred tax liabilities		
Net unrealized gain on securities available-for-sale	\$ -	\$ 63
Tax credit investments — federal tax basis difference	1,581	2,739
Deferred loan origination costs	1,631	1,470
Other, net	882	839
Gross deferred tax liabilities	<u>4,094</u>	<u>5,111</u>
Net deferred tax assets	<u><u>\$ 19,680</u></u>	<u><u>\$ 20,726</u></u>



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 11 – Income Taxes, continued

The statutory federal income tax rate was 21% for 2018 and 35% for 2017. The difference between the effective tax rate in the financial statements and the federal income tax rate is attributed to the following:

	2018	2017
Federal income tax rate	21.0%	35.0%
State income taxes, net of federal benefit	8.6%	6.4%
Tax-exempt interest income	(2.6%)	(4.9%)
Tax credits, net of amortization	(6.3%)	(15.7%)
Write down of DTA/DTL due to tax rate change	-	7.6%
Other	0.4%	0.2%
	<u>21.1%</u>	<u>28.6%</u>

The lower effective tax rate during the year ended December 31, 2018, compared to the same period in 2017 was primarily due to the decrease of the statutory federal income tax rate from 35% to 21% as a result of the Tax Reform Act, which was enacted into law on December 22, 2017. In 2017, as a result of the Tax Reform Act, there was a one-time write down of deferred tax assets and liabilities and the Bank recognized \$6.8 million of additional tax expense due to the revaluation. This additional income tax expense contributed to a higher tax rate in 2017. The reduction in the effective tax rate for 2018 was partially offset by fewer tax credits available to the Bank in 2018 compared to 2017. Tax credits available in 2018 were \$11.5 million compared to \$20.4 million in 2017. In addition, as of December 31, 2018, the Bank did not have any federal tax credit carryforwards while there was \$1.4 million in 2017.

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 the Bank's 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 that remain open to audit. As of December 31, 2018, tax years 2015 through 2018 for federal purposes, and taxes years 2009 through 2011 and 2014 through 2018 for state purposes, 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, 2018 and 2017, 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, 2018 and 2017.

	<u>2018</u>	<u>2017</u>
	<u>(In thousands, except share</u>	<u>and per share data)</u>
Basic and diluted earnings per share:		
Net income available to common stockholders	\$ 85,636	\$ 64,764
Weighted average number of common shares outstanding	130,928	130,928
Weighted basic and diluted earnings per common share	\$ 654.07	\$ 494.65

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>2018</u>	<u>2017</u>
	<u>(In thousands)</u>	
Commitments to extend credit	\$ 1,669,926	\$ 1,459,527
Financial standby letters of credit	13,909	12,998
Performance standby letters of credit	6,463	6,971
	<u>\$ 1,690,298</u>	<u>\$ 1,479,496</u>



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 13 – Commitments & 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 securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.

Loans held for sale — Loans held for sale are carried at the lower of cost or fair value. The Bank records loans held for sale at fair value based on quoted prices from third party sale analysis, existing sale agreements, or appraisal reports adjusted by sales commission assumption, which is 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 that 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 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.



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 14 – Fair Value Measurements, continued

The following table presents the Bank's hierarchy for its assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities are reported on the balance sheets at their fair values as of December 31, 2018 and 2017:

	Fair Value Measurements Using			Total at
	Level 1	Level 2	Level 3	Fair Value
	(In thousands)			
As of December 31, 2018				
Assets				
On a recurring basis:				
Securities available-for-sale	\$ -	\$ 134,008	\$ -	\$ 134,008
Loans held for sale	-	19,813	-	19,813
On a non-recurring basis:				
Impaired loans	-	-	-	-
Other real estate owned	-	-	-	-
Total assets	\$ -	\$ 153,821	\$ -	\$ 153,821
As of December 31, 2017				
Assets				
On a recurring basis:				
Securities available-for-sale	\$ -	\$ 187,102	\$ -	\$ 187,102
Loans held for sale	-	-	-	-
On a non-recurring basis:				
Impaired loans	-	-	-	-
Other real estate owned	-	-	-	-
Total assets	\$ -	\$ 187,102	\$ -	\$ 187,102

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, 2018 and 2017, the amounts that will actually be realized could be significantly different.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 15 – Fair Value of Financial Instruments, continued

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 the quoted price for similar financial characteristics, commitments outstanding from investors, or book value.

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. In 2018, the Bank adopted ASU 2016-01 and has updated its valuation methods as necessary to conform to an "exit price" concept as required by ASU 2016-01.

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.



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE15—Fair Value of Financial Instruments, continued

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 the fair value of the fees charged to enter into such agreements to be nominal.

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

	Carrying Value	Level 1	Level 2	Level 3	Estimated Fair Value
			(In thousands)		
As of December 31, 2018					
Financial Assets:					
Cash and due from banks	\$ 87,147	\$ 87,147	\$ -	\$ -	\$ 87,147
Securities available-for-sale	134,008	-	134,008	-	134,008
Securities held-to-maturity	2,649,460	-	2,593,555	17,451	2,611,006
Loans held for sale	20,718	-	20,732	-	20,732
Loans, net of allowance for loan losses	4,191,670	-	-	4,275,651	4,275,651
Investments in FHLB and FRB stock	20,690	-	20,690	-	20,690
Financial Liabilities:					
Deposits:					
Non-interest-bearing deposits	\$ 2,098,097	\$ -	\$ 2,098,097	\$ -	\$ 2,098,097
Interest-bearing deposits	1,178,886	-	1,178,886	-	1,178,886
Savings and money market deposits	1,566,446	-	1,566,446	-	1,566,446
Time deposits	741,037	-	741,037	-	741,037
Securities sold under repurchase agreements	609,791	-	609,791	-	609,791
FHLB advances	30,000	-	30,000	-	30,000

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 15 – Fair Value of Financial Instruments, continued

Off-Balance-Sheet Financial Instruments, continued

	Carrying Value	Level 1	Level 2	Level 3	Estimated Fair Value
	(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	-	-	-	-	-

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 leased its Torrance branch location from Queen City, which is subject to an ongoing lease agreement. The Bank paid \$284,000 and \$276,000, respectively, in lease expense to Queen City for the years ended December 31, 2018 and 2017.

The Bank and the Trust Company have 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 2018 and 2017, the Trust Company paid the Bank a net total of \$354,000 and \$361,000, respectively, under this agreement.



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 16—Related Party Transactions, continued

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. For the years ended December 31, 2018 and 2017, the Trust Company paid the Bank a total of \$58,000 and \$56,000, respectively, for the difference between the values of services exchanged between the parties.

The Trust Company also has leased office space from the Bank at the Long Beach, Laguna Hills and Newport Beach locations, which are subject to ongoing lease agreements. For the years ended December 31, 2018 and 2017, the Trust Company paid \$147,000 and \$63,000, respectively, in lease expense to the Bank related to these ongoing lease agreements. In 2018, the Bank also had a lease agreement with the Trust Company to lease office space at the Santa Barbara location. For the year ended December 31, 2018, the Bank paid the Trust Company a total of \$10,000 in lease expense related to this lease agreement.

A related party of the Bank has leased office space at the Bank's Rossmoor location, which is subject to an ongoing lease agreement. For the year ended December 31, 2018, the related party paid a total of \$41,000 related to this lease agreement.

At December 31, 2018 and 2017, no loans were outstanding with any related party. At December 31, 2018 and 2017, related-party deposits were \$159 million and \$98 million, respectively, of which, \$155 million and \$89 million, respectively, were attributable to Queen City and its subsidiaries.

In the ordinary course of business, the Bank may enter into other transactions with various related parties. Related party transactions not included herein were not material for the years ended December 31, 2018 and 2017.

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 \$7.3 million and \$6.9 million for the profit-sharing plan in 2018 and 2017, respectively. At December 31, 2018 and 2017, 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 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.

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 18 – Regulatory Matters, continued

As of December 31, 2018, the most recent notification from the FRB 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.

	Actual		Minimum Capital Requirements		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Rate	Amount	Rate	Amount	Rate
(Dollars in thousands)						
As of December 31, 2018:						
Total risk-based capital ratio	\$ 1,096,976	19.89% ≥	\$ 414,217	≥ 8.00%	\$ 551,521	≥ 10.00%
Tier 1 risk-based capital ratio	1,028,827	18.66% ≥	330,813	≥ 6.00%	441,083	≥ 8.00%
Common equity tier 1 capital ratio	1,028,827	18.66% ≥	248,109	≥ 4.50%	358,380	≥ 6.50%
Tier 1 leverage ratio	1,028,827	14.04% ≥	293,113	≥ 4.00%	366,391	≥ 5.00%
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%

NOTE 19—REVENUE FROM CONTRACTS WITH CUSTOMERS

The Bank adopted Topic 606, *Revenue from Contracts with Customers* effective as of January 1, 2018. Revenue from contracts with customers in the scope of Topic 606 is measured based on the consideration specified in the contract with a customer, and excludes amounts collected on behalf of third parties. The Bank recognizes revenue from contracts with customers when it satisfies its performance obligations. The Bank's performance obligations are typically satisfied as services are rendered and payment is generally collected at the time services are rendered, or on a monthly, quarterly or annual basis. The Bank had no material unsatisfied performance obligations as of December 31, 2018.

In certain cases, other parties are involved with providing products and services to our customers. If the Bank is a principal in the transaction (providing goods or services itself), revenues are reported based on the gross consideration received from the customer and any related expenses are reported gross in noninterest expense. If the Bank is an agent in the transaction (arranging for another party to provide goods or services), the Bank reports its net fee or commission retained as revenue.



Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 19—Revenue from Contracts With Customers, continued

Rebates, waivers, and reversals are recorded as a reduction of revenue either when the revenue is recognized by the Bank or at the time the rebate, waiver, or reversal is earned by the customer.

Card Income consists of interchange fees from merchant bankcards and debit cards, merchant acquirer revenue, and other card related services. Prior to the adoption of Topic 606, the Bank disclosed merchant bankcard income as a separate line in the Bank's Statement of Income and debit card income as part of other income. Interchange fees are earned by the Bank each time a request for payment is initiated by a customer at a merchant for which the Bank transfers the funds on behalf of the customer. Interchange rates are set by the payment network and are based on purchase volumes and other factors. The Bank is considered an agent of the customer and incurs costs with the payment network to facilitate the interchange with the merchant; therefore, the related payment network expense is recognized as a reduction of card income. The Bank offers rewards and/or rebates to its customers based on card usage. The costs associated with these programs are recognized as a reduction of Card Income. Prior to the adoption of Topic 606, these expenses were recognized in merchant bankcard expense and other expense in the Bank's Statements of Income.

The table below shows the impact to 2017's presentation if Topic 606 was applied to 2017:

	2017
	(In thousands)
Merchant bankcard income	\$ 10,773
Topic 606 reclasses:	
Merchant bankcard expense	(8,486)
Debit card income	2,855
Debit card expense	(1,640)
Card Income, net of related expenses	<u>\$ 3,502</u>

The Bank has elected the following practical expedients: (1) we do not disclose information about remaining performance obligations that have original expected durations of one year or less; and (2) we do not adjust the consideration from customers for the effects of a significant financing component if at contract inception the period between when the Bank transfers the goods or services and when the customer pays for that good or service will be one year or less.

Nature of Goods and Services

Substantially all of the Bank's revenue, such as interest income on loans, investment securities, and interest-earning deposits in financial institutions, is specifically out-of-scope of Topic 606. For the revenue that is in-scope, the following is a description of principal activities, separated by the timing of revenue recognition, from which the Bank generates its revenue from contracts with customers:

Farmers & Merchants Bank of Long Beach

Notes to Financial Statements

NOTE 19 – Revenue from Contracts with Customers, continued

Nature of Goods and Services, continued

Revenue earned at a point in time: Examples of revenue earned at a point in time are ATM transaction fees, wire transfer fees, NSF fees, and merchant and debit card interchange fees. Revenue is generally derived from transactional information accumulated by our systems and is recognized as revenue immediately as the transactions occur or upon providing the service to complete the customer's transaction. The Bank is the principal in each of these contracts with the exception of merchant and debit card interchange fees, in which case the Bank is acting as the agent and records revenue net of expenses paid to the principal.

Revenue earned over time: The Bank earns certain revenue from contracts with customers as services are rendered on a monthly, quarterly or annual basis. Examples of this type of revenue are deposit account service fees, HELOC fees, letter of credit, and safe deposit box fees. Account service fees are recognized on a monthly basis. Revenue is primarily based on services rendered on the number and type of transactions. Revenue is recorded in the same period as the related transactions occur or services are rendered to the customer.

NOTE 20 – SUBSEQUENT EVENTS

The Bank has evaluated events that have occurred subsequent to December 31, 2018 and through April 23, 2019, 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 2018.



Corporate Information

Board of Directors

Daniel K. Walker, Chairman of the Board
JoAnn M. Bourne
Richard W. Darling
Walter M. Florie
Lawrence J. McLaughlin
Christine A. Scheuneman
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, Janofsky & Walker LLP
695 Town Center Drive, 17th Floor
Costa Mesa, CA 92626

Investor Relations

PondelWilkinson Inc.
1880 Century Park East, Suite 350
Los Angeles, CA 90067

Transfer Agent

American Stock Transfer & 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

East Long Beach

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

Lake Forest

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

Orange

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

San Juan Capistrano

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

Belmont Shore

4827 E. 2nd St.
Long Beach, CA 90803
(562) 621-1430
Since 1971

Fullerton

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

Lakewood

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

Redondo Beach

1333 S. Pacific Coast Hwy.
Redondo Beach, CA 90277
(310) 802-7560
Since 2015

Santa Ana

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

Bixby Knolls

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

Garden Grove

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

Los Altos

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

Rolling Hills Estates

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

Santa Barbara

33 E. Carrillo St.
Santa Barbara, CA 93101
(805) 280-4700
Since 2018

Corona del Mar

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

Huntington Beach

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

Memorial Hospital

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

Rossmoor

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

Torrance

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

Downey

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

Laguna Hills

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

Newport Beach

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

San Clemente

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

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

OC Regional Headquarters

4695 MacArthur Ct., Ste.130
Newport Beach, CA 92660
(949) 241-8280
Since 2018

Religious Client Services

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







FMB.com

Member FDIC