F&M BANK CORP
Form 10-K
March 16, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For fiscal year ended December 31, 2017
Commission file number: 0-13273
F & M BANK CORP.

(Exact name of registrant as specified in its charter)

Virginia	54-1280811
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

P. O. Box 1111, Timberville, Virginia 22853
(Address of principal executive offices) (Zip Code)
(540) 896-8941
(Registrant's telephone number including area code)
Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act:
Common Stock - $5 Par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Sarbanes Act. Yes [ ] No [x]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [ ] No [x]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [x]

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

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

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

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

The registrant's Common Stock is traded Over-the-Counter under the symbol FMBM. The aggregate market value of the 2,932,029 shares of Common Stock of the registrant issued and outstanding held by non-affiliates on June 30, 2017 was approximately $85,615,255 based on the closing sales price of $29.20 per share on that date. For purposes of this calculation, the term "affiliate" refers to all directors and executive officers of the registrant.

As of the close of business on March 9, 2018, there were 3,256,579 shares of the registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Part III: Proxy Statement for the Annual Meeting of Shareholders to be held on May 12, 2018 (the "Proxy Statement").

Table of Contents

PART IV

PART I

Item 1. Business

General

F & M Bank Corp. (the “Company” or “we”), incorporated in Virginia in 1983, is a one bank financial holding company pursuant to section 3(a)(1) of the Bank Holding Company Act of 1956, and owns 100% of the outstanding stock of its affiliate, Farmers & Merchants Bank (“Bank”) and a majority interest in VS Title, LLC (“VST”). TEB Life Insurance Company (“TEB”) and Farmers & Merchants Financial Services, Inc. (“FMFS”) are wholly owned subsidiaries of the Bank. The Bank also holds a majority ownership in VBS Mortgage, LLC (“VBS”).

The Bank was chartered on April 15, 1908, as a state chartered bank under the laws of the Commonwealth of Virginia. TEB was incorporated on January 27, 1988, as a captive life insurance company under the laws of the State of Arizona. FMFS is a Virginia chartered corporation and was incorporated on February 25, 1993. VBS (formerly Valley Broker Services, Inc.) was incorporated on May 11, 1999. The Bank purchased a majority interest in VBS on November 3, 2008 and the Company purchased a majority interest in VST on January 1, 2017. VBS Mortgage owns the remaining minority interest in VST.

As a commercial bank, the Bank offers a wide range of banking services including commercial and individual demand and time deposit accounts, commercial and individual loans, internet and mobile banking, drive-in banking services, ATMs at all branch locations and several off-site locations, as well as a courier service for its commercial banking customers. TEB was organized to re-insure credit life and accident and health insurance currently being sold by the Bank in connection with its lending activities. FMFS was organized to write title insurance but now provides brokerage services, commercial and personal lines of insurance to customers of the Bank. VBS originates conventional and government sponsored mortgages through their offices in Harrisonburg, Woodstock and Fishersville. VS Title provides title insurance and real estate settlement services through their offices in Harrisonburg, Fishersville and Charlottesville, VA.

The Bank makes various types of commercial and consumer loans and has a large portfolio of residential mortgages and indirect auto lending. The local economy is relatively diverse with strong employment in the agricultural, manufacturing, service and governmental sectors.

The Company’s and the Bank’s principal executive office is at 205 South Main Street, Timberville, VA 22853, and its phone number is (540) 896-8941.

Filings with the SEC

The Company files annual, quarterly and other reports under the Securities Exchange Act of 1934 with the Securities and Exchange Commission (“SEC”). These reports are posted and are available at no cost on the Company’s website, www.FMBankVA.com, as soon as reasonably practicable after the Company files such documents with the SEC. The Company’s filings are also available through the SEC’s website at www.sec.gov.

Employees

On December 31, 2017, the Bank had 178 full-time and part-time employees; including executive officers, loan and other banking officers, branch personnel, operations personnel and other support personnel. None of the Company’s employees is represented by a union or covered under a collective bargaining agreement. Management of the Company considers their employee relations to be excellent. No one employee devotes full-time services to F & M Bank Corp.

Competition

The Bank's offices face strong competition from numerous other financial institutions. These other institutions include large national and regional banks, other community banks, nationally chartered savings banks, credit unions, consumer finance companies, mortgage companies, loan production offices, mutual funds and life insurance companies. Competition for loans and deposits is affected by a variety of factors including interest rates, types of products offered, the number and location of branch offices, marketing strategies and the reputation of the Bank within the communities served.

PART I, continued

Item 1. Business, continued

Regulation and Supervision

General. The operations of the Company and the Bank are subject to federal and state statutes, which apply to financial holding companies and state member banks of the Federal Reserve System. The common stock of the Company is registered pursuant to and subject to the periodic reporting requirements of the Securities Exchange Act of 1934 (the “Exchange Act”). These include, but are not limited to, the filing of annual, quarterly, and other current reports with the Securities and Exchange Commission (the “SEC”). As an Exchange Act reporting company, the Company is directly affected by the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”). The Company believes it is in compliance with SEC and other rules and regulations implemented pursuant to Sarbanes-Oxley and intends to comply with any applicable rules and regulations implemented in the future.

The Company, as a financial holding company, is subject to the provisions of the Bank Holding Company Act of 1956, as amended (the "Act") and is supervised by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”). The Act requires the Company to secure the prior approval of the Federal Reserve Board before the Company acquires ownership or control of more than 5% of the voting shares or substantially all of the assets of any institution, including another bank.

As a financial holding company, the Company is required to file with the Federal Reserve Board an annual report and such additional information as it may require pursuant to the Act. The Federal Reserve Board may also conduct examinations of F & M Bank Corp. and any or all of its subsidiaries. Under Section 106 of the 1970 Amendments to the Act and the regulations of the Federal Reserve Board, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with an extension of credit, provision of credit, sale or lease of property or furnishing of services.

The Federal Reserve Board regulations limit activities of financial holding companies to managing or controlling banks or non-banking activities closely related to banking. These activities include the making or servicing of loans, performing certain data processing services, and certain leasing and insurance agency activities. Since 1994, the Company has entered into agreements with the Virginia Community Development Corporation to purchase equity positions in several Low-Income Housing Funds; these funds provide housing for low-income individuals throughout Virginia. Approval of the Federal Reserve Board is necessary to engage in any of the activities described above or to acquire interests engaging in these activities.

The Bank as a state member bank is supervised and regularly examined by the Virginia Bureau of Financial Institutions and the Federal Reserve Board; such supervision and examination by the Virginia Bureau of Financial Institutions and the Federal Reserve Board is intended primarily for the protection of depositors and not the stockholders of the Company.

Payment of Dividends. The Company is a legal entity, separate and distinct from its subsidiaries. A significant portion of the revenues of the Company result from dividends paid to it by the Bank. There are various legal limitations applicable to the payment of dividends by the Bank to the Company. Under the current regulatory guidelines, prior approval from the Federal Reserve Board is required if cash dividends declared in any given year exceed net income for that year, plus retained net profits of the two preceding years. A bank also may not declare a dividend out of or in excess of its net undivided profits without regulatory approval. The payment of dividends by the Bank or the Company may also be limited by other factors, such as requirements to maintain capital above regulatory guidelines.

Bank regulatory agencies have the authority to prohibit the Bank or the Company from engaging in an unsafe or unsound practice in conducting their businesses. The payment of dividends, depending on the financial condition of the Bank, or the Company, could be deemed to constitute such an unsafe or unsound practice. Based on the Bank's current financial condition, the Company does not expect that any of these laws will have any impact on its ability to obtain dividends from the Bank.

PART I, continued

Item 1. Business, continued

Regulation and Supervision, continued

The Company also is subject to regulatory restrictions on dividends to its shareholders. Regulators have indicated that bank holding companies should generally pay dividends only if the organization's net income available to common shareholders over the past year has been sufficient to fully fund the dividends and the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality, and overall financial condition. Further, a bank holding company should inform and consult with the Federal Reserve Board prior to declaring a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the organization's capital structure.

Capital Requirements. In 2013, the Federal Reserve, the Federal Deposit Insurance Company (FDIC) and the Office of the Comptroller of the Currency (OCC) approved a new rule that substantially amends the regulatory risk-based capital rules applicable to us. The final rule implements the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act (see definition below). The final rule includes new minimum risk-based capital and leverage ratios which was effective for us on January 1, 2015, and refines the definition of what constitutes "capital" for purposes of calculating these ratios. The new minimum capital requirements are: (i) a new common equity Tier 1 ("CET1") capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6%, which is increased from 4%; (iii) a total capital ratio of 8%, which is unchanged from the previous rules; and (iv) a Tier 1 leverage ratio of 4%. The final rule also establishes a "capital conservation buffer" of 2.5% above the new regulatory minimum capital ratios, and when fully effective in 2019, will result in the following minimum ratios: (a) a common equity Tier 1 capital ratio of 7.0%; (b) a Tier 1 to risk-based assets capital ratio of 8.5%; and (c) a total capital ratio of 10.5%. The capital conservation buffer is being phased in from 0.00% for 2015 to 2.50% by 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that can be utilized for such activities.

The CETI and Tier 1 leverage ratio of the Bank as of December 31, 2017, were 14.43% and 12.07%, respectively, which are significantly above the minimum requirements. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

In September 2017, the federal bank regulatory agencies proposed to revise and simplify the capital treatment for certain deferred tax assets, mortgage servicing assets, investments in non-consolidated financial entities and minority interests for banking organizations, such as the Bank, that are not subject to the advanced approaches requirements. In November 2017, the regulatory agencies revised the capital rules enacted in 2013 to extend the current transitional treatment of these items for non-advanced approaches banking organizations until the September 2017 proposal is finalized. The September 2017 proposal would also change the capital treatment of certain commercial real estate loans under the standardized approach, which the Bank uses to calculate its capital ratios.

In December 2017, the Basel Committee published standards that it described as the finalization of the Basel III post-crisis regulatory reforms (the standards are commonly referred to as "Basel IV"). Among other things, these standards revise the Basel Committee's standardized approach for credit risk (including by recalibrating risk weights and introducing new capital requirements for certain "unconditionally cancellable commitments," such as unused credit card lines of credit) and provide a new standardized approach for operational risk capital. Under the proposed framework, these standards will generally be effective on January 1, 2022, with an aggregate output floor phasing-in through January 1, 2027. Under the current capital rules, operational risk capital requirements and a capital floor apply only to advanced approaches institutions, and not to the Company. The impact of Basel IV on the Company and the Bank will depend on the manner in which it is implemented by the federal bank regulatory agencies.

PART I, continued

Item 1. Business, continued

Regulation and Supervision, continued

Source of Strength. Federal Reserve policy has historically required bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. The Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement, the Company is expected to commit resources to support the Bank, including at times when the Company may not be in a financial position to provide such resources. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to depositors and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Safety and Soundness. There are a number of obligations and restrictions imposed on bank holding companies and their subsidiary banks by law and regulatory policy that are designed to minimize potential loss to the depositors of such depository institutions and the FDIC insurance fund in the event of a depository institution default. For example, under the Federal Deposit Insurance Corporation Improvement Act of 1991, to avoid receivership of an insured depository institution subsidiary, a bank holding company is required to guarantee the compliance of any subsidiary bank that may become "undercapitalized" with the terms of any capital restoration plan filed by such subsidiary with its appropriate federal bank regulatory agency up to the lesser of (i) an amount equal to 5% of the institution's total assets at the time the institution became undercapitalized or (ii) the amount that is necessary (or would have been necessary) to bring the institution into compliance with all applicable capital standards as of the time the institution fails to comply with such capital restoration plan. Under the Federal Deposit Insurance Act, the federal bank regulatory agencies have adopted guidelines prescribing safety and soundness standards. These guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines.

The Gramm-Leach-Bliley Act. Effective on March 11, 2001, the Gramm-Leach-Bliley Act (the “GLB Act”) allows a bank holding company or other company to certify status as a financial holding company, which will allow such company to engage in activities that are financial in nature, that are incidental to such activities, or are complementary to such activities. The GLB Act enumerates certain activities that are deemed financial in nature, such as underwriting insurance or acting as an insurance principal, agent or broker; dealing in or making markets in securities; and engaging in merchant banking under certain restrictions. It also authorizes the Federal Reserve to determine by regulation what other activities are financial in nature, or incidental or complementary thereto.

USA Patriot Act of 2001. In October 2001, the USA Patriot Act of 2001 was enacted in response to the terrorist attacks in New York, Pennsylvania and Northern Virginia which occurred on September 11, 2001. The Patriot Act is intended to strengthen U.S. law enforcements’ and the intelligence communities’ abilities to work cohesively to combat terrorism on a variety of fronts. The continuing and potential impact of the Patriot Act and related regulations and policies on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws, and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Community Reinvestment Act. The requirements of the Community Reinvestment Act are also applicable to the Bank. The act imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. A financial institution's efforts in meeting community needs currently are evaluated as part of the examination process pursuant to twelve assessment factors. These factors are also considered in evaluating mergers, acquisitions and applications to open a branch or facility.

PART I, continued

Item 1. Business, continued

Regulation and Supervision, continued

Dodd-Frank Wall Street Reform and Consumer Protection Act. The Dodd-Frank Act was signed into law on July 21, 2010. Its wide-ranging provisions affect all federal financial regulatory agencies and nearly every aspect of the American financial services industry. Among the provisions of the Dodd-Frank Act that directly impact the Company is the creation of an independent Consumer Financial Protection Bureau (CFPB), which has the ability to implement, examine and enforce complaints with federal consumer protection laws, which govern all financial institutions. For smaller financial institutions, such as the Company and the Bank, their primary regulators will continue to conduct its examination activities.

The Dodd-Frank Act contains provisions designed to reform mortgage lending, which includes the requirement of additional disclosures for consumer mortgages. In addition, the Federal Reserve has issued new rules that have the effect of limiting the fees charged to merchants for debit card transactions. The result of these rules will be to limit the amount of interchange fee income available explicitly to larger banks and indirectly to us. The Dodd-Frank Act also contains provisions that affect corporate governance and executive compensation.

Although the Dodd-Frank Act provisions themselves are extensive, the ultimate impact on the Company of this massive legislation is unknown. The Act provides that several federal agencies, including the Federal Reserve and the Securities and Exchange Commission, shall issue regulations implementing major portions of the legislation, and this process is ongoing.

Mortgage Lending. In 2013, the CFPB adopted a rule, effective in January 2014, to implement certain sections of the Dodd-Frank Act requiring creditors to make a reasonable, good faith determination of a consumer’s ability to repay any closed-end consumer credit transaction secured by a 1-4 family dwelling. The rule also establishes certain protections from liability under this requirement to ensure a borrower’s ability to repay for loans that meet the definition of “qualified mortgage.” Loans that satisfy this “qualified mortgage” safe harbor will be presumed to have complied with the new ability-to-repay standard.

Forward-Looking Statements

Certain information contained in this report may include “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. These forward-looking statements are generally identified by phrases such as “we expect,” “we believe” or words of similar import. Such forward-looking statements involve known and unknown risks including, but not limited to:

Changes in the quality or composition of our loan or investment portfolios, including adverse developments in borrower industries, declines in real estate values in our markets, or in the repayment ability of individual borrowers or issuers;

The strength of the economy in our target market area, as well as general economic, market, or business conditions;

An insufficient allowance for loan losses as a result of inaccurate assumptions;

Our ability to maintain our “well-capitalized” regulatory status;

Changes in the interest rates affecting our deposits and our loans;

Changes in our competitive position, competitive actions by other financial institutions and the competitive nature of the financial services industry and our ability to compete effectively against other financial institutions in our banking markets;

Our ability to manage growth;

Our potential growth, including our entrance or expansion into new markets, the opportunities that may be presented to and pursued by us and the need for sufficient capital to support that growth;

Our exposure to operational risk;

Our ability to raise capital as needed by our business;

Changes in laws, regulations and the policies of federal or state regulators and agencies;

Other circumstances, many of which are beyond our control; and

Other factors identified in "Risk Factors" below and in other reports the Company files with the SEC from time to time.

PART I, continued

Item 1. Business, continued

Forward-Looking Statements, continued

Although we believe that our expectations with respect to the forward-looking statements are based upon reliable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that our actual results, performance or achievements will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

Operating Revenue

The following table displays components that contributed 15% or more of the Company's total operating revenue for the years ended December 31, 2017, 2016, and 2015:

Period	Class of Service	Percentage of Total Revenues
December 31, 2017	Interest and fees on loans held for investment	77.35%
December 31, 2016	Interest and fees on loans held for investment	79.02%
December 31, 2015	Interest and fees on loans held for investment	81.75%

Executive Officers of the Company

Dean W. Withers, 60, has served as CEO of the Company and Bank since March 1, 2018. Prior to that he served as President/CEO of the Bank since May 2004; Executive Vice President of the Bank from Jan. 2003 to May 2004; Vice President of the Bank from 1993 to 2003. As stated in the form 8-K/A filed in December 2017, Mr. Withers will continue as CEO of the Company and Bank for a transition period, no official retirement date has been set.

Mark C. Hanna, 49, has served as President of the Bank since December 2017. Prior to joining the Company, he served as Executive Vice President and Tidewater Regional President of EVB and its successor, Sonabank from November 2014 through October 2017. Previously, he served as President and Chief Executive Officer of Virginia Company Bank from November 2006 through November 2014.

Neil W. Hayslett, 56, has served as Executive Vice President and Chief Operating Officer of the Bank and the Company since March 1, 2018, prior to that he served as Executive Vice President/Chief Administrative Officer of the Bank and the Company from June 2013 until March 2018 and Executive Vice President/Chief Financial Officer from November 2007 until June 2013. Prior to that time, he served as Senior Vice President/Chief Financial Officer of the Bank and the Company from January 2003 until November 2007 and served as Vice President/Chief Financial Officer from October 1996 to January 2003.

Carrie A. Comer, 48, has served as Executive Vice President and Chief Financial Officer of the Bank and the Company since March 1, 2018, prior to that she served as Senior Vice President/Chief Financial Officer of the Company and Bank since June 2013. Ms. Comer served as Vice President/Controller of the Bank from March 2009 to June 2013. From December 2005 to March 2009, Ms. Comer served as Assistant Vice President/Controller of F&M Bank.

Larry A. Caplinger, 65, has served as Executive Vice President and Chief Projects Officer of the Bank and the Company since January 1, 2018. Prior to that he served as Executive Vice President/Chief Lending Officer of the Bank and the Company since November 2007. Prior to that time, he served as Senior Vice President of the Bank from

May 1990 until November 2007 and Senior Vice President of the Company from April 2002 until November 2007. Larry has held a number of positions with the Bank over his 45-year career with the Company.

Stephanie E. Shillingburg, 56, has served as Executive Vice President/Chief Banking Officer of the Bank and the Company since July 2016, Executive Vice President/Chief Retail Officer from June 2013 until July 2016, Senior Vice President/Branch Administrator from February 2005 until June 2013. She also served as Vice President/Branch Administrator from March 2003 until February 2005 and as Branch Manager of the Edinburg Branch from February 2001 until March 2003.

PART I, continued

Item 1. Business, continued

Executive Officers of the Company continued

Edward Strunk, 61, has served as Executive Vice President and Chief Credit Officer of the Bank and the Company since March 1, 2018. Prior to that he serviced as Senior Vice President/Senior Lending Officer since July 2006, Senior Vice President/Commercial Loan Administrator from May 2011 until July 2016, Vice President/Commercial Loan Administrator from February 2011 until May 2011 and Vice Present/Business Development Officer III from May 2007 until February 2011.

Josh Hale, 41, has served as Executive Vice President and Chief Lending Officer of the Bank and the Company since March 1, 2018. Prior to that he served as Senior Vice President/Business Development Leader since June 2013, Vice President/Commercial Relationship Manager III from December 2010 until June 2013, Vice President/Business Development Officer II from March 2009 until December 2010 and Assistant Vice President/Business Development Officer II from December 2004 until March 2009.

Item 1A. Risk Factors

General economic conditions in our market area could adversely affect us.

We are affected by the general economic conditions in the local markets in which we operate. Conditions such as economic recession, falling home prices, rising foreclosures and other factors beyond our control could lead to, among other things, an increased level of commercial and consumer delinquencies. If economic conditions in our market deteriorate, we could experience further adverse consequences, including a decline in demand for our products and services and an increase in problem assets, forecloses and loan losses. Future economic conditions in our market will depend on factors outside of our control such as political and market conditions, broad trends in industry and finance, legislative and regulatory changes, changes in government, military and fiscal policies and inflation, any of which could negatively affect our performance and financial condition.

Our allowance for loan losses may prove to be insufficient to absorb losses in the loan portfolio.

Like all financial institutions, we maintain an allowance for loan losses to provide for loans that our borrowers may not repay in their entirety. We believe that we maintain an allowance for loan losses at a level adequate to absorb probable losses inherent in the loan portfolio. Through a periodic review and consideration of the loan portfolio, management determines the amount of the allowance for loan losses by considering general market conditions, credit quality of the loan portfolio, the collateral supporting the loans and performance of customers relative to their financial obligations with us. At December 31, 2017, our non-performing loans were $7.1 million, compared to $4.9 million at December 31, 2016. Approximately $1.5 million of the increase is related to one relationship that is reviewed for impairment and a specific reserve of $249,000 has been recorded. The Company did not record a provision for loan losses for the year ended December 31, 2017, and our loan loss allowance was $6.04 million, or .98% of total loans held for investment at December 31, 2017. The Company anticipates that a provision for loan losses will be required in 2018 based on expected growth coupled with normalized five year historical charge-offs in the lookback period.

The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, which may be beyond our control, and these losses may exceed current estimates. Although we believe the allowance for loan losses is a reasonable estimate of known and inherent losses in the loan portfolio, it cannot fully predict such losses or that the loss allowance will be adequate in the future. While the risk of nonpayment is inherent in banking, we could experience greater nonpayment levels than we anticipate. In addition, we have loan participation arrangements with several other banks within the region and may not be able to exercise control of negotiations with borrowers in the event these loans do not perform. Additional problems with asset quality could cause our interest income and net interest margin to decrease and our provisions for loan losses to increase, which could adversely affect our results of operations and financial condition.

Federal and state regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs, based on judgments different than those of management. Any increase in the amount of the provision or loans charged-off as required by these regulatory agencies could have a negative effect on our operating results.

PART I, continued

Item 1A. Risk Factors, continued

Our loan concentrations could, as a result of adverse market conditions, increase credit losses which could adversely impact earnings.

We offer a variety of secured loans, including commercial lines of credit, commercial term loans, real estate, construction, home equity, consumer and other loans. Many of our loans are secured by real estate (both residential and commercial) in our market area, which could result in adverse consequences to us in the event of a prolonged economic downturn in our market. As of December 31, 2017, approximately 80% of our loans had real estate as a primary or secondary component of collateral. A significant decline in real estate values in our market would mean that the collateral for many of our loans would provide less security. As a result, we would be more likely to suffer losses on defaulted loans because our ability to fully recover on defaulted loans by selling the real estate collateral would be diminished. In addition, our consumer loans (such as automobile loans) are collateralized, if at all, with assets that may not provide an adequate source of repayment of the loan due to depreciation, damage or loss.

In addition, we have a large portfolio of residential mortgages which could be adversely affected by a decline in the real estate markets. Construction and development lending entails significant additional risks, because these loans, which often involve larger loan balances concentrated with single borrowers or groups of related borrowers, are dependent on the successful completion of real estate projects. Loan funds for construction and development loans often are advanced upon the security of the land or home under construction, which value is estimated prior to the completion of construction. The deterioration of one or a few of these loans could cause a significant increase in the percentage of non-performing loans. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the provision for loan losses and an increase in charge-offs, all of which could have a material adverse effect on our financial condition.

Our dealer finance division exposes us to increased credit risks.

In 2012, the Bank began a loan production office which specializes in providing consumer installment loans to finance automobile purchases through a network of automobile dealers. As of December 31, 2017, we had approximately $75 million in loans outstanding in this portfolio. We serve customers over a broad range of creditworthiness, and the required terms and rates are reflective of those risk profiles. While these loans have higher yields than many of our other loans, such loans involve significant risks in addition to normal credit risk. Potential risk elements associated with indirect lending include the limited personal contact with the borrower as a result of indirect lending through our network of dealers, the absence of assured continued employment of the borrower, the varying general creditworthiness of the borrower, changes in the local economy and difficulty in monitoring collateral. While indirect automobile loans are secured, such loans are secured by depreciating assets and characterized by loan to value ratios that could result in us not recovering the full value of an outstanding loan upon default by the borrower. Delinquencies, charge-offs and repossessions of vehicles in this portfolio are always concerns. If general economic conditions worsen, we may experience higher levels of delinquencies, repossessions and charge-offs.

Our small-to-medium sized business target market may have fewer financial resources to weather continued downturn in the economy.

We target our commercial development and marketing strategy primarily to serve the banking and financial services needs of small and medium sized businesses. These businesses generally have less capital or borrowing capacity than larger entities. If general economic conditions negatively impact this major economic sector in the markets in which we operate, our results of operations and financial condition may be adversely affected.

9

PART I, continued

Item 1A. Risk Factors, continued

Our inability to maintain adequate sources of funding and liquidity may negatively impact our current financial condition or our ability to grow.

Our access to funding and liquidity sources in amounts adequate to finance our activities on terms which are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general. In managing our balance sheet, a primary source of funding asset growth and liquidity historically has been deposits, including both local customer deposits and brokered deposits. If the level of deposits were to materially decrease, we would have to raise additional funds by increasing the interest that we pay on certificates of deposit or other depository accounts, seek other debt or equity financing, or draw upon our available lines of credit. Our access to these funding and liquidity sources could be detrimentally impacted by a number of factors, including operating losses, rising levels of non-performing assets, a decrease in the level of our business activity as a result of a downturn in the markets in which our loans or deposits are concentrated or regulatory restrictions. In addition, our ability to continue to attract deposits and other funding or liquidity sources is subject to variability based upon additional factors including volume and volatility in the securities markets and the relative interest rates that we are prepared to pay for these liabilities. We do not maintain significant additional sources of liquidity through potential sales in our investment portfolio or liquid assets at the holding company level. Our potential inability to maintain adequate sources of funding or liquidity may, among other things, inhibit our ability to fund asset growth or negatively impact our financial condition, including our ability to pay dividends or satisfy our obligations.

If we do not maintain our capital requirements and our status as a “well-capitalized” bank, there could an adverse effect on our liquidity and our ability to fund our loan portfolio.

We are subject to regulatory capital adequacy guidelines. If we fail to meet the capital adequacy guidelines for a “well-capitalized” bank, it could increase the regulatory scrutiny for the Bank and the Company. In addition, if we failed to be “well capitalized” for regulatory capital purposes, we would not be able to renew or accept brokered deposits without prior regulatory approval and we would not be able to offer interest rates on our deposit accounts that are significantly higher than the average rates in our market area. As a result, it would be more difficult for us to attract new deposits as our existing brokered deposits mature and do not roll over and to retain or increase existing, non-brokered deposits. If we are prohibited from renewing or accepting brokered deposits and are unable to attract new deposits, our liquidity and our ability to fund our loan portfolio may be adversely affected. In addition, we would be required to pay higher insurance premiums to the FDIC, which would reduce our earnings.

We are subject to more stringent capital requirements as a result of the Basel III regulatory capital reforms and the Dodd-Frank Act which could adversely affect our results of operations and future growth.

In 2013, the Federal Reserve, the FDIC and the OCC approved a new rule that substantially amends the regulatory risk-based capital rules applicable to us. The final rule implements the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act. The final rule includes new minimum risk-based capital and leverage ratios which were effective for us on January 1, 2015 and refines the definition of what constitutes “capital” for purposes of calculating these ratios. The new minimum capital requirements are: (i) a new common equity Tier 1 (“CET1”) capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6%, which is increased from 4%; (iii) a total capital ratio of 8%, which is unchanged from the previous rules; and (iv) a Tier 1 leverage ratio of 4%. The final rule also establishes a “capital conservation buffer” of 2.5% above the new regulatory minimum capital ratios, and when fully effective in 2019, will result in the following minimum ratios: (a) a common equity Tier 1 capital ratio of 7.0%; (b) a Tier 1 to risk-based assets capital ratio of 8.5%; and (c) a total capital ratio of 10.5%. The capital conservation buffer is being phased in from 0.00% for 2015 to 2.50% by 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that can be utilized for such activities. In addition, the final rule provides for a number of new deductions from and adjustments to capital and prescribes a revised approach for risk weightings that could result in higher risk weights for a variety of asset categories.

The application of these more stringent capital requirements for us could, among other things, result in lower returns on equity, require the raising of additional capital, adversely affect our future growth opportunities, and result in regulatory actions such as a prohibition on the payment of dividends or on the repurchase shares if we are unable to comply with such requirements.

PART I, continued

Item 1A. Risk Factors, continued

Consumer financial protection laws and regulations could adversely impact our earnings due to, among other things, increased compliance costs or costs due to noncompliance.

The Dodd-Frank Act established the Consumer Financial Protection Bureau (“CFPD”) with broad authority to administer a new federal regulatory framework of consumer financial regulation, including consumer mortgage banking. For example, the CFPB issued a rule, effective as of January 14, 2014, designed to clarify for lenders how they can avoid monetary damages under the Dodd-Frank Act, which would hold lenders accountable for ensuring a borrower’s ability to repay a mortgage. Loans that satisfy this “qualified mortgage” safe-harbor will be presumed to have complied with the new ability-to-repay standard. Under the Consumer Financial Protection Bureau’s rule, a “qualified mortgage” loan must not contain certain specified features, including but not limited to:

excessive upfront points and fees (those exceeding 3% of the total loan amount, less “bona fide discount points” for prime loans);

interest-only payments;

negative-amortization; and

terms longer than 30 years.

Also, to qualify as a “qualified mortgage,” a borrower’s total monthly debt-to-income ratio may not exceed 43%. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments. The CFPB’s rule on qualified mortgages and other consumer financial protection laws could limit our ability or desire to make certain types of loans or loans to certain borrowers or could make it more expensive and/or time consuming to make these loans, which could adversely impact our growth or profitability.

In addition, the CFPB has been directed to write rules identifying practices or acts that are unfair, deceptive or abusive in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service, and has initiated enforcement actions against a variety of bank and non-bank market participants with respect to a number of consumer financial products and services. These enforcement actions may serve as precedent for how the CFPB and other regulatory agencies interpret and enforce consumer protection laws, including practices or acts that are deemed to be unfair, deceptive or abusive, with respect to all supervised institutions, which may result in the imposition of higher standards of compliance with such laws.

Our future success is dependent on our ability to effectively compete in the face of substantial competition from other financial institutions in our primary markets.

We encounter significant competition for deposits, loans and other financial services from banks and other financial institutions, including savings and loan associations, savings banks, finance companies, and credit unions in our market area. A number of these banks and other financial institutions are significantly larger than us and have substantially greater access to capital and other resources, larger lending limits, more extensive branch systems, and may offer a wider array of banking services. To a limited extent, we compete with other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies, insurance companies and governmental organizations any of which may offer more favorable financing rates and terms than us. Many of these non-bank competitors are not subject to the same extensive regulations that govern us. As a result, these non-bank competitors may have advantages in providing certain services. This competition may reduce or limit our margins and our market share and may adversely affect our results of operations and financial condition.

PART I, continued

Item 1A. Risk Factors, continued

Our exposure to operational risk may adversely affect us.

Similar to other financial institutions, we are exposed to many types of operational risk, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems.

Reputational risk, or the risk to our earnings and capital from negative public opinion, could result from our actual alleged conduct in any number of activities, including lending practices, corporate governance, regulatory compliance or the occurrence of any of the events or instances mentioned below, or from actions taken by government regulators or community organizations in response to that conduct. Negative public opinion could also result from adverse news or publicity that impairs the reputation of the financial services industry generally.

Further, if any of our financial, accounting, or other data processing systems fail or have other significant shortcomings, we could be adversely affected. We depend on internal systems and outsourced technology to support these data storage and processing operations. Our inability to use or access these information systems at critical points in time could unfavorably impact the timeliness and efficiency of our business operations. We could be adversely affected if one of our employees causes a significant operational break-down or failure, either as a result of human error or where an individual purposefully sabotages or fraudulently manipulates our operations or systems. We are also at risk of the impact of natural disasters, terrorism and international hostilities on our systems or for the effects of outages or other failures involving power or communications systems operated by others.

Misconduct by employees could include fraudulent, improper or unauthorized activities on behalf of clients or improper use of confidential information. We may not be able to prevent employee errors or misconduct, and the precautions we take to detect this type of activity might not be effective in all cases. Employee errors or misconduct could subject us to civil claims for negligence or regulatory enforcement actions, including fines and restrictions on our business.

In addition, there have been instances where financial institutions have been victims of fraudulent activity in which criminals pose as customers to initiate wire and automated clearinghouse transactions out of customer accounts. Although we have policies and procedures in place to verify the authenticity of our customers, we cannot assure that such policies and procedures will prevent all fraudulent transfers. Such activity can result in financial liability and harm to our reputation.

If any of the foregoing risks materialize, it could have a material adverse effect on our business, financial condition and results of operations.

Changes in market interest rates could affect our cash flows and our ability to successfully manage our interest rate risk.

Our profitability and financial condition depend to a great extent on our ability to manage the net interest margin, which is the difference between the interest income earned on loans and investments and the interest expense paid for deposits and borrowings. The amounts of interest income and interest expense are principally driven by two factors; the market levels of interest rates, and the volumes of earning assets or interest bearing liabilities. The management of the net interest margin is accomplished by our Asset Liability Committee. Short term interest rates are highly sensitive to factors beyond our control and are effectively set and managed by the Federal Reserve, while longer term rates are generally determined by the market based on investors’ inflationary expectations. Thus, changes in monetary and or fiscal policy will affect both short term and long term interest rates which in turn will influence the origination of loans, the prepayment speed of loans, the purchase of investments, the generation of deposits and the rates received on loans and investment securities and paid on deposits or other sources of funding. The impact of these changes may be magnified if we do not effectively manage the relative sensitivity of our earning assets and interest bearing liabilities to changes in market interest rates. We generally attempt to maintain a neutral position in terms of the volume of earning assets and interest bearing liabilities that mature or can re-price within a one year period in order that we may maintain the maximum net interest margin; however, interest rate fluctuations, loan prepayments, loan production and deposit flows are constantly changing and greatly influence this ability to maintain a neutral position.

PART I, continued

Item 1A. Risk Factors, continued

Generally, our earnings will be more sensitive to fluctuations in interest rates the greater the difference between the volume of earning assets and interest bearing liabilities that mature or are subject to re-pricing in any period. The extent and duration of this sensitivity will depend on the cumulative difference over time, the velocity and direction of interest rate changes, and whether we are more asset sensitive or liability sensitive. Additionally, the Asset Liability Committee may desire to move our position to more asset sensitive or more liability sensitive depending upon their expectation of the direction and velocity of future changes in interest rates in an effort to maximize the net interest margin. Should we not be successful in maintaining the desired position, or should interest rates not move as anticipated, our net interest margin may be negatively impacted.

Our inability to successfully manage growth or implement our growth strategy may adversely affect our results of operations and financial condition.

We may not be able to successfully implement our growth strategy if we are unable to identify attractive markets, locations or opportunities to expand in the future. Our ability to manage growth successfully also depends on whether we can maintain capital levels adequate to support our growth, maintain cost controls, asset quality and successfully integrate any businesses acquired into the organization.

As we continue to implement our growth strategy, we may incur increased personnel, occupancy and other operating expenses. We must absorb those higher expenses while we begin to generate new deposits, and there is a further time lag involved in redeploying new deposits into attractively priced loans and other higher yielding earning assets. Thus, our plans to branch could depress earnings in the short run, even if we efficiently execute a branching strategy leading to long-term financial benefits.

Our operations rely on certain external vendors.

We are reliant upon certain external vendors to provide products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with the contracted arrangements under service agreements. Although we maintain a system of comprehensive policies and a control framework designed to monitor vendor risks, the failure of an external vendor to perform in accordance with the contracted arrangements under service agreements could be disruptive to our operations, which could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

Our operations may be adversely affected by cyber security risks.

In the ordinary course of business, we collect and store sensitive data, including proprietary business information and personally identifiable information of its customers and employees in systems and on networks. The secure processing, maintenance and use of this information is critical to operations and our business strategy. We have invested in accepted technologies and review processes and practices that are designed to protect our networks, computers and data from damage or unauthorized access. Despite these security measures, our computer systems and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. A breach of any kind could compromise systems and the information stored there could be accessed, damaged or disclosed. A breach in security could result in legal claims, regulatory penalties, disruption in operations, and damage to our reputation, which could adversely affect our business.

Legislative or regulatory changes or actions, or significant litigation, could adversely impact us or the businesses in which we are engaged.

We are subject to extensive state and federal regulation, supervision and legislation that govern almost all aspects of our operations. Laws and regulations may change from time to time and are primarily intended for the protection of consumers, depositors and the deposit insurance funds. The impact of any changes to laws and regulations or other actions by regulatory agencies may negatively impact us or our ability to increase the value of our business. Additionally, actions by regulatory agencies or significant litigation against us could cause us to devote significant time and resources to defending ourselves and may lead to penalties that materially affect us. Future changes in the laws or regulations or their interpretations or enforcement could be materially adverse us and our shareholders.

PART I, continued

Item 1A. Risk Factors, continued

Changes in accounting standards could impact reported earnings.

The accounting standard setters, including the Financial Accounting Standards Board (FASB), SEC and other regulatory bodies, periodically change the financial accounting and reporting standards that govern the preparation of our consolidated financial statements. These changes can be difficult to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in the restatement of prior period financial statements.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to complete financial transactions through alternative methods that historically have involved banks. The activity and prominence of so-called marketplace lenders and other technological financial service companies have grown significantly over recent years and is expected to continue growing. In addition, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts, mutual funds or general-purpose reloadable prepaid cards. Consumers can also complete transactions, such as paying bills and/or transferring funds directly without the assistance of banks. If we are unable to address the competitive pressures that we face, we could lose market share, which could result in reduced net revenue and profitability and lower returns, as well as the loss of customer deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

Failure to keep pace with technological change could adversely affect our business.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

The full impact of changes to federal tax laws is uncertain and may negatively impact our financial performance.

We are subject to changes in tax law that could increase our effective tax rates. These law changes may be retroactive to previous periods and, as a result, could negatively affect our current and future financial performance.

The Tax Cuts and Jobs Act, the full impact of which is subject to further evaluation and analysis, is likely to have both positive and negative effects on our financial performance. For example, the new legislation will result in a reduction in our federal corporate tax rate from 35% to 21% beginning in 2018, which is expected to have a favorable impact on our earnings and capital generation abilities. However, the new legislation also enacted limitations on certain deductions, such as the deduction of FDIC deposit insurance premiums, which will partially offset the anticipated increase in net earnings from the lower tax rate. In addition, as a result of the lower corporate tax rate, we were required under Generally Accepted Accounting Principles (GAAP) to record a tax expense due to remeasurement in the fourth quarter of 2017 with respect to our deferred tax assets amounting to $811,000. Further, the full impact of the Tax Act may differ from the foregoing and from our expectations, possibly materially, due to changes in interpretations or in assumptions that we have made or that we make in 2018, guidance or regulations that may be promulgated, and other actions that we may take as a result of the Tax Act.

Similarly, the Bank's customers are likely to experience varying effects from both the individual and business tax provisions of the Tax Act. For example, changes to tax deductibility of business interest expense could impact business customer borrowing. Such effects, whether positive or negative, may have a corresponding impact on our business and the economy as a whole.

PART I, continued

Item 1B. Unresolved Staff Comments

The Company does not have any unresolved staff comments to report for the year ended December 31, 2017.

Item 2. Properties

The locations of F & M Bank Corp. and its subsidiaries are shown below.

Corporate Offices 205 South Main Street Timberville, VA 22853	Timberville Branch 165 New Market Road Timberville, VA 22853	Elkton Branch 127 West Rockingham Street Elkton, VA 22827
Broadway Branch 126 Timberway Broadway, VA 22815	Coffman's Corner Branch 2030 Legacy Lane Harrisonburg, VA 22801	
Bridgewater Branch 100 Plaza Drive Bridgewater, VA 22812	Edinburg Branch 120 South Main Street Edinburg, VA 22824	
Woodstock Branch 161 South Main Street Woodstock, VA 22664	Crossroads Branch 80 Cross Keys Road Harrisonburg, VA 22801	
Luray Branch 700 East Main Street Luray, VA 22835	Dealer Finance Division 4759 Spotswood Trail Penn Laird, VA 22846	
Myers Corner Branch 30 Gosnell Crossing Staunton, VA 24401	North Augusta Branch 2813 North Augusta Street Staunton, VA 22401	
Craigsville Branch 125 W. Craig Street Craigsville, VA 24430	Grottoes Branch 200 Augusta Avenue Grottoes, VA 24441	

With the exception of the Edinburg Branch, Luray Branch, Dealer Finance Division, and the North Augusta Branch, the remaining facilities are owned by Farmers & Merchants Bank. ATMs are available at all branch locations.

Through an agreement with FCTI, Inc., the Bank also operates cash only ATMs at five Food Lion grocery stores, one in Mt. Jackson, VA and four in Harrisonburg, VA. The Bank has an agreement with CardTronics ATM to operate twelve cash only ATMs in various Rite Aid Pharmacies, CVS Pharmacies and Target Stores in Rockingham and Augusta Counties of VA. The Bank also has an agreement with ATM USA to operate ATMs in various locations in our market area.

VBS' offices are located at:

Harrisonburg Office 2040 Deyerle Avenue	Fishersville Office 1842 Jefferson Hwy	Woodstock Office 161 South Main Street

Suite 107	Fishersville, VA 22939	Woodstock, VA 22664
Harrisonburg, VA 22801		

VS Title's offices are located at:

Harrisonburg Office	Fishersville Office	Charlottesville Office
410 Neff Avenue	1707 Jefferson Highway	154 Hansen Rd., Suite 202-C
Harrisonburg, VA 22801	Fishersville, VA 22939	Charlottesville, VA 22911

Item 3. Legal Proceedings

In the normal course of business, the Company may become involved in litigation arising from banking, financial, or other activities of the Company. Management after consultation with legal counsel, does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on the Company's financial condition, operating results or liquidity.

Item 4. Mine Safety Disclosures

None.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Stock Listing
The Company's Common Stock is quoted under the symbol "FMBM" on the OTCQX Market. The bid and ask price is quoted at www.OTCMARKETS.com/Stock/FMBM/quote. With its inclusion on the OTCQX Markets, there are now several active market makers for FMBM stock.

Transfer Agent and Registrar
Broadridge Financial Solutions
2 Journal Plaza Square, 7th Floor
Jersey City, NJ 07306

Stock Performance
The following graph compares the cumulative total return to the shareholders of the Company for the last five fiscal years with the total return of the Russell 2000 Index and the SNL Bank Index, as reported by SNL Financial, LC, assuming an investment of $100 in the Company's common stock on December 31, 2012, and the reinvestment of dividends.

	Period Ending					
Index	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17
F & M Bank Corp.	100.00	126.23	138.04	166.31	197.11	258.36
Russell 2000 Index	100.00	138.82	145.62	139.19	168.85	193.58
SNL Bank Index	100.00	137.30	153.48	156.10	197.23	232.91

16

17

PART II, continued

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, continued

Recent Stock Prices and Dividends

Dividends to common shareholders totaled $2,972,000 and $2,628,000 in 2017 and 2016, respectively. Preferred stock dividends were $415,000 and $487,000 in 2017 and 2016, respectively. Regular quarterly dividends have been declared for at least 25 years. The payment of dividends depends on the earnings of the Company and its subsidiaries, the financial condition of the Company and other factors including capital adequacy, regulatory requirements, general economic conditions and shareholder returns. The ratio of dividends per common share to net income per common share was 35.67% in 2017, compared to 28.88% in 2016.

Refer to Payment of Dividends in Item 1. Business, Regulation and Supervision section above for a summary of applicable restrictions on the Company's ability to pay dividends.

Stock Repurchases

As previously reported, on September 18, 2008, the Company's Board of Directors approved an increase in the number of shares of common stock that the Company can repurchase under the share repurchase program from 150,000 to 200,000 shares. On October 20, 2016, the Company's Board of Directors approved a plan to repurchase up to an additional 150,000 shares of common stock. Shares repurchased through the end of 2017 totaled 221,976 shares; of this amount, 21,984 were repurchased in 2017 at an average price of $32.39 per share.

The number of common shareholders was approximately 2,104 as of March 9, 2018. This amount includes all shareholders, whether titled individually or held by a brokerage firm or custodian in street name.

Quarterly Stock Information

These quotes include the terms of trades transacted through a broker. The terms of exchanges occurring between individual parties may not be known to the Company.

	2017			2016		
	Stock Price Range		Per Share	Stock Price Range		Per Share
Quarter	Low	High	Dividends Declared	Low	High	Dividends Declared
1st	$26.50	$28.45	$.22	$21.75	$23.55	$.19
2nd	27.50	29.35	.23	23.02	25.00	.19
3rd	29.20	32.00	.24	23.50	26.25	.20
4th	30.02	34.50	.25	24.82	27.00	.22

Total	$.94	$.80

18

PART II, continued

Item 6. Selected Financial Data

Five Year Summary of Selected Financial Data

(Dollars and shares in thousands, except per share data)	2017	20166	20156	2014	2013
Income Statement Data:					
Interest and Dividend Income	$34,095	$32,150	$29,404	$26,772	$25,966
Interest Expense	3,897	3,599	2,876	3,648	4,773
Net Interest Income	30,198	28,551	26,528	23,124	21,193
Provision for Loan Losses	-	-	300	2,250	3,775
Net Interest Income After Provision for Loan Losses	30,198	28,551	26,228	20,874	17,418
Noninterest Income6	8,517	6,313	5,412	3,530	4,032
Low income housing partnership losses	(625)	(731)	(619)	(608)	(856)
Noninterest Expenses6	24,719	21,272	19,554	15,656	14,720
Income before income taxes	13,371	12,861	11,467	8,140	5,874
Income Tax Expense	4,330	3,099	2,886	2,293	1,051
Net income attributable to noncontrolling interest	(31)	(194)	(164)	(45)	(107)
Net Income attributable to F & M Bank Corp.	$9,010	$9,568	$8,417	$5,802	$4,716
Per Common Share Data:					
Net Income – basic	$2.63	$2.77	$2.40	$1.82	$1.88
Net Income - diluted	$2.48	$2.57	$2.25	$1.80	$1.88
Dividends Declared	.94	.80	.73	.68	.68
Book Value per Common Share	25.73	24.18	22.38	20.77	21.56
Balance Sheet Data:					
Assets	$753,270	$744,889	$665,357	$605,308	$552,788
Loans Held for Investment	616,974	591,636	544,053	518,202	478,453
Loans Held for Sale	39,775	62,735	57,806	13,382	3,804
Securities	41,243	39,475	25,329	22,305	38,486
Deposits	569,177	537,085	494,670	491,505	464,149
Short-Term Debt	25,296	40,000	24,954	14,358	3,423
Long-Term Debt	49,733	64,237	48,161	9,875	21,691
Stockholders’ Equity	91,275	86,682	82,950	77,798	54,141
Average Common Shares Outstanding – basic	3,270	3,282	3,291	3,119	2,504
Average Common Shares Outstanding – diluted	3,632	3,717	3,735	3,230	2,504
Financial Ratios:					
Return on Average Assets1	1.21%	1.34%	1.31%	1.00%	.82%
Return on Average Equity1	10.01%	11.18%	10.46%	8.65%	9.11%
Net Interest Margin	4.53%	4.34%	4.43%	4.30%	4.02%
Efficiency Ratio 2	63.54%	60.78%	60.97%	58.51%	58.15%
Dividend Payout Ratio - Common	35.74%	28.88%	30.42%	37.36%	36.17%
Capital and Credit Quality Ratios:					
Average Equity to Average Assets1	12.10%	11.97%	12.49%	11.59%	9.00%
Allowance for Loan Losses to Loans3	.98%	1.27%	1.61%	1.68%	1.71%
Nonperforming Loans to Total Assets4	.94%	.65%	.98%	1.15%	2.28%
Nonperforming Assets to Total Assets5	1.21%	.94%	1.34%	1.73%	2.75%

Net Charge-offs to Total Loans3	.24%	.21%	.04%	.33%	.78%

1
Ratios are primarily based on daily average balances.
2
The Efficiency Ratio equals noninterest expenses divided by the sum of tax equivalent net interest income and noninterest income. Noninterest income excludes gains (losses) on securities transactions and LIH Partnership losses. Ratio for 2017, 2016 and 2015 reflects reclassification of VBS and VST (2017 only) to report gross income/expense rather than net.
3
Calculated based on Loans Held for Investment, excludes Loans Held for Sale.
4
Calculated based on 90 day past due and non-accrual to Total Assets.
5
Calculated based on 90 day past due, non-accrual and OREO to Total Assets
6
Data reflects reclassification of VBS (2017, 2016, 2015) and VST (2017) to report gross income/expense rather than net

19

PART II, continued

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides information about the major components of the results of operations and financial condition, liquidity and capital resources of F & M Bank Corp. and its subsidiaries. This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and the Notes to the Consolidated Financial Statements presented in Item 8, Financial Statements and Supplementary Information, of this Form 10-K.

Lending Activities

Credit Policies

The principal risk associated with each of the categories of loans in our portfolio is the creditworthiness of our borrowers. Within each category, such risk is increased or decreased, depending on prevailing economic conditions. In an effort to manage the risk, our loan policy gives loan amount approval limits to individual loan officers based on their position and level of experience and to our loan committees based on the size of the lending relationship. The risk associated with real estate and construction loans, commercial loans and consumer loans varies, based on market employment levels, consumer confidence, fluctuations in the value of real estate and other conditions that affect the ability of borrowers to repay indebtedness. The risk associated with real estate construction loans varies, based on the supply and demand for the type of real estate under construction.

We have written policies and procedures to help manage credit risk. We have a loan review policy that includes regular portfolio reviews to establish loss exposure and to ascertain compliance with our loan policy.

We use a management loan committee and a directors’ loan committee to approve loans. The management loan committee is comprised of members of senior management, and the directors’ loan committee is comprised of any six directors. Both committees approve new, renewed and or modified loans that exceed officer loan authorities. The directors’ loan committee also reviews any changes to our lending policies, which are then approved by our board of directors.

Construction and Development Lending

We make construction loans, primarily residential, and land acquisition and development loans. The construction loans are secured by residential houses under construction and the underlying land for which the loan was obtained. The average life of a construction loan is approximately 12 months, and it is typically re-priced as the prime rate of interest changes. The majority of the interest rates charged on these loans float with the market. Construction lending entails significant additional risks, compared with residential mortgage lending. Construction loans often involve larger loan balances concentrated with single borrowers or groups of related borrowers. Another risk involved in construction lending is attributable to the fact that loan funds are advanced upon the security of the land or home under construction, which value is estimated prior to the completion of construction. Thus, it is more difficult to evaluate accurately the total loan funds required to complete a project and related loan-to-value ratios. To mitigate the risks associated with construction lending, we generally limit loan amounts to 75% to 90% of appraised value, in addition to analyzing the creditworthiness of our borrowers. We also obtain a first lien on the property as security for our construction loans and typically require personal guarantees from the borrower’s principal owners.

PART II, continued

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations, Continued

Commercial Real Estate Lending

Commercial real estate loans are secured by various types of commercial real estate in our market area, including multi-family residential buildings, commercial buildings and offices, shopping centers and churches. Commercial real estate lending entails significant additional risks, compared with residential mortgage lending. Commercial real estate loans typically involve larger loan balances concentrated with single borrowers or groups of related borrowers. Additionally, the payment experience on loans secured by income producing properties is typically dependent on the successful operation of a business or a real estate project and thus may be subject, to a greater extent, to adverse conditions in the real estate market or in the economy in general. Our commercial real estate loan underwriting criteria require an examination of debt service coverage ratios and the borrower’s creditworthiness, prior credit history and reputation. We also evaluate the location of the security property and typically require personal guarantees or endorsements of the borrower’s principal owners.

Business Lending

Business loans generally have a higher degree of risk than residential mortgage loans but have higher yields. To manage these risks, we generally obtain appropriate collateral and personal guarantees from the borrower’s principal owners and monitor the financial condition of our business borrowers. Residential mortgage loans generally are made on the basis of the borrower’s ability to make repayment from employment and other income and are secured by real estate whose value tends to be readily ascertainable. In contrast, business loans typically are made on the basis of the borrower’s ability to make repayment from cash flow from its business and are secured by business assets, such as real estate, accounts receivable, equipment and inventory. As a result, the availability of funds for the repayment of business loans is substantially dependent on the success of the business itself. Furthermore, the collateral for business loans may depreciate over time and generally cannot be appraised with as much precision as residential real estate.

Consumer Lending

We offer various consumer loans, including personal loans and lines of credit, automobile loans, deposit account loans, installment and demand loans, and home equity lines of credit and loans. Such loans are generally made to clients with whom we have a pre-existing relationship. We currently originate all of our consumer loans in our geographic market area.

The underwriting standards employed by us for consumer loans include a determination of the applicant’s payment history on other debts and an assessment of their ability to meet existing obligations and payments on the proposed loan. The stability of the applicant’s monthly income may be determined by verification of gross monthly income from primary employment and additionally from any verifiable secondary income. Although creditworthiness of the applicant is of primary consideration, the underwriting process also includes an analysis of the value of the security in relation to the proposed loan amount. For home equity lines of credit and loans we require title insurance, hazard insurance and, if required, flood insurance.

Residential Mortgage Lending

The Bank makes residential mortgage loans for the purchase or refinance of existing loans with loan to value limits ranging between 80 and 90% depending on the age of the property, borrower’s income and credit worthiness. Loans that are retained in our portfolio generally carry adjustable rates that can change every three to five years, based on amortization periods of twenty to thirty years.

PART II, continued

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations, Continued

Loans Held for Sale

The Bank makes fixed rate mortgage loans with terms of typically fifteen or thirty years through its subsidiary VBS Mortgage. These loans are funded by VBS utilizing a line of credit at the Bank until sold to investors in the secondary market. Similarly, the Bank also has a relationship with Northpointe Bank in Grand Rapids, MI whereby it purchases fixed rate conforming 1-4 family mortgage loans for short periods of time pending those loans being sold to investors in the secondary market. These loans have an average duration of ten days to two weeks, but occasionally remain on the Bank’s books for up to 60 days. The Bank began its relationship with Northpointe Bank in 2014 and had a similar program with a prior bank since 2003. This relationship allows the Bank to achieve a higher rate of return than is available on other short term investment opportunities.

Dealer Finance Division

In September 2012, the Bank started a loan production office in Penn Laird, VA which specializes in providing automobile financing through a network of automobile dealers. The Dealer Finance Division was originally staffed with three officers that have extensive experience in Dealer Finance. Based on the strong growth of this division the staff has been increased to six employees. This office is serving the automobile finance needs for customers of dealers throughout the existing geographic footprint of the Bank. Approximately fifty dealers have signed contracts to originate loans on behalf of the Bank. As of year end 2017, the division had total loans outstanding of $75.2 million.

Critical Accounting Policies

General

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

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

Allowance for Loan Losses

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

PART II, continued

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations, continued

Allowance for Loan Losses, continued

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

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

Goodwill and Intangibles

In June 2001, the Financial Accounting Standards Board issued ASC 805, Business Combinations and ASC 350, Intangibles. The provisions of ASC 350 discontinue and amortization of goodwill and intangible assets with indefinite lives. Instead, these assets are subject to an annual impairment review and more frequently if certain impairment indicators are in evidence. ASC 350 also requires that reporting units be identified for the purpose of assessing potential future impairments of goodwill.

The Company adopted ASC 350 on January 1, 2002. Goodwill totaled $2,639,000 at January 1, 2002. As of December 31, 2008, the Company recognized $31,000 in additional goodwill related to the purchase of 70% ownership in VBS Mortgage. In 2017 the Company recognized $211,000 in goodwill and $285,000 in intangibles related to the purchase of 76% ownership in VST. The goodwill is not amortized but is tested for impairment at least annually. Based on this testing, there were no impairment charges for 2017, 2016 or 2015. The Intangibles related to the VST purchase are amortized over periods up to 15 years with $53,000 recorded in 2017.

Income Tax

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

PART II, continued

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations, continued

Fair Value

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

Pension Plan Accounting

The accounting guidance for the measurement and recognition of obligations and expense related to pension plans generally applies the concept that the cost of benefits provided during retirement should be recognized over the employees’ active working life. Inherent in this concept is the requirement to use various actuarial assumptions to predict and measure costs and obligations many years prior to the settlement date. Major actuarial assumptions that require significant management judgment and have a material impact on the measurement of benefits expense and accumulated obligation include discount rates, expected return on assets, mortality rates, and projected salary increases, among others. Changes in assumptions or judgments related to any of these variables could result in significant volatility in the Company’s financial condition and results of operations. As a result, accounting for the Company’s pension expense and obligation is considered a significant estimate. The estimation process and the potential materiality of the amounts involved result in this item being identified as critical.

Other Real Estate Owned (OREO)

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

PART II, continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, continued

Overview

The Company's net income for 2017 totaled $9,010,000 or $2.63 per common share, a decrease of 5.83% from $9,568,000 or $2.77 a share in 2016. Return on average equity decreased in 2017 to 10.01% versus 11.18% in 2016, and the return on average assets decreased from 1.34% in 2016 to 1.21% in 2017. These results reflect an $811,000 tax adjustment due to the write down of deferred tax assets as a result of the change in federal corporate income tax rate from 34% to 21% with the passing of the Tax Cuts & Jobs Act.

See page 19 for a five-year summary of selected financial data.

Changes in Net Income per Common Share (Basic)

	2017 to 2016	2016 to 2015
Prior Year Net Income Per Common Share (Basic)	$2.77	$2.40
Change from differences in:		
Net interest income 1	.52	.62
Provision for loan losses	-	.09
Noninterest income, excluding securities gains	1.36	(.08)
Security gains (losses), net	(.01)	-
Noninterest expenses1	(1.66)	(.40)
Income taxes	(.38)	.12
Effect of preferred stock dividend	.02	.01
Change in average shares outstanding	.01	.01
Total Change	(.14)	.37
Net Income Per Common Share (Basic)	$2.63	$2.77

1Noninterest income and noninterest expense reflect the reclassification of VBS to record gross income/expense rather than net.

Net Interest Income

The largest source of operating revenue for the Company is net interest income, which is calculated as the difference between the interest earned on earning assets and the interest expense paid on interest bearing liabilities. Net interest income increased 5.78% from 2016 to 2017 following an increase of 7.60% from 2015 to 2016. The net interest margin is the net interest income expressed as a percentage of interest earning assets. Changes in the volume and mix of interest earning assets and interest bearing liabilities, along with their yields and rates, have a significant impact on the level of net interest income. Tax equivalent net interest income for 2017 was $30,342,000 representing an increase of $1,714,000 or 5.99% over the prior year. A 7.60% increase in 2016 versus 2015 resulted in total tax equivalent net interest income of $28,683,000.

In this discussion and in the tabular analysis of net interest income performance, entitled "Consolidated Average Balances, Yields and Rates," (found on page 26), the interest earned on tax exempt loans and investment securities has been adjusted to reflect the amount that would have been earned had these investments been subject to normal income taxation. This is referred to as tax equivalent net interest income. For a reconciliation of tax equivalent net interest income to GAAP measures, see the table on page 40.

Tax equivalent income on earning assets increased $2,012,000 in 2017 compared to 2016. Loans held for investment, expressed as a percentage of total earning assets, increased in 2017 to 90.29% as compared to 86.02% in 2016. During 2017, yields on earning assets increased 23 basis points (BP), primarily due to rate increases during 2017 specifically in commercial loans, investments and federal funds sold. The average cost of interest bearing liabilities increased 6BP in 2017, following an increase of 9BP in 2016. The increase in 2017 in due to increased cost of deposits and debt as rates increased.

The analysis on the next page reveals an increase in the net interest margin to 4.53% in 2017 from 4.34% in 2016, primarily due to changes in balance sheet leverage and increased interest rates during the year.

PART II, Continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Consolidated Average Balances, Yields and Rates1

	2017			2016			2015		
	Balance	Interest	Rate	Balance	Interest	Rate	Balance	Interest	Rate
ASSETS									
Loans2									
Commercial	$182,646	$9,475	5.19%	$176,389	$8,362	4.74%	$170,272	$8,103	4.76%
Real estate	330,828	16,678	5.04%	312,435	15,781	5.05%	295,892	14,976	5.07%
Installment	90,787	6,470	7.13%	78,524	5,805	7.39%	65,870	4,981	7.56%
Loans held for investment4	604,261	32,623	5.40%	567,348	29,948	5.28%	532,034	28,087	5.28%
Loans held for sale	37,008	1,112	3.00%	68,438	1,924	2.81%	40,450	1,099	2.72%
Investment securities3									
Fully taxable	10,886	338	3.10%	15,714	372	2.37%	17,372	327	1.88%
Partially taxable	125	-	-	125	-	-	125	-	-
Total investment securities	11,011	338	3.07%	15,839	372	2.37%	17,497	327	1.88%
Interest bearing deposits in banks	1,512	10	.66%	727	3	.41%	1,223	-	-
Federal funds sold	15,475	156	1.01%	7,195	35	.49%	9,310	21	.23%
Total Earning Assets	669,267	34,239	5.12%	659,547	32,282	4.89%	600,514	29,534	4.92%
Allowance for loan losses	(6,793)			(8,162)			(8,933)		
Nonearning assets	81,552			63,205			52,378		
Total Assets	$744,026			$714,590			$643,959		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Deposits									
Demand –interest bearing	$121,095	$538	.44%	$113,525	$499	.44%	$112,334	$539	.48%
Savings	114,489	516	.45%	100,298	441	.44%	76,491	212	.28%
Time deposits	159,415	1,634	1.02%	160,221	1,440	.90%	171,829	1,402	.82%

Total interest bearing deposits	394,999	2,688	.68%	374,044	2,380	.64%	360,654	2,153	.60%
Short-term debt	20,398	63	.31%	37,716	55	.15%	32,017	69	.22%
Long-term debt	53,004	1,146	2.16%	56,253	1,164	2.07%	31,856	654	2.05%
Total interest bearing liabilities	468,401	3,897	.83%	468,013	3,599	.77%	424,527	2,876	.68%
Noninterest bearing deposits	153,640			141,180			125,665		
Other liabilities	31,936			19,824			13,318		
Total liabilities	653,977			629,017			563,510		
Stockholders’ equity	90,049			85,572			80,449		
Total liabilities and stockholders’ equity	$744,026			$714,590			$643,959		
Net interest earnings		$30,342			$28,683			$26,658	
Net yield on interest earning assets (NIM)			4.53%			4.34%			4.44%

1
Income and yields are presented on a tax-equivalent basis using the applicable federal income tax rate of 34%.
2
Interest income on loans includes loan fees.
3
Average balance information is reflective of historical cost and has not been adjusted for changes in market value.
4
Includes nonaccrual loans.

26

PART II, Continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

The following table illustrates the effect of changes in volumes and rates.

	2017 Compared to 2016			2016 Compared to 2015		
	Increase (Decrease)			Increase (Decrease)		
	Due to Change in Average:		Increase Or	Due to Change in Average:		Increase or
	Volume	Rate	(Decrease)	Volume	Rate	(Decrease)
Interest income						
Loans held for investment	$1,949	$726	$2,675	$1,865	$(4)	$1,861
Loans held for sale	(884)	72	(812)	761	64	825
Investment securities						
Fully taxable	(114)	80	(34)	(31)	76	45
Partially taxable	-	-	-	-	-	-
Interest bearing deposits in banks	3	4	7	-	3	3
Federal funds sold	40	81	121	(5)	19	14
Total Interest Income	994	963	1,957	2,590	158	2,748
Interest expense						
Deposits						
Demand - interest bearing	33	6	39	6	(46)	(40)
Savings	62	13	75	67	162	229
Time deposits	(7)	201	194	(95)	133	38
Short-term debt	(25)	33	8	13	(27)	(14)
Long-term debt	(67)	49	(18)	500	10	510
Total Interest Expense	(4)	302	298	491	232	723
Net Interest Income	$998	$661	$1,659	$2,099	$(74)	$2,025

Note: Volume changes have been determined by multiplying the prior years' average rate by the change in average balances outstanding. The rate change is determined by multiplying the current year average balance outstanding by the change in rate from the prior year to the current year.

Interest Income

Tax equivalent interest income increased $2,012,000 or 6.24% in 2017, after increasing 9.31% or $2,744,000 in 2016. Overall, the yield on earning assets increased .23%, from 4.89% to 5.12%. Average loans held for investment grew during 2017, with average loans outstanding increasing $36,913,000 to $604,261,000. Average real estate loans increased 5.89%, commercial loans increased 3.55% and consumer installment loans increased 15.62% on average. The increase in average consumer loans is a result of the growth in our Dealer Finance Division which opened at the end of 2012. The increase in tax equivalent interest income is primarily due to the growth in the loan portfolio, with commercial loans contributing the most interest income growth.

PART II, Continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

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

GAAP Financial Measurements: (Dollars in thousands).	2017	2016	2015
Interest Income – Loans	$33,591	$31,740	$29,056
Interest Income - Securities and Other Interest-Earnings Assets	504	410	348
Interest Expense – Deposits	2,688	2,380	2,153
Interest Expense - Other Borrowings	1,209	1,219	723
Total Net Interest Income	30,198	28,551	26,528
Non-GAAP Financial Measurements:			
Add: Tax Benefit on Tax-Exempt Interest Income – Loans	144	132	130
Add: Tax Benefit on Tax-Exempt Interest Income - Securities and Other Interest-Earnings Assets	-	-	-
Total Tax Benefit on Tax-Exempt Interest Income	144	132	130
Tax-Equivalent Net Interest Income	$30,342	$28,683	$26,658

Interest Expense

Interest expense increased $298,000 or 8.28% during 2017, which followed a 25.14% increase or $723,000 in 2016. The average cost of funds of .83% increased .06% compared to 2016, which followed an increase of .09% in 2016 compared to 2015. Average interest bearing liabilities increased $388,000 in 2017 following an increase of $43,486,000 in 2016. The average interest bearing liabilities have remained flat in 2017 and increased 10.24% in 2016. Changes in the cost of funds attributable to rate and volume variances can be found in the table at the top of page 27.

Noninterest Income

Noninterest income continues to be an increasingly important factor in maintaining and growing profitability. Management is conscious of the need to constantly review fee income and develop additional sources of complementary revenue. During 2017, VBS Mortgage's income was reclassified to report gross income and gross expenses in the appropriate income statement categories rather than netting in noninterest income, 2016 and 2015 income statements were reclassified to be comparative.

Noninterest income, exclusive of security gains or losses, increased 42.14% or $2,352,000, in 2017 following an increase of 16.46% in 2016. The increase is due to the addition of VST Title, increases in VBS Mortgage gross revenue and service charges on deposit account. In addition, the FHLB prepayment gain of $504,000 is recorded in noninterest income. The losses on low income housing projects decreased 14.5% for 2017 due to recognition of $162,000 in gains related to a fund that was dissolved. The 2016 increase over 2015 was primarily due to record earnings at VBS Mortgage.

The Company reported an investment loss related to both the Bank and VBS exiting the Bankers Title investment in 2017. The total loss was $42,000. There were no security transactions in 2016 or 2015 which resulted in a gain or loss.

PART II, Continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Noninterest Expense

Noninterest expenses increased from $21,272,000 in 2016 to $24,719,000 in 2017, a 16.20% increase. Salary and benefits increased 16.05% to $14,854,000 in 2017 following an increase of 11.72% in 2016. This increase was the result of normal salary increases, additions to staff for new branches, the addition of VS Title (in 2017) and administrative positions as well as increasing benefit costs (including health care cost, pension expense and profit sharing expenses). Occupancy and Equipment expenses increased $268,000 or 16.72% due to the growth in our branch network following an increase of 5.74% in 2016. Other operating expenses increased $1,125,000 in 2017, following a $288,000 increase in 2016. The primary increases were in the areas of information technology ($211,000), credit and debit card related services ($114,000), contributions ($266,000), and VBS and VST other operating expense growth ($101,000). The 2016 primary increases were in advertising and employee appreciation ($70,000), other loan related costs ($127,000), legal and professional expense ($108,000) and checking account program expenses ($257,000). Total noninterest expense as a percentage of average assets totaled 3.32%, 2.98%, and 3.04%, in 2017, 2016 and 2015, respectively. With the growth in branches, addition of VST and increased staff at VBS mortgage noninterest expenses have shown increase relative to peer data. Peer group averages (as reported in the most recent Uniform Bank Performance Report) have ranged between 2.80%, 2.84% and 2.86% over the same time period.

Provision for Loan Losses

Management evaluates the loan portfolio in light of national and local economic trends, changes in the nature and volume of the portfolio and industry standards. Specific factors considered by management in determining the adequacy of the level of the allowance for loan losses include internally generated loan review reports, past due reports and historical loan loss experience. This review also considers concentrations of loans in terms of geography, business type and level of risk. Management evaluates nonperforming loans relative to their collateral value, when deemed collateral dependent, and makes the appropriate adjustments to the allowance for loan losses when needed. Based on the factors outlined above, the current year provision for loan losses remained at $0 as in 2016. The current levels of the allowance for loan losses reflect increased net charge-off activity, loan growth, and other credit risk factors that the Company considers in assessing the adequacy of the allowance for loan losses. The Company has experienced an increase in past due loans and nonperforming loans at year end; the nonperforming loans increase can be attributed to one borrower ($1.1 million) that has a specific reserve in the allowance for loan losses; the past due loan increase is primarily attributed to one borrower ($5.9 million) that is being closely monitored. Management is in the process of restructuring the relationship and has determined that there is no impairment at this time. Management will continue to monitor nonperforming and past due loans and will make necessary adjustments to specific reserves and record provision for loan losses if conditions change regarding collateral values or cash flow expectations. Management anticipates the Bank will need to record provision expense in 2018 due to expected growth and a normalized historical charge-off rate.

Actual net loan charge-offs were $1,499,000 in 2017 and $1,238,000 in 2016. Net charge-offs as a percentage of loans held for investment totaled .24% and .21% in 2017 and 2016, respectively. The Dealer Finance Division's charge-off percentage is the largest category at .11% of loans held for investment and land development was .09%. As stated in the most recently available Uniform Bank Performance Report (UPBR), peer group loss averages were .10% in 2017 and .11% in 2016. The Bank anticipates losses will remain above peer due to the Dealer Finance Division, however these losses have been in line with expectations and are more than offset by the increased yield derived from this portfolio.

Balance Sheet

Total assets increased 1.13% during the year to $753,270,000, an increase of $8,381,000 from $744,889,000 in 2016. Loans held for investment grew $25,338,000, Bank premises and equipment increased $5,554,000, whereas loans held for sale decreased $22,960,000 and other asset categories experienced modest fluctuations. Average earning assets increased 1.47% or $9,720,000 to $669,267,000 at December 31, 2017. The increase in earning assets is due largely to the growth in the loans held for investment offset by the decrease in short-term loan participation program with Northpointe Bank. Deposits grew $32,092,000 and other liabilities decreased $28,304,000 in 2017. Average interest bearing deposits increased $20,955,000 for 2017 or 5.60%, with increases in both interest-bearing demand accounts and savings accounts. There was a slight decrease in the time deposit category. The Company continues to utilize its assets well, with 89.95% of average assets consisting of earning assets.

PART II, Continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Investment Securities

Total securities increased $1,768,000 or 4.48% in 2017 to $41,243,000 at December 31, 2017 from $39,475,000 at December 31, 2016. Average balances in investment securities decreased 30.48% in 2017 to $11,011,000. At year end, 1.65% of average earning assets of the Company were held as investment securities, all of which are unpledged. Management strives to match the types and maturities of securities owned to balance projected liquidity needs, interest rate sensitivity and to maximize earnings through a portfolio bearing low credit risk. Portfolio yields averaged 3.07% for 2017, up from 2.37% in 2016.

There were no Other Than Temporary Impairments (OTTI) write-downs in 2017, 2016 or 2015. In 2017, the Company recognized a $42,000 loss on exit of the Banker's Title investment; there were no security gains or losses in 2016 or 2015.

The composition of securities at December 31 was:

(Dollars in thousands)	2017	2016	2015
Available for Sale[1]			
U.S. Treasury and Agency	$27,978	$24,014	$12,095
Mortgage-backed obligations of federal agencies[2]	502	634	817
Equity securities	135	135	135
Total	28,615	24,783	13,047
Held to Maturity			
U.S. Treasury and Agency	125	125	125
Total	125	125	125
Other Equity Investments	12,503	14,567	12,157
Total Securities	$41,243	$39,475	$25,329

1
At estimated fair value. See Note 4 to the Consolidated Financial Statements for amortized cost.
2
Issued by a U.S. Government Agency or secured by U.S. Government Agency collateral.

Maturities and weighted average yields of securities at December 31, 2017 are presented in the table below. Amounts are shown by contractual maturity; expected maturities will differ as issuers may have the right to call or prepay obligations. Maturities of other investments are not readily determinable due to the nature of the investment; see Note 4 to the Consolidated Financial Statements for a description of these investments.

	Less Than one Year		One to Five Years		Five to Ten Years		Over Ten Years			
(Dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield
Debt Securities Available for Sale										
U.S. Treasury & Agency	$19,998	1.05%	$7,980	2.06%	$-		$-		$27,978	1.34%
Mortgage-backed obligations of federal agencies					502	2.41%	-		502	2.41%
Equity securities	-		-		-		135		135	
Total	$19,978	1.05%	$7,980	2.06%	$502	2.41%	$135		$28,615	1.36%
Debt Securities Held to Maturity										
U.S. Treasury & Agency	$125	.75%							$125	.75%
Total	$125	.75%							$125	.75%

30

PART II, Continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Analysis of Loan Portfolio

The Company's market area has a relatively stable economy which tends to be less cyclical than the national economy. Major industries in the market area include agricultural production and processing, higher education, retail sales, services and light manufacturing.

The Company's portfolio of loans held for investment totaled $616,974,000 at December 31, 2017 compared with $591,636,000 at the beginning of the year. The Company's policy has been to make conservative loans that are held for future interest income, utilizing prudent underwriting and a strong loan review program. Collateral required by the Company is determined on an individual basis depending on the purpose of the loan and the financial condition of the borrower. Commercial loans, including agricultural and multifamily loans, increased 3.89% during 2017 to $209,721,000. Real estate mortgages increased $12,260,000 or 5.14%. Growth has included a variety of loan and collateral types including owner occupied residential real estate and residential rental properties. Construction loans decreased $4,552,000 or 5.98%. The Bank also has loan participation arrangements with several other banks within the region to aid in diversification of the loan portfolio geographically, by collateral type and by borrower.

Consumer installment loans increased $9,411,000 or 13.06%. This category includes personal loans, auto loans and other loans to individuals. This category began increasing during the fourth quarter of 2012 due to the opening of the Dealer Finance Division in Penn Laird, Virginia; at year end this Division had a loan portfolio of $75,169,000. Credit card balances increased $117,000 to $2,939,000 but are a minor component of the loan portfolio. The following table presents the changes in the loan portfolio over the previous five years.

	December 31				
(Dollars in thousands)	2017	2016	2015	2014	2013
Real estate – mortgage	$250,891	$238,631	$232,321	$223,824	$212,630
Real estate – construction	71,620	76,172	69,759	67,180	68,512
Consumer installment	81,458	72,048	62,239	49,615	30,643
Commercial	182,360	178,392	153,691	147,599	135,835
Agricultural	17,064	15,876	15,672	15,374	16,265
Multi-family residential	10,298	7,605	7,559	11,775	11,797
Credit cards	2,939	2,822	2,745	2,705	2,680
Other	344	90	67	130	91
Total Loans	$616,974	$591,636	$544,053	$518,202	$478,453

The following table shows the Company's loan maturity and interest rate sensitivity as of December 31, 2017:

	Less Than	1-5	Over

(Dollars in thousands)	1 Year	Years	5 Years	Total
Commercial and				
agricultural loans	$66,586	$106,048	$26,790	$199,424
Multi-family residential	4,628	5,173	497	10,298
Real Estate – mortgage	104,699	141,572	4,620	250,891
Real Estate – construction	50,857	18,637	2,126	71,620
Consumer – installment/credit cards/other	9,027	61,600	14,114	84,741
Total	$235,797	$333,030	$48,147	$616,974
Loans with predetermined rates	$28,101	$79,748	$30,378	$138,227
Loans with variable or				
adjustable rates	207,696	253,282	17,769	478,747
Total	$235,797	$333,030	$48,147	$616,974

31

PART II, Continued

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations, Continued

Analysis of Loan Portfolio, continued

Residential real estate loans are generally made for a period not to exceed 25 years and are secured by a first deed of trust which normally does not exceed 90% of the appraised value. If the loan to value ratio exceeds 90%, the Company requires additional collateral, guarantees or mortgage insurance. On approximately 94% of the real estate loans, interest is adjustable after each one, three or five-year period. The remainder of the portfolio is comprised of fixed rate loans that are generally made for a fifteen-year or a twenty-year period with an interest rate adjustment after ten years.

Since 1992, fixed rate real estate loans have been funded with fixed rate borrowings from the Federal Home Loan Bank, which allows the Company to control its interest rate risk. In addition, the Company makes home equity loans secured by second deeds of trust with total indebtedness not to exceed 90% of the appraised value. Home equity loans are made for three, five or ten year periods at a fixed rate or as a revolving line of credit.

Construction loans may be made to individuals, who have arranged with a contractor for the construction of a residence, or to contractors that are involved in building pre-sold, spec-homes or subdivisions. The majority of commercial loans are made to small retail, manufacturing and service businesses. Consumer loans are made for a variety of reasons; however, approximately 74% of the loans are secured by automobiles and trucks.

Approximately 80% of the Company’s loans are secured by real estate; however, policies relating to appraisals and loan to value ratios are adequate to control the related risk. Market values appear to have rebounded from the recession with modest increases in 2015, 2016, and 2017. Unemployment rates in the Company’s market area continue to be below both the national and state averages.

The Bank has not identified any loan categories that would be considered loan concentrations of greater than 25% of capital. While the Bank has not developed a formal policy limiting the concentration level to any particular loan type or industry segment, it has established target limits on both a nominal and percentage of capital basis. Concentrations are monitored and reported to the board of directors quarterly. Concentration levels have been used by management to determine how aggressively we may price or pursue new loan requests. At December 31, 2017, there are no industry categories of loans that exceed 10% of total loans.

Nonaccrual and Past Due Loans

Nonperforming loans include nonaccrual loans and loans 90 days or more past due. Nonaccrual loans are loans on which interest accruals have been suspended or discontinued permanently. The Company would have earned approximately $102,000 in additional interest income had the loans on nonaccrual status been current and performing. Nonperforming loans totaled $7,102,000 at December 31, 2017 compared to $4,870,000 at December 31, 2016. At December 31, 2017, $198,000 of loans 90 days or more past due were not on nonaccrual status. Approximately 88% of these nonperforming loans are secured by real estate. Although management expects that there may be additional loan losses, the Bank believes that it is generally well secured and continues to actively work with its customers to effect payment. As of December 31, 2017, the Company holds $1,984,000 of real estate which was acquired through foreclosure.

Nonperforming loans have increased approximately $2,232,000 since December 31, 2016. Of the increase, $1.5 million relates to two borrowers; one of which has sold equipment and the loan will be modified for collection of the remaining balance, with no loss anticipated as of December 31, 2017. The other relationship is in the process of subdividing property to sell in order to bring the loan current; this loan has been reviewed for impairment and has a specific reserve of $249,000 in our allowance for loan losses at December 31, 2017.

PART II, Continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Nonaccrual and Past Due Loans, continued

The following is a summary of information pertaining to nonperforming loans:

(Dollars in thousands)	2017	2016	2015	2014	2013
Nonaccrual Loans:					
Real Estate	$5,628	$4,204	$5,698	$5,481	$9,963
Commercial	599	70	109	1,179	1,890
Home Equity	451	311	40	153	402
Other	226	178	108	161	-
Loans past due 90 days or more:					
Real Estate	143	81	272	0	246
Commercial	-	-	25	0	4
Home Equity	-	-	107	0	61
Other	55	26	67	1	16
Total Nonperforming loans	$7,102	$4,870	$6,526	$6,975	$12,582
Restructured Loans current and performing:					
Real Estate	7,710	8,641	8,713	3,913	7,484
Commercial	-	1,121	1,463	518	3,989
Home Equity	-	-	1,414	290	727
Other	78	76	91	22	-
Nonperforming loans as a percentage of loans held for investment	1.15%	.82%	1.20%	1.35%	2.63%
Net Charge Offs to Total Loans Held for Investment	.24%	.21%	.04%	.33%	.78%
Allowance for loan and lease losses to nonperforming loans	85.10%	154.89%	134.55%	125.09%	65.04%

Potential Problem Loans

Loans classified for regulatory purposes as loss, doubtful, substandard, or special mention do not represent or result from trends or uncertainties which management reasonably expects will materially impact future operating results, liquidity or capital resources. Nor do they represent material credits about which management is aware of any information which causes it to have serious doubts as to the ability of such borrowers to comply with the loan repayment terms. As of December 31, 2017, management is not aware of any potential problem loans which are not already classified for regulatory purposes or on the watch list as part of the Bank's internal grading system.

33

PART II, Continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Loan Losses and the Allowance for Loan Losses

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

Loans that are not impaired are categorized by call report code into unimpaired and classified loans. For unimpaired loans an estimate is calculated based on actual loss experience over the last five years, for loans of that type. During 2015, the Company felt the two-year loss history utilized in 2014 and prior would not be indicative of the amount of losses that could occur in our current economic cycle, therefore the loss history was expanded to five years to capture a more representative loss history. Dealer finance loans utilize a two-year loss history. The Company monitors the net losses for this division and adjusts based on how the portfolio performs since the department was established in 2012. For classified loans, loans are grouped by call code and past due or adverse risk rating. Loss rates are assigned based on actual loss experience over the last five years multiplied by a risk factor. The Dealer finance loans are given a higher risk factor for past due and adverse risk ratings based on back testing of the risk factors.

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

The allowance for loan losses of $6,044,000 at December 31, 2017 is equal to .98% of total loans held for investment. This compares to an allowance of $7,543,000 or 1.27% at December 31, 2016 and 1.61% at December 31, 2015. Management and the Board of Directors feel that the current reserve level is adequate based on the analysis of historical losses, delinquency rates, collateral values of delinquent loans and a thorough review of the loan portfolio. The allowance for loan losses to nonperforming loans has decreased from 154.89% to 85.10% in 2017; increases in the nonperforming loans have been analyzed and, where necessary, a specific reserve has been recorded. In addition, past due and adversely risk rated loans have higher allocation factors within the allowance for loan losses calculation. The Company has experienced a continued decline in historical charge-off rates with 2017 replacing 2012 in the five-year lookback and the local economy showing continued improvements in unemployment. Management will continue to monitor relationships that have recently become past due but are not considered impaired at this time.

Loan losses, net of recoveries, totaled $1,499,000 in 2017 which is equivalent to .24% of total loans outstanding. Over the preceding three years, the Company has had an average loss rate of .16%, compared to a .11% loss rate for its peer group.

PART II, Continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Loan Losses and the Allowance for Loan Losses, continued

A summary of the activity in the allowance for loan losses follows:

(Dollars in thousands)	2017	2016	2015	2014	2013
Balance at beginning of period	$7,543	$8,781	$8,725	$8,184	$8,154
Provision charged to expenses	-	-	300	2,250	3,775
Loan losses:					
Construction/land development	620	356	156	1,611	2,127
Farmland	-	-	-	-	-
Real Estate	-	23	25	208	173
Multi-family	-	-	-	-	-
Commercial Real Estate	-	19	-	-	201
Home Equity – closed end	7	8	26	-	159
Home Equity – open end	26	370	51	80	68
Commercial & Industrial – Non Real Estate	179	293	-	385	986
Consumer	136	37	32	33	173
Dealer Finance	1,806	1,081	251	107	17
Credit Cards	98	74	60	46	121
Total loan losses	2,872	2,261	601	2,470	4,025
Recoveries:					
Construction/land development	-	7	85	223	40
Farmland	-	-	-	-	-
Real Estate	2	4	37	-	-
Multi-family	-	-	-	-	-
Commercial Real Estate	13	135	65	108	42
Home Equity – closed end	25	-	6	-	-
Home Equity – open end	53	120	-	-	29
Commercial & Industrial – Non Real Estate	72	267	62	356	127
Consumer	28	19	32	33	14
Dealer Finance	1,143	417	24	6	-
Credit Cards	37	54	46	35	28
Total recoveries	1,373	1,023	357	761	280
Net loan losses	(1,499)	(1,238)	(244)	(1,709)	(3,745)
Balance at end of period	$6,044	$7,543	$8,781	$8,725	$8,184
Allowance for loan losses as a percentage of loans	.98%	1.27%	1.61%	1.68%	1.71%
Net loan losses to loans held for investment	.24%	.21%	.04%	.33%	.78%

35

PART II, Continued

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Loan Losses and the Allowance for Loan Losses, continued

ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

	2017		2016		2015		2014		2013	
Allowance for loan losses: (dollars in thousands)	Balance	Percentage of Loans in Each Category	Balance	Percentage of Loans in Each Category	Balance	Percentage of Loans in Each Category	Balance	Percentage of Loans in Each Category	Balance	Percentage of Loans in Each Category
Construction/Land Development	$2,547	42.14%	$3,381	44.82%	$4,442	50.59%	$4,738	54.30%	$4,007	48.96%
Real Estate	719	11.90%	843	11.18%	806	9.18%	623	7.14%	400	4.89%
Commercial, Financial and Agricultural	863	14.28%	1,348	17.88%	1,666	18.97%	1,337	15.33%	2,239	27.36%
Consumer	1,640	27.13%	1,426	18.90%	1,059	12.06%	1,685	19.31%	905	11.06%
Home Equity	275	4.55%	545	7.22%	808	9.20%	342	3.92%	633	7.73%
Total	$6,044	100.00%	$7,543	100.00%	$8,781	100.00%	$8,725	100.00%	$8,184	100.00%

Deposits and Borrowings

The average deposit balances and average rates paid for 2017, 2016 and 2015 were as follows:

Average Deposits and Rates Paid (Dollars in thousands)

	December 31,					
	2017		2016		2015	
	Average Balance	Rate	Average Balance	Rate	Average Balance	Rate
Noninterest-bearing	$153,640		$141,180		$125,665	

Interest-bearing:						
Interest Checking	$121,095	.44%	$113,525	.44%	$112,334	.48%
Savings Accounts	114,489	.45%	100,298	.44%	76,491	.28%
Time Deposits:						
CDARS	1,247	.56%	1,253	.88%		