FARMERS & MERCHANTS BANCORP INC
Form 10-K
February 28, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2006

or

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from __________ to __________

Commission File Number 0-14492

FARMERS & MERCHANTS BANCORP, INC.

OHIO	34-1469491
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

307-11 North Defiance Street Archbold, Ohio	43502
(Address of principal Executive offices)	(Zip Code)

Registrant's telephone number, including area code (419)446-2501

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
None	None

Securities registered pursuant to Section 12(g) of the Act:

Common shares without par value
(Title of class)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or Section 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 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Ace. (Check one):

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

As of June 30, 2006, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $119,347,000.00.

As of February 21, 2007, the Registrant had 5,200,000 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of Form 10-K -- Portions of the definitive Proxy Statement for the 2006 Annual Meeting of Shareholders of Farmers & Merchants Bancorp, Inc.

FARMERS & MERCHANTS BANCORP, INC.

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Statements contained in this portion of the Company's annual report may be forward-looking statements, as that term is defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of such words as "intend," "believe," "expect," "anticipate," "should," "planned," "estimated," and "potential." Such forward-looking statements are based on current expectations, but may differ materially from those currently anticipated due to a number of factors, which include, but are not limited to, factors discussed in documents filed by the Company with the Securities and Exchange Commission from time to time. Other factors which could have a material adverse effect on the operations of the company and its subsidiaries which include, but are not limited to, changes in interest rates, general economic conditions, legislative and regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Bank's market area, changes in relevant accounting principles and guidelines and other factors over which management has no control. The forward-looking statements are made as of the date of this report, and the Company assumes no obligation to update the forward-looking statements or to update the reasons why actual results could differ from those projected in the forward-looking statements.

PART 1.

ITEM 1. BUSINESS:

GENERAL

Farmers & Merchants Bancorp, Inc. (Company) is a bank holding company under the

laws of Ohio and was incorporated in 1985. Our primary subsidiary, The Farmers & Merchants State Bank (Bank) is a community bank operating in Northwest Ohio since 1897. Our only other subsidiary, Farmers & Merchants Life Insurance Company, a reinsurance company for life, accident and health insurance for the Bank's consumer credits, was formed in 1992. We report our financial condition and net income on a consolidated basis and we report only one segment.

Our executive offices are located at 307-11 North Defiance Street, Archbold, Ohio 43502, and our telephone number is (419) 446-2501.

NATURE OF ACTIVITIES

The Farmers & Merchants State Bank engages in general commercial banking and savings business. Our activities include commercial and residential mortgage, consumer, and credit card lending activities. Because our Bank's branches are located in Northwest Ohio, a substantial amount of our loan portfolio is comprised of loans made to customers in the farming industry for such things as farm land, farm equipment, livestock and general operation loans for seed, fertilizer, feed, etc. Other types of lending activities include loans for home improvements, student loans, and loans for such items as autos, trucks, recreational vehicles, mobile homes, motorcycles, etc. We have previously engaged in direct finance leasing and have invested in leveraged type leases, although the activity in this area has since ceased.

We also provide checking account services, as well as savings and other time deposit services such as certificates of deposits. In addition, ATM's (automated teller machines) are also provided in our offices in Archbold, Wauseon, Stryker, West Unity, Bryan, Delta, Napoleon, Montpelier, Swanton, and Defiance. Two ATM's are also located at Sauder Woodworking Co., Inc., a major employer in Archbold. Additional locations are at Northwest State Community College, Archbold; Williams County Hospital, Bryan; Fairlawn Haven Wyse Commons, Archbold; Repp Oil, Fayette; Delta Eagles, Bryan Eagles; Sauder Village , Archbold; Fulton County Hospital, Wauseon; and a Mobil Trailer ATM.

Farmers & Merchants Life Insurance Company was established to provide services to our customers through the issuance of life and disability insurance policies. Our Bank's lending officers are the selling agents of the policies to customers. The activities of Farmers & Merchants Life Insurance Co. are not significant to the consolidated company.

F&M Investments, the brokerage department of the Bank, opened for business in April, 1999. Securities are offered through Raymond James Financial Services, Inc.

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956. Our subsidiary bank is in turn regulated and examined by the Ohio Division of Financial Institutions, the Federal Deposit Insurance Corporation and the Federal Reserve System. The activities of our bank subsidiary are also subject to other federal and state laws and regulations, including usury and consumer credit laws, state laws relating to fiduciaries, the Federal Truth-in-Lending Act and Regulation Z as promulgated thereunder by the Board of Governors, the Truth in Savings Act, the Bank Bribery Act, the Competitive Equality Banking Act of 1987, the Expedited Funds Availability Act, the Community Reinvestment Act, the FDICIA (Federal Deposit Insurance Corporation Insurance Act), FIRREA (Federal Institutions Reform, Recovery, and Enforcement Act of 1989), the Bank Merger Act, and the Graham-Leach-Bliley Act regarding financial modernization among others.

The Bank's primary market includes communities located in the Ohio counties of Defiance, Williams, Fulton and Henry. The commercial banking business in this market is highly competitive, with approximately 17 other depository institutions currently doing business in the Bank's primary market. In our

banking activities,

we compete directly with other commercial banks and savings and loan institutions in each of our operating localities. In a number of our locations, we compete against entities which are much larger than us. The primary factors in competing for loans and deposits are the rates charged as well as location and quality of the services provided.

At December 31, 2006, we had 252 full time equivalent employees. The employees are not represented by a collective bargaining unit. We provide our employees with a comprehensive benefit program, some of which are contributory. We consider our employee relations to be excellent.

SUPERVISION AND REGULATION

General

The Company is a corporation organized under the laws of the State of Ohio. The business in which the Company and its subsidiary are engaged is subject to extensive supervision, regulation and examination by various bank regulatory authorities. The supervision, regulation and examination to which the Company and its subsidiary are subject are intended primarily for the protection of depositors and the deposit insurance funds that insure the deposits of banks, rather than for the protection of shareholders.

Several of the more significant regulatory provisions applicable to banks and bank holding companies to which the Company and its subsidiary are subject are discussed below, along with certain regulatory matters concerning the Company and its subsidiary. To the extent that the following information describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory provisions. Any change in applicable law or regulation may have a material effect on the business and prospects of the Company and its subsidiary.

Regulatory Agencies

The Company is a registered bank holding company and is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") pursuant to the Bank Holding Company Act of 1956, as amended.

The Bank is an Ohio chartered commercial bank. It is subject to regulation and examination by both the Ohio Division of Financial Institutions (the "ODFI") and the FDIC.

Holding Company Activities

As a bank holding company incorporated and doing business within the State of Ohio, the Company is subject to regulation and supervision under the Bank Holding Act of 1956, as amended (the "Act"). The Company is required to file with the Federal Reserve Board on a quarterly basis information pursuant to the Act. The Federal Reserve Board may conduct examinations or inspections of the Company and its subsidiaries.

The Company is required to obtain prior approval from the Federal Reserve Board for the acquisition of more than five percent of the voting shares or substantially all of the assets of any bank or bank holding company. In

addition, the Company is generally prohibited by the Act from acquiring direct or indirect ownership or control of more than five percent of the voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiaries. The Company may, however, subject to the prior approval of the Federal Reserve Board, engage in, or acquire shares of companies engaged in activities which are deemed by the Federal Reserve Board by order or by regulation to be so closely related to banking or managing and controlling a bank as to be a proper activity.

On November 12, 1999, the Gramm-Leach-Bliley Act (the "GLB Act") was enacted into law. The GLB Act made sweeping changes with respect to the permissible financial services which various types of financial institutions may now provide. The Glass-Steagall Act, which had generally prevented banks from affiliation with securities and insurance firms, was repealed. Pursuant to the GLB Act, bank holding

companies may elect to become a "financial holding company," provided that all of the depository institution subsidiaries of the bank holding company are "well capitalized" and "well managed" under applicable regulatory standards.

Under the GLB Act, a bank holding company that has elected to become a financial holding company may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. Activities that are "financial in nature" include securities underwriting, dealing and market-making, sponsoring mutual funds and investment companies, insurance underwriting and agency, merchant banking, and activities that the Federal Reserve Board has determined to be closely related to banking. No Federal Reserve Board approval is required for the Company to acquire a company, other than a bank holding company, bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. Prior Federal Reserve Board approval is required before the Company may acquire the beneficial ownership or control of more than 5% of the voting shares, or substantially all of the assets, of a bank holding company, bank or savings association. If any subsidiary bank of the Company ceases to be "well capitalized" or "well managed" under applicable regulatory standards, the Federal Reserve Board may, among other actions, order the Company to divest the subsidiary bank. Alternatively, the Company may elect to conform its activities to those permissible for a bank holding company that is not also a financial holding company. If any subsidiary bank of the Company receives a rating under the Community Reinvestment Act of 1977 of less than satisfactory, the Company will be prohibited from engaging in new activities or acquiring companies other than bank holding companies, banks or savings associations. The Company has not elected to become a financial holding company and has no current intention of making such an election.

Affiliate Transactions

Various governmental requirements, including Sections 23A and 23B of the Federal Reserve Act, limit borrowings by holding companies and non-bank subsidiaries from affiliated insured depository institutions, and also limit various other transactions between holding companies and their non-bank subsidiaries, on the one hand, and their affiliated insured depository institutions on the other. Section 23A of the Federal Reserve Act also generally requires that an insured depository institution's loan to its non-bank affiliates be secured, and Section 23B of the Federal Reserve Act generally requires that an insured depository institution's transactions with its non-bank affiliates be on arms-length terms.

Interstate Banking and Branching

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act ("Riegle-Neal"), subject to certain concentration limits and other requirements, bank holding companies such as the Company are permitted to acquire banks and bank holding companies located in any state. Any bank that is a subsidiary of a bank holding company is permitted to receive deposits, renew time deposits, close loans, service loans and receive loan payments as an agent for any other bank subsidiary of that bank holding company. Banks are permitted to acquire branch offices outside their home states by merging with out-of-state banks, purchasing branches in other states and establishing de novo branch offices in other states. The ability of banks to acquire branch offices is contingent, however, on the host state having adopted legislation "opting in" to those provisions of Riegle-Neal. In addition, the ability of a bank to merge with a bank located in another state is contingent on the host state not having adopted legislation "opting out" of that provision of Riegle-Neal. The Company could from time to time use Riegle-Neal to acquire banks in additional states.

Control Acquisitions

The Change in Bank Control Act prohibits a person or group of persons from acquiring "control" of a bank holding company, unless the Federal Reserve Board has been notified and has not objected to the transaction. Under the rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act, such as the Company, would, under the circumstances set forth in the presumption, constitute acquisition of control of the bank holding company. In addition, a company is required to obtain the approval of the Federal Reserve Board under the Bank Holding Company Act before

acquiring 25% (5% in the case of an acquiror that is a bank holding company) or more of any class of outstanding voting stock of a bank holding company, or otherwise obtaining control or a "controlling influence" over that bank holding company.

Liability for Banking Subsidiaries

Under the current Federal Reserve Board policy, a bank holding company is expected to act as a source of financial and managerial strength to each of its subsidiary banks and to maintain resources adequate to support each subsidiary bank. This support may be required at times when the bank holding company may not have the resources to provide it. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a U.S. federal bank regulatory agency to maintain the capital of a subsidiary bank would be assumed by the bankruptcy trustee and entitled to priority of payment. Any depository institution insured by the FDIC can be held liable for any loss incurred, or reasonably expected to be incurred, by the FDIC in connection with (1) the "default" of a commonly controlled FDIC-insured depository institution; or (2) any assistance provided by the FDIC to both a commonly controlled FDIC-insured depository institution "in danger of default." The Company's subsidiary bank is an FDIC-insured depository institution. If a default occurred with respect to the Bank, any capital loans to the Bank from its parent holding company would be subordinate in right of payment to payment of the Bank's depositors and certain of its other obligations.

Regulatory Capital Requirements

The Company is required by the various regulatory authorities to maintain certain capital levels. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve capital adequacy guidelines. If capital falls below minimum guideline levels, a bank holding company, among other things, may be denied approval to acquire or establish additional banks or non-bank businesses. The required capital levels and the Company's capital position at December 31, 2006 are summarized in the table included in Note 14 to the consolidated financial statements.

FDICIA

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), and the regulations promulgated under FDICIA, among other things, established five capital categories for insured depository institutions-well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized-and requires U.S. federal bank regulatory agencies to implement systems for "prompt corrective action" for insured depository institutions that do not meet minimum capital requirements based on these categories. Unless a bank is well capitalized, it is subject to restrictions on its ability to offer brokered deposits and on certain other aspects of its operations. An undercapitalized bank must develop a capital restoration plan and its parent bank holding company must guarantee the bank's compliance with the plan up to the lesser of 5% of the banks or thrift's assets at the time it became undercapitalized and the amount needed to comply with the plan. As of December 31, 2006, the Company's banking subsidiary was well capitalized pursuant to these prompt corrective action guidelines.

Dividend Restrictions

The ability of the Company to obtain funds for the payment of dividends and for other cash requirements will be largely dependent on the amount of dividends which may be declared by its banking subsidiary. Various U.S. federal statutory provisions limit the amount of dividends the Company's banking subsidiaries can pay to the Company without regulatory approval. Dividend payments by the Bank are limited to its retained earnings during the current year and its prior two years.

Deposit Insurance Assessments

The deposits of the Company's banking subsidiary are insured up to regulatory limits by the FDIC, and, accordingly, are subject to deposit insurance assessments based on the Federal Deposit Insurance Reform Act of 2005, as adopted and took effect on April 21, 2006.

Depositor Preference Statute

In the "liquidation or other resolution" of an institution by any receiver, U.S. federal legislation provides that deposits and certain claims for administrative expenses and employee compensation against the insured depository institution would be afforded a priority over general unsecured claims against that institution, including federal funds and letters of credit.

Government Monetary Policy

The earnings of the Company are affected primarily by general economic

conditions, and to a lesser extent by the fiscal and monetary policies of the federal government and its agencies, particularly the Federal Reserve. Its policies influence, to some degree, the volume of bank loans and deposits, and interest rates charged and paid thereon, and thus have an effect on the earnings of the Company's subsidiary Bank.

Additional Regulation

The Bank is also subject to federal regulation as to such matters as required reserves, limitation as to the nature and amount of its loans and investments, regulatory approval of any merger or consolidation, issuance or retirement of their own securities, limitations upon the payment of dividends and other aspects of banking operations. In addition, the activities and operations of the Bank are subject to a number of additional detailed, complex and sometimes overlapping laws and regulations. These include state usury and consumer credit laws, state laws relating to fiduciaries, the Federal Truth-in-Lending Act and Regulation Z, the Federal Equal Credit Opportunity Act and Regulation B, the Fair Credit Reporting Act, the Truth in Savings Act, the Community Reinvestment Act, anti-redlining legislation and antitrust laws.

Future Legislation

Changes to the laws and regulations, both at the federal and state levels, can affect the operating environment of the Company and its subsidiary in substantial and unpredictable ways. The Company cannot accurately predict whether those changes in laws and regulations will occur, and, if those changes occur, the ultimate effect they would have upon the financial condition or results of operations of the Company or its subsidiary.

Available Information:

The Company maintains an Internet web site at the following internet address: http://www.fm-bank.com. The Company files reports with the Securities and Exchange Commission (SEC). Copies of all filings made with the SEC may be read and copied at the SEC's Public Reference Room, 450 Fifth Street, Washington, DC, 20549. You may obtain information about the SEC's Public Reference Room by calling (800/SEC-0330). Because the Company makes its filing with the SEC electronically, you may access such reports at the SEC's website, www.sec.gov. The Company makes available, free of charge through its internet address, copies of its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to these reports as soon as reasonable practicable after such materials have been filed with or furnished to the SEC. Copies of these documents may also be obtained, either in electronic or paper form, by contacting Barbara J. Britenriker, Chief Financial Officer of the Company at (419) 446-2501.

ITEM 1A. RISK FACTORS

SIGNIFICANT COMPETITION FROM AN ARRAY OF FINANCIAL SERVICE PROVIDERS

Our ability to achieve strong financial performance and a satisfactory return on investment to shareholders will depend in part on our ability to expand our available financial services. In addition to the challenge of attracting and retaining customers for traditional banking services, our competitors now include securities

dealers, brokers, mortgage bankers, investment advisors and finance and

insurance companies who seek to offer one-stop financial services to their customers that may include services that banks have not been able or allowed to offer to their customers in the past. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems and the accelerating pace of consolidation among financial services providers. If we fail to adequately address each of the competitive pressures in the banking industry, our financial condition and results of operations could be adversely affected.

CREDIT RISK

The risk of nonpayment of loans is inherent in commercial banking. Such nonpayment could have an adverse effect on the Company's earnings and our overall financial condition as well as the value of our common stock. Management attempts to reduce the Bank's credit exposure by carefully monitoring the concentration of its loans within specific industries and through loan application and approval procedures. However, there can be no assurance that such monitoring and procedures will reduce such lending risks. Credit losses can cause insolvency and failure of a financial institution and, in such event, its shareholders could lose their entire investment. For a more information on the exposure of the Company and the Bank to credit risk, see the section under Part II, Item 7 of this Form 10-K captioned "Loan Portfolio."

SUSCEPTIBILITY TO CHANGES IN REGULATION

Any changes to state and federal banking laws and regulations may negatively impact our ability to expand services and to increase the value of our business. We are subject to extensive state and federal regulation, supervision, and legislation that govern almost all aspects of our operations. These laws may change from time to time and are primarily intended for the protection of consumers, depositors and the deposit insurance funds. In addition, the Company's earnings are affected by the monetary policies of the Board of Governors of the Federal Reserve. These policies, which include regulating the national supply of bank reserves and bank credit, can have a major effect upon the source and cost of funds and the rates of return earned on loans and investments. The Federal Reserve influences the size and distribution of bank reserves through its open market operations and changes in cash reserve requirements against member bank deposits. The Gramm-Leach-Bliley Act regarding financial modernization that became effective in November, 1999 removed many of the barriers to the integration of the banking, securities and insurance industries and is likely to increase the competitive pressures upon the Bank. We cannot predict what effect such Act and any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, but such changes could be materially adverse to our financial performance. For a more information on this subject, see the section under Part I, Item 1 of this Form 10-K captioned "Supervision and Regulation."

INTEREST RATE RISK

Changes in interest rates affect our operating performance and financial condition in diverse ways. Our profitability depends in substantial part on our "net interest spread," which is the difference between the rates we receive on loans and investments and the rates we pay for deposits and other sources of funds. Our net interest spread will depend on many factors that are partly or entirely outside our control, including competition, federal economic, monetary and fiscal policies, and economic conditions generally. Historically, net interest spreads for other financial institutions have widened and narrowed in response to these and other factors, which are often collectively referred to as "interest rate risk." Over the last few years, the Bank, along with most other financial institutions, has experienced a "margin squeeze" as higher interest rates have made it difficult to maintain a more favorable net interest spread.

The Bank manages interest rate risk within an overall asset/liability framework. The principal objectives of asset/liability management are to manage sensitivity of net interest spreads and net income to potential changes in interest rates. Funding positions are kept within predetermined limits designed to ensure that risk-taking is not excessive and that liquidity is properly managed. In the event that our asset/liabilities management strategies are unsuccessful, our profitability may be adversely affected. For more information regarding the Company's exposure to interest rate risk, see Part II, Item 7A of this Form 10-K.

ATTRACTION AND RETENTION OF KEY PERSONNEL

Our success depends upon the continued service of our senior management team and upon our ability to attract and retain qualified financial services personnel. Competition for qualified employees is intense. In our experience, it can take a significant period of time to identify and hire personnel with the combination of skills and attributes required in carrying out our strategy. If we lose the services of our key personnel, or are unable to attract additional qualified personnel, our business, financial condition, results of operations and cash flows could be materially adversely affected.

DIVIDEND PAYOUT RESTRICTIONS

We currently pay a quarterly dividend on our common shares. However, there is no assurance that we will be able to pay dividends in the future. Dividends are subject to determination and declaration by our board of directors, which takes into account many factors. The declaration of dividends by us on our common stock is subject to the discretion of our board and to applicable state and federal regulatory limitations. The Company's ability to pay dividends on its common stock depends on its receipt of dividends from the Bank. The Bank is subject to restrictions and limitations in the amount and timing of the dividends it may pay to the Company.

ANTI-TAKEOVER PROVISIONS

Provisions of our Articles of Incorporation and Ohio law could have the effect of discouraging takeover attempts which certain stockholders might deem to be in their interest. These anti-takeover provisions may make us a less attractive target for a takeover bid or merger, potentially depriving shareholders of an opportunity to sell their shares of common stock at a premium over prevailing market prices as a result of a takeover bid or merger.

OPERATIONAL RISKS

We are subject to certain operations risks, including, but not limited to, data processing system failures and errors, customer or employee fraud and catastrophic failures resulting from terrorist acts or natural disasters. We maintain a system of internal controls to mitigate against such occurrences and maintain insurance coverage for such risks that are insurable, but should such an event occur that is not prevented or detected by our internal controls, uninsured or in excess of applicable insurance limits, it could have a significant adverse impact on our business, financial condition or results of operations.

LIMITED TRADING MARKET

Our common stock is not listed on any exchange or The Nasdaq Stock Market. While

our stock is currently quoted in the over-the-counter markets, it trades infrequently.

ITEM 2. PROPERTIES

Our principal office is located in Archbold, Ohio.

The Bank operates from the facilities at 307-11 North Defiance Street. In addition, the Bank owns the property from 200 to 208 Ditto Street, Archbold, Ohio, which it uses for Bank parking and a community mini-park area. The Bank owns real estate at two locations, 207 Ditto Street and 209 Ditto Street in Archbold, Ohio upon which the bank built a commercial building to be used for storage, and a parking lot for company vehicles and employee parking. The Bank also owns real estate across from the main facilities to provide for parking.

The Bank occupies an Operations Center at 622 Clydes Way in Archbold, Ohio to accommodate our growth over the years.

The Bank owns all of its branch locations. Current locations of retail banking services are:

Branch	Location
Archbold, Ohio	1313 South Defiance Street
Wauseon, Ohio	1130 North Shoop Avenue
	119 North Fulton Street
Stryker, Ohio	300 South Defiance Street
West Unity, Ohio	200 West Jackson Street
Bryan, Ohio	924 W. High Street
	1000 South Main Street
Delta, Ohio	101 Main Street
Montpelier, Ohio	225 West Main Street
	1150 East Main Street
Napoleon, Ohio	2255 Scott Street
Swanton, Ohio	7 Turtle Creek Circle
Defiance, Ohio	1175 Hotel Drive

The majority of the above locations have drive-up service facilities.

ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings, other than ordinary routine proceedings incidental to the business of the Bank or the Company, to which we are a party or of which any of our properties are the subject.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No items were submitted during the fourth quarter of the year covered by this report to a vote of the security holders through solicitation of proxies or

otherwise.

PART II.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is not quoted on the National Association of Securities Dealers Automated Quotations System (NASDAQ) or any other market or exchange. While there is no established public trading market for our common stock, our shares are currently dually-quoted by various market makers on the Pink Sheets and the Over the Counter Bulletin Board, which are both over-the-counter quotation services for participant broker-dealers.

We have five market makers that set a price for our stock; however, private sales continue to occur. The high and low sale price was from sales of which we have been made aware by our Market Makers. The high and low sale prices known to our management are as follows:

		1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
2006	High	$22.88	$26.00	$23.25	$22.50
	Low	$21.63	$22.25	$21.25	$21.17
2005	High	$28.75	$28.75	$28.75	$28.75
	Low	$27.50	$27.50	$25.31	$20.75

The Company utilizes Registrar and Transfer Company as its transfer agent.

As of February 5, 2007, there were 2055 record holders of our common stock.

Below is a line-graph presentation comparing the cumulative total shareholder returns for the Corporation, an index for NASDAQ Stock Market (U.S. Companies) comprised of all domestic common shares traded on the NASDAQ National Market System and the NASDAQ Bank Index for the five-year period ended December 31, 2006. The chart compares the value of $100 invested in the Corporation and each of the indices and assumes investment on December 31, 2001 with all dividends reinvested.

The Board of Directors recognizes that the market price of stock is influenced by many factors, only one of which is performance. The stock price performance shown on the graph is not necessarily indicative of future performance.

(PERFORMANCE GRAPH)

	2001	2002	2003	2004	2005	200
FMSB	$100.00	$ 89.73	$ 94.92	$ 96.38	$ 78.69	$ 80.
NASDAQ - COMPOSITE	$100.00	$ 68.80	$103.64	$113.07	$115.43	$127.
NASDAQ - BANK INDEX	$100.00	$106.98	$141.83	$160.89	$157.70	$179.

Dividends are declared and paid quarterly. Per share dividends declared for the years ended 2006 and 2005 are as follows:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
2006	$ .125	$ .15	$ .15	$ .15	$0.575
2005	$.1125	$.1125	$.1125	$.1625	$ 0.50

The ability of the Company to pay dividends is limited by the dividend that the Company receives from the Bank. The Bank may pay as dividends to the Company its retained earnings during the current year and its prior two years. Currently, such limitation on the payment of dividends from the Bank to the Company does not materially restrict the Company's ability to pay dividends to its shareholders.

Dividends declared during 2006 were $0.575 per share totaling $3.0 million, 15 percent higher than 2005 declared dividends of $0.50 per share. The Company purchased back 4,000 shares in the third quarter of 2005 to award to employees of the

Bank under its long-term incentive plan. 80 shares were held in Treasury stock at year-end after having been forfeited by an employee. During 2006, the Company purchased 42,000 shares and awarded 6,100 restricted shares to 41 employees. 200 restricted shares were forfeited during 2006. At year end, the Company held 36,180 shares in Treasury stock and 9,820 in unearned stock awards. The Company initiated a 4:1 stock split on May 12, 2006. The Company has authorization to purchase 228,000 shares throughout 2007. The Company continues to have a strong capital base and to maintain regulatory capital ratios that are significantly above the defined regulatory capital ratios.

ISSUER PURCHASES OF EQUITY SECURITIES

PERIOD	TOTAL NUMBER OF SHARES PURCHASED	AVERAGE PRICE PAID PER SHARE	TOTAL NUMBER OF SHARES PURCHASED AS PART OF PUBLICLY ANNOUNCED PROGRAMS	REMAINING SHARE REPURCHASE AUTHORIZATION
10/1/2006 to 10/31/2006	--	--	--	250,000
11/1/2006 to 11/30/2006	--	--	--	250,000
12/1/2006 to 12/31/2006	22,000	$22.30	22,000(1)	228,000
Total	22,000	$22.30	22,000(1)	228,000

(1) The Company purchased these shares pursuant to a stock repurchase program publicly announced on October 20, 2006. On that date, the Board of Directors authorized the repurchase of up to 250,000 common shares through December 31, 2007.

RECLASSIFICATION

Certain amounts in the 2005 and 2004 consolidated financial statements have been reclassified to conform with the 2006 presentation. The Company's Board of Directors declared a 4 for 1 stock split effective May 12, 2006. Therefore, all references in the financial statements and other disclosures related to the number of shares and per share amounts of the Company's stock have been retroactively restated to reflect the increased number of shares outstanding.

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ITEM 6. SELECTED FINANCIAL DATA

SUMMARY OF SELECTED CONSOLIDATED FINANCIAL DATA

000s omitted except share data)

SUMMARY OF CONSOLIDATED STATEMENT OF INCOME - UNAUDITED

	(In Thousands)			
	2006	2005	2004	2003
Summary of Income:				
Interest income	$ 42,269	$ 38,101	$ 37,351	$ 41,107
Interest expense	18,535	13,539	11,222	14,283
Net Interest Income	23,734	24,562	26,129	26,824
Provision for loan loss	525	(425)	884	6,903
Net interest income after provision for loan loss	23,209	24,987	25,245	19,921
Other income (expense), net	(11,966)	(13,209)	(13,442)	(9,836)
Net income before income taxes	11,243	11,778	11,803	10,085
Income taxes	3,107	3,202	3,573	2,459
Net income	$ 8,136	$ 8,576	$ 8,230	$ 7,626
Per Share of Common Stock:				
Earnings per common share outstanding (Based on weighted average number of shares outstanding)				
Net income	$ 1.57	$ 1.65	$ 1.58	$ 1.47
Dividends	$ 0.575	$ 0.500	$ 0.475	$ 1.688
Weighted average number of shares outstanding	5,186,329	5,198,728	5,200,000	5,200,000

In 2003, a special $1.25 dividend was paid

SUMMARY OF CONSOLIDATED BALANCE SHEET - UNAUDITED

	(In Thousands)				
	2006	2005	2004	2003	2002
Total assets	$737,096	$720,945	$702,513	$705,703	$726,486
Loans	498,580	458,704	472,211	480,339	497,515
Total Deposits	585,409	576,297	574,205	575,066	576,373
Stockholders' equity	87,732	82,588	78,845	74,856	77,738
Key Ratios					
Return on average equity	9.64%	10.62%	10.72%	9.87%	9.93%
Return on average assets	1.14%	1.22%	1.16%	1.06%	1.06%
Loan to deposits	85.17%	79.65%	82.24%	83.53%	86.32%
Capital to assets	11.90%	11.46%	11.22%	10.61%	10.70%
Dividend payout	36.63%	30.31%	30.02%	115.07%	28.99%

ITEM 7. MANAGEMENTS DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CRITICAL ACCOUNTING POLICY AND ESTIMATES

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, and the Company follows general practices within the

financial services industry in which it operates. At times the application of these principles requires Management to make assumptions, estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. These assumptions, estimates and judgments are based on information available as of the date of the financial statements. As this information changes, the financial statements could reflect different assumptions, estimates and judgments. Certain policies inherently have a greater reliance on assumptions, estimates and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Examples of critical assumptions, estimates and judgments are when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not required to be recorded at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability must be recorded contingent upon a future event.

All significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements. These policies, along with the disclosures presented in the notes to the consolidated financial statements and in the management discussion and analysis of financial condition and results of operations, provide information on how significant assets and liabilities are valued and how those values are determined for the financial statements. Based on the valuation techniques used and the sensitivity of financial statement amounts to assumptions, estimates and judgments underlying those amounts, management has identified the determination of the Allowance for Loan and Lease Losses (ALLL) and the valuation of its Mortgage Servicing Rights as the

accounting areas that requires the most subjective or complex judgments, and as such could be the most subject to revision as new information becomes available.

The ALLL represents management's estimate of credit losses inherent in the Bank's loan portfolio at the report date. The estimate is a composite of a variety of factors including past experience, collateral value, and the general economy. ALLL includes a specific portion, a formula driven portion, and a general nonspecific portion. The collection and ultimate recovery of the book value of the collateral, in most cases, is beyond our control.

The Company is also required to estimate the value of its Mortgage Servicing Rights. The Company recognizes as separate assets rights to service fixed rate single-family mortgage loans that it has sold without recourse but services for others for a fee. Mortgage servicing assets are initially recorded at cost, based upon pricing multiples as determined by the purchaser, when the loans are sold. Mortgage servicing assets are carried at the lower of the initial carrying value, adjusted for amortization, or estimated fair value. Amortization is determined in proportion to and over the period of estimated net servicing income using the level yield method. For purposes of determining impairment, the mortgage servicing assets are stratified into like groups based on loan type, term, new versus seasoned and interest rate. The valuation is completed by an independent third party.

The expected and actual rates of mortgage loan prepayments are the most significant factors driving the potential for the impairment of the value of mortgage servicing assets. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced.

For more information regarding the estimates and calculations used to establish the ALLL and the value of Mortgage Servicing Rights, please see Note 1 to the consolidated financial statements provided herewith.

MATERIAL CHANGES IN RESULTS OF OPERATIONS

Total assets reached a record high for year-end reporting on December 31, 2006 at $737 million. This was achieved with an 8.6% growth in loans corresponding to a new five year high year-end balance of $504.2 million. Asset quality continued to improve with past due loans as a percentage of total loans hitting record lows while impaired loans dropped 45% to $4.7 million as compared to 2005 total impaired loans of $8.5 million.

The continued improvement in asset quality correlated to the decrease of the total allowance for credit losses (ACL) by $467 thousand during 2006. Provision for loan loss was $525 thousand and net charge offs were

the lowest of the three years presented, $319 thousand for 2006 compared to $1,001 and $684 thousand for 2005 and 2004 respectively. The net result was an increase in the allowance for loan and lease losses (ALLL) of $206 thousand to end at approximately $5.6 million. The allowance for unfunded loan commitments and letters of credit (AULC) decreased by $673 thousand ending at $168 thousand. In recognition of the lower risk the AULC represented as compared to the ALLL, the AULC was lowered during 2006. The utilization percentage of many of the Bank's lines remained low and/or constant resulting in little movement in the exposure for which the AULC is to cover. These funds are better utilized in providing funds for the Bank's funded loans or ALLL.

The decrease of $673 thousand in the AULC comprised over 50% of the improvement in non-interest expense. Total non-interest expense decreased during 2006 along with non-interest income's decrease of only $7 thousand during 2006. Netting both non-interest components resulted in net non-interest expense ending at $11.97 million for 2006, a 9.41% improvement over 2005's $13.21 million and a 10.98% improvement over 2004's $13.44 million. The additional fees derived from the first full year of offering overdraft privilege were mainly responsible for the improvement in non-interest income. The program was originally introduced in February 2005 and has been well received by the bank's customers. It has been a boost to non-interest revenue for the bank also. The bank was successful in controlling costs and focused on improving efficiencies within its processes. The million and a quarter dollar decrease in non-interest expense highlights the accomplishment.

Overall, the bank had a solid performance in 2006. Financial performance measures closely mirrored the ten year averages of the bank. The impact and causes of the constriction of the net interest margin is discussed in the following section. While it was a tough year in the interest margin arena, the bank worked on improving the non-interest side of the business and was successful in that endeavor.

NET INTEREST INCOME

Tough competition, a flat or inverted yield curve and a raising rate environment, triggered by the Federal Reserve rate increases, were all factors in driving the net interest margin down during 2006. While interest income increased from loan rate adjustments and the growth in loans, it did not outpace the increased interest cost of the liabilities used for funding. The results are 10.9% higher interest income, 36.9% higher interest expense and 3.4% lower net interest income in 2006 compared to 2005.

Interest income was $42.3 million for 2006, $38.1 million for 2005 and $37.4 million for 2004. Interest expense was $18.5, $13.5 and $11.2 million, respectively for 2006, 2005, and 2004. Net Interest income decreased to $23.7 million for 2006 compared to $24.6 million for 2005 and $26.1 million for 2004.

The following table presents net interest income, interest spread and net interest margin for the three years 2004 through 2006, comparing average outstanding balances of earning assets and interest bearing liabilities with the associated interest income and expense. The table also shows their corresponding average rates of interest earned and paid. The tax-exempt asset yields have been tax affected to reflect a marginal corporate tax rate of 34%. Average outstanding loan balances include non-performing loans and mortgage loans held for sale. Average outstanding security balances are computed based on carrying values including unrealized gains and losses on available-for-sale securities.

As the charts indicate, the Company experienced increased growth on an average basis for year 2006 compared to 2005 and 2004. Interest earning assets average balance increased from 2005 to 2006 but was lower than 2004. The biggest component of the interest earning assets was loans with 2004's average being $6.4 million higher than 2006. The yield for 2006 was higher for interest earning assets as compared to 2005 and 2004 in all categories.

Overall, the tax equivalent yield on interest earning assets increased to 6.49% compared to 5.93% and 5.71% for 2005 and 2004 respectively. The percentage of interest earning assets to total assets decreased slightly the past three years but remained above 90% at a respectable 93.82% for 2006.

As stated previously, the increased yield on the assets was unfortunately outpaced by the increased cost of funds. The average balances for interest bearing liabilities increased only slightly, $652 thousand as compared to 2005. While the balance increased slightly, the cost or yield on those funds trended

significantly higher. The average yield for 2006 was 3.32% compared to 2005's 2.43% and 2004's 1.95%. The balances in non-interest bearing liabilities increased during the last three years. With the addition of free checking in 2005, the non-interest bearing demand deposits average balance increased 7.48% over

2005 numbers. This was also in part due to the streamlining of the Bank's checking account offerings and the introduction of Platinum checking in 2006. Non-interest bearing liabilities also represent a higher portion of the total liabilities. This is a trend the Company would like to see continue.

As stated previously, the charts show the constriction on the net interest margin and spread from 2004 to 2006. The largest tightening occurring during 2006. Net interest spread decreased 31 basis points during 2006 compared to a 27 basis points decrease during 2005. The same statement can be made for net interest margin, a 17 basis point drop in 2006 compared to a 15 basis point drop in 2005. Competition played a major role in the pressure applied on these margins along with the rising rate environment and the slope of the yield curve during 2005 and 2006. The ability to grow loans was directly impacted by the ability to aggressively price the loans at least equal to competition. The Company's market was extremely competitive and thus the yields on assets, while increasing, were not able to be increased as high as management would have liked. At least one third of the loan growth came from the assistance of the use of participations. The bank participated with five other banks to fund loans outside of the bank's market area. These loans are generally larger commercial loans with at market or lower yields. These also assisted in keeping the asset yields low. This is confirmed in the charts to follow showing the impact on interest components due to volume and rate changes.

The yield on Tax-Exempt investments securities shown in the following charts were computed on a tax equivalent basis. The yield on Loans has been tax adjusted for the portion of tax-exempt IDB loans included in the total. Total Interest Earning Assets is therefore also reflecting a tax equivalent yield in both line items, also with the Net Interest Spread and Margin. The adjustments were based on a 34% tax rate.

	2006 (In Thousands)		
	Average Balance	Interest/ Dividends	Yield/Rate
ASSETS			
INTEREST EARNING ASSETS:			
Loans (1)	$484,364	$35,069	7.28%
Taxable investment securities	129,406	5,070	3.92%
Tax-exempt investment securities	49,202	1,858	5.72%
Interest bearing deposits	305	13	4.26%
Federal funds sold	5,086	259	5.09%

TOTAL INTEREST EARNING ASSETS	668,363	$42,269	6.49%
NON-INTEREST EARNING ASSETS:			
Cash and cash equivalents	17,145		
Other assets	26,881		
TOTAL ASSETS	$712,389		
LIABILITIES AND SHAREHOLDERS' EQUITY			
INTEREST BEARING LIABILITIES:			
Savings deposits	$192,754	$ 3,784	1.96%
Other time deposits	305,586	12,063	3.95%
Other borrowed money	30,311	1,268	4.18%
Federal funds purchased and securities sold under agreement to repurchase	30,042	1,420	4.73%
TOTAL INTEREST BEARING LIABILITIES	558,693	$18,535	3.32%
NON-INTEREST BEARING LIABILITIES:			
Non-interest bearing demand deposits	45,531		
Other	23,764		
TOTAL LIABILITIES	627,988		
SHAREHOLDERS' EQUITY	84,401		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$712,389		
Interest/Dividend income/yield		$42,269	6.49%
Interest Expense / yield		18,535	3.32%
Net Interest Spread		$23,734	3.18%
Net Interest Margin			3.72%

	2005 (In Thousands)		
	Average Balance	Interest/ Dividends	Yield/Rate
ASSETS			
INTEREST EARNING ASSETS:			
Loans (1)	$468,934	$31,388	6.75%
Taxable investment securities	134,420	4,609	3.43%
Tax-exempt investment securities	51,022	1,839	5.46%
Interest bearing deposits	7,974	256	3.21%
Federal funds sold	204	9	4.41%
TOTAL INTEREST EARNING ASSETS	662,554	$38,101	5.93%

	Average Balance	Interest/ Dividends	Yield/Rate
NON-INTEREST EARNING ASSETS:			
Cash and cash equivalents	16,372		
Other assets	22,954		
TOTAL ASSETS	$701,880		
LIABILITIES AND SHAREHOLDERS' EQUITY			
INTEREST BEARING LIABILITIES:			
Savings deposits	$195,748	$ 2,383	1.22%
Other time deposits	311,855	9,461	3.03%
Other borrowed money	24,995	896	3.58%
Federal funds purchased and securities sold under agreement to repurchase	25,443	799	3.14%
TOTAL INTEREST BEARING LIABILITIES	558,041	$13,539	2.43%
NON-INTEREST BEARING LIABILITIES:			
Non-interest bearing demand deposits	42,363		
Other	20,686		
TOTAL LIABILITIES	621,090		
SHAREHOLDERS' EQUITY	80,790		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$701,880		
Interest/Dividend income/yield		$38,101	5.93%
Interest Expense / yield		13,539	2.43%
Net Interest Spread		$24,562	3.49%
Net Interest Margin			3.89%

	2004 (In Thousands)		
	Average Balance	Interest/ Dividends	Yield/Rate
ASSETS			
INTEREST EARNING ASSETS:			
Loans (1)	$490,793	$31,156	6.39%
Taxable investment securities	127,432	4,393	3.45%
Tax-exempt investment securities	46,730	1,688	5.47%
Interest bearing deposits	5,141	80	1.56%
Federal funds sold	3,543	34	0.96%
TOTAL INTEREST EARNING ASSETS	673,639	$37,351	5.71%
NON-INTEREST EARNING ASSETS:			
Cash and cash equivalents	14,945		
Other assets	20,349		

TOTAL ASSETS	$708,933		
LIABILITIES AND SHAREHOLDERS' EQUITY			
INTEREST BEARING LIABILITIES:			
Savings deposits	$204,049	$ 1,268	0.62%
Other time deposits	323,527	8,712	2.69%
Other borrowed money	23,694	817	3.45%
Federal funds purchased and securities sold under agreement to repurchase	24,218	425	1.75%
TOTAL INTEREST BEARING LIABILITIES	575,488	$11,222	1.95%
NON-INTEREST BEARING LIABILITIES:			
Non-interest bearing demand deposits	42,205		
Other	14,497		
TOTAL LIABILITIES	632,190		
SHAREHOLDERS' EQUITY	76,743		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$708,933		
Interest/Dividend income/yield		$37,351	5.71%
Interest Expense / yield		11,222	1.95%
Net Interest Spread		$26,129	3.76%
Net Interest Margin			4.04%

(1) For purposes of these computations, non-accruing loans are included in the daily average outstanding loan amounts.

The primary source of the Company's traditional banking revenue is net interest income. Net interest income is the difference between interest income on interest earning assets, such as loans and securities, and interest expense on liabilities used to fund those assets, such as interest bearing deposits and other borrowings. Net interest income is affected by changes in both interest rates and the amount and composition of earning assets and liabilities. The change in net interest income is most often measured as a result of two statistics -- interest spread and net interest margin. The difference between the yields on earning assets and the rates paid for interest bearing liabilities supporting those funds represents the interest spread. Because non-interest bearing sources of funds such as demand deposits and stockholders' equity also support earning assets, the net interest margin exceeds the interest spread.

The following tables show changes in interest income, interest expense and net interest resulting from changes in volume and rate variances for major categories of earnings assets and interest bearing liabilities.

2006 vs 2005
(In Thousands)

Due to Change in

	Net Change	Volume	Rate
INTEREST EARNED ON:			
Loans	$3,681	$1,041	$2,640
Taxable investment securities	461	(172)	633
Tax-exempt investment securities	19	(99)	118
Interest bearing deposits	(243)	(246)	3
Federal funds sold	250	215	35
TOTAL INTEREST EARNING ASSETS	$4,168	$ 739	$3,429
INTEREST PAID ON:			
Savings deposits	$1,401	$ (36)	$1,437
Other time deposits	2,602	(190)	2,792
Other borrowed money	372	191	181
Federal funds purchased and securties sold under agreement to repurchase	621	144	477
TOTAL INTEREST BEARING LIABILITIES	$4,996	$ 109	$4,887

	2005 vs 2004 (In Thousands)		
		Due to Change in	
	Net Change	Volume	Rate
INTEREST EARNED ON:			
Loans	$ 232	$(1,397)	$1,629
Taxable investment securities	216	241	(25)
Tax-exempt investment securities	151	235	(84)
Interest bearing deposits	176	44	132
Federal funds sold	(25)	(32)	7
TOTAL INTEREST EARNING ASSETS	$ 750	$ (909)	$1,659
INTEREST PAID ON:			
Savings deposits	$1,115	$ (51)	$1,166
Other time deposits	749	(315)	1,064
Other borrowed money	79	45	34
Federal funds purchased and securties sold under agreement to repurchase	374	22	352
TOTAL INTEREST BEARING LIABILITIES	$2,317	$ (299)	$2,616

The Federal Reserve began raising the Federal Funds rate in June of 2004 and

continued along that path through mid 2006. The increased interest income from loans for 2005 is due to the increased rate. In 2006, increased interest income came from both rate and growth but mainly rate. Loans and federal funds sold were the only assets that had interest income increased due to change in volume in 2006. There was minimal change due to volume on the liability side of the balance sheet during 2006. The Time deposits increase was caused by the renewing of CD's from lower rates of previous years into higher rate buckets. With the pausing of Federal Fund rate hikes the second half of 2006 the bank focused on keeping "specials" shorter term going into 2007.

ALLOWANCE FOR CREDIT LOSSES

The company segregated its Allowance for Loan and Lease Losses (ALLL) into two reserves at the period ending December 31, 2004: The ALLL and the Allowance for Unfunded Loan Commitments and Letters of Credit (AULC). When combined, these reserves constitute the total Allowance for Credit Losses (ACL).

The Company decreased the allowance for credit losses for 2006. The allowance stands at $5.8 million for 2006 compared to $6.2 million for 2005. The Bank has worked hard to improve loan quality while making credit available to all of those who are in need and deemed an acceptable credit risk. This decrease was due to the improvement in asset quality and the decrease in impaired loans. Charge-off activity of $1.0 million was extremely low for 2006 compared to $2.1 million for 2005 and $1.8 million for 2004. The allowance for credit loss activity resulted in expense of $0.9 million for 2004. For 2005 and 2006, it actually resulted in income of $1.3 million and $467 thousand respectively. Net charge-offs were also lower in 2006 at $319 thousand than 2005's $1.0 million and 2004's $684 thousand. The Company expects to see the lower levels of 2006 and 2005 charge-offs continue in future years as the indicators of asset quality have shown improvement.

NON-INTEREST INCOME

Non-interest income of $6.4 million is almost equivalent to 2005, down only $7 thousand and $1.0 million over 2004. Mortgage servicing rights income was $371 thousand for 2006 compared to $483 thousand for 2005. Mortgage rates were higher in 2005 and 2006 so the level of mortgage activity was slower. Sold mortgage originations dropped from $48.8 million for 2004 to $42.8 million for 2005 and further dropped to $33.4 million for 2006. Along with the mortgage servicing rights income, gains on the sale of those loans decreased in 2006 to $683 compared to $704 and $925 thousand for 2005 and 2004, respectively. The recognition of both income sources due to the mortgage activity was $1.1 million in 2006 and $1.2 million in 2005 compared to $1.3 million in 2004.

An increase of over $1 million in non-interest income in 2005 compared to 2004 was generated from the new product Overdraft Privilege. Overdraft Privilege was introduced in February 2005 along with free personal checking and a free small business checking account. While maintenance fees collected on the traditional products declined, Overdraft Privilege more than replaced it. Overdraft Privilege enabled more automation to be utilized in the overdraft/return check process and alleviated concern by most customers of having their checks returned. The increased revenue level of 2005 decreased only slightly in 2006. Overdraft privilege remains an important portion of non-interest income.

NON-INTEREST EXPENSE

Non-interest expense decreased in 2006 compared to 2005 and 2004. Salaries and wages decreased in 2006 as compared to 2005. Two reasons for the decrease : 1) Full time equivalent numbers of employees for December 2006 compared to December 2005 decreased by nine and 2) the incentive paid based on performance for 2006 was lower than 2005 as the overall performance of the Bank was lower. Employee benefits were higher as the Bank's cost for medical insurance increased during

2006.

The biggest contributor to the improvement of non-interest expense was mentioned earlier, the adjustment for the Allowance for Unfunded Loan Commitments and letters of Credit (AULC). The decrease of $673 thousand is reflected in the $1.2 million decrease in other general and administrative expenses, making up an $828 thousand decrease when adding the expense of 2005. The second largest contributor to the improvement was the cost of audit, accounting and exam fees. These were decreased by $204 thousand compared to 2005. Improvements in audit procedures and SOX reporting experience were

responsible for the decrease. The Company has worked diligently to decrease costs while increasing non-interest income and was successful in this endeavor in 2006.

FEDERAL INCOME TAXES

Effective tax rates were 27.63%, 27.19%, and 30.27% for 2006, 2005 and 2004, respectively. The Company increased its tax-exempt holdings in 2005 with 2006's average investment balance in tax-exempt securities at $49.2 million compared to $51 and $46.7 million for 2005 and 2004, respectively. In comparing year end fair market balances, the investment in tax-exempt securities decreased by $17.4 million during 2006. This was accomplished through sales, maturities and paydowns, with the proceeds used to fund loan growth.

FINANCIAL CONDITION

Average earning assets increased $5.8 million during 2006 over 2005 but were lower by $5.3 million as compared to 2004. The increase and decrease in average earning assets each year represents a less than 1 percent change. The main cause of fluctuation was loans with investments serving as a contra account in movements, increased loans - decreased investments and vice versa. Average interest bearing liabilities increased $652 thousand over 2005 and decreased $16.8 million from 2004. The decrease occurred to offset the decrease of loans in 2005 and the increase in 2006 over 2005 was to fund the increase in loans. The average balance in loans is still lower in 2006 as compared to 2004. Slowing in the increase in average interest- bearing liabilities as compared to the increase in average interest bearing assets is being done to help ease the pressure on margin. The increase in non-interest bearing liabilities is helping to lessen the reliance on interest-bearing liabilities for funding.

SECURITIES

Security balances as of December 31 are summarized below:

	(In Thousands)		
	2006	2005	2004
U.S. Treasury and Government Agencies	$ 91,355	$112,199	$ 88,344
Mortgage-backed securities	31,264	28,514	30,088
State and local governments	45,495	62,891	54,647
Corporate debt securities	--	--	--
Equity securities	47	47	48

$168,161	$203,651	$173,127

The following table sets forth (dollars in thousands) the maturities of investment securities as of December 31, 2006 and the weighted average yields of such securities calculated on the basis of cost and effective yields weighted for the scheduled maturity of each security. Tax-equivalent adjustments, using a thirty-four percent rate have been made in yields on obligations of state and political subdivisions. Stocks of domestic corporations have not been included.

	Maturities			
	Within One Year		After One Year Within Five Years	
	Amount	Yield	Amount	Yield
U.S. Treasury	$ 288	3.80%	$ 99	4.40%
U.S. Government agency	42,014	3.61%	47,461	4.38%
Mortgage-backed securities	422	5.02%	30,842	4.40%
State and local governments	3,775	4.86%	15,822	5.18%
Taxable state and local governments	2,982	3.80%	1,121	6.22%

	Maturities			
	After Five Years Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield
U.S. Treasury	$ --	--	$ --	--
U.S. Government agency	1,493	5.59%	--	--
Mortgage-backed securities	--	0.00%	--	--
State and local governments	19,528	5.50%	2,267	5.71
Taxable state and local governments	--	--	--	--

As of December 31, 2006 the Bank did not hold a large block of any one investment security, except for U.S. Treasury and other U.S. Government agencies. The Bank also holds stock in the Federal Home Loan Bank of Cincinnati at a cost of $4.0 million. This is required in order to obtain Federal Home Loan Bank Loans.

LOAN PORTFOLIO

The Bank's various loan portfolios are subject to varying levels of credit risk. Management mitigates these risks through portfolio diversification and through standardization of lending policies and procedures.

The following table shows the Bank's loan portfolio by category of loan including loans held for sale:

	(In Thousands)				
	2006	2005	2004	2003	2002
Loans:					
Commercial/industrial	$105,371	$ 90,227	$ 98,518	$102,101	$100,119
Agricultural	69,771	62,023	55,219	63,082	66,136
Real estate mortgage	294,218	268,315	274,156	267,312	278,933
Consumer	27,732	34,686	41,276	47,984	51,156
Industrial Development Bonds	7,335	9,237	10,687	7,944	7,810
Total Loans	$504,427	$464,488	$479,856	$488,423	$504,154

The following table shows the maturity of loans as of December 31, 2006:

	Maturities (In Thousands)			
	Within One Year	After One Year Within Five Years	After Five Years	Total
Commercial and industrial	$45,477	$35,068	$ 24,826	$105,371
Agricultural	51,454	15,881	2,436	69,771
Real estate mortgage	9,651	28,635	255,932	294,218
Consumer	5,717	17,323	4,692	27,732
Industrial Development Bonds	4,555	1,678	1,102	7,335

The following table presents the total of loans due after one year which have 1) predetermined interest rates and 2) floating or adjustable interest rates:

	(In Thousands)	
	Fixed Rate	Variable Rate
Commercial and industrial	$38,729	$ 21,165
Agricultural	17,718	599
Real estate	37,923	246,644
Consumer, Credit Card and overdrafts	22,015	--
Industrial Development Bonds	2,780	--

The following table summarizes the Company's non-accrual and past due loans as of December 31 for each of the last five years:

	(In Thousands)				
	2006	2005	2004	2003	2002
Non-accrual loans	$4,254	$4,663	$6,059	$6,236	$5,792
Accruing loans past due 90 days or more	--	--	393	2,042	2,674
Total	$4,254	$4,663	$6,452	$8,278	$8,466

Although loans may be classified as non-performing, some pay on a regular basis, many continue to pay interest irregularly or at less than original contractual rates. Interest income that would have been recorded under the original terms of these loans was $561 thousand for 2004 and $246 thousand for 2005 and $174 thousand for 2006. Any collections of interest on non-accrual loans are included in interest income when collected unless it is on an impaired loan with a specific allocation. A collection of interest on an impaired loan with a specific allocation is applied to the loan balance to decrease the allocation needed. Total interest collections amounted to $279 for 2004, $473 for 2005, $167 thousand for 2006. $171 thousand of the interest collected in 2006 was applied to reduce the specific allocations on those loans.

Loans are placed on non-accrual status in the event that the loan is in past due status for more than 90 days or payment in full of principal and interest is not expected.

The $4.3 million of non-accrual loans as of December 31, 2006 are secured.

As of December 31, 2006 the Bank has $12.0 million of loans which it considers to be potential problem loans in that the borrowers are experiencing financial difficulties. These loans are subject to constant management attention and are reviewed more frequently than quarterly.

The amount of the potential problem loans was considered in management's review of the loan loss reserve required at December 31, 2006.

In extending credit to families, businesses and governments, banks accept a measure of risk against which an allowance for possible loan loss is established by way of expense charges to earnings. This expense, used to enlarge a bank's allowance for loan losses, is determined by management based on a detailed monthly review of the risk factors affecting the loan portfolio, including general economic conditions, changes in the portfolio mix, past due loan-loss experience and the financial condition of the bank's borrowers.

As of December 31, 2006, the Bank had loans outstanding to individuals and firms engaged in the various fields of agriculture in the amount of $69 million. The ratio of this segment of loans to the total loan portfolio is not considered unusual for a bank engaged in and servicing rural communities.

The allowance for loan losses is evaluated based on an assessment of the losses inherent in the loan portfolio. This assessment results in an allowance consisting of two components, allocated and unallocated.

Management considers several different risk assessments in determining the allowance for loan losses. The allocated component of the allowance for loan losses reflects expected losses resulting from an analysis of

individual loans, developed through specific credit allocations for individual loans and historical loss experience for each loan category. For those loans where the internal credit rating is at or below a predetermined classification and management can reasonably estimate the loss that will be sustained based upon collateral, the borrowers operating activity and economic conditions in which the borrower operates, a specific allocation is made. For those borrowers that are not currently behind in their payment, but for which management believes based on economic conditions and operating activities of the borrower, the possibility exists for future collection problems, a reserve is established. The amount of reserve allocated to each loan portfolio is based on past loss experiences and the different levels of risk within each loan portfolio. The historical loan loss portion is determined using a historical loss analysis by loan category.

The unallocated portion of the reserve for loan losses is determined based on management's assessment of general economic conditions as well as specific economic factors in the Bank's marketing area. This assessment inherently involves a higher degree of uncertainty. It represents estimated inherent but undetected losses within the portfolio that are probable due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition and other current risk factors that may not have yet manifested themselves in the Bank's historical loss factors used to determine the allocated component of the allowance.

Actual charge-off of loan balances is based upon periodic evaluations of the loan portfolio by management. These evaluations consider several factors, including, but not limited to, general economic conditions, financial condition of the borrower, and collateral.

As presented on the next page, charge-offs decreased to $985 thousand for 2006, and the provision was $525 thousand. A few large commercial credits included in the $5.7 million charged off in the commercial and agricultural segment in 2003 caused 2003 to have the largest charge offs of the years presented. The commercial and agricultural segment was in a net recovery position for 2004 and 2006. The consumer segment was also in a net recovery position for 2006. The negative provision of 2005 was necessary to decrease the allowance because of the overall decrease of the loan portfolio and the improved asset quality position. The decrease in the total allowance for credit losses for 2006 was due to the continued improvement in the asset quality position and reassessment of the risk existent in the unfunded loan commitments. The improvement in the ratio of net charge offs to average loans outstanding is evidence of the improved asset quality.

The following table presents a reconciliation of the allowance for credit losses:

(In Thousands)

	2006	2005	2004	2003	2002
Loans	$504,427	$464,488	$479,681	$488,247	$498,078
Daily average of outstanding loans	$484,663	$469,326	$491,104	$500,517	$475,035
Allowance for Loan Losses-Jan. 1	$ 5,388	$ 6,814	$ 7,300	$ 6,400	$ 7,275
Loans Charged off:					
Commercial & Agricultural	282	945	491	5,706	2,987
Consumer	321	722	739	1,156	1,050
Real estate mortgages	382	429	549	424	215
	985	2,096	1,779	7,286	4,252
Loan Recoveries:					
Commercial & Agricultural	288	631	652	601	801
Consumer	351	412	405	546	366
Real estate mortgages	27	52	38	136	16
	666	1,095	1,095	1,283	1,183
Net Charge Offs	319	1,001	684	6,003	3,069
Provision for loan loss	525	(425)	884	6,903	2,194
Allowance for Loan & Lease Losses - Dec 31	$ 5,594	$ 5,388	$ 6,814	$ 7,300	$ 6,400
Allowance for Unfunded Loan Commitments & Letters of Credit Dec 31	$ 168	$ 841	$ 686	$ --	$ --
Total Allowance for Credit Losses - Dec 31	$ 5,762	$ 6,229	$ 7,500	$ 7,300	$ 6,400
Ratio of net charge-offs to average Loans outstanding	0.07%	0.21%	0.14%	1.20%	0.65

Allocation of the allowance for credit losses per Loan Category in terms of dollars and percentage among the various loan categories is as follows:

	2006 Amount (000's)	%	2005 Amount (000's)	%	2004 Amount (000's)	%	2 Am (00
Balance at End of Period Applicable To:							
Commercial/industrial	$2,721	2.58%	$2,753	2.77%	$3,917	3.98%	$1
Agricultural	250	0.36%	390	0.63%	681	1.23%	
Real estate	1,671	0.57%	910	0.34%	644	0.23%	
Consumer	634	2.29%	557	1.61%	549	1.33%	
Unallocated	318		778		1,024		3
Allowance for Loan & Lease Losses	$5,594	1.11%	$5,388	1.16%	$6,815	1.42%	$7
Off Balance Sheet Commitments	$ 168	0.24%	$ 841	0.60%	$ 686	0.56%	$
Total Allowance for Credit Losses	$5,762		$6,229		$7,500		$7

DEPOSITS

The amount of outstanding time certificates of deposits and other time deposits in amounts of $100,000 or more by maturity as of December 31, 2006 are as follows:

	(In Thousands)			
	Under Three Months	Over Three Months Less than Six Months	Over Six Months Less Than One Year	Over One Year
Time Deposits	$16,162	$22,829	$23,350	$15,736

The following table presents the average amount of and average rate paid on each deposit category:

	(In Thousands)			
	Demand Deposits	NOW Accounts	Savings Accounts	Time Accounts
December 31, 2006:				
Average balance	$42,073	$83,154	$109,601	$305,586
Average rate	0.00%	2.16%	1.81%	3.95%
December 31, 2005:				
Average balance	$42,363	$83,107	$112,642	$311,855
Average rate	0.00%	1.31%	1.14%	3.03%
December 31, 2004:				
Average balance	$42,205	$88,666	$115,383	$323,527
Average rate	0.00%	0.67%	0.58%	2.69%

LIQUIDITY

Maintaining sufficient funds to meet depositor and borrower needs on a daily basis continues to be among our management's top priorities. This is accomplished not only by the immediately liquid resources of cash, due from banks and federal funds sold, but also by the Bank's available for sale securities portfolio. The average aggregate balance of these assets was $198 million during 2004, $207 million for 2005, compared to $198 million for 2006. This represented 28.0 percent, 29.7 percent, and 28.0 percent of total average assets, respectively. Of the almost $171.4 million of debt securities in the company's portfolio as of December 31, 2006, $49.2 million or 28.7 percent of the portfolio is expected to mature in 2007. Taking into consideration possible calls of the debt securities, the amount climbs to $64.9 million or 37.9 percent of the portfolio becomes a source of funds. This liquidity provides the opportunity to fund loan growth without having to over aggressively price deposits.

Historically, the primary source of liquidity has been core deposits that include non-interest bearing demand deposits, NOW, money market accounts and time deposits of individuals. Core deposits increased as of year end balances in 2006, specifically the savings and time deposits portfolios. Overall deposits decreased an average of $6.1 million during 2006 compared to 2005's decrease over 2004 of $19.8 million in average deposits. These represent changes of (1.1) percent and (3.6) percent in average total deposits, respectively. The biggest change shows in the most expensive time accounts and represents rate shoppers moving funds out of the Bank. The Bank also utilized Federal Funds purchased at times during 2006, the average balance for 2006 was $1.2 million.

Again, historically, the primary use of new funds is placing the funds back into the community through loans for the acquisition of new homes, consumer products and for business development. The use of new funds for loans is measured by the loan to deposit ratio. The Company's loan to deposit ratio for 2006 was 85.97 percent, 2005 was 79.6 percent, 2004 was 82.23 percent. The decrease in 2004 and 2005 is due to the lack of growth in both the credit and deposit portfolios. 2006 represents the increased loan growth outpacing deposit growth. The Company's goal is for this ratio to be higher with loan growth the driver; this was achieved in 2006.

Short-term debt such as federal funds purchased and securities sold under agreement to repurchase also provides the Company with liquidity. Short-term debt for both federal funds purchased and securities sold under agreement to repurchase amounted to $34.8 million at the end of 2006 compared to $21.2 million at the end of 2005 and $22.9 million at December 31, 2004. Though no federal funds were purchased at year end, the Bank does have arrangements with correspondent Banks that can be utilized when necessary.

Securities Sold Under
Agreement to Repurchase
For Year Ended 2006

Amount Oustanding at End of Period (000'S)	Weighted Average Rate End of Period	Maximum Amount Borrowings Outstanding Month End (000's)	Approximate Average Outstanding in Period (000's)	App Ave
$34,818	5.07%	$35,205	$28,868	

Other borrowings are also a source of funds. Other borrowings consist of loans from the Federal Home Loan Bank of Cincinnati. These funds are then used to provide fixed rate mortgage loans secured by homes in our community. Borrowings from this source decreased by $11.7 million to $23.2 million at December 31, 2006. This compares to increased borrowings during 2005 of $13 million to $347 million at December 31, 2005 and decreased borrowings during 2004 of $2.4 to $22 million at December 31, 2004. The increased borrowings of 2005 were used to leverage the Company with the proceeds purchasing tax exempt municipals that provided a set profit margin. The decreased borrowings were payoffs of matured notes. Sufficient funds were available to fund growth so new advances were not needed.

CONTRACTUAL OBLIGATIONS

Contractual Obligations of the Company totaled $372.6 million as of December 31,2006. Time deposits represent contractual agreements for certificates of deposits held by its customers. Long term debt represents the borrowings with the Federal Home Loan Bank and are further defined in Note 4 and 9 of the Consolidated Financial Statements.

	Payment Due by Period (In Thousands)				
Contractual Obligations	Total	Less than 1 year	1-3 Years	3-5 Years	More t 5 yea
Securities sold under agreement to repurchase	$ 34,818	$ 34,818	$ --	$ --	$
Time Deposits	313,787	241,303	70,161	1,331	9
Dividends Payable	774	774			
Long Term Debt	23,233	6,416	1,176	10,571	5,0
Total	$372,612	$283,311	$71,337	$11,902	$6,0

CAPITAL RESOURCES

Shareholders' equity was $87.7 million as of December 31, 2006 compared to $82.6 million at December 31, 2005. Dividends declared during 2006 were $0.575 per share totaling $3.0 million, 15 percent higher than 2005 declared dividends of $0.50 per share. The Company purchased back 4,000 shares in the third quarter of 2005 to award to employees of the Bank under its long-term incentive plan. 80 shares were held in Treasury stock at year-end after having been forfeited by an employee. During 2006 the Company purchased 42,000 shares and awarded 6,100 restricted shares to 41 employees. 200 restricted shares were forfeited during 2006. At year end, the Company held 36,180 shares in Treasury stock and 9,820 in unearned stock awards. The Company initiated a 4:1 stock split on May 12, 2006. The Company has authorization to purchase 228,000 shares throughout 2007. The Company continues to have a strong capital base and to maintain regulatory capital ratios that are significantly above the defined regulatory capital ratios.

At December 31, 2006, The Farmers & Merchants State Bank and Farmers & Merchants Bancorp, Inc had total risk-based capital ratios of 17.04% and 17.27%, respectively. Core capital to risk-based asset ratios of 13.24% and 16.22% are well in excess of regulatory guidelines. The Bank's leverage ratio of 9.5% is also substantially in excess of regulatory guidelines as is the Company's at 12.4%.

The Company's subsidiaries are restricted by regulations from making dividend distributions in excess of certain prescribed amounts.

ASSET/LIABILITY MANAGEMENT

The primary functions of asset/liability management are to assure adequate liquidity and maintain an appropriate balance between interest earning assets

and interest bearing liabilities. It involves the management of the balance sheet mix, maturities, repricing characteristics and pricing components to provide an adequate and stable net interest margin with an acceptable level of risk. Interest rate sensitivity management seeks to avoid fluctuating net interest margins and to enhance consistent growth of net interest income through periods of changing interest rates.

Changes in net income, other than those related to volume arise when interest rates on assets reprice in a time frame or interest rate environment that is different from that of the repricing period for liabilities. Changes in net interest income also arise from changes in the mix of interest-earning assets and interest-bearing liabilities.

Historically, the Bank has maintained liquidity through cash flows generated in the normal course of business, loan repayments, maturing earning assets, the acquisition of new deposits, and borrowings. The Bank's asset and liability management program is designed to maximize net interest income over the long term while taking into consideration both credit and interest rate risk.

Interest rate sensitivity varies with different types of interest-earning assets and interest bearing liabilities. Overnight federal funds on which rates change daily and loans that are tied to the market rate differ considerably from long-term investment securities and fixed rate loans. Similarly, time deposits over $100,000 and money market certificates are much more interest rate sensitive than passbook savings accounts. The Bank utilizes shock analysis to examine the amount of exposure an instant rate change of 100, 200, and 300 basis points in both increasing and decreasing directions would have on the financials. Acceptable ranges of earnings and equity at risk are established and decisions are made to maintain those levels based on the shock results.

IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements and notes thereto presented herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of the Company's operations. Unlike most industrial companies, nearly all the assets and liabilities of the Company are monetary in nature. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

Market risk is the exposure to loss resulting from changes in interest rates and equity prices. The primary market risk to which we are subject is interest rate risk. The majority of our interest rate risk arises from the instruments, positions and transactions entered into for purposes other than trading such as loans, available for sale securities, interest bearing deposits, short term borrowings and long term borrowings. Interest rate risk occurs when interest bearing assets and liabilities reprice at different times as market interest rates change. For example, if fixed rate assets are funded with variable rate debt, the spread between asset and liability rates will decline or turn negative if rates increase.

Interest rate risk is managed within an overall asset/liability framework. The principal objectives of asset/liability management are to manage sensitivity of net interest spreads and net income to potential

changes in interest rates. Funding positions are kept within predetermined limits designed to ensure that risk-taking is not excessive and that liquidity is properly managed. In the event that our asset/liabilities management strategies are unsuccessful, our profitability may be adversely affected. The Company employs a sensitivity analysis utilizing interest rate shocks to help in this analysis. The shocks presented below assume an immediate change of rate in the percentages and directions shown:

Interest Rate Shock on Net Interest Margin				Interest Rate Shock on Net Interest Income	
Net Interest Margin (Ratio)	% Change to Flat Rate	Rate Direction	Rate changes by	Cumulative Total ($000)	% Change to Flat Rate
2.95%	-15.35%	Rising	3.00%	21,897	-14.74%
3.13%	-10.17%	Rising	2.00%	23,166	-9.80%
3.31%	-5.06%	Rising	1.00%	24,428	-4.88%
3.48%	0.00%	Flat	0	25,682	0.00%
3.66%	4.99%	Falling	-1.00%	26,924	4.83%
3.86%	10.74%	Falling	-2.00%	28,084	9.35%
3.89%	11.76%	Falling	-3.00%	27,959	8.86%

ASSET/LIABILITY MANAGEMENT

The primary functions of asset/liability management are to assure adequate liquidity and maintain an appropriate balance between interest earning assets and interest bearing liabilities. It involves the management of the balance sheet mix, maturities, repricing characteristics and pricing components to provide an adequate and stable net interest margin with an acceptable level of risk. Interest rate sensitivity management seeks to avoid fluctuating net interest margins and to enhance consistent growth of net interest income through periods of changing interest rates.

Changes in net income, other than those related to volume arise when interest rates on assets reprice in a time frame or interest rate environment that is different from that of the repricing period for liabilities. Changes in net interest income also arise from changes in the mix of interest-earning assets and interest-bearing liabilities.

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points in both increasing and decreasing directions would have on the financials. Acceptable ranges of earnings and equity at risk are established and decisions are made to maintain those levels based on the shock results.

ITEM 8. FINANCIAL STATEMENTS

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

Independent Auditors' Report

Consolidated Balance Sheet at December 31, 2006 and 2005

Consolidated Statements of Income for the years ended December 31, 2006, 2005 and 2004

Consolidated Statements of Changes in Shareholders' Equity for the year ended December 31, 2006, 2005 and 2004

Consolidated Statements of Cash Flow for the years ended December 31, 2006, 2005 and 2004

Notes to Consolidated Financial Statements

(PLANTE & MORAN LOGO)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Farmers & Merchants Bancorp, Inc. and Subsidiaries
Archbold, Ohio

We have audited the accompanying consolidated balance sheet of Farmers & Merchants Bancorp, Inc. and Subsidiaries as of December 31, 2006 and December 31, 2005 and the related consolidated statements of income, stockholders' equity, and cash flows for each year in the three year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and

significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Farmers & Merchants Bancorp, Inc. and Subsidiaries as of December 31, 2006 and December 31, 2005 and the consolidated results of its operations and its cash flows for each year in the three year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Farmers & Merchants Bancorp, Inc. and Subsidiaries internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission an our report dated February 21, 2007, expressed an unqualified opinion thereon.

(PLANTE & MORAN, PLLC)

February 21, 2007
Auburn Hills, Michigan

CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2006 AND 2005
(000'S OMITTED, EXCEPT PER SHARE DATA)

	2006	2005
ASSETS		
ASSETS		
Cash and due from banks (Note 2)	$ 23,583	$ 20,056
Interest-bearing deposits in banks	311	2,533
Federal Funds Sold	13,353	--
Total cash and cash equivalents	37,247	22,589
Securities - available for sale (Note 3)	168,161	203,651
Federal Home Loan Bank stock, at cost	4,016	3,791
Loans, net (Note 4)	498,580	458,704
Premises and equipment (Note 5)	14,189	14,874
Other assets (Note 6 & 10)	14,903	17,336
TOTAL ASSETS	$737,096	$720,945
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits (Note 7)		
Noninterest-bearing	$ 60,211	$ 64,791
Interest-bearing		
NOW accounts	88,235	84,835
Savings	123,176	114,825

Time (Note 7)	313,787	311,846
Total deposits	585,409	576,297
Securities sold under agreement to repurchase (Note 8)	34,818	21,158
Long-term debt (Note 9)	23,233	34,952
Dividend payable	774	844
Accrued expenses and other liabilities	5,130	5,106
Total liabilities	649,364	638,357
STOCKHOLDERS' EQUITY (NOTE 14 AND 15)		
Common stock - No par value - 6,500,000 shares authorized; 5,200,000 shares issued & outstanding	12,677	12,677
Treasury Stock - 36,180 Shares 2006, 80 shares 2005	(816)	(2)
Unearned Stock Awards - 9,820 Shares 2006, 3,920 shares 2005	(244)	(113)
Retained earnings	77,089	71,933
Accumulated other comprehensive income (Loss)	(974)	(1,907)
Total stockholders' equity	87,732	82,588
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$737,096	$720,945

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENT OF INCOME
YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(000'S OMITTED, EXCEPT PER SHARE DATA)

	2006	2005	2004
INTEREST INCOME			
Loans, including fees	$ 35,069	$ 31,388	$ 31,15
Debt securities:			
U.S. Treasury and government agency	4,615	4,142	3,91
Municipalities	2,086	2,121	2,02
Corporate debt securities	--	--	
Dividends	227	185	14
Federal funds sold	259	9	3
Other	13	256	8
Total interest income	42,269	38,101	37,35
INTEREST EXPENSE			
Deposits	15,847	11,844	9,98
Federal funds purchased and securities sold under agreements to repurchase	1,420	799	42
Borrowed funds	1,268	896	81
Total interest expense	18,535	13,539	11,22
NET INTEREST INCOME - Before provision for loan losses	23,734	24,562	26,12
PROVISION FOR LOAN LOSSES (Note 4)	525	(425)	88

NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	23,209	24,987	25,24
NONINTEREST INCOME			
Customer service fees	3,548	3,618	2,14
Other service charges and fees	2,212	2,109	2,23
Net gain on sale of loans (Note 6)	683	704	92
Net gain (loss) on sale of available-for-sale securities	(10)	9	12
Total noninterest income	6,433	6,440	5,42
NONINTEREST EXPENSES			
Salaries and Wages	8,304	8,411	7,97
Employee benefits (Note 11)	2,456	2,275	2,25
Occupancy expense	605	656	64
Furniture and equipment	1,421	1,492	1,43
Data processing	998	1,013	1,10
Franchise taxes	839	817	71
Mortgage servicing rights amortization (Note 6)	263	293	33
Other general and administrative	3,513	4,692	4,41
Total other operating expenses	18,399	19,649	18,86
INCOME BEFORE INCOME TAXES	11,243	11,778	11,80
INCOME TAXES (NOTE 10)	3,107	3,202	3,57
NET INCOME	$ 8,136	$ 8,576	$ 8,23
EARNINGS PER SHARE - BASIC	$ 1.57	$ 1.65	$ 1.5
WEIGHTED AVERAGE SHARES OUTSTANDING	5,186,329	5,198,728	5,200,00

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDER'S EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(000'S OMITTED, EXCEPT PER SHARE DATA)

	Shares of Common Stock	Common Stock	Treasury Stock	Unearned Stock Awards	Retained Earnings
BALANCE - January 1, 2004	5,200,000	$12,677	$ --	$ --	$60,196
Comprehensive income (Note 1):					
Net income	--	$ --	$ --	$ --	$ 8,230
Change in net unrealized gain on securities available for sale, net of reclassification adjustment and tax effects	--	$ --	$ --	$ --	$ --
Total comprehensive income					
Cash dividends declared - $0.475 per share	--	$ --	$ --	$ --	$(2,470)

	Shares of Common Stock	Common Stock	Treasury Stock	Unearned Stock Awards	Retained Earnings
BALANCE - December 31, 2004	5,200,000	$12,677	$ --	$ --	$65,956
Comprehensive income (Note 1):					
Net income	--	$ --	$ --	$ --	$ 8,576
Change in net unrealized gain on securities available for sale, net of reclassification adjustment and tax effects	--	$ --	$ --	$ --	$ --
Total comprehensive income					
Purchase of Treasury Stock 4000 shares	(4,000)		$(115)	$ --	
Grant of Restricted Stock Awards-4000 shares (Net of Forfeiture - 80)	3,920		$ 113	$(113)	
Cash dividends declared - $0.50 per share	--	$ --	$ --	$ --	$(2,599)
BALANCE - December 31, 2005	5,199,920	$12,677	$ (2)	$(113)	$71,933

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOW
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(000'S OMITTED)

	Shares of Common Stock	Common Stock	Treasury Stock	Unearned Stock Awards	Retained Earnings
Comprehensive income (Note 1):					
Net income	--	$ --	$ --	$ --	$ 8,136
Change in net unrealized gain on securities available for sale, net of reclassification adjustment and tax effects	--	$ --	$ --	$ --	$ --
Total comprehensive income					
Purchase of Treasury Stock	(42,000)		$(945)	$ --	
Grant of Restricted Stock Awards-6100 shares (Net of Forfeiture - 200)	5,900		$ 131	$(131)	
Cash dividends declared - $0.575 per share	--	$ --	$ --	$ --	$(2,980)
BALANCE - December 31, 2006	5,163,820	$12,677	$(816)	$(244)	$77,089

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOW

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(000'S OMITTED)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 8,136	$ 8,576
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	1,107	1,167
Amortization of servicing rights	263	293
Provision for loan loss	525	(425)
Accretion and amortization of securities	382	989
Deferred income taxes (benefit)	282	387
(Gain) loss on sale of other assets	5	(2)
Realized (gain) loss on sales of available-for-sale securities, net	10	(9)
Net Change in:		
Loans held for sale	--	175
Change in other assets and other liabilities, net	2,670	(1,931)
Net cash provided (used) by operating activities	13,380	9,220
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available-for-sale securities:		
Sales	19,006	--
Maturities, prepayments and calls	61,654	38,477
Purchases	(44,382)	(73,376)
Loan and lease originations and principal collections, net	(41,630)	13,732
Proceeds from sales of assets	1	18
Additions to premises and equipment	(428)	(539)
Net cash provided (used) by investing activities	(5,779)	(21,688)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	9,112	2,092
Net change in federal funds purchased and securities sold under agreements to repurchase	13,660	(1,694)
Proceeds from issuance of long-term debt	--	15,000
Repayment of long-term debt	(11,720)	(2,012)
Purchase of Treasury Stock	(945)	(115)
Cash dividends paid on common stock	(3,050)	(2,470)
Net cash provided (used) by financing activities	7,057	10,801
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	14,658	(1,667)
CASH AND CASH EQUIVALENTS - Beginning of Year	22,589	24,256
CASH AND CASH EQUIVALENTS - End of Year	$ 37,247	$ 22,589
SUPPLEMENTAL INFORMATION		
Cash paid during the year for:		
Interest	$ 18,235	$ 13,227
Income taxes	$ 2,757	$ 2,640

See Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

The Farmers & Merchants Bancorp, Inc. (the Company) through its bank subsidiary, The Farmers & Merchants State Bank (the Bank) provide a variety of financial services to individuals and small businesses through its offices in Northwest Ohio.

CONSOLIDATION POLICY

The consolidated financial statements include the accounts of Farmers & Merchants Bancorp, Inc. and its wholly-owned subsidiaries, The Farmers & Merchants State Bank (the Bank), a commercial banking institution, and the Farmers & Merchants Life Insurance Company, a reinsurance company for life, accident and health insurance for the Bank's consumer credits. All significant inter-company balances and transactions have been eliminated.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of mortgage servicing rights. Actual results could differ from those estimates.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

The Bank's loans are generally secured by specific items of collateral including real property, consumer assets, and business assets. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions in the agricultural industry.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

CASH AND CASH EQUIVALENTS

For purposes of the consolidated statement of cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. This includes cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold for one day periods.

SECURITIES

Debt securities are classified as available-for-sale. Securities available-for-sale are carried at fair value with unrealized gains and losses reported in other comprehensive income. Realized gains and losses on securities available for sale are included in other income (expense) and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. Gains and losses on sales of securities are determined on the specific-identification method.

Declines in the fair value of securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The related write-downs are included in earnings as realized losses.

FEDERAL HOME LOAN BANK STOCK

The Federal Home Loan Bank stock is recorded at cost since it is a restricted stock. The Federal Home Loan Bank sells and purchases its stock at par; therefore cost approximates market value. The stock is held as collateral security for all indebtedness of the Bank to the Federal Home Loan Bank.

LOANS

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at the amount of unpaid principal, reduced by unearned discounts and deferred loan fees and costs, as well as, by the allowance for loan losses. Interest income is accrued on a daily basis based on the principal outstanding.

Generally, a loan is classified as nonaccrual and the accrual of interest income is generally discontinued when a loan becomes ninety days past due as to principal or interest and these loans are placed on a "cash basis" for purposes of income recognition. Management may elect to continue the accrual of interest when the estimated net realizable value of collateral is sufficient to cover the principal and accrued interest, and the loan is in the process of collection. When a loan is placed on nonaccrual status, all previously accrued and unpaid interest receivable is charged against income.

Loan origination and commitment fees and certain direct loan origination costs are deferred and amortized as a net adjustment to the related loan's yield. The Bank is generally amortizing these costs over the contractual

life of such loans.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established through a provision for loan losses charged to income. Loans deemed to be uncollectable and changes in the allowance relating to impaired loans are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based on management's periodic review of the collectibility of the loans in light of historical experiences, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing

economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. The unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual

terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer loans for impairment disclosures.

LOANS HELD FOR SALE

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized in a valuation allowance by charges to income.

SERVICING ASSETS

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into noninterest expense in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum. Fees received for servicing loans owned by investors are based on a percentage of the outstanding monthly principal balance of such loans and are included in operating income as loan payments are received. Costs of servicing loans are charged to expense as incurred.

OFF BALANCE SHEET INSTRUMENTS

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

BANK PREMISES AND EQUIPMENT

Land is carried at cost. Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is based on the estimated useful lives of the various properties and is computed using straight line and accelerated methods. Costs for maintenance and repairs are charged to operations as incurred. Gains and losses on dispositions are included in current operations.

FEDERAL INCOME TAX

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

EARNINGS PER SHARE

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. The Company has no dilutive shares, as the restricted stock

grants are anti-dilutive.

COMPREHENSIVE INCOME

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet. Such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

	(In Thousands)		
	2006	2005	2004
Net Unrealized gain (loss) on available-for-sale securities	$1,404	$(3,202)	$(2,556)
Tax Effect	(478)	1,089	869
Net-of-tax amount	926	(2,113)	(1,687)
Reclassification adjustment for gain on sale of available-for-sale securities	$ 10	$ (9)	$ (127)
Tax Effect	(3)	3	43
Net-of-tax amount	7	(6)	(84)
Other comprehensive income	$ 933	$(2,119)	$(1,771)

RECENT ACCOUNTING PRONOUNCEMENTS

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140." SFAS 156 requires an entity to recognize a

servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into certain servicing contracts. SFAS 156 also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS 156 permits an entity to choose between the amortization and fair value methods for subsequent measurements. SFAS 156 also requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS 156 is effective for fiscal years beginning after September 15, 2006. The Company does not expect the implementation of SFAS 156 to have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement."

This statement clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. This Statement applies to other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. FSAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company has not determined the impact the adoption of SFAS 157 will have on the financial statements.

In September 2006, the FASB ratified the Emerging Issues Task Force's (EITF) Issue 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements, which requires companies to recognize a liability and related compensation costs for endorsement split-dollar life insurance policies that provide a benefit to an employee extending to postretirement periods. The liability should be recognized based on the substantive agreement with the employee. This Issue is effective beginning January 1, 2008. The Issue can be applied as either a change in accounting principle through a cumulative- effect adjustment to retained earnings as of the beginning of the year of adoption, or a change in accounting principle through retrospective application to all periods. The Company is in the process of evaluating the impact the adoption of Issue 06-4 will have on the financial statements.

RECLASSIFICATION

Certain amounts in the 2005 and 2004 consolidated financial statements have been reclassified to conform with the 2006 presentation.

The Company's Board of Directors declared a 4 for 1 stock split effective May 12, 2006. Therefore, all references in the financial statements and other disclosures related to the number of shares and per share amounts of the Company's stock have been retroactively restated to reflect the increased number of shares outstanding.

NOTE 2 - RESTRICTIONS ON CASH AND AMOUNTS DUE FROM BANKS

The Bank is required to maintain average balances on hand with the Federal Reserve Bank. The aggregate reserve remains the same at December 31, 2006 as it was for December 31, 2005 at $4.6 million.

The Company and its subsidiaries maintain cash balances with high quality credit institutions. At times such balances may be in excess of the federally insured limits.

NOTE 3 - SECURITIES

The amortized cost and fair value of securities, with gross unrealized gains and losses, follows:

(In Thousands) 2006			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value

Available-for-Sale:				
U.S. Treasury	$ 388	$ --	$ 1	$ 387
U.S. Government agency	91,656	131	819	90,968
Mortgage-backed securities	31,911	16	663	31,264
State and local governments	45,636	240	381	45,495
Equity securities	47	--	--	47
	$ 169,638	$387	$1,864	$168,161

	(In Thousands) 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available-for-Sale:				
U.S. Treasury	$ 2,380	$ --	$ 26	$ 2,354
U.S. Government agency	111,503	4	1,662	109,845
Mortgage-backed securities	29,470	10	966	28,514
State and local governments	63,141	426	676	62,891
Equity securities	47	--	--	47
	$206,541	$440	$3,330	$203,651

Information pertaining to securities with gross unrealized losses at December 31, 2006 and 2005, aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

	2006			
	(In Thousands) Less Than Twelve Months		(In Thousands) Twelve Months & Over	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U S Treasury	$--	$ 99	$ 1	$ 174
U S Government agency	$18	$13,944	$801	$58,457
Mortgage-backed securities	$ 2	$ 710	$661	$21,801
State and local governments	$35	$ 7,442	$346	$22,182

	2005			
	(In Thousands) Less Than Twelve Months		(In Thousands) Twelve Months & Over	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U S Treasury	$ 2	$ 237	$ 24	$ 2,117
U S Government agency	$286	$39,837	$1,376	$63,039
Mortgage-backed securities	$123	$ 8,448	$ 843	$18,738
State and local governments	$480	$30,354	$ 196	$ 6,404

Unrealized losses on securities have not been recognized into income because the issuers' bonds are of high credit quality, the Bank has the intent and ability to hold the securities for the foreseeable future, and the decline in fair value is primarily due to increased market interest rates. The fair value is expected to recover as the bonds approach the maturity date.

The gross realized gains and losses for the years ended December 31, are presented below:

	(In Thousands)		
	2006	2005	2004
Gross realized gains	$ 27	$ 9	$133
Gross realized losses	(37)	--	(6)
Net Realized Gains	$(10)	$ 9	$127
Tax expense related to net realized gains	$ (3)	$ 3	$ 43

The amortized cost and fair value of debt securities at December 31, 2006, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	(In Thousands)	
	Amortized Cost	Fair Value
One year or less	$ 47,962	$ 47,688
After one year through five years	74,927	74,125
After five years through ten years	20,203	19,916
After ten years	26,499	26,385

	169,591	168,114
Equity securities	47	47
Total	$169,638	$168,161

Investments with a carrying value and fair value of $142.9 million at December 31, 2006 and $140.3 million at December 31, 2005 were pledged to secure public deposits and securities sold under repurchase agreements.

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NOTE 4 - LOANS

Loans at December 31, are summarized below:

	(In Thousands)	
	2006	2005
Loans:		
Real estate (Consumer, Cml & Ag)	$294,218	$268,315
Commercial and industrial	105,371	90,227
Agricultural	69,771	62,023
Consumer, Overdrafts and other loans	27,732	34,686
Industrial Development Bonds	7,335	9,237
	504,427	464,488
Less: Deferred loan fees and costs	(253)	(396)
	504,174	464,092
Less: Allowance for loan losses	(5,594)	(5,388)
Loans - Net	$498,580	$458,704

The following is a maturity schedule by major category of loans including available for sale loans:

	(In Thousands) Principal Payments Due Within		
	One Year	Two to Five Years	After Five Years
Real estate loans (Consumer, Cml & Ag)	$ 9,651	$28,635	$255,932
Commercial and industrial loans	45,477	35,068	24,826
Agricultural	51,454	15,881	2,436
Consumer, Master Card and Overdrafts	5,717	17,323	4,692
Industrial Development Bonds	4,555	1,678	1,102

The distribution of fixed rate loans and variable rate loans by major loan category is as follows as of December 31, 2006:

	(In Thousands)	
	Fixed Rate	Variable Rate
Real estate loans (Consumer, Cml & Ag)	$44,856	$249,362
Commercial and industrial loans	46,613	58,758
Agricultural	22,225	47,546
Consumer, Master Card and Overdrafts	25,958	1,774
Industrial Development Bonds	7,335	--

One to four family residential mortgage loans amounting to $74.1 million have been pledged as security for loans the Bank has received from the Federal Home Loan Bank.

As of December 31, 2006 and 2005 there were $10.6 and $8.9 million, respectively, of undisbursed loans in process.

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The following is an analysis of the allowance for loan loss:

	(In Thousands)		
	2006	2005	2004
Allowance for Loan Losses			
Balance at beginning of year	$5,388	$ 6,814	$ 7,300
Provision for loan loss	525	(425)	884
Loans charged off	(985)	(2,096)	(1,779)
Recoveries	666	1,095	1,095
Allowance for Unfunded Loan Commitments & Letters of Credit	$ --	$ --	$ (686)
Allowance for Loan & Leases Losses	$5,594	$ 5,388	$ 6,814
Allowance for Unfunded Loan Commitments & Letters of Credit	$ 168	$ 841	$ 686
Total Allowance for Credit Losses	$5,762	$ 6,229	$ 7,500

The company segregated its Allowance for Loan and Lease Losses (ALLL) into two reserves at the period ending December 31, 2004: The ALLL and the Allowance for Unfunded Loan Commitments and Letters of Credit (AULC). When combined, these reserves constitute the total Allowance for Credit Losses (ACL).

The AULC is reported within other liabilities on the balance sheet while the ALLL is netted within the loans, net asset line. The ACL presented above represents the full amount of reserves available to absorb possible credit losses.

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

	(In Thousands)	
	2006	2005
Impaired loans without a valuation allowance	$1,587	$1,273
Impaired loans with a valuation allowance	3,095	7,221
Total impaired loans	$4,682	$8,494
Valuation allowance related to impaired loans	$ 838	$1,978
Total non-accrual loans	$4,254	$4,663
Total loans past-due ninety days or more and still accruing	$ --	$ --

	(In Thousands)		
	2006	2005	2004
Average investment in impaired loans	$6,588	$9,926	$16,030
Interest income recognized on impaired loans	$ 288	$ 480	$ 572
Interest income recognized on a cash basis on impaired loans	$ 167	$ 473	$ 279

No additional funds are committed to be advanced in connection with impaired loans.

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NOTE 5 -- PREMISES AND EQUIPMENT

The major categories of banking premises and equipment and accumulated depreciation at December 31 are summarized below:

	(In Thousands)	
	2006	2005
Land	$ 2,811	$ 2,756
Buildings (useful life 15-39 years)	15,100	15,080
Furnishings (useful life 3-15 years)	8,960	9,758
	26,871	27,594
Less: Accumulated depreciation	(12,682)	(12,720)
Premises and Equipment (Net)	$ 14,189	$ 14,874

NOTE 6 - SERVICING

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of loans serviced for others were $251 and $249 million at December 31, 2006 and 2005, respectively.

The balance of capitalized servicing rights included in other assets at December 31, 2006 and 2005, was $1.8 and $1.7 million, respectively. The capitalized addition of servicing rights is included in net gain on sale of loans on the consolidated statement of income. The capitalized additions are as shown in the table following.

The fair market value of the capitalized servicing rights as of December 31, 2006 and 2005 was $2.2 and $1.9 million, respectively. The valuations were completed by stratifying the loans into like groups based on loan type, term and new versus seasoned. Impairment was measured by estimating the fair value of each stratum, taking into consideration an estimated level of prepayment based upon current market conditions. An average constant prepayment rate of 10.0 and 12.5 were utilized for 2006 and 2005, respectively. All stratums showed positive values compared to carrying value using a discount yield of 8.5% for both years.

The following summarizes mortgage servicing rights capitalized and amortized during each year:

	(In Thousands)	
	2006	2005
Beginning Year	$1,690	$1,500
Capitalized Additions	$ 371	$ 483
Amortization	$ (263)	$ (293)
Valuation Allowance	$ --	$ --
End of Year	$1,798	$1,690

NOTE 7 - DEPOSITS

Time deposits at December 31 consist of the following:

	(In Thousands)	
	2006	2005
Time deposits under $100,000	$235,710	$236,864
Time deposits of $100,000 or more	78,077	74,982
	$313,787	$311,846

At December 31, 2006 the scheduled maturities for time deposits are as follows:

	(In Thousands)
2007	$241,303
2008	41,511
2009	28,650
2010	907
2011	424
thereafter	992
	$313,787

NOTE 8 - SECURITIES SOLD UNDER AGREEMENT TO REPURCHASE

The Bank's policy requires qualifying securities to be used as collateral for the underlying repurchase agreements. As of December 31, 2006 and 2005 securities with a book value of $45.6 million and $38.8 million, respectively, were underlying the repurchase agreements and were under the Bank's control.

NOTE 9 - LONG TERM DEBT

Long term debt consists of various loans from the Federal Home Loan Bank. Repayment structures vary, ranging from monthly installments, annual payments or upon maturity. Interest payments are due monthly with interest rates on the loans varying from 2.92% to 7.05%. Total borrowings were $23.0 and $35.0 million for 2006 and 2005, respectively. Notes are secured by a blanket lien on 100% of the one to four family residential mortgage loan portfolio (Note 4).

The following is a schedule by years of future minimum principal payments:

(In Thousands)

2007	$ 6,416
2008	712
2009	464
2010	5,346
2011	5,225
thereafter	5,070
	$23,233

NOTE 10 - FEDERAL INCOME TAXES

The components of income tax expense for the years ended December 31 are as follows:

	(In Thousands)		
	2006	2005	2004
Current:			
Federal	$2,825	$2,815	$ 3,587
Deferred:			
Federal	282	387	(14)
	$3,107	$3,202	$ 3,573

The following is a reconciliation of the statutory federal income tax rate to the effective tax rate:

	(In Thousands)		
	2006	2005	2004
Income tax at statutory rates	$3,826	$4,004	$4,013
Increase(decrease) resulting from:			
Tax exempt interest	(749)	(784)	(706)
Change in prior estimates and other	30	(18)	266
	$3,107	$3,202	$3,573

Deferred tax assets and liabilities at December 31 are comprised of the following:

(In Thousands)

	2006	2005
Deferred Tax Assets:		
Allowance for loan losses	$1,902	$1,832
Net unrealized loss on available-for-sale securities	503	984
Other	249	484
Total deferred tax assets	2,654	3,300
Deferred Tax Liabilities:		
Accreted discounts on bonds	71	74
FHLB stock dividends	798	721
Mortgage servicing rights	610	572
Other	506	505
Net unrealized gain on available-for-sale securities	--	--
Total deferred tax liabilities	1,985	1,872
Net Deferred Tax Asset (Liability)	$ 669	$1,428

NOTE 11 - EMPLOYEE BENEFIT PLAN

The Bank has established a 401(k) profit sharing plan, which allows eligible employees to save at a minimum one percent of eligible compensation on a pre-tax basis, subject to certain Internal Revenue Service limitations. The Bank will match 50% of employee 401(k) contributions up to four percent of total eligible compensation. In addition, the Bank may make a discretionary contribution from time to time. A participant is 100% vested in the participant's deferral contributions and employer matching contributions. A six-year vesting schedule applies to employer discretionary contributions. Contributions to the 401(k) profit sharing plan for both the employer matching contribution and the discretionary contribution were $611, $608, and $546 thousand for 2006, 2005 and 2004, respectively.

The Company has a Long-Term Stock Incentive Plan under which 6,000 shares of restricted stock were issued to 40 employees during 2006 and 4,000 shares were issued to 38 employees during 2005. Under the plan, the shares vest 100% in three years. Due to employee termination, there were 200 shares forfeited during 2006 and 80 shares forfeited during 2005. Compensation expense applicable to the restricted stock totaled $60 and $14 thousand for the year ended December 31, 2006 and 2005, respectively.

NOTE 12 - RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank has granted loans to senior officers and directors and their affiliated companies amounting to $20.9 and $22.3 million at December 31, 2006 and 2005, respectively. Loans made during 2006 were $142.4 million and repayments were $143.7 million. During 2005, two directors retired from the Board and two directors were added. Their difference in related borrowings amounted to $1.3 million,

net deletion. Deposits of directors, executive officers and companies in

which they have a direct or indirect ownership as of December 31, 2006 and 2005 amounted to $27.6 million and $23.4 million, respectively.

NOTE 13 - OFF BALANCE SHEET ACTIVITIES

CREDIT RELATED FINANCIAL INSTRUMENTS

The Bank is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing need of its customer. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policies in making commitments as it does for on-balance-sheet instruments. At year end 2004 the Bank segregated the Allowance for Loan Losses into two components. The allowance as it relates to unfunded loan commitments (AULC) is included under other liabilities. The AULC as of December 31, 2006 and 2005 was $168 thousand and $841 thousand, respectively. At December 31, 2006 and 2005, the following financial instruments were outstanding whose contract amounts represent credit risk:

	(In Thousands)	
	2006	2005
Commitments to extend credit	$132,477	$121,857
Credit card arrangements	16,098	16,092
Standby letters of credit	11,900	12,039

Commitments to extend credit, credit card arrangements and standby letters of credit all include exposure to some credit loss in the event of nonperformance of the customer. The Bank's credit policies and procedures for credit commitments and financial guarantees are the same as those for extensions of credit that are recorded in the financial statements. Because these instruments have fixed maturity dates, and because many of them expire without being drawn upon, they generally do not present any significant liquidity risk to the Bank.

COLLATERAL REQUIREMENTS

To reduce credit risk related to the use of credit-related financial instruments, the Bank might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Bank's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant, and real estate.

LEGAL CONTINGENCIES

Various legal claims also arise from time to time in the normal course of business, which, in the opinion of management, will have no material effect on the Company's consolidated financial statements.

NOTE 14 - MINIMUM REGULATORY CAPITAL REQUIREMENTS

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on

the Company's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of: total risk-based capital and Tier I capital to risk-weighted assets (as defined in the regulations), and Tier I capital to adjusted total assets (as defined). Management believes, as of December 31, 2006, that the Bank meets all the capital adequacy requirements to which it is subject.

As of December 31, 2006 the most recent notification from the FDIC indicated the Bank was categorized as well capitalized under the regulatory framework for prompt corrective action. To remain categorized as well capitalized, the Bank will have to maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as disclosed in the table to follow. There are no conditions or events since the most recent notification that management believes have changed the Bank's prompt corrective action category.

The Company and the Bank's actual and required capital amounts and ratios as of December 31, 2006 and 2005 are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under the Prompt Corrective Action Provisions	
	(000's) Amount	Ratio	(000's) Amount	Ratio	(000's) Amount	Ratio
As of December 31, 2006						
Total Risk-Based Capital						
(to Risk Weighted Assets)						
Consolidated	$94,468	17.27%	$43,753	8.00%	N/A	N/A
Farmers & Merchants State Bank	93,179	17.04%	43,753	8.00%	54,691	10.00%
Tier 1 Capital						
(to Risk Weighted Assets)						

Consolidated	88,706	16.22%	21,876	4.00%	N/A	N/A
Farmers & Merchants State Bank	72,417	13.24%	21,876	4.00%	32,815	6.00%
Tier 1 Capital (to Adjusted Total Assets)						
Consolidated	88,706	12.40%	28,625	4.00%	N/A	N/A
Farmers & Merchants State Bank	72,417	10.13%	28,585	4.00%	35,731	5.00%

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under the Prompt Corrective Action Provisions	
	(000's) Amount	Ratio	(000's) Amount	Ratio	(000's) Amount	Ratio
As of December 31, 2005						
Total Risk-Based Capital (to Risk Weighted Assets)						
Consolidated	$90,724	17.68%	$41,042	8.00%	N/A	N/A
Farmers & Merchants State Bank	89,717	17.49%	41,044	8.00%	51,306	10.00%
Tier 1 Capital (to Risk Weighted Assets)						
Consolidated	84,495	16.47%	20,521	4.00%	N/A	N/A
Farmers & Merchants State Bank	68,488	13.35%	20,522	4.00%	30,783	6.00%
Tier 1 Capital (to Adjusted Total Assets)						
Consolidated	84,495	11.87%	28,475	4.00%	N/A	N/A
Farmers & Merchants State Bank	68,488	9.53%	28,759	4.00%	35,949	5.00%

NOTE 15 - RESTRICTIONS OF DIVIDENDS & INTER-COMPANY BORROWINGS

The Bank is restricted as to the amount of dividends that can be paid. Dividends declared by the Bank that exceed the net income for the current year plus retained income for the preceding two years must be approved by federal and state regulatory agencies. Under this formula dividends of $11.2 million may be paid without prior regulatory approval. Regardless of formal regulatory restrictions, the Bank may not pay dividends that would result in its capital levels being reduced below the minimum requirements shown above. Under current Federal Reserve regulations, the Bank is limited as to the amount and type of loans it may make to the Company and its non-bank subsidiary. These loans are subject to qualifying collateral requirements on which the amount of the loan may be based.

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair values of financial instruments are management's estimate of the values at which the instruments could be exchanged in a transaction between

willing parties. These estimates are subjective and may vary significantly from amounts that would be realized in actual transactions. In addition, other significant assets are not considered financial assets including deferred tax assets, premises, equipment and intangibles. Further, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered in any of the estimates.

The estimated fair values, and related carrying or notional amounts, for on and off-balance sheet financial instruments as of December 31, 2006 and 2005 are reflected on the next page.

	(In Thousands)			
	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets:				
Cash and Cash Equivalents	$ 23,894	$ 23,894	$ 22,589	$ 22,589
Securities - available for sale	168,161	168,161	203,651	203,651
Federal Home Loan Bank Stock	4,016	4,016	3,791	3,791
Loans, net	498,580	497,866	458,704	459,598
Interest receivable	5,244	5,244	5,036	5,036
Loans held for sale	--	--	--	--
Financial Liabilities:				
Deposits	$585,409	$583,955	$576,297	$575,554
Short-term debt				
Federal funds purchased	--	--	--	--
Repurchase agreement sold	34,818	34,818	21,158	21,158
Long -term debt	23,233	22,723	34,952	34,551
Interest payable	1,491	1,491	1,191	1,191
Dividends payable	774	774	844	844
Off-Balance Sheet Financial Instruments				
Commitments to extend credit	$ --	$ --	$ --	$ --
Standby letters of credit	--	--	--	--

The following assumptions and methods were used in estimating the fair value for financial instruments:

CASH AND CASH EQUIVALENTS

The carrying amounts reported in the balance sheet for cash, cash equivalents and federal funds sold approximate their fair values. Also included in this line item are the carrying amounts of interest-bearing deposits maturing within ninety days which approximate their fair values. Fair values of other interest-bearing deposits are estimated using discounted cash flow analyses based on current rates for similar types of deposits.

SECURITIES AND FEDERAL HOME LOAN BANK STOCK

Fair values for securities, excluding Federal Home Loan Bank stock, are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

LOANS

Most commercial and real estate mortgage loans are made on a variable rate basis. For those variable-rate loans that reprice frequently, and with no significant change in credit risk, fair values are based on carrying values. The fair values of the fixed rate and all other loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers with similar credit quality.

LOANS HELD FOR SALE

Fair values for loans held for sale approximate the carrying values as these loans are generally sold within forty-five days of being made.

DEPOSITS

The fair values disclosed for deposits with no defined maturities are equal to their carrying amounts, which represent the amount payable on demand. The carrying amounts for variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair value at the reporting date. Fair value for fixed-rate certificates of deposit are estimated using a discounted cash flow analysis that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

BORROWINGS

Short-term borrowings are carried at cost that approximates fair value. Other long-term debt was generally valued using a discounted cash flows analysis with a discounted rate based on current incremental borrowing rates for similar types of arrangements, or if not available, based on an approach similar to that used for loans and deposits.

ACCRUED INTEREST RECEIVABLE AND PAYABLE

The carrying amounts of accrued interest approximate their fair values.

DIVIDENDS PAYABLE

The carrying amounts of dividends payable approximate their fair values and are generally paid within forty days of declaration.

OFF BALANCE SHEET FINANCIAL INSTRUMENTS

Fair values for off-balance-sheet, credit related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

NOTE 17 -- CONDENSED FINANCIAL STATEMENTS OF PARENT COMPANY

BALANCE SHEET

	(In Thousands)	
	2006	2005
ASSETS		
Cash	$ 916	$ 325
Related party receivables:		
Dividends & Accounts receivable from subsidiaries	810	1,100
Note receivable from Bank subsidiary	15,000	15,000
Investment in subsidiaries	72,036	67,164
TOTAL ASSETS	$88,762	$83,589
LIABILITIES		
Accrued expenses	$ 256	$ 157
Dividends payable	774	844
Total Liabilities	1,030	1,001
STOCKHOLDERS' EQUITY		
Common stock - No par value - 6,500,000 shares authorized; 5,200,000 shares issued	12,677	12,677
Treasury Stock - 36,180 shares, 80 shares	(816)	(2)
Unearned Stock Awards - 9820 shares, 3920 shares	(244)	(113)
Retained earnings	77,089	71,933
Accumulated other comprehensive income (Loss)	(974)	(1,907)
Total Stockholders' Equity	87,732	82,588
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$88,762	$83,589

STATEMENT OF INCOME

	(In Thousands)		
	2006	2005	2004
INCOME			
Dividends from subsidiaires	$3,985	$2,855	$2,185
Interest	713	713	713
Total Income	4,698	3,568	2,898
OPERATING EXPENSES	353	344	170
INCOME BEFORE INCOME TAXES AND EQUITY IN			

UNDISTRIBUTED EARNINGS AND SUBSIDIARIES	4,345	3,224	2,728
INCOME TAXES	148	132	185
	4,197	3,092	2,543
Equity in undistributed earnings of subsidiaries	3,939	5,484	5,687
NET INCOME	$8,136	$8,576	$8,230

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STATEMENTS OF CASHFLOWS

	(In Thousands)		
	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 8,136	$ 8,576	$ 8,230
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Equity in undistributed net income of subsidiaries	(3,939)	(5,484)	(5,687)
Changes in Operating Assets and Liabilities:			
Account receivable	(35)	--	--
Dividends receivable	325	(800)	(300)
Other Liabilities	99	(33)	(25)
Net Cash Provided by Operating Activities	4,586	2,259	2,218
CASH FLOWS FROM FINANCING ACTIVITIES			
Payment of dividends	(3,050)	(2,470)	(2,470)
Purchase of Treasury Stock	(945)	(115)	--
Net Change in Cash and Cash Equivalents	591	(326)	(252)
CASH AND CASH EQUIVALENTS Beginning of year	325	651	903
CASH AND CASH EQUIVALENTS End of year	$ 916	$ 325	$ 651

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(000S OMITTED EXCEPT PER SHARE DATA)

Quarterly Financial Data - UNAUDITED

	Quarter Ended in 2006			
	Mar 31	June 30	Sep 30	Dec 31
Summary of Income:				
Interest income	$ 10,067	$ 10,405	$ 10,731	$ 11,066
Interest expense	4,160	4,385	4,837	5,153
Net Interest Income	5,907	6,020	5,894	5,913
Provision for loan loss	(50)	15	652	(92)
Net interest income after provision for loan loss	5,957	6,005	5,242	6,005
Other income (expense)	(3,192)	(3,317)	(2,336)	(3,121)
Net income before income taxes	2,765	2,688	2,906	2,884
Income taxes	747	721	789	850
Net income	$ 2,018	$ 1,967	$ 2,117	$ 2,034
Earnings per Common Share	$ 0.39	$ 0.38	$ 0.41	$ 0.39
Average common shares outstanding	5,195,920	5,192,689	5,185,883	5,170,000

	Quarter Ended in 2005			
	Mar 31	June 30	Sep 30	Dec 31
Summary of Income:				
Interest income	$ 9,285	$ 9,207	$ 9,384	$ 10,135
Interest expense	3,018	3,159	3,442	3,920
Net Interest Income	6,267	6,048	5,942	6,215
Provision for loan loss	96	(205)	(352)	36
Net interest income after provision for loan loss	6,171	6,253	6,294	6,179
Other income (expense)	(3,426)	(3,243)	(3,245)	(3,205)
Net income before income taxes	2,745	3,010	3,049	2,974
Income taxes	712	803	821	866
Net income	$ 2,033	$ 2,207	$ 2,228	$ 2,108
Earnings per common share	$ 0.390	$ 0.425	$ 0.430	$ 0.405
Average common shares outstanding	5,200,000	5,200,000	5,198,956	5,196,000

ITEM 9. CHANGE IN AND DISAGREEMENTS WITH ACCOUNTING AND FINANCIAL DISCLOSURE

No disagreements exist on accounting and financial disclosures or related matters.

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ITEM 9A. CONTROLS AND PROCEDURES

Management Report Regarding Disclosure Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2006, pursuant to Exchange Act 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2006, in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

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MANAGEMENT REPORT REGARDING INTERNAL CONTROL AND COMPLIANCE WITH DESIGNATED LAWS AND REGULATIONS

Management of Farmers & Merchants Bancorp, Inc. and Subsidiaries is responsible for preparing the Bank's annual financial statements. Management is also responsible for establishing and maintaining internal control over financial reporting presented in conformity with both generally accepted accounting principles and regulatory reporting in conformity with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (call report instructions). The Bank's internal control contains monitoring mechanisms, and actions are taken to correct deficiencies identified.

There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal control can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

It is also management's responsibility to ensure satisfactory compliance with all designated laws and regulations and in particular, those laws and regulations concerning loans to insiders. The federal laws concerning loans to insiders are codified at 12 USC 375a and 375b, and the federal regulations are set forth at 12 CFR 23.5, 31, and 215.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control -- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control -- Intergrated Framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2006.

Plante & Moran, PLLC, the independent registered public accounting firm that

audited the financial statements contained herein, has issued an attestation report on management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006.

There was no change in the company's internal control over financial reporting that occurred during the Company's fiscal quarter ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

February 21, 2007

Farmers & Merchants Bancorp, Inc. and Subsidiaries

/s/ Paul S. Siebenmorgen

Paul S. Siebenmorgen,
President/CEO

/s/ Barbara J. Britenriker

Barbara J. Britenriker,
Chief Financial Officer

(PLANTE MORAN LOGO)

Plante & Moran, PLLC
Suite 500
2601 Cambridge Court
Auburn Hills, MI 48326
Tel: 248,375,7100
Fax: 248,378,7101
plantemoran.com

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
Farmers & Merchants Bancorp, Inc. and Subsidiaries
Archbold, Ohio

We have audited management's assessment included in the accompanying Report of Management on Farmers & Merchants Bancorp, Inc. and Subsidiaries Internal Control over Financial Reporting, that the Company maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the committee of Sponsoring Organizations of the Treadway Commission (COSO). Management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material

respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of

effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Farmers & Merchants Bancorp, Inc. and Subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on COSO criteria. Also in our opinion, Farmers & Merchants Bancorp, Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006 based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Consolidated Balance Sheets of Farmers & Merchants Bancorp, Inc. and Subsidiaries as of December 31, 2006 and 2005 and the related consolidated statements of earnings, shareholders equity and cash flow for each of the three years in the period ended December 31, 2006 and our report dated February 21, 2007, expressed an unqualified opinion thereon.

/s/ Plante & Moran, PLLC

February 21, 2007
Auburn Hills, Michigan

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

BOARD OF DIRECTORS

The information called for herein is presented below:

NAME	AGE	PRINCIPAL OCCUPATION OR EMPLOYMENT FOR PAST FIVE YEARS	YEAR FIRST BECAME DIRECTOR
Dexter Benecke	64	President, Freedom Ridge, Inc	1999
Joe E. Crossgrove*	70	Chairman of the Corporation and The Farmers & Merchants State Bank	1992
Steven A. Everhart	52	Secretary/Treasurer, MBC Holdings, Inc	2003
Robert G. Frey	66	President, E.H. Frey & Sons, Inc.	1987
Jack C. Johnson	54	President, Hawk's Clothing, Inc.	1991
Dean E. Miller	63	Chairman, MBC Holdings, Inc.	1986
Anthony J. Rupp	57	President, Rupp Furniture Co.	2000
David P. Rupp Jr.	65	Attorney	2001
James C. Saneholtz	60	President, Saneholtz-McKarns, Inc.	1995
Kevin J. Sauder	46	President, Chief Executive Officer Sauder Woodworking Company	2004
Merle J. Short	66	President Promow, Inc.	1987
Paul S. Siebenmorgen	57	President and CEO of the Corporation and the Farmers & Merhcants State Bank	2005
Steven J. Wyse	62	Private Investor	1991
Dr. Betty K. Young	51	President, Northwest State Community College	2005

* Mr Crossgrove discontinued full time employment from the Farmers & Merchants State Bank as of December 31, 2006. He remains Chairman of the Corporation and the Farmers & Merchants State Bank.

EXECUTIVE OFFICERS

Name	Age	Principal Occupation & offices Held with Corporation & Bank for Past Five Years
Joe E. Crossgrove	70	Chairman

Paul S. Siebenmorgan	57	President & Chief Executive Officer
Rex D. Rice	48	Executive Vice President Senior Commercial Loan Officer
Edward A. Leininger	50	Executive Vice President Chief Operating Officer
Barbara J. Britenriker	45	Executive Vice President Chief Financial Officer
Richard J. Lis	65	Executive Vice President Chief Lending Officer

The information called for under Rule 405 of Regulation S-K regarding compliance with Section 16(a) is presented in the proxy statement to be furnished in connection with the soliciation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held on April 21, 2007, and is incorporated herein by reference.

The Board of Directors of the Company adopted a Code of Business Conduct and Ethics (the "Code") at its meeting on February 13, 2004. While the Sarbanes-Oxley Act of 2002 mandates the adoption of a code of ethics for the most senior executive officers of all public companies, the Code adopted by the Corporation's Board of Directors is broader in the activities covered and applies to all officers, directors and employees of the Corporation and the Bank, including the chief executive officer, chief financial officer, principal accounting officer and other senior officers performing accounting, auditing, financial management or similar functions. The administration of the Code has been delegated to the Audit Committee of the Board of Directors, a Committee comprised entirely of "independent directors." The Code addresses topics such as compliance with laws and regulations, honest and ethical conduct, conflicts of interest, confidentiality and protection of Corporation assets, fair dealing and accurate and timely periodic reports, and also provides for enforcement mechanisms. The Board and management of the Corporation intends to continue to monitor not only the developing legal requirements in this area, but also the best practices of comparable companies, to assure that the Corporation maintains sound corporate governance practices in the future.

A copy of the Corporation's Code is available on the website of the Bank (www.fm-bank.com). In addition, a copy of the Code is available to any shareholder free of charge upon request. Shareholders desiring a copy of the Code should address written requests to Mr. Paul S. Siebenmorgen, President, Chief Executive Officer and Treasurer of Farmers & Merchants Bancorp, Inc., 307-11 North Defiance Street, Archbold, Ohio 43502, and are asked to mark Code of Business Conduct and Ethics on the outside of the envelope containing the request.

ITEM 11. EXECUTIVE COMPENSATION

The information called for herein is presented in the proxy statement to be furnished in connection with the solicitation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held on April 21, 2007, and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information called for herein is presented in the proxy statement to be furnished in connection with the solicitation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held Saturday, April 21, 2007, and is incorporated herein by reference.

On April 23, 2005 the Company's shareholders approved the Farmers & Merchants Bancorp, Inc. 2005 Long-Term Stock Incentive Plan. The plan authorizes the issuance of up to 800,000 of the Company's common shares in the form of stock options, restricted stock, performance shares, and unrestricted stock to employees of the Company and its subsidiares. During 2005, 4,000 shares of restricted stock were issued under the plan to 38 employees of the Bank. These grants will become completely vested in three years. Due to employee termination, there were 80 shares forfeited during 2005. During 2006, the Company purchased 42,000 shares and awarded 6,100 restricted shares to 41 employees. 200 shares were forfeited during 2006. At year end, the Company held 36,180 shares in Treasury stock and 9,820 in unearned stock awards. The Company initiated a 4:1 stock split on May 12, 2006.

EQUITY COMPENSATION PLAN INFORMATION

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of secur remaining avai for future iss under equit compensation p (excluding secu reflected in colu (c)
Equity compensation plans approved by security holders	0	$0.00	790,180
Equity compensation plans not approved by security holders	0	$0.00	0
Total	0	$0.00	790,180

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information called for herein is presented in the proxy statement to be furnished in connection with the solicitation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held on April 21, 2007, and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information called for herein is presented in the proxy statement to be furnished in connection with the solicitation of proxies on behalf of the Board of Directors of the Registrant for use at its Annual Meeting to be held on April 21, 2007, and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENTS SCHEDULES

(a) The Following documents are filed as part of this report:

(1) Financial Statements (included in this 10-K under item 8)

Report of Independent Accountants
Consolidated Balance Sheets
Consolidated Statements of Income
Consolidated Statements of Changes in Shareholders' Equity
Consolidated Statements of Cash Flows
Note to Consolidated Financial Statements

(2) Financial Statement Schedules

Five Year Summary of Operations

(3) Exhibits Required by Item 601 of Regulation S-K

(3.1) a. Articles of Incorporation are incorporated by reference to the Company's Quarterly Report on Form 10-Q that was filed with the Commission on May 10, 2004

b. Amendment to Articles of Incorporation, incorporated by reference to the Company's Current Report on Form 8-K that was filed with the Commission on April 26, 2006.

(3.2) Code of Regulations are incorporated by reference to the Company's Quarterly Report on Form 10-Q that was filed with the Commission on May 10, 2004.

(10.1) Change in Control Agreement executed by and between the Company and Paul S. Siebenmorgen on February 18, 2005(incorporated by reference to the Current Report on Form 8-K filed with the Commission on February 22, 2005).

(10.2) Change in Control Agreement executed by and between the Company and Barbara J. Britenriker on February 18, 2005 (incorporated by reference to the Current Report on Form 8-K filed with the Commission on February 22, 2005).

(10.3) Change in Control Agreement executed by and between the Company and Edward A. Leininger on February 18, 2005 (incorporated by reference to the Current Report on Form 8-K filed with the Commission on February 22, 2005).

(10.4) Change in Control Agreement executed by and between the Company and Rex D. Rice on February 18, 2005 (incorporated by reference to the Current Report on Form 8-K filed with the Commission on February 22, 2005).

(10.5) Change in Control Agreement executed by and between the Company and Richard J Lis on December 16, 2005 (incorporated by Reference to the Current Report on Form 8-K file with the Commission on December 16,2005).

(10.6) 2005 Long-Term Stock Incentive Plan (incorporated by reference to the Quarterly Report on Form 10-Q filed with the Commission on October 27, 2005)

(10.7) Form of Restricted Stock Agreement (incorporated by reference to the Quarterly Report on Form 10-Q filed with the Commission on October 27, 2005)

(21) Subsidiaries of Farmers & Merchants Bancorp, Inc.

(31.1) Certification of the Chief Executive Officer Required under Rule 13(a)-14(a)/15d-14(a)

(31.2) Certification of the Chief Financial Officer Required under Rule 13(a)- 14(a)/15d-14(a)

(32.1) Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(32.2) Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

FARMERS & MERCHANTS BANCORP, INC

Signatures

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934. The registrant has duly caused this report to be signed on its behalf by the undersigned, herunto duly authorized

By: /s/ Paul S. Siebenmorgen Date: February 16, 2007

Paul S. Siebenmorgen
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Paul S Siebenmorgen Date: February 16, 2007

Paul S Siebenmorgen
Chief Executive Officer (Principal Executive Officer)

/s/ Joe E. Crossgrove Date: February 16, 2007

Joe E. Crossgrove
Director & Chairman

/s/ Anthony J. Rupp Date: February 16, 2007

Anthony J. Rupp, Director

/s/ David P. Rupp Jr. Date: February 16, 2007

David P. Rupp Jr, Director

/s/ James Saneholtz Date: February 16, 2007

James Saneholtz, Director

/s/ Merle J. Short Date: February 16, 2007

Merle J. Short, Director

/s/ Dexter Benecke Date: February 16, 2007

Dexter Benecke, Director

/s/ Dr. Betty Young Date: February 16, 2007

Dr Betty Young, Director

/s/ Barbara J. Britenriker Date: February 16, 2007

Barbara J. Britenriker
Chief Financial Officer
(Principal Financial Officer/
Principal Accounting Officer)

/s/ Jack C. Johnson Date: February 16, 2007

Jack C. Johnson, Director

/s/ Dean E. Miller Date: February 16, 2007

Dean E. Miller, Director

/s/ Steven A. Everhart Date: February 16, 2007

Steven A. Everhart, Director

/s/ Kevin J. Sauder Date: February 16, 2007

Kevin J. Sauder, Director

/s/ Robert G. Frey Date: February 16, 2007

Robert G. Frey, Director

/s/ Steven J. Wyse Date: February 16, 2007

Steven J. Wyse, Director