

# *Generations of Pride*

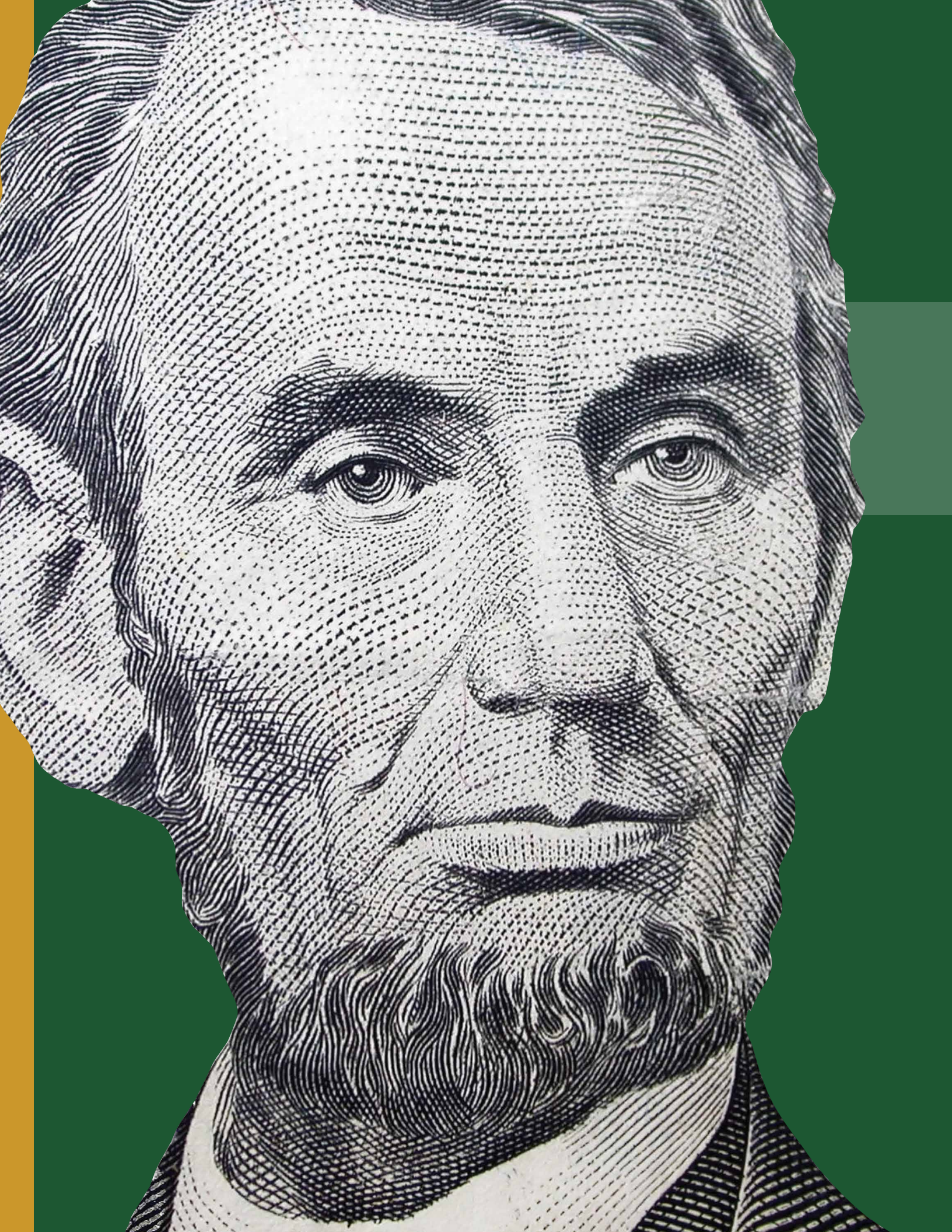


## FARMERS BANKSHARES

*Annual Report 2015*

COURTEOUS | PROMPT | RELIABLE | SECURE







*I like to see a man proud of the place in which he lives.  
I like to see a man live so that his place will be proud of him.*

*-Abraham Lincoln*



## **Our Mission**

It is the mission of Farmers Bank to be unique and distinct from all other financial institutions, set apart by excelling in the following areas:

*Pride for our customers and their unique needs.*

- To offer a superior level of service that is responsive, courteous, cooperative and professional.

*Proud of our communities and all that they have to offer.*

- To remain an independent financial institution close to the people of Isle of Wight County, Southampton County, the City of Suffolk and the surrounding communities, being sensitive to their financial needs and designing and offering products to specifically meet those needs.

*Proud of our local charitable organizations and their devotion to our citizens.*

- To be good corporate citizens, serving as leaders to strengthen our communities and promote their welfare.

*Pride for our employees and their dedication.*

- To employ men and women who are loyal to the bank and committed to our direction, policies and goals.

*Pride for our shareholders and their commitment to Farmers Bank.*

- To bring our shareholders a fair rate of return on their investments.

## Dear Shareholder,



Richard J. Holland, Jr.



Vernon M. Towler

As noted throughout our annual report, we have many things for which to be proud. Most importantly, 2015 was a record year of earnings for Farmers Bank. While the financial institution industry still has its challenges, we are realizing the results from strategically planning and positioning ourselves for the future.

Consolidated earnings for 2015 were approximately \$3.8 million, an improvement over 2014 of twelve percent. Core earnings, excluding loan loss recoveries, for 2015 increased fifty percent over 2014. This progress in our earnings was reflected in our dividends to you, which also increased fifty percent over the prior year. Of equal importance, we have significantly improved asset quality, reduced the efficiency ratio and managed the balance sheet to ensure future growth. Non-interest income, excluding securities gains, added approximately \$1 million to gross income over last year, while non-interest expenses were held steady even while enhancing staff and technology.

Strategically, the Board and Management have set an aggressive course for 2016. Our focuses include growing loans and non-interest deposits, managing expenses and increasing our mortgage business within our markets. Our focus on the insurance partnership with Manry Rawls will include organic growth, as well as growth through acquisitions. We are also planning to expand our footprint with a loan production office in the Chesapeake area in the second quarter of 2016. As always, we continue to explore alternative sources of revenue that may fall slightly outside of traditional banking.

Institutions like Farmers Bank are becoming somewhat archaic. We are a small, independent bank in an industry that is dictating toward larger organizations. Regulations for the financial industry continue to be costly and require constant strategic focus and planning. To excel in banking today requires a strong and committed team. I am once again proud to report that we have assembled a team that is dedicated to success for our shareholders, serving our customers and being involved to better our communities. As a community bank, our management team sets goals that are outside of traditional banking which ensure we are more than just a bank and set apart from other institutions. We strive to provide a working environment that encourages growth and promotes building better relationships and being superior role models. We want to be the bed rock of our communities; and as stated in the inside of our annual report we want those surrounding communities and citizens to be proud of our presence and contribution.

We want to thank our Board of Directors, Management and Staff for their continued efforts. It is truly our privilege to work alongside each of these groups on a daily basis. In conclusion, we also want to thank you, our shareholders. We genuinely consider each of you part of our team and appreciate the loyalty, patronage and referrals that encourage others to join our banking family.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard J. Holland, Jr.".

Richard J. Holland, Jr.  
*Chairman and CEO*

A handwritten signature in black ink, appearing to read "Vernon M. Towler".

Vernon M. Towler  
*President*

# Board of Directors



Richard J. Holland, Jr.\*  
*Chairman*



William A. Gwaltney, Jr.\*  
*Vice Chairman  
Indika Farms, Inc., President*



G. Thomas Alphin, Jr.\*  
*Commonwealth Gin,  
Co-Owner*



E. Warren Beale, Jr.  
*Entrepreneur*



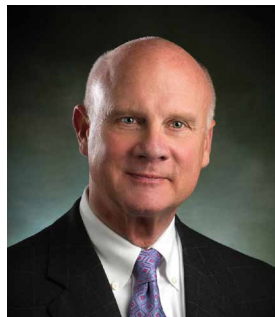
Harold U. Blythe  
*Retired Bank CEO*



William L. Chorey  
*Chorey & Associates Realty, Ltd.,  
Owner/Broker*



David T. Owen\*  
*Wakefield Farm Service, Inc.,  
President*



Peter D. Pruden, III  
*Taste Unlimited, Co-Owner*



William H. Riddick, III\*  
*Attorney at Law - Smithfield*



Kent B. Spain\*  
*Suffolk Insurance Corporation,  
Executive Vice President*



O. A. Spady  
*Retired Entrepreneur*



Vernon M. Towler\*  
*President*

\*Farmers Bankshares, Inc. Board Members



# Executive Management



Richard J. Holland, Jr.  
*Chief Executive Officer*



Vernon M. Towler  
*President*



Patricia T. Allen  
*Senior Vice President, Director  
of Loan & Deposit Operations*



Kathy C. Bryant  
*Senior Vice President, Director of  
Human Resources and Retail*



Norman F. Carr, Jr.  
*Senior Vice President,  
Director of Financial Services*



Kristy E. DeJarnette  
*Executive Vice President,  
Chief Financial Officer*



Chad A. Rountree  
*Senior Vice President, Western  
Tidewater Market Executive*



Thomas L. Woodward, III  
*Senior Vice President,  
Chief Lending Officer*

# Bank Officers

Jeffrey S. Creekmore  
*Senior Vice President, Chesapeake Market Executive*

P. Kelley Gowen  
*Senior Vice President, Chief Credit Officer*

Elizabeth D. Jones  
*Senior Vice President, Smithfield Market Executive*

James C. Saunders  
*Senior Vice President, Suffolk Market Executive*

William N. Bailey  
*Vice President, Information Technology*

Lauren P. Harper  
*Vice President, Loans*

Charles A. Powers II  
*Vice President, Loans*

Sharon A. Smith  
*Vice President, Compliance*

Andrea B. Curry  
*Assistant Vice President, Information Technology*

Kelly D. Dewitt  
*Assistant Vice President, BSA, AML, OFAC & Security Officer*

C. Thomas Eure, Jr.  
*Assistant Vice President, Branch Administration*

Melanie S. Gwaltney  
*Assistant Vice President, Operations*

Kelley T. Healey, Jr.  
*Assistant Vice President, Loans*

Blanche E. Hecker  
*Assistant Vice President, Retail*

Joanne F. Joyner  
*Assistant Vice President, Retail*

Erin W. Park  
*Assistant Vice President, Controller*

D. Renee Scott  
*Assistant Vice President, Retail*

Meghan D. White  
*Assistant Vice President, Loan Operations*

Susan F. Boone  
*Corporate Secretary*



# Suffolk Community Board

Timothy K. Palmer, Chairman

*Attorney at Law & Certified Public Accountant*

James C. Adams, III

*President, Featherlite Coaches*

Alison Dodson Anderson

*Owner, A. Dodson's*

J. Clifton Harrell, Jr.

*President, Suffolk Iron Works*

Roy A. Runyon, III

*Director of Research and Development, The Gartman Letter, L.C.*

H. Hadley Whitlock, Jr.

*Retired Commercial Lender*



# Western Tidewater Community Board

Vincent Carollo, Chairman

*Anna's Ristorante & JVC Holdings, LLC*

Christopher T. Alphin

*Commonwealth Gin*

Tammy W. Edwards

*Windsor Hardware and Supply Company*

Randolph H. Pack

*Smithfield Station*

V.S. Pittman, II

*Manry Rawls, LLC*

John T. Randall

*Randall & Page, P.C.*





# Financial Highlights

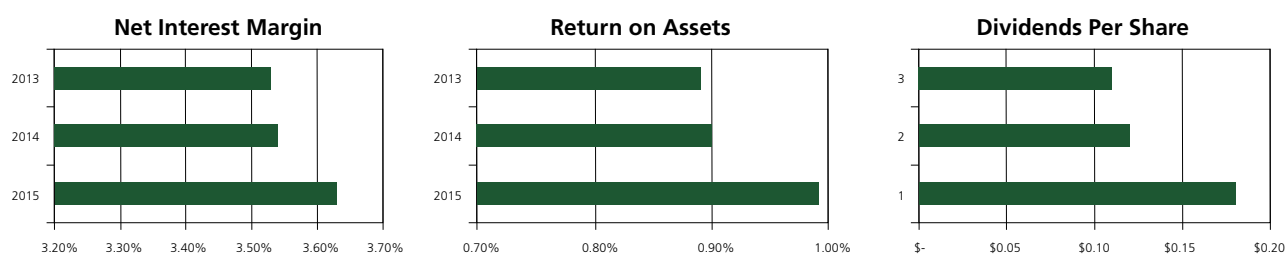
At or for the Years Ended December 31,	2015	2014	2013
		(Dollars in thousands, except per share data)	
<b>Summary of Operations</b>			
Interest income	\$16,044	\$16,128	\$15,909
Interest expense	2,730	3,156	3,182
Net interest income	13,314	12,972	12,727
Provision for loan losses	-	(850)	(500)
Net interest income after provision for loan losses	13,314	13,822	13,227
Non-interest income	2,919	1,763	1,337
Non-interest expense	11,492	11,317	10,150
Income (loss) before income taxes	4,741	4,268	4,414
Income taxes	967	907	1,098
Net income (loss)	\$3,774	\$3,361	\$3,316
<b>Per Share and Shares Outstanding (1)</b>			
Basic net income (loss)	\$1.24	\$1.11	\$0.93
Book value at end of period	\$13.30	\$12.49	\$10.81
Basic weighted average shares outstanding	3,053,845	3,040,195	3,036,785
Dividends per share	\$0.18	\$0.12	\$0.11
Shares outstanding at period end	3,054,092	3,060,780	3,040,100
<b>Balance Sheet Data</b>			
Total assets	\$414,933	\$426,791	\$412,162
Total loans, net	242,032	239,325	221,843
Total deposits	335,877	342,809	343,350
Borrowings	25,000	30,000	20,000
<b>Selected Performance Ratios (Bank Only)</b>			
Return on average assets	0.99%	0.90%	0.89%
Return on average stockholders' equity	8.54%	8.20%	8.30%
Net interest margin (2)	3.63%	3.54%	3.53%
Non-interest income as a percentage of total revenue (3)	17.98%	11.97%	9.50%
Efficiency ratio (4)	66.68%	71.24%	69.16%
<b>Asset Quality Ratios</b>			
Nonperforming loans to period-end loans	0.55%	2.39%	2.45%
Allowance for loan losses to period-end loans	2.54%	3.29%	3.22%
Net charge-offs to average loans outstanding	0.73%	-0.68%	0.23%
<b>Capital (Bank Only)</b>			
Tier 1 leverage ratio	11.53%	10.83%	10.37%
Total risk-based capital ratio	18.50%	17.92%	18.40%
Stockholder's equity	\$49,166	\$48,037	\$43,104

(1) Computed based on the weighted average number of shares outstanding during each period.

(2) Net interest margin is net interest income divided by average interest earning assets.

(3) Total revenue consists of net interest income and non-interest income

(4) Efficiency ratio is non-interest expense divided by the sum of net interest income and non-interest income.



# Farmers Bankshares, Inc.

## Consolidated Financial Statements for Years Ended December 31, 2015 and 2014

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## **Independent Auditors' Report**

To the Board of Directors  
Farmers Bankshares, Inc.  
Windsor, Virginia

We have audited the accompanying consolidated financial statements of Farmers Bankshares, Inc., which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Farmers Bankshares, Inc. as of December 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Dixon Hughes Goodman LLP*

**Charlotte, North Carolina**  
**March 21, 2016**

**Farmers Bankshares, Inc.**  
**Consolidated Balance Sheets**

	December 31,	
	2015	2014
<b>Assets</b>		
Cash and cash equivalents		
Cash and due from banks	\$ 14,636,916	\$ 18,946,788
Federal Funds sold	1,648,069	8,631,880
<b>Total cash and cash equivalents</b>	<b>16,284,985</b>	<b>27,578,668</b>
Available-for-sale securities (Note 3)	134,739,604	136,634,119
Mortgage loans held for sale	911,050	986,000
Loans held for investment, net of allowance for loan losses of \$6,343,636 and \$8,181,827, respectively (Note 4)	242,031,797	239,325,310
Premises and equipment, net (Note 5)	3,547,672	3,806,446
Other real estate owned	612,798	1,498,798
Accrued interest	1,774,430	1,725,181
Prepaid expenses	337,341	366,467
Income taxes receivable	92,323	666,602
Non-marketable equity securities (Note 6)	4,519,175	4,355,547
Bank-owned life insurance	9,909,100	9,584,982
Other assets	172,930	262,418
	398,648,220	399,211,870
<b>Total assets</b>	<b>\$ 414,933,205</b>	<b>\$ 426,790,538</b>
<b>Liabilities and Stockholders' Equity</b>		
Deposits		
Noninterest-bearing deposits	\$ 96,420,933	\$ 86,085,407
Interest-bearing deposits (Note 7)	239,456,439	256,723,297
<b>Total deposits</b>	<b>335,877,372</b>	<b>342,808,704</b>
Federal Home Loan Bank borrowings (Note 9)	25,000,000	30,000,000
Capital notes (Note 8)	9,928,475	11,253,475
Securities sold under agreements to repurchase (Note 9)	823,102	1,929,599
Deferred compensation plans	1,240,929	1,104,315
Net deferred tax liability	148,656	374,802
Other liabilities	1,108,511	1,095,387
Accrued interest	198,802	249,229
<b>Total liabilities</b>	<b>374,325,847</b>	<b>388,815,511</b>
<b>Stockholders' equity</b>		
Common stock, \$0.125 par value; 50,000,000 shares authorized; 3,054,092 and 3,060,780 shares issued and outstanding at December 31, 2015 and 2014, including nonvested shares of 13,800 and 17,250 shares, respectively	381,763	382,600
Capital surplus	2,754,141	2,723,028
Retained earnings	35,070,594	31,849,329
Accumulated other comprehensive income	2,400,860	3,020,070
<b>Total stockholders' equity</b>	<b>40,607,358</b>	<b>37,975,027</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 414,933,205</b>	<b>\$ 426,790,538</b>



**Farmers Bankshare, Inc.**  
**Consolidated Statements of Operations**

	Years Ended December 31,	
	2015	2014
<b>Interest income</b>		
Interest and fees on loans held for investment	\$ 12,000,584	\$ 11,917,161
Interest on mortgage loans held for sale	21,202	2,470
Interest on available-for-sale securities	2,512,889	2,815,959
Interest on tax exempt available-for-sale securities	1,376,381	1,269,922
Interest on federal funds sold	33,505	41,970
Other interest income	99,106	80,391
<b>Total interest and dividend income</b>	<b>16,043,667</b>	<b>16,127,873</b>
<b>Interest expense</b>		
Interest on deposits	1,589,455	1,966,110
Interest on Federal Home Loan Bank advances	618,542	614,693
Interest on capital notes	517,478	569,160
Interest on repurchase agreements	4,620	5,941
Interest on federal funds purchased	3	3
<b>Total interest expense</b>	<b>2,730,098</b>	<b>3,155,907</b>
<b>Net interest income</b>	<b>13,313,569</b>	<b>12,971,966</b>
<b>Recovery of loan losses</b>	<b>-</b>	<b>(850,000)</b>
<b>Net interest income after provision for loan losses</b>	<b>13,313,569</b>	<b>13,821,966</b>
<b>Noninterest income</b>		
Service charges	613,468	353,212
Income from automated teller machines and bank card interchange	514,642	450,090
Gain on disposition of securities	422,821	288,847
Income on bank owned life insurance	324,118	240,019
Gain/(loss) on sale of premises and equipment	(58)	20,404
Income from investment in Manry Rawls, LLC	437,428	175,611
Income from mortgage loan sales	438,471	74,863
Other income	168,585	160,278
<b>Total noninterest income</b>	<b>2,919,475</b>	<b>1,763,324</b>
<b>Noninterest expense</b>		
Salaries and employee benefits	6,134,982	5,755,188
Equipment expense	646,016	731,347
Occupancy expense	621,718	615,749
Bank franchise tax	495,830	402,681
Advertising and marketing	321,175	547,556
Data processing	855,719	843,361
Loan related legal and other expenses	192,458	276,056
Federal Deposit Insurance Corporation assessment	246,032	286,513
Loss on sale and write-downs of other real estate owned	91,469	288,130
Other real estate owned	51,218	313,914
Prepayment penalty on borrowings	355,592	-
Other	1,479,326	1,256,677
<b>Total noninterest expense</b>	<b>11,491,535</b>	<b>11,317,172</b>
<b>Income before income taxes</b>	<b>4,741,509</b>	<b>4,268,118</b>
<b>Income tax expense (Note 11)</b>	<b>967,121</b>	<b>907,229</b>
<b>Net income attributable to common shareholders</b>	<b>\$ 3,774,388</b>	<b>\$ 3,360,889</b>
<b>Basic earnings per common share (Note 18)</b>	<b>\$ 1.24</b>	<b>\$ 1.11</b>
<b>Diluted earnings per common share</b>	<b>\$ 1.23</b>	<b>\$ 1.10</b>
<b>Cash dividends declared per common share</b>	<b>\$ 0.18</b>	<b>\$ 0.12</b>

The accompanying notes are an integral part of these consolidated financial statements.

**Farmers Bankshares, Inc.**  
**Consolidated Statements of Comprehensive Income**

	Years Ended December 31,	
	2015	2014
<b>Net income</b>	\$ 3,774,388	\$ 3,360,889
<b>Other comprehensive income (loss):</b>		
Unrealized holding gains (losses) on available-for-sale securities	(515,376)	3,438,321
Tax effect	175,228	(1,169,029)
Unrealized holding gains (losses) on available-for-sale securities, net of tax amount	(340,148)	2,269,292
Reclassification adjustment for realized gains	(422,821)	(288,847)
Tax effect	143,759	98,208
Reclassification adjustment for realized gains, net of tax amount	(279,062)	(190,639)
Other comprehensive income (loss), net of tax	(619,210)	2,078,653
<b>Comprehensive income</b>	\$ 3,155,178	\$ 5,439,541



**Farmers Bankshares, Inc.**  
**Consolidated Statements of Changes in Stockholders' Equity**

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total
<b>Balances, December 31, 2013</b>	<u>\$ 380,015</u>	<u>\$ 2,695,613</u>	<u>\$ 28,853,472</u>	<u>\$ 941,417</u>	<u>\$ 32,870,517</u>
Net income	-	-	3,360,889	-	3,360,889
Changes in net unrealized gain on securities available for sale, net of reclassification adjustment and tax effect	-	-	-	2,078,653	2,078,653
Issuance of restricted common shares	2,156	(2,156)	-	-	-
Issuance of common stock - director stock plan	429	29,571	-	-	30,000
Cash dividends declared on common shares, \$0.12 per share	-	-	(365,032)	-	(365,032)
<b>Balances, December 31, 2014</b>	<u>\$ 382,600</u>	<u>\$ 2,723,028</u>	<u>\$ 31,849,329</u>	<u>\$ 3,020,070</u>	<u>\$ 37,975,027</u>
Net income	-	-	3,774,388	-	3,774,388
Changes in net unrealized gain on securities available for sale, net of reclassification adjustment and tax effect	-	-	-	(619,210)	(619,210)
Repurchase common shares	(908)	(57,416)	-	-	(58,324)
Issuance of common stock - director stock plan	502	40,098	-	-	40,600
Compensation expense, restricted stock	-	48,000	-	-	48,000
Forfeiture of restricted stock	(431)	431	-	-	-
Cash dividends declared on common shares, \$0.18 per share	-	-	(553,123)	-	(553,123)
<b>Balances, December 31, 2015</b>	<u>\$ 381,763</u>	<u>\$ 2,754,141</u>	<u>\$ 35,070,594</u>	<u>\$ 2,400,860</u>	<u>\$ 40,607,358</u>

**Farmers Bankshares, Inc.**  
**Consolidated Statements of Cash Flows**

	Years Ended December 31,	
	2015	2014
<b>Cash flows from operating activities</b>		
Net income	\$ 3,774,388	\$ 3,360,889
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	454,801	487,942
Recovery of loan losses	-	(850,000)
Provision for deferred income taxes	92,841	360,364
Amortization of investment securities premiums	846,954	884,280
Net gain on disposition of available-for-sale securities	(422,821)	(288,847)
Loss on sales and writedowns on other real estate owned	91,469	288,130
(Gain)/loss on sale of premises and equipment	58	(20,404)
(Gain) on mortgages held for sale	(210,353)	-
Increase in cash value of bank owned life insurance	(324,118)	(240,019)
Compensation expense for stock issuance	48,000	-
Director expense for stock issuance	40,600	30,000
Change in operating assets and liabilities		
Origination of mortgage loans held for sale	(12,170,944)	(2,091,950)
Proceeds from sale of mortgage loans held for sale	12,456,247	1,105,950
Interest receivable	(49,249)	71,685
Interest payable	(50,427)	14,875
Prepaid expenses	29,126	22,453
Income taxes receivable	574,279	(453,136)
Other assets	89,488	49,301
Deferred compensation	136,614	132,860
Other liabilities	55,894	184,764
<b>Net cash provided by operating activities</b>	<b>5,462,847</b>	<b>3,049,137</b>
<b>Cash flows from investing activities</b>		
Proceeds from sales, prepayments and maturities of available-for-sale securities	28,677,043	17,521,826
Purchase of available-for-sale securities	(28,144,858)	(11,308,586)
Purchase of bank owned life insurance	-	(3,500,000)
Proceeds from sale of non-marketable equity securities	425,000	-
Purchase of non-marketable equity securities	(588,628)	(2,099,458)
Proceeds from sale of other real estate owned	794,531	1,440,628
Loan originations, net of repayments	(2,706,487)	(18,251,293)
Proceeds from sale of premises and equipment	150	1,235,085
Purchases of premises and equipment	(196,235)	(470,903)
<b>Net cash used in investing activities</b>	<b>(1,739,484)</b>	<b>(15,432,701)</b>
<b>Cash flows from financing activities</b>		
Cash dividends paid on common shares	(595,893)	(340,492)
Repurchase of common shares	(58,324)	-
Repayment of capital notes	(1,325,000)	-
Proceeds from FHLB borrowings	5,000,000	10,000,000
Repayment of FHLB borrowings	(10,000,000)	-
Change in noninterest-bearing deposits	10,335,526	15,045,762
Change in interest-bearing deposits	(17,266,858)	(15,587,545)
Change in securities sold under agreements to repurchase	(1,106,497)	(666,177)
<b>Net cash provided by or (used in) financing activities</b>	<b>(15,017,046)</b>	<b>8,451,548</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(11,293,683)</b>	<b>(3,932,016)</b>
<b>Cash and cash equivalents</b>		
Beginning of the year	27,578,668	31,510,684
End of year	<b>\$ 16,284,985</b>	<b>\$ 27,578,668</b>



**Farmers Bankshares, Inc.**  
**Consolidated Statements of Cash Flow (concluded)**

	Years Ended December 31,	
	2015	2014
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for		
Income taxes	\$ 300,000	\$ 1,000,000
Interest on deposits and other borrowings	2,780,525	3,141,032
 <b>Supplemental schedule of non-cash investing activities</b>		
Change in unrealized gains on available-for-sale securities, net of income tax	\$ (619,210)	\$ 2,078,653
Income from investment in Manry Rawls, LLC	(437,428)	(175,611)
Transfer of loans to other real estate owned	-	(1,618,758)
Contribution of other real estate owned	-	(180,000)

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 1 - Organization and nature of business

Farmers Bankshares, Inc. (the "Company") was organized and incorporated under the laws of the Commonwealth of Virginia on July 26, 2013. On December 31, 2013, the Company was consummated as the Bank Holding Company of Farmers Bank, Windsor, Virginia (the "Bank") through a reorganization plan, under the laws of the Commonwealth of Virginia. As of this date, the Bank became a wholly-owned subsidiary of Farmers Bankshares, Inc. The Bank was formed on November 12, 1919 and has offices in Windsor, Smithfield, Suffolk, and Courtland, Virginia. Through its banking subsidiary the Company provides a wide variety of banking services primarily in southeastern Virginia.

The Bank provides small and mid-sized businesses, professionals, corporate executives and entrepreneurs with banking services comparable to those of the large national and regional institutions. These services include loans that are priced on a deposit-based relationship, direct access to the Bank's decision makers, and quick, innovative response to customers' financial needs. If customers have credit requirements that exceed the Bank's credit limits, the Bank seeks to accommodate those customers by arranging loans on a participation basis with other financial institutions.

### Note 2 - Summary of significant accounting policies

*Basis of presentation and consolidation* - The consolidated financial statements of the Company are prepared in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, the Bank and FB Properties of Virginia, L.L.C., which owns certain Bank assets. All significant intercompany balances and transactions have been eliminated in consolidation.

*Cash and cash equivalents* - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits with banks and federal funds sold, all of which mature within 90 days or less. The Company is required by the Federal Reserve to maintain average reserve balances. For the final quarterly reporting period in 2015 and 2014, the aggregate amount of daily-required balances was \$98,000 and \$44,000, respectively.

*Investment securities* - Investments in debt securities classified as held-to-maturity, if any, are stated at cost, adjusted for amortization of premiums and accretion of discounts using the interest method. The Company held no such securities during the periods reported in the financial statements.

Investments in debt securities classified as trading, if any, are stated at fair value. Such securities are purchased and held principally for the purpose of selling them in the near term. Unrealized holding gains and losses for trading securities are included in the statements of operations. The Company held no such securities during the periods reported on in the financial statements.

Investments not classified as either held-to-maturity or trading are classified as available-for-sale. Debt securities classified as available-for-sale are stated at fair value with unrealized holding gains and losses excluded from earnings and reported as a component of accumulated other comprehensive income until realized. The income statement line items impacted by the reclassification of realized gains (losses) on the sale of securities are the gains (losses) on disposition of securities and income tax expense line items in the income statement.

Gains and losses on the sale of securities are determined using the specific identification method and are recognized on a trade date basis. Other than temporary declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost, if any, are included in earnings as realized losses. Other-than-temporarily impaired ("OTTI") guidance for investment states that an impairment is OTTI if any of the following conditions exist: the entity intends to sell the security; it is more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis; or, the entity does not expect to recover the security's entire amortized cost basis (even if the entity does not intend to sell).



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 2 - Summary of significant accounting policies (continued)

*Loans* - The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial and consumer mortgage loans throughout Southeastern Virginia. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans held for investment that management has the intent and ability to hold for the foreseeable future or until maturity generally are stated at their outstanding unpaid principal balances. Loans held for sale are originated and intended for sale in the secondary market. These loans are carried at the lower of cost or market in the aggregate. Net unrealized losses, if any, are recognized through charges to income. Interest income is accrued on the unpaid principal balance for all loan classes. Discounts and premiums are amortized to income using the interest method. Net deferred fees and costs are amortized over the lives of the applicable loans using the effective interest rate method.

*Allowance for loan losses* - The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. 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 upon management's periodic review of the collectibility of the loans in light of historical experience, 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 a specific, a historic and a qualitative, general component. The specific component relates to loans that are considered impaired. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of an impaired loan are lower than the carrying value of that loan. The historic component covers non-classified and criticized loans and is based on historical loss experience adjusted for qualitative factors. The qualitative reserve of the allowance reflects adjustments to historical experience to account for current conditions impacting the loan portfolio.

For all classes, 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 the 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 and construction 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 smaller balance homogeneous loans are collectively evaluated for impairment.

The allowance model is applied to determine the specific allowance balance for impaired loans and the general allowance balance for unimpaired loans grouped by loan type.

The Bank's loan charge-off policy for all loan classes is to charge down loans to net realizable value once a portion of the loan is determined to be uncollectible, and the underlying collateral shortfall is assessed. Loans are moved to nonaccrual status when the loan becomes 90 days delinquent or a portion of the loan is determined to be uncollectible and supporting collateral is not considered to be sufficient to cover potential losses.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 2 - Summary of significant accounting policies (continued)

*Allowance for loan losses* (concluded) - Nonaccrual loans are reviewed monthly to determine if all or a portion of the loan is uncollectible. Nonaccrual loans that are determined to be solely collateral dependent are monitored for possible charge downs to net realizable value upon determination that they are impaired.

*Income recognition on impaired and non-accrual loans* - All classes of loans are generally classified as non-accrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. All classes of loans that are on a current payment status or past due less than 90 days may also be classified as non-accrual, if repayment in full of principal and/or interest is in doubt.

All classes of loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower, in accordance with the contractual terms of interest and principal.

When all classes of loans are classified as non-accrual and the future collectibility of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding. When the future collectibility of the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a non-accrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

*Other real estate owned* - Real estate acquired through, or in lieu of, foreclosure is held for sale and is initially recorded at fair value less estimated cost to sell at the date of foreclosure, establishing a new cost basis. Principal and interest losses existing at the time of acquisition of such assets are charged against the allowance for loan losses and interest income, respectively. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Revenue and expenses from operations associated with other real estate owned and the impact of any subsequent changes in the carrying value are included in other expenses.

*Premises and equipment* - Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. For financial reporting purposes, assets are depreciated over their estimated useful lives using the straight-line method. Useful lives for these assets are within the following ranges, buildings from 10-39 years, equipment, furniture and fixtures 3-15 years, computer equipment 3-7 years and software 3-5 years. For income tax purposes, the accelerated cost recovery system and the modified accelerated cost recovery system are used.

*Non-marketable equity securities* - Non-marketable equity securities are restricted securities, carried at cost, and periodically evaluated for impairment. These securities are restricted, do not have a readily determinable fair value, and lack a market. Because of the redemption provisions of the Federal Reserve Bank and Federal Home Loan Bank stock, the Bank estimated that the fair value equaled or exceeded the cost of these investments and the investments were not impaired. In April 2014, the Bank invested approximately \$1.4 million in return for a one-third ownership in Manry Rawls, LLC. Manry Rawls, LLC is a local and independent regional insurance agency offering a wide array of insurance products. The Bank's proportionate share of Manry Rawls' income is recorded as an increase in the investment and directly to other non-interest income. Any cash distributions made by Manry Rawls' would lower the recorded investment at the time of payment. The difference between the carrying value of the investment and the underlying equity in net assets amounts to approximately \$923,000 and is considered equity method goodwill. Equity method investments are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment might not be recoverable. No such impairment was identified in 2015.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 2 - Summary of significant accounting policies (continued)

*Income taxes* - Income taxes are provided for the tax effects of transactions reported in the financial statements, and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of investment securities, deferred loan fees, allowance for loan losses, deferred compensation, interest on non-performing loans and accumulated depreciation for financial and income tax reporting.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered in income. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized. Management has evaluated all other tax positions that could have a significant effect on the financial statements and determined the Company had no uncertain income tax positions at December 31, 2015 and 2014. The years ending on or after December 31, 2012 remain subject to examination by federal and state tax authorities. The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

*Deferred compensation plans* - The Company maintains deferred compensation and retirement arrangements with certain officers. The Company's policy is to accrue the estimated amounts to be paid under the contracts over the expected period of active employment. The Company purchased life insurance contracts to fund the expected liabilities under the contracts.

*Earnings per common share* - Basic earnings per share (EPS) are computed by dividing income available to common shareholders by the weighted-average number of shares outstanding for the period. Diluted earnings per share reflect the potential dilution if restricted stock, or other common stock equivalents, would result in the issuance of additional shares of common stock that share in earnings. Potential common shares that may be issued by the Company relate solely to outstanding non-vested restricted stock.

*Off-balance sheet financial instruments* - In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commitments under credit card arrangements, commercial letters of credit, standby letters of credit, and financial guarantees written. Such financial instruments are generally recorded in the financial statements when they become payable. A reserve for these off-balance sheet financial instruments is considered immaterial as is the fair value of the financial guarantees.

*Use of estimates* - The preparation of financial statements 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. Actual results could differ from those estimates.

*Estimation of fair values* - The following notes summarize the major methods and assumptions used in estimating the fair value of financial instruments:

Short-term financial instruments are valued at their carrying amounts included in the Company's balance sheet, which are reasonable estimates of fair value due to the relatively short period to maturity of the instruments. This approach applies to cash and cash equivalents, deposits in other banks, federal funds sold, and short-term borrowings.

Loans are valued on the basis of estimated future receipts of principal and interest, discounted at various rates. Loan prepayments are assumed to occur at the same rate as in previous periods when interest rates were at levels similar to current levels. Future cash flows for homogeneous categories of consumer loans are estimated on a portfolio basis and discounted at current rates offered for similar loan terms to new borrowers with similar credit profiles.



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 2 - Summary of significant accounting policies (continued)

*Estimation of fair values* (concluded) – A liquidity discount is not considered in determining the fair value of the loan portfolio.

Investment securities are valued at quoted market prices, if available. The fair value of equity investments in the restricted stock of the FRB and FHLB approximates the carrying value due to the redemptive provisions of these securities.

For unquoted securities, the fair value is estimated by the Company on the basis of financial and other information.

The carrying amounts of accrued interest approximate fair value.

The fair value of demand deposits and deposits with no defined maturity is taken to be the amount payable on demand at the reporting date. The fair value of fixed-maturity deposits is estimated using discounted cash flow analyses and rates currently offered for deposits of similar remaining maturities. The intangible value of long-term relationships with depositors is not taken into account in estimating the fair values disclosed.

Fair values of capital notes are based on market prices for debt securities having similar maturity and interest rate characteristics. The impact of the Company's assessment of its own credit risk is not factored into the fair value of the notes.

The carrying amounts of federal funds purchased and borrowings under repurchase agreements approximate their fair values.

The fair values of the Company's Federal Home Loan Bank advances are estimated using discounted cash flow analyses based on current rates offered on similar debt instruments.

It is not practicable to separately estimate the fair values for off-balance-sheet credit commitments, including standby letters of credit and guarantees written, due to the lack of cost-effective, reliable measurement methods for these instruments.

*Certain significant estimates* - Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans and the valuation of other real estate owned. Management uses available information to recognize losses on loans and other real estate owned. Future additions to the allowances may be necessary based on changes in local economic conditions and other factors. Management believes the allowances recorded at December 31, 2015 and 2014 are sufficient to cover inherent losses in the portfolio.

*Recent accounting pronouncements* - In January 2014, the FASB issued ASU 2014-04, "Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure". The amendments in this update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments are effective for fiscal years beginning after December 31, 2014. The adoption of this standard did not have a material impact on the consolidated financial statements of the Company, but new disclosures were added.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 2 - Summary of significant accounting policies (continued)

*Recent accounting pronouncements (continued)* - In June 2014, the FASB issues ASU No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2015; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2016, and interim period beginning after March 15, 2015. Early adoption is not permitted. The adoption of the new guidance did not have a material impact on our consolidated financial statements, but new disclosures were added.

In August 2014, the FASB issued ASU No. 2014-14, "Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure". The amendments in this ASU apply to creditors that hold government-guaranteed mortgage loans and is intended to eliminate the diversity in practice related to the classification of these guaranteed loans upon foreclosure. The new guidance stipulates that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if (1) the loan has a government guarantee that is not separable from the loan prior to foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the other receivable should be measured on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. Entities may adopt the amendments on a prospective basis or modified retrospective basis as of the beginning of the annual period of adoption; however, the entity must apply the same method of transition as elected under ASU 2014-04. Early adoption is permitted provided the entity has already adopted ASU 2014-04. The adoption of this standard did not have a material impact on the consolidated financial statements of the Company.

In February 2015, FASB issued ASU No. 2015-02, "Consolidation: Topic 810: Amendments to the Consolidation Analysis." The amendments to this ASU changes the guidance with respect to the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The amendments include: (1) modifying the evaluation of limited partnerships and similar legal entities, (2) amending when fees paid to a decision maker should be included in the variable interest entity analysis, (3) amending the related party relationship guidance, and (4) providing a scope exception from the consolidation guidance for reporting entities with interest in certain investment funds. The ASU is effective for interim and annual reporting periods beginning after December 15, 2015, although early adoption is permitted. The adoption of this standard is not expected to have a material impact on the consolidated financial statements of the Company.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 2 - Summary of significant accounting policies (concluded)

*Recent accounting pronouncements* (concluded) - In August 2015, the ASB issued ASU No. 2015-14, "Revenue from Contracts with Customers: Topic 606". This ASU is an update to the original ASU No. 2014-09 and the deferral of the effective date. Both ASU applies to any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition", most industry-specific guidance, and some cost guidance Table of Contents 10 included in Subtopic 605-35, "Revenue Recognition-Construction-Type and Production-Type Contracts". The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To be in alignment with the core principle, an entity must apply a five step process including: identification of the contract(s) with a customer, identification of performance obligations in the contract(s), determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue when (or as) the entity satisfies a performance obligation. Additionally, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer have also been amended to be consistent with the guidance on recognition and measurement. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2017 for public business entities. Early adoption is permitted but not before the original public entity effective date, i.e. annual periods beginning after December 15, 2017. The Company is currently evaluating the impact of this standard.

In January 2016, the ASB issued ASU No. 2016-1, "Financial Instruments - Overall: Subtopic 825-10: Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU addresses certain aspects of recognition, measurement, presentation and disclosure. The amendments in this ASU (1) require equity investments to be measured at fair value with changes in fair value recognized in net income; (2) simplify the impairment assessment of equity investments without readily determinable fair value; (3) require public business entities to use exit prices, rather than entry prices, when measuring fair value of financial instruments for disclosure purposes; (4) require separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements; (5) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value for financial statements measured at amortized cost on the balance sheet; (6) require separate presentation in other comprehensive income of the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; and (7) state that a valuation allowance on deferred tax assets related to available-for-sale securities should be evaluated in combination with other deferred tax assets. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The ASU only permits early adoption of the instrument-specific credit risk provision. The Company is currently evaluating the impact of this standard.

*Reclassifications* - Certain reclassifications have been made to prior period balances to conform to the current year presentation with no impact on net income or stockholders equity as previously recorded.



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 3 - Available-for-sale securities

At December 31, 2015 and 2014, securities are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2015				
State and municipal	\$ 41,640,706	\$ 2,209,085	\$ 15,586	\$ 43,834,205
Residential mortgage-backed securities	15,946,319	27,472	88,728	15,885,063
Collateralized mortgage obligations	46,427,399	445,531	403,312	46,469,618
Small Business Administration Pools	27,087,514	1,463,204	-	28,550,718
	<u>\$ 131,101,938</u>	<u>\$ 4,145,292</u>	<u>\$ 507,626</u>	<u>\$ 134,739,604</u>
December 31, 2014				
State and municipal	\$ 34,040,522	\$ 2,010,653	\$ 4,050	\$ 36,047,125
Residential mortgage-backed securities	19,048,941	403,228	28,123	19,424,046
Collateralized mortgage obligations	46,442,057	804,844	443,032	46,803,869
Small Business Administration Pools	32,526,739	1,832,340	-	34,359,079
	<u>\$ 132,058,259</u>	<u>\$ 5,051,065</u>	<u>\$ 475,205</u>	<u>\$ 136,634,119</u>

At December 31, 2015 and 2014, gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position, are as follows:

	Approximate Market Value	Continuous Unrealized Losses Existing for:		Total Losses
		Less than 12 Months	More than 12 Months	
December 31, 2015				
Available-for-sale securities:				
State and municipal	\$ 521,665	\$ 15,586	\$ -	\$ 15,586
Residential mortgage-backed securities	14,269,851	88,728	-	88,728
Collateralized mortgage obligations	23,041,626	77,196	326,116	403,312
Total temporarily impaired investment securities	<u>\$ 37,833,142</u>	<u>\$ 181,510</u>	<u>\$ 326,116</u>	<u>\$ 507,626</u>
December 31, 2014				
Available-for-sale securities:				
State and municipal	\$ 400,388	\$ -	\$ 4,050	\$ 4,050
Residential mortgage-backed securities	7,007,611	-	28,123	28,123
Collateralized mortgage obligations	14,639,068	-	443,032	443,032
Total temporarily impaired investment securities	<u>\$ 22,047,067</u>	<u>\$ -</u>	<u>\$ 475,205</u>	<u>\$ 475,205</u>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 3 - Available-for-sale securities (concluded)

*State and municipal* - The Company's unrealized losses on state and municipal securities were caused by the interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because of the Company's intent to hold the securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell these securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

*Residential and mortgage-backed securities and collateralized mortgage obligations* - The Company's unrealized losses on residential and mortgage-backed securities and collateralized mortgage obligations were caused by the interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Because our mortgage-related securities are backed by FNMA and FHLMC, which are GSEs, or are collateralized by securities backed by these agencies, and because of the Company's intent to hold the securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell these securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

At December 31, 2015 and 2014, securities with a carrying value of approximately \$27,905,116 and \$24,085,310, respectively, are pledged to the Commonwealth of Virginia to secure public deposits. In addition, at December 31, 2015 and 2014, securities with a carrying value of \$14,632,536 and \$19,123,648, respectively, are pledged to the Federal Home Loan Bank to secure advances. Investment securities with carrying values of \$4,030,844 and \$2,869,847 are pledged to secure repurchase agreements at December 31, 2015 and 2014, respectively.

At December 31, 2015, the amortized cost and fair value of debt securities by maturity date are as follows:

	Amortized Cost	Fair Value
Due in one year or less	\$ 1,105,000	\$ 1,130,676
Due from one to five years	2,808,939	2,993,804
Due from five to ten years	15,771,717	16,779,674
Due after ten years	111,416,282	113,835,450
Total debt securities	<u>\$ 131,101,938</u>	<u>\$ 134,739,604</u>

Gross realized gains on available-for-sale securities were:

	2015	2014
State and municipal	\$ 20,870	\$ 288,847
Residential mortgage-backed securities	295,885	-
Collateralized mortgage obligations	106,066	-
Total gross realized gains	<u>\$ 422,821</u>	<u>\$ 288,847</u>

There were no gross realized losses on available-for-sale securities during 2015 or 2014.

Proceeds from the sale of available-for-sale securities totaled \$10,516,241 and \$3,757,225 for the years ended December 31, 2015 and 2014, respectively.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses

*General* - The Bank provides to its customers a full range of short- to medium-term commercial, agricultural, Small Business Administration guaranteed, mortgage, home equity, and personal loans, both secured and unsecured. The Bank also makes real estate mortgage and construction loans. At December 31, 2015 and 2014, loans held for investment consisted of the following:

	2015	2014
Mortgage loans on real estate:		
Construction	\$ 32,098,516	\$ 32,212,181
Commercial Real Estate:		
Non-owner occupied	32,488,510	33,355,157
Owner occupied	60,588,745	59,344,528
Residential 1-4 family	42,636,675	44,829,015
Multifamily	5,223,426	7,283,745
Equity lines of credit	12,388,863	12,517,764
Total mortgage loans on real estate	185,424,735	189,542,390
Commercial and industrial	40,233,731	35,342,391
Agricultural	20,859,784	20,733,384
Individuals	1,839,447	1,873,436
Total loans	248,357,697	247,491,601
Less: Allowance for loan losses	(6,343,636)	(8,181,827)
Net deferred loan fees and costs	17,736	15,536
Loans, net	<u>\$ 242,031,797</u>	<u>\$ 239,325,310</u>

*Real Estate Loans* - Real estate loans include construction and land development loans, commercial real estate loans, home equity lines of credit and residential mortgages.

Construction/development lending totaled \$32.1 million and \$32.2 million at December 31, 2015 and 2014, respectively. The Bank originates one-to-four family residential construction loans for the construction of custom homes (where the home buyer is the borrower) and provides financing to builders and consumers for the construction of pre-sold homes. The Bank generally receives a pre-arranged permanent financing commitment from an outside banking entity prior to financing the construction of pre-sold homes. The Bank also makes commercial real estate construction loans, primarily for owner-occupied properties. The Bank limits its construction lending risk through adherence to established underwriting procedures. Residential one-to-four family loans amounted to \$42.6 million and \$44.8 million at December 31, 2015 and 2014, respectively.

Commercial real estate loans totaled \$93.1 million and \$92.7 million at December 31, 2015 and 2014, respectively. This lending has involved loans secured by owner-occupied commercial buildings for office, storage and warehouse space, as well as non-owner occupied commercial buildings. The Bank generally requires the personal guaranty of borrowers and a demonstrated cash flow capability sufficient to service the debt. Loans secured by commercial real estate may be larger in size and may involve a greater degree of risk than one-to-four family residential mortgage loans. Payments on such loans are often dependent on successful operation or management of the properties.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 – Loans and Allowance for Loan Losses (continued)

*Commercial and Industrial Loans* - At December 31, 2015 and 2014, the Bank's commercial loan portfolio totaled \$40.2 million and \$35.3 million, respectively. Commercial loans include both secured and unsecured loans for working capital, expansion, and other business purposes. Short-term working capital loans are secured by accounts receivable, inventory and/or equipment. The Bank also makes term commercial loans secured by equipment and real estate. Lending decisions are based on an evaluation of the financial strength, cash flow, management and credit history of the borrower, and the quality of the collateral securing the loan. With few exceptions, the Bank requires personal guarantees and secondary sources of repayment. Commercial loans generally provide greater yields and re-price more frequently than other types of loans, such as real estate loans.

*Agricultural Loans* - Agricultural loans totaled \$20.9 million and \$20.7 million at December 31, 2015 and 2014, respectively and include loans secured by farm equipment, inventory and farm land. Lending decisions are based on an evaluation of the financial strength, cash flow, management and credit history of the borrower, and the quality of the collateral securing the loan. Payments on such loans are often dependent on successful operation or management of the farming operation.

*Loans to Individuals* - Loans to individuals (consumer loans) include automobile loans, boat and recreational vehicle financing, and miscellaneous secured and unsecured personal loans and totaled \$1.8 million and \$1.9 million at December 31, 2015 and 2014, respectively. Consumer loans generally can carry significantly greater risks than other loans, even if secured, if the collateral consists of rapidly depreciating assets such as automobiles and equipment. Repossessed collateral securing a defaulted consumer loan may not provide an adequate source of repayment of the loan. Consumer loan collections are sensitive to job loss, illness and other personal factors. The Bank manages the risks inherent in consumer lending by following established credit guidelines and underwriting practices designed to minimize risk of loss.

*Loan Approvals* - The Bank's loan policies and procedures establish the basic guidelines governing its lending operations. The guidelines address the type of loans that the Bank seeks, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower's total outstanding indebtedness to the Bank, including any indebtedness as a guarantor. The policies are reviewed and approved at least annually by the Board of Directors of the Bank. The Bank supplements its own supervision of the loan underwriting and approval process with periodic loan reviews by independent, outside professionals experienced in loan review. Responsibility for loan review and loan underwriting resides with the Chief Credit Officer position. This position is responsible for loan underwriting and approval. On an annual basis, the Board of Directors of the Bank determines officers lending authority. Authorities may include loans, letters of credit, overdrafts, uncollected funds and such other authorities as determined by the Board of Directors.

Substantially all of the Bank's loans have been granted to customers in the Hampton Roads area of Virginia.

*Credit Review and Evaluation* - The Bank outsources the credit risk review function which reports to the Board of Directors. The focus of the engagement is on policy compliance and proper grading of higher credit risk loans as well as new and existing loans on a sample basis. Additional reporting for problem/criticized assets has been developed along with an after-the-fact loan review.

The Bank uses a risk grading program to facilitate the evaluation of probable inherent loan losses and the adequacy of the allowance for loan losses. In this program, risk grades are initially assigned by loan officers, reviewed by the Chief Credit Officer and reviewed by credit review analysts on a test basis. The Bank strives to maintain the loan portfolio in accordance with conservative loan underwriting policies that result in loans specifically tailored to the needs of the Bank's market area. Every effort is made to identify and minimize the credit risks associated with such lending strategies.



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

*Credit Review and Evaluation* (concluded) - All loans are risk graded on a scale from 1 (highest quality) to 9 (loss). Acceptable loans at inception are grades 1 through 5. These grades have underwriting requirements that at least meet the minimum requirements of a secondary market source. If borrowers do not meet credit history requirements, other mitigating criteria such as substantial liquidity and low loan-to-value ratios could be considered and would generally have to be met in order to make the loan. The Bank's loan policy states that a guarantor may be necessary if reasonable doubt exists as to the borrower's ability to repay.

The Board of Directors has authorized the loan officers to have individual approval authority for risk grade 1 through 5 loans up to maximum exposure limits for each customer. New or renewed loans that are graded 6 (special mention) or lower must have approval from the Chief Credit Officer and Chief Lending Officer. Any changes in risk assessments as determined by loan officers, credit administrators, regulatory examiners and management are also considered.

The risk grades, normally assigned by the loan officers when the loan is originated and reviewed by the Chief Credit Officer, are based on several factors including historical data, current economic factors, composition of the portfolio, and evaluations of the total loan portfolio and assessments of credit quality within specific loan types. In some cases the risk grades are assigned by the Chief Credit Officer or the Chief Lending Officer, depending upon dollar exposure. Because these factors are dynamic, the provision for loan losses can fluctuate. Credit quality reviews are based primarily on analyses of borrowers' cash flows, with asset values considered only as a second source of payment. Credit analysts work with lenders in underwriting, structuring and risk grading the Bank's credits. The Chief Lending Officer and the Chief Credit Officer focus on lending policy compliance, credit risk grading, and credit risk reviews on larger dollar exposures. Management uses the information developed from the procedures above in evaluating and grading the loan portfolio. This continual grading process is used to monitor the credit quality of the loan portfolio and to assist management in determining the appropriate levels of the allowance for loan losses. The following is a summary of the credit risk grade definitions for all loan types:

"1" – Prime - Credits in this category are virtually risk-free and are well-collateralized by cash or cash-equivalent instruments held by the Bank. The repayment program is well-defined and achievable, and repayment sources are numerous. No material documentation deficiencies or exceptions exist.

"2" – Good - This grade is reserved for loans secured by readily marketable collateral, or loans within guidelines to borrowers with liquid financial statements. A liquid financial statement is generally a financial statement with substantial liquid assets, particularly relative to the debts. These loans have excellent sources of repayment, with no significant identifiable risk of collection, and conform in all respects to Bank policy, guidelines, underwriting standards, and Federal and State regulations (no exceptions of any kind).

"3" – Acceptable 1 - This grade is reserved for the Bank's top quality loans. These loans have excellent sources of repayment, with no significant identifiable risk of collection. Generally, loans assigned this risk grade will demonstrate the following characteristics:

- Conformity in all respects with Bank policy, guidelines, underwriting standards, and Federal and State regulations (no exceptions of any kind).
- Documented historical cash flow that meets or exceeds required minimum Bank guidelines, or that can be supplemented with verifiable cash flow from other sources.
- Adequate secondary sources to liquidate the debt, including combinations of liquidity, liquidation of collateral, or liquidation value to the net worth of the borrower or guarantor.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

“4” – Acceptable 2 – This grade is given to acceptable loans. These loans have adequate sources of repayment, with little identifiable risk of collection. Loans assigned this risk grade will demonstrate the following characteristics:

- General conformity to the Bank's underwriting requirements, with limited exceptions to the Bank's policy, product or underwriting guidelines. All exceptions noted have documented mitigating factors that offset any additional risk associated with the exceptions noted.
- Documented historical cash flow that meets or exceeds required minimum Bank guidelines, or that can be supplemented with verifiable cash flow from other sources.
- Adequate secondary sources to liquidate the debt, including combinations of liquidity, liquidation of collateral, or liquidation value to the net worth of the borrower or guarantor.

“5” – Weak Pass – This grade is given to acceptable loans that show signs of weakness in either adequate sources of repayment or collateral, but have demonstrated mitigating factors that minimize the risk of delinquency or loss. Loans assigned this grade may demonstrate some or all of the following characteristics:

- Additional exceptions to the Bank's policy requirements, product guidelines or underwriting standards that present a higher degree of risk to the Bank. Although the combination and/or severity of identified exceptions is greater for this risk grade, the exceptions may be properly mitigated by other documented factors that offset any additional risks.
- Unproved, insufficient or marginal primary sources of repayment that appear sufficient to service the debt at this time. Repayment weaknesses may be due to minor operational issues, financial trends, or reliance on projected (not historic) performance.
- Marginal or unproven secondary sources to liquidate the debt, including combinations of liquidation of collateral and liquidation value to the net worth of the borrower or guarantor.

“6” – Special Mention – Special Mention loans include the following characteristics:

- Loans with underwriting guideline tolerances and/or exceptions and with no mitigating factors;
- Extending loans that are currently performing satisfactorily but with potential weaknesses that may, if not corrected, weaken the asset or inadequately protect the Bank's position at some future date. Potential weaknesses are the result of deviations from prudent lending practices; or
- Loans where adverse economic conditions have developed subsequent to the loan origination that do not jeopardize liquidation of the debt, but do substantially increase the level of risk, may also warrant this rating.

“7” – Substandard – A substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt; they are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Loans consistently not meeting the repayment schedule should be downgraded to substandard. Loans in this category are characterized by deterioration in quality exhibited by any number of well-defined weaknesses requiring corrective action. The weaknesses may include, but are not limited to:

- High debt to worth ratios
- Declining or negative earnings trends
- Declining or inadequate liquidity
- Questionable repayment sources
- Lack of well-defined secondary repayment source, and
- Unfavorable competitive comparisons.

Such loans are no longer considered to be adequately protected due to the borrower's declining net worth, lack of earnings capacity, declining collateral margins and/or unperfected collateral positions. A possibility of loss of a portion of the loan balance cannot be ruled out. The repayment ability of the borrower is marginal or weak and the loan may have exhibited excessive overdue status or extensions and/or renewals.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

“8” – Doubtful - Loans classified Doubtful have all the weaknesses inherent in loans classified Substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. However, these loans are not yet rated as loss because certain events may occur which would salvage the debt. Among these events are:

- Injection of capital
- Alternative financing
- Liquidation of assets or the pledging of additional collateral.

The ability of the borrower to service the debt is extremely weak, overdue status is constant, the debt has been placed on non-accrual status, and no definite repayment schedule exists. Doubtful is a temporary grade where a loss is expected but is presently not quantified with any degree of accuracy. Once the loss position is determined, the amount is charged off.

“9” – Loss - Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off the loan even though partial recovery may be effected in the future. Probable Loss portions of problem assets should be charged against the Reserve for Loan Losses. Loans may reside in this classification for administrative purposes for a period not to exceed the earlier of thirty (30) days or calendar quarter-end.

The following is a summary of credit quality indicators by class at December 31, 2015 and 2014:

#### Real Estate Credit Exposure as of December 31, 2015

	Construction	Commercial Real Estate		Residential 1-4 Family	Multifamily	Equity lines of credit
		Non-owner occupied	Owner occupied			
		(in thousands)				
Prime	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Good	-	106	59	56	-	117
Acceptable 1	2,924	5,291	9,445	9,231	51	6,630
Acceptable 2	14,118	10,899	25,870	18,479	5,132	4,258
Weak Pass	13,210	10,986	19,355	9,917	40	1,014
Special Mention	1,548	5,123	705	3,380	-	148
Substandard	298	84	4,941	1,574	-	222
Doubtful	-	-	214	-	-	-
Loss	-	-	-	-	-	-
	<u>\$ 32,098</u>	<u>\$ 32,489</u>	<u>\$ 60,589</u>	<u>\$ 42,637</u>	<u>\$ 5,223</u>	<u>\$ 12,389</u>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

#### Other Credit Exposures as of December 31, 2015

	Commerical and industrial	Agricultural	Individuals	Total
	(in thousands)			
Prime	\$ -	\$ -	\$ -	\$ -
Good	-	-	-	337
Acceptable 1	2,145	4,368	676	40,761
Acceptable 2	23,293	12,376	497	114,922
Weak Pass	12,840	3,125	294	70,781
Special Mention	254	991	372	12,522
Substandard	1,702	-	-	8,821
Doubtful	-	-	-	214
Loss	-	-	-	-
	<u>\$ 40,234</u>	<u>\$ 20,860</u>	<u>\$ 1,839</u>	<u>\$ 248,358</u>

#### Real Estate Credit Exposure as of December 31, 2014

	Commercial Real Estate			Residential 1-4 Family	Multifamily	Equity lines of credit
	Construction	Non-owner occupied	Owner occupied			
	(in thousands)					
Prime	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Good	-	205	111	80	-	237
Acceptable 1	5,015	4,931	9,958	12,034	69	7,289
Acceptable 2	10,387	12,496	21,740	16,979	5,242	3,780
Weak Pass	13,224	11,128	16,581	10,681	1,164	975
Special Mention	2,945	4,511	3,060	2,681	-	-
Substandard	641	84	7,061	2,374	809	237
Doubtful	-	-	834	-	-	-
Loss	-	-	-	-	-	-
	<u>\$ 32,212</u>	<u>\$ 33,355</u>	<u>\$ 59,345</u>	<u>\$ 44,829</u>	<u>\$ 7,284</u>	<u>\$ 12,518</u>



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

#### Other Credit Exposures as of December 31, 2014

	Commerical and industrial	Agricultural	Individuals	Total
	(in thousands)			
Prime	\$ -	\$ -	\$ -	\$ -
Good	-	-	-	633
Acceptable 1	2,161	3,907	599	45,963
Acceptable 2	20,179	11,281	654	102,738
Weak Pass	11,155	4,127	232	69,267
Special Mention	1,179	873	388	15,637
Substandard	668	546	-	12,420
Doubtful	-	-	-	834
Loss	-	-	-	-
	<u>\$ 35,342</u>	<u>\$ 20,734</u>	<u>\$ 1,873</u>	<u>\$ 247,492</u>

*Nonaccrual loans and past due loans* - Nonperforming assets include loans classified as nonaccrual, foreclosed bank-owned property and loans past due 90 days or more on which interest is still being accrued. There were no financing receivables past due over 90 days accruing interest as of December 31, 2015 or 2014. Nonaccrual loans as of December 31, 2015 totaled \$1.4 million, or 0.55% of total loans, compared with \$5.9 million, or 2.39% of total loans, as of December 31, 2014. The Bank aggressively pursues the collection and repayment of all loans. Other nonperforming assets, such as repossessed and foreclosed collateral are aggressively liquidated by the Bank's management. The total number of loans on nonaccrual status as of December 31, 2015 and 2014 was 12 and 24, respectively.

For the years ended December 31, 2015 and 2014, the Bank recognized \$0- and \$9,621 in interest income on nonaccrual loans. If interest on those loans had been accrued in accordance with the original terms, interest income would have increased by approximately \$114,677 and \$175,472 for the years ended December 31, 2015 and 2014, respectively.

The following is a breakdown of nonaccrual loans as of December 31, 2015 and 2014:

	2015	2014
Mortgage loans on real estate:		
Construction	\$ 297,846	\$ 323,067
Commercial real estate:		
Non-owner occupied	-	-
Owner occupied	311,615	2,588,564
Residential 1-4 family	733,616	1,606,145
Multifamily	-	808,547
Equity lines of credit	24,813	43,609
Commerical and industrial	-	-
Agricultural	-	546,046
Individuals	-	-
Total	<u>\$ 1,367,890</u>	<u>\$ 5,915,978</u>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

*Nonaccrual loans and past due loans* (concluded) - All classes of loans are considered past due if the required principal and interest income have not been received as of the date such payments were due. The following tables present the Bank's aged analysis of past due loans as of December 31, 2015 and 2014:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Greater Than 90 Days Still Accruing	Total Past Due	Current	Total Loans
(in thousands)							
<b>December 31, 2015</b>							
Mortgage loans on real estate:							
Construction	\$ 19	\$ -	\$ 298	\$ -	\$ 317	\$ 31,781	\$ 32,098
Commercial real estate:							
Non-owner occupied	-	-	-	-	-	32,489	32,489
Owner occupied	-	-	312	-	312	60,277	60,589
Residential 1-4 family	126	108	601	-	835	41,802	42,637
Multifamily	-	-	-	-	-	5,223	5,223
Equity lines of credit	51	-	-	-	51	12,338	12,389
Commercial and industrial	9	-	-	-	9	40,225	40,234
Agricultural	-	-	-	-	-	20,860	20,860
Individuals	-	-	-	-	-	1,839	1,839
<b>Total</b>	<b>\$ 205</b>	<b>\$ 108</b>	<b>\$ 1,211</b>	<b>\$ -</b>	<b>\$ 1,524</b>	<b>\$ 246,834</b>	<b>\$ 248,358</b>

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Greater Than 90 Days Still Accruing	Total Past Due	Current	Total Loans
(in thousands)							
<b>December 31, 2014</b>							
Mortgage loans on real estate:							
Construction	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 32,212	\$ 32,212
Commercial real estate:							
Non-owner occupied	-	-	-	-	-	33,355	33,355
Owner occupied	-	-	834	-	834	58,511	59,345
Residential 1-4 family	208	483	-	-	691	44,138	44,829
Multifamily	-	-	408	-	408	6,876	7,284
Equity lines of credit	-	-	17	-	17	12,501	12,518
Commercial and industrial	-	-	-	-	-	35,342	35,342
Agricultural	-	-	546	-	546	20,188	20,734
Individuals	-	-	-	-	-	1,873	1,873
<b>Total</b>	<b>\$ 208</b>	<b>\$ 483</b>	<b>\$ 1,805</b>	<b>\$ -</b>	<b>\$ 2,496</b>	<b>\$ 244,996</b>	<b>\$ 247,492</b>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

*Troubled Debt Restructurings* - In order to maximize the collection of loan balances, the Bank evaluates troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. Loan modifications may be utilized where there is a reasonable chance that an appropriate modification would allow the Bank's customers to continue servicing debt. A loan is a troubled debt restructuring ("TDR") if both of the following exist: 1) a creditor has granted a concession to the debtor, and, 2) the debtor is experiencing financial difficulties. Non-accruing loans that are modified can be placed back on accrual status when both principal and interest are current and it is probable that the Bank will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement and a sustained period of payment performance is demonstrated. Interest on troubled debt restructured loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur and a sustained payment performance period is obtained. For the years ended December 31, 2015 and 2014, the following table presents a breakdown of the types of concession made by loan class:

	Year ended December 31, 2015			Year ended December 31, 2014		
	Pre-Modification Outstanding Number of loans	Pre-Modification Recorded Investment	Post- Modification Outstanding Recorded Investment	Pre-Modification Outstanding Number of loans	Pre-Modification Recorded Investment	Post- Modification Outstanding Recorded Investment
Extended payment terms						
Mortgage loans on real estate:						
Construction	-	\$ -	\$ -	-	\$ -	\$ -
Commercial real estate:						
Non-owner occupied	-	-	-	1	47,144	47,394
Owner occupied	2	2,499,716	2,499,716	2	880,858	884,915
Residential 1-4 family	-	-	-	1	435,000	433,621
Multifamily	-	-	-	-	-	-
Equity lines of credit	-	-	-	-	-	-
Commercial and industrial	-	-	-	-	-	-
Agricultural	-	-	-	-	-	-
Individuals	-	-	-	-	-	-
Total	2	\$ 2,499,716	\$ 2,499,716	4	\$ 1,363,002	\$ 1,365,930

The restructured loans generally include terms to reduce the interest rate and extend payment terms. The Bank did not forgive any principal associated with any of the above loans during 2015 or 2014. Within the last 12 months, no loans that were restructured in 2014, subsequently defaulted and were foreclosed upon. Two loans that were restructured within the last 12 months during 2013 with a total principal balance of \$2.1million at December 31, 2013 subsequently defaulted and were foreclosed upon during 2014. These modifications resulted in specific reserves in the Bank's allowance for loan losses of \$592,950 and \$0- as of December 31, 2015 and 2014, respectively.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

*Troubled Debt Restructurings (concluded)* - There was one TDR that was on non-accrual status and had a total current principal balance of \$297,846 as of December 31, 2015. There were two TDRs that are on non-accrual status and have a total current principal balance of \$871,859 as of December 31, 2014. Eighteen TDRs with a current principal balance of \$10.5 million and nineteen TDRs with current principal balance of \$9.7 million were considered performing loans and are accruing interest based on their sustained payment performance as of December 31, 2015 and 2014, respectively.

The specific reserve portion of the allowance for loan losses on TDRs is determined by discounting the restructured cash flows at the original effective rate of the loan before modification or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Bank either establishes a valuation allowance as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio.

*Other real estate owned* - At December 31, 2015 and 2014 the Company held \$-0- and \$486,000, respectively of foreclosed residential real estate. The recorded investment in one-to-four family residential loans secured by residential real estate properties where formal foreclosure procedures were in process as of December 31, 2015 and 2014 was \$279,832 and \$-0-, respectively.

*Impaired Loans* - Management considers certain loans graded “doubtful” (loans graded 8) or “loss” (loans graded 9) to be individually impaired and may consider “substandard” loans (loans graded 7) individually impaired depending on the borrower’s payment history. Any loans classified as troubled debt restructurings regardless of loan grade are also classified as impaired loans. The Bank measures impairment based upon discounted expected cash flows or the value of the collateral. Collateral value is assessed based on collateral value trends, liquidation value trends, and other liquidation expenses to determine logical and credible discounts that may be needed. Updated appraisals are required for all impaired loans and typically at renewal or modification of larger loans if the appraisal is more than 12 months old.

Impaired loans for all classes of loans typically include nonaccrual loans, loans over 90 days past due still accruing, troubled debt restructured loans and other problem loans considered impaired based on other underlying factors. Potential problem loans totaled \$12.5 million and \$15.6 million as of December 31, 2015 and 2014, respectively. These totals include loans which are currently performing and are not included in nonaccrual or restructured loans above, but about which we have serious doubts as to the borrower’s ability to comply with present repayment terms. These loans are likely to be included later in nonaccrual, past due or troubled debt restructured loans, so they are considered by management in assessing the adequacy of the allowance for loan losses. No additional funds are committed to be advanced in connection with impaired loans.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

The following tables present the Bank's investment in loans considered to be impaired and related information on those impaired loans as of December 31, 2015 and 2014:

	Recorded Investment	Unpaid Principal Balance	Related Allowance (in thousands)	Year to Date	
				Average Recorded Investment	Interest Income Recognized
<b>December 31, 2015</b>					
<b>Impaired loans without a related allowance for loan losses</b>					
Mortgage loans on real estate:					
Construction	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate:					
Non-owner occupied	129	129	-	130	8
Owner occupied	1,745	2,032	-	2,100	77
Residential 1-4 family	417	749	-	764	2
Multifamily	-	-	-	-	-
Equity lines of credit	-	-	-	-	-
Commercial and industrial	-	-	-	-	-
Agricultural	-	-	-	-	-
Individuals	-	-	-	-	-
<b>Impaired loans with a related allowance for loan losses</b>					
Mortgage loans on real estate:					
Construction	1,503	1,503	108	1,535	75
Commercial real estate:					
Non-owner occupied	1,304	1,304	57	1,326	71
Owner occupied	5,302	5,302	637	5,338	254
Residential 1-4 family	1,323	1,323	322	1,341	68
Multifamily	-	-	-	-	-
Equity lines of credit	25	25	25	26	-
Commercial and industrial	250	250	2	250	10
Agricultural	-	-	-	-	-
Individuals	-	-	-	-	-
<b>Total impaired loans</b>					
Mortgage loans on real estate:					
Construction	\$ 1,503	\$ 1,503	\$ 108	\$ 1,535	\$ 75
Commercial real estate:					
Non-owner occupied	1,433	1,433	57	1,456	79
Owner occupied	7,047	7,334	637	7,438	331
Residential 1-4 family	1,740	2,072	322	2,105	70
Multifamily	-	-	-	-	-
Equity lines of credit	25	25	25	26	-
Commercial and industrial	250	250	2	250	10
Agricultural	-	-	-	-	-
Individuals	-	-	-	-	-
<b>Total impaired loans</b>	<b>\$ 11,998</b>	<b>\$ 12,617</b>	<b>\$ 1,151</b>	<b>\$ 12,810</b>	<b>\$ 565</b>



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

	Recorded Investment	Unpaid Principal Balance	Related Allowance (in thousands)	Year to Date	
				Average Recorded Investment	Interest Income Recognized
<b>December 31, 2014</b>					
<b>Impaired loans without a related allowance for loan losses</b>					
Mortgage loans on real estate:					
Construction	\$ 318	\$ 318	\$ -	\$ 323	\$ 20
Commercial real estate:					
Non-owner occupied	131	131	-	187	13
Owner occupied	3,224	3,224	-	3,256	178
Residential 1-4 family	540	540	-	250	13
Multifamily	73	73	-	73	-
Equity lines of credit	17	17	-	21	-
Commercial and industrial	-	-	-	-	-
Agricultural	-	-	-	-	-
Individuals	-	-	-	-	-
<b>Impaired loans with a related allowance for loan losses</b>					
Mortgage loans on real estate:					
Construction	1,342	1,342	31	1,373	67
Commercial real estate:					
Non-owner occupied	1,349	1,349	28	1,369	74
Owner occupied	4,863	4,863	1,493	4,981	212
Residential 1-4 family	2,181	2,181	959	2,229	95
Multifamily	736	963	283	986	22
Equity lines of credit	27	27	27	28	1
Commercial and industrial	250	250	9	208	8
Agricultural	546	546	236	583	25
Individuals	-	-	-	-	-
<b>Total impaired loans</b>					
Mortgage loans on real estate:					
Construction	\$ 1,660	\$ 1,660	\$ 31	\$ 1,696	\$ 87
Commercial real estate:					
Non-owner occupied	1,480	1,480	28	1,556	87
Owner occupied	8,087	8,087	1,493	8,237	390
Residential 1-4 family	2,721	2,721	959	2,479	108
Multifamily	809	1,036	283	1,059	22
Equity lines of credit	44	44	27	49	1
Commercial and industrial	250	250	9	208	8
Agricultural	546	546	236	583	25
Individuals	-	-	-	-	-
<b>Total impaired loans</b>	<b>\$ 15,597</b>	<b>\$ 15,824</b>	<b>\$ 3,066</b>	<b>\$ 15,867</b>	<b>\$ 728</b>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

*Allowance for Loan Losses* - The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate for probable losses that have been incurred within the existing portfolio of loans. The primary risks inherent in the Bank's loan portfolio, including the adequacy of the allowance or reserve for loan losses, are based on management's assumptions regarding, among other factors, general and local economic conditions, which are difficult to predict and are beyond the Bank's control. In estimating these risks, and the related loss reserve levels, management also considers the financial conditions of specific borrowers and credit concentrations with specific borrowers, groups of borrowers, and industries.

The allowance for loan losses is adjusted by direct charges to provision expense. Losses on loans are charged against the allowance for loan losses in the accounting period in which they are determined by management to be uncollectible. Recoveries during the period are credited to the allowance for loan losses. The Bank realized no provisions and negative provisions of \$850,000 for the years ended December 31, 2015 and 2014, respectively. During 2014 the Bank received several large recoveries, which were credited to the allowance. The recoveries and the continued improvement in our credit related trends were the main contributors to the negative provisions in 2014. The provision expense is determined by the Bank's allowance for loan losses model. The components of the model are specific reserves for impaired loans and a general allocation for unimpaired loans. The general allocation has three components, an estimate based on historical loss experience, an additional estimate based on internal and external environmental factors due to the uncertainty of historical loss experience in predicting current embedded losses in the portfolio that will be realized in the future and an unallocated portion to cover uncertainties that could affect management's estimate of probable losses.

In determining the general allowance allocation, the ratios from the actual loss history for the various categories are applied to the homogeneous pools of loans in each category.

The portion of the general allocation on environmental factors includes estimates of losses related to the following:

- Current national and local economic conditions
- Composition of the nature and volume of the portfolio
- Changes in the trend or volume of past due, watch list and classified loans
- The existence and effect of concentrations or changes in concentrations upon the portfolio
- The existence and effect of granularity in the size of credits in the portfolio
- The existence and effect of loan to values in excess of regulatory guidance - percentage of loans in each category with regulatory exceptions
- Cumulative effect of other factors such as loan portfolio quality, underwriting strength and general determinations about the portfolio held by executive management.

Markets served by the Bank continue to experience softening from the general economy and a stagnant real estate market. Other factors impacting the allowance at December 31, 2015 were watch list trends, unemployment rate trends, government spending expectations and underwriting and servicing assessments.

During 2010 and 2011 the Bank charged-off approximately \$2.4 million of principal of a \$3.6 million construction loan due to the deteriorating financial condition of the borrower and a current ruling on a related court case. In 2014 this court ruling was overturned. The borrower's payment as a result of the court ruling resulted in a recovery of approximately \$2.2 million which increased the Bank's allowance for loan losses and is included in recoveries on construction loans in the 2014 table below.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (continued)

*Allowance for Loan Losses* (continued) - The following table's present changes in the allowance for loan losses for the years ended December 31, 2015 and 2014:

	December 31, 2014	Charge-offs	Recoveries	Provision	December 31, 2015
	(Amounts in thousands)				
Mortgage loans on real estate:					
Construction	\$ 1,108	\$ -	\$ -	\$ (7)	\$ 1,101
Commercial real estate:					
Non-owner occupied	684	-	-	(170)	514
Owner occupied	2,620	542	-	(147)	1,931
Residential 1-4 family	1,939	1,559	379	666	1,425
Multifamily	308	189	12	(32)	99
Equity lines of credit	208	-	56	(101)	163
Commercial and industrial	713	-	8	35	756
Agricultural	575	-	-	(245)	330
Individuals	27	4	1	1	25
	<u>\$ 8,182</u>	<u>\$ 2,294</u>	<u>\$ 456</u>	<u>\$ -</u>	<u>\$ 6,344</u>

	December 31, 2013	Charge-offs	Recoveries	Provision	December 31, 2014
	(Amounts in thousands)				
Mortgage loans on real estate:					
Construction	\$ 1,598	\$ 757	\$ 2,197	\$ (1,930)	\$ 1,108
Commercial real estate:					
Non-owner occupied	893	-	449	(658)	684
Owner occupied	1,728	247	-	1,139	2,620
Residential 1-4 family	1,500	32	54	417	1,939
Multifamily	190	-	-	118	308
Equity lines of credit	292	-	17	(101)	208
Commercial and industrial	590	34	3	154	713
Agricultural	550	-	-	25	575
Individuals	40	2	3	(14)	27
	<u>\$ 7,381</u>	<u>\$ 1,072</u>	<u>\$ 2,723</u>	<u>\$ (850)</u>	<u>\$ 8,182</u>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 4 - Loans and Allowance for Loan Losses (concluded)

Allowance for Loan Losses (concluded) - The activity in the allowance for loan loss for 2015 and 2014 are summarized by loan class as follows:

As of December 31, 2015	Reserves for	Loans	Reserves for	Loans
	loans individually evaluated for impairment	individually evaluated for impairment	loans collectively evaluated for impairment	collectively evaluated for impairment
	(Amounts in thousands)			
Mortgage loans on real estate:				
Construction	\$ 108	\$ 1,503	\$ 993	\$ 30,595
Commercial real estate:				
Non owner occupied	57	1,433	457	31,056
Owner occupied	637	7,047	1,294	53,542
Residential 1-4 family	322	1,740	1,103	40,897
Multifamily	-	-	99	5,223
Equity lines of credit	25	25	138	12,364
Commercial and industrial	2	250	754	39,984
Agricultural	-	-	330	20,860
Individuals	-	-	25	1,839
	<u>\$ 1,151</u>	<u>\$ 11,998</u>	<u>\$ 5,193</u>	<u>\$ 236,360</u>

As of December 31, 2014	Reserves for	Loans	Reserves for	Loans
	loans individually evaluated for impairment	individually evaluated for impairment	loans collectively evaluated for impairment	collectively evaluated for impairment
	(Amounts in thousands)			
Mortgage loans on real estate:				
Construction	\$ 31	\$ 1,660	\$ 1,077	\$ 30,552
Commercial real estate:				
Non owner occupied	28	1,480	656	31,875
Owner occupied	1,493	8,087	1,127	51,257
Residential 1-4 family	959	2,721	980	42,108
Multifamily	283	809	25	6,475
Equity lines of credit	27	44	181	12,474
Commercial and industrial	9	250	704	35,092
Agricultural	236	546	339	20,187
Individuals	-	-	27	1,875
	<u>\$ 3,066</u>	<u>\$ 15,597</u>	<u>\$ 5,116</u>	<u>\$ 231,895</u>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 5 - Premises and equipment

At December 31, 2015 and 2014, premises and equipment consist of the following:

	2015	2014
Land	\$ 456,450	\$ 456,450
Buildings	5,877,372	5,837,763
Equipment, furniture and fixtures	2,723,595	2,643,475
Computer equipment	213,776	213,776
Software	457,799	455,235
	<u>9,728,992</u>	<u>9,606,699</u>
Less accumulated depreciation	(6,181,320)	(5,800,253)
Total premises and equipment, net	<u>\$ 3,547,672</u>	<u>\$ 3,806,446</u>

For 2015 and 2014, depreciation charged to operating expense was \$454,801 and \$487,942, respectively.

### Note 6 - Non-marketable equity securities

Non-marketable equity securities consist of the following at December 31, 2015 and 2014:

	2015	2014
Federal Home Loan Bank stock	\$ 1,446,500	\$ 1,721,200
Federal Reserve Bank stock	398,250	397,350
Community Bankers' Bank stock	61,300	61,300
Bankers Title, LLC	99,178	99,178
Manry Rawls, LLC	2,013,947	1,576,519
Senior Housing Crime Prevention Foundation stock	500,000	500,000
Total non-marketable equity securities	<u>\$ 4,519,175</u>	<u>\$ 4,355,547</u>

### Note 7 - Interest-bearing deposits

Interest-bearing deposits consist of the following:

	2015	2014
NOW accounts	\$ 31,768,251	\$ 30,262,637
Money market accounts	88,156,146	88,955,844
Savings accounts	24,655,033	22,848,756
Certificates of deposits and IRAs \$250,000 and over	12,733,288	15,900,016
Certificates of deposit and IRAs under \$250,000	82,143,721	98,756,044
Total interest-bearing deposits	<u>\$ 239,456,439</u>	<u>\$ 256,723,297</u>



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 7 - Interest-bearing deposits (concluded)

At December 31, 2015, the scheduled maturities of time deposits are as follows:

2016	\$	39,632,801
2017		15,177,675
2018		20,402,627
2019		11,082,646
2020		8,581,260
Thereafter		-
Total time deposits	\$	<u>94,877,009</u>

### Note 8 - Capital notes

During the fourth quarter of 2013, the Company closed the private placement of unregistered debt securities (the "2013 Offering") pursuant to which the Company issued approximately \$11.3 million in principal of notes (the "2013 Notes"). The 2013 Notes have not been and will not be registered under the Securities Act of 1933 and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. The 2013 Notes bear interest at the rate of 5% per year with interest payable quarterly in arrears. The 2013 Notes mature on December 31, 2018, but are subject to prepayment in whole or in part on or after December 31, 2014 at the Company's sole discretion on 30 days written notice to the holders. There are no assets pledged as collateral for the 2013 Notes.

During 2015, the Company repaid \$1.325 million of capital notes to accommodate investor's liquidity needs and to reduce our debt service obligations. \$925,000 of the capital notes were redeemed at a premium price of 102%, equating to total premium paid of \$18,500. An additional \$400,000 of capital notes were redeemed at the original investment price.

Of these capital notes, \$400,000 and \$900,000 is due to executive officers and board members of the Bank as of December 31, 2015 and 2014, respectively. Interest expense of \$25,188 and \$45,125 was paid to these related parties on the capital notes for the years ended December 31, 2015 and 2014, respectively.

### Note 9 - Securities sold under agreements to repurchase and other borrowings

The Bank utilizes securities sold under agreement to repurchase to facilitate the needs of customers. Securities sold under agreements to repurchase, are classified as secured borrowings, generally mature within one day from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The average interest rate was 0.27% and 0.25% during the years ended December 31, 2015 and 2014, respectively.

The Bank monitors collateral levels on a continuous basis and maintains records of each transaction specifically describing the applicable security and the customer's fractional interest in that security, and the Bank segregates the security from its general assets in accordance with regulations governing custodial holding of securities. The primary risk with the Bank's repurchase agreements is market risk associated with the investments securing the transactions, as the Bank may be required to provide additional collateral based on air value changes of the underlying investments. Securities pledged as collateral under repurchase agreements are maintained with the Bank's safekeeping agent. The carrying value of available for sale investment securities pledged as collateral under repurchase agreement was \$4,090,844 and \$2,869,847 at December 31, 2015 and 2014, respectively.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 9 - Securities sold under agreements to repurchase and other borrowings (continued)

The remaining contractual maturity of the securities sold under agreements to repurchase by class of collateral pledged included in short-term borrowings in the Consolidated Balance Sheets as of December 31, 2015 and December 31, 2014 is presented in the following tables.

December 31, 2015	Overnight and continuous	Up to 30 Days	30-90 Days	Greater than 90	Total
(Amounts in thousands)					
Repurchase agreements:					
Small Business Administration Pools	\$ 823	\$ -	\$ -	\$ -	\$ 823
Total borrowings	<u>\$ 823</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 823</u>
Gross amount of recognized liabilities for repurchase agreements					<u>\$ 823</u>

December 31, 2014	Overnight and continuous	Up to 30 Days	30-90 Days	Greater than 90	Total
(Amounts in thousands)					
Repurchase agreements:					
Small Business Administration Pools	\$ 1,930	\$ -	\$ -	\$ -	\$ 1,930
Total borrowings	<u>\$ 1,930</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,930</u>
Gross amount of recognized liabilities for repurchase agreements					<u>\$ 1,930</u>

The Bank has arrangements with various banks which enables the Bank to borrow up to \$30,000,000 in federal funds on an unsecured basis, at a variable rate. At December 31, 2015 and 2014, the Bank had outstanding federal funds purchased in the amount of \$-0.

The Bank also has arrangements with the Federal Home Loan Bank which enables the Bank to borrow up to twenty-five percent of total assets.

At December 31, 2015 and 2014, Federal Home Loan Bank advances were as follows:

#### December 31, 2015

Maturity date	Call Feature	Amount	Rate
January 9, 2017	-	\$ 5,000,000	0.990%
January 8, 2019	-	5,000,000	1.977%
September 3, 2019	-	5,000,000	1.999%
April 15, 2020	-	2,500,000	2.040%
July 29, 2020	-	5,000,000	1.944%
October 13, 2020	-	<u>2,500,000</u>	2.176%
Total FHLB borrowings/weighted average rate		<u>\$ 25,000,000</u>	1.800%

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 9 - Securities sold under agreements to repurchase and other borrowings (concluded)

December 31, 2014

Maturity date	Call Feature	Amount	Rate
August 31, 2015	-	\$ 5,000,000	3.080%
January 9, 2017	-	5,000,000	0.990%
May 29, 2018	One-time call	5,000,000	3.690%
January 8, 2019	-	5,000,000	1.977%
September 3, 2019	-	5,000,000	1.999%
April 15, 2020	-	2,500,000	2.040%
October 13, 2020	-	2,500,000	2.176%
Total FHLB borrowings/weighted average rate		\$ 30,000,000	2.310%

The carrying value of loans pledged as collateral to the Federal Home Loan Bank were \$32,310,989 and \$21,447,533 at December 31, 2015 and 2014, respectively.

During 2015, the Company prepaid \$5 million in FHLB advances with a weighted average rate of 3.69%. These advances were paid prior to their maturity date in order to enhance future earning by way of reduction in interest expense. These repayments resulting in a prepayment penalty on borrowings equaling \$355,592.

### Note 10 - Employee benefit plans

*Profit sharing plan* - The Company has a profit sharing plan covering substantially all employees. Contributions to the plan are determined annually by the Compensation Committee and are the lesser of 10% of the participants' base compensation or 10% of the net income of the Bank. Employee benefits expense included \$378,300 and \$337,000 for the plan for 2015 and 2014, respectively.

*Post-retirement benefits* - The Company has entered into deferred compensation arrangements with certain key personnel which call for the payment of benefits upon the retirement or death of the individuals. These arrangements are funded through life insurance policies on the individuals, with the intent that the proceeds from the life insurance policies approximate amounts payable under the deferred compensation arrangements. The liabilities associated with these deferred compensation arrangements were \$1,240,929 and \$1,104,315 as of December 31, 2015 and 2014, respectively. Salaries and employee benefits expense included \$140,614 and \$136,400 of expense related to these arrangements for 2015 and 2014, respectively.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 11 - Income taxes

The principal components of the income tax expense as of December 31, 2015 and 2014 are as follows:

	2015	2014
Federal - current tax provision	\$ 874,280	\$ 546,865
Federal - deferred (benefit)	92,841	360,364
	<u>\$ 967,121</u>	<u>\$ 907,229</u>

The differences between expected federal income taxes at statutory rates and actual income tax expense are summarized as follows:

	2015	2014
Income tax expense computed at federal statutory rate (34%)	\$ 1,612,112	\$ 1,451,160
Tax effects of:		
Tax-exempt interest	(550,810)	(473,721)
Non-taxable bank owned life insurance	(102,512)	(73,670)
Non-deductible expenses	7,594	16,170
Other	737	(12,710)
	<u>\$ 967,121</u>	<u>\$ 907,229</u>

The Bank's deferred tax assets and liabilities and their components are included in other assets and liabilities on the balance sheets. The components of these deferred tax assets and liabilities are as follows:

	2015	2014
Deferred tax assets:		
Allowance for loan losses	\$ 1,074,456	\$ 1,074,456
Deferred compensation	421,916	384,624
Interest on non-performing loans	10,257	652
Write-down of value related to other real estate owned	-	42,160
Other	11,733	172,440
Total deferred tax asset	<u>1,518,362</u>	<u>1,674,332</u>
Deferred tax liabilities:		
Unrealized gains on available-for-sale investment securities	(133,272)	(136,987)
Accumulated depreciation	(288,462)	(352,450)
Net unamortized deferred fees and expenses	(8,478)	(3,904)
Net unrealized gain on available-for-sale securities	(1,236,806)	(1,555,793)
Total deferred tax liability	<u>(1,667,018)</u>	<u>(2,049,134)</u>
Net deferred tax liability	<u>\$ (148,656)</u>	<u>\$ (374,802)</u>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 12 - Commitments and contingencies

The Company leases banking premises and various equipment for periods extending through February 2021. Total rental expense was \$179,854 and \$189,521 for 2015 and 2014, respectively.

Pursuant to the terms of non-cancelable lease agreements in effect at December 31, 2015, pertaining to bank premises and equipment, future minimum rental commitments under various operating leases are as follows:

2016	\$	124,734
2017		121,244
2018		116,354
2019		74,294
2020		68,456
Thereafter		69,423
	\$	<u>574,505</u>

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 13 - Related party transactions

In the ordinary course of business, the Bank has loan and deposit transactions with its executive officers and directors, and with companies in which the officers and directors have a significant financial interest. These transactions are at substantially the same rates as similarly situated customers. A summary of related party loan activity during 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>
Beginning balance, January 1	\$ 4,079,553	\$ 3,593,573
Originations	963,765	1,216,723
Repayments	(1,663,606)	(730,743)
Ending balance, December 31,	<u>\$ 3,379,712</u>	<u>\$ 4,079,553</u>

Commitments to extend credit to related parties amounted to \$8,685,848 and \$7,451,081 at December 31, 2015 and 2014, respectively.

Deposits from related parties held by the Bank amounted to \$5,227,190 and \$4,478,645 at December 31, 2015 and 2014, respectively.

The Bank currently has a loan outstanding to Mary Rawls, LLC with a current principal balance of \$2,260,211 and \$2,844,624 as of December 31, 2015 and 2014, respectively. This loan is at substantially the same terms as similarly situated customers.

See Note 8 for additional disclosures of related party transactions.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 14 - Credit commitments and concentrations of credit risk

Commitments to extend credit are agreements to lend funds to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer. Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized, usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year.

The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments if deemed necessary.

The amounts of loan commitments, guarantees and standby letters of credit are set out in the following table as of December 31, 2015 and 2014. Because many commitments and almost all standby letters of credit and guarantees expire without being funded in whole or in part, the contract amounts are not estimates of future cash flows. A summary of loan commitments and standby letters of credit is as follows:

	2015	2014
Loan commitments	\$ 50,152,525	\$ 49,689,725
Standby letters of credit and guarantees written	\$ 726,327	\$ 300,038

Standby letters of credit outstanding at December 31, 2015 expire during 2016 and 2020.

Loan commitments, standby letters of credit and written guarantees have off-balance sheet credit risk because only origination fees and accruals for probable losses, if any, are recognized in the statements of financial position until the commitments are fulfilled or the standby letters of credit or guarantees expire. Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. The credit risk amounts are equal to the contractual amounts, assuming that the amounts are fully advanced and collateral or other security is of no value. The Bank's policy is to require customers to provide collateral prior to the disbursement of approved loans. For retail loans, the Bank usually retains a security interest in the property or products financed, which provides repossession rights in the event of default by the customer. For business loans and financial guarantees, collateral is usually in the form of inventory or marketable securities (held in trust) or property (notations on title).

Concentrations of credit risk (whether on or off-balance sheet) arising from financial instruments exist in relation to certain groups of customers. A group concentration arises when a number of counterparties have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. A group concentration exists as most of the Bank's customers are located within southeastern Virginia.

The credit risk amounts represent the maximum accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted and any collateral or security proved to be of no value. The Bank has experienced little difficulty in accessing collateral when required.



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 15 - Regulatory matters

The Bank is 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 Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors.

In July 2013, the FDIC and other federal banking agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (commonly known as Basel III). On January 1, 2015, the Company became subject to the Basel III Capital Rules which revises definitions of regulatory capital, the new minimum regulatory capital ratios, and various regulatory capital adjustments and deductions according to transition provision and timelines. The revised rules now require the bank to maintain (i) a minimum ratio of Common Tier 1 capital to risk-weighted assets of at least 4.5%, plus 2.5% "capital conservation buffer" (conservation buffer will be phased in), (ii) minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, (iii) a minimum ratio of total capital to risk-weighted assets of at 8.0%, and (iv) a minimum leverage ratio of 4.0%. A transition period for the capital conservation buffer under Basel III for all banking organizations will begin on January 1, 2016 and end January 1, 2019. The conservation buffer will begin at the 0.625% level and be phased in over a four-year period (increasing on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

Management believes, as of December 31, 2015, the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2015, the most recent notification from the Board of Governors of the Federal Reserve Board categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, Common Equity risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 15 - Regulatory matters (concluded)

The Bank's actual capital amounts (dollars in thousands) and ratios are presented in the table below:

	Actual		For Capital Adequacy Purposes		Under Prompt Corrective Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2015:	<i>(Dollars in thousands)</i>					
Total Capital						
(to Risk-Weighted Assets)	\$ 50,194	18.5%	\$ 21,709	8.0%	\$ 21,137	10.0%
Tier I Risk-Based Capital						
(to Risk-Weighted Assets)	46,766	17.2%	16,282	6.0%	21,709	8.0%
Common Equity Risk-Based Capital						
(to Risk-Weighted Assets)	46,766	17.2%	12,211	4.5%	17,639	6.5%
Tier I Leverage Ratio						
(to Average Assets)	46,766	11.5%	16,226	4.0%	20,283	5.0%
As of December 31, 2014:						
Total Capital						
(to Risk-Weighted Assets)	\$ 48,402	17.9%	\$ 21,602	8.0%	\$ 27,002	10.0%
Tier I Capital						
(to Risk-Weighted Assets)	45,017	16.7%	10,801	4.0%	16,201	6.0%
Tier I Capital						
(to Average Assets)	45,017	10.8%	16,623	4.0%	20,779	5.0%

The above tables set forth the capital position and analysis for the Bank only. Because total assets on a consolidated basis are less than \$500 million, the Company is not subject to the consolidated capital requirements imposed by the Bank Holding Company Act. Consequently, the Company does not calculate its financial ratios on a consolidated basis. If calculated, the capital ratios for the Company on a consolidated basis would no longer be comparable to the capital ratios of the Bank because the proceeds of the capital notes do not qualify as equity capital on a consolidated basis.

### Note 16 - Fair value measurements

The Company refers to the *Fair Value Measurements and Disclosures* Topic of the FASB Accounting Standards Codification (ASC 820) to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. This guidance clarifies that fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

The fair market value measurement specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions.

The three levels of the fair value hierarchy are based on these two types of inputs are as follows:

Level 1 - Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 - Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 - Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

## Farmers Bankshares, Inc.

### Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

#### Note 16 - Fair value measurements (continued)

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the consolidated financial statements:

*Securities available for sale* - Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that considers observable market data (Level 2).

The following table presents the balances of available-for-sale securities measured at fair value on a recurring basis as of December 31, 2015 and 2014:

Description	Balance as of December 31, 2015	Level 1	Level 2	Level 3
State and municipal	\$ 43,834,205	\$ -	\$ 43,834,205	\$ -
Residential mortgage-backed securities	15,885,063	-	15,885,063	-
Collateralized mortgage obligations	46,469,618	-	46,469,618	-
Small Business Administration Pools	28,550,718	-	28,550,718	-
	<u>\$ 134,739,604</u>	<u>\$ -</u>	<u>\$ 134,739,604</u>	<u>\$ -</u>

Description	Balance as of December 31, 2014	Level 1	Level 2	Level 3
State and municipal	\$ 36,047,125	\$ -	\$ 36,047,125	\$ -
Residential mortgage-backed securities	19,424,046	-	19,424,046	-
Collateralized mortgage obligations	46,803,869	-	46,803,869	-
Small Business Administration Pools	34,359,079	-	34,359,079	-
	<u>\$ 136,634,119</u>	<u>\$ -</u>	<u>\$ 136,634,119</u>	<u>\$ -</u>

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain financial assets recorded at fair value on a nonrecurring basis in the consolidated financial statements:

*Impaired Loans* - Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on the observable market price of the loan, the fair value of the collateral or by using the discounted cash flow method. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 16 - Fair value measurements (continued)

*Impaired Loans (concluded)* - The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company. The Company records impaired loans secured by real estate as Level 3 assets. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports are recorded as Level 3 assets. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Statements of Operations.

*Other real estate owned* - Other real estate owned is considered held for sale and is adjusted to fair value less estimated selling costs upon transfer of the loan to foreclosed assets. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. The Company considers the other real estate owned as nonrecurring Level 3.

The following table summarizes the Company's financial assets that were measured at fair value on a nonrecurring basis during the periods.

Description	Balance as of			
	December 31, 2015	Level 1	Level 2	Level 3
Assets				
Other real estate owned	\$ -	\$ -	\$ -	\$ -
Impaired loans	8,556,119	-	-	8,556,119
Total assets	<u>\$ 8,556,119</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,556,119</u>

Description	Balance as of			
	December 31, 2014	Level 1	Level 2	Level 3
Assets				
Other real estate owned	\$ 486,000	\$ -	\$ -	\$ 486,000
Impaired loans	8,227,915	-	-	8,227,915
Total assets	<u>\$ 8,713,915</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,713,915</u>

The following table summarized quantitative information about Level 3 fair value measurements:

Description	Fair Value at December 31, 2015	Valuation Technique	Unobservable Input	Range
				(Weighted Average)
Impaired loans	\$ 8,556,119	Discounted appraisals	Collateral discounts	10-30%
		Discounted cash flows	Discount rate	6%

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 16 - Fair value measurements (concluded)

Description	Fair Value at December 31, 2014	Valuation Technique	Unobservable Input	Range (Weighted Average)
<b>Assets</b>				
Other real estate owned	\$ 486,000	Discounted appraisals	Collateral discounts	10-20%
Impaired loans	8,227,915	Discounted appraisals	Collateral discounts	10-30%
		Discounted cash flows	Discount rate	6%
<b>Total assets</b>	<b>\$ 8,713,915</b>			

The following table presents the carrying amounts and fair value of the Company's financial instruments as of December 31, 2015 and 2014. FASB Accounting Standards Codification's *Financial Instruments* (ASC 825), defines the fair value of financial instruments as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The carrying amounts in the table are included in the balance sheets under the indicated captions.

	2015		2014	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
<i>(Dollars in thousands)</i>				
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 16,285	\$ 16,285	\$ 27,579	\$ 27,579
Investment securities, available-for-sale	134,740	134,740	136,634	136,634
Loans held for sale	911	911	986	986
Loans held for investment, net	242,032	242,453	239,325	238,620
Accrued interest receivable	1,774	1,774	1,725	1,725
<b>Financial liabilities:</b>				
Demand deposits, NOW, savings and money market accounts	241,000	241,000	228,153	228,153
Time deposits	94,877	94,933	114,656	115,801
Accrued interest payable	199	199	249	249
FHLB Advances	25,000	25,220	30,000	30,668
Capital notes	9,928	9,928	11,253	11,253
Securities sold under agreement to repurchase	823	823	1,930	1,930

### Note 17 - Stock incentive plan

The Board approved a stock incentive plan effective January 1, 2007. The plan authorizes the grant of awards for a period of ten years. The number of shares authorized for issuance under the plan is limited to 2.25% of the total authorized and unissued shares of common stock. Three types of awards may be granted under the plan: Incentive Stock Options, Nonqualified Stock Options and Restricted Stock. The Bank granted restricted stock awards during 2014. The Bank accounts for this plan in accordance with the *Stock Compensation* Topic of the FASB Accounting Standards Codification (ASC 718). The non-vested equity share or non-vested equity share unit awarded to an employee is measured at its fair value on the grant date. The compensation expense is recognized over the requisite service period.

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 17 - Stock incentive plan (concluded)

The fair value of the shares of restricted stock was determined by an outside appraisal. The vesting requirements are five years. The compensation expense recognized for the years ended December 31, 2015 and 2014 was \$48,000 and \$0-, respectively. Members of the Board of Directors of the Bank can elect to receive a portion or all of their director's fees in the form of common stock. During the year ended December 31, 2015 and 2014, the expense related to these issuances was \$40,600 and \$30,000, respectively.

A summary of the status of the non-vested shares in relation to our restricted stock awards as of December 31, 2015 and 2014, and changes during the years ended December 31, 2015 and 2014, is presented below; the weighted average price is the weighted average fair value at the date of grant:

Restricted Share Awards	2015		2014	
	Shares	Weighted Average Price	Shares	Weighted Average Price
Nonvested - Beginning of the year	17,250	\$ 8.70	-	\$ -
Granted	-	-	17,250	8.70
Vested	-	-	-	-
Forfeited	3,450	8.70	-	-
Nonvested - End of year	<u>13,800</u>	<u>\$ 8.70</u>	<u>17,250</u>	<u>\$ 8.70</u>

### Note 18 - Earnings per share

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of diluted potential common stock. Potential dilutive common stock had no effect on income attributable to common shareholders.

	2015	2014
<b>Basic</b>		
Net income, as reported	\$ 3,774,388	\$ 3,360,889
Preferred stock dividends and accretion of discount	-	-
Net income attributable to common shareholders	<u>\$ 3,774,388</u>	<u>\$ 3,360,889</u>
Average common shares outstanding	<u>3,053,845</u>	<u>3,040,195</u>
Basic earnings per share amount	<u>\$ 1.24</u>	<u>\$ 1.11</u>
<b>Diluted</b>		
Net income attributable to common shareholders	<u>\$ 3,774,388</u>	<u>\$ 3,360,889</u>
Average common shares outstanding	3,053,845	3,040,195
Effect of dilutive unvested restricted stock awards	5,271	1,725
Average diluted shares outstanding	<u>3,059,116</u>	<u>3,041,920</u>
Diluted earnings per share	<u>\$ 1.23</u>	<u>\$ 1.10</u>



# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 19 – Condensed financial statements of parent company

On July 26, 2013, the Board of Directors of the Bank approved an Agreement and Plan of Reorganization and Share Exchange (the “Agreement”) whereby the Bank would become a subsidiary of Farmers Bankshares, Inc., a company incorporated in Virginia on July 26, 2013 for the purpose of becoming a holding company for the Bank. The Agreement provided for the statutory share exchange of all of the Bank’s common stock held by stockholders for the common stock of Farmers Bankshares, Inc., on a one-for-one basis.

The Agreement was approved by the Bank’s stockholders at a special meeting of the Bank’s stockholders held on September 26, 2013 (the “Special Stockholders’ Meeting”). The holding company reorganization was consummated on December 31, 2013 (see Note 1). Prior to the holding company reorganization, Farmers Bankshares, Inc. conducted no operations other than obtaining regulatory approval for the holding company reorganization. As this event is considered reorganization under common control, the consolidated financial statements, discussion of the statements and all other information presented herein for the years ending December 31, 2015 and 2014 are presented for the Company as a consolidated entity.

Financial information pertaining only to Farmers Bankshares, Inc. is as follows:

### Balance Sheets

	December 31,	
	2015	2014
<b>Assets</b>		
Cash	\$ 954,727	\$ 954,727
Taxes receivable	398,991	216,758
Investment in Farmers Bank	49,167,346	48,037,325
Other assets	166,783	214,477
<b>Total assets</b>	<b>\$ 50,687,847</b>	<b>\$ 49,423,287</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Capital notes, 5% due December 31, 2018	\$ 9,928,475	\$ 11,253,475
Other liabilities	152,014	194,785
<b>Total liabilities</b>	<b>10,080,489</b>	<b>11,448,260</b>
<b>Stockholders' equity</b>		
Common stock, \$0.125 par value	381,763	382,600
Capital surplus	2,754,141	2,723,028
Retained earnings	35,070,594	31,849,329
Accumulated other comprehensive income	2,400,860	3,020,070
<b>Total stockholders' equity</b>	<b>40,607,358</b>	<b>37,975,027</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 50,687,847</b>	<b>\$ 49,423,287</b>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 19 – Condensed financial statements of parent company (concluded)

#### Statements of Operations

	Years Ended December 31,	
	2015	2014
<b>Income</b>	\$ 2,409,178	\$ 929,268
<b>Operating expenses</b>		
Interest expense	517,478	569,159
Legal and professional fees	-	26,131
Other expenses	18,500	34
<b>Total expenses</b>	<u>535,978</u>	<u>595,324</u>
<b>Allocated income tax benefits</b>	(182,233)	(202,410)
<b>Income before equity in undistributed income of subsidiary</b>	<u>2,055,433</u>	<u>536,354</u>
<b>Equity in undistributed income - Farmers Bank</b>	1,718,955	2,824,535
<b>Net income</b>	<u>\$ 3,774,388</u>	<u>\$ 3,360,889</u>

#### Statements of Cash Flows

	Years Ended December 31,	
	2015	2014
<b>Cash flows from operating activities</b>		
Net income	\$ 3,774,388	\$ 3,360,889
Adjustments to reconcile net income to net cash provided by operating activities		
Taxes receivable	(182,233)	(202,410)
Other assets	47,693	(23,614)
Other liabilities	-	(58,003)
Equity in undistributed net income of Farmers Bank	(1,718,955)	(2,824,535)
<b>Net cash provided by operating activities</b>	<u>1,920,893</u>	<u>252,327</u>
<b>Cash flows from financing activities</b>		
Cash dividends paid on common shares	(595,893)	(340,492)
Redemption of capital notes	(1,325,000)	-
<b>Net cash (used in) financing activities</b>	<u>(1,920,893)</u>	<u>(340,492)</u>
<b>Decrease in cash and cash equivalents</b>	-	(88,165)
<b>Cash and cash equivalents</b>		
Beginning of the year	<u>954,727</u>	<u>1,042,892</u>
End of year	<u>\$ 954,727</u>	<u>\$ 954,727</u>

# Farmers Bankshares, Inc.

## Notes to Consolidated Financial Statements For Years Ended December 31, 2015 and 2014

### Note 20 – Stock Split

Common shares outstanding at December 31, 2014 have been adjusted for the effect of a five for one stock split on October 15, 2015.

### Note 21 – Subsequent events

The Company has evaluated subsequent events through March 21, 2016, in connection with the preparation of these financial statements which is the date the financial statements were available to be issued.

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# Branch Locations

[www.farmersbankva.com](http://www.farmersbankva.com) • 757-242-6111



**Courtland**  
28319 Southampton Parkway, Suite D



**Harbour View – Suffolk**  
6255 College Drive, Suite L



**Lakeside – Suffolk**  
1008 West Washington Street



**Hillpoint – Suffolk**  
3100 Godwin Boulevard



**Smithfield**  
1119 South Church Street, PO Box 888



**Windsor**  
50 East Windsor Boulevard, PO Box 285



# FARMERS BANK

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