



F&M Bank Corp.



2008 ANNUAL REPORT

One hundred years

President's Letter



Dear Stockholder:

December 31, 2008 marked the completion of our 100th year in operation, and what a year it was. We had Live Radio Remotes at all of our Branches in conjunction with Customer Appreciation Celebrations involving food and prizes. The final Remote was at the Timberville Headquarters Branch where we had a daylong celebration including prizes and lunch for the community (over 600 people). I want to thank the shareholders for their support through the years and the employees and directors for their hard work to make it all possible. We truly have "stood the test of time".

Last year was also an interesting year from a financial perspective. The Federal Reserve reduced the Federal Funds Rate seven times to an unprecedented low of 0 to .25%. This resulted in both deposit and loan rates reaching lows not seen in the last forty years. The Dow Jones Industrial Average lost 34% of its value, 25 banks failed, including the two largest bank failures in our country's history (Indy Mac and Washington Mutual). Large brokerage firms, such as Lehman Brothers failed. Insurance companies, banks, auto makers and state governments all tried to line up at the federal trough, all the while mortgaging our children and grandchildren's future. After considering it, Management and the Board decided to not apply for Federal Assistance due to the "Strings" attached to the program by the Government. Given the current mood of our Congress and Administration, I definitely feel this was the right decision.

In 2008 F & M Bank Corp. experienced both significant growth and significant challenges. Total assets of our company grew to \$472 million, an increase of \$85 million since last year. This growth was fueled by rapid growth in the portfolio of loans held for investment from \$317 million to \$399. However, as has been the case in recent years, deposit growth has been more difficult. Local deposits increased only \$16 million, with non-local, brokered deposits and Federal Home Loan Bank debt providing the bulk of the funding for loan growth.

The interest income generated by the rapid growth in the loan portfolio resulted in very good earnings for Farmers & Merchants Bank; however, due to the significant drop in the stock market, F & M Bank Corp. experienced record losses within its equities portfolio. The losses within the securities portfolio were not the result of securities actually sold, but due to accounting rules that required us to recognize Other Than Temporary Impairment (OTTI) losses on securities that declined significantly in value. Typically securities are considered impaired when their value has been significantly below cost for over a year. With the continued decline in the stock market, there will likely be more OTTI losses in 2009 unless the markets experience a rapid and significant recovery.

Net income for the year totaled \$3.204 million versus \$4.453 million in 2007, a decrease of \$1.249 million. This decrease was driven by securities losses totaling \$1.680 million. However, for the year, core earnings from operations totaled \$4.399 million versus \$4.125 million in 2007, an increase of \$274 thousand or 6.65%. This increase in core earnings was the result of our strong loan growth. Earnings per share decreased from \$1.89 to \$1.38. With the increase in Assets but lower earnings, both our Return on Average Assets and Return on Average Equity at .75% and 8.5% were down significantly again due to the OTTI on the Securities Portfolio.



President's Letter (continued)

Credit quality remained good with charge offs at .08% of Loans Held for Investment in 2008; which is an improvement from .11% in 2007. With the slowing economy, we may see some increase in charge offs for 2009. Nonperforming assets decreased to 1.01% of total assets, which is still higher than it has been in the last few years except for 2007. The Allowance for Loan Losses remained relatively steady at .55% of Loans Held for Investment, which is below our bank peer group; however, we feel it is adequate to cover any potential losses.

Dividends increased from \$.86 to \$.90 per share, an increase of 4.65%. In 2008 we paid out 65.01% of our earnings in dividends. This was obviously a significant increase over 2007, however it is still in line with previous years based on true cash flow rather than net income. Financial stocks in general are at their lowest levels in years and F & M has seen some decline since the first of the year to around \$22.00 from a year end price of \$30.25. Still, in light of our peers at historical lows, our price has held up well.

This report is for the year ending 2008. However, since the first of the year, the economy has continued to decline along with no positive moves in the housing market. Even though our local economy is stronger than the national economy, we are starting to see an increase in the unemployment numbers and cutbacks on the hours worked per week even for those that are employed. The stock market has also continued to decline since year end and the current administration's policies may or may not have their intended effects of stimulating the economy.

Furthermore, the FDIC seems intent on assessing more and more FDIC assessments on the Banking industry to cover potential losses. I want to note that the losses that they have had so far are primarily at the larger banks, and not the community banks like F & M. We have conducted business responsibly; however, we along with our peers, are being asked to cover losses associated with the larger banks who didn't act responsibly. Based on the current proposal of the FDIC, the assessments in 2009 will be significantly higher than 2008. This increase along with the potential for more OTTI's mentioned above and the slowing economy will make 2009 a difficult year. I can assure you that your Management Team, Board of Directors, and Staff will work diligently to make it the best year we can.

We do have a couple of projects either ready to roll out or will be shortly. After many years of research we are ready for Document Imaging to help with filing efficiency and storage space. Also, we now offer Remote Capture for businesses or individuals who want to scan their deposits themselves and electronically send them to us. In 2008 we completed the Branch Capture where the branches scan their daily work and electronically send it to Bookkeeping. In November we purchased a majority interest in VBS Mortgage, which will give us more of a presence in this field once the real estate market improves. In 2009 they have been very profitable due to the amount of refinancing to lower interest rates. We have all the services and products that meet the needs of our customers. Please refer any friends, family or associates to us to see if we can meet their needs.

I want to thank everyone again for your support and I look forward to leading your Corporation as we begin our second century in operation.

Dean W Withers
President/CEO

Five Year Summary of Selected Financial Data



(Dollars in thousands, except per share data)	2008	2007	2006	2005	2004
Income Statement Data:					
Interest and Dividend Income	\$ 25,544	\$ 24,635	\$ 22,526	\$ 19,878	\$ 16,804
Interest Expense	<u>10,498</u>	<u>11,043</u>	<u>9,091</u>	<u>6,998</u>	<u>5,396</u>
Net Interest Income	15,046	13,592	13,435	12,880	11,408
Provision for Loan Losses	<u>815</u>	<u>270</u>	<u>240</u>	<u>360</u>	<u>240</u>
Net Interest Income after Provision for Loan Losses	14,231	13,322	13,195	12,520	11,168
Noninterest Income	3,169	3,215	2,754	2,643	2,254
Securities Gains (Losses)	(1,680)	101	193	71	532
Noninterest Expenses	<u>11,097</u>	<u>10,532</u>	<u>9,688</u>	<u>8,608</u>	<u>7,741</u>
Income before Income Taxes	4,623	6,106	6,454	6,626	6,213
Income Tax Expense	<u>1,419</u>	<u>1,653</u>	<u>1,925</u>	<u>1,846</u>	<u>1,863</u>
Net Income	<u>\$ 3,204</u>	<u>\$ 4,453</u>	<u>\$ 4,529</u>	<u>\$ 4,780</u>	<u>\$ 4,350</u>
Per Share Data:					
Net Income	\$ 1.38	\$ 1.89	\$ 1.90	\$ 1.99	\$ 1.80
Dividends Declared	.90	.86	.82	.78	.74
Book Value	15.64	16.71	16.05	15.22	14.21
Average Shares Outstanding	2,319	2,360	2,386	2,404	2,414
Balance Sheet Data:					
Assets	\$ 472,058	\$ 386,727	\$ 375,924	\$ 346,328	\$ 369,957
Loans Held for Investment	399,233	317,180	309,461	277,398	248,972
Loans Held for Sale	3,780	-	-	3,528	47,150
Securities	30,785	36,614	37,373	34,921	38,800
Deposits	342,225	298,560	289,522	267,310	246,505
Short-Term Debt	20,510	12,743	11,717	14,345	57,362
Long-Term Debt	65,331	29,714	29,247	22,808	26,462
Shareholders' Equity	36,258	39,165	38,105	36,567	34,260
Financial Ratios:					
Return on Average Assets ¹	.75%	1.17%	1.26%	1.34%	1.31%
Return on Average Equity ¹	8.50%	11.53%	12.13%	13.56%	13.11%
Net Interest Margin	3.89%	3.94%	4.17%	4.01%	3.82%
Efficiency Ratio ²	58.60%	60.31%	57.45%	53.07%	54.02%
Dividend Payout Ratio	65.01%	45.60%	43.12%	38.70%	41.06%
Capital and Credit Quality Ratios:					
Average Equity to Average Assets ¹	8.85%	10.05%	10.36%	9.86%	10.00%
Allowance for Loan Losses to Loans ³	.55%	.54%	.58%	.60%	.61%
Nonperforming Assets to Total Assets	1.01%	1.11%	.58%	.20%	.63%
Net Charge-offs to Total Loans ³	.08%	.11%	.04%	.07%	.09%

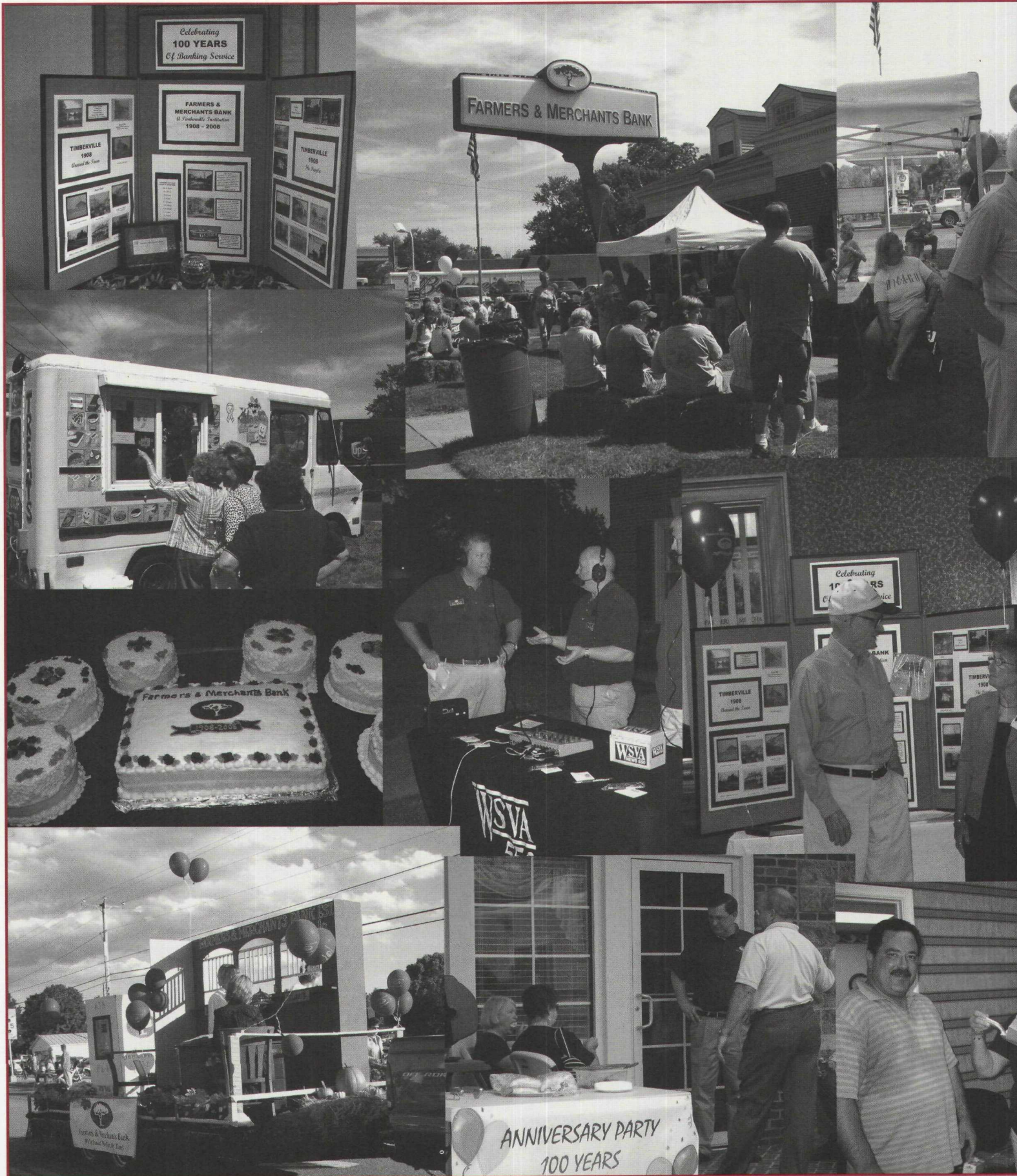
¹ Ratios are primarily based on daily average balances.

² The Efficiency Ratio equals noninterest expenses divided by the sum of tax equivalent net interest income and noninterest income. Noninterest expenses exclude intangible asset amortization. Noninterest income excludes gains (losses) on securities transactions.

³ Calculated based on Loans Held for Investment, excludes Loans Held for Sale.



OUR 100TH YEAR



The 100th Anniversary of our bank's original opening date was August 22, 2008, and all our branches helped make sure that residents of every town knew all about it. Over nine weeks, each branch had a week-long Anniversary Party, offering refreshments and giving prizes including Millionaire For A Day cash. WWSA Radio visited each branch at the crack of dawn on a Wednesday morning, and bank folks talked about the things that make our bank special. The entire project was lots of

100th ANNIVERSARY



work, but lots of fun too. Things culminated in Timberville on August 22, when we served lunch to over 600 people, cut over 500 slices of anniversary cake, and gave out over 400 servings of ice cream. The big Grand Prize drawing for "Millionaire For A Week" was the exciting ending to the big promotion. At local parades, the bank entered a float, built and staffed by employees, to commemorate our 100th Anniversary.



VBS Mortgage



[standing] Vickie Wendt –Mortgage Processor, Kevin Russell- President, Richard Elliott –Mortgage Advisor (Roanoke office), Eddie Blackwell – Mortgage Advisor, Charles Whately – Mortgage Advisor (Roanoke office), Ron Ross- Mortgage Advisor, Jonathan Dean – Mortgage Advisor, Linda Labbe – Mortgage Processor

Bottom Row (left to right):

Kitty Purcell – Mortgage Advisor, Terri Dart- Office Manager, Tina Eppard – Mortgage Processor, Sue Hughes- Mortgage Advisor, Tonja Showalter- Mortgage Advisor, Amanda Cousins- Mortgage Advisor, Anita Beckman – Mortgage Advisor

In November of 2008, Farmers & Merchants Bank acquired 70% ownership in VBS Mortgage, headquartered in Harrisonburg, VA. This affiliation combines the mortgage expertise of VBS Mortgage with the branch network offered by Farmers & Merchants Bank, offering additional mortgage products to Bank customers and giving VBS Mortgage customers direct access to a wide variety of bank products. This relationship enables VBS Mortgage to provide a fully integrated product delivery system, from construction financing, permanent financing, to title insurance and homeowners insurance along with traditional bank services.



Employee Service Anniversaries



Jean Y. Estep
55 Years



Linda D. Jenkins
40 Years



Stephanie Shillingburg
30 Years

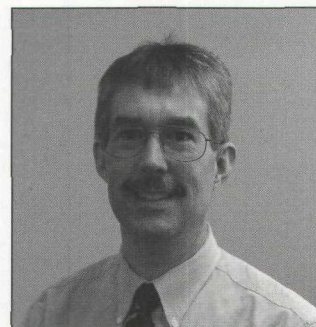
Employee Service Anniversaries



Jeffrey L. Lam
25 Years



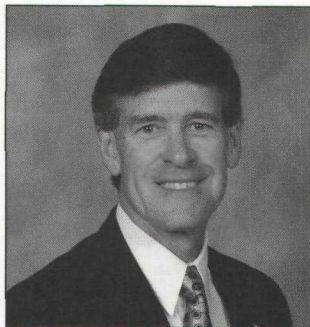
Kathy Grubbs
20 Years



Anthony W. Keyser
20 Years



Cynthia L. Merica
20 Years



Richard S. Myers
20 Years



Eleanor C. Nicholson
20 Years



Kathy Sherman
20 Years

Retired



Frances L. Showalter

Frances L. Showalter, head teller at our Broadway branch, retired on September 30, 2008. She had worked for our bank from 1968-1975, and after rearing her family returned here to work in May 1994 as a teller. In 1998 Frances moved to the Broadway office and in December 2002 was promoted to Head Teller. She has three sons and four grandchildren to enjoy during retirement.



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President, Mac Lease, Inc.

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Partner, Hoover Penrod, PLC-Attorneys

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Farmers & Merchants Bank and
F & M Bank Corp.

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Partner, Dove Ohio Farms, LLC. and
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Deborah D. Vance
Assistant Vice Presidents



Bridgewater
100 Plaza Drive
828-6300

Broadway
126 North Timber Way
896-7071

Edinburg
120 South Main Street
984-4128

Elkton
127 West Rockingham Street
298-1251

Harrisonburg
Crossroads
80 Cross Keys Road
433-7575

Harrisonburg
Port Road
1085 Port Republic Road
433-0112

Luray
700 East Main Street
743-1130

Timberville
205 South Main Street
896-8941

Woodstock
161 South Main Street
459-3707

VBS Mortgage
2040 Deyerle Avenue, Ste 102
Harrisonburg
442-8583