

F&M BANK CORP  
Form 10-Q  
May 14, 2013

Financial Statements

F & M Bank Corp.

March 31, 2013

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

FORM 10-Q

Quarterly report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2013.

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

Commission File Number: 000-13273

F & M BANK CORP.

Virginia  
(State or Other Jurisdiction of Incorporation  
or Organization)

54-1280811  
(I.R.S. Employer Identification No.)

P. O. Box 1111  
Timberville, Virginia 22853  
(Address of Principal Executive Offices) (Zip Code)

(540) 896-8941  
(Registrant's Telephone Number, Including Area Code)

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

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

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

|                         |                          |                           |                                     |
|-------------------------|--------------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer         | <input type="checkbox"/>            |
| Non-accelerated filer   | <input type="checkbox"/> | Smaller reporting Company | <input checked="" type="checkbox"/> |

(Do not check if a smaller reporting company)

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

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State the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

| Class                         | Outstanding at May 14, 2013 |
|-------------------------------|-----------------------------|
| Common Stock, par value - \$5 | 2,501,274 shares            |

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## F &amp; M BANK CORP.

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## PART I FINANCIAL INFORMATION

## ITEM 1 FINANCIAL STATEMENTS

## F &amp; M BANK CORP.

## Consolidated Statements of Income

(In Thousands of Dollars Except per Share Amounts)

(Unaudited)

|   | Three Months Ended<br>March 31, |         |
|---|---------------------------------|---------|
|   | 2013                            | 2012    |
| Interest income                                     |                                 |         |
| Interest and fees on loans held for investment      | \$6,056                         | \$6,260 |
| Interest and fees on loans held for sale            | 489                             | 379     |
| Interest on federal funds sold                      | 10                              | 7       |
| Interest on interest bearing deposits               | 1                               | 2       |
| Dividends on equity securities                      | -                               | -       |
| Interest on debt securities                         | 43                              | 45      |
| Total interest income                               | 6,599                           | 6,693   |
| Interest expense                                    |                                 |         |
| Interest on demand deposits                         | 189                             | 346     |
| Interest on savings accounts                        | 50                              | 49      |
| Interest on time deposits over \$100,000            | 207                             | 234     |
| Interest on other time deposits                     | 427                             | 542     |
| Total interest on deposits                          | 873                             | 1,171   |
| Interest on short-term debt                         | 17                              | 6       |
| Interest on long-term debt                          | 388                             | 519     |
| Total interest expense                              | 1,278                           | 1,696   |
| Net interest income                                 | 5,321                           | 4,997   |
| Provision for loan losses                           | 900                             | 900     |
| Net interest income after provision for loan losses | 4,421                           | 4,097   |
| Noninterest income                                  |                                 |         |
| Service charges                                     | 261                             | 284     |
| Insurance and other commissions                     | 183                             | 133     |
| Other   | 324                             | 298     |
| Income on bank owned life insurance                 | 126                             | 60      |
| Total noninterest income                            | 894                             | 775     |
| Noninterest expense                                 |                                 |         |
| Salaries  | 1,566                           | 1,427   |
| Employee benefits                                   | 576                             | 480     |
| Occupancy expense                                   | 160                             | 135     |
| Equipment expense                                   | 135                             | 144     |
| FDIC insurance assessment                           | 202                             | 181     |
| Other   | 964                             | 884     |

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|                                      |           |           |
|--------------------------------------|-----------|-----------|
| Total noninterest expense            | 3,603     | 3,251     |
| Income before income taxes           | 1,712     | 1,621     |
| Income tax expense                   | 468       | 474       |
| Consolidated net income              | 1,244     | 1,147     |
| Net income - Noncontrolling interest | (28 )     | (12 )     |
| Net Income – F & M Bank Corp         | \$1,216   | \$1,135   |
| Per share data                       |           |           |
| Net income (basic and dilutive)      | \$.49     | \$.46     |
| Cash dividends                       | \$.17     | \$.16     |
| Weighted average shares outstanding  | 2,500,473 | 2,493,758 |

See notes to unaudited consolidated financial statements

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F & M BANK CORP.  
 Consolidated Statements of Comprehensive Income  
 (In Thousands of Dollars)  
 (Unaudited)

|   | Three Months Ended<br>March 31, |                |
|---|---------------------------------|----------------|
|   | 2013                            | 2012           |
| Net Income:   |                                 |                |
| Net Income – F & M Bank Corp  | \$1,216                         | \$1,135        |
| Net Income attributable to noncontrolling interest                  | 28                              | 12             |
| <b>Total Net Income:</b>  | <b>1,244</b>                    | <b>1,147</b>   |
| Other comprehensive income (loss):                                  |                                 |                |
| Prepaid pension adjustment  | -                               | -              |
| Unrealized holding gains (losses) on available-for-sale securities: | (21 )                           | (6 )           |
| Reclassification adjustment for (gains) losses realized in income   | -                               | -              |
| Net unrealized gains (losses)                                       | (21 )                           | (6 )           |
| Tax Expense (benefit)   | (7 )                            | (2 )           |
| Unrealized holding gain (loss), net of tax                          | (14 )                           | (4 )           |
| <b>Total other comprehensive income (loss)</b>                      | <b>(14 )</b>                    | <b>(4 )</b>    |
| <b>Comprehensive income</b>   | <b>\$1,230</b>                  | <b>\$1,143</b> |

See notes to unaudited consolidated financial statements



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F &amp; M BANK CORP.

Consolidated Balance Sheets  
(In Thousands of Dollars Except per Share Amounts)

|   | March 31,<br>2013<br>(Unaudited) | December<br>31,<br>2012<br>(Audited) |
|---|----------------------------------|--------------------------------------|
| <b>Assets</b>   |                                  |                                      |
| Cash and due from banks                                 | \$5,845                          | \$7,961                              |
| Money market funds                                      | 730                              | 1,036                                |
| Federal funds sold                                      | 27,244                           | -                                    |
| Cash and cash equivalents                               | 33,819                           | 8,997                                |
| Interest bearing deposits in banks                      | 248                              | 248                                  |
| <b>Securities:</b>                                      |                                  |                                      |
| Held to maturity – fair value of \$107 in 2012 and 2011 | 107                              | 107                                  |
| Available for sale                                      | 10,483                           | 8,678                                |
| Other investments                                       | 8,500                            | 10,022                               |
| Loans held for sale                                     | 21,130                           | 77,207                               |
| Loans held for investment                               | 465,742                          | 465,819                              |
| Less allowance for loan losses                          | (8,259 )                         | (8,154 )                             |
| Net loans held for investment                           | 457,483                          | 457,665                              |
| Other real estate owned                                 | 2,769                            | 2,884                                |
| Bank premises and equipment, net                        | 6,383                            | 6,445                                |
| Interest receivable                                     | 1,706                            | 1,702                                |
| Goodwill  | 2,670                            | 2,670                                |
| Bank owned life insurance                               | 11,776                           | 11,662                               |
| Other assets  | 9,420                            | 8,617                                |
| <b>Total assets</b>                                     | <b>\$566,494</b>                 | <b>\$596,904</b>                     |
| <b>Liabilities</b>                                      |                                  |                                      |
| <b>Deposits:</b>  |                                  |                                      |
| Noninterest bearing                                     | \$85,457                         | \$84,749                             |
| <b>Interest bearing:</b>                                |                                  |                                      |
| Demand  | 96,810                           | 95,368                               |
| Money market accounts                                   | 25,323                           | 24,559                               |
| Savings   | 50,481                           | 47,602                               |
| Time deposits over \$100,000                            | 70,041                           | 68,585                               |
| All other time deposits                                 | 130,868                          | 132,933                              |
| <b>Total deposits</b>                                   | <b>458,980</b>                   | <b>453,796</b>                       |
| Short-term debt   | 3,172                            | 34,597                               |
| Accrued liabilities                                     | 11,701                           | 11,222                               |
| Subordinated debt                                       | 10,191                           | 10,191                               |
| Long-term debt  | 32,286                           | 37,714                               |
| <b>Total liabilities</b>                                | <b>516,330</b>                   | <b>547,520</b>                       |
| <b>Stockholders' Equity</b>                             |                                  |                                      |

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|  |           |           |
|--|-----------|-----------|
| Common stock, \$5 par value, 6,000,000 shares authorized,<br>2,501,150 and 2,499,544 shares issued and outstanding<br>in 2013 and 2012, respectively | 12,506    | 12,498    |
| Retained earnings  | 39,736    | 38,927    |
| Noncontrolling interest  | 339       | 362       |
| Accumulated other comprehensive loss   | (2,417 )  | (2,403 )  |
| Total stockholders' equity   | 50,164    | 49,384    |
| Total liabilities and stockholders' equity   | \$566,494 | \$596,904 |

See notes to unaudited consolidated financial statements

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F &amp; M BANK CORP.

Consolidated Statements of Cash Flows  
(In Thousands of Dollars)  
(Unaudited)

|   | Three Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|
|   | 2013                            | 2012      |
| Cash flows from operating activities  |                                 |           |
| Net income  | \$1,244                         | \$1,147   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |           |
| Depreciation  | 150                             | 155       |
| Amortization of security premiums, net  | 9                               | 26        |
| Net decrease in loans held for sale   | 56,076                          | 35,383    |
| Provision for loan losses   | 900                             | 900       |
| (Increase) decrease in interest receivable  | (4 )                            | 196       |
| Decrease in other assets  | 9                               | 1,502     |
| Decrease in accrued expenses  | (363 )                          | (1,820 )  |
| Amortization of limited partnership investments                                   | 150                             | 131       |
| Income from life insurance investment   | (126 )                          | (74 )     |
| Other Real Estate Owned valuation adjustments                                     | -                               | 85        |
| Gain on Other Real Estate Owned   | -                               | (48 )     |
| Net adjustments   | 56,801                          | 36,436    |
| Net cash provided by operating activities   | 58,045                          | 37,583    |
| Cash flows from investing activities  |                                 |           |
| Purchase of investments available for sale  | (4,002 )                        | (6,065 )  |
| Proceeds from maturity of investments available for sale                          | 3,539                           | 1,043     |
| Net (increase) decrease in loans held for investment                              | (934 )                          | 247       |
| Proceeds from the sale of other real estate owned                                 | 331                             | 939       |
| Purchase of property and equipment  | (88 )                           | (166 )    |
| Net decrease in interest bearing bank deposits                                    | -                               | 521       |
| Purchase of bank owned life insurance   | -                               | (3,914 )  |
| Net cash used in investing activities   | (1,154 )                        | (7,395 )  |
| Cash flows from financing activities  |                                 |           |
| Net change in demand and savings deposits   | 5,792                           | 7,695     |
| Net change in time deposits   | (609 )                          | 1,292     |
| Net change in short-term debt   | (31,425 )                       | (13,879 ) |
| Cash dividends paid   | (425 )                          | (399 )    |
| Proceeds from issuance of common stock  | 27                              | 27        |
| Proceeds from long-term debt  | -                               | -         |
| Repayment of long-term debt   | (5,429 )                        | (5,607 )  |
| Net cash used in financing activities   | (32,069 )                       | (10,871 ) |
| Net Increase in Cash and Cash Equivalents   | 24,822                          | 19,317    |
| Cash and cash equivalents, beginning of period                                    | 8,997                           | 8,994     |
| Cash and cash equivalents, end of period  | \$33,819                        | \$28,311  |
| Supplemental disclosure   |                                 |           |

|   |         |         |
|---|---------|---------|
| Cash paid for:                                  |         |         |
| Interest expense                                | \$1,237 | \$1,717 |
| Income taxes                                    | -       | -       |
| Transfers from loans to Other Real Estate Owned | 216     | -       |

See notes to unaudited consolidated financial statements

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F &amp; M BANK CORP.

Consolidated Statements of Changes in Stockholders' Equity  
(In Thousands of Dollars)  
(Unaudited)

|  | Three Months Ended<br>March 31, |          |
|--|---------------------------------|----------|
|  | 2013                            | 2012     |
| Balance, beginning of period   | \$49,384                        | \$46,180 |
| <b>Comprehensive income</b>  |                                 |          |
| Net income – F & M Bank Corp   | 1,216                           | 1,135    |
| Net income attributable to noncontrolling interest                                   | 28                              | 12       |
| Net change in unrealized appreciation on securities available for sale, net of taxes | (14 )                           | (4 )     |
| Total comprehensive income   | 1,230                           | 1,143    |
| <b>Minority Interest Contributed Capital (Distributions)</b>                         |                                 |          |
| Issuance of common stock   | 26                              | 27       |
| Dividends declared   | (425 )                          | (399 )   |
| Balance, end of period   | \$50,164                        | \$46,951 |

See notes to unaudited consolidated financial statements

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F & M BANK CORP.

Notes to (unaudited) Consolidated Financial Statements

Note 1. Accounting Principles

The consolidated financial statements include the accounts of F & M Bank Corp. and its subsidiaries (the “Company”). Significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements conform to accounting principles generally accepted in the United States of America and to general industry practices. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position as of March 31, 2013 and the results of operations for the quarters ended March 31, 2013 and 2012. The notes included herein should be read in conjunction with the notes to financial statements included in the 2012 annual report to stockholders of F & M Bank Corp.

The Company does not expect the anticipated adoption of any newly issued accounting standards to have a material impact on future operations or financial position.

Comprehensive Income

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

Subsequent Events

In preparing these financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through the date the financial statements were issued.

Loans

Loans are carried on the balance sheet net of any unearned interest and the allowance for loan losses. Interest income on loans is determined using the effective interest method on the daily amount of principal outstanding except where serious doubt exists as to collectability of the loan, in which case the accrual of income is discontinued.

Allowance for Loan Losses

The provision for loan losses charged to operations is an amount sufficient to bring the allowance for loan losses to an estimated balance that management considers adequate to absorb potential losses in the portfolio. Loans are charged against the allowance when management believes the collectability of the principal is unlikely. Recoveries of amounts previously charged-off are credited to the allowance. Management’s determination of the adequacy of the allowance is based on an evaluation of the composition of the loan portfolio, the value and adequacy of collateral, current economic conditions, historical loan loss experience, and other risk factors. Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions, particularly those affecting real estate values. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.



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F &amp; M BANK CORP.

## Notes to (unaudited) Consolidated Financial Statements

## Note 1. Accounting Principles, continued

## Allowance for Loan Losses, continued

A loan is considered impaired when, based on current information and events, it is probable that the Company 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.

## Nonaccrual Loans

Loans are placed on nonaccrual status when they become ninety days or more past due, unless there is an expectation that the loan will either be brought current or paid in full in a reasonable period of time.

## Note 2. Investment Securities

Investment securities available for sale are carried in the consolidated balance sheets at their approximate market value, amortized cost and unrealized gains and losses at March 31, 2013 and December 31, 2012 are reflected in the table below. The amortized costs of investment securities held to maturity are carried in the consolidated balance sheets and their approximate market values at March 31, 2013 and December 31, 2012 are as follows:

|                                       | 2013     |                   | 2012   |              |
|---------------------------------------|----------|-------------------|--------|--------------|
|                                       | Cost     | Market Value      | Cost   | Market Value |
| Securities held to maturity           |          |                   |        |              |
| U. S. Treasury and agency obligations | \$107    | \$107             | \$107  | \$107        |
| Total                                 | \$107    | \$107             | \$107  | \$107        |
|                                       |          | March 31, 2013    |        |              |
|                                       |          | Unrealized        |        | Market       |
|                                       | Cost     | Gains             | Losses | Value        |
| Securities available for sale         |          |                   |        |              |
| Government sponsored enterprises      | \$9,011  | \$14              | \$5    | \$9,020      |
| Mortgage-backed securities            | 1,436    | 27                | -      | 1,463        |
| Total                                 | \$10,447 | \$41              | \$5    | \$10,483     |
|                                       |          | December 31, 2012 |        |              |
|                                       |          | Unrealized        |        | Market       |



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|                                  | Cost    | Gains | Losses | Value   |
|----------------------------------|---------|-------|--------|---------|
| Securities available for sale    |         |       |        |         |
| Government sponsored enterprises | \$7,012 | \$19  | \$-    | \$7,031 |
| Mortgage-backed securities       | 1,609   | 38    | -      | 1,647   |
| Total                            | \$8,621 | \$57  | \$-    | \$8,678 |

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Notes to (unaudited) Consolidated Financial Statements

Note 2. Investment Securities, continued

The amortized cost and fair value of securities at March 31, 2013, by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|                                       | Securities Held to Maturity |            | Securities Available for Sale |            |
|---------------------------------------|-----------------------------|------------|-------------------------------|------------|
|                                       | Amortized Cost              | Fair Value | Amortized Cost                | Fair Value |
| Due in one year or less               | \$ 107                      | \$ 107     | \$ 1,997                      | \$ 2,010   |
| Due after one year through five years | -                           | -          | 8,450                         | 8,473      |
| Due after five years                  | -                           | -          | -                             | -          |
| Total                                 | \$ 107                      | \$ 107     | \$ 10,447                     | \$ 10,483  |

There were no gains and losses on sales of debt and equity securities in the first quarter of 2013 or 2012.

## Securities Impairment

The Company follows the guidance in ASC 320-10 and Staff Accounting Bulletin (SAB) Topic 5M, Other Than Temporary Impairment in evaluating if these impairments are temporary or other than temporary in nature. This determination is made on an investment by investment basis and includes all available evidence at the time of the determination including the following:

- The length of time of impairment;
- The extent of the impairment relative to the cost of the investment;
- Recent volatility in the market value of the investment;
- The financial condition and near-term prospects of the issuer, including any specific events which may impair the earnings potential of the issuer; or
- The intent and ability of the Company to hold its investment for a period of time sufficient to allow for any anticipated recovery in market value.

The following description provides our policies/procedures for the evaluation for Other Than Temporary Impairment (OTTI):

We begin our evaluation using a default position that OTTI has occurred and then use all available evidence to determine whether prospects for the individual security are sufficient to support temporary impairment at the date of the SEC filing. This evaluation will be conducted at each filing date.

For purposes of determining OTTI, the security value recovery period will be projected for a maximum of a two year holding period. This will be the maximum; a shorter period may be used when there are particular conditions related to the individual security which make recovery unlikely.

The primary focus in determining whether a security is OTTI, and projecting potential recovery, is the prospects for the individual security, rather than broad market indices. All available evidentiary material is considered, including the Company's public filings with the SEC, press releases, analyst reports, etc.



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## Notes to (unaudited) Consolidated Financial Statements

Note 2. Investment Securities, continued

## Securities Impairment continued

Secondary consideration is given to historic returns, but only to the extent that this evidence is instructive in determining whether the individual security has shown a history of outperforming (or underperforming) the market (or industry) in prior economic cycles. These factors are only considered when the declines in value are not limited to the individual security, but were prevalent over the broader market. This measure is considered to aid in determining whether OTTI should be recognized earlier, rather than later (i.e. a security which underperforms relative to the industry or market will result in early recognition of OTTI). In no event will OTTI recognition be delayed beyond the two year projection period.

OTTI may be recognized as early as quarter 1, regardless of holding period projections, when there are specific factors relative to the security which make recovery unlikely. These factors could include evidence contained in the aforementioned SEC filings, press releases, analyst reports, but may also be based on the severity of the impairment.

Situations where a security has declined in value more rapidly than the industry (or market), absent strong evidence supporting prospects for recovery, will result in OTTI being recognized in quarter 1 or quarter 2 rather than continuing to evaluate the security over several quarters, based on holding period projections.

Declines determined to be other than temporary are charged to operations; there were no OTTI charges in the first three months of 2013 or 2012.

The fair value and gross unrealized losses for securities, segregated by the length of time that individual securities have been in a continuous gross unrealized loss position, at March 31, 2013 and December 31, 2012 were as follows (dollars in thousands):

|                      | Less than 12 Months |                   | More than 12 Months |                   | Total      |                   |
|----------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                      | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| March 31, 2013       |                     |                   |                     |                   |            |                   |
| Government sponsored |                     |                   |                     |                   |            |                   |
| Enterprises          | \$1,995             | \$(5 )            | \$-                 | \$-               | \$1,995    | \$(5 )            |
| Total                | \$1,995             | \$(5 )            | \$-                 | \$-               | \$1,995    | \$(5 )            |
| December 31, 2012    |                     |                   |                     |                   |            |                   |
| Government sponsored |                     |                   |                     |                   |            |                   |
| Enterprises          | \$2,000             | \$(.5 )           | \$-                 | \$-               | \$2,000    | \$(.5 )           |
| Total                | \$2,000             | \$(.5 )           | \$-                 | \$-               | \$2,000    | \$(.5 )           |

Other investments, which consist of stock of correspondent banks and investments in low income housing projects, decreased since December 31, 2012. This decrease is due to FHLB stock repurchases during the first quarter.

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## Notes to (unaudited) Consolidated Financial Statements

## Note 3. Loans Held for Investment

Loans outstanding at March 31, 2013 and December 31, 2012 are summarized as follows:

|   | 2013      | 2012      |
|---|-----------|-----------|
| Construction/Land Development             | \$75,522  | \$71,251  |
| Farmland                                  | 11,938    | 12,259    |
| Real Estate                               | 141,964   | 144,066   |
| Multi-Family                              | 9,169     | 9,357     |
| Commercial Real Estate                    | 120,507   | 123,819   |
| Home Equity – closed end                  | 11,006    | 10,984    |
| Home Equity – open end                    | 48,413    | 49,762    |
| Commercial & Industrial – Non-Real Estate | 25,527    | 25,110    |
| Consumer                                  | 11,186    | 12,698    |
| Credit cards                              | 2,541     | 2,788     |
| Dealer Finance                            | 7,969     | 3,725     |
| Total                                     | \$465,742 | \$465,819 |

The following is a summary of information pertaining to impaired loans (in thousands):

| March 31, 2013                                | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|---|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| Impaired loans without a valuation allowance: |                        |                                |                      |                                   |                                  |
| Construction/Land Development                 | \$ 6,740               | \$ 6,740                       | \$ -                 | \$ 2,799                          | \$ 38                            |
| Farmland                                      | 1,481                  | 1,481                          | -                    | 597                               | 12                               |
| Real Estate                                   | 723                    | 723                            | -                    | 2,112                             | -                                |
| Multi-Family                                  | -                      | -                              | -                    | -                                 | 3                                |
| Commercial Real Estate                        | 538                    | 538                            | -                    | 275                               | 3                                |
| Home Equity – closed end                      | 311                    | 311                            | -                    | 173                               | 12                               |
| Home Equity – open end                        | -                      | -                              | -                    | 175                               | -                                |
| Commercial & Industrial – Non-Real Estate     |                        |                                |                      |                                   |                                  |
| Estate  | 18                     | 18                             | -                    | 51                                | -                                |
| Consumer                                      | -                      | -                              | -                    | 120                               | -                                |
| Credit cards                                  | -                      | -                              | -                    | -                                 | -                                |
| Dealer Finance                                | -                      | -                              | -                    | -                                 | -                                |
| Impaired loans with a valuation allowance     |                        |                                |                      |                                   |                                  |
| Construction/Land Development                 | 12,464                 | 12,464                         | 1,956                | 9,385                             | 36                               |
| Farmland                                      | -                      | -                              | -                    | -                                 | -                                |
| Real Estate                                   | 1,360                  | 1,360                          | 168                  | 1,208                             | 6                                |
| Multi-Family                                  | -                      | -                              | -                    | -                                 | -                                |
| Commercial Real Estate                        | 1,062                  | 1,062                          | 159                  | 1,304                             | 1                                |
| Home Equity – closed end                      | 529                    | 529                            | 110                  | 390                               | 2                                |
| Home Equity – open end                        | 113                    | 113                            | 7                    | 187                               | -                                |

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|                                    |                  |                  |                 |                  |               |
|------------------------------------|------------------|------------------|-----------------|------------------|---------------|
| Commercial & Industrial – Non-Real |                  |                  |                 |                  |               |
| Estate                             | -                | -                | -               | 883              | -             |
| Consumer                           | -                | -                | -               | 9                | -             |
| Credit cards                       | -                | -                | -               | -                | -             |
| Dealer Finance                     | -                | -                | -               | -                | -             |
| <b>Total impaired loans</b>        | <b>\$ 25,339</b> | <b>\$ 25,339</b> | <b>\$ 2,400</b> | <b>\$ 19,668</b> | <b>\$ 113</b> |

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## Notes to (unaudited) Consolidated Financial Statements

## Note 3. Loans Held for Investment, continued

The Recorded Investment is defined as the principal balance less principal payments and charge-offs.

| December 31, 2012                             | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|---|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| Impaired loans without a valuation allowance: |                        |                                |                      |                                   |                                  |
| Construction/Land Development                 | \$5,743                | \$5,743                        | \$-                  | \$1,493                           | \$279                            |
| Farmland                                      | 1,481                  | 1,481                          | -                    | 301                               | 76                               |
| Real Estate                                   | -                      | -                              | -                    | 2,561                             | -                                |
| Multi-Family                                  | -                      | -                              | -                    | -                                 | -                                |
| Commercial Real Estate                        | 541                    | 541                            | -                    | 168                               | 23                               |
| Home Equity – closed end                      | -                      | -                              | -                    | 153                               | -                                |
| Home Equity – open end                        | -                      | -                              | -                    | 274                               | -                                |
| Commercial & Industrial – Non-Real Estate     | -                      | -                              | -                    | 56                                | -                                |
| Consumer                                      | -                      | -                              | -                    | 135                               | -                                |
| Credit cards                                  | -                      | -                              | -                    | -                                 | -                                |
| Dealer Finance                                | -                      | -                              | -                    | -                                 | -                                |
| Impaired loans with a valuation allowance     |                        |                                |                      |                                   |                                  |
| Construction/Land Development                 | 10,466                 | 10,466                         | 1,363                | 7,875                             | 217                              |
| Farmland                                      | -                      | -                              | -                    | -                                 | -                                |
| Real Estate                                   | 901                    | 901                            | 146                  | 1,089                             | 38                               |
| Multi-Family                                  | -                      | -                              | -                    | -                                 | -                                |
| Commercial Real Estate                        | 1,585                  | 1,585                          | 253                  | 1,092                             | 4                                |
| Home Equity – closed end                      | 415                    | 415                            | 29                   | 319                               | 9                                |
| Home Equity – open end                        | 250                    | 250                            | 78                   | 193                               | 19                               |
| Commercial & Industrial – Non-Real Estate     | 707                    | 707                            | 277                  | 1,005                             | -                                |
| Consumer                                      | 2                      | 2                              | -                    | 13                                | -                                |
| Credit cards                                  | -                      | -                              | -                    | -                                 | -                                |
| Dealer Finance                                | -                      | -                              | -                    | -                                 | -                                |
| Total impaired loans                          | \$22,091               | \$22,091                       | \$2,146              | \$16,727                          | \$665                            |

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## Notes to (unaudited) Consolidated Financial Statements

## Note 4. Allowance for Loan Losses

A summary of the allowance for loan losses follows:

| March 31, 2013<br>(in thousands) | Beginning<br>Balance | Charge-offs  | Recoveries  | Provision    | Ending<br>Balance | Individually<br>Evaluated<br>for<br>Impairment | Collectively<br>Evaluated<br>for<br>Impairment |
|----------------------------------|----------------------|--------------|-------------|--------------|-------------------|--|--|
| Allowance for<br>loan losses:    |                      |              |             |              |                   |  |  |
| Construction/Land<br>Development | \$2,771              | \$-          | \$3         | \$567        | \$3,341           | \$1,955  | \$1,386  |
| Farmland                         | (2 )                 | -            | -           | -            | (2 )              | -  | (2 )   |
| Real Estate                      | 924                  | 35           | -           | 9            | 898               | 168  | 730  |
| Multi-Family                     | (37 )                | -            | -           | 2            | (35 )             | -  | (35 )  |
| Commercial Real<br>Estate        | 1,113                | 201          | -           | 128          | 1,040             | 160  | 880  |
| Home Equity –<br>closed end      | 360                  | 10           | -           | (14 )        | 336               | 110  | 226  |
| Home Equity –<br>open end        | 659                  | 68           | 5           | (49 )        | 547               | 7  | 540  |
| Commercial &<br>Industrial –     |                      |              |             |              |                   |  |  |
| Non-Real Estate                  | 2,113                | 412          | 21          | 111          | 1,833             | -  | 1,833  |
| Consumer                         | 51                   | 79           | 2           | 73           | 47                | -  | 47   |
| Dealer Finance                   | 72                   | -            | -           | 69           | 141               | -  | 141  |
| Credit Cards                     | 130                  | 26           | 5           | 4            | 113               | -  | 113  |
| Unallocated                      | -                    | -            | -           | -            | -                 | -  | -  |
| <b>Total</b>                     | <b>\$8,154</b>       | <b>\$831</b> | <b>\$36</b> | <b>\$900</b> | <b>\$8,259</b>    | <b>\$2,400</b>                                 | <b>\$5,859</b>                                 |

| December 31,<br>2012 (in<br>thousands) | Beginning<br>Balance | Charge-offs | Recoveries | Provision | Ending<br>Balance | Individually<br>Evaluated<br>for<br>Impairment | Collectively<br>Evaluated<br>for<br>Impairment |
|--|----------------------|-------------|------------|-----------|-------------------|--|--|
| Allowance for<br>loan losses:          |                      |             |            |           |                   |  |  |
| Construction/Land<br>Development       | \$2,071              | \$1,481     | \$192      | \$1,989   | \$2,771           | \$1,363  | \$1,408  |
| Farmland                               | 145                  | -           | 3          | (150 )    | (2 )              | -  | (2 )   |
| Real Estate                            | 625                  | 482         | -          | 781       | 924               | 146  | 778  |
| Multi-Family                           | 92                   | -           | -          | (129 )    | (37 )             | -  | (37 )  |
| Commercial Real<br>Estate              | 2,285                | 424         | 48         | (796 )    | 1,113             | 164  | 949  |
| Home Equity –<br>closed end            | 91                   | 69          | -          | 338       | 360               | 117  | 243  |
|  | 867                  | -           | -          | (208 )    | 659               | 79   | 580  |



|                              |         |         |       |         |         |         |         |
|------------------------------|---------|---------|-------|---------|---------|---------|---------|
| Home Equity –<br>open end    |         |         |       |         |         |         |         |
| Commercial &<br>Industrial – |         |         |       |         |         |         |         |
| Non-Real Estate              | 457     | 776     | 62    | 2,370   | 2,113   | 277     | 1,836   |
| Consumer                     | 128     | 44      | 27    | (60 )   | 51      | -       | 51      |
| Dealer Finance               | -       | -       | -     | 72      | 72      | -       | 72      |
| Credit Cards                 | 176     | 71      | 32    | (7 )    | 130     | -       | 130     |
| Unallocated                  | -       | -       | -     | -       | -       | -       | -       |
| Total                        | \$6,937 | \$3,347 | \$364 | \$4,200 | \$8,154 | \$2,146 | \$6,008 |

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## Notes to (unaudited) Consolidated Financial Statements

Note 4. Allowance for Loan Losses, continued

Recorded Investment in Loan Receivables (in thousands)

|   | Loan<br>Receivable | Individually<br>Evaluated<br>for<br>Impairment | Collectively<br>Evaluated<br>for<br>Impairment |
|---|--------------------|--|--|
| March 31, 2013                            |                    |  |  |
| Construction/Land Development             | \$75,522           | \$ 19,205                                      | \$ 56,317                                      |
| Farmland                                  | 11,938             | 1,481  | 10,457   |
| Real Estate                               | 141,964            | 2,083  | 139,881  |
| Multi-Family                              | 9,169              | -  | 9,169  |
| Commercial Real Estate                    | 120,507            | 1,600  | 118,907  |
| Home Equity – closed end                  | 11,006             | 839  | 10,167   |
| Home Equity –open end                     | 48,413             | 113  | 48,300   |
| Commercial & Industrial – Non-Real Estate | 25,527             | 18   | 25,509   |
| Consumer                                  | 11,186             | -  | 11,186   |
| Dealer Finance                            | 7,969              | -  | 7,969  |
| Credit Cards                              | 2,541              | -  | 2,541  |
| Total                                     | \$465,742          | \$ 25,339                                      | \$ 440,403                                     |
| December 31, 2012                         |                    |  |  |
| Construction/Land Development             | \$71,251           | \$ 16,206                                      | \$ 55,045                                      |
| Farmland                                  | 12,259             | 1,481  | 10,778   |
| Real Estate                               | 144,066            | 901  | 143,165  |
| Multi-Family                              | 9,357              | -  | 9,357  |
| Commercial Real Estate                    | 123,819            | 2,128  | 121,691  |
| Home Equity – closed end                  | 10,984             | 415  | 10,569   |
| Home Equity –open end                     | 49,762             | 250  | 49,512   |
| Commercial & Industrial – Non-Real Estate | 25,110             | 708  | 24,402   |
| Consumer                                  | 12,698             | 2  | 12,696   |
| Dealer Finance                            | 3,725              | -  | 3,725  |
| Credit Cards                              | 2,788              | -  | 2,788  |
| Total                                     | \$465,819          | \$ 22,091                                      | \$ 443,728                                     |

Aging of Past Due Loans Receivable (in thousands) as of March 31, 2013

|  | 30-59 Days<br>Past due | 60-89<br>Days Past<br>Due | Greater than<br>90 Days<br>(excluding<br>non-accrual) | Non-Accrual<br>Loans | Total Past<br>Due | Current | Total Loan<br>Receivable |
|--|------------------------|---------------------------|---|----------------------|-------------------|---------|--------------------------|
|--|------------------------|---------------------------|---|----------------------|-------------------|---------|--------------------------|

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March 31, 2013

|                   |          |         |        |           |          |           |           |
|-------------------|----------|---------|--------|-----------|----------|-----------|-----------|
| Construction/Land |          |         |        |           |          |           |           |
| Development       | \$2,690  | \$47    | \$ 172 | \$ 7,169  | \$10,078 | \$65,444  | \$75,522  |
| Farmland          | -        | -       | -      | -         | -        | 11,938    | 11,938    |
| Real Estate       | 6,128    | 1,407   | -      | 995       | 8,530    | 133,434   | 141,964   |
| Multi-Family      | -        | -       | -      | -         | -        | 9,169     | 9,169     |
| Commercial Real   |          |         |        |           |          |           |           |
| Estate            | 4,374    | -       | 74     | 1,889     | 6,337    | 114,170   | 120,507   |
| Home Equity –     |          |         |        |           |          |           |           |
| closed end        | 66       | 424     | -      | 305       | 795      | 10,211    | 11,006    |
| Home Equity –     |          |         |        |           |          |           |           |
| open end          | 192      | 37      | -      | 170       | 399      | 48,014    | 48,413    |
| Commercial &      |          |         |        |           |          |           |           |
| Industrial – Non- |          |         |        |           |          |           |           |
| Real Estate       | 105      | 149     | -      | 801       | 1,055    | 24,472    | 25,527    |
| Consumer          | 63       | 1,032   | 3      | 107       | 1,205    | 9,981     | 11,186    |
| Dealer Finance    | -        | -       | -      | -         | -        | 7,969     | 7,969     |
| Credit Cards      | 16       | 1       | -      | -         | 17       | 2,524     | 2,541     |
| Total             | \$13,634 | \$3,097 | \$ 249 | \$ 11,436 | \$28,416 | \$437,326 | \$465,742 |

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Notes to (unaudited) Consolidated Financial Statements

Note 4. Allowance for Loan Losses, continued

Aging of Past Due Loans Receivable (in thousands) as of December 31, 2012

|  | 30-59 Days<br>Past due | 60-89 Days<br>Past Due | Greater<br>than 90<br>Days<br>(excluding<br>non-accrual) | Non-Accrual<br>Loans | Total Past<br>Due | Current   | Total Loan<br>Receivable |
|--|------------------------|------------------------|--|----------------------|-------------------|-----------|--------------------------|
| December 31,<br>2012                             |                        |                        |  |                      |                   |           |                          |
| Construction/Land<br>Development                 | \$1,173                | \$598                  | \$ -   | \$ 7,974             | \$9,745           | \$61,506  | \$71,251                 |
| Farmland   | 1,524                  | -                      | -  | -                    | 1,524             | 10,735    | 12,259                   |
| Real Estate                                      | 5,032                  | 1,743                  | -  | 1,637                | 8,412             | 135,654   | 144,066                  |
| Multi-Family                                     | -                      | -                      | -  | -                    | -                 | 9,357     | 9,357                    |
| Commercial Real<br>Estate                        | 3,238                  | 124                    | -  | 1,823                | 5,185             | 118,634   | 123,819                  |
| Home Equity –<br>closed end                      | 199                    | 163                    | -  | 196                  | 558               | 10,426    | 10,984                   |
| Home Equity –<br>open end                        | 370                    | 130                    | -  | 544                  | 1,044             | 48,718    | 49,762                   |
| Commercial &<br>Industrial – Non-<br>Real Estate | 635                    | 5                      | -  | 1,091                | 1,731             | 23,379    | 25,110                   |
| Consumer   | 62                     | 66                     | -  | 121                  | 249               | 12,449    | 12,698                   |
| Dealer Finance                                   | -                      | -                      | -  | -                    | -                 | 3,725     | 3,725                    |
| Credit Cards                                     | 10                     | 13                     | -  | -                    | 23                | 2,765     | 2,788                    |
| Total  | \$12,243               | \$2,842                | \$ -   | \$ 13,386            | \$28,471          | \$437,348 | \$465,819                |

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## Notes to (unaudited) Consolidated Financial Statements

Note 4. Allowance for Loan Losses, continued

CREDIT QUALITY INDICATORS (in thousands)  
AS OF MARCH 31, 2013  
Corporate Credit Exposure  
Credit Risk Profile by Creditworthiness Category

|   | Grade<br>1<br>Minimal<br>Risk | Grade 2<br>Modest<br>Risk | Grade 3<br>Average<br>Risk | Grade 4<br>Acceptable<br>Risk | Grade 5<br>Marginally<br>Acceptable | Grade 6<br>Watch | Grade 7<br>Substandard | Grade<br>8<br>Doubtful | Total     |
|---|-------------------------------|---------------------------|----------------------------|-------------------------------|-------------------------------------|------------------|------------------------|------------------------|-----------|
| Construction/Land<br>Development                | \$-                           | \$350                     | \$4,528                    | \$ 20,693                     | \$ 15,696                           | \$9,493          | \$ 24,762              | \$-                    | \$75,522  |
| Farmland  | 69                            | -                         | 1,414                      | 4,164                         | 4,381                               | 330              | 1,580                  | -                      | 11,938    |
| Real Estate                                     | -                             | 339                       | 35,725                     | 67,910                        | 25,855                              | 4,488            | 7,557                  | 90                     | 141,964   |
| Multi-Family                                    | -                             | 614                       | 2,151                      | 1,701                         | 4,703                               | -                | -                      | -                      | 9,169     |
| Commercial Real<br>Estate                       | -                             | 2,072                     | 18,685                     | 53,447                        | 29,022                              | 6,688            | 10,593                 | -                      | 120,507   |
| Home Equity –<br>closed end                     | -                             | -                         | 2,207                      | 5,602                         | 2,098                               | 368              | 731                    | -                      | 11,006    |
| Home Equity –<br>open end                       | -                             | 1,433                     | 14,656                     | 26,235                        | 4,845                               | 666              | 578                    | -                      | 48,413    |
| Commercial &<br>Industrial<br>(Non-Real Estate) | 158                           | 107                       | 3,419                      | 16,324                        | 3,637                               | 995              | 887                    | -                      | 25,527    |
| Total   | \$227                         | \$4,915                   | \$82,785                   | \$ 196,076                    | \$ 90,237                           | \$23,028         | \$ 46,688              | \$90                   | \$444,046 |

Consumer Credit Exposure  
Credit Risk Profile Based on Payment Activity

|                | Credit<br>Cards | Consumer |
|----------------|-----------------|----------|
| Performing     | \$2,541         | \$19,152 |
| Non performing | -               | 3        |
| Total          | \$2,541         | \$19,155 |

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Notes to (unaudited) Consolidated Financial Statements

Note 4. Allowance for Loan Losses, continued

CREDIT QUALITY INDICATORS (in thousands)  
AS OF DECEMBER 31, 2012  
Corporate Credit Exposure  
Credit Risk Profile by Creditworthiness Category

|   | Grade<br>1<br>Minimal<br>Risk | Grade 2<br>Modest<br>Risk | Grade 3<br>Average<br>Risk | Grade 4<br>Acceptable<br>Risk | Grade 5<br>Marginally<br>Acceptable | Grade 6<br>Watch | Grade 7<br>Substandard | Grade<br>8<br>Doubtful | Total             |
|---|-------------------------------|---------------------------|----------------------------|-------------------------------|-------------------------------------|------------------|------------------------|------------------------|-------------------|
| Construction/Land<br>Development                | \$ -                          | \$ 831                    | \$ 4,400                   | \$ 16,616                     | \$ 15,783                           | \$ 9,013         | \$ 24,608              | \$ -                   | \$ 71,251         |
| Farmland  | 70                            | -                         | 1,544                      | 4,327                         | 4,214                               | 524              | 1,580                  | -                      | 12,259            |
| Real Estate                                     | -                             | 448                       | 36,342                     | 69,343                        | 22,413                              | 6,472            | 8,721                  | -                      | 143,739           |
| Multi-Family                                    | -                             | 632                       | 2,185                      | 1,815                         | 4,725                               | -                | -                      | -                      | 9,357             |
| Commercial Real<br>Estate                       | -                             | 2,033                     | 18,663                     | 56,951                        | 28,650                              | 4,910            | 12,939                 | -                      | 124,146           |
| Home Equity –<br>closed end                     | -                             | -                         | 2,280                      | 6,198                         | 1,268                               | 530              | 708                    | -                      | 10,984            |
| Home Equity –<br>open end                       | -                             | 1,460                     | 15,294                     | 26,595                        | 4,735                               | 694              | 869                    | 115                    | 49,762            |
| Commercial &<br>Industrial<br>(Non-Real Estate) | -                             | 87                        | 3,505                      | 15,448                        | 3,621                               | 531              | 1,918                  | -                      | 25,110            |
| <b>Total</b>                                    | <b>\$ 70</b>                  | <b>\$ 5,491</b>           | <b>\$ 84,213</b>           | <b>\$ 197,293</b>             | <b>\$ 85,409</b>                    | <b>\$ 22,674</b> | <b>\$ 51,343</b>       | <b>\$ 115</b>          | <b>\$ 446,608</b> |

Consumer Credit Exposure  
Credit Risk Profile Based on Payment Activity

|                | Credit Cards    | Consumer         |
|----------------|-----------------|------------------|
| Performing     | \$ 2,788        | \$ 16,404        |
| Non performing | -               | 19               |
| <b>Total</b>   | <b>\$ 2,788</b> | <b>\$ 16,423</b> |

## Description of loan grades:

Grade 1 – Minimal Risk: Excellent credit, superior asset quality, excellent debt capacity and coverage, and recognized management capabilities.

Grade 2 – Modest Risk: Borrower consistently generates sufficient cash flow to fund debt service, excellent credit, above average asset quality and liquidity.

Grade 3 – Average Risk: Borrower generates sufficient cash flow to fund debt service. Employment (or business) is stable with good future trends. Credit is very good.

Grade 4 – Acceptable Risk: Borrower's cash flow is adequate to cover debt service; however, unusual expenses or capital expenses must be covered through additional long term debt. Employment (or business) stability is reasonable,

but future trends may exhibit slight weakness. Credit history is good. No unpaid judgments or collection items appearing on credit report.

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Notes to (unaudited) Consolidated Financial Statements

Note 4. Allowance for Loan Losses, continued

Grade 5 – Marginally acceptable: Credit to borrowers who may exhibit declining earnings, may have leverage that is materially above industry averages, liquidity may be marginally acceptable. Employment or business stability may be weak or deteriorating. May be currently performing as agreed, but would be adversely affected by developing factors such as layoffs, illness, reduced hours or declining business prospects. Credit history shows weaknesses, past dues, paid or disputed collections and judgments, but does not include borrowers that are currently past due on obligations or with unpaid, undisputed judgments.

Grade 6 – Watch: Loans are currently protected, but are weak due to negative balance sheet or income statement trends. There may be a lack of effective control over collateral or the existence of documentation deficiencies. These loans have potential weaknesses that deserve management’s close attention. Other reasons supporting this classification include adverse economic or market conditions, pending litigation or any other material weakness. Existing loans that become 60 or more days past due are placed in this category pending a return to current status.

Grade 7 – Substandard: Loans having well-defined weaknesses where a payment default and or loss is possible, but not yet probable. Cash flow is inadequate to service the debt under the current payment, or terms, with prospects that the condition is permanent. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the borrower and there is the likelihood that collateral will have to be liquidated and/or guarantor(s) called upon to repay the debt. Generally, the loan is considered collectible as to both principal and interest, primarily because of collateral coverage, however, if the deficiencies are not corrected quickly; there is a probability of loss.

Grade 8 – Doubtful: The loan has all the characteristics of a substandard credit, but available information indicates it is unlikely the loan will be repaid in its entirety. Cash flow is insufficient to service the debt. It may be difficult to project the exact amount of loss, but the probability of some loss is great. Loans are to be placed on non-accrual status when any portion is classified doubtful.



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## Notes to (unaudited) Consolidated Financial Statements

## Note 5. Employee Benefit Plan

The Bank has a qualified noncontributory defined benefit pension plan that covers substantially all of its employees. The benefits are primarily based on years of service and earnings. The Bank contributed \$750,000 to the plan in the first quarter of 2013 and does not anticipate additional contributions for the 2013 plan year. The following is a summary of net periodic pension costs for the three-month periods ended March 31, 2013 and 2012.

|  | Three Months Ended |                   |
|--|--------------------|-------------------|
|  | March 31,<br>2013  | March 31,<br>2012 |
| Service cost                                 | \$ 149,983         | \$ 129,659        |
| Interest cost                                | 87,578             | 81,981            |
| Expected return on plan assets               | (159,020 )         | (135,017 )        |
| Amortization of net obligation at transition | -                  | -                 |
| Amortization of prior service cost           | (3,809 )           | (3,809 )          |
| Amortization of net (gain) or loss           | 50,796             | 43,305            |
| Net periodic pension cost                    | \$ 125,528         | \$ 116,119        |

## Note 6. Fair Value

Accounting Standards Codification (ASC) 820, defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement

The following sections provide a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

**Securities:** Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy.



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## Notes to (unaudited) Consolidated Financial Statements

## Note 6. Fair Value, continued

**Loans Held for Sale:** Loans held for sale are short-term loans purchased at par for resale to investors at the par value of the loan. These loans are generally repurchased within 15 days. Because of the short-term nature and fixed repurchased price, the book value of these loans approximates fair value.

**Impaired Loans:** ASC 820 applies to loans measured for impairment using the practical expedients permitted by ASC 310 including impaired loans measured at an observable market price (if available), or at the fair value of the loan's collateral (if the loan is collateral dependent). Fair value of the loan's collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral.

**Other Real Estate Owned:** Certain assets such as other real estate owned (OREO) are measured at the lower of carrying amount or fair value less cost to sell. We believe that the fair value component in its valuation follows the provisions of ASC 820.

**Derivative Financial Instruments:** The equity derivative contracts are purchased as part of our Indexed Certificate of Deposit (ICD) program and are an offset of an asset and liability. ICD values are measured on the S&P 500 Index.

## Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis.

| March 31, 2013  | Total            | Level 1     | Level 2          | Level 3     |
|---|------------------|-------------|------------------|-------------|
| Government sponsored enterprises                      | \$ 9,020         | \$ -        | \$ 9,020         | \$ -        |
| Mortgage-backed obligations of federal agencies       | 1,463            | -           | 1,463            | -           |
| Investment securities available for sale              | \$ 10,483        | \$ -        | \$ 10,483        | \$ -        |
| <b>Total assets at fair value</b>                     | <b>\$ 10,483</b> | <b>\$ -</b> | <b>\$ 10,483</b> | <b>\$ -</b> |
| <b>Total liabilities at fair value</b>                | <b>\$ -</b>      | <b>\$ -</b> | <b>\$ -</b>      | <b>\$ -</b> |
| <b>Derivative financial instruments at fair value</b> | <b>\$ 22</b>     | <b>\$ -</b> | <b>\$ 22</b>     | <b>\$ -</b> |
| <br>  |                  |             |                  |             |
| December 31, 2012                                     | Total            | Level 1     | Level 2          | Level 3     |
| Government sponsored enterprises                      | \$ 7,031         | \$ -        | \$ 7,031         | \$ -        |
| Mortgage-backed obligations of federal agencies       | 1,647            | -           | 1,647            | -           |
| Investment securities available for sale              | 8,678            | -           | 8,678            | -           |
| <b>Total assets at fair value</b>                     | <b>\$ 8,678</b>  | <b>\$ -</b> | <b>\$ 8,678</b>  | <b>\$ -</b> |
| <b>Total liabilities at fair value</b>                | <b>\$ -</b>      | <b>\$ -</b> | <b>\$ -</b>      | <b>\$ -</b> |
| <b>Derivative financial instruments at fair value</b> | <b>\$ 15</b>     | <b>\$ -</b> | <b>\$ 15</b>     | <b>\$ -</b> |



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## Notes to (unaudited) Consolidated Financial Statements

Note 6. Fair Value, continued

## Assets and Liabilities Recorded at Fair Value on a Non-recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a non-recurring basis. The Company has determined that Other Real Estate Owned and Impaired Loans are Level 3.

| March 31, 2013                            | Total    | Level 1 | Level 2  | Level 3  |
|---|----------|---------|----------|----------|
| Loans Held for Sale                       | \$21,130 | \$-     | \$21,130 | \$-      |
| Other Real Estate Owned                   | 2,769    | -       | -        | 2,769    |
| Construction/Land Development             | 10,509   | -       | -        | 10,509   |
| Farmland                                  | -        | -       | -        | -        |
| Real Estate                               | 1,192    | -       | -        | 1,192    |
| Multi-Family                              | -        | -       | -        | -        |
| Commercial Real Estate                    | 903      | -       | -        | 903      |
| Home Equity – closed end                  | 418      | -       | -        | 418      |
| Home Equity – open end                    | 106      | -       | -        | 106      |
| Commercial & Industrial – Non-Real Estate | -        | -       | -        | -        |
| Consumer                                  | -        | -       | -        | -        |
| Credit cards                              | -        | -       | -        | -        |
| Dealer Finance                            | -        | -       | -        | -        |
| Total Impaired loans                      | 13,128   | -       | -        | 13,128   |
| Total assets at fair value                | \$37,027 | \$-     | \$21,130 | \$15,897 |
| Total liabilities at fair value           | \$-      | \$-     | \$-      | \$-      |
| December 31, 2012                         | Total    | Level 1 | Level 2  | Level 3  |
| Loans Held for Sale                       | \$77,207 | \$-     | \$77,207 | \$-      |
| Other Real Estate Owned                   | 2,884    | -       | -        | 2,884    |
| Construction/Land Development             | 9,100    | -       | -        | 9,100    |
| Farmland                                  | -        | -       | -        | -        |
| Real Estate                               | 756      | -       | -        | 756      |
| Multi-Family                              | -        | -       | -        | -        |
| Commercial Real Estate                    | 1,422    | -       | -        | 1,422    |
| Home Equity – closed end                  | 298      | -       | -        | 298      |
| Home Equity – open end                    | 171      | -       | -        | 171      |
| Commercial & Industrial – Non-Real Estate | 431      | -       | -        | 431      |
| Consumer                                  | 2        | -       | -        | 2        |
| Credit cards                              | -        | -       | -        | -        |
| Dealer Finance                            | -        | -       | -        | -        |
| Total Impaired loans                      | 12,180   | -       | -        | 12,180   |
| Total assets at fair value                | \$92,271 | \$-     | \$77,207 | \$15,064 |

|                                 |     |     |     |     |
|---------------------------------|-----|-----|-----|-----|
| Total liabilities at fair value | \$- | \$- | \$- | \$- |
|---------------------------------|-----|-----|-----|-----|

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## Notes to (unaudited) Consolidated Financial Statements

## Note 7. Disclosures About Fair Value of Financial Instruments

ASC 825 “Financial Instruments” defines the fair value of a financial instrument as the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation or sale. As the majority of the Bank’s financial instruments lack an available trading market, significant estimates, assumptions and present value calculations are required to determine estimated fair value. The following presents the carrying amount, fair value and placement in the fair value hierarchy of the Company’s financial instruments as of March 31, 2013 and December 31, 2012. This table excludes financial instruments for which the carrying amount approximates the fair value, which would be Level 1; inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. All financial instruments below are considered Level 2; inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

|                              | March 31, 2013          |                   | December 31, 2012       |                   |
|------------------------------|-------------------------|-------------------|-------------------------|-------------------|
|                              | Estimated<br>Fair Value | Carrying<br>Value | Estimated<br>Fair Value | Carrying<br>Value |
| <b>Financial Assets</b>      |                         |                   |                         |                   |
| Loans                        | \$491,963               | \$465,742         | \$488,164               | \$465,819         |
| <b>Financial Liabilities</b> |                         |                   |                         |                   |
| Time deposits                | \$203,623               | \$200,909         | \$203,539               | \$201,518         |
| Long-term debt               | \$34,739                | \$32,286          | \$39,551                | \$37,714          |

The carrying value of cash and cash equivalents, other investments, deposits with no stated maturities, short-term borrowings, and accrued interest approximate fair value. The fair value of securities was calculated using the most recent transaction price or a pricing model, which takes into consideration maturity, yields and quality. The remaining financial instruments were valued based on the present value of estimated future cash flows, discounted at various rates in effect for similar instruments entered into as of the end of each respective period shown above.

## Note 8. Troubled Debt Restructuring

As a result of adopting the amendments in ASU 2011-02, the Company reassessed all restructurings that occurred on or after the beginning of the fiscal year of adoption (January 1, 2011) to determine whether they are considered troubled debt restructurings (TDRs) under the amended guidance. The Company identified as TDRs certain loans for which the allowance for loan losses had previously been measured under a general allowance methodology. Upon identifying those loans as TDRs, the Company identified them as impaired under the guidance in ASC 310-10-35. The amendments in ASU 2011-02 require prospective application of the impairment measurement guidance in ASC 310-10-35 for those loans newly identified as impaired. At the end of the first interim period of adoption (September 30, 2011), the recorded investment in loans for which the allowance was previously measured under a general allowance methodology and are now impaired under ASC 310-10-35 was \$7,020,000, which had no effect on the allowance for loan losses.





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## Notes to (unaudited) Consolidated Financial Statements

## Note 8. Troubled Debt Restructuring (continued)

In the determination of the allowance for loan losses, management considers troubled debt restructurings and subsequent defaults in these restructurings by adjusting the loan grades of such loans, which figure into the environmental factors associated with the allowance. Defaults resulting in charge-offs affect the historical loss experience ratios which are a component of the allowance calculation. Additionally, specific reserves may be established on restructured loans evaluated individually.

During the three months ended, March 31, 2013, there were no loan modifications that were considered to be troubled debt restructurings. There were also no troubled debt restructurings from the previous twelve months that went into default in the first quarter of 2013. A restructured loan is considered in default when it becomes 90 days past due.

During the twelve months ended March 31, 2012, the Bank modified 1 loan that was considered to be troubled debt restructurings. Modifications may have included rate adjustments, revisions to amortization schedules, suspension of principal payments for a temporary period, re-advancing funds to be applied as payments to bring the loan(s) current, or any combination thereof.

|                              | Number<br>of<br>Contracts | For the three months ending<br>March 31, 2012             |  |
|------------------------------|---------------------------|---|--|
|                              |                           | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
| Troubled Debt Restructurings |                           |   |  |
| Commercial                   |                           | \$ -  | \$ -   |
| Real Estate                  | 1                         | 147   | 147  |
| Home Equity                  |                           | -   | -  |
| Credit Cards                 |                           | -   | -  |
| Consumer                     |                           | -   | -  |
| Total                        |                           | \$ 147  | \$ 147   |

As of March 31, 2012, there were no troubled debt restructurings from the previous twelve months that went into default during the quarter. A restructured loan is considered in default when it becomes 90 days past due.

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F & M BANK CORP.

Notes to (unaudited) Consolidated Financial Statements

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

F & M Bank Corp. (Company) incorporated in Virginia in 1983, is a one-bank holding company pursuant to section 3(a)(1) of the Bank Holding Company Act of 1956, which provides financial services through its wholly-owned subsidiary Farmers & Merchants Bank (Bank). TEB Life Insurance Company (TEB) and Farmers & Merchants Financial Services (FMFS) are wholly-owned subsidiaries of the Bank. The Bank also holds a majority ownership in VBS Mortgage LLC (VBS).

The Bank is a full service commercial bank offering a wide range of banking and financial services through its nine branch offices. As well as its loan production offices located in Penn Laird, VA (which specializes in providing automobile financing through a network of automobile dealers) and in Fishersville, VA. TEB reinsures credit life and accident and health insurance sold by the Bank in connection with its lending activities. FMFS provides title insurance, brokerage services and property/casualty insurance to customers of the Bank. VBS originates conventional and government sponsored mortgages through their offices in Harrisonburg and Woodstock.

The Company's primary trade area services customers in Rockingham County, Shenandoah County, Page County and Augusta County.

Management's discussion and analysis is presented to assist the reader in understanding and evaluating the financial condition and results of operations of the Company. The analysis focuses on the consolidated financial statements, footnotes, and other financial data presented. The discussion highlights material changes from prior reporting periods and any identifiable trends which may affect the Company. Amounts have been rounded for presentation purposes. This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and the Notes to the Consolidated Financial Statements presented in Item 1, Part 1 of this Form 10-Q.

Forward-Looking Statements

Certain statements in this report may constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that include projections, predictions, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often characterized by the use of qualified words (and their derivatives) such as "expect," "believe," "estimate," "plan," "project," or other statements concerning opinions or judgment of the Company and its management about future events.

Although the Company believes that its expectations with respect to certain forward-looking statements are based upon reasonable assumptions within the bounds of its existing knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Actual future results and trends may differ materially from historical results or those anticipated depending on a variety of factors, including, but not limited to, the effects of and changes in: general economic conditions, the interest rate environment, legislative and regulatory requirements, competitive pressures, new products and delivery systems, inflation, changes in the stock and bond markets, technology, and consumer spending and savings habits.

We do not update any forward-looking statements that may be made from time to time by or on behalf of the Company.



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Notes to (unaudited) Consolidated Financial Statements

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Critical Accounting Policies

General

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within the statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. The Company uses historical loss factors as one factor in determining the inherent loss that may be present in its loan portfolio. Actual losses could differ significantly from the historical factors that are used. The fair value of the investment portfolio is based on period end valuations but changes daily with the market. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of these transactions would be the same, the timing of events that would impact these transactions could change.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on two basic principles of accounting: (i) ASC 450 "Contingencies", which requires that losses be accrued when they are probable of occurring and estimable and (ii) ASC 310 "Receivables", which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance. For further discussion refer to page 31 in the Management Discussion and Analysis.

Goodwill and Intangibles

ASC 805 "Business Combinations" and ASC 350 "Intangibles" require that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Additionally, it further clarifies the criteria for the initial recognition and measurement of intangible assets separate from goodwill. ASC 350 prescribes the accounting for goodwill and intangible assets subsequent to initial recognition. The provisions of ASC 350 discontinue the amortization of goodwill and intangible assets with indefinite lives. Instead, these assets will be subject to at least an annual impairment review and more frequently if certain impairment indicators are in evidence. ASC 350 also requires that reporting units be identified for the purpose of assessing potential future impairments of goodwill.

Securities Impairment

For a complete discussion of securities impairment see Note 2 of the Notes to Consolidated Financial Statements.

Overview

Net income for the three months ended March 31, 2013 was \$1,216,000 or \$.49 per share, compared to \$1,135,000 or \$.46 in the same period in 2012, an increase of 7.14%. During the three months ended March 31, 2013, noninterest income, exclusive of securities transactions, increased 15.33% and noninterest expense increased 10.83% during the

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same period. Net income from Bank operations adjusted for income or loss from Parent activities is as follows:

| In thousands                                    | 2013    | 2012    |
|---|---------|---------|
| Net Income from Bank Operations                 | \$1,207 | \$1,104 |
| Income or (loss) from Parent Company Activities | 9       | 31      |
| Net Income for the three months ended March 31  | \$1,216 | \$1,135 |

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F &amp; M BANK CORP.

## Notes to (unaudited) Consolidated Financial Statements

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Core operating earnings, (exclusive of securities transactions, non-recurring tax adjustments and non-recurring historic rehabilitation credits related to the investment in low income housing projects) totaled \$1,148,000 in 2013 and \$1,048,000 in 2012, an increase of 9.54%. Income from core operations increased in 2013 primarily due to a decrease in interest expense. A reconciliation of core earnings follows:

| In thousands                                      | 2013    | 2012    |
|---|---------|---------|
| Net Income  | \$1,216 | \$1,135 |
| Non-recurring Tax Items                           | (68 )   | (87 )   |
| Non-recurring Securities Transactions, net of tax | -       | -       |
| Core Earnings for the three months ended March 31 | \$1,148 | \$1,048 |

Management and the Board of Directors use Core Earnings (a non-GAAP financial measure) in a variety of ways, including comparing various operating units (branches) to prior periods, establishing goals and incentive plans that are based on Core Earnings.

## Results of Operations

As shown in Table I, the 2013 year to date tax equivalent net interest income increased \$326,000 or 6.50% compared to the same period in 2012. The yield on earning assets decreased .25%, while the cost of funds decreased .39% compared to the same period in 2012.

Year to date, the combination of the decrease in both yield on assets and the decrease in cost of funds coupled with changes in balance sheet leverage has resulted in the net interest margin increasing to 3.98%, an increase of .10% when compared to the same period in 2012. A schedule of the net interest margin for the three month periods ended March 31, 2013 and 2012 can be found in Table I on page 35.

The Interest Sensitivity Analysis contained in Table II on page 36 indicates the Company is in an asset sensitive position in the one year time horizon. As the notes to the table indicate, the data was based in part on assumptions as to when certain assets or liabilities would mature or reprice. Approximately 51.52% of rate sensitive assets and 43.64% of rate sensitive liabilities are subject to repricing within one year. Due to the relatively flat yield curve, management has continued to reduce deposit rates. Liquid assets have been used to pay off maturing long term FHLB borrowings, which when coupled with depositors reluctance to tie up funds at historically low rates has resulted in the decrease in the positive GAP position in the one year time period.

Noninterest income, exclusive of securities transactions, increased \$119,000 or 15.33% for the three month period ended March 31, 2013. The increase is primarily due to increase in Insurance and Other Commissions income and income derived from Bank Owned Life Insurance.

Noninterest expense increased \$352,000 for the three month period ended March 31, 2013 as compared to 2012. Salary and benefits expense increased \$235,000 (12.32%) through March 2013. This increase is resulted primarily from lending personnel hired to staff the new loan production offices, as well as normal salary increases, health insurance and retirement plan expenses. Exclusive of personnel expenses, other noninterest expenses increased at a

rate of 8.70% for the first three months of 2013 as compared to 2012. The primary reasons for the increase in these expenses relates to increases in the FDIC Assessment, legal and professional expenses, and data processing expenses. Operating costs continue to compare very favorably to the peer group. As stated in the most recently available (December 31, 2012) Bank Holding Company Performance Report, the Company's and peer's noninterest expenses averaged 2.35% and 3.14% of average assets, respectively. The Company's operating costs have always compared favorably to the peer group due to an excellent asset to employee ratio and below average facilities costs.

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Notes to (unaudited) Consolidated Financial Statements

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Balance Sheet

Federal Funds Sold and Interest Bearing Bank Deposits

The Company's subsidiary bank invests a portion of its excess liquidity in either federal funds sold or interest bearing bank deposits. Federal funds sold offer daily liquidity and pay market rates of interest that at quarter end were benchmarked at 0% to .25% by the Federal Reserve. Actual rates received vary slightly based upon money supply and demand among banks. Interest bearing bank deposits are held either in money market accounts or as short-term certificates of deposits. Combined balances in fed funds sold and interest bearing bank deposits have increased since year end.

Securities

The Company's securities portfolio serves several purposes. Portions of the portfolio are held to assist the Company with liquidity, asset liability management and as security for certain public funds and repurchase agreements.

The securities portfolio consists of investment securities commonly referred to as securities held to maturity and securities available for sale. Securities are classified as Held to Maturity investment securities when management has the intent and ability to hold the securities to maturity. Held to Maturity Investment securities are carried at amortized cost. Securities available for sale include securities that may be sold in response to general market fluctuations, liquidity needs and other similar factors. Securities available for sale are recorded at market value. Unrealized holding gains and losses on available for sale securities are excluded from earnings and reported (net of deferred income taxes) as a separate component of stockholders' equity.

As of March 31, 2013, the market value of securities available for sale exceeded their cost by \$36,000. This includes an increase in the value of government obligations held by the Bank. The portfolio is made up of primarily agency securities with an average portfolio life of just over one year. This short average life results in less portfolio volatility and positions the Bank to redeploy assets in response to rising rates. There is \$2,010,000 of securities scheduled to mature in 2013.

In reviewing investments as of March 31, 2013, there were no securities which met the definition for other than temporary impairment. Management continues to re-evaluate the portfolio for impairment on a quarterly basis.

Loan Portfolio

The Company operates in a predominately rural area that includes the counties of Rockingham, Page, Shenandoah and Augusta in the western portion of Virginia. The local economy benefits from a variety of businesses including agri-business, manufacturing, service businesses and several universities and colleges. The Bank is an active residential mortgage and residential construction lender and generally makes commercial loans to small and mid size businesses and farms within its primary service area.

Lending is geographically diversified within the service area. The only concentration within the portfolio is in construction and development lending. Management and the Board of Directors review this concentration and other potential areas of concentration quarterly.





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## Notes to (unaudited) Consolidated Financial Statements

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Loans Held for Investment at \$465,742,000 remained virtually flat compared to December 31, 2012. However, the dealer finance portfolio increased \$4.2 million and construction and land development loans increased \$4.3 million. These increases were offset by decreases in the amortizing real estate lending (both consumer and commercial) totaling \$5.4 million and consumer loans totaling \$1.5 million.

Loans Held for Sale totaled \$21,130,000 at March 31, 2013, a decrease of \$56,067,000 compared to December 31, 2012. Secondary Market loan originations are typically subject to seasonal declines in the first quarter of each calendar year. This seasonal drop in volume was compounded by a modest increase in interest rates, which resulted in a reduction in mortgage refinancing for the period. The funds resulting from this decrease allowed the Company to repay FHLB short term borrowings and led to increased liquidity in the first quarter.

Nonperforming loans include nonaccrual loans and loans 90 days or more past due. Nonaccrual loans are loans on which interest accruals have been suspended or discontinued permanently. Nonperforming loans totaled \$11,685,000 at March 31, 2013 compared to \$13,386,000 at December 31, 2012. Although the potential exists for loan losses, management believes the bank is generally well secured and continues to actively work with its customers to effect payment. As of March 31, 2013, the Company holds \$2,769,000 of real estate which was acquired through foreclosure. This is decrease of \$115,000 compared to December 31, 2012.

The following is a summary of information pertaining to risk elements and nonperforming loans (in thousands):

|  | March 31,<br>2013 | December<br>31,<br>2012 |      |   |
|--|-------------------|-------------------------|------|---|
| Nonaccrual Loans   |                   |                         |      |   |
| Real Estate  | \$8,164           | \$9,611                 |      |   |
| Commercial   | 2,690             | 2,914                   |      |   |
| Home Equity  | 474               | 740                     |      |   |
| Other  | 108               | 121                     |      |   |
|  | 11,436            | 13,386                  |      |   |
| Loans past due 90 days or more (excluding nonaccrual)            |                   |                         |      |   |
| Real Estate  | 172               | -                       |      |   |
| Commercial   | 74                | -                       |      |   |
| Home Equity  | -                 | -                       |      |   |
| Other  | 3                 | -                       |      |   |
|  | 249               | -                       |      |   |
| Total Nonperforming loans  | \$11,685          | \$13,386                |      |   |
| Nonperforming loans as a percentage of loans held for investment | 2.51              | %                       | 2.87 | % |
| Net Charge Offs to total loans held for investment               | .17               | %                       | .64  | % |

---

|  |       |   |       |   |
|--|-------|---|-------|---|
| Allowance for loan and lease losses to nonperforming loans | 70.68 | % | 60.91 | % |
|--|-------|---|-------|---|

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Notes to (unaudited) Consolidated Financial Statements

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Allowance for Loan Losses

The allowance for loan losses provides for the risk that borrowers will be unable to repay their obligations. The risk associated with real estate and installment notes to individuals is based upon employment, the local and national economies and consumer confidence. All of these affect the ability of borrowers to repay indebtedness. The risk associated with commercial lending is substantially based on the strength of the local and national economies.

Management evaluates the allowance for loan losses on a quarterly basis in light of national and local economic trends, changes in the nature and volume of the loan portfolio and trends in past due and criticized loans. Specific factors evaluated include internally generated loan review reports, past due reports, historical loan loss experience and changes in the financial strength of individual borrowers that have been included on the Bank's watch list or schedule of classified loans.

In evaluating the portfolio, loans are segregated into loans with identified potential losses and pools of loans by type and a general allowance based on a variety of criteria. Loans with identified potential losses include examiner and bank classified loans. Classified relationships in excess of \$500,000 are reviewed individually for impairment under ASC 310. A variety of factors are taken into account when reviewing these credits including borrower cash flow, payment history, fair value of collateral, company management, the industry in which the borrower is involved and economic factors. Loan relationships that are determined to have no impairment are placed back into the appropriate loan pool and reviewed under ASC 450.

For loans that are not impaired, the portfolio is segmented into multiple pools of homogenous loan types that do not exhibit any signs of weakness. Loss rates are assigned based on historical charge offs over the prior two year period. A general allowance for inherent losses (such as trends in past due/criticized loans, volume and terms of loans, changes in lending policies/procedures, experience of lending staff/management, local/national economic trends and credit concentrations) has been established to reflect other unidentified losses within the portfolio. The general allowance assists in managing recent changes in portfolio risk that may not be captured in individually impaired loans or in the homogeneous pools based on two year loss histories. The Board approves the loan loss provision for each quarter based on this evaluation. An effort is made to keep the actual allowance at or above the midpoint of the range established by the evaluation process.

The allowance for loan losses of \$8,259,000 at March 31, 2013 is equal to 1.77% of loans held for investment. This compares to an allowance of \$8,154,000 (1.75%) at December 31, 2012. Based on the evaluation of the loan portfolio described above, management has funded the allowance a total of \$900,000 in the first three months of 2013. Net charge-offs year to date totaled \$795,000.

The overall level of the allowance has been increasing for several years and now approximates the national peer group average. Based on historical losses, delinquency rates, collateral values of delinquent loans and a thorough review of the loan portfolio, management is of the opinion that the allowance for loan losses fairly states the estimated losses in the current portfolio.



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F & M BANK CORP.

Notes to (unaudited) Consolidated Financial Statements

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Deposits and Other Borrowings

The Company's main source of funding is comprised of deposits received from individuals, governmental entities and businesses located within the Company's service area. Deposit accounts include demand deposits, savings, money market and certificates of deposit. Total deposits have increased \$5,184,000 since December 31, 2012. Time deposits decreased \$609,000 during this period while demand deposits and savings deposits increased \$5,793,000. The decrease in certificates of deposits is a result of a decrease in core time deposits. The increase in demand deposits and savings deposits is a result of new account growth during the year. The Bank also participates in the CDARS program. CDARS (Certificate of Deposit Account Registry Service) is a program that allows the bank to accept customer deposits in excess of FDIC limits and through reciprocal agreements with other network participating banks by offering FDIC insurance up to as much as \$50 million in deposits. The CDARS program also allows the Bank to purchase funds through its One-Way Buy program. At quarter end the Bank had a total of \$10.6 million in CDARS funding, which is an increase of \$2.9 million over December 31, 2012.

Short-term debt

Short-term debt consists of federal funds purchased, daily rate credit obtained from the Federal Home Loan Bank (FHLB), short-term fixed rate FHLB borrowings and commercial repurchase agreements (repos). Commercial customers deposit operating funds into their checking account and by mutual agreement with the bank their excess funds are swept daily into the repurchase accounts. These accounts are not considered deposits and are not insured by the FDIC. The Bank pledges securities held in its investment portfolio as collateral for these short-term loans. Federal funds purchased are overnight borrowings obtained from the Bank's primary correspondent bank to manage short-term liquidity needs. Borrowings from the FHLB have been used to finance loans held for sale and also to finance the increase in short-term residential and commercial construction loans. As of March 31, 2013 there were no FHLB short-term borrowings and commercial repurchase agreements totaled \$3,172,000.

Long-term debt

Borrowings from the FHLB continue to be an important source of funding. The Company's subsidiary bank borrows funds on a fixed rate basis. These borrowings are used to fund loan growth and also assist the Bank in matching the maturity of its fixed rate real estate loan portfolio with the maturity of its debt and thus reduce its exposure to interest rate changes. Scheduled repayments totaled \$5,428,000 through March 31, 2013. There were no additional borrowings through March 31, 2013.

In August 2009, the Company began issuing subordinated debt agreements with local investors with terms of 7 to 10 years. Interest rates are fixed on the notes for the full term but vary by maturity. Rates range from 7.0% on the 7 year note to 8.05% on the 10 year note. As of March 31, 2013 the balance outstanding was \$10,191,000.

Capital

The Company seeks to maintain a strong capital base to expand facilities, promote public confidence, support current operations and grow at a manageable level. As of March 31, 2013, the Company's total risk based capital and leverage ratios were 14.82% and 8.61%, respectively, increasing over year end from 13.98% and 8.29%, respectively.

For the same period, Bank only total risk based capital and leverage ratios were 14.92% and 8.68%, respectively, increasing over year end from 14.10% and 8.36%, respectively . For both the Company and the Bank these ratios are in excess of regulatory minimums.

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F & M BANK CORP.

Notes to (unaudited) Consolidated Financial Statements

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Liquidity

Liquidity is the ability to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest-bearing deposits with banks, federal funds sold, investments and loans maturing within one year. Liquidity increased significantly in the first quarter as repayments of Loans Held for Sale were used to increase Federal Funds Sold and to repay short term FHLB debt. The decrease in Loans Held for Sale is a result of seasonal fluctuations in mortgage lending and an uptick in mortgage rates. The Company's ability to obtain deposits and purchase funds at favorable rates determines its liquidity exposure. As a result of the Company's management of liquid assets and the ability to generate liquidity through liability funding, management believes that the Company maintains overall liquidity sufficient to satisfy its depositors' requirements and meet its customers' credit needs.

Additional sources of liquidity available to the Company include, but are not limited to, loan repayments, the ability to obtain deposits through the adjustment of interest rates and the purchasing of federal funds. To further meet its liquidity needs, the Company's subsidiary bank also maintains a line of credit with its primary correspondent financial institution. The Bank also has a line of credit with the Federal Home Loan Bank of Atlanta that allows for secured borrowings.

Interest Rate Sensitivity

In conjunction with maintaining a satisfactory level of liquidity, management must also control the degree of interest rate risk assumed on the balance sheet. Managing this risk involves regular monitoring of interest sensitive assets relative to interest sensitive liabilities over specific time intervals. The Company monitors its interest rate sensitivity periodically and makes adjustments as needed. There are no off balance sheet items that will impair future liquidity.

As of March 31, 2013, the Company had a cumulative Gap Rate Sensitivity Ratio of 16.73% for the one year repricing period. This generally indicates that earnings would increase in an increasing interest rate environment as assets reprice more quickly than liabilities. However, in actual practice, this may not be the case as balance sheet leverage, funding needs and competitive factors within the market could dictate the need to raise deposit rates more quickly. Management constantly monitors the Company's interest rate risk and has decided the current position is acceptable for a well-capitalized community bank.

A summary of asset and liability repricing opportunities is shown in Table II, on page 36.

Stock Repurchase

On September 18, 2008, the Company's Board of Directors approved an increase in the number of shares of common stock that the Company can repurchase under the share repurchase program from 150,000 to 200,000 shares. However, due to the impact on capital ratios resulting from the growth in the balance sheet, other than temporary impairment securities write downs in 2009 and increased funding of the allowance for loan losses, the stock repurchase plan has been suspended. There have been no stock repurchases in 2013.

Effect of Newly Issued Accounting Standards



In July 2012, the Intangibles topic was amended to permit an entity to consider qualitative factors to determine whether it is more likely than not that indefinite-lived intangible assets are impaired. If it is determined to be more likely than not that indefinite-lived intangible assets are impaired, then the entity is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The amendments did not have a material effect on the Company's financial statements.

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F & M BANK CORP.

Notes to (unaudited) Consolidated Financial Statements

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

In February 2013, the FASB further amended the Comprehensive Income topic clarifying the conclusions from such redeliberations. Specifically, the amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. These amendments did not have a material effect on the Company's financial statements.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not expected to have a material effect on the Company's financial position, result of operations or cash flows.

Existence of Securities and Exchange Commission Web Site

The Securities and Exchange Commission maintains a Web site that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Commission, including F & M Bank Corp. and the address is (<http://www.sec.gov>).

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F &amp; M BANK CORP.

Notes to (unaudited) Consolidated Financial Statements

TABLE I

F & M BANK CORP.  
Net Interest Margin Analysis  
(on a fully taxable equivalent basis)  
(Dollar Amounts in Thousands)

| Average   | Three Months Ended<br>March 31, 2013 |                    |                  | Three Months Ended<br>March 31, 2012 |                    |                  |        |
|---|--------------------------------------|--------------------|------------------|--------------------------------------|--------------------|------------------|--------|
|   | Balance <sup>2,4</sup>               | Income/<br>Expense | Average<br>Rates | Balance <sup>2,4</sup>               | Income/<br>Expense | Average<br>Rates |        |
| Interest income                                 |                                      |                    |                  |                                      |                    |                  |        |
| Loans held for investment <sup>1,2</sup>        | \$467,240                            | \$6,238            | 5.41 %           | \$450,331                            | \$6,281            | 5.59 %           |        |
| Loans held for sale                             | 42,362                               | 330                | 3.16 %           | 40,877                               | 379                | 3.73 %           |        |
| Federal funds sold                              | 20,144                               | 10                 | .20 %            | 13,021                               | 7                  | .22 %            |        |
| Interest bearing deposits                       | 1,690                                | 2                  | .48 %            | 1,489                                | 2                  | .27 %            |        |
| Investments                                     |                                      |                    |                  |                                      |                    |                  |        |
| Taxable <sup>3</sup>                            | 12,463                               | 43                 | 1.40 %           | 13,181                               | 46                 | 1.37 %           |        |
| Partially taxable                               | 107                                  | 0                  | -                | 108                                  | -                  | 1.86 %           |        |
| Total earning assets                            | \$544,006                            | \$6,623            | 4.94 %           | \$519,007                            | \$6,715            | 5.19 %           |        |
| Interest Expense                                |                                      |                    |                  |                                      |                    |                  |        |
| Demand deposits                                 | 122,253                              | 189                | .63 %            | 121,169                              | 346                | 1.15 %           |        |
| Savings   | 49,942                               | 50                 | .41 %            | 41,808                               | 49                 | .48 %            |        |
| Time deposits                                   | 204,426                              | 634                | 1.26 %           | 206,206                              | 776                | 1.51 %           |        |
| Short-term debt                                 | 13,679                               | 17                 | .50 %            | 6,428                                | 6                  | .37 %            |        |
| Long-term debt                                  | 42,929                               | 388                | 3.67 %           | 52,248                               | 519                | 3.98 %           |        |
| Total interest bearing liabilities              | \$433,229                            | \$1,278            | 1.20 %           | \$427,859                            | \$1,696            | 1.59 %           |        |
| Tax equivalent net interest income <sup>1</sup> |                                      |                    |                  |                                      |                    |                  |        |
|   |                                      | \$5,345            |                  |                                      | \$5,019            |                  |        |
| Net interest margin                             |                                      |                    | 3.98 %           |                                      |                    |                  | 3.88 % |

1 Interest income on loans includes loan fees.

2 Loans held for investment include nonaccrual loans.

3 An incremental income tax rate of 34% was used to calculate the tax equivalent income on nontaxable and partially taxable investments and loans.

4 Average balance information is reflective of historical cost and has not been adjusted for changes in market value annualized.

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F &amp; M BANK CORP.

Notes to (unaudited) Consolidated Financial Statements

TABLE II

F & M BANK CORP.  
Interest Sensitivity AnalysisMarch 31, 2013  
(In Thousands of Dollars)

The following table presents the Company's interest sensitivity.

|  | 0 – 3<br>Months | 4 – 12<br>Months | 1 – 5<br>Years | Over 5<br>Years | Not<br>Classified | Total     |
|--|-----------------|------------------|----------------|-----------------|-------------------|-----------|
| Uses of funds                                      |                 |                  |                |                 |                   |           |
| Loans  |                 |                  |                |                 |                   |           |
| Commercial   | \$35,063        | \$30,526         | \$86,098       | \$13,614        | \$-               | \$165,301 |
| Installment  | 4,499           | 1,123            | 10,980         | 2,551           | -                 | 19,153    |
| Real estate loans for<br>investments               | 88,234          | 57,382           | 118,966        | 14,165          | -                 | 278,747   |
| Loans held for sale                                | 21,130          | -                | -              | -               | -                 | 21,130    |
| Credit cards                                       | 2,541           | -                | -              | -               | -                 | 2,541     |
| Federal funds sold                                 | 27,244          | -                | -              | -               | -                 | 27,244    |
| Interest bearing bank<br>deposits                  | 730             | 248              | -              | -               | -                 | 978       |
| Investment securities                              | 107             | 2,010            | 7,010          | 1,463           | -                 | 10,590    |
| Total  | \$179,548       | \$91,289         | \$223,054      | \$31,793        | \$-               | \$525,684 |
| Sources of funds                                   |                 |                  |                |                 |                   |           |
| Interest bearing demand<br>deposits                |                 |                  |                |                 |                   |           |
| Savings deposits                                   | \$-             | \$32,023         | \$70,748       | \$19,362        | \$-               | \$122,133 |
| Certificates of deposit                            | -               | 10,096           | 30,289         | 10,096          | -                 | 50,481    |
| \$100,000 and over                                 | 12,250          | 27,232           | 30,559         | -               | -                 | 70,041    |
| Other certificates of deposit                      | 18,775          | 54,575           | 57,518         | -               | -                 | 130,868   |
| Short-term borrowings                              | 3,172           | -                | -              | -               | -                 | 3,172     |
| Long-term borrowings                               | 9,429           | 15,357           | 11,138         | 6,553           | -                 | 42,477    |
| Total  | \$43,626        | \$139,283        | \$200,252      | \$36,011        | \$-               | \$419,172 |
| Discrete Gap                                       | \$135,922       | \$(47,994 )      | \$22,802       | \$(4,218 )      | \$-               | \$106,512 |
| Cumulative Gap                                     | \$135,922       | \$87,928         | \$110,730      | \$106,512       | \$106,512         |           |
| Ratio of Cumulative Gap to<br>Total Earning Assets | 25.86           | % 16.73          | % 21.06        | % 20.26         | % 20.26           | %         |

Table II reflects the earlier of the maturity or repricing dates for various assets and liabilities as of March 31, 2013. In preparing the above table, no assumptions were made with respect to loan prepayments. Loan principal payments are

included in the earliest period in which the loan matures or can reprice. Principal payments on installment loans scheduled prior to maturity are included in the period of maturity or repricing. Proceeds from the redemption of investments and deposits are included in the period of maturity. Estimated maturities of deposits, which have no stated maturity dates, were derived from guidance contained in FDICIA 305.

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F & M BANK CORP.

Notes to (unaudited) Consolidated Financial Statements

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As a result of the enactment of the Sarbanes-Oxley Act of 2002, issuers such as F & M Bank Corp. that file periodic reports under the Securities Exchange Act of 1934 (the "Act") are required to include in those reports certain information concerning the issuer's controls and procedures for complying with the disclosure requirements of the federal securities laws. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports it files or submits under the Act, is communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

We have established our disclosure controls and procedures to ensure that material information related to the Company is made known to our principal executive officers and principal financial officer on a regular basis, in particular during the periods in which our quarterly and annual reports are being prepared. These disclosure controls and procedures consist principally of communications between and among the Chief Executive Officer and the Chief Financial Officer, and the other executive officers of the Company and its subsidiaries to identify any new transactions, events, trends, contingencies or other matters that may be material to the Company's operations. As required, we will evaluate the effectiveness of these disclosure controls and procedures on a quarterly basis, and most recently did so as of the end of the period covered by this report.

The Company's Chief Executive Officer and Chief Financial Officer, based on their evaluation as of the end of the period covered by this quarterly report of the Company's disclosure controls and procedures (as defined in Rule 13(a)-14(e) of the Securities Exchange Act of 1934), have concluded that the Company's disclosure controls and procedures are adequate and effective for purposes of Rule 13(a)-14(e) and timely, alerting them to financial information relating to the Company required to be included in the Company's filings with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

Changes in Internal Controls

Due to the nature of the Company's business as stewards of assets of customers; internal controls are of the utmost importance. The Company has established procedures during the normal course of business to reasonably ensure that fraudulent activity of either a material amount to these results or in any amount is not occurring. In addition to these controls and review by executive officers, the Company retains the services of an internal auditor to complete regular audits, which examine the processes and procedures of the Company and the Bank to ensure that these processes are reasonably effective to prevent internal or external fraud and that the processes comply with relevant regulatory guidelines of all relevant banking authorities. The findings of the internal auditor are presented to management of the Bank and to the Audit Committee of the Company. There were no material changes to the internal controls of the Company.



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F & M BANK CORP.

Notes to (unaudited) Consolidated Financial Statements

PART II OTHER INFORMATION

|   |                |
|---|----------------|
| Item 1. Legal Proceedings –   | Not Applicable |
| Item 1a. Risk Factors –   | Not Applicable |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds – | Not Applicable |
| Item 3. Defaults Upon Senior Securities –                             | Not Applicable |
| Item 4. Mine Safety Disclosures –                                     | Not Applicable |
| Item 5. Other Information –   | Not Applicable |

Item 6. Exhibits

(a) Exhibits

3 i Restated Articles of Incorporation of F & M Bank Corp. are incorporated by reference to Exhibits to F & M Bank Corp.'s 2001 Form 10K filed March 1, 2002.

3 ii Amended and Restated Bylaws of F & M Bank Corp. are incorporated by reference to Exhibits to F & M Bank Corp.'s Form 10K filed March 1, 2002.

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) (filed herewith).

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) (filed herewith).

32 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sabanes-Oxley Act of 2002 (filed herewith).

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

F & M BANK CORP.

May 14, 2013

By: /s/ Dean W. Withers  
Dean W. Withers  
President and Chief Executive  
Officer

By: /s/ Neil W. Hayslett  
Neil W. Hayslett  
Executive Vice President and Chief  
Financial Officer