

F&M BANK CORP
Form 10-Q
August 13, 2012

Financial Statements

F & M Bank Corp.

June 30, 2012

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 June 30, 2012.

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

Edgar Filing: F&M BANK CORP - Form 10-Q

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 August 9, 2012
Common Stock, par value - \$5	2,496,402 shares

F & M BANK CORP.

Index

	Page
Part I Financial Information	2
Item 1. Financial Statements	2
Consolidated Statements of Income – Three Months Ended June 30, 2012 and 2011	2
Consolidated Statements of Income – Six Months Ended June 30, 2012 and 2011	3
Consolidated Statements of Comprehensive Income – Six Months And Three Months Ended Six 30, 2012 and 2011	4
Consolidated Balance Sheets – June 30, 2012 and December 31, 2011	5
Consolidated Statements of Cash Flows – Six Months Ended June 30, 2012 and 2011	6
Consolidated Statements of Changes in Stockholders’ Equity – Six Months Ended June 30, 2012 and 2011	7
Notes to Consolidated Financial Statements	8
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3. Quantitative and Qualitative Disclosures About Market Risk	32
Item 4. Controls and Procedures	32
Part II Other Information	33
Item 1. Legal Proceedings	33
Item 1a. Risk Factors	33
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	33
Item 3. Defaults upon Senior Securities	33
Item 4. Mine Safety Disclosures	33
Item 5. Other Information	33
Item 6. Exhibits	33
Signatures	34

Certifications

1

Part I Financial Information

ITEM FINANCIAL STATEMENTS

1.

F & M BANK CORP.

Consolidated Statements of Income
(In Thousands of Dollars Except per Share Amounts)
(Unaudited)

	Three Months Ended June 30,	
	2012	2011
Interest income		
Interest and fees on loans held for investment	\$6,227	\$6,644
Interest and fees on loans held for sale	217	214
Interest on federal funds sold	12	8
Interest on interest bearing deposits	1	8
Dividends on equity securities	-	53
Interest on debt securities	65	67
Total interest income	6,522	6,994
Interest expense		
Interest on demand deposits	318	430
Interest on savings accounts	53	48
Interest on time deposits over \$100,000	224	296
Interest on other time deposits	515	623
Total interest on deposits	1,110	1,397
Interest on short-term debt	5	4
Interest on long-term debt	508	585
Total interest expense	1,623	1,986
Net interest income	4,899	5,008
Provision for loan losses	900	1,100
Net interest income after provision for loan losses	3,999	3,908
Noninterest income		
Service charges	291	279
Insurance and other commissions	216	162
Other	312	271
Income on bank owned life insurance	129	88
Other than temporary impairment losses	-	(57)
Gain on the sale of securities	-	346
Total noninterest income	948	1,089
Noninterest expense		
Salaries	1,451	1,370
Employee benefits	494	459
Occupancy expense	134	140

Edgar Filing: F&M BANK CORP - Form 10-Q

Equipment expense	142	148
FDIC insurance assessment	181	285
Other	912	937
Total noninterest expense	3,314	3,339
Income before income taxes	1,633	1,658
Income tax expense	454	406
Consolidated net income	1,179	1,252
Net income - Noncontrolling interest	(39)	(21)
Net Income – F & M Bank Corp	\$1,140	\$1,231
Per share data		
Net income	\$.46	\$.49
Cash dividends	\$.16	\$.15
Weighted average shares outstanding	2,495,464	2,488,306

See notes to unaudited consolidated financial statements

F & M BANK CORP.

Consolidated Statements of Income

(In Thousands of Dollars Except per Share Amounts)

(Unaudited)

	Six Months Ended June 30,	
	2012	2011
Interest income		
Interest and fees on loans held for investment	\$12,487	\$13,013
Interest and fees on loans held for sale	596	311
Interest on federal funds sold	19	26
Interest on interest bearing deposits	3	16
Dividends on equity securities	-	87
Interest on debt securities	110	134
Total interest income	13,215	13,587
Interest expense		
Interest on demand deposits	664	861
Interest on savings accounts	102	95
Interest on time deposits over \$100,000	458	596
Interest on time deposits	1,057	1,250
Total interest on deposits	2,281	2,802
Interest on short-term debt	11	9
Interest on long-term debt	1,027	1,207
Total Interest Expense	3,319	4,018
Net interest income	9,896	9,569
Provision for loan losses	1,800	2,200
Net interest income after provision for loan losses	8,096	7,369
Noninterest income		
Service charges	575	519
Insurance and other commissions	349	234
Other	610	663
Income on bank owned life insurance	189	175
Other than temporary impairment losses	-	(57)
Gain on the sale of securities	-	346
Total noninterest income	1,723	1,880
Noninterest expense		
Salaries	2,878	2,695
Employee benefits	974	905
Occupancy expense	269	275
Equipment expense	286	297
Intangible amortization	-	46
FDIC insurance assessment	362	568
Other	1,796	1,825
Total noninterest expense	6,565	6,611

Edgar Filing: F&M BANK CORP - Form 10-Q

Income before income taxes	3,254	2,638
Income taxes	928	701
Consolidated net income	2,326	1,937
Net income – Noncontrolling interest	(51)	(20)
Net Income – F & M Bank Corp	\$2,275	\$1,917
Per share data		
Net income	\$.91	\$.80
Cash dividends	\$.31	\$.30
Weighted average shares outstanding	2,494,611	2,408,023

See notes to unaudited consolidated financial statements

F & M BANK CORP.

Consolidated Statements of Comprehensive Income
(In Thousands of Dollars)
(Unaudited)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2012	2011	2012	2011
Net Income:				
Net Income – F & M Bank Corp	\$ 2,275	\$ 1,917	\$1,140	\$ 1,231
Net Income attributable to noncontrolling interest	51	20	39	21
	2,326	1,937	1,179	1,252
Other comprehensive income (loss):				
Prepaid pension adjustment	-	(52)	-	-
Unrealized holding gains (losses) on available-for-sale securities	17	164	23	(4)
Reclassification adjustment for (gains) losses realized in income	-	(346)	-	(346)
Net unrealized gains (losses)	17	(182)	23	(350)
Tax effect	6	62	8	119
Unrealized holding gain (loss), net of tax	11	(120)	15	(231)
Total other comprehensive income (loss)	11	(172)	15	(231)
Comprehensive income	\$ 2,337	\$ 1,765	\$1,194	\$ 1,021

See notes to unaudited consolidated financial statements

F & M BANK CORP.

Consolidated Balance Sheets

(In Thousands of Dollars Except per Share Amounts)

	June 30, 2012 (Unaudited)	December 31, 2011 (Audited)
Assets		
Cash and due from banks	\$6,359	\$6,813
Federal funds sold	6,560	2,181
Cash and cash equivalents	12,919	8,994
Interest bearing deposits in banks	1,048	1,188
Securities: (note 2)		
Held to maturity – fair value of \$108,000 in 2012 and 2011	108	108
Available for sale	13,010	13,127
Other investments	7,924	8,872
Loans held for sale	40,984	60,543
Loans held for investment (note 3)	450,540	451,570
Less allowance for loan losses (note 4)	(7,607)	(6,937)
Net loans held for investment	442,933	444,633
Other real estate owned		
Bank premises and equipment, net	3,317	3,074
Interest receivable	6,624	6,477
Goodwill	1,700	1,816
Bank owned life insurance	2,670	2,670
Other assets	11,430	7,179
Total assets	\$553,873	\$566,734
Liabilities		
Deposits:		
Noninterest bearing	\$74,317	\$70,789
Interest bearing:		
Demand	96,933	96,683
Money market accounts	20,972	25,177
Savings	47,322	39,940
Time deposits over \$100,000	68,473	66,538
All other time deposits	133,450	136,820
Total deposits	441,467	435,947
Short-term debt		
Accrued liabilities	4,030	18,539
Subordinated debt	9,343	8,770
Long-term debt	10,191	10,191
Total liabilities	41,071	47,107
Stockholders' Equity		
Common stock, \$5 par value, 6,000,000 shares authorized,	506,102	520,554

Edgar Filing: F&M BANK CORP - Form 10-Q

2,496,195 and 2,487,197 shares issued and outstanding in 2012 and 2011, respectively	12,481	12,464
Retained earnings	37,064	35,552
Noncontrolling interest	267	216
Accumulated other comprehensive loss	(2,041)	(2,052)
Total stockholders' equity	47,771	46,180
Total liabilities and stockholders' equity	\$ 553,873	\$ 566,734

See notes to unaudited consolidated financial statements

F & M BANK CORP.

Consolidated Statements of Cash Flows

(In Thousands of Dollars)

(Unaudited)

	Six Months Ended June	
	2012	2011
Cash flows from operating activities		
Net income	\$2,275	\$1,917
Net change – Noncontrolling interest	51	(12)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	310	308
Amortization of security premiums, net	48	29
Net (increase) decrease in loans held for sale	19,559	(18,915)
Provision for loan losses	1,800	2,200
Intangible amortization	-	46
Decrease in interest receivable	116	348
(Increase) decrease in other assets	1,318	(741)
Gain on sale of fixed assets	-	(85)
Decrease in accrued expenses	(1,904)	(635)
Gain on security transactions	-	(289)
Amortization of limited partnership investments	263	233
Income from life insurance investment	(189)	(175)
Other Real Estate Owned valuation adjustments	122	-
Gain on Other Real Estate Owned	(48)	-
Net adjustments	21,395	(17,676)
Net cash provided by (used in) operating activities	23,721	(15,771)
Cash flows from investing activities		
Purchase of investments available for sale	(15,071)	(12,077)
Proceeds from maturity of investments available for sale	15,843	1,035
Proceeds from sales of investments available for sale	-	11,137
Net (increase) decrease in loans held for investment	(1,648)	(18,064)
Proceeds from the sale of other real estate owned	1,232	1,433
Proceeds from the sale of fixed assets	-	276
Purchase of property and equipment	(457)	(113)
Net (increase) decrease in interest bearing bank deposits	140	1,574
Purchase of bank owned life insurance	(4,064)	-
Net cash used in investing activities	(4,025)	(14,799)
Cash flows from financing activities		
Net change in demand and savings deposits	6,956	8,884
Net change in time deposits	(1,435)	492
Net change in short-term debt	(14,509)	6,459
Cash dividends paid	(799)	(682)
Proceeds from rights offering	-	2,381
Proceeds from issuance of common stock	52	47
Proceeds from long-term debt	-	247

Edgar Filing: F&M BANK CORP - Form 10-Q

Repayment of long-term debt	(6,036)	(2,047)
Net cash provided by (used in) financing activities	(15,771)	15,781
Net Increase (Decrease) in Cash and Cash Equivalents	3,925	(14,789)
Cash and cash equivalents, beginning of period	8,994	20,924
Cash and cash equivalents, end of period	\$12,919	\$6,135
Supplemental disclosure		
Cash paid for:		
Interest expense	\$3,153	\$3,989
Income taxes	500	500
Transfers from loans to Other Real Estate Owned	1,549	2,332

See notes to unaudited consolidated financial statements

F & M BANK CORP.

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

	Six Months Ended June 30,	
	2012	2011
Balance, beginning of period	\$ 46,180	\$ 42,229
Comprehensive income		
Net income – F & M Bank Corp	2,275	1,917
Net income attributable to noncontrolling interest	51	20
Prepaid pension adjustment	-	(52)
Net change in unrealized appreciation on securities available for sale, net of taxes	11	(120)
Total comprehensive income	2,337	1,765
Minority Interest Contributed Capital (Distributions)	-	(32)
Issuance of common stock	52	2,428
Dividends declared	(798)	(718)
Balance, end of period	\$ 47,771	\$ 45,672

See notes to unaudited consolidated financial statements

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 June 30, 2012 and the results of operations for the quarters and six month periods ended June 30, 2012 and June 30, 2011. The notes included herein should be read in conjunction with the notes to financial statements included in the 2011 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.

8

F & 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

Commercial 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. Interest accruals are generally continued on past due, secured residential real estate loans and consumer purpose loans until the principal and accrued interest equal the value of the collateral and on unsecured loans until the financial condition of the borrower deteriorates to the point that any further accrued interest would be determined to be uncollectible.

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 June 30, 2012 and December 31, 2011 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 June 30, 2012 and December 31, 2011 are as follows:

	2012		2011	
	Cost	Market Value	Cost	Market Value
Securities held to maturity				
U. S. Treasury and agency obligations	\$108	\$108	\$ 108	\$108
Total	\$108	\$108	\$ 108	\$108
			June 30, 2012	
			Unrealized	Market
	Cost	Gains	Losses	Value
Securities available for sale				
Government sponsored enterprises	\$11,027	\$30	\$8	\$11,049
Mortgage-backed securities	1,936	25	-	1,961
Total	\$12,963	\$55	\$8	\$13,010

Edgar Filing: F&M BANK CORP - Form 10-Q

	Cost	December 31, 2011		Market Value
		Unrealized Gains	Unrealized Losses	
Securities available for sale				
Government sponsored enterprises	\$ 11,034	\$ 36	\$ 6	\$ 11,064
Mortgage-backed securities	2,063	-	-	2,063
Total	\$ 13,097	\$ 36	\$ 6	\$ 13,127

F & M BANK CORP.
Notes to (unaudited) Consolidated Financial Statements

Note 2. Investment Securities, continued

The amortized cost and fair value of securities at June 30, 2012, 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	\$108	\$108	\$8,001	\$8,024
Due after one year through five years	-	-	3,026	3,025
Due after five years	-	-	1,936	1,961
Total	\$108	\$108	\$12,963	\$13,010

There were no gains and losses on sales of debt and equity securities in the first or second quarter of 2012 or the first quarter of 2011. There were gains of \$346,000 on equity securities in the second quarter of 2011.

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.

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.

F & M BANK CORP.
Notes to (unaudited) Consolidated Financial Statements

Note 2. Investment Securities, continued

Securities Impairment, continued

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 or second quarter of 2012 or the first quarter of 2011. There were \$57,000 of charges to OTTI in the second quarter of 2011.

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 June 30, 2012 and December 31, 2011 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
June 30, 2012						
Government sponsored						
Enterprises	\$4,000	\$(8)	\$-	\$-	\$4,000	\$(8)
Total	\$4,000	\$(8)	\$-	\$-	\$4,000	\$(8)
December 31, 2011						
Government sponsored						
Enterprises	\$5,033	\$(6)	\$-	\$-	\$5,033	\$(6)
Total	\$5,033	\$(6)	\$-	\$-	\$5,033	\$(6)

Other investments, which consist of stock of correspondent banks and investments in low income housing projects, decreased since December 31, 2011. This decrease is due to a stock repurchase by the FHLB and regular amortization of the carrying value of the investment in low income housing projects.

Note 3. Loans Held for Investment

Loans outstanding at June 30, 2012 and December 31, 2011 are summarized as follows:

	2012	2011
Commercial	\$170,271	\$170,157
Real Estate	207,344	208,244
Home Equity	57,841	57,259

Edgar Filing: F&M BANK CORP - Form 10-Q

Credit cards	2,655	2,813
Consumer	12,429	13,097
Total	\$450,540	\$451,570

11

F & M BANK CORP.
Notes to (unaudited) Consolidated Financial Statements

Note 3. Loans Held for Investment, continued

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

June 30, 2012	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Impaired loans without a valuation allowance					
Real Estate	\$3,633	\$3,633	\$-	\$3,815	\$106
Commercial	251	251	-	552	5
Home Equity	388	388	-	561	9
Other	197	197	-	155	3
	4,469	4,469	-	5,083	123
Impaired loans with a valuation allowance					
Real Estate	13,548	13,548	1,087	7,441	172
Commercial	530	530	84	621	2
Home Equity	400	400	38	280	10
Other	713	713	177	352	1
	15,191	15,191	1,386	8,694	185
Total impaired loans	\$19,660	\$19,660	\$1,386	\$13,777	\$308

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

December 31, 2011	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Impaired loans without a valuation allowance					
Real Estate	\$3,174	\$3,174	-	\$4,493	\$190
Commercial	45	45	-	1,064	3
Home Equity	709	709	-	757	30
Other	72	72	-	165	5
	4,000	4,000	-	6,479	228
Impaired loans with a valuation allowance					
Real Estate	5,678	5,678	697	6,107	238
Commercial	568	568	268	948	2
Home Equity	313	313	29	316	21
Other	56	56	8	11	2
	6,615	6,615	1,002	7,382	263
Total impaired loans	\$10,615	\$10,615	\$1,002	\$13,861	\$491

F & M BANK CORP.
Notes to (unaudited) Consolidated Financial Statements

Note 4. Allowance for Loan Losses

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

Six Months Ended June 30, 2012	Commercial	Real Estate	Home Equity	Credit Cards	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning Balance	\$ 1,567	\$ 1,684	\$ 456	\$ 79	\$ 71	\$ 3,080	\$ 6,937
Charge-offs	(523)	(601)	(50)	(27)	(11)	-	(1,212)
Recoveries	45	-	-	22	15	-	82
Provision	281	951	61	1	171	335	1,800
Ending Balance	\$ 1,370	\$ 2,034	\$ 467	\$ 75	\$ 246	\$ 3,415	\$ 7,607

Three Months Ended June 30, 2012	Commercial	Real Estate	Home Equity	Credit Cards	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning Balance	\$ 1,365	\$ 1,907	\$ 468	\$ 75	\$ 522	\$ 2,977	\$ 7,314
Charge-offs	(302)	(293)	(37)	(21)	(7)	-	(660)
Recoveries	34	-	-	11	8	-	53
Provision	273	420	36	10	(277)	438	900
Ending Balance	\$ 1,370	\$ 2,034	\$ 467	\$ 75	\$ 246	\$ 3,415	\$ 7,607

Six Months Ended June 30, 2011	Commercial	Real Estate	Home Equity	Credit Cards	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning Balance	\$ 1,724	\$ 1,814	\$ 407	\$ 59	\$ 111	\$ 1,671	\$ 5,786
Charge-offs	(453)	(706)	(56)	(45)	(310)	-	(1,570)
Recoveries	32	9	27	14	10	-	92
Provision	509	667	3	29	624	368	2,200
Ending Balance	\$ 1,812	\$ 1,784	\$ 381	\$ 57	\$ 435	\$ 2,039	\$ 6,508

Three Months Ended June 30, 2011	Commercial	Real Estate	Home Equity	Credit Cards	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning Balance	\$ 1,696	\$ 1,490	\$ 425	\$ 64	\$ 649	\$ 1,771	\$ 6,095
Charge-offs	(143)	(229)	(56)	(10)	(299)	-	(737)
Recoveries	16	1	27	4	2	-	50
Provision	243	522	(15)	(1)	83	268	1,100

Ending Balance	\$ 1,812	\$ 1,784	\$ 381	\$ 57	\$ 435	\$ 2,039	\$ 6,508
----------------	----------	----------	--------	-------	--------	----------	----------

F & M BANK CORP.
Notes to (unaudited) Consolidated Financial Statements

Note 4. Allowance for Loan Losses, continued

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

June 30, 2012	Commercial	Real Estate	Home Equity	Credit Cards	Consumer	Unallocated	Total
Allowance for loan losses:	\$ 1,370	\$ 2,034	\$ 467	\$ 75	\$ 246	\$ 3,415	\$ 7,607
Individually evaluated for impairment	\$ 84	\$ 1,087	\$ 38	\$ -	\$ 177	\$ -	\$ 1,386
Collectively evaluated for impairment	\$ 1,286	\$ 947	\$ 429	\$ 75	\$ 69	\$ 3,415	\$ 6,221
December 31, 2011							
Allowance for loan losses:	\$ 1,567	\$ 1,684	\$ 456	\$ 79	\$ 71	\$ 3,080	\$ 6,937
Individually evaluated for impairment	\$ 268	\$ 697	\$ 29	\$ -	\$ 8	\$ -	\$ 1,002
Collectively evaluated for impairment	\$ 1,299	\$ 987	\$ 427	\$ 79	\$ 63	\$ 3,080	\$ 5,935

Recorded Investment in Loan Receivables (in thousands)

June 30, 2012	Commercial	Real Estate	Home Equity	Credit Cards	Consumer	Unallocated	Total
Loan Receivable:	\$ 170,271	\$ 207,344	\$ 57,841	\$ 2,655	\$ 12,429	\$ -	\$ 450,540
Individually evaluated for impairment	\$ 17,189	\$ 29,319	\$ 1,425	\$ -	\$ 717	\$ -	\$ 48,650
Collectively evaluated for impairment	\$ 153,082	\$ 178,025	\$ 56,416	\$ 2,655	\$ 11,712	\$ -	\$ 401,890
December 31, 2011							
Loan Receivable:	\$ 170,157	\$ 208,244	\$ 57,259	\$ 2,813	\$ 13,097	\$ -	\$ 451,570

Individually evaluated for impairment	\$ 16,009	\$ 32,335	\$ 1,785	\$ -	\$ 109	\$ -	\$ 50,238
Collectively evaluated for impairment	\$ 154,148	\$ 175,909	\$ 55,474	\$ 2,813	\$ 12,988	\$ -	\$ 401,332

Aging of Past Due Loans Receivable (in thousands) as of June 30, 2012

	30-59 Days Past due	60-89 Days Past Due	Greater than 90 Days still accruing	Non-Accrual Loans	Total Past Due	Current	Total Loans Receivable
Commercial	\$ 678	\$ 4,417	\$ 2,499	\$ 5,160	\$ 12,754	\$ 157,517	\$ 170,271
Real Estate	4,309	2,781	732	8,066	15,888	191,456	207,344
Home Equity	884	126	165	180	1,355	56,486	57,841
Credit Cards	33	8	-	-	41	2,614	2,655
Consumer	124	17	111	37	289	12,140	12,429
Total	\$ 6,028	\$ 7,349	\$ 3,507	\$ 13,443	\$ 30,327	\$ 420,213	\$ 450,540

F & M BANK CORP.
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, 2011

	30-59 Days Past due	60-89 Days Past Due	Greater than 90 Days (excluding non-accrual)	Total Past Due	Non-Accrual Loans	Current	Total Loans Receivable
Commercial	\$ 227	\$ 1,408	\$ -	\$ 1,635	\$ 5,888	\$ 162,634	\$ 170,157
Real Estate	5,146	5,055	646	10,847	7,671	189,726	208,244
Home Equity	503	98	260	861	266	56,132	57,259
Credit Cards	22	5	-	27	-	2,786	2,813
Consumer	77	85	6	168	39	12,890	13,097
Total	\$ 5,975	\$ 6,651	\$ 912	\$ 13,538	\$ 13,864	\$ 424,168	\$ 451,570

Credit quality indicators as of June 30, 2012

Corporate Credit Exposure

Credit Risk Profile by Creditworthiness Category

	June 30, 2012		
	Real Estate	Commercial	Home Equity
Grade 1 - Minimal Risk	\$-	\$ 137	\$-
Grade 2 - Modest Risk	606	2,688	1,419
Grade 3 - Average Risk	24,735	26,610	9,083
Grade 4 - Acceptable Risk	84,847	72,397	38,349
Grade 5 - Marginally Acceptable	53,762	45,140	5,653
Grade 6 – Watch	10,414	4,869	1,449
Grade 7 – Substandard	32,980	18,430	1,888
Grade 8 – Doubtful	-	-	-
Total	\$207,344	\$ 170,271	\$57,841

Consumer Credit Exposure

Credit Risk Profile Based on Payment Activity

	Credit Cards	Consumer
Performing	\$2,655	\$12,318
Non performing (past due 90 days or greater)	-	111
Total	\$2,655	\$12,429

See following page for description of loan grades.

F & M BANK CORP.
Notes to (unaudited) Consolidated Financial Statements

Note 4. Allowance for Loan Losses, continued

Credit quality indicators as of December 31, 2011

Corporate Credit Exposure

Credit Risk Profile by Creditworthiness Category

	December 31, 2011		
	Real Estate	Commercial	Home Equity
Grade 1 - Minimal Risk	\$ 120	\$ 150	\$-
Grade 2 - Modest Risk	1,211	3,268	404
Grade 3 - Average Risk	23,199	16,418	8,052
Grade 4 - Acceptable Risk	87,425	86,874	39,170
Grade 5 - Marginally Acceptable	46,945	41,144	6,152
Grade 6 – Watch	12,975	5,994	1,192
Grade 7 – Substandard	36,331	16,309	2,289
Grade 8 – Doubtful	38	-	-
Total	\$208,244	\$ 170,157	\$57,259

Consumer Credit Exposure

Credit Risk Profile Based on Payment Activity

	Credit Cards	Consumer
Performing	\$ 2,813	\$ 13,091
Non performing (past due 90 days or greater)	-	6
Total	\$ 2,813	\$ 13,097

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.

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.

F & M BANK CORP.
Notes to (unaudited) Consolidated Financial Statements

Note 4. Allowance for Loan Losses, continued

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.

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 2012 and does not anticipate additional contributions for the 2012 plan year. The following is a summary of net periodic pension costs for the six-month and three-month periods ended June 30, 2012 and 2011.

	Six Months Ended		Three Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Service cost	\$259,318	\$222,710	\$129,659	\$111,355
Interest cost	163,962	160,756	81,981	80,378
Expected return on plan assets	(270,034)	(252,218)	(135,017)	(126,109)
Amortization of net obligation at transition	-	-	-	-
Amortization of prior service cost	(7,618)	(3,886)	(3,809)	(1,943)
Amortization of net (gain) or loss	86,610	31,922	43,305	15,961
Net periodic pension cost	\$232,238	\$159,284	\$116,119	\$79,642

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

F & M BANK CORP.
Notes to (unaudited) Consolidated Financial Statements

Note 6. Fair Value, continued

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.

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 table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis.

June 30, 2012	Total	Level 1	Level 2	Level 3
Government sponsored enterprises	\$ 11,049	\$ -	\$ 11,049	\$ -
Mortgage-backed obligations of federal agencies	1,961	-	1,961	-
Investment securities available for sale	\$ 13,010	\$ -	\$ 13,010	\$ -
Total assets at fair value	\$ 13,010	\$ -	\$ 13,010	\$ -
Total liabilities at fair value	\$ -	\$ -	\$ -	\$ -
Derivative financial instruments at fair value	\$ 14	\$ -	\$ 14	\$ -

F & M BANK CORP.
Notes to (unaudited) Consolidated Financial Statements

Note 6. Fair Value, continued

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

December 31, 2011	Total	Level 1	Level 2	Level 3
Government sponsored enterprises	\$11,064	\$-	\$11,064	\$-
Mortgage-backed obligations of federal agencies	2,063	-	2,063	-
Investment securities available for sale	13,127	-	13,127	-
Total assets at fair value	\$13,127	\$-	\$13,127	\$-
Total liabilities at fair value	\$-	\$-	\$-	\$-
Derivative financial instruments at fair value	\$13	\$-	\$13	\$-

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.

June 30, 2012	Total	Level 1	Level 2	Level 3
Loans Held for Sale	\$40,984	\$-	\$40,984	\$-
Other Real Estate Owned	3,317	-	3,317	-
Real Estate	12,461	-	12,461	-
Commercial	446	-	446	-
Consumer	536	-	536	-
Home Equity	362	-	362	-
Impaired loans	13,805	-	13,805	-
Total assets at fair value	\$58,106	\$-	\$58,106	\$-
Total liabilities at fair value	\$-	\$-	\$-	\$-
December 31, 2011	Total	Level 1	Level 2	Level 3
Loans Held for Sale	\$60,543	\$-	\$60,543	\$-
Other Real Estate Owned	3,074	-	3,074	-
Real Estate	4,981	-	4,981	-
Commercial	300	-	300	-
Consumer	48	-	48	-
Home Equity	284	-	284	-
Impaired loans	5,613	-	5,613	-

Edgar Filing: F&M BANK CORP - Form 10-Q

Total assets at fair value	\$69,230	\$-	\$69,230	\$-
Total liabilities at fair value	\$-	\$-	\$-	\$-

There were no significant transfers between levels 1 and 2.

F & M BANK CORP.
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 June 30, 2012 and December 31, 2011. 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.

	June 30, 2012		December 31, 2011	
	Estimated Fair Value	Carrying Value	Estimated Fair Value	Carrying Value
Financial Assets				
Loans	479,293	450,540	484,500	451,570
Financial Liabilities				
Time deposits	\$203,639	\$201,923	\$205,325	\$203,358
Long-term debt	43,986	41,071	49,765	47,107

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.

F & M BANK CORP.
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.

	For the three and six months ending June 30, 2012		
	Number of Contracts	Pre-Modification Outstanding	Post-Modification Outstanding
		Recorded Investment	Recorded Investment
Troubled Debt Restructurings			
Commercial		\$ -	\$ -
Real Estate	2	492	492
Home Equity		-	-
Total		\$ 492	\$ 492

	For the six months ending June 30, 2011		
	Number of Contracts	Pre-Modification Outstanding	Post-Modification Outstanding
		Recorded Investment	Recorded Investment
Troubled Debt Restructurings			
Commercial	3	\$ 1,016	\$ 1,016
Real Estate	2	1,306	1,306
Home Equity	1	314	314
Total		\$ 2,636	\$ 2,636

	For the three months ending June 30, 2011		
	Number of Contracts	Pre-Modification Outstanding	Post-Modification Outstanding
		Recorded Investment	Recorded Investment
Troubled Debt Restructurings			
Commercial		\$ -	\$ -
Real Estate	1	1,040	1,040
Home Equity		-	-
Total		\$ 1,040	\$ 1,040

During 2012 the Bank modified 2 loans that were considered to be troubled debt restructurings. There were 6 loans modified during the first six months of 2011, one of which was modified in the three months ending June 30, 2011. All of these 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.

There were no loans modified as a troubled debt restructuring within the previous 12 months for which there was a payment default during the first six months 2012 or 2011. A restructured loan is considered in default when it becomes 90 days past due.

Note 9. Rights Offering

The Company completed a rights offering during the first quarter of 2011 that resulted in the issuance of 179,699 shares totaling \$2,381,000 in additional capital.

ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF 2. 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. 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 the northern part of 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.

ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF 2. 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 28 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.

Core deposit intangibles are amortized on a straight-line basis over ten years. The Company adopted ASC 350 on January 1, 2002 and determined that the core deposit intangible would continue to be amortized over the estimated useful life. As of February 2011 the Bank completed its amortization of the core deposit intangible arising from the branch purchase which occurred in February 2001.

Securities Impairment

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

Overview

Edgar Filing: F&M BANK CORP - Form 10-Q

Net income for the six months ended June 30, 2012 was \$2,275,000 or \$.91 per share, compared to \$1,917,000 or \$.80 in the same period in 2011, an increase of 18.68%. During the six months ended June 30, 2012, noninterest income, exclusive of securities transactions, increased 8.30% and noninterest expense decreased .70% during the same period. Net income from Bank operations adjusted for income or loss from Parent activities is as follows:

In thousands	2012	2011
Net Income from Bank Operations	\$2,264	\$2,084
Income or (loss) from Parent Company Activities	11	(167)
Net Income for the six months ended June 30	\$2,275	\$1,917

ITEMMANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
2. 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 \$2,193,000 in 2012 and \$1,678,000 in 2011, an increase of 30.69%. Income from core operations increased in 2012 primarily due to a decrease in interest expense. A reconciliation of core earnings follows:

In thousands	2012	2011
Net Income	\$2,275	\$1,917
Non-recurring Tax Items	(82)	20
Non-recurring Securities Transactions, net of tax	-	(259)
Core Earnings for the six months ended June 30	\$2,193	\$1,678

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 2012 year to date tax equivalent net interest income increased \$306,000 or 3.18% compared to the same period in 2011. The yield on earning assets decreased .22%, while the cost of funds decreased .30% compared to the same period in 2011.

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 3.84%, an increase of .07% when compared to the same period in 2011. While, for the three month period ending June 30, 2012, the tax equivalent net interest margin decreased from 3.96% in 2011 to 3.80% in 2012. A schedule of the net interest margin for the six month and three month periods ended June 30, 2012 and 2011 can be found in Table I on page 30.

The Interest Sensitivity Analysis contained in Table II on page 31 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 49.68% of rate sensitive assets and 43.36% 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 \$132,000 or 8.30% for the six month period ended June 30, 2012 and increased \$148,000 or 18.50% for the three month period. The increase is primarily due to increase in Insurance and Other Commissions income.

Noninterest expense decreased \$46,000 for the six month period and decreased \$25,000 for the three month period of 2012 as compared to 2011. Salary and benefits expense increased \$252,000 (7.00%) through June 2012. This increase is due to increases in professional personnel as well as salary increases, health insurance and retirement plan expenses. Exclusive of personnel expenses, other noninterest expenses decreased at a rate of 9.90% for the first six months of 2012 as compared to 2011. The primary reason for the decrease in these expenses relates to the revisions to the FDIC Assessment calculation which resulted in a lower quarterly assessment. Operating costs continue to compare

very favorably to the peer group. As stated in the most recently available (March 31, 2012) Bank Holding Company Performance Report, the Company's and peer's noninterest expenses averaged 2.35% and 3.10% 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.

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

Financial Condition

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 due to the decrease in Loans Held for Sale.

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 June 30, 2012, the market value of securities available for sale exceeded their cost by \$47,000. 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 are no scheduled maturities for the remainder of 2012.

In reviewing investments as of June 30, 2012, 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 and Shenandoah 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.

The allowance for loan losses (see subsequent section) provides for the risk that borrowers will be unable to repay their obligations and is reviewed quarterly for adequacy. 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.

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

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. Due to the sluggish economy, the first six months of 2012 resulted in a decrease of \$1 million in the Bank's core loan portfolio.