

F & M Bank Corp. (FMBM – OTCQX)

October 25, 2016

Investor Relations Report

Another Spike in Earnings...Another Dividend Increase

In F & M Bank Corp.'s second quarter press release, management struck a positive tone in their comments surrounding market conditions. We were hopeful that those comments would lead to positive results for the rest of the year, which is precisely what we saw in the bank's third quarter results. Earnings in the third quarter pushed higher to yet another record level for the bank, setting up F & M Bank Corp. for another year of record earnings in 2016.

The strong results led the Board of Directors to approve yet another common stock dividend increase. Historically, F & M Bank Corp. has increased the dividend once a year when conditions warranted an increase, so the fact that the Board felt confident enough to increase the dividend for two consecutive quarters really speaks strongly to how well the bank is currently running and that the outlook for the next few quarters is positive. The third quarter dividend will be \$0.22 per share, which is a \$0.02 increase and follows the \$0.01 increase in the second quarter. The increased dividend now yields approximately 3.35%, certainly an attractive yield relative to many (if not most) other bank stocks and asset classes.

The increase in earnings leads us to boost our full-year earnings estimate yet again, this time to \$2.70 per share from \$2.55 per share previously. Our revised estimate could prove conservative if credit costs remain low in the fourth quarter and market conditions remain favorable.

It appears that community bank investors are becoming a bit more confident in their outlook for the sector, although stock valuation levels have not expanded significantly in recent months. While valuation levels have not pushed materially higher, they have not weakened either, which suggests investors are becoming less skittish and, perhaps, regaining their confidence in the sector. It is widely assumed that higher interest rates will be a net positive for banks, which we could see over the next year (although we have learned that making assumptions about interest rates is a fool's game). FMBM shares have quietly appreciated by approximately 15.6% year-to-date, no doubt in part to the increase in profitability and rising dividend.

Company Overview

F & M Bank Corp. is the holding company for Farmers & Merchants Bank. The bank operates twelve branches throughout Western Virginia, including Augusta County, Rockingham County, Shenandoah County and Page County. The bank provides a full suite of commercial and consumer banking products, as well as financial services through Farmers & Merchants Financial Services, mortgage banking services through VBS Mortgage and insurance products through TEB Life Insurance Company. At quarter-end, the bank had \$745.3 million in assets. F & M Bank Corp.'s common stock trades on the OTCQX exchange under the ticker FMBM.

Last Price: \$26.25
Market Capitalization: \$86.3 million

52 Week Range:
\$21.30 - \$26.25

Annual Dividend: \$0.88
Dividend Yield: 3.35%

Book Value: \$23.77
Tangible Book Value: \$23.56

EPS Actuals and Estimates
FY2014A: \$1.82
FY2015A: \$2.40
FY2016E: \$2.70

Price/Earnings (P/E)
2014A: 14.4x
2015A: 10.9x
2016E: 9.7x

Price/Book Value: 1.1x
Price/Tangible Book Value: 1.1x

Analyst Contact:
Allan G. Bach
abach@dogwoodresearch.com
(804) 310-8951

Company Contact:
Neil Hayslett, EVP and CAO
(540) 896-8941

See second page for
important disclosures

Pace of Loan Growth Picks Up; New Branches Contribute to Growth

F & M Bank Corp. reported third quarter net income to common shareholders of nearly \$2.5 million, which is up from the \$2.2 million earned in the second quarter and a \$412 thousand (20.0%) increase over the nearly \$2.1 million earned in last year's third quarter. On a per share basis, third quarter earnings came in at \$0.75 versus \$0.68 in the second quarter and \$0.63 in the year ago quarter. On a year-to-date basis, earnings per common share have totaled \$2.03, a 14.0% increase over the \$1.78 earned during the same period of 2015.

It is worth calling out the strong profitability ratios that F & M Bank Corp. has delivered in recent quarters. Return on Average Assets (ROAA) and Return on Average Equity (ROAE) are two common ratios used to measure a bank's profitability. F & M Bank Corp.'s third quarter and year-to-date ROAA came in at 1.43% and 1.35%, respectively, both of which exceed industry norms handily. Equally as impressive, the bank's ROAE over the same time frames has been 11.99% and 11.03%, respectively.

Branch Expansion Strategy Underway

F & M Bank Corp. recently opened their twelfth branch, which is located in Grottoes, Virginia, and has begun construction on their thirteenth branch, which will be located in Fishersville, Virginia. All four of the bank's newest branches (including the branch under construction) are located in the southern portion of F & M Bank Corp.'s footprint and should help to drive market share growth in that region. F & M Bank Corp. has operated in the region with loan production offices in recent years, so they have already gained some traction, which should only increase as the new branches come on-line. The strategy of driving growth through gradual market expansion in contiguous markets is a lower risk strategy that should support the next leg of growth for the bank.

Loan Growth Picks Up Pace

After recording a \$9.1 million increase in loans in the second quarter, which we thought would be towards the top of the range of quarterly loan (Continued...)

(Continued) Loan Growth Picks Up Pace

growth, F & M Bank Corp. delivered an impressive \$12.1 million in loan growth in the third quarter (loans held for investment). Over the past twelve months, loans held for investment have increased by \$37.7 million, a 7.1% increase. Market conditions clearly remain favorable and F & M Bank Corp. has done a good job taking advantage. We suspect the bank's newest branches will be a positive contributor to loan growth as we close out 2016 and throughout 2017.

Credit Quality Mixed in Q3; Improved Since Last Year

Overall credit quality was largely unchanged from the end of the previous quarter and has improved over the past year. During the third quarter, nonperforming loans ticked higher by \$651 thousand (up 11.7%), but total nonperforming assets, which includes foreclosed assets, were only \$39 thousand higher. As a percentage of total assets, nonperforming assets total a low 0.83%, which is down from 0.97% a year ago. We continue to expect some quarterly fluctuations in credit quality with the general, longer-term trend pointing towards lower nonperforming assets.

Net Interest Margin Ticks Lower; Still Healthy

In true F & M Bank Corp. fashion, the bank's third quarter results benefited from a strong net interest margin. The third quarter and year-to-date net interest margin came in at 4.23% and 4.33%, respectively, both of which eclipse most all other community banks. We have seen the margin tick lower so far in 2016, from 4.39% in the first quarter to 4.37% in the second quarter to the current 4.23%. FMBM's cost of funds (rate paid on interest bearing liabilities) has crept up to 0.79% from 0.67% a year ago, which contributed to the lower margin. In addition, the yield on earning assets (primarily loans and securities) has come down to 4.80% from 4.91% in the first quarter, which is a function of broader market conditions that currently reflect strong competition for quality loans and lower yields on securities.

Important Disclosures and Information about Dogwood Research

Copyright 2016 Dogwood Research LLC. All rights reserved. Dogwood Research LLC is an equity research firm that provides third-party research and investor relations services to community banks in the Mid-Atlantic region. This report is deemed an investor relations report and Dogwood Research LLC receives a fee from the company discussed in this report to prepare the material. The report is for informational purposes only and is not an offer to purchase or sell any securities; nor is it a recommendation to purchase or sell any securities. Information included in this report is compiled from sources that we believe are reliable, but is not guaranteed by Dogwood Research LLC. The report includes forward-looking statements, including estimates, that may differ materially from those listed in the report. Any opinions, estimates or forward-looking statements are subject to change without notification. Neither the analyst nor a member of the analyst's household owns shares of the subject company. The analyst is separately employed by Virginia Community Development Corporation. For more information, please visit www.dogwoodresearch.com.