HERCULES TECHNOLOGY GROWTH CAPITAL INC
Form 10-Q
May 02, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For The Quarterly Period Ended March 31, 2013

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number: 814-00702

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

(Exact Name of Registrant as Specified in its Charter)

Maryland	**743113410**
(State or Jurisdiction of	**(IRS Employer**
Incorporation or Organization)	**Identification No.)**
400 Hamilton Ave., Suite 310	
Palo Alto, California	**94301**
(Address of Principal Executive Offices)	**(Zip Code)**

(650) 289-3060

(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 periods that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this Chapter) 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ¨	Accelerated Filer x
Non-Accelerated Filer ¨	Smaller Reporting Company ¨

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

On April 30, 2013, there were 61,554,003 shares outstanding of the Registrant s common stock, $0.001 par value.

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PART I: FINANCIAL INFORMATION

In this Quarterly Report, the Company, Hercules, we, us and our refer to Hercules Technology Growth Capital, Inc. and its wholly owned subsidiaries and its affiliated securitization trusts unless the context otherwise requires.

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES

(unaudited)

(dollars in thousands, except per share data)

	March 31, 2013	December 31, 2012
Assets		
Investments:		
Non-control/Non-affiliate investments (cost of $957,508 and $896,031, respectively)	$ 953,788	$ 894,428
Affiliate investments (cost of $20,196 and $18,307, respectively)	14,196	11,872
Total investments, at fair value (cost of $977,704 and $914,338, respectively)	967,984	906,300
Cash and cash equivalents	206,928	182,994
Restricted Cash	810	
Interest receivable	9,674	9,635
Other assets	25,790	24,714
Total assets	$ 1,211,186	$ 1,123,643
Liabilities		
Accounts payable and accrued liabilities	$ 8,456	$ 11,575
Long-term Liabilities (Convertible Senior Note)	71,707	71,436
Asset-Backed Notes	120,051	129,300
2019 Notes	170,364	170,364
Long-term SBA Debentures	225,000	225,000
Total liabilities	$ 595,578	$ 607,675
Commitments and Contingencies (Note 9)		
Net assets consist of:		
Common stock, par value	62	53
Capital in excess of par value	660,833	564,508
Unrealized depreciation on investments	(8,281)	(7,947)
Accumulated realized losses on investments	(34,925)	(36,916)
Distributions in excess of investment income	(2,081)	(3,730)
Total net assets	$ 615,608	$ 515,968
Total liabilities and net assets	$ 1,211,186	$ 1,123,643
Shares of common stock outstanding ($0.001 par value, 100,000,000 authorized)	61,554	52,925

Net asset value per share	$	10.00	$	9.75

See notes to consolidated financial statements.

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The following table presents the assets and liabilities of our consolidated variable interest entity (VIE). The assets of the VIE can only be used to settle obligations of the consolidated VIE, and the creditors (or beneficial interest holders) do not have recourse to our general credit. These assets and liabilities are included in the Consolidated Statements of Assets and Liabilities above.

(Unaudited, in thousands)	March 31, 2013	December 31, 2012
ASSETS		
Restricted Cash	$ 810	$
Total investments, at fair value (cost of $219,853 and $0, respectively)	218,142	226,997
Total assets	$ 218,952	$ 226,997
LIABILITIES		
Asset-Backed Notes	$ 120,051	$ 129,300
Total liabilities	$ 120,051	$ 129,300

See notes to consolidated financial statements.

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(in thousands, except per share data)

	Three Months Ended March 31,	
	2013	**2012**
Investment income:		
Interest Income		
Non-control/Non-affiliate investments	$ 28,319	$ 20,281
Affiliate investments	610	6
Control investments		13
Total interest income	28,929	20,300
Fees		
Non-control/Non-affiliate investments	2,028	2,067
Total fees	2,028	2,067
Total investment income	30,957	22,367
Operating expenses:		
Interest	7,631	3,896
Loan fees	1,079	1,076
General and administrative	2,252	1,817
Employee Compensation:		
Compensation and benefits	3,798	3,395
Stock-based compensation	1,165	808
Total employee compensation	4,963	4,203
Total operating expenses	15,925	10,992
Net investment income	15,032	11,375
Net realized (losses) gains on investments		
Non-control/Non-affiliate investments	1,991	2,877
Total net realized (loss) gain on investments	1,991	2,877
Net unrealized (depreciation) appreciation on investments		
Non-control/Non-affiliate investments	(768)	1,751
Affiliate investments	434	1,076
Control investments		26
Total net unrealized (depreciation) appreciation on investments	(334)	2,853
Total net realized (unrealized) gain	1,657	5,730
Net increase in net assets resulting from operations	$ 16,689	$ 17,105
Net investment income before investment gains and losses per common share:		

Basic	$ 0.27	$ 0.24
Change in net assets per common share:		
Basic	$ 0.30	$ 0.36
Diluted	$ 0.30	$ 0.36
Weighted average shares outstanding		
Basic	53,682	47,018
Diluted	53,823	47,210

See notes to consolidated financial statements.

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

(unaudited)

(dollars and shares in thousands)

	Common Stock Shares	Common Stock Par Value	Capital in excess of par value	Unrealized Appreciation on Investments	Accumulated Realized Gains (Losses) on Investments	Distributions in Excess of Investment Income	Provision for Income Taxes on Investment Gains	Net Assets
Balance at December 31, 2011	43,853	$ 44	$ 484,244	$ (3,431)	$ (43,042)	$ (6,432)	$ (342)	$ 431,041
Net increase in net assets resulting from operations				2,853	2,877	11,375		17,105
Issuance of common stock	5,425	5	49,773					49,778
Issuance of common stock under restricted stock plan	620	1						1
Issuance of common stock as stock dividend	62		670					670
Retired shares from net issuance	(239)		(2,562)					(2,562)
Dividends declared						(11,412)		(11,412)
Stock-based compensation			826					826
Balance at March 31, 2012	49,721	$ 50	$ 532,951	$ (578)	$ (40,165)	$ (6,469)	$ (342)	$ 485,447
Balance at December 31, 2012	52,925	$ 53	$ 564,509	$ (7,947)	$ (36,916)	$ (3,389)	$ (342)	$ 515,968
Net increase in net assets resulting from operations				(334)	1,991	15,032		16,689
Issuance of common stock	80		910					910
Issuance of common stock under restricted stock plan	531	1	(1)					
Issuance of common stock as stock dividend	40		488					488
Retired shares from net issuance	(72)		(1,808)					(1,808)
Public Offering	8,050	8	95,550					95,558
Dividends declared						(13,382)		(13,382)
Stock-based compensation			1,185					1,185
Balance at March 31, 2013	61,554	$ 62	$ 660,833	$ (8,281)	$ (34,925)	$ (1,739)	$ (342)	$ 615,608

See notes to consolidated financial statements.

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(dollars in thousands)

	For the Three Months Ended March 31, 2013	2012
Cash flows from operating activities:		
Net increase in net assets resulting from operations	$ 16,689	$ 17,105
Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities:		
Purchase of investments	(139,095)	(64,961)
Principal payments received on investments	75,987	35,533
Proceeds from sale of investments	5,212	8,726
Net unrealized (appreciation) / depreciation on investments	334	(2,853)
Net realized (gain) / loss on investments	(1,991)	(2,877)
Accretion of paid-in-kind principal	(555)	(280)
Accretion of loan discounts	(1,455)	(916)
Accretion of loan discount on Convertible Senior Notes	271	271
Accretion of loan exit fees	(1,819)	(2,685)
Change in deferred loan origination revenue	313	(198)
Unearned fees related to unfunded commitments	(856)	(2,360)
Amortization of debt fees and issuance costs	938	913
Depreciation	68	71
Stock-based compensation and amortization of restricted stock grants	1,185	826
Change in operating assets and liabilities:		
Interest and fees receivable	(41)	(143)
Prepaid expenses and other assets	33	(75)
Accounts payable	(250)	(51)
Accrued liabilities	(2,682)	(3,733)
Net cash used in operating activities	(47,714)	(17,687)
Cash flows from investing activities:		
Purchases of capital equipment	(24)	(12)
Investment in restricted cash	(810)	
Other long-term assets	(30)	
Net cash used in investing activities	(864)	(12)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	94,660	47,218
Dividends paid	(12,894)	(10,742)
Repayments of credit facilities	(9,254)	(34,818)
Net cash provided by financing activities	72,512	1,658
Net increase / (decrease) in cash	23,934	(16,041)
Cash and cash equivalents at beginning of year	182,994	64,474

Cash and cash equivalents at end of year	$ 206,928	$ 48,433

See notes to consolidated financial statements.

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS

March 31, 2013

(unaudited)

(dollars in thousands)

Portfolio Company	Sub-Industry	Type of Investment[1]	Principal Amount	Cost[2]	Value[3]
Maturity: Upon Liquidation					
Paratek Pharmaceuticals, Inc.	Drug Discovery & Development	Senior Debt[9] Matures upon liquidation Interest rate Fixed 10.00%	$ 45	$ 45	$ 45
		Senior Debt[9] Matures upon liquidation Interest rate Fixed 10.00%	$ 36	31	31
		Senior Debt[9] Matures upon liquidation No initial interest rate	$ 28	28	28
Total Paratek Pharmaceuticals, Inc.				104	104
Maturity: Under 1 Year Maturity					
Chroma Therapeutics, Ltd.[5][10]	Drug Discovery & Development	Senior Debt Matures November 2013 Interest rate Prime + 7.75% or Floor rate of 12.00%	$ 3,007	3,714	3,675
Maturity: 1-5 Years Maturity					
ADMA Biologics, Inc.	Drug Discovery & Development	Senior Debt Matures April 2016 Interest rate Prime + 2.75% or Floor rate of 8.50%	$ 5,000	4,844	4,844
Anthera Pharmaceuticals Inc.[3]	Drug Discovery & Development	Senior Debt[11] Matures December 2014 Interest rate Prime + 7.30% or Floor rate of 10.55%	$ 18,199	18,574	18,574
Aveo Pharmaceuticals, Inc.[3]	Drug Discovery & Development	Senior Debt[11] Matures September 2015 Interest rate Prime + 7.15% or Floor rate of 11.90%	$ 26,500	26,500	27,030
Cell Therapeutics, Inc.[3]	Drug Discovery & Development	Senior Debt Matures October 2016	$ 10,000	9,670	9,670

		Interest rate Prime + 9.00% or Floor rate of 12.25%			
Cempra, Inc.[3]	Drug Discovery & Development	Senior Debt[11] Matures December 2015 Interest rate Prime + 6.30% or Floor rate of 9.55%	$ 10,000	9,898	9,815
Concert Pharmaceuticals, Inc.	Drug Discovery & Development	Senior Debt[4] Matures October 2015 Interest rate Prime + 3.25% or Floor rate of 8.50%	$ 20,000	19,687	18,946
Coronado BioSciences, Inc.[3]	Drug Discovery & Development	Senior Debt[11] Matures March 2016 Interest rate Prime + 6.00% or Floor rate of 9.25%	$ 15,000	14,838	14,430
Dicerna Pharmaceuticals, Inc.	Drug Discovery & Development	Senior Debt Matures January 2015 Interest rate Prime + 4.40% or Floor rate of 10.15%	$ 8,168	8,039	7,921
Insmed, Inc.	Drug Discovery & Development	Senior Debt[11] Matures January 2016 Interest rate Prime + 4.75% or Floor rate of 9.25%	$ 20,000	19,438	19,498
Merrimack Pharmaceuticals, Inc.	Drug Discovery & Development	Senior Debt Matures May 2016 Interest rate Prime + 5.30% or Floor rate of 10.55%	$ 40,000	39,840	39,840

See notes to consolidated financial statements.

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

March 31, 2013

(unaudited)

(dollars in thousands)

Portfolio Company	Sub-Industry	Type of Investment[1]	Principal Amount	Cost[2]	Value[3]
Neuralstem, Inc.[3]	Drug Discovery & Development	Senior Debt Matures June 2016 Interest rate Prime + 7.75% or Floor rate of 11.00%	$ 8,000	$ 7,654	$ 7,654
NeurogesX, Inc.[3]	Drug Discovery & Development	Senior Debt Matures February 2015 Interest rate Prime + 7.50% or Floor rate of 10.75%	$ 4,041	4,429	4,397
Total Debt Drug Discovery & Development (30.28%)*				187,229	186,398
Maturity: Under 1 Year Maturity					
PeerApp, Inc.	Communications & Networking	Senior Debt[4] Matures April 2013 Interest rate Prime + 7.50% or Floor rate of 11.50%	$ 159	248	248
Maturity: 1-5 Years Maturity					
Bridgewave Communications	Communications & Networking	Senior Debt Matures March 2016 Interest rate Fixed 8.00%	$ 7,500	7,163	4,369
OpenPeak, Inc.	Communications & Networking	Senior Debt[11] Matures July 2015 Interest rate Prime + 8.75% or Floor rate of 12.00%	$ 14,129	14,330	14,472
UPH Holdings, Inc.[8]	Communications & Networking	Senior Debt Matures April 2015 Interest rate Libor + 11.00% or	$ 6,600	6,489	3,478

		Floor rate of 13.50%			
		Senior Debt Matures September 2015 Interest rate Libor + 11.00% or Floor rate of 13.50%	$ 338	333	178
		Senior Debt Matures January 2017 Interest rate Libor + 11.00% or Floor rate of 13.50%	$ 3,594	3,594	1,894
Total UPH Holdings, Inc.				10,416	5,550
Total Debt Communications & Networking (4.00%)*				32,157	24,639
Maturity: 1-5 Years Maturity					
Clustrix, Inc.	Electronics & Computer Hardware	Senior Debt Matures December 2015 Interest rate Prime + 6.50% or Floor rate of 9.75%	$ 696	669	678
Identive Group, Inc.	Electronics & Computer Hardware	Senior Debt Matures November 2015 Interest rate Prime + 7.75% or Floor rate 11.00%	$ 7,500	7,562	7,562
OCZ Technology Group, Inc.(3)	Electronics & Computer Hardware	Senior Debt Matures April 2016 Interest rate Prime + 8.75% or Floor rate of 12.50%, PIK Interest 3.00%	$ 10,000	9,473	9,473
Total Debt Electronics & Computer Hardware (2.88%)				17,704	17,713
Maturity: Upon Liquidation					
Tada Innovations, Inc.	Software	Senior Debt(9) Matures upon liquidation Interest rate Fixed 8.00%	$ 100	100	

See notes to consolidated financial statements.

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

March 31, 2013

(unaudited)

(dollars in thousands)

Portfolio Company	Sub-Industry	Type of Investment[1]	Principal Amount	Cost[2]	Value[3]
Maturity: 1-5 Years Maturity					
Box, Inc.	Software	Senior Debt[4] Matures March 2016 Interest rate Prime + 3.75% or Floor rate of 7.50%	$ 10,000	$ 9,947	$ 9,513
		Senior Debt[4] Matures July 2014 Interest rate Prime + 5.25% or Floor rate of 8.50%	$ 866	930	919
		Senior Debt[11] Matures July 2016 Interest rate Prime + 5.13% or Floor rate of 8.88%	$ 20,000	20,211	19,574
Total Box, Inc.				31,088	30,006
Clickfox, Inc.	Software	Senior Debt Matures November 2015 Interest rate Prime + 8.25% or Floor rate of 11.50%	$ 7,788	7,209	7,443
EndPlay,Inc.	Software	Senior Debt Matures August 2015 Interest rate Prime + 7.35% or Floor rate 10.6%	$ 2,000	1,945	1,945
Hillcrest Laboratories, Inc	Software	Senior Debt Matures July 2015 Interest rate Prime + 7.50% or Floor rate of 10.75%	$ 3,764	3,701	3,664
JackBe Corporation	Software	Senior Debt Matures January 2016 Interest rate Prime + 7.25% or	$ 3,000	2,922	2,929

		Floor rate of 10.50%				
Kxen, Inc.	Software	Senior Debt(4) Matures January 2015 Interest rate Prime + 5.08% or Floor rate of 8.33%	$	2,078	2,126	1,980
Neos Geosolutions, Inc.	Software	Senior Debt Matures May 2016 Interest rate Prime + 5.75% or Floor rate of 9.50%	$	4,000	3,955	3,955
Total Debt Software (8.44%)*					53,046	51,922
Maturity: Under 1 Year Maturity						
Althea Technologies, Inc.	Specialty Pharmaceuticals	Senior Debt Matures October 2013 Interest rate Prime + 7.70% or Floor rate of 10.95%	$	6,933	7,285	7,285
Quatrx Pharmaceuticals Company	Specialty Pharmaceuticals	Senior Debt(9) Matures March 2014 Interest rate Fixed 8.00%	$	1,888	1,888	2,767
Total Debt Specialty Pharmaceuticals (1.63%)*					9,173	10,052
Maturity: 1-5 Years Maturity						
Achronix Semiconductor Corporation	Semiconductors	Senior Debt Matures January 2015 Interest rate Prime + 10.60% or Floor rate of 13.85%	$	1,653	1,618	1,602
Total Debt Semiconductors (0.26%)*					1,618	1,602

See notes to consolidated financial statements.

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

March 31, 2013

(unaudited)

(dollars in thousands)

Portfolio Company	Sub-Industry	Type of Investment[1]	Principal Amount	Cost[2]	Value[3]
Maturity: Under 1 Year Maturity					
Alexza Pharmaceuticals, Inc.[3]	Drug Delivery	Senior Debt[11] Matures October 2013 Interest rate Prime + 6.50% or Floor rate of 10.75%	$ 3,594	$ 3,994	$ 3,994
Maturity: 1-5 Years Maturity					
AcelRX Pharmaceuticals, Inc.[3]	Drug Delivery	Senior Debt[11] Matures December 2014 Interest rate Prime + 3.25% or Floor rate of 8.50%	$ 14,452	14,402	14,108
BIND Therapeutics, Inc.	Drug Delivery	Senior Debt Matures July 2014 Interest rate Prime + 7.45% or Floor rate of 10.70%	$ 2,838	2,875	2,926
Intelliject, Inc.	Drug Delivery	Senior Debt[11] Matures June 2016 Interest rate Prime + 5.75% or Floor rate of 11.00%	$ 15,000	14,705	15,155
Nupathe, Inc.[3]	Drug Delivery	Senior Debt Matures May 2016 Interest rate Prime - 3.25% or Floor rate of 9.85%	$ 8,500	8,220	8,220
Revance Therapeutics, Inc.	Drug Delivery	Senior Debt Matures March 2015 Interest rate Prime + 6.60% or Floor rate of 9.85%	$ 16,594	16,582	16,379
Total Debt Drug Delivery (9.87%)*				60,778	60,782
Maturity: Under 1 Year Maturity					
Loku, Inc.		Senior Debt[9]			

	Internet Consumer & Business Services	Matures June 2013 Interest rate Fixed 6.00%	$ 100	100	100
Tectura Corporation	Internet Consumer & Business Services	Revolving Line of Credit Matures July 2013 Interest rate LIBOR + 8.00% or Floor rate of 11.00%	$ 16,340	18,033	17,663
		Senior Debt Matures April 2013 Interest rate LIBOR + 10.00% or Floor rate of 13.00%	$ 563	553	553
		Senior Debt Matures July 2013 Interest rate LIBOR + 10.00% or Floor rate of 13.00%	$ 1,000	1,000	1,000
Total Tectura Corporation				19,586	19,216
Maturity: 1-5 Years Maturity					
Ahhha, Inc.(8)	Internet Consumer & Business Services	Senior Debt Matures January 2015 Interest rate Fixed 12.00%	$ 350	347	
Blurb, Inc.	Internet Consumer & Business Services	Senior Debt Matures December 2015 Interest rate Prime + 5.25% or Floor rate 8.50%	$ 8,000	7,749	7,547
Education Dynamics, LLC	Internet Consumer & Business Services	Senior Debt Matures March 2016 Interest rate Fixed 12.50%, PIK Interest 1.50%	$ 26,750	26,386	25,563

See notes to consolidated financial statements.

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

March 31, 2013

(unaudited)

(dollars in thousands)

Portfolio Company	Sub-Industry	Type of Investment[1]	Principal Amount	Cost[2]	Value[3]
Just.Me, Inc.	Internet Consumer & Business Services	Senior Debt Matures June 2015 Interest rate Prime + 2.50% or Floor rate 5.75%	$ 750	$ 737	$ 689
		Senior Debt Matures June 2015 Interest rate Prime + 5.00% or Floor rate 8.25%	$ 750	732	709
Total Just.Me, Inc.				1,469	1,398
NetPlenish, Inc.	Internet Consumer & Business Services	Senior Debt Matures April 2015 Interest rate Fixed 10.00%	$ 500	492	460
Reply! Inc.	Internet Consumer & Business Services	Senior Debt[11] Matures September 2015 Interest rate Prime + 6.875% or Floor rate of 10.125%	$ 11,749	11,638	11,525
		Senior Debt[11] Matures September 2015 Interest rate Prime + 7.25% or Floor rate of 11.00%	$ 2,000	1,957	2,005
		Senior Debt Matures February 2016 Interest rate Prime + 7.25% or Floor rate of 10.50%	$ 3,000	2,977	2,977
Total Reply! Inc.				16,572	16,507
Second Rotation, Inc.	Internet Consumer & Business Services	Senior Debt Matures April 2016	$ 12,142	12,013	12,013

		Interest rate Prime + 7.00% or Floor rate of 10.25%, PIK interest 2.50%			
ShareThis, Inc.	Internet Consumer & Business Services	Senior Debt Matures June 2016 Interest rate Prime + 7.50% or Floor rate of 10.75%	$ 15,000	14,349	14,349
Tectura Corporation	Internet Consumer & Business Services	Senior Debt Matures December 2014 Interest rate LIBOR + 10.00% or Floor rate of 13.00%	$ 6,468	6,412	6,230
Trulia, Inc.(3)	Internet Consumer & Business Services	Senior Debt(11) Matures September 2015 Interest rate Prime + 2.75% or Floor rate of 6.00%	$ 5,000	4,934	4,794
		Senior Debt(11) Matures September 2015 Interest rate Prime + 5.50% or Floor rate of 8.75%	$ 5,000	4,933	4,640
Total Trulia, Inc.				9,867	9,434
Vaultlogix, Inc.	Internet Consumer & Business Services	Senior Debt Matures September 2016 Interest rate LIBOR + 8.50% or Floor rate of 10.00%, PIK interest 2.50%	$ 7,500	7,740	7,680
		Senior Debt Matures September 2015 Interest rate LIBOR + 7.00% or Floor rate of 8.50%	$ 9,903	9,864	9,580
Total Vaultlogix, Inc.				17,604	17,260

See notes to consolidated financial statements.

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

March 31, 2013

(unaudited)

(dollars in thousands)

Portfolio Company	Sub-Industry	Type of Investment[1]	Principal Amount	Cost[2]	Value[3]
Wavemarket, Inc.	Internet Consumer & Business Services	Senior Debt[11] Matures September 2015 Interest rate Prime + 5.75% or Floor rate of 9.50%	$ 10,000	$ 9,876	$ 9,458
Total Debt Internet Consumer & Business Services (22.67%)*				142,822	139,535
Maturity: Under 1 Year Maturity					
InXpo, Inc.	Information Services	Senior Debt Matures March 2014 Interest rate Prime + 7.50% or Floor rate of 10.75%	$ 2,550	2,432	2,316
Maturity: 1-5 Years Maturity					
Cha Cha Search, Inc.	Information Services	Senior Debt Matures February 2015 Interest rate Prime + 6.25% or Floor rate of 9.50%	$ 2,364	2,334	2,277
Eccentex Corporation	Information Services	Senior Debt[11] Matures May 2015 Interest rate Prime + 7.00% or Floor rate of 10.25%	$ 966	949	449
Jab Wireless, Inc.	Information Services	Senior Debt Matures November 2017 Interest rate Prime + 6.75% or Floor rate of 8.00%	$ 30,000	29,861	29,850
RichRelevance, Inc.	Information Services	Senior Debt Matures January 2015 Interest rate Prime + 3.25% or Floor rate of 7.50%	$ 3,778	3,762	3,661
Womensforum.com, Inc.	Information Services	Senior Debt[11]			

		Matures October 2016 Interest rate LIBOR + 6.50% or Floor rate of 9.25%	$ 8,000	7,853	7,853
		Senior Debt(11) Matures October 2016 Interest rate LIBOR + 7.50% or Floor rate of 10.25%	$ 4,500	4,451	4,451
Total Womensforum.com, Inc.				12,304	12,304
Total Debt Information Services (8.26%)*				51,642	50,857
Maturity: Upon Liquidation					
Novasys Medical, Inc.	Medical Device & Equipment	Senior Debt(9) Matures upon liquidation Interest rate Fixed 8.00%	$ 65	65	65
Maturity: Under 1 Year Maturity					
Gynesonics, Inc.	Medical Device & Equipment	Senior Debt Matures October 2013 Interest rate Prime + 8.25% or Floor rate of 11.50%	$ 3,073	3,178	3,178
Optiscan Biomedical, Corp.(6)	Medical Device & Equipment	Senior Debt Matures December 2013 Interest rate Prime + 8.20% or Floor rate of 11.45%	$ 8,260	9,101	9,265
Oraya Therapeutics, Inc.	Medical Device & Equipment	Senior Debt(9) Matures December 2013 Interest rate Fixed 7.00%	$ 500	500	500

See notes to consolidated financial statements.

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HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS (Continued)

March 31, 2013

(unaudited)

(dollars in thousands)

Portfolio Company	Sub-Industry	Type of Investment[1]	Principal Amount	Cost[2]	Value[3]
Maturity: 1-5 Years Maturity					
Lanx, Inc.	Medical Device & Equipment	Senior Debt Matures October 2016 Interest rate Prime + 8.00% or Floor rate of 11.75%	$ 15,000	$ 14,651	$ 15,101
		Revolving Line of Credit Matures October 2015 Interest rate Prime + 6.75% or Floor rate of 10.50%	$ 5,500	5,313	5,276
Total Lanx, Inc.				19,964	20,377
Medrobotics Corporation	Medical Device & Equipment	Senior Debt Matures March 2016 Interest rate Prime + 7.85% or Floor rate of 11.10%	$ 5,000	4,766	4,766
MELA Sciences, Inc.	Medical Device & Equipment	Senior Debt Matures November 2016 Interest rate Prime + 7.20% or Floor rate of 10.45%	$ 6,000	5,919	5,919
NinePoint Medical, Inc.	Medical Device & Equipment	Senior Debt Matures January 2016 Interest rate Prime + 5.85% or Floor rate of 9.10%	$ 7,000	6,805	6,805
Oraya Therapeutics, Inc.	Medical Device & Equipment	Senior Debt[11]			

		Matures September 2015 Interest rate Prime + 5.50% or Floor rate of 10.25%	$ 9,711	9,542	9,678
United Orthopedic Group, Inc.	Medical Device & Equipment	Senior Debt Matures July 2016 Interest rate Prime + 8.60% or Floor rate of 11.85%	$ 25,000	24,215	24,215
SonaCare Medical, LLC	Medical Device & Equipment	Senior Debt(11) Matures April 2016 Interest rate Prime + 7.75% or Floor rate of 11.00%	$ 6,000	5,919	5,855
Total Debt Medical Device & Equipment (14.72%)*				89,974	90,623
Maturity: 1-5 Years Maturity					
Navidea Biopharmaceuticals, Inc. (pka Neoprobe)(3)	Diagnostic	Senior Debt Matures December 2014 Interest rate Prime + 6.75% or Floor rate of 10.00%	$ 5,086	5,086	5,147
Tethys Bioscience Inc.	Diagnostic	Senior Debt(11) Matures December 2015 Interest rate Prime + 8.40% or Floor rate of 11.65%	$ 10,000	10,057	9,614
Total Debt Diagnostic (2.40%)*				15,143	14,761

	Cost	Value	Amortized Cost	Fair Value
Due in one year or less	$ 125	$ 125	$ -	$ -
Due after one year through five years	-	-	10,079	10,075
Due after five years	-	-	1,195	1,200
Total	$ 125	$ 125	$ 11,274	$ 11,275

There were no gains and losses on sales of securities in the third quarter or nine month period ended September 30 of 2014 or 2013. There were also no securities with an other than temporary impairment.

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 September 30, 2014 and December 31, 2013 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
September 30, 2014						
U. S. Treasury	$4,021	$(8)	$-	$-	$4,021	$(8)
Government sponsored Enterprises	1,996	(4)	2,008	(3)	4,004	(7)
Total	$6,017	$(12)	$2,008	$(3)	$8,025	$(15)
December 31, 2013						
Government sponsored Enterprises	$4,984	$(22)	$-	$-	$4,984	$(22)
Mortgage backed obligations	1,191	(8)	-	-	1,191	(8)
Total	$6,175	$(30)	$-	$-	$6,175	$(30)

Other investments, which consist of stock of correspondent banks and investments in low income housing projects, decreased since December 31, 2013. This decrease is due to FHLB stock repurchases which were partially offset with an increase in the Federal Reserve Bank Stock holding requirement.

	2014	2013
Construction/Land Development	$69,654	$68,512
Farmland	11,955	13,197
Real Estate	155,302	154,628
Multi-Family	11,461	11,797
Commercial Real Estate	120,939	113,415
Home Equity – closed end	9,519	10,228
Home Equity – open end	51,446	47,358
Commercial & Industrial – Non-Real Estate	26,454	25,903
Consumer	9,980	10,163
Dealer Finance	37,610	20,572
Credit Cards	2,526	2,680
Total	$506,846	$478,453

Note 3. Loans Held for Investment

Loans outstanding at September 30, 2014 and December 31, 2013 are summarized as follows (in thousands):

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):

September 30, 2014	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Impaired loans without a valuation allowance:					
Construction/Land Development	$4,547	$5,130	$-	$5,726	$110
Farmland	1,444	1,445	-	1,457	42
Real Estate	142	142	-	286	4
Multi-Family	-	-	-	-	-
Commercial Real Estate	1,448	1,747	-	1,283	60
Home Equity – closed end	-	-	-	221	-
Home Equity – open end	-	-	-	20	-
Commercial & Industrial – Non-Real Estate	194	194	-	205	8
Consumer	-	-	-	-	-
Credit cards	-	-	-	-	-
Dealer Finance	-	-	-	-	-
	7,775	8,658		9,198	224
Impaired loans with a valuation allowance					
Construction/Land Development	11,293	12,484	1,440	10,789	241
Farmland	-	-	-	-	-
Real Estate	914	914	118	900	46
Multi-Family	-	-	-	-	-
Commercial Real Estate	1,015	1,015	68	1,050	7
Home Equity – closed end	-	-	-	142	-
Home Equity – open end	-	-	-	40	-
Commercial & Industrial – Non-Real Estate	-	-	-	-	-
Consumer	-	-	-	-	-
Credit cards	-	-	-	-	-
Dealer Finance	-	-	-	-	-
	13,222	14,413	1,626	12,921	294
Total impaired loans	$20,997	$23,071	$1,626	$22,119	$518

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

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

Note 3. Loans Held for Investment, continued

December 31, 2013	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Impaired loans without a valuation allowance:					
Construction/Land Development	$4,543	$5,125	$-	$5,750	$153
Farmland	1,459	1,459	-	1,475	67
Real Estate	49	49	-	529	3
Multi-Family	-	-	-	-	-
Commercial Real Estate	851	851	-	616	56
Home Equity – closed end	308	308	-	284	25
Home Equity – open end	-	-	-	20	-
Commercial & Industrial – Non-Real Estate	242	242	-	64	12
Consumer	-	-	-	-	-
Credit cards	-	-	-	-	-
Dealer Finance	-	-	-	-	-
	7,452	8,034		8,738	316
Impaired loans with a valuation allowance					
Construction/Land Development	9,716	11,141	1,560	10,855	175
Farmland	-	-	-	-	-
Real Estate	1,145	1,145	154	966	48
Multi-Family	-	-	-	-	-
Commercial Real Estate	1,118	1,418	282	1,171	4
Home Equity – closed end	180	180	17	409	3
Home Equity – open end	100	100	9	93	5
Commercial & Industrial – Non-Real Estate	-	-	-	141	-
Consumer	2	2	-	1	1
Credit cards	-	-	-	-	-
Dealer Finance	-	-	-	-	-
	12,261	13,986	2,022	13,636	236
Total impaired loans	$19,713	$22,020	$2,022	$22,374	$552

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

Note 4. Allowance for Loan Losses

A summary of the allowance for loan losses follows (in thousands):

September 30, 2014	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance	Percentage of loans in each category to total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Allowance for loan losses:								
Construction/Land Development	$ 4,007	$ 1,191	$ 14	$ 1,128	$ 3,958	46.03 %	$ 1,440	$ 2,518
Farmland	(2)	-	-	-	(2)	(.02 %)	-	(2)
Real Estate	400	205	-	158	353	4.10 %	118	235
Multi-Family	-	-	-	-	-		-	-
Commercial Real Estate	777	-	32	(194)	615	7.14 %	68	547
Home Equity – closed end	157	-	-	(15)	142	1.65 %	-	142
Home Equity – open end	476	79	-	130	527	6.13 %	-	527
Commercial & Industrial – Non-Real Estate	1,464	385	49	403	1,531	17.80 %	-	1,531
Consumer	156	32	23	23	170	1.98 %	-	170
Dealer Finance	628	60	5	616	1,189	13.82 %	-	1,189
Credit Cards	121	35	31	1	118	1.37 %	-	118
Total	$ 8,184	$ 1,987	$ 154	$ 2,250	$ 8,601	100.00 %	$ 1,626	$ 6,975

December 31, 2013	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance	Percentage of loans in each category to total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Allowance for loan losses:								
Construction/Land Development	$ 2,771	$ 2,127	$ 40	$ 3,323	$ 4,007	48.96 %	$ 1,560	$ 2,447
Farmland	(2)	-	-	-	(2)	(.03 %)	-	(2)
Real Estate	924	173	-	(351)	400	4.89 %	154	246
Multi-Family	(37)	-	-	37	-	-	-	-
Commercial Real Estate	1,113	201	42	(177)	777	9.49 %	282	495
Home Equity – closed end	360	159	-	(44)	157	1.92 %	17	140

Home Equity – open end	659	68	29	(144)	476	5.82 %	9	467
Commercial & Industrial – Non-Real Estate	2,113	986	127	210	1,464	17.89 %	-	1,464
Consumer	51	173	14	264	156	1.90 %	-	156
Dealer Finance	72	17	-	573	628	7.68 %	-	628
Credit Cards	130	121	28	84	121	1.48 %	-	121
Unallocated	-	-	-	-	-	-	-	-
Total	$ 8,154	$ 4,025	$ 280	$ 3,775	$ 8,184	100.00 %	$ 2,022	$ 6,162

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

Note 4. Allowance for Loan Losses, continued

September 30, 2014	Loan Receivable	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Construction/Land Development	$69,654	$ 15,840	$ 53,814
Farmland	11,955	1,444	10,511
Real Estate	155,302	1,056	154,246
Multi-Family	11,461	-	11,461
Commercial Real Estate	120,939	2,463	118,476
Home Equity – closed end	9,519	-	9,519
Home Equity –open end	51,446	-	51,446
Commercial & Industrial – Non-Real Estate	26,454	194	26,260
Consumer	9,980	-	9,980
Dealer Finance	37,610	-	37,610
Credit Cards	2,526	-	2,526
Total	$506,846	$ 20,997	$ 485,849

Recorded Investment in Loan Receivables (in thousands)

December 31, 2013	Loan Receivable	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Construction/Land Development	$68,512	$ 14,259	$ 54,253
Farmland	13,197	1,459	11,738
Real Estate	154,628	1,194	153,434
Multi-Family	11,797	-	11,797
Commercial Real Estate	113,415	1,969	111,446
Home Equity – closed end	10,228	488	9,740
Home Equity –open end	47,358	100	47,258
Commercial & Industrial – Non-Real Estate	25,903	242	25,661
Consumer	10,163	2	10,161
Dealer Finance	20,572		20,572
Credit Cards	2,680	-	2,680
Total	$478,453	$ 19,713	$ 458,740

Aging of Past Due Loans Receivable (in thousands) as of September 30, 2014

September 30, 2014	30-59 Days Past due	60-89 Days Past Due	Greater than 90 Days (excluding non-accrual)	Non-Accrual Loans	Total Past Due	Current	Total Loan Receivable
Construction/Land Development	$1,217	$200	$ -	$ 4,928	$6,345	$63,309	$69,654

Farmland	97	-	-	-	97	11,858	11,955
Real Estate	2,329	536	-	657	3,522	151,780	155,302
Multi-Family	-	-	-	-	-	11,461	11,461
Commercial Real Estate	74	-	-	1,319	1,393	119,546	120,939
Home Equity – closed end	95	15	10	-	120	9,399	9,519
Home Equity – open end	532	10	-	23	565	50,881	51,446
Commercial & Industrial – Non-Real Estate	39	5	-	15	59	26,395	26,454
Consumer	89	106	11	3	209	9,771	9,980
Dealer Finance	301	98	75	12	486	37,124	37,610
Credit Cards	15	1	-	-	16	2,510	2,526
Total	$4,788	$971	$ 96	$ 6,957	$12,812	$494,034	$506,846

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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, 2013

	30-59 Days Past due	60-89 Days Past Due	Greater than 90 Days (excluding non-accrual)	Non-Accrual Loans	Total Past Due	Current	Total Loan Receivable
December 31, 2013							
Construction/Land Development	$167	$735	$ -	$ 8,556	$9,458	$59,054	$68,512
Farmland	-	-	-	-	-	13,197	13,197
Real Estate	4,659	920	246	1,407	7,232	147,396	154,628
Multi-Family	107	-	-	-	107	11,690	11,797
Commercial Real Estate	858	-	-	1,474	2,332	111,083	113,415
Home Equity – closed end	122	79	10	180	391	9,837	10,228
Home Equity – open end	549	39	51	222	861	46,497	47,358
Commercial & Industrial – Non-Real Estate	148	20	4	416	588	25,315	25,903
Consumer	169	71	5	-	245	9,918	10,163
Dealer Finance	335	72	11	-	418	20,154	20,572
Credit Cards	21	3	-	-	24	2,656	2,680
Total	$7,135	$1,939	$ 327	$ 12,255	$21,656	$456,797	$478,453

CREDIT QUALITY INDICATORS (in thousands)
AS OF SEPTEMBER 30, 2014
Corporate Credit Exposure
Credit Risk Profile by Creditworthiness Category

	Grade 1 Minimal Risk	Grade 2 Modest Risk	Grade 3 Average Risk	Grade 4 Acceptable Risk	Grade 5 Marginally Acceptable	Grade 6 Watch	Grade 7 Substandard	Grade 8 Doubtful	Total
Construction/Land Development	$-	$167	$8,228	$ 25,851	$ 8,394	$4,134	$ 22,880	$-	$69,654
Farmland	68	-	1,582	3,257	4,913	-	2,135	-	11,955
Real Estate	-	635	59,484	62,139	23,260	7,311	2,473	-	155,302
Multi-Family	-	487	4,189	2,207	4,578		-	-	11,461
Commercial Real Estate	-	1,449	22,315	64,766	18,890	10,820	2,699	-	120,939
	-	-	4,473	3,039	1,832	163	12	-	9,519

Home Equity – closed end									
Home Equity – open end	-	1,535	13,153	28,219	4,123	1,859	2,557	-	51,446
Commercial & Industrial (Non-Real Estate)	684	76	4,129	16,226	4,597	725	17	-	26,454
Total	$752	$4,349	$117,553	$ 205,704	$ 70,587	$25,012	$ 32,773	$-	$456,730

Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Credit Cards	Consumer
Performing	$2,526	$47,489
Non performing	-	101
Total	$2,526	$47,590

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

Note 4. Allowance for Loan Losses, continued

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

	Grade 1 Minimal Risk	Grade 2 Modest Risk	Grade 3 Average Risk	Grade 4 Acceptable Risk	Grade 5 Marginally Acceptable	Grade 6 Watch	Grade 7 Substandard	Grade 8 Doubtful	Total
Construction/Land Development	$-	$-	$3,166	$ 25,657	$ 11,116	$2,946	$ 25,627	$-	$68,512
Farmland	69	-	1,406	5,206	4,816	143	1,557	-	13,197
Real Estate	-	562	68,241	52,190	19,037	7,821	6,777	-	154,628
Multi-Family	-	668	4,442	2,275	4,412	-	-	-	11,797
Commercial Real Estate	-	1,897	18,062	55,350	21,677	13,406	3,023	-	113,415
Home Equity – closed end	-	-	4,574	3,117	1,870	281	386	-	10,228
Home Equity – open end	-	1,482	13,308	26,734	4,840	327	667	-	47,358
Commercial & Industrial (Non-Real Estate)	815	92	3,631	16,265	3,108	1,516	476	-	25,903
Total	$884	$4,701	$116,830	$ 186,794	$ 70,876	$26,440	$ 38,513	$-	$445,038

Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Credit Cards	Consumer
Performing	$2,680	$30,719
Non performing	-	16
Total	$2,680	$30,735

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 by 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.

F & M BANK CORP.
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.

F & M BANK CORP.
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 $1,500,000 to the plan in the first quarter of 2014 and does not anticipate additional contributions for the 2014 plan year. The following is a summary of net periodic pension costs for the nine month and three month periods ended September 30, 2014 and 2013.

	Nine Months Ended		Three Months Ended	
	September 30 2014	September 30, 2013	September 30, 2014	September 30, 2013
Service cost	$375,771	$449,949	$125,257	$149,983
Interest cost	283,281	262,734	94,427	87,578
Expected return on plan assets	(523,689)	(477,060)	(174,563)	(159,020)
Amortization of net obligation at transition	-	-	-	-
Amortization of prior service cost	(11,427)	(11,427)	(3,809)	(3,809)
Amortization of net (gain) or loss	27,084	152,388	9,028	50,796
Net periodic pension cost	$151,020	$376,584	$50,340	$125,528

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. Treasury, 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.

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

Note 6. Fair Value, continued

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.

For level 3 assets and liabilities measured at fair value on a recurring basis or non-recurring basis as of September 30, 2014 and December 31, 2013, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value at September 30, 2014		Valuation Technique	Significant Unobservable Inputs	Range
Impaired Loans	$	11,596	Discounted appraised value	Discount for selling costs and age of appraisals	15%-55%
Other Real Estate Owned	$	3,956	Discounted appraised value	Discount for selling costs and age of appraisals	15%-55%

	Fair Value at December 31, 2013		Valuation Technique	Significant Unobservable Inputs	Range
Impaired Loans	$	10,239	Discounted appraised value	Discount for selling costs and age of appraisals	15%-55%
Other Real Estate Owned	$	2,628	Discounted appraised value	Discount for selling costs and age of appraisals	15%-55%

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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 tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis (in thousands).

September 30, 2014	Total	Level 1	Level 2	Level 3
U.S. Treasury Securities	$4,021	$-	$4,021	
Government sponsored enterprises	6,054	-	6,054	-
Mortgage-backed obligations of federal agencies	1,065	-	1,065	-
Corporate equities	135	-	135	-
Investment securities available for sale	$11,275	$-	$11,275	$-
Total assets at fair value	$11,275	$-	$11,275	$-
Total liabilities at fair value	$-	$-	$-	$-
Derivative financial instruments at fair value	$33	$-	$33	$-

December 31, 2013	Total	Level 1	Level 2	Level 3
Government sponsored enterprises	$29,065	$-	$29,065	$-
Mortgage-backed obligations of federal agencies	1,201	-	1,201	-
Investment securities available for sale	30,266	-	30,266	-
Total assets at fair value	$30,266	$-	$30,266	$-
Total liabilities at fair value	$-	$-	$-	$-
Derivative financial instruments at fair value	$31	$-	$31	$-

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

Note 6. Fair Value, continued

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

September 30, 2014	Total	Level 1	Level 2	Level 3
Other Real Estate Owned	$3,956	-	-	$3,956
		-	-	
Construction/Land Development	9,854	-	-	9,854
Farmland	-	-	-	-
Real Estate	796	-	-	796
Multi-Family	-	-	-	-
Commercial Real Estate	946	-	-	946
Home Equity – closed end	-	-	-	-
Home Equity – open end	-	-	-	-
Commercial & Industrial – Non-Real Estate	-	-	-	-
Consumer	-	-	-	-
Credit cards	-	-	-	-
Dealer Finance	-	-	-	-
Total Impaired loans	11,596	-	-	11,596
Total assets at fair value	$15,552	$-	$-	$15,552
Total liabilities at fair value	$-	$-	$-	$-

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

December 31, 2013	Total	Level 1	Level 2	Level 3
Other Real Estate Owned	$2,628	-	-	$ 2,628
		-	-	
Construction/Land Development	8,156	-	-	8,156
Farmland	-	-	-	-
Real Estate	991	-	-	991
Multi-Family	-	-	-	-
Commercial Real Estate	836	-	-	836
Home Equity – closed end	163	-	-	163
Home Equity – open end	91	-	-	91
Commercial & Industrial – Non-Real Estate	-	-	-	-
Consumer	2	-	-	2
Credit cards	-	-	-	-
Dealer Finance	-	-	-	-
Total Impaired loans	10,239	-	-	10,239
Total assets at fair value	$12,867	-	$ -	12,867
Total liabilities at fair value	$-	$ -	$ -	$ -

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 September 30, 2014 and December 31, 2013. 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 above and below are considered Level 2 with the exception of impaired loans of $11,596,000 and $10,239,000 at September 30, 2014 and December 31, 2013, respectively, which are considered level 3. 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 (in thousands).

	September 30, 2014		December 31, 2013	
	Estimated Fair Value	Carrying Value	Estimated Fair Value	Carrying Value
Financial Assets				
Loans, gross	$537,765	$506,846	$512,250	$478,453
Financial Liabilities				
Time deposits	$198,070	$196,649	$197,729	$196,004
Long-term debt	$27,651	$25,191	$23,791	$21,691

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

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.

In the nine months ended September 30, 2014, there were three (one loan during quarter ended September 30, 2014) loan modifications that were 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.

There were no troubled debt restructurings from the previous twelve months that went into default in 2014. 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

Note 8. Troubled Debt Restructuring, continued

	Nine months ended September 30, 2014		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial		$ -	$ -
Real Estate	2	181	181
Home Equity		-	-
Credit Cards		-	-
Consumer	1	23	23
Total		$ 204	$ 204

During the nine months and quarter ended, September 30, 2013, there was one real estate loan modification that was considered to be troubled debt restructuring.

There were also no troubled debt restructurings from the previous twelve months that went into default in the nine months and quarter ended September 30, 2013. A restructured loan is considered in default when it becomes 90 days past due.

	Nine months ended September 30, 2013		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial		$ -	$ -
Real Estate	1	50	50
Home Equity		-	-
Credit Cards		-	-
Consumer		-	-
Total		$ 50	$ 50

F & M BANK CORP.

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, VA.

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. Such forward-looking statements involve known and unknown risks including, but not limited to:

Changes in the quality or composition of our loan or investment portfolios, including adverse developments in borrower industries, declines in real estate values in our markets, or in the repayment ability of individual borrowers or issuers;

The strength of the economy in our target market area, as well as general economic, market, or business conditions;

An insufficient allowance for loan losses as a result of inaccurate assumptions;

Our ability to maintain our "well-capitalized" regulatory status;

Changes in the interest rates affecting our deposits and our loans;

Changes in our competitive position, competitive actions by other financial institutions and the competitive nature of the financial services industry and our ability to compete effectively against other financial institutions in our banking markets;

Our ability to manage growth;

Our potential growth, including our entrance or expansion into new markets, the opportunities that may be presented to and pursued by us and the need for sufficient capital to support that growth;

Our exposure to operational risk;

Our ability to raise capital as needed by our business;
Changes in laws, regulations and the policies of federal or state regulators and agencies; and
Other circumstances, many of which are beyond our control.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Forward-Looking Statements (continued)

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.

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

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.

F & M BANK CORP.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Overview

Net income for the nine months ended September 30, 2014 was $4,236,000 or $1.38 per share, compared to $3,532,000 or $1.41 in the same period in 2013, an increase of 19.93% in net income however earnings per share decreased due to the shares of common stock issued by the Company in its private placement capital raise in the first quarter of 2014. Net interest income increased 7.53% from $15,866,000 to $17,061,000 compared to the same period in 2013. During the nine months ended September 30, 2014, noninterest income decreased 12.52% and noninterest expense increased 5.84%. The provision for loan losses decreased from $3,025,000 to $2,250,000 or 25.62%. Net income from Bank operations adjusted for income or loss from Parent activities is as follows:

In thousands	2014	2013
Net Income from Bank Operations	$4,141	$3,442
Income from Parent Company Activities	95	90
Net Income for the nine months ended September 30	$4,236	$3,532

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Results of Operations

As shown in Table I on page 35, the 2014 year to date tax equivalent net interest income increased $1,198,000 or 7.52% compared to the same period in 2013. Third quarter tax equivalent net interest income increased $707,000 or 13.37% compared to September 30, 2013. The tax equivalent adjustment to net interest income totaled $74,000 for the quarter. The year to date yield on earning assets increased .05%, while the cost of funds decreased .26% compared to the same period in 2013. The cost of time deposits decreased by .32% due to continued low market rates and accounted for most of the change in the overall cost of funds.

Year to date, the combination of the increase in 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 4.29%, an increase of .26% when compared to the same period in 2013. Third quarter net interest margin increased to 4.36%, an increase of .38% when compared to September 30, 2013. The $18 million increase in non-interest bearing deposits has allowed the Company to fund loan growth while reducing our cost of funds. The Company has developed a rewards deposit product to encourage deposit growth, this along with continued low rates have resulted in the growth in non-interest bearing deposits. A schedule of the net interest margin for the nine month and three month periods ended September 30, 2014 and 2013 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. This would indicate that in a rising rate environment net interest income and net interest margin would increase as a result of assets repricing faster than liabilities. 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 42.65% of rate sensitive assets and 40.58% of rate sensitive liabilities are subject to repricing within one year. 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 decreased $387,000 or 12.52% for the nine month period ended September 30, 2014. The decrease is primarily due to a decrease in VBS Mortgage income. This loss resulted from a decline in mortgage refinancing as rates have rebounded and a particularly hard winter which depressed home sales throughout the region during the first quarter of 2014. VBS Mortgage returned to profitability in the second quarter of 2014 as home sales recovered.

Noninterest expense increased $632,000 for the nine month period ended September 30, 2014 as compared to 2013. Other expenses, as shown on the income statement, increased in the areas of data processing, legal and professional, supplies, travel and ATM expenses. As stated in the most recently available (June 30, 2014) Bank Holding Company Performance Report, the Company’s and peer’s (Holding Companies with Consolidated Assets of $500 million to $1billion) noninterest expenses averaged 2.67% and 3.03% 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.

F & M BANK CORP.

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 due to the maturity of a short term investment held at year end as well as growth in the loan portfolio.

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 September 30, 2014, the market value of securities available for sale exceeded the cost by $1,000. The portfolio is made up of primarily agency securities with an average portfolio life of just under four years. This short average life results in less portfolio volatility and positions the Bank to redeploy assets in response to rising rates. There are no additional scheduled maturities in 2014. The Bank held a short term security at year end which matured resulting in the decreased balance at September 30, 2014.

In reviewing investments as of September 30, 2104, 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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F & M BANK CORP.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Loans Held for Investment of $506,846,000 increased $28.4 million at September 30, 2014 compared to December 31, 2013. The dealer finance portfolio increased $17.0 million, commercial real estate increased $7.5 million and open ended home equities increased $4.1 million. These increases were offset by decreases in farmland loans of $1.2 million and closed end home equities totaling $.7 million.

Loans Held for Sale totaled $16,131,000 at September 30, 2014, an increase of $12,327,000 compared to December 31, 2013. While the portfolio has grown compared to December 31, 2013, the Company experienced a rapid decline in this portfolio during the first half of 2013 due to the decline in the real estate refinancing market which has not rebounded. Average balances and income from loans held for sale are detailed in the Table 1 on page 35.

Nonperforming loans include nonaccrual loans, loans 90 days or more past due and restructured loans. Nonaccrual loans are loans on which interest accruals have been suspended or discontinued permanently. Nonperforming loans totaled $7,257,000 at September 30, 2014 compared to $14,082,000 at December 31, 2013. 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 September 30, 2014, the Company holds $3,956,000 of real estate which was acquired through foreclosure. This is an increase of $1,328,000 compared to December 31, 2013.

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

	September 30, 2014	December 31, 2013
Nonaccrual Loans		
Real Estate	$5,585	$9,963
Commercial	1,334	1,890
Home Equity	23	402
Other	15	-
	6.957	12,255
Loans past due 90 days or more (excluding nonaccrual)		
Real Estate	-	246
Commercial	-	4
Home Equity	10	61
Other	86	16
	96	327
Restructured Loans		
Real Estate	204	50
Commercial	-	1,450
	204	1,500
Total Nonperforming loans	$7,257	$14,082
Nonperforming loans as a percentage of loans held for investment	1.43 %	2.94 %

Net loan losses to average loans outstanding (held for investment)	.37	%	.79	%
Allowance for loan and lease losses to nonperforming loans	118.52	%	58.12	%
Restructured Nonaccrual	-		-	

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F & M BANK CORP.

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 and loans identified as Troubled Debt Restructurings 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.

Loans that are not impaired are categorized by call report code and an estimate is calculated based on actual loss experience over the last two years. Dealer finance loans utilize a five year loss history. The Company will monitor the net losses for this division and adjust based on how the portfolio performs since the department was established in 2012. A general allowance for inherent losses has been established to reflect other unidentified losses within the portfolio. The general allowance is calculated using eight environmental factors (loan growth, unemployment, past due/criticized loans, interest rates, changes in underwriting practices, local real estate industry conditions, and experience of lending staff) with a range for worst and best case. 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 $8,601,000 at September 30, 2014 is equal to 1.70% of loans held for investment. This compares to an allowance of $8,184,000 (1.71%) at December 31, 2013. Based on the evaluation of the loan portfolio described above, as well as a significant decline in non-performing loans, management has funded the allowance a total of $2,250,000 in the first nine months of 2014, versus $3,025,000 of allowance funding for the same period of 2013. Net charge-offs year to date totaled $1,833,000.

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.

F & M BANK CORP.

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 $23,492,000 since December 31, 2013. Time deposits increased $645,000 during this period while demand deposits and savings deposits increased $22,847,000. 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 $25.5 million in CDARS funding, which is an increase of $14.2 million over December 31, 2013.

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 September 30, 2014 there were no FHLB short-term borrowings and commercial repurchase agreements totaled $3,784,000 compared to $3,423,000 at December 31, 2013.

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. In addition to the $4.0 million maturity in the second quarter, there was a borrowing that matured during the third quarter that totaled $2.5 million and a new borrowing of $10.0 million, resulting in a balance of $15,000,000 at September 30, 2014.

In August 2009, the Bank began issuing subordinated debt to 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 September 30, 2014 and December 31, 2013 the balance outstanding was $10,191,000.

F & M BANK CORP.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Capital

The Company successfully completed a private placement of common stock in March 2014. In the private placement the Company sold 774,231 shares of common stock for net proceeds of $12 million. The resulting increase in equity improved the Company's risked based capital and leverage ratios by 2.64% and 2.16%, respectively as of March 31, 2014. The Company also has filed a registration statement with respect to a public offering of up to $10 million of mandatorily convertible preferred stock that is expected to close on November 14, 2014.

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 September 30, 2014, the Company's total risk based capital and leverage ratios were 17.04% and 11.49%, respectively, increasing over year end from 15.37% and 9.37%, respectively. For the same period, Bank-only total risk based capital and leverage ratios were 16.78% and 11.25%, respectively, increasing over year end from 15.43% and 9.41%, respectively. For both the Company and the Bank these ratios are in excess of regulatory minimums to be considered "well capitalized".

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. 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 September 30, 2014, the Company had a cumulative Gap Rate Sensitivity Ratio of 12.79% 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.

F & M BANK CORP.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Effect of Newly Issued Accounting Standards

In January 2014, the FASB amended the Equity Method and Joint Ventures topic of the Accounting Standards Codification. The amendments provide criteria that must be met in order to apply a proportional amortization method to Low-Income Housing Tax Credit investments and provide guidance on the method used to amortize the investment, the impairment approach, and the eligibility criteria for entities that have other arrangements (e.g., loans) with the limited liability entity. The amendments will be effective for the Company for new investments in qualified affordable housing projects for interim and annual periods beginning after December 15, 2014. The Company does not expect these amendments to have a material effect on its financial statements.

In May 2014, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for reporting periods beginning after December 15, 2016. The Companydoes not expect this guidance to have a material effect on its financial statements.

In August 2014, the FASB issued guidance that is intended to define management’s responsibility to evaluate whether there is substantial doubt about an organization’s ability to continue as a going concern and to provide related footnote disclosures. In connection with preparing financial statements, management will need to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the organization’s ability to continue as a going concern within one year after the date that the financial statements are issued. The amendments will be effective for the Company for annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. The Company does not expect these amendments to have a material effect on its 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).

TABLE I

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

	Nine Months Ended September 30, 2014			Nine Months Ended September 30, 2013			Three Months Ended September 30, 2014			Three Months Enc September 30, 20	
Average		Income/	Average		Income/	Average		Income/	Average		Income/A
	Balance2,4	Expense	Rates	Balance2,4	Expense	Rates5	Balance2,4	Expense	Rates	Balance2,4	Expense
Interest income											
Loans held for investment1,2	$490,970	$19,516	5.31%	$468,664	$18,835	5.37%	$500,623	$6,692	5.30%	$474,131	$6,344
Loans held for sale	8,684	228	3.51%	27,581	623	3.02%	18,718	164	3.48%	10,222	79
Federal funds sold	19,392	31	.21 %	22,079	36	.22 %	11,743	7	.24 %	30,424	17
Interest bearing deposits	891	-	-	1,140	4	.47 %	1,139	-	-	748	2
Investments											
Taxable 3	13,347	137	1.37%	11,856	140	1.58%	13,644	38	1.11%	11,157	39
Partially taxable	116	-	-	107	-	-	113	-	-	107	-
Total earning assets	$533,400	$19,912	4.99%	$531,427	$19,638	4.94%	$545,980	$6,901	5.01%	$526,789	$6,481
Interest Expense											
Demand deposits	117,542	501	.57 %	120,747	608	.67 %	114,996	165	.57 %	117,017	198
Savings	58,940	88	.20 %	51,993	91	.23 %	61,910	31	.20 %	53,899	29
Time deposits	195,282	1,309	.90 %	199,598	1,804	1.21%	193,883	416	.85 %	197,137	575
Short-term debt	3,556	7	.26 %	7,098	22	.41 %	3,808	3	.31 %	3,378	3
Long-term debt	22,277	872	5.23%	39,506	1,175	3.98%	23,995	292	4.83%	35,474	389
Total interest bearing liabilities	$397,597	$2,777	.93 %	$418,942	$3,700	1.19%	$398,592	$907	.90 %	$406,905	$1,194
Tax equivalent net interest income 1		$17,135			$15,938			$5,994			$5,287

Net interest margin	4.29%	4.01%	4.36%

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 (see page 27) 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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TABLE II

F & M BANK CORP.
Interest Sensitivity Analysis

September 30, 2014
(In Thousands of Dollars)

The following table presents the Company's interest sensitivity.

	0 – 3 Months	4 – 12 Months	1 – 5 Years	Over 5 Years	Not Classified	Total
Uses of funds						
Loans						
Commercial	$28,400	$24,713	$110,346	$7,349	$-	$170,808
Installment	4,486	855	31,220	11,030	-	47,591
Real estate loans for investments	94,934	45,876	138,451	6,660	-	285,921
Loans held for sale	16,131	-	-	-	-	16,131
Credit cards	2,526	-	-	-	-	2,526
Federal funds sold	16,165	-	-	-	-	16,165
Interest bearing bank deposits	1,039	-	-	-	-	1,039
Investment securities	-	125	10,076	1,064	135	11,400
Total	$163,681	$71,569	$290,093	$26,103	$135	$551,581
Sources of funds						
Interest bearing demand deposits	$-	$30,944	$67,612	$18,335	$-	$116,891
Savings deposits	-	12,680	38,041	12,680	-	63,401
Certificates of deposit $100,000 and over	28,178	17,989	32,144	-	-	78,311
Other certificates of deposit	19,372	46,258	52,708	-	-	118,338
Short-term borrowings	3,784	-	-	-	-	3,784
Long-term borrowings	5,125	375	8,785	10,906	-	25,191
Total	$56,459	$108,246	$199,290	$41,920	$-	$405,915
Discrete Gap	$107,222	$(36,677)	$90,803	$(15,817)	$135	$145,666
Cumulative Gap	$107,222	$70,545	$161,348	$145,531	$145,666	
Ratio of Cumulative Gap to Total Earning Assets	19.44 %	12.79 %	29.25 %	26.38 %	26.41 %	

Table II reflects the earlier of the maturity or repricing dates for various assets and liabilities as of September 30, 2014. 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.

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 recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and is accumulated and 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.

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)-15(e) of the Act), have concluded that the Company’s disclosure controls and procedures are effective for purposes of Rule 13(a)-15(b).

Changes in Internal Controls

The findings of the internal auditor are presented to management of the Bank and to the Audit Committee of the Company. During the period covered by this report, there were no changes to the internal controls over financial reporting of the Company that have materially affected, or are reasonably likely to materially affect, the Company’s internal controls over financial reporting.

F & M BANK CORP.

Part II Other Information

Item 1. Legal Proceedings

There are no material pending legal proceedings other than ordinary routine litigation incidental to its business, to which the Company is a party or of which the property of the Company is subject.

Item 1a. Risk Factors

There have been no material changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

None

Item 5. Other Information

None

Item 6. Exhibits

(a) Exhibits

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 Sarbanes-Oxley Act of 2002 (filed herewith).
101	The following materials from F&M Bank Corp.'s Quarterly Report on Form 10-Q for the period ended September 30, 2014, formatted in Extensible Business Reporting Language (XBRL), include: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Stockholders' Equity, (v) Consolidated Statements of Cash Flows and (vi) related notes (filed herewith).

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F & M BANK CORP.

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.

By:	/s/ Dean W. Withers Dean W. Withers President and Chief Executive Officer
By:	/s/ Carrie A. Comer Carrie A. Comer Senior Vice President and Chief Financial Officer

November 14, 2014

F & M BANK CORP.

Exhibit Index:

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