Celsion CORP
Form 424B5
December 08, 2017
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Registration Statement No. 333-221543

PROSPECTUS

1,314,443 Shares of Common Stock

Issuable upon Exercise of Outstanding Warrants

This prospectus relates to the resale, from time to time, by the selling stockholders identified in this prospectus under the caption "Selling Stockholders," of up to 1,314,443 shares of our common stock, par value $0.01 per share, including (i) 1,166,250 shares issuable upon exercise of certain outstanding investor common stock purchase warrants and (ii) 66,000 shares issuable upon exercise of certain outstanding representative common stock purchase warrants. We are not selling any shares of common stock under this prospectus and will not receive any proceeds from the sale of shares of common stock by the selling stockholders. We will receive proceeds from cash exercise of the warrants which, if exercised in cash with respect to all of the 1,232,250 shares of common stock, would result in gross proceeds of approximately $7.4 million to us. The selling stockholders will bear all commissions and discounts, if any, attributable to the sale of the shares.

The selling stockholders may sell the shares of our common stock offered by this prospectus from time to time on terms to be determined at the time of sale through ordinary brokerage transactions or through any other means described in this prospectus under the caption "Plan of Distribution." The shares of common stock may be sold at fixed prices, at market prices prevailing at the time of sale, at prices related to prevailing market price or at negotiated prices.

Our common stock is listed on The NASDAQ Capital Market under the symbol "CLSN." On December 7, 2017, the last reported closing sale price of our common stock on The NASDAQ Capital Market was $2.56 per share.

Investing in our common stock involves a high degree of risk. Before making an investment decision, please read "Risk Factors" on page 13 of this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is December 8, 2017.

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ABOUT THIS PROSPECTUS

This prospectus relates to the resale, from time to time, by the selling stockholders identified in this prospectus under the caption “Selling Stockholders,” of up to 1,314,443 shares of our common stock, par value $0.01 per share, including (i) 1,166,250 shares issuable upon exercise of certain outstanding investor common stock purchase warrants and (ii) 66,000 shares issuable upon exercise of certain outstanding representative common stock purchase warrants. As described below under “Description of the Private Placement” on page 10 of this prospectus, (i) on October 4, 2018, 1,166,250 shares of common stock will become exercisable at $6.20 per share by the selling stockholders and (ii) on April 30, 2018, 66,000 shares of common stock will become exercisable at $2.87 per share by the selling stockholders. We are not selling any shares of common stock under this prospectus and will not receive any proceeds from the sale of shares of common stock by the selling stockholders. We will receive proceeds from the cash exercise of the warrants which, if exercised in cash with respect to all of the 1,232,250 shares of common stock, would result in gross proceeds of $7,420,170 to us.

This prospectus is part of a registration statement on Form S-1 that we filed with the Securities and Exchange Commission (SEC). It omits some of the information contained in the registration statement and reference is made to the registration statement for further information with regard to us and the securities being offered by the selling stockholders. Any statement contained in the prospectus concerning the provisions of any document filed as an exhibit to the registration statement or otherwise filed with the SEC is not necessarily complete, and in each instance, reference is made to the copy of the document filed.

You should read this prospectus, any documents that we incorporate by reference in this prospectus and the additional information described below under “Where You Can Find Additional Information” and “Information Incorporated By Reference” before making an investment decision. You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized any other person to provide you with different information. If anyone provides you with additional, different or inconsistent information, you should not rely on it. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

You should not assume that the information in this prospectus or any documents we incorporate by reference herein is accurate as of any date other than the date on the front of those documents. Our business, financial condition, results of operations and prospects may have changed since those dates.

Unless the context indicates otherwise, as used in this prospectus, the terms “Celsion,” “the Company,” “we,” “us” and “our” refer to Celsion Corporation, a Delaware corporation, and its wholly-owned subsidiary CLSN Laboratories, Inc., also a Delaware corporation. The Celsion brand and product names, including but not limited to Celsion® and ThermoDox® contained in this prospectus are trademarks, registered trademarks or service marks of Celsion Corporation or its subsidiary in the United States and certain other countries. This document may also contain references to trademarks and service marks of other companies that are the property of their respective owners.

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the information requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act). In accordance with the Exchange Act, we file annual, quarterly and current reports, proxy statements and other information with the SEC. Such reports, proxy statements and other information filed by us are available to the public free of charge at www.sec.gov. You may also read and copy any document we file with the SEC at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the public reference facilities by calling the SEC at 1-800-SEC-0330. Copies of certain information filed by us with the SEC are also available on our website at www.celsion.com. The information available on or through our website is not part of this prospectus and should not be relied upon.

This prospectus is part of a registration statement that we filed with the SEC. This prospectus omits some information contained in the registration statement in accordance with SEC rules and regulations. You should review the information and exhibits in the registration statement for further information about us and the securities being offered hereby. Statements in this prospectus concerning any document we filed as an exhibit to the registration statement or that we otherwise filed with the SEC are not intended to be comprehensive and are qualified by reference to the filings. You should review the complete document to evaluate these statements.

INFORMATION INCORPORATED BY REFERENCE

SEC rules allow us to “incorporate by reference” into this prospectus much of the information we file with the SEC, which means that we can disclose important information to you by referring you to those publicly available documents. The information that we incorporate by reference into this prospectus is considered to be part of this prospectus. These documents may include Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as proxy statements. You should read the information incorporated by reference because it is an important part of this prospectus.

This prospectus incorporates by reference the documents listed below, other than those documents or the portions of those documents deemed to be furnished and not filed in accordance with SEC rules:

- our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the SEC on March 24, 2017;
- our Quarterly Report on Form 10-Q for the quarter ended March 31, 2017, filed with the SEC on May 12, 2017;
- our Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, filed with the SEC on August 14, 2017;
- our Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, filed with the SEC on November 14, 2017;
- our Current Reports on Form 8-K filed with the SEC on February 15, 2017, May 16, 2017, May 26, 2017, June 6, 2017, June 9, 2017, June 19, 2017, June 22, 2017, June 23, 2017, June 26, 2017, July 6, 2017, July 11, 2017, August 15, 2017, September 21, 2017, October 4, 2017, October 27, 2017 and October 31, 2017;
- our Definitive Proxy Statement on Schedule 14A filed with the SEC on April 4, 2017; and
- the description of our common stock contained in our registration statement on Form 8-A filed with the SEC on May 26, 2000, as amended by a Form 8-A/A dated February 7, 2008, and any amendments or reports filed for the purpose of updating such description.

Any statement contained in any document incorporated by reference herein shall be deemed to be modified or superseded for purposes of this prospectus to the extent that a statement contained in this prospectus or any prospectus modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this prospectus.

We also incorporate by reference any future filings, other than current reports furnished under Item 2.02 or Item 7.01 of Form 8-K and exhibits filed on such form that are related to such items, made with the SEC pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act, in each case, other than those documents or the portions of those documents deemed to be furnished and not filed in accordance with SEC rules, until the offering of the securities under the registration statement of which this prospectus forms a part is terminated or completed. Information in such future filings updates and supplements the information provided in this prospectus. Any statements in any such future filings will be deemed to modify and supersede any information in any document we previously filed with the SEC that is incorporated or deemed to be incorporated herein by reference to the extent that statements in the later filed document modify or replace such earlier statements.

Because we are incorporating by reference future filings with the SEC, this prospectus is continually updated and later information filed with the SEC may update and supersede some of the information included or incorporated by reference in this prospectus. This means that you must look at all of the SEC filings that we incorporate by reference to determine if any of the statements in this prospectus or in any document previously incorporated by reference have been modified or superseded.

We will provide without charge to each person, including any beneficial owners, to whom this prospectus is delivered, upon his or her written or oral request, a copy of any or all reports or documents referred to above which have been or may be incorporated by reference into this prospectus but not delivered with this prospectus, excluding exhibits to those reports or documents unless they are specifically incorporated by reference into those documents. You may request a copy of these documents by writing or telephoning us at the following address.

Celsion Corporation

997 Lenox Drive, Suite 100

Lawrenceville, New Jersey 08648

(609) 896-9100

Attention: Jeffrey W. Church

Senior Vice President, Chief Financial Officer and Corporate Secretary

FORWARD-LOOKING STATEMENTS

Certain statements contained or incorporated by reference in this prospectus, in any applicable prospectus and in any related free writing prospectus constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and releases issued by the SEC and within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Exchange Act. From time to time, we may publish forward-looking statements relating to such matters as anticipated financial performance, business prospects, technological developments, product pipelines, clinical trials and research and development activities, the adequacy of capital reserves and anticipated operating results and cash expenditures, current and potential collaborations, strategic alternatives and other aspects of our present and future business operations and similar matters that also constitute such forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our or our industry’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Such statements include, without limitation:

- any statements regarding future operations, plans, regulatory filings or approvals, including the plans and objectives of management for future operations or programs or proposed new products or services;
- any statements regarding the performance, or likely performance, or outcomes or economic benefit of any of our research and development activities, proposed or potential clinical trials or new drug filing strategies or timelines, including whether any of our clinical trials will be completed successfully within any specified time period or at all;
- any projections of earnings, cash resources, revenue, expense or other financial terms;
- any statements regarding the initiation, timing, progress and results of our research and development programs, preclinical studies, any clinical trials and Investigational New Drug application, New Drug Application and other regulatory submissions;
- any statements regarding cost and timing of development and testing, capital structure, financial condition, working capital needs and other financial items;
- any statements regarding the implementation of our business model and integration of acquired technologies, assets or businesses and existing or future collaborations, mergers, acquisitions or other strategic transactions;
- any statements regarding approaches to medical treatment, any introduction of new products by others, any possible licenses or acquisitions of other technologies, assets or businesses, or possible actions by customers, suppliers, strategic partners, potential strategic partners, competitors or regulatory authorities;
- any statements regarding development or success of our collaboration arrangements or future payments that may come due to us under these arrangements;
- any statements regarding compliance with the listing standards of The NASDAQ Capital Market; and
- any statements regarding future economic conditions or performance and any statement of assumptions underlying any of the foregoing.

In some cases, you can identify forward-looking statements by terminology such as “expect,” “anticipate,” “estimate,” “continue,” “plan,” “believe,” “could,” “intend,” “predict,” “may,” “should,” “will,” “would” and words of similar import rega expectations. Forward-looking statements are only predictions. Actual events or results may differ materially. Although we believe that our expectations are based on reasonable assumptions within the bounds of our knowledge of our industry, business and operations, we cannot guarantee that actual results will not differ materially from our expectations. In evaluating such forward-looking statements, you should specifically consider various factors, including the risks outlined under “Risk Factors” contained in this prospectus and any related free writing prospectus, and in our most recent Annual Report on Form 10-K and our most recent filed Quarterly Reports on Form 10-Q, as well as any amendments thereto reflected in subsequent filings with the SEC. The discussion of risks and uncertainties set forth in those filings is not necessarily a complete or exhaustive list of all risks facing us at any particular point in time. We operate in a highly competitive, highly regulated and rapidly changing environment, and our business is in a state of evolution. Therefore, it is likely that new risks will emerge and the nature and elements of existing risks will change. It is not possible for management to predict all such risk factors or changes therein or to assess either the impact of all such risk factors on our business or the extent to which any individual risk factor, combination of factors or new or altered factors may cause results to differ materially from those contained in any forward-looking statement. Forward-looking statements represent our estimates and assumptions only as of the date such forward-looking statements are made. You should carefully read this prospectus and any related free writing prospectus, together with the information incorporated herein or therein by reference as described under the section titled “Information Incorporated By Reference,” and with the understanding that our actual future results may materially differ from what we expect.

Except as required by law, forward-looking statements speak only as of the date they are made, and we assume no obligation to update any forward-looking statements publicly, or to update the reasons why actual results could differ materially from those anticipated in any forward-looking statements, even if new information becomes available.

PROSPECTUS SUMMARY

The following summary highlights information contained elsewhere or incorporated by reference in this prospectus. This summary does not contain all of the information you should consider before investing in the securities. Before making an investment decision, you should read the entire prospectus carefully, including the matters discussed under the heading "Risk Factors" in this prospectus and under similar headings in other documents that are incorporated by reference into this prospectus.

Overview

Celsion is a fully-integrated development stage oncology drug company focused on advancing a portfolio of innovative cancer treatments, including directed chemotherapies, DNA-mediated immunotherapy and RNA based therapies. Our lead product candidate is ThermoDox®, a proprietary heat-activated liposomal encapsulation of doxorubicin, currently in a Phase III clinical trial for the treatment of primary liver cancer (the "OPTIMA Study"), and a Phase II clinical trial for the treatment of recurrent chest wall breast cancer (the "DIGNITY Study"). Second in our pipeline is GEN-1, a DNA-mediated immunotherapy for the localized treatment of ovarian and brain cancers. We have two platform technologies providing the basis for the future development of a range of therapeutics for difficult-to-treat forms of cancer including: Lysolipid Thermally Sensitive Liposomes, a heat sensitive liposomal based dosage form that targets disease with known therapeutics in the presence of mild heat and TheraPlas, a novel nucleic acid-based treatment for local transfection of therapeutic plasmids. With these technologies we are working to develop and commercialize more efficient, effective and targeted oncology therapies that maximize efficacy while minimizing side-effects common to cancer treatments.

ThermoDox®

ThermoDox® is being evaluated in a Phase III clinical trial for primary liver cancer, which we call the OPTIMA Study, which was initiated in 2014, and a Phase II clinical trial for recurrent chest wall breast cancer, which we call the DIGNITY Study. ThermoDox® is a liposomal encapsulation of doxorubicin, an approved and frequently used oncology drug for the treatment of a wide range of cancers. Localized heat at hyperthermia temperatures (greater than 40° Celsius) releases the encapsulated doxorubicin from the liposome enabling high concentrations of doxorubicin to be deposited preferentially in and around the targeted tumor.

The OPTIMA Study. The OPTIMA Study represents an evaluation of ThermoDox® in combination with a first line therapy, radiofrequency ablation ("RFA"), for newly diagnosed, intermediate stage HCC patients. HCC incidence globally is approximately 850,000 new cases per year and is the third largest cancer indication globally. Approximately 30% of newly diagnosed patients can be addressed with RFA alone.

On February 24, 2014, we announced that the United States Food and Drug Administration (the "FDA"), after its customary 30-day review period, provided clearance for the OPTIMA Study, which is a pivotal, double-blind, placebo-controlled Phase III trial of ThermoDox®, in combination with standardized RFA, for the treatment of primary liver cancer. The trial design of the OPTIMA Study is based on the comprehensive analysis of data from an earlier clinical trial called the HEAT Study, which is described below. The OPTIMA Study is supported by a hypothesis developed from an overall survival analysis of a large subgroup of patients from the HEAT Study.

We initiated the OPTIMA Study in the first half of 2014. The OPTIMA Study was designed with extensive input from globally recognized hepatocellular carcinoma ("HCC") researchers and expert clinicians and after receiving formal written consultation from the FDA. The OPTIMA Study is expected to enroll up to 550 patients globally at up to 65 sites in the United States, Canada, Europe Union, China and other countries in the Asia-Pacific region, and will evaluate ThermoDox® in combination with standardized RFA, which will require a minimum of 45 minutes across all investigators and clinical sites for treating lesions three to seven centimeters, versus standardized RFA alone. The primary endpoint for this clinical trial is overall survival ("OS"), and the secondary endpoints are progression free survival and safety. The statistical plan calls for two interim efficacy analyses by an independent Data Monitoring Committee ("DMC").

On December 16, 2015, we announced that we had received the clinical trial application approval from the China Food and Drug Administration (the "CFDA") to conduct the OPTIMA Study in China. This clinical trial application approval will allow Celsion to enroll patients at up to 20 clinical sites in China. On April 26, 2016, we announced that the first patient in China had been enrolled in the OPTIMA Study. Results from the OPTIMA Study, if successful, will provide the basis for a global registration filing and marketing approval.

On August 7, 2017, the Company announced that the independent Data Monitoring Committee (DMC) for the Company's OPTIMA Study completed a regularly scheduled review of the first 50% of patients enrolled in the trial and has unanimously recommended that the OPTIMA Study continue according to protocol to its final data readout. The DMC reviewed study data at regular intervals, with the primary responsibilities of ensuring the safety of all patients enrolled in the study, the quality of the data collected, and the continued scientific validity of the study design. As part of its review of the first 275 patients, the DMC monitored a quality matrix relating to the total clinical data set, confirming the timely collection of data, that all data are current as well as other data collection and quality criteria.

The Company hosted an Investigators Meeting with physicians in South East Asia and key opinion leaders on July 22-23, 2017 in Bangkok, Thailand. A second Investigators Meeting was held on September 23, 2017 with physicians in China. The Company has initiated approximately 70 clinical sites in 14 countries with plans to activate up to 8 additional clinical trial sites in China or Vietnam by the end of 2017. In addition, the Company announced that patient enrollment in the 550 patient Phase III global study has reached over 67%. Based on current enrollment rates, the Company expects to complete enrollment of the study by mid-2018.

Post-hoc data analysis from the Company’s earlier Phase III HEAT Study suggest that ThermoDox® may substantially improve OS, when compared to the control group, in patients if their lesions undergo a 45 minute RFA procedure standardized for a lesion greater than 3 cm in diameter. Data from nine OS sweeps have been conducted since the top line progression free survival (“PFS”) data from the HEAT Study were announced in January 2013, with each data set demonstrating substantial improvement in clinical benefit over the control group with statistical significance. On August 15, 2016, the Company announced updated results from its final retrospective OS analysis of the data from the HEAT Study. These results demonstrated that in a large, well bounded, subgroup of patients with a single lesion (n=285, 41% of the HEAT Study patients), treatment with a combination of ThermoDox® and optimized RFA provided an average 54% risk improvement in OS compared to optimized RFA alone. The Hazard Ratio (“HR”) at this analysis is 0.65 (95% CI 0.45 - 0.94) with a p-value of 0.02. Median OS for the ThermoDox® group has been reached which translates into a two year survival benefit over the optimized RFA group (projected to be greater than 80 months for the ThermoDox® plus optimized RFA group compared to less than 60 months projection for the optimized RFA only group). Additional findings from this most recent analysis specific to the Chinese patient cohort of 223 patients are summarized below:

In the population of 154 patients with a single lesion who received optimized RFA treatment for 45 minutes or more showed a 53% risk improvement in OS (HR = 0.66) when treated with ThermoDox® plus optimized RFA.

These data continue to support and further strengthen ThermoDox®’s potential to significantly improve OS compared to an RFA control in patients with lesions that undergo optimized RFA treatment for 45 minutes or more. The clinical benefit seen in the intent-to-treat Chinese patient cohort further confirms the importance of RFA heating time as 72% of patients in this large patient cohort in China received an optimized RFA treatment.

While this information should be viewed with caution since it is based on a retrospective analysis of a subgroup, we also conducted additional analyses that further strengthen the evidence for the HEAT Study sub-group. We commissioned an independent computational model at the University of South Carolina Medical School. The results indicate that longer RFA heating times correlate with significant increases in doxorubicin concentration around the RFA treated tissue. In addition, we conducted a prospective preclinical study in 22 pigs using two different manufacturers of RFA and human equivalent doses of ThermoDox® that clearly support the relationship between increased heating duration and doxorubicin concentrations.

On November 29, 2016, the Company announced the results of an independent analysis conducted by the National Institutes of Health (the "NIH") from the HEAT Study which reaffirmed the correlation between increased RFA burn time per tumor volume and improvements in overall survival. The NIH analysis, which sought to evaluate the correlation between RFA burn time per tumor volume (min/ml) and clinical outcome, concluded that increased burn time per tumor volume significantly improved overall survival in patients treated with RFA plus ThermoDox® compared to patients treated with RFA alone. For all patients with single lesions treated with RFA plus ThermoDox®:

One unit increase in RFA duration per tumor volume improved overall survival by 20% (p=0.017; n=227);

More significant differences in subgroup of patients with RFA burn times per tumor volume greater than 2.5 minutes per ml;

Cox multiple covariate analysis showed overall survival to be significant (p=0.038; Hazard Ratio = 0.85); and

Burn time per tumor volume did not have a significant effect on overall survival in single lesion patients treated with RFA only.

The HEAT Study. On January 31, 2013, the Company announced that the HEAT Study, ThermoDox® in combination with RFA, did not meet the primary endpoint, PFS, of a Phase III clinical trial enrolling 701 patients with primary liver cancer. This determination was made after conferring with the HEAT Study independent DMC, that the HEAT Study did not meet the goal of demonstrating a clinically meaningful improvement in progression free survival. In the trial, ThermoDox® was well-tolerated with no unexpected serious adverse events. Following the announcement of the HEAT Study results, we continued to follow patients for OS, the secondary endpoint of the HEAT Study. We have conducted a comprehensive analysis of the data from the HEAT Study to assess the future strategic value and development strategy for ThermoDox®.

The DIGNITY Study. On December 14, 2015, we announced final data from our ongoing DIGNITY study, which is an open-label, dose-escalating Phase II trial of ThermoDox® in patients with recurrent chest wall ("RCW") breast cancer. The DIGNITY Study was designed to establish a safe therapeutic dose in Phase I, and to demonstrate local control in Phase II, including complete and partial responses, and stable disease as its primary endpoint. The DIGNITY Study was also designed to evaluate kinetics in ThermoDox® produced from more than one manufacturing site. Of the 29 patients enrolled and treated, 21 patients were eligible for evaluation of efficacy. Approximately 62% of evaluable patients experienced a local response, including six complete responses and seven partial responses.

Acquisition of EGEN Assets

On June 20, 2014, we completed the acquisition of substantially all of the assets of Egen, Inc., an Alabama corporation, which has changed its company name to EGWU, Inc. after the closing of the acquisition ("EGEN"), pursuant to an asset purchase agreement dated as of June 6, 2014, by and between EGEN and Celsion (the "Asset Purchase Agreement"). We acquired all of EGEN's right, title and interest in and to substantially all of the assets of EGEN, including cash and cash equivalents, patents, trademarks and other intellectual property rights, clinical data, certain contracts, licenses and permits, equipment, furniture, office equipment, furnishings, supplies and other tangible personal property. In addition, CLSN Laboratories assumed certain specified liabilities of EGEN, including the liabilities arising out of the acquired contracts and other assets relating to periods after the closing date.

The total purchase price for the asset acquisition is up to $44.4 million, including potential future earnout payments of up to $30.4 million contingent upon achievement of certain earnout milestones set forth in the Asset Purchase Agreement. At the closing, we paid approximately $3.0 million in cash after the expense adjustment and issued 193,728 shares of our common stock to EGEN. The shares of common stock were issued in a private transaction exempt from registration under the Securities Act, pursuant to Section 4(2) thereof. In addition, 47,862 shares of common stock were held back by us at the closing and are issuable to EGEN pending satisfactory resolution of any post-closing adjustments for expenses or in relation to EGEN's indemnification obligations under the Asset Purchase Agreement. These shares were issued on June 16, 2017.

The earnout payments of up to $30.4 million will become payable, in cash, shares of our common stock or a combination thereof, at our option upon achievement of three major milestone events as follows:

$12.4 million will become payable upon achieving certain specified development milestones relating to an ovarian cancer study of GEN-1 (formerly known as EGEN-001) to be conducted by us or our subsidiary;

$12.0 million will become payable upon achieving certain specified development milestones relating to a GEN-1 glioblastoma multiforme brain cancer study to be conducted by us or our subsidiary; and up to $6.0 million will become payable upon achieving certain specified milestones relating to the TheraSilence technology acquired from EGEN in the acquisition.

Our obligations to make the earnout payments will terminate on the seventh anniversary of the closing date. In the acquisition, we purchased GEN-1, a DNA-based immunotherapy for the localized treatment of ovarian and brain cancers, and two platform technologies for the development of treatments for those suffering with difficult-to-treat forms of cancer, novel nucleic acid-based immunotherapies and other anticancer DNA or RNA therapies, including TheraPlas and TheraSilence.

GEN-1

GEN-1 is a DNA-based immunotherapeutic product for the localized treatment of ovarian and brain cancers by intraperitoneally administering an Interleukin-12 (“IL-12”) plasmid formulated with our proprietary TheraPlas delivery system. In this DNA-based approach, the immunotherapy is combined with a standard chemotherapy drug, which can potentially achieve better clinical outcomes than with chemotherapy alone. We believe that increases in IL-12 concentrations at tumor sites for several days after a single administration could create a potent immune environment against tumor activity and that a direct killing of the tumor with concomitant use of cytotoxic chemotherapy could result in a more robust and durable antitumor response than chemotherapy alone. We believe the rationale for local therapy with GEN-1 are based on the following.

We believe the rationale for local therapy with GEN-1 are based on the following:

Loco-regional production of the potent cytokine IL-12 avoids toxicities and poor pharmacokinetics associated with systemic delivery of recombinant IL-12;

Persistent local delivery of IL-12 lasts up to one week and dosing can be repeated; and

Ideal for long-term maintenance therapy.

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GEN-1 OVATION Study. In February 2015, we announced that the FDA accepted, without objection, the Phase I dose-escalation clinical trial of GEN-1 in combination with the standard of care in neo-adjuvant ovarian cancer (the "OVATION Study"). On September 30, 2015, we announced enrollment of the first patient in the OVATION Study. The OVATION Study will seek to identify a safe, tolerable and potentially therapeutically active dose of GEN-1 by recruiting and maximizing an immune response and is designed to enroll three to six patients per dose level and will evaluate safety and efficacy and attempt to define an optimal dose for a follow-on Phase I/II study combining GEN-1 with Avastin® and Doxil®. In addition, the OVATION Study establishes a unique opportunity to assess how cytokine-based compounds such as GEN-1, directly affect ovarian cancer cells and the tumor microenvironment in newly diagnosed patients. The study is designed to characterize the nature of the immune response triggered by GEN-1 at various levels of the patients' immune system, including:

- infiltration of cancer fighting T-cell lymphocytes into primary tumor and tumor microenvironment including peritoneal cavity, which is the primary site of metastasis of ovarian cancer;

- changes in local and systemic levels of immuno-stimulatory and immunosuppressive cytokines associated with tumor suppression and growth, respectively; and

- expression profile of a comprehensive panel of immune related genes in pre-treatment and GEN-1-treated tumor tissue.

We initiated the OVATION Study at four clinical sites at the University of Alabama at Birmingham, Oklahoma University Medical Center, Washington University in St. Louis and the Medical College of Wisconsin. During 2016 and 2017, we announced data from the first fourteen patients in the OVATION Study who completed treatment.

On October 3, 2017, we announced final clinical and translational research data from its OVATION Study, a Phase Ib dose escalating clinical trial combining GEN-1, the Company's DNA-based immunotherapy, with the standard of care for the treatment of newly-diagnosed patients with advanced Stage III/IV ovarian cancer who will undergo neoadjuvant chemotherapy followed by interval debulking surgery.

Key translational research findings from all evaluable patients are consistent with the earlier reports from partial analysis of the data and are summarized below:

- The intraperitoneal treatment of GEN-1 in conjunction with neoadjuvant chemotherapy resulted in dose dependent increases in IL-12 and Interferon-gamma (IFN-g) levels that were predominantly in the peritoneal fluid compartment with little to no changes observed in the patients' systemic circulation. These and other post-treatment changes including decreases in VEGF levels in peritoneal fluid are consistent with an IL-12 based immune mechanism.

Consistent with the previous partial reports, the effects observed in the IHC analysis were pronounced decreases in the density of immunosuppressive T-cell signals (Foxp3, PD-1, PDL-1, IDO-1) and increases in CD8+ cells in the tumor microenvironment.

The ratio of CD8+ cells to immunosuppressive cells was increased in approximately 75% of patients suggesting an overall shift in the tumor microenvironment from immunosuppressive to pro-immune stimulatory following treatment with GEN-1. An increase in CD8+ to immunosuppressive T-cell populations is a leading indicator and believed to be a good predictor of improved overall survival.

Analysis of peritoneal fluid by cell sorting, not reported before, shows treatment-related decrease in the percentage of immunosuppressive T-cell (Foxp3+), which is consistent with the reduction of Foxp3+ T-cells in the primary tumor tissue, and a shift in tumor naïve CD8+ cell population to more efficient tumor killing memory effector CD8+ cells.

Celsion also reported positive clinical data from the first fourteen patients who have completed treatment in the OVATION Study. GEN-1 plus standard chemotherapy produced positive clinical results, with no dose limiting toxicities and positive dose dependent efficacy signals which correlate well with positive surgical outcomes as summarized below:

Of the fourteen patients treated in the entire study, two patients demonstrated a complete response, ten patients demonstrated a partial response and two patients demonstrated stable disease, as measured by RECIST criteria. This translates to a 100% disease control rate ("DCR") and an 86% objective response rate ("ORR"). Of the five patients treated in the highest dose cohort, there was a 100% objective response rate with one complete response and four partial responses.

Fourteen patients had successful resections of their tumors, with nine patients (64%) having an R0 resection, which indicates a microscopically margin-negative resection in which no gross or microscopic tumor remains in the tumor bed. Seven out of eight (87%) patients in the highest two dose cohorts experienced a R0 surgical resection. All five patients treated at the highest dose cohort experienced a R0 surgical resection.

All patients experienced a clinically significant decrease in their CA-125 protein levels as of their most recent study visit. CA-125 is used to monitor certain cancers during and after treatment. CA-125 is present in greater concentrations in ovarian cancer cells than in other cells.

Of the eight patients who have received GEN-1 treatment over one year prior to the date of this prospectus (cohort 1 - 3) and are being followed; only two patients' cancer has progressed. This compares favorably to the historical median progression free survival (PFS) of 12 months for newly-diagnosed patients with Stage III and IV ovarian cancer that undergo neoadjuvant chemotherapy followed by interval debulking surgery. Of the remaining six patients who have been on the study for over one year, their average PFS as of September 30, 2017 is 18 months with the longest progression-free patient at 24 months.

The Company also held an Advisory Board Meeting on September 27, 2017 with the clinical investigators and scientific experts including those from Roswell Park Cancer Institute, Vanderbilt University Medical School, and M.D. Anderson Cancer Center to review and finalize clinical, translational research and safety data from the OVATION Study in order to determine the next steps forward for our GEN-1 immunotherapy. With the endorsement and recommendations from the Advisory Board, the Company expects to file a next phase protocol with FDA by the end of 2017.

GEN-1 Plus Doxil® and Avastin® Trial. On April 29, 2015, we announced the expansion of our ovarian cancer development program to include a Phase I dose escalating trial to evaluate GEN-1 in combination with Avastin® and Doxil® in platinum-resistant ovarian cancer patients. This new combination study in platinum-resistant ovarian cancer is supported by three preclinical studies indicating that the combination of GEN-1 with Avastin® may result in significant clinical benefit with a favorable safety profile.

Specifically:

In two preclinical studies using an animal model of disseminated ovarian cancer, GEN-1 in combination with Avastin® led to a significant reduction in tumor burden and disease progression. The effectiveness of the combined treatment was seen when GEN-1 was combined with various dose levels of Avastin® (low-medium-high). Additionally, it was shown that GEN-1 treatment alone resulted in anti-tumor activity that was as good as or better than Avastin® treatment alone.

The preclinical studies indicated that no obvious overt toxicities were associated with the combined treatments of GEN-1 and Avastin®. The preclinical data are also consistent with the mechanism of action for GEN-1, which exhibits certain anti-angiogenic properties and suggests that combining GEN-1 with lower doses of Avastin® may enhance efficacy and help reduce the known toxicities associated with this anti-VEGF drug.

The distinct biological activities of GEN-1 (immune stimulation) and Avastin® (inhibition of tumor blood vessel formation) also suggest scientific rationale for this combination approach. Additionally, the anti-angiogenic activity of GEN-1 mediated through up regulation of the interferon gamma ("IFN-g") pathway may help to explain the synergy between GEN-1 and Avastin® and potentially addresses the VEGF escape mechanisms associated with resistance to Avastin® therapy.

TheraPlas™ Technology Platform. TheraPlas™ is a technology platform for the delivery of DNA and messenger RNA ("mRNA") therapeutics via synthetic non-viral carriers and is capable of providing cell transfection for double-stranded DNA plasmids and large therapeutic RNA segments such as mRNA. There are two components of the TheraPlas™ system, a plasmid DNA or mRNA payload encoding a therapeutic protein and a delivery system. The delivery system is designed to protect the DNA/RNA from degradation and promote trafficking into cells and through intracellular compartments. We designed the delivery system of TheraPlas™ by chemically modifying the low molecular weight polymer to improve its gene transfer activity without increasing toxicity. We believe TheraPlas™ is a viable alternative to current approaches to gene delivery due to several distinguishing characteristics, including enhanced molecular versatility that allows for complex modifications to improve activity and safety.

Technology Development and Licensing Agreements. Our current efforts and resources are applied on the development and commercialization of cancer drugs including tumor-targeting chemotherapy treatments using focused heat energy in combination with heat-activated drug delivery systems, immunotherapies and RNA-based therapies. To support our research and development, we raised gross proceeds of approximately $127.2 million in equity financings and warrant and option exercises in the years 2010 through 2015. During 2016, we raised gross proceeds of $7.8 million through two registered direct equity financings with several institutional investors. In 2017 thus far, we raised $10.1 million in gross proceeds from a public offering equity financing and $22.0 million from the exercise of warrants to purchase common stock. We had cash and cash equivalents totaling $2.7 million at September 30, 2017. We have one credit facility for a total principle amount of up to $20 million and have drawn down $10 million under this credit facility.

On August 8, 2016, we signed a Technology Transfer, Manufacturing and Commercial Supply Agreement (the "GEN-1 Agreement") with Hisun to pursue an expanded partnership for the technology transfer relating to the clinical and commercial manufacture and supply of GEN-1, Celsion's proprietary gene mediated, IL-12 immunotherapy, for the greater China territory, with the option to expand into other countries in the rest of the world after all necessary regulatory approvals are obtained. The GEN-1 Agreement will help to support supply for both ongoing and planned clinical studies in the United States, and for potential future studies of GEN-1 in China. GEN-1 is currently being evaluated by Celsion in first line ovarian cancer patients.

In June 2012, Celsion and Hisun signed a long-term commercial supply agreement for the production of ThermoDox®. Hisun is one the largest manufacturers of chemotherapy agents globally, including doxorubicin. In July 2013, the ThermoDox® collaboration was expanded to focus on next generation liposomal formulation development with the goal of creating safer, more efficacious versions of marketed cancer chemotherapeutics. During 2015, Hisun successfully completed the manufacture of three registration batches for ThermoDox® and has obtained regulatory approvals to supply ThermoDox® to participating clinical trial sites in all of the countries of South East Asia, Europe and North America, as well as to the European Union countries allowing for early access to ThermoDox®. The future manufacturing of clinical and commercial supplies by Hisun will result in a cost structure allowing Celsion to profitably access all global markets, including third world countries, and help accelerate the Company's product development program in China for ThermoDox® in primary liver cancer and other approved indications.

Business Strategy and Development Plan

We have not generated and do not expect to generate any revenue from product sales in the next several years, if at all. An element of our business strategy has been to pursue, as resources permit, the research and development of a range of product candidates for a variety of indications. We may also evaluate licensing cancer products from third parties for cancer treatments to expand our current product pipeline. This is intended to allow us to diversify the risks associated with our research and development expenditures. To the extent we are unable to maintain a broad range of product candidates, our dependence on the success of one or a few product candidates would increase and results such as those announced in relation to the HEAT study on January 31, 2013 will have a more significant impact on our financial prospects, financial condition and market value. We may also consider and evaluate strategic alternatives, including investment in, or acquisition of, complementary businesses, technologies or products. As demonstrated by the HEAT Study results, drug research and development is an inherently uncertain process and there is a high risk of failure at every stage prior to approval. The timing and the outcome of clinical results are extremely difficult to predict. The success or failure of any preclinical development and clinical trial can have a disproportionately positive or negative impact on our results of operations, financial condition, prospects and market value.

Our current business strategy includes the possibility of entering into collaborative arrangements with third parties to complete the development and commercialization of our product candidates. In the event that third parties take over the clinical trial process for one or more of our product candidates, the estimated completion date would largely be under the control of that third party rather than us. We cannot forecast with any degree of certainty which proprietary products or indications, if any, will be subject to future collaborative arrangements, in whole or in part, and how such arrangements would affect our development plan or capital requirements. We may also apply for subsidies, grants or government or agency-sponsored studies that could reduce our development costs.

As of September 30, 2017, we have approximately $2.7 million in cash and cash equivalents. In July 2017, the Company completed a $5 million registered direct equity offering of shares of common stock, or pre-funded warrants in lieu thereof, and a concurrent private placement of warrants to purchase common stock, with several institutional healthcare investors. In early October 2017, the Company received $17 million in gross proceeds collectively from certain warrant holders exercising warrants to purchase collectively 5.0 million shares of common stock. On October 27, 2017, we entered into an underwriting agreement whereby the Company sold approximately 2.6 million shares of common stock and warrants to purchase approximately 1.3 million shares of common stock for gross proceeds of $6.6 million. The Company has a Controlled Equity Offering℠ Sales Agreement (the "ATM Agreement") with Cantor Fitzgerald & Co. In connection with the underwritten offering, we have agreed not to sell any additional shares under the Sales Agreement for a period of two months after the closing date of this offering. The Company will be required to obtain additional funding in order to continue the development of its current product candidates within the anticipated time periods, if at all, and to continue to fund operations. The Company has $7.5 million available under a controlled equity offering facility it has with Cantor Fitzgerald & Co. Besides this equity facility, the Company does not have any committed sources of financing at this time, and there is substantial uncertainty whether additional funding will be available when needed on terms that will be acceptable to it, or at all. If the Company would not be able to obtain financing when needed, it could be unable to carry out the business plan and may have to significantly limit its operations and its business and its financial condition and results of operations could be materially harmed. With the current cash on hand and from the gross proceeds of $23.6 million from warrant exercises and the equity offering in October 2017, the Company believes it has sufficient capital resources to fund its operations well into the second quarter of 2019.

Recent Developments

On October 4, 2017, the Company entered into letter agreements (the “Exercise Agreements”) with the holders of the Series AAA and Series BBB Warrants issued in the July 6, 2017 Common Stock Offering (the “Exercising Holders”). The Exercise Agreements amended the Series AAA Warrants to permit their immediate exercise. Prior to the execution of the Exercise Agreements, the Series AAA Warrants were not exercisable until January 11, 2018. Pursuant to the Exercise Agreements, the Exercising Holders and the Company agreed that the Exercising Holders would exercise all of their Existing Warrants with respect to 4,665,000 shares of Common Stock underlying such Existing Warrants. The Series AAA Warrants and Series BBB Warrants were exercised at a price of $2.07 per share and $4.75 per share, respectively, which were their respective original exercise prices.

The Exercise Agreements also provide for the issuance of 1,166,250 Series DDD Warrants, each to purchase one share of Common Stock (the “Series DDD Warrants”). The Series DDD Warrants are initially exercisable no sooner than six months following issuance, and terminate six months following when the Series DDD Warrants are initially exercisable. The Series DDD Warrants have an exercise price no than less than $6.20 per share.

The Series DDD Warrants and the shares of Common Stock issuable upon the exercise of the Series DDD Warrants are not being registered under the Securities Act of 1933, as amended, and are being offered pursuant to the exemption provided in Section 4(a)(2) under the Securities Act or Rule 506(b) promulgated thereunder. Pursuant to the Exercise Agreements, the Series DDD Warrants shall be substantially in the form of the Existing Warrants and the Company will be required to register for resale the shares of Common Stock underlying the Series DDD Warrants.

In early October 2017, certain holders of the other 205,000 Series BBB Warrants and 108,455 Series AA Warrants from the February 14, 2017 Public Offering were exercised and, together with the exercise of the 4,665,000 Series AAA and Series BBB Warrants exercised by the Exercising Holders, the Company received aggregate gross proceeds of approximately $20.0 million in October 2017.

On October 27, 2017, the Company entered into an underwriting agreement (the “Underwriting Agreement”) with Oppenheimer & Co. Inc. (the “Underwriter”), relating to the issuance and sale (the “Offering”) of 2,640,000 shares (the “Shares”) of the Company’s common stock, $0.01 par value per share (the “Common Stock”), and warrants to purchase an aggregate of 1,320,000 shares of Common Stock. Each share of Common Stock is being sold together with 0.5 warrants (the “Investor Warrants”), each whole Investor Warrant being exercisable for one share of Common Stock, at an offering price of $2.50 per share and related Investor Warrants.

Pursuant to the terms of the Underwriting Agreement, the Underwriter has agreed to purchase the Shares and related Investor Warrants from the Company at a price of $2.325 per share and related Investor Warrants. Each Investor

Warrant is exercisable six months from the date of issuance. The Investor Warrants have an exercise price of $3.00 per whole share, and expire five years from the date first exercisable.

The Company received $6.6 million of gross proceeds from the sale of the Shares and Investor Warrant. The Offering closed on October 31, 2017. This Offering was made pursuant to the Company's effective shelf registration statement on Form S-3 (File No. 333-206789) filed with the Securities and Exchange Commission on September 4, 2015, and declared effective on September 25, 2015.

The Underwriting Agreement contains customary representations, warranties and agreements by the Company, customary conditions to closing, indemnification obligations of the Company and the Underwriters, including for liabilities under the Securities Act, other obligations of the parties, and termination provisions. The Company also agreed to issue to the Underwriter warrants to purchase up to 66,000 shares of the Company's common stock, such issuance being exempt from registration pursuant to Section 4(a)(2) of the Securities Act.

Corporate Information

We were founded in 1982 and are a Delaware corporation. Our shares of common stock trade on The NASDAQ Capital Market under the symbol "CLSN." Our principal executive offices are located at 997 Lenox Drive, Suite 100, Lawrenceville, New Jersey 08648. Our telephone number is (609) 896-9100 and our website is www.celsion.com. The information available on or through our website is not part of, nor incorporated by reference into, this prospectus, and should not be relied upon.

Description of the Private Placement

As previously reported, on July 6, 2017, the Company entered into a securities purchase agreement (the "Purchase Agreement") with certain investors pursuant to which the Company agreed, among other things, to issue 2,435,000 Series AAA Warrants (the "Series AAA Warrants") and 2,435,000 Series BBB Warrants (the "Series BBB Warrants" and together with the Series AAA Warrants, the "Existing Warrants"), each to purchase one share of common stock of the Company, par value $0.01 ("Common Stock"), to such investors in a private placement.

On October 4, 2017, the Company entered into letter agreements (the “Exercise Agreements”) with the holders of certain of the Existing Warrants (the “Exercising Holders”). The Exercise Agreements amend the Series AAA Warrants to permit their immediate exercise. Prior to the execution of the Exercise Agreements, the Series AAA Warrants were not exercisable until January 11, 2018. Pursuant to the Exercise Agreements, the Exercising Holders and the Company agreed that the Exercising Holders would exercise all of their Existing Warrants with respect to 4,665,000 shares of Common Stock underlying such Existing Warrants. The Series AAA Warrants and Series BBB Warrants will be exercised at a price of $2.07 per share and $4.75 per share, respectively, which were their respective original exercise prices.

The Exercise Agreements also provide for the issuance of 1,166,250 Series DDD Warrants in a concurrent private placement, each to purchase one share of Common Stock (the “Series DDD Warrants”). The Series DDD Warrants are initially exercisable twelve (12) months following issuance, and terminate six months following when the Series DDD Warrants are initially exercisable. The Series DDD Warrants have an exercise price $6.20 per share. Subject to limited exceptions, a holder of a Series DDD Warrant will not have the right to exercise any portion of its warrants if the holder, together with its affiliates, would beneficially own in excess of 4.99% of the number of shares of Common Stock outstanding immediately after giving effect to such exercise (the “Beneficial Ownership Limitation”); provided, however, that upon 61 days’ prior notice to the Company, the holder may increase or decrease the Beneficial Ownership Limitation, provided that in no event shall the Beneficial Ownership Limitation exceed 9.99%.

We filed the registration statement on Form S-1, of which this prospectus is a part, to fulfill our contractual obligations under the Exercise Agreement to provide for the resale by these investors of up to 1,166,250 shares of common stock issuable upon exercise of the warrants. We agree to use commercially reasonable efforts to cause such registration to become effective 60 days following the date of issuance of the warrants and to keep such registration statement effective at all times until (a) the warrant shares are sold under such registration statement or pursuant to Rule 144 under the Securities Act, (b) the warrant shares may be sold without volume or manner-of-sale restrictions pursuant to Rule 144 under the Securities Act, and (c) the one and one-half year anniversary of the date of the issuance of the warrants, whichever is the earliest to occur.

On October 31, 2017, the Company issued warrants to purchase up to 66,000 shares of Common Stock in a private placement. The exercise price of the warrants was equal to $2.87 per share of Common Stock. The representative’s warrants have been deemed underwriting compensation by FINRA and are therefore subject to a 180-day lock-up pursuant to Rule 5110(g)(1) of FINRA’s Rules.

We issued 82,193 shares of Common Stock in a private placement to satisfy obligations from the July 6, 2017 Common Stock Offering.

The Offering

Shares of common stock offered by the selling stockholders:	1,314,443 shares of our common stock including (i) 1,166,250 shares issuable upon exercise of certain outstanding investor common stock purchase warrants and (ii) 66,000 shares issuable upon exercise of certain outstanding representative common stock purchase warrants
Shares of common stock outstanding before this offering:	8,354,679 shares (as more fully described in the notes following this table)
Shares of common stock outstanding after completion of this offering, assuming full exercise of the common stock purchase warrants:	9,669,122 shares (as more fully described in the notes following this table)
Terms of the Offering:	The selling stockholders, including their transferees, donees, pledgees, assignees and successors-in-interest, may sell, transfer or otherwise dispose of any or all of the shares of common stock offered by this prospectus from time to time on The NASDAQ Capital Market or any other stock exchange, market or trading facility on which the shares are traded or in private transactions. The shares of common stock may be sold at fixed prices, at market prices prevailing at the time of sale, at prices related to prevailing market price or at negotiated prices.
Use of Proceeds:	All proceeds from the sale of shares of common stock issuable upon exercise of the outstanding common stock purchase warrants will be for the account of the selling stockholders. We will not receive any proceeds from the sale of common stock offered pursuant to this prospectus. However, we will receive proceeds upon any cash exercise of the common stock warrants. See the section titled "Use of Proceeds" in this prospectus.
NASDAQ Capital Market symbol:	CLSN
Trading:	Our shares of common stock currently trade on The NASDAQ Capital Market. There is no established trading market for the common stock purchase warrants and we do not intend to list the common stock purchase warrants on any exchange or other trading system.
Risk Factors:	Investing in our securities involves a high degree of risk and purchasers of our securities may lose their entire investment. See "Risk Factors" below and the other information included elsewhere in this prospectus and incorporated by reference in this prospectus for a discussion of factors you should consider before deciding to invest in our securities.

The number of shares of our common stock shown above to be outstanding immediately before and after this offering is based on 8,354,679 shares outstanding as of September 30, 2017, and excludes, as of such date:

- 679,752 shares of our common stock subject to outstanding options having a weighted average exercise price of $9.94 per share;
- 29,498 shares of our common stock reserved for future issuance pursuant to our existing stock incentive plans;
- 5,528,634 shares of our common stock issuable upon exercise of warrants outstanding, having a weighted average exercise price of $5.33 per share; and
- 334 shares of our common stock held as treasury stock.

Subsequent to September 30, 2017, the Company issued 4,978,445 shares of common stock upon the exercise of outstanding warrants, 2,640,000 shares issued from an underwritten equity offering completed on October 31, 2017 and 89,217 shares of common shares from other transactions. Including such issuances, as of December 7, 2017, the Company had 16,062,341 shares of common stock outstanding.

RISK FACTORS

Investing in our securities involves a high degree of risk. You should carefully consider and evaluate all of the information contained in this prospectus and in the documents incorporated by reference in this prospectus before you decide to purchase our securities. In particular, you should carefully consider and evaluate the risks and uncertainties described in “Part I — Item 1A. Risk Factors” of our most recent Annual Report on Form 10-K, as updated by the additional risks and uncertainties set forth in our most recent Quarterly Reports on Form 10-Q and in other filings we make with the SEC, as well as the risks and uncertainties described under the heading “Risk Factors” contained in the applicable prospectus or in any other document incorporated by reference into this prospectus. Any of the risks and uncertainties set forth therein could materially and adversely affect our business, results of operations and financial condition, which in turn could materially and adversely affect the trading price or value of our securities. As a result, you could lose all or part of your investment.

USE OF PROCEEDS

All shares of our common stock offered by this prospectus are being registered for the account of the selling stockholders. We will not receive any of the proceeds from the sale of these shares. We will receive proceeds from the cash exercise of the warrants which, if exercised in cash with respect to all of the 1,232,250 shares of common stock, would result in gross proceeds of $7,420,170 to us. We will use any proceeds received by us from the cash exercise of the warrants for general corporate purposes, including research and development activities, capital expenditures and working capital. We may also use all or a portion of such proceeds to fund possible investments in, or acquisitions of, complementary businesses, technologies or products, but we currently have no agreements or commitments with respect to any investment or acquisition. We cannot predict when or if the warrants will be exercised, and it is possible that the warrants may expire and never be exercised.

MARKET INFORMATION FOR OUR COMMON STOCK

The following table sets forth the high and low reported closing sale prices on NASDAQ for the periods indicated:

Period	High	Low
Year Ending December 31, 2017		
First Quarter	$7.14	$2.94
Second Quarter	$4.31	$2.05
Third Quarter	$2.42	$1.28
Fourth Quarter (October 1, 2017 to December 7, 2017)	$6.06	$1.51
Year Ended December 31, 2016		
First Quarter	$27.86	$14.56
Second Quarter	$24.92	$18.20
Third Quarter	$18.76	$16.80
Fourth Quarter	$13.86	$4.20
Year Ended December 31, 2015		
First Quarter	$49.56	$30.10
Second Quarter	$49.98	$33.88
Third Quarter	$38.08	$22.82
Fourth Quarter	$32.34	$22.54

The reported last sale price of our common stock on NASDAQ on December 7, 2017 was $2.56 per share.

Dividend Policy

We have never declared or paid any cash dividends on our common stock and do not currently anticipate declaring or paying cash dividends on our common stock in the foreseeable future. We currently intend to retain all of our future earnings, if any, to finance operations. Any future determination relating to our dividend policy will be made at the discretion of our board of directors and will depend on a number of factors, including future earnings, capital requirements, financial conditions, future prospects, contractual restrictions and other factors that our board of directors may deem relevant.

Holders of Record

As of September 30, 2017, there were approximately 16,000 holders of record of our common stock. The actual number of stockholders is greater than this number of record stockholders and includes stockholders who are beneficial owners but whose shares are held in street name by brokers and other nominees. This number of stockholders of record also does not include stockholders whose shares may be held in trust by other entities.

DESCRIPTION OF CAPITAL STOCK

General

Our authorized capital stock consists of 112,500,000 shares of common stock, $0.01 par value per share, and 100,000 shares of preferred stock, $0.01 par value per share. As of September 30, 2017, there were 8,354,679 shares of our common stock outstanding and no shares of preferred stock outstanding.

The following summary description of our capital stock is based on the applicable provisions of the Delaware General Corporation Law, as amended (the "DGCL"), and on the provisions of our certificate of incorporation, as amended (our "certificate of incorporation"), and our bylaws, as amended (our "bylaws"). This information is qualified entirely by reference to the applicable provisions of the DGCL, our certificate of incorporation and bylaws. For information on how to obtain copies of our certificate of incorporation and bylaws, which are exhibits to the registration statement of which this prospectus is a part, see the section titled "Where You Can Find More Information" in this prospectus.

Common Stock

Holders of common stock to be registered hereunder are entitled to one vote for each share held of record on all matters submitted to a vote of stockholders and do not have cumulative voting rights. Subject to any preferential rights of any outstanding preferred stock, holders of common stock are entitled to receive ratably such dividends, if any, as may be declared from time to time by the board of directors of the Company (our board) out of funds legally available therefor. In the event of a dissolution, liquidation or winding-up of the Company, holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities and any preferential rights of any outstanding preferred stock.

Holders of common stock have no preemptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions applicable to the common stock. All outstanding shares of common stock are fully paid and non-assessable. The rights, preferences and privileges of the holders of common stock are subject to, and may be adversely affected by, the rights of the holders of shares of any series of preferred stock which may be designated and issued in the future.

Preferred Stock

Pursuant to our certificate of incorporation, our board has the authority, without further action by the stockholders (unless such stockholder action is required by applicable law or NASDAQ rules), to designate and issue shares of preferred stock in one or more series, to establish from time to time the number of shares to be included in each such series, to fix the designations, powers (including voting), privileges, preferences and relative participating, optional or other rights, if any, of the shares of each such series and the qualifications, limitations or restrictions thereof and to increase or decrease the number of shares of any such series, but not below the number of shares of such series then outstanding.

The DGCL provides that the holders of preferred stock will have the right to vote separately as a class or, in some cases, as a series on an amendment to our certificate of incorporation if the amendment would change the par value or, unless our certificate of incorporation provides otherwise, the number of authorized shares of the class or the powers, preferences or special rights of the class or series so as to adversely affect the class or series, as the case may be. This right is in addition to any voting rights that may be provided in the applicable certificate of designation.

Our board may authorize the issuance of preferred stock with voting or conversion rights that could adversely affect the voting power or other rights of the holders of our common stock or other securities. Preferred stock could be issued quickly with terms designed to delay or prevent a change in control of our company or make removal of management more difficult. Additionally, the issuance of preferred stock may have the effect of decreasing the market price of our common stock.

Anti-Takeover Considerations and Special Provisions of Our Certificate of Incorporation, Our Bylaws and the Delaware General Corporation Law

Certificate of Incorporation and Bylaws

A number of provisions of our certificate of incorporation and bylaws concern matters of corporate governance and the rights of our stockholders. Provisions that grant our board the ability to issue shares of preferred stock and to set the voting rights, preferences and other terms thereof may discourage takeover attempts that are not first approved by our board, including takeovers that may be considered by some stockholders to be in their best interests, such as those attempts that might result in a premium over the market price for the shares held by stockholders. Certain provisions could delay or impede the removal of incumbent directors even if such removal would be beneficial to our stockholders, such as the classification of our board and the lack of cumulative voting. Since our board has the power to retain and discharge our officers, these provisions could also make it more difficult for existing stockholders or another party to effect a change in management.

These provisions may have the effect of deterring hostile takeovers or delaying changes in our control or in our management. These provisions are intended to enhance the likelihood of continued stability in the composition of our board and in the policies they implement and to discourage certain types of transactions that may involve an actual or threatened change of our control. These provisions are designed to reduce our vulnerability to an unsolicited acquisition proposal. The provisions also are intended to discourage certain tactics that may be used in proxy fights. However, such provisions could have the effect of discouraging others from making tender offers for our shares and, as a consequence, they also may inhibit fluctuations in the market price of our shares that could result from actual or rumored takeover attempts.

These provisions also could discourage or make more difficult a merger, tender offer or proxy contest, even if they could be favorable to the interests of stockholders, and could potentially depress the market price of our common stock. Our board believes that these provisions are appropriate to protect our interests and the interests of our stockholders.

Classification of Board; No Cumulative Voting. Our certificate of incorporation and bylaws provide for our board to be divided into three classes, with staggered three-year terms. Only one class of directors is elected at each annual meeting of our stockholders, with the other classes continuing for the remainder of their respective three-year terms. Because our stockholders do not have cumulative voting rights, our stockholders representing a majority of the shares of common stock outstanding will be able to elect all of our directors due to be elected at each annual meeting of our stockholders.

Meetings of and Actions by Stockholders. Our bylaws provide that annual meetings of our stockholders may take place at the time and place designated by our board. A special meeting of our stockholders may be called at any time by our board, the chairman of our board or the president. Our bylaws provide that (i) our board can fix separate record dates for determining stockholders entitled to receive notice of a stockholder meeting and for determining stockholders entitled to vote at the meeting; (ii) we may hold a stockholder meeting by means of remote communications; (iii) any stockholder seeking to have the stockholders authorize or take corporate action by written consent shall, by written notice to the secretary of the Company, request that the board fix a record date and the board shall adopt a resolution fixing the record date in all events within ten calendar days after a request is received; and (iv) a written consent of stockholders shall not be effective unless a written consent signed by a sufficient number of stockholders to take such action is received by us within 60 calendar days of the earliest dated written consent received.

Advance Notice Requirements for Stockholder Proposals and Director Nominations. Our bylaws provide that stockholders seeking to bring business before an annual meeting of stockholders or to nominate candidates for election as directors at an annual meeting of stockholders must provide timely notice in writing. To be timely, a stockholder’s notice must be delivered to, or mailed and received by, the secretary of the Company at our principal executive offices not later than the close of business on the 90th calendar day, nor earlier than the close of business on the 120th calendar day in advance of the date specified in the Company’s proxy statement released to stockholders in connection with the previous year’s annual meeting of stockholders. If the date of the annual meeting is more than 30 calendar days before or after such anniversary date, notice by the stockholder to be timely must be so not earlier than the close of business on the 120th calendar day in advance of such date of annual meeting and not later than the close of business on the later of the 90th calendar day in advance of such date of annual meeting or the tenth calendar day following the date on which public announcement of the date of the meeting is made. In no event shall the public announcement of an adjournment or postponement of an annual meeting commence a new time period (or extend any time period) for the giving of an advance notice by any stockholder. Any stockholder that proposes director nominations or other business must be a stockholder of record at the time the advance notice is delivered by such stockholder to us and entitled to vote at the meeting. Our bylaws also specify requirements as to the form and content of a stockholder’s notice. These provisions may preclude stockholders from bringing matters before an annual meeting of stockholders or from making nominations for the election of directors at an annual meeting of stockholders. Unless otherwise required by law, any director nomination or other business shall not be made or transacted if the stockholder (or a qualified representative of the stockholder) does not appear at the meeting to present the director nominee or other proposed business.

Filling of Board Vacancies. Our certificate of incorporation and bylaws provide that the authorized size of our board shall be determined by the board by board resolution from time to time and that our board has the exclusive power to fill any vacancies and newly created directorships resulting from any increase in the authorized number of directors and the stockholders do not have the power to fill such vacancies. Vacancies in our board and newly created directorships resulting from any increase in the authorized number of directors on our board may be filled by a majority of the directors remaining in office, even though that number may be less than a quorum of our board, or by a sole remaining director. A director so elected to fill a vacancy shall serve for the remaining term of the predecessor he or she replaced and until his or her successor is elected and has qualified, or until his or her earlier resignation, removal or death.

Amendment of the Certificate of Incorporation. Our certificate of incorporation may be amended, altered, changed or repealed at a meeting of our stockholders entitled to vote thereon by the affirmative vote of a majority of the outstanding stock entitled to vote thereon and a majority of the outstanding stock of each class entitled to vote thereon as a class, in the manner prescribed by the DGCL.

Amendment of the Bylaws. Our bylaws may be amended or repealed, or new bylaws may be adopted, by either our board or the affirmative vote of at least 66 2/3 percent of the voting power of our outstanding shares of capital stock.

Section 203 of the Delaware General Corporation Law

We are subject to Section 203 of the DGCL, which prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years after the date that such stockholder became an interested stockholder, with the following exceptions:

- before such date, the board of directors of the corporation approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder;

- upon completion of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85 percent of the voting stock of the corporation outstanding at the time the transaction began, excluding for purposes of determining the voting stock outstanding (but not the outstanding voting stock owned by the interested stockholder) those shares owned (i) by persons who are directors and also officers and (ii) pursuant to employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; and

- on or after such date, the business combination is approved by the board of directors and authorized at an annual or special meeting of the stockholders, and not by written consent, by the affirmative vote of at least 66 2/3 percent of the outstanding voting stock that is not owned by the interested stockholder.

In general, Section 203 defines a business combination to include the following:

- any merger or consolidation involving the corporation and the interested stockholder;

- any sale, lease, transfer, pledge or other disposition of ten percent or more of the assets of the corporation to or with the interested stockholder;

- subject to certain exceptions, any transaction that results in the issuance or transfer by the corporation of any stock of the corporation to the interested stockholder;

any transaction involving the corporation that has the effect of increasing the proportionate share of the stock or any class or series of the corporation beneficially owned by the interested stockholder; and

the receipt by the interested stockholder of the benefit of any loss, advances, guarantees, pledges or other financial benefits by or through the corporation.

In general, Section 203 of the DGCL defines an “interested stockholder” as an entity or person who, together with the entity’s or person’s affiliates and associates, beneficially owns, or is an affiliate of the corporation and within three years prior to the time of determination of interested stockholder status did own, 15 percent or more of the outstanding voting stock of the corporation.

A Delaware corporation may “opt out” of these provisions with an express provision in its certificate of incorporation. We have not opted out of these provisions, which may as a result, discourage or prevent mergers or other takeover or change of control attempts of us.

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is American Stock Transfer & Trust Company, LLC (“AST”), located at 6201 15th Avenue, Brooklyn, New York 11219. AST’s phone number is (800) 937-5449.

NASDAQ Capital Market Listing

Our common stock is listed on the NASDAQ Capital Market under the symbol “CLSN.” We do not plan on applying to list the base warrants or the pre-funded warrants on NASDAQ, any national securities exchange or any other nationally recognized trading system.

SELLING STOCKHOLDERS

This prospectus covers an aggregate of up to 1,314,443 shares of our common stock that may be sold or otherwise disposed of by the selling stockholders. Such shares are issuable to the selling stockholders upon the exercise of the common stock purchase warrants we issued to the selling stockholders in a private placement transaction.

The following table sets forth certain information with respect to each selling stockholder, including (i) the shares of our common stock beneficially owned by the selling stockholder prior to this offering, (ii) the number of shares being offered by the selling stockholder pursuant to this prospectus and (iii) the selling stockholder's beneficial ownership after completion of this offering, assuming that all of the shares covered hereby (but none of the other shares, if any, held by the selling stockholders) are sold. The registration of the shares of common stock issuable to the selling stockholders upon the exercise of the warrants does not necessarily mean that the selling stockholders will sell all or any of such shares.

The table is based on information supplied to us by the selling stockholders, with beneficial ownership and percentage ownership determined in accordance with the rules and regulations of the SEC and includes voting or investment power with respect to shares of stock. This information does not necessarily indicate beneficial ownership for any other purpose. In computing the number of shares beneficially owned by a selling stockholder and the percentage ownership of that selling stockholder, shares of common stock subject to warrants held by that selling stockholder that are exercisable as of September 30, 2017, or exercisable within 60 days after September 30, 2017, are deemed outstanding. Such shares, however, are not deemed outstanding for the purposes of computing the percentage ownership of any other person. The percentage of beneficial ownership after this offering is based on 8,354,679 shares outstanding on September 30, 2017.

The registration of these shares of common stock does not mean that the selling stockholders will sell or otherwise dispose of all or any of those securities. The selling stockholders may sell or otherwise dispose of all, a portion or none of such shares from time to time. We do not know the number of shares, if any, that will be offered for sale or other disposition by any of the selling stockholders under this prospectus. Furthermore, the selling stockholders may have sold, transferred or disposed of the shares of common stock covered hereby in transactions exempt from the registration requirements of the Securities Act since the date on which we filed this prospectus.

To our knowledge and except as noted below, none of the selling stockholders has, or within the past three years has had, any position, office or other material relationship with us or any of our predecessors or affiliates.

	Beneficial Ownership	Beneficial Ownership After This Offering

Selling Stockholder[1]	Before This Offering Number of Shares Owned	Shares Offered Hereby	Shares Underlying Warrants Offered Hereby[9]	Number of Shares Owned	Percentage of Outstanding Shares
Sabby Management, LLC [2]	834,632 (6)		485,000	834,632 (6)	9.99%
Anson Investments Master Fund [3]	834,632 (7)	82,193	358,750 (10)	834,632 (7)	9.99%
Intracoastal Capital LLC [4]	647,425 (8)		322,500	647,425 (8)	7.75%
Oppenheimer & Co. Inc. [5]	66,000		66,000	66,000	0.79%

(1) This table and the information in the notes below are based upon information supplied by the selling stockholders, including reports and amendments thereto filed with the SEC on Schedule 13G.

(2) Sabby Management, LLC is the investment manager of Sabby Healthcare Master Fund, Ltd. and Sabby Volatility Warrant Master Fund, Ltd. and shares voting and investment power with respect to these shares in this capacity. As manager of Sabby Management, LLC, Hal Mintz also shares voting and investment power on behalf of each selling stockholder. Each of Sabby Management, LLC and Hal Mintz disclaims beneficial ownership over the securities listed except to the extent of their pecuniary interest therein. The address of the principal business office of each of Sabby Healthcare Master Fund, Ltd., Sabby Volatility Warrant Master Fund, Ltd., Sabby Management, LLC and Hal Mintz is 10 Mountainview Road, Suite 205, Upper Saddle River, New Jersey 07458. Neither Sabby Healthcare Master Fund, Ltd. nor Sabby Volatility Warrant Master Fund, Ltd. is a registered broker-dealer or an affiliate of a registered broker-dealer.

(3) M5V Advisors Inc. ("M5V") and Frigate Ventures LP ("Frigate"), the Co-Investment Advisers of Anson Investments Master Fund LP ("Anson"), hold voting and dispositive power over the shares of our common stock held by Anson. Bruce Winson is the managing member of Admiralty Advisors LLC, which is the general partner of Frigate. Moez Kassam and Adam Spears are directors of M5V. Mr. Winson, Mr. Kassam and Mr. Spears each disclaim beneficial ownership of these shares except to the extent of their pecuniary interest therein. The principal business address of Anson is 190 Elgin Ave, George Town, Grand Cayman. Anson is not a registered broker-dealer or an affiliate of a registered broker-dealer.

(4) Mitchell P. Kopin and Daniel B. Asher, each of whom are managers of Intracoastal Capital LLC ("Intracoastal"), have shared voting control and investment discretion over the securities reported herein that are held by Intracoastal. As a result, each of Mr. Kopin and Mr. Asher may be deemed to have beneficial ownership (as determined under Section 13(d) of the Exchange Act) of the securities reported herein that are held by Intracoastal. Mr. Asher, who is a manager of Intracoastal, is also a control person of a broker-dealer. As a result of such common control, Intracoastal may be deemed to be an affiliate of a broker-dealer. Intracoastal acquired the ordinary shares being registered hereunder in the ordinary course of business, and at the time of the acquisition of the ordinary shares and warrants described herein, Intracoastal did not have any arrangements or understandings with any person to distribute such securities. The principal business address of Mr. Kopin and Intracoastal is 245 Palm Trail, Delray Beach, Florida 33483. The principal business address of Mr. Asher is 111 W. Jackson Boulevard, Suite 2000, Chicago, IL 60604.

(5) Oppenheimer & Co. Inc. is a broker/dealer and is a subsidiary of Oppenheimer Holdings, Inc. In addition to the shares registered hereby, Oppenheimer & Co. Inc. may purchase and sell our shares from time to time for its own account or for the accounts of its customers.

(6) Excluding 485,000 shares of common stock, issuable upon exercise of the common stock purchase warrants being offered for resale pursuant to this prospectus, the terms of which warrants include a blocker provision that restricts exercise to the extent the securities beneficially owned by the selling stockholder and its affiliates would represent beneficial ownership in excess of 9.99% of shares of our common stock outstanding immediately after giving effect to such exercise, subject to the holder's option, on 61 days' prior notice to us, to increase or decrease this beneficial ownership limitation not to exceed 9.99% of shares of our common stock and 457,338 shares of common stock upon exercise of other warrants, which may only be exercised to the extent beneficial ownership by Sabby Healthcare Master Fund, Ltd. and Sabby Volatility Warrant Master Fund, Ltd., in the aggregate, does not exceed 9.99% of our common stock. See the section titled "Description of the Private Placement" in this prospectus.

(7) Including 82,193 shares of common stock issued to satisfy obligations from the July 6, 2017 Common Stock Offering being offered for resale pursuant to this prospectus. Excluding 358,750 shares of common stock, issuable upon exercise of the common stock purchase warrants being offered for resale pursuant to this prospectus. The terms of these warrants include a blocker provision that restricts exercise to the extent the securities beneficially owned by the selling stockholder and its affiliates would represent beneficial ownership in excess of 9.99% of shares of our common stock outstanding immediately after giving effect to such exercise, subject to the holder's option, on 61 days' prior notice to us, to increase or decrease this beneficial ownership limitation not to exceed 9.99% of shares of our common stock and 170,946 shares of common stock upon exercise of other warrants, which may only be exercised to the extent beneficial ownership by Anson Investments Master Fund LP, in the aggregate, does not exceed 9.99% of our common stock. See the section titled "Description of the Private Placement" in this prospectus.

(8) Excluding 322,500 shares of common stock, issuable upon exercise of the common stock purchase warrants being offered for resale pursuant to this prospectus. The terms of these warrants include a blocker provision that restricts exercise to the extent the securities beneficially owned by the selling stockholder and its affiliates would represent beneficial ownership in excess of 9.99% of shares of our common stock outstanding immediately after giving effect to such exercise, subject to the holder's option, on 61 days' prior notice to us, to increase or decrease this beneficial ownership limitation not to exceed 9.99% of shares of our common stock. See the section titled

"Description of the Private Placement" in this prospectus.

(9) The actual number of shares of common stock offered hereby and included in the registration statement of which this prospectus forms a part includes, in accordance with Rule 416 under the Securities Act, such indeterminate number of additional shares of our common stock as may become issuable in connection with any proportionate adjustment for any stock splits, stock combinations, stock dividends, recapitalizations or similar events with respect to common stock.

(10) Excluding 82,193 shares of common stock issued to satisfy obligations from the July 6, 2017 Common Stock Offering being offered for resale pursuant to this prospectus. These shares were issued directly and were not underlying warrants.

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PLAN OF DISTRIBUTION

The selling stockholders, including their transferees, donees, pledgees, assignees and successors-in-interest, may sell, transfer or otherwise dispose of any or all of the shares of common stock offered by this prospectus from time to time on The NASDAQ Capital Market or any other stock exchange, market or trading facility on which the shares are traded or in private transactions. These dispositions may be at fixed prices, at market prices prevailing at the time of sale, at prices related to prevailing market price or at negotiated prices. The selling stockholders may use any one or more of the following methods when selling shares:

- ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;
- block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- purchases by a broker-dealer as principal and resale by the broker-dealer for its account;
- an exchange distribution in accordance with the rules of the applicable exchange;
- privately negotiated transactions;
- broker-dealers may agree with the selling shareholder to sell a specified number of such shares at a stipulated price per share;
- a combination of any such methods of sale;
- through the writing or settlement of options or other hedging transactions, whether through an options exchange or otherwise; or
- any other method permitted pursuant to applicable law.

The selling stockholders may also sell shares under Rule 144 under the Securities Act, if available, rather than under this prospectus.

Broker-dealers engaged by the selling stockholders may arrange for other brokers-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the selling stockholders or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser in amounts to be negotiated. The selling stockholders does not expect these commissions and discounts relating to its sales of shares to exceed what is customary in the types of transactions involved.

The selling stockholder may enter into hedging transactions with broker-dealers or other financial institutions, which may in turn engage in short sales of the common stock in the course of hedging the positions they assume. The selling shareholders may also sell shares of our common stock short and deliver these securities to close out its short positions, or loan or pledge the common stock to broker-dealers that in turn may sell these securities. The selling shareholders may also enter into option or other transactions with broker-dealers or other financial institutions or the creation of one or more derivative securities which require the delivery to such broker-dealer or other financial institution of shares offered by this prospectus, which shares such broker-dealer or other financial institution may resell pursuant to this prospectus, as supplemented or amended to reflect such transaction.

The selling stockholders and any broker-dealers or agents that are involved in selling the shares may be deemed to be "underwriters" within the meaning of the Securities Act in connection with such sales. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act. Each selling stockholder has informed us that it does not have any agreement or understanding, directly or indirectly, with any person to distribute the common stock.

Because the selling stockholders may be deemed to be an "underwriter" within the meaning of the Securities Act, it will be subject to the prospectus delivery requirements of the Securities Act. In addition, any securities covered by this prospectus which qualify for sale pursuant to Rule 144 under the Securities Act may be sold under Rule 144 rather than under this prospectus. The selling stockholders have advised us that there is no underwriter or coordinating broker acting in connection with the proposed sale of the resale securities by the selling stockholders.

The shares will be sold only through registered or licensed brokers or dealers if required under applicable state securities laws. In addition, in certain states, the shares may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and is complied with.

Under applicable rules and regulations under the Exchannt> 14,267 12,918

Total Non-Interest Expense	41,945	43,121	40,617	36,175	33,286
Income Before Income Taxes	35,565	32,442	28,658	26,299	22,818
Provision for Income Taxes	12,870	11,813	10,230	9,625	8,043
Net Income Before Cumulative Effect of Change in Accounting Principle	22,695	20,629	18,428	16,674	14,775
Cumulative Effect of a Change in Accounting Principle (net of tax)	-	-	-	(224)	-
Net Income	$22,695	$20,629	$18,428	$16,450	$14,775
Balance Sheet Data:					
Total Assets	$1,519,172	$1,411,233	$1,352,989	$1,226,295	$1,148,565
Loans	1,140,969	1,046,912	973,257	866,908	806,906
Allowance for Loan Losses	18,483	18,099	17,860	17,727	17,220
Investment Securities	247,637	243,867	267,940	275,440	261,922
Deposits	1,310,790	1,198,528	1,103,340	1,002,110	904,349
Federal Home Loan Bank Advances	28,954	47,532	98,847	80,889	111,928
Shareholders' Equity	143,418	132,340	123,648	116,547	109,605
Selected Ratios:					
Return on Average Assets	1.56%	1.51%	1.46%	1.40%	1.36%
Return on Average Equity	16.26%	16.16%	15.26%	14.50%	13.68%
Dividend Payout Ratio(1)	34.51%	33.77%	34.55%	34.79%	32.05%
Average Loans to Average Deposits	86.86%	90.24%	87.28%	86.41%	85.29%
Average Equity to Average Assets	9.60%	9.38%	9.58%	9.68%	9.97%
Period-end Shareholders' Equity to Total Assets	9.44%	9.38%	9.14%	9.50%	9.54%

Per Share Data:

Net Income (2) (3)	$28.05	$25.25	$22.24	$19.68	$17.55
Cash Dividends Per Share (1)(3)	$9.70	$8.55	$7.68	$6.85	$5.63

(1) Not including cash paid in lieu of fractional shares related to stock dividend.

(2) Based on the weighted average number of shares outstanding of 809,057, 817,044, 828,537, 835,746 and 841,857 for the years ended December 31, 2007, 2006, 2005, 2004, and 2003, respectively.

(3) Per share data has been adjusted, where applicable, for stock dividends issued in any of the above years.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company's primary service area encompasses the northern Central Valley of California, a region that can be significantly impacted by the seasonal needs of the agricultural industry. Accordingly, discussion of the Company's Financial Condition and Results of Operations is influenced by the seasonal banking needs of its agricultural customers (e.g., during the spring and summer customers draw down their deposit balances and increase loan borrowing to fund the purchase of equipment and planting of crops. Correspondingly, deposit balances are replenished and loans repaid in late fall and winter as crops are harvested and sold).

The Five Year Period: 2003 through 2007
The following table presents key performance data for the Company over the past five years.

(in thousands, except per share data)

Financial Performance Indicator	2007	2006	2005	2004	2003
Net Income	$ 22,695	$ 20,629	$ 18,428	$ 16,450	$ 14,775
Total Assets	$ 1,519,172	$ 1,411,233	$ 1,352,989	$ 1,226,295	$ 1,148,565
Total Loans	$ 1,140,969	$ 1,046,912	$ 973,257	$ 866,908	$ 806,906
Total Deposits	$ 1,310,790	$ 1,198,528	$ 1,103,340	$ 1,002,110	$ 904,349
Total Shareholders' Equity	$ 143,418	$ 132,340	$ 123,648	$ 116,547	$ 109,605
Total Risk-Based Capital Ratio	12.21%	12.17%	12.32%	13.34%	13.24%
Non-Performing Loans as a % of Total Loans	0.02%	0.01%	0.07%	0.03%	0.32%
Net Charge-Offs to Average Loans	0.10%	0.00%	0.03%	0.08%	0.01%
Loan Loss Allowance as a % of Total Loans	1.62%	1.72%	1.83%	2.04%	2.13%
Return on Average Assets	1.56%	1.51%	1.46%	1.40%	1.36%
Return on Average Equity	16.26%	16.16%	15.26%	14.50%	13.68%
Earnings Per Share (1)	$ 28.05	$ 25.25	$ 22.24	$ 19.68	$ 17.55
Cash Dividends Per Share (1) (2)	$ 9.70	$ 8.55	$ 7.68	$ 6.85	$ 5.63
Cash Dividends Declared (2)	$ 7,831	$ 6,966	$ 6,366	$ 5,723	$ 4,736
# Shares Repurchased During Year	11,821	11,718	8,066	7,981	5,732
Average Share Price of Repurchased Shares	$ 460	$ 507	$ 496	$ 389	$ 256
High Stock Price – Fourth Quarter	$ 460	$ 557	$ 500	$ 455	$ 375
Low Stock Price – Fourth Quarter	$ 381	$ 505	$ 465	$ 400	$ 300
	$ 460	$ 515	$ 490	$ 404	$ 300

Closing Stock Price – Fourth Quarter

(1) Prior years have been restated for stock dividends issued in 2003 through 2005. No stock dividend was issued in 2006 or 2007.
(2) Not including cash paid in lieu of fractional shares related to stock dividends. These payments totaled $639,000 between 2003 and 2005.

During the five-year period 2003 through 2007, the Company's operating performance improved every year.

- Annual net income increased 54% to $22.7 million from $14.8 million.
- Earnings Per Share increased 60% to $28.05 from $17.55.
- Return on Average Equity increased 258 basis points to 16.26% from 13.68%.
- Total assets increased 32% to $1.5 billion.

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- Total loans increased 41% to $1.1 billion.

Importantly, during this period of asset and earnings growth:

- The Bank's risk based capital ratio has remained above the 10% level that federal and state banking regulators require for banks to be considered "well capitalized." See "Financial Condition – Capital."

- The Company's asset quality has remained strong, as reflected by net charge-offs never exceeding 0.10% of average loans in any year and non-performing loans totaling 0.02% of total loans at December 31, 2007. See "Financial Condition – Non-Performing Assets."

- The Company's allowance for loan losses has been maintained above 1.6% of total loans, reflecting a conservative approach to providing for loan losses. See "Results of Operations – Provision and Allowance for Loan Losses."

As a result of this strong earnings performance, capital position and asset quality, shareholders have benefited well in excess of overall Bank and Bank Holding Company stock market returns over the past five years.

- Return on Average Equity has increased every year from 13.68% in 2003 to 16.26% in 2007.

- Cash Dividends per Share, restated for stock dividends issued, have increased 87% since 2002, and totaled $38.41 per share over the five year period.

- The total return on the Company's stock over the past five years compares very favorably to overall stock market returns as represented by the Hemscott Group Index of Banks and Bank Holding Companies. See "Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Security - Performance Graphs."

The Current Year: 2007
At the completion of our 91st year, management and the Board are pleased to report the highest net income in the Company's history. For the year ended December 31, 2007, Farmers & Merchants Bancorp reported net income of $22.7 million, earnings per share of $28.05, return on average assets of 1.56% and return on average equity of 16.30%.

The Company's continuing strong earnings performance in 2007 was due to a carefully implemented strategy to balance growth with asset quality and margin protection, which resulted in: (1) 6.3% growth in average earning assets; (2) improvement in the mix of earning assets as reflected by an increase in loans as a percentage of average earning assets from 79% in 2006 to 81% in 2007; and (3) improvement in the efficiency ratio from 56.9% in 2006 to 53.0% in 2007. These factors offset a decline in the net interest margin from 5.18% in 2006 to 4.85% in 2007.

The following is a summary of the financial accomplishments achieved during 2007 as compared to 2006.

- Net income increased 10.0% to $22.7 million from $20.6 million.

- Earnings per share increased 11.1% to $28.05 from $25.25.

- Total assets increased 7.6% to $1.52 billion from $1.41 billion.

- Gross loans increased 9.0% to $1.1 billion from $1.0 billion.

- Total deposits increased 9.4% to $1.3 billion from $1.2 billion.

- Total shareholders' equity increased 8.4% to $143.4 million from $132.3 million, after dividends of $7.8 million and stock repurchases of $5.5 million.

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Looking Forward: 2008 and Beyond

In management's opinion, the following key issues will influence the financial results of the Company in 2008 and future years:

- The Company's earnings are sensitive to changes in market interest rates. See "Item 7A. Quantitative and Qualitative Disclosures About Market Risk - Interest Rate Risk."

  - Between 2004 and 2006, as a result of the FRB increasing market interest rates, the Company's net interest margin improved approximately 81 basis points to a high of 5.37% in the first quarter of 2006.
  - Once short-term market rates stabilized in 2006, since increases in the Company's deposit rates typically lag increases in loan rates, the Company's net interest margin dropped by 48 bps to 4.89% in the second quarter of 2007.
  - In September 2007 the FRB began decreasing short-term market rates, resulting in further pressure on the Company's net interest margin, which declined to 4.78% in the fourth quarter of 2007.

In addition to changes in market interest rates, the Company's net interest margin has come under pressure from (1) competitor pricing strategies for both loans and deposits that the Company needs to respond to in order to retain key customers and (2) changes in deposit mix as customers move funds from low or non-interest bearing transaction and savings accounts to higher yielding time deposits.

- The Company's results can be influenced by changes in the credit quality of its borrowers. See "Provision and Allowance for Loan Losses" and "Non-Performing Assets." Non-performing loans totaled $203,000 or 0.02% of total loans at December 31, 2007, and $54,000 or 0.01% of total loans at December 31, 2006. Management believes that these levels are adequately covered by the Company's current loan loss reserves, however, general economic conditions in the Company's service area have softened over the past year and may continue to do so in 2008. Accordingly, future financial results could be impacted should deterioration in economic conditions or other factors that affect credit quality cause the level of the Company's non-performing loans to increase.

In addition to the preceding issues, over the past several years management has reviewed the Company's existing branch delivery system, along with the availability and desirability of additional branch locations, and initiated a major branch expansion, relocation and renovation program. New branches were opened during 2006 in Sacramento, Lodi and Stockton and the downtown Turlock branch will be relocated to a new facility in 2008. In management's opinion, these moves are integral to the long-term strategic positioning of the Company.

The Company currently estimates that the total capital expenditures associated with this multi-year branch program, which began in 2004, will be in excess of $13 million which will result in an increase in the Company's future occupancy expense as compared to prior years. Approximately $10 million has been spent as of December 31, 2007. In addition, the increased staffing and other operating expense associated with these new branches will place pressure on the Company's earnings over the next 24-36 months, the timeframe in which these branches are estimated to reach break-even.

Results of Operations

The following discussion and analysis is intended to provide a better understanding of Farmers & Merchants Bancorp and its subsidiaries' performance during each of the years in the three-year period ended December 31, 2007, and the material changes in financial condition, operating income and expense of the Company and its subsidiaries as shown in the accompanying financial statements.

Net Interest Income/Net Interest Margin

The tables on the following pages reflect the Company's average balance sheets and volume and rate analysis for the years ending 2007, 2006 and 2005. Average balance amounts for assets and liabilities are the computed average of daily balances.

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Net interest income is the amount by which the interest and fees on loans and other interest earning assets exceed the interest paid on interest bearing sources of funds. For the purpose of analysis, the interest earned on tax-exempt investments and municipal loans is adjusted to an amount comparable to interest subject to normal income taxes. This adjustment is referred to as “tax equivalent” adjustment and is noted wherever applicable.

The Volume and Rate Analysis of Net Interest Income summarizes the changes in interest income and interest expense based on changes in average asset and liability balances (volume) and changes in average rates (rate). For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to: (1) changes in volume (change in volume multiplied by initial rate); (2) changes in rate (change in rate multiplied by initial volume); and (3) changes in rate/volume (allocated in proportion to the respective volume and rate components).

The Company’s earning assets and rate sensitive liabilities are subject to repricing at different times, which exposes the Company to income fluctuations when interest rates change. In order to minimize income fluctuations, the Company attempts to match asset and liability maturities. However, some maturity mismatch is inherent in the asset and liability mix. See “Item 7A. Quantitative and Qualitative Disclosures About Market Risk - Interest Rate Risk.”

2007 Compared to 2006

Net interest income decreased 0.4% to $63.6 million during 2007. During 2006 net interest income was $63.8 million, representing an increase of 9.2% from 2005. On a fully tax equivalent basis, net interest income decreased 0.4% and totaled $65.1 million during 2007, compared to $65.4 million for 2006. As more fully discussed below, the decrease in net interest income was primarily due to increasing deposit costs, but, beginning in September 2007 the FRB began dropping market interest rates which has resulted in declining loan yields during the fourth quarter of 2007, a trend that will continue into 2008 as the FRB dropped rates by 125 basis points in January.

Net interest income on a tax equivalent basis, expressed as a percentage of average total earning assets, is referred to as the net interest margin. For 2007, the Company’s net interest margin was 4.85% compared to 5.18% in 2006. Recent trends in: (1) market interest rates; and (2) competitive pricing of both loans and deposits will continue, in management’s opinion, to place pressure on the Company’s net interest margin in future quarters. See “Overview – Looking Forward: 2008 and Beyond” for a discussion of factors impacting the Company’s future net interest margin.

Loans, generally the Company’s highest earning assets, increased $94.0 million as of December 31, 2007, compared to December 31, 2006. See “Financial Condition – Loans” for further discussion of this increase. On an average balance basis, loans increased by $91.6 million for the year ended December 31, 2007. As a result of this loan growth, the mix of the Company’s earning assets improved as loans increased from 79.1% of average earning assets during 2006 to 81.2% in 2007. Despite decreases in market rates from mid- September through December 2007 the year-to-date yield on the loan portfolio remained almost unchanged at 7.71% for the year ended December 31, 2007, compared to 7.70% for the year ended December 31, 2006. Some of this resilience in loan yields is due to pricing floors that the Bank has placed in some of its customer loan agreements. However, these floors typically expire annually and are renegotiated based upon current market conditions. Even with no increase in yield, the growth in loan balances resulted in interest revenue from loans increasing 9.4% to $84.1 million for 2007. The Company has been experiencing aggressive competitor pricing for loans that it may need to continue to respond to in order to retain key customers. This, in conjunction with recent and possible future decreases in market interest rates by the FRB, could place even greater negative pressure on future loan yields and net interest margin.

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Farmers & Merchants Bancorp
Year-to-Date Average Balances and Interest Rates
(Interest and Rates on a Taxable Equivalent Basis)
(in thousands)

	Year Ended December 31, 2007		
Assets	Balance	Interest	Rate
Federal Funds Sold and Securities Purchased Under Agreements to Resell	$ 10,443	$ 538	5.15%
Investment Securities Available-for-Sale			
U.S. Agencies	-	-	-
Municipals - Non-Taxable	11,065	786	7.10%
Mortgage-backed Securities	114,984	5,995	5.21%
Other	6,315	297	4.70%
Total Investment Securities Available-for-Sale	132,364	7,078	5.35%
Investment Securities Held-to-Maturity			
U.S. Agencies	30,490	1,271	4.17%
Municipals - Non-Taxable	68,987	4,005	5.81%
Mortgage-backed Securities	7,700	295	3.83%
Other	2,100	61	2.90%
Total Investment Securities Held-to-Maturity	109,277	5,632	5.15%
Loans			
Real Estate	628,490	45,917	7.31%
Home Equity	65,975	5,188	7.86%
Agricultural	195,482	16,417	8.40%
Commercial	180,006	14,823	8.23%
Consumer	13,493	1,184	8.77%
Credit Card	5,435	537	9.88%
Other	1,102	15	1.36%
Total Loans	1,089,983	84,081	7.71%
Total Earning Assets	1,342,067	$ 97,329	7.25%
Unrealized Loss on Securities Available-for-Sale	(1,232)		
Allowance for Loan Losses	(17,940)		
Cash and Due From Banks	38,761		
All Other Assets	92,389		
Total Assets	$ 1,454,045		
Liabilities & Shareholders' Equity			
Interest Bearing Deposits			
Interest Bearing DDA	$ 130,723	$ 102	0.08%
Savings	290,611	4,386	1.51%
Time Deposits	554,936	25,472	4.59%
Total Interest Bearing Deposits	976,270	29,960	3.07%
Other Borrowed Funds	26,428	1,397	5.29%
Subordinated Debt	10,310	868	8.42%
Total Interest Bearing Liabilities	1,013,008	$ 32,225	3.18%

Interest Rate Spread			4.07%
Demand Deposits	278,625		
All Other Liabilities	22,836		
Total Liabilities	1,314,469		
Shareholders' Equity	139,576		
Total Liabilities & Shareholders' Equity	$ 1,454,045		
Impact of Non-Interest Bearing Deposits and Other Liabilities			0.78%
Net Interest Income and Margin on Total Earning Assets		65,104	4.85%
Tax Equivalent Adjustment		(1,554)	
Net Interest Income		$ 63,550	4.74%

Notes: Yields on municipal securities have been calculated on a fully taxable equivalent basis. Loan interest income includes fee income and unearned discount of $2.2 million for the year ended December 31, 2007. Nonaccrual loans and lease financing receivables have been included in the average balances. Yields on securities available-for-sale are based on historical cost.

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Farmers & Merchants Bancorp
Year-to-Date Average Balances and Interest Rates
(Interest and Rates on a Taxable Equivalent Basis)
(in thousands)

	Year Ended December 31, 2006		
Assets	Balance	Interest	Rate
Federal Funds Sold and Securities Purchased Under Agreements to Resell	$ 1,030	$ 49	4.76%
Investment Securities Available-for-Sale			
U.S. Agencies	27,295	1,112	4.07%
Municipals - Non-Taxable	15,121	957	6.33%
Mortgage-backed Securities	103,763	4,981	4.80%
Other	6,870	385	5.60%
Total Investment Securities Available-for-Sale	153,049	7,435	4.86%
Investment Securities Held-to-Maturity			
U.S. Agencies	30,593	1,270	4.15%
Municipals - Non-Taxable	67,490	3,947	5.85%
Mortgage-backed Securities	9,785	375	3.83%
Other	2,120	62	2.92%
Total Investment Securities Held-to-Maturity	109,988	5,654	5.14%
Loans			
Real Estate	567,479	40,915	7.21%
Home Equity	67,251	5,356	7.96%
Agricultural	164,897	13,843	8.39%
Commercial	178,528	14,976	8.39%
Consumer	13,587	1,205	8.87%
Credit Card	5,445	536	9.84%
Municipal	1,215	41	3.37%
Total Loans	998,402	76,872	7.70%
Total Earning Assets	1,262,469	$ 90,010	7.13%
Unrealized Gain (Loss) on Securities Available-for-Sale	(3,629)		
Allowance for Loan Losses	(18,280)		
Cash and Due From Banks	37,906		
All Other Assets	83,238		
Total Assets	$ 1,361,704		
Liabilities & Shareholders' Equity			
Interest Bearing Deposits			
Interest Bearing DDA	$ 128,199	$ 89	0.07%
Savings	277,185	2,310	0.83%
Time Deposits	424,745	16,231	3.82%
Total Interest Bearing Deposits	830,129	18,630	2.24%
Other Borrowed Funds	99,484	5,164	5.19%
Subordinated Debt	10,310	827	8.02%
Total Interest Bearing Liabilities	939,923	$ 24,621	2.62%

Interest Rate Spread			4.51%
Demand Deposits	276,289		
All Other Liabilities	17,824		
Total Liabilities	1,234,036		
Shareholders' Equity	127,668		
Total Liabilities & Shareholders' Equity	$ 1,361,704		
Impact of Non-Interest Bearing Deposits and Other Liabilities			0.67%
Net Interest Income and Margin on Total Earning Assets		65,389	5.18%
Tax Equivalent Adjustment		(1,614)	
Net Interest Income		$ 63,775	5.05%

Notes: Yields on municipal securities have been calculated on a fully taxable equivalent basis. Loan interest income includes fee income and unearned discount of $2.7 million for the year ended December 31, 2006. Nonaccrual loans and lease financing receivables have been included in the average balances. Yields on securities available-for-sale are based on historical cost.

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Farmers & Merchants Bancorp
Year-to-Date Average Balances and Interest Rates
(Interest and Rates on a Taxable Equivalent Basis)
(in thousands)

	Year Ended December 31, 2005		
Assets	Balance	Interest	Rate
Federal Funds Sold and Securities Purchased Under Agreements to Resell	$ 5,593	$ 188	3.36%
Investment Securities Available-for-Sale			
U.S. Agencies	58,226	2,187	3.76%
Municipals - Taxable	81	5	6.17%
Municipals - Non-Taxable	15,987	976	6.10%
Mortgage-backed Securities	79,290	3,112	3.92%
Other	4,582	255	5.57%
Total Investment Securities Available-for-Sale	158,166	6,535	4.13%
Investment Securities Held-to-Maturity			
U.S. Agencies	28,255	1,167	4.13%
Municipals - Non-Taxable	64,968	3,880	5.97%
Mortgage-backed Securities	12,223	465	3.80%
Other	432	26	6.02%
Total Investment Securities Held-to-Maturity	105,878	5,538	5.23%
Loans			
Real Estate	507,315	34,133	6.73%
Home Equity	65,397	4,172	6.38%
Agricultural	142,008	9,880	6.96%
Commercial	170,081	12,012	7.06%
Consumer	12,694	1,106	8.71%
Credit Card	5,046	491	9.73%
Municipal	1,029	44	4.28%
Total Loans	903,570	61,838	6.84%
Total Earning Assets	1,173,207	$ 74,099	6.32%
Unrealized Gain (Loss) on Securities Available-for-Sale	(1,856)		
Allowance for Loan Losses	(17,910)		
Cash and Due From Banks	35,453		
All Other Assets	72,235		
Total Assets	$ 1,261,129		
Liabilities & Shareholders' Equity			
Interest Bearing Deposits			
Interest Bearing DDA	$ 117,460	$ 79	0.07%
Savings	298,181	1,319	0.44%
Time Deposits	351,552	8,430	2.40%
Total Interest Bearing Deposits	767,193	9,828	1.28%
Other Borrowed Funds	78,719	3,561	4.52%
Subordinated Debt	10,310	643	6.24%

Total Interest Bearing Liabilities	856,222	$ 14,032	1.64%
Interest Rate Spread			4.68%
Demand Deposits	268,038		
All Other Liabilities	16,092		
Total Liabilities	1,140,352		
Shareholders' Equity	120,777		
Total Liabilities & Shareholders' Equity	$ 1,261,129		
Impact of Non-Interest Bearing Deposits and Other Liabilities			0.44%
Net Interest Income and Margin on Total Earning Assets		60,067	5.12%
Tax Equivalent Adjustment		(1,641)	
Net Interest Income		$ 58,426	4.98%

Notes: Yields on municipal securities have been calculated on a fully taxable equivalent basis. Loan interest income includes fee income and unearned discount of $3.5 million for the year ended December 31, 2005. Nonaccrual loans and lease financing receivables have been included in the average balances. Yields on securities available-for-sale are based on historical cost.

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Farmers & Merchants Bancorp
Volume and Rate Analysis of Net Interest Revenue
(Interest and Rates on a Taxable Equivalent Basis)
(in thousands)

	2007 versus 2006 Amount of Increase (Decrease) Due to Change in:		
Interest Earning Assets	Volume	Rate	Net Chg.
Federal Funds Sold	$ 485	$ 4	$ 489
Investment Securities Available-for-Sale			
U.S. Agencies	(1,112)	-	(1,112)
Municipals - Non-Taxable	(278)	107	(171)
Mortgage-backed Securities	564	450	1,014
Other	(29)	(59)	(88)
Total Investment Securities Available-for-Sale	(855)	498	(357)
Investment Securities Held-to-Maturity			
U.S. Agencies	(4)	5	1
Municipals - Non-Taxable	87	(29)	58
Mortgage-backed Securities	(80)	-	(80)
Other	(1)	-	(1)
Total Investment Securities Held-to-Maturity	2	(24)	(22)
Loans:			
Real Estate	4,451	551	5,002
Home Equity	(101)	(67)	(168)
Agricultural	2,569	5	2,574
Commercial	124	(277)	(153)
Consumer	(8)	(13)	(21)
Credit Card	(1)	2	1
Other	(4)	(22)	(26)
Total Loans	7,030	179	7,209
Total Earning Assets	6,662	657	7,319
Interest Bearing Liabilities			
Interest Bearing Deposits:			
Interest Bearing DDA	2	11	13
Savings	117	1,959	2,076
Time Deposits	5,579	3,662	9,241
Total Interest Bearing Deposits	5,698	5,632	11,330
Other Borrowed Funds	(3,860)	93	(3,767)
Subordinated Debt	-	41	41
Total Interest Bearing Liabilities	1,838	5,766	7,604
Total Change	$ 4,824	$ (5,109)	$ (285)

Notes: Rate/volume variance is allocated based on the percentage relationship of changes in volume and changes in rate to the total "net change." The above figures have been rounded to the nearest whole number.

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Farmers & Merchants Bancorp
Volume and Rate Analysis of Net Interest Revenue
(Interest and Rates on a Taxable Equivalent Basis)
(in thousands)

	2006 versus 2005 Amount of Increase (Decrease) Due to Change in:		
Interest Earning Assets	Volume	Rate	Net Chg.
Federal Funds Sold	$ (195)	$ 56	$ (139)
Investment Securities Available-for-Sale			
U.S. Agencies	(1,247)	172	(1,075)
Municipals - Taxable	(2)	(3)	(5)
Municipals - Non-Taxable	(54)	35	(19)
Mortgage-backed Securities	1,085	784	1,869
Other	128	2	130
Total Investment Securities Available-for-Sale	(90)	990	900
Investment Securities Held-to-Maturity			
U.S. Agencies	97	6	103
Municipals - Non-Taxable	149	(82)	67
Mortgage-backed Securities	(94)	4	(90)
Other	56	(20)	36
Total Investment Securities Held-to-Maturity	208	(92)	116
Loans:			
Real Estate	4,229	2,553	6,782
Home Equity	121	1,063	1,184
Agricultural	1,736	2,227	3,963
Commercial	620	2,344	2,964
Consumer	79	20	99
Credit Card	39	6	45
Other	7	(10)	(3)
Total Loans	6,831	8,203	15,034
Total Earning Assets	6,754	9,157	15,911
Interest Bearing Liabilities			
Interest Bearing Deposits:			
Interest Bearing DDA	7	3	10
Savings	(99)	1,090	991
Time Deposits	2,026	5,775	7,801
Total Interest Bearing Deposits	1,934	6,868	8,802
Other Borrowed Funds	1,028	575	1,603
Subordinated Debt	-	184	184
Total Interest Bearing Liabilities	2,962	7,627	10,589
Total Change	$ 3,792	$ 1,530	$ 5,322

Notes: Rate/volume variance is allocated based on the percentage relationship of changes in volume and changes in rate to the total "net change." The above figures have been rounded to the nearest whole number.

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The investment portfolio is the other main component of the Company's earning assets. The Company invests primarily in mortgage-backed securities issued by government-sponsored entities, U.S. Government Agencies, and high-grade municipals. Since the risk factor for these types of investments is significantly lower than that of loans, the yield earned on investments is generally less than that of loans.

Average investment securities decreased $21.4 million in 2007 compared to the average balance during 2006 reflecting a redeployment to loans. Interest income on securities decreased $379,000 to $12.7 million for the year ended December 31, 2007, compared to $13.1 million for the year ended December 31, 2006. The average yield, on a tax equivalent basis, in the investment portfolio was 5.3% in 2007 compared to 5.0% in 2006. See "Financial Condition – Investment Securities" for a discussion of the Company's repositioning of its securities portfolio during 2006 which resulted in this increase in yield. Net interest income on the Schedule of Year-to-Date Average Balances and Interest Rates shown on a tax equivalent basis, which is higher than net interest income as reflected on the Consolidated Statement of Income because of adjustments that relate to income on securities that are exempt from federal income taxes.

Average interest-bearing sources of funds increased $73.1 million or 7.8% during 2007. Of that increase, average borrowed funds, primarily Federal Home Loan Bank Advances, decreased $73.0 million, interest-bearing deposits increased $146.1 million, and subordinated debt remained unchanged.

During 2007 the Company was able to grow average interest bearing deposits by $146.1 million. The increase was primarily in time deposits, which grew $130.2 million, as lower cost savings and interest bearing DDA increased by $15.9 million. See "Financial Condition – Deposits" for a discussion of trends in the Company's deposit base. Total interest expense on deposits was $30.0 million in 2007 as compared to $18.6 million in 2006. The average rate paid on interest-bearing deposits was 3.1% in 2007 and 2.2% in 2006. This increase in rates is a result of the lagging impact of increases in market interest rates that occurred in mid-2004 through mid-2006. Since September 2007 the FRB has been lowering market rates. The Company has begun to feel this impact as the average rate paid on interest-bearing deposits declined to 3.0% in December 2007. The Company anticipates that this decline in deposit rates will continue into 2008, particularly if the FRB continues to lower market interest rates. See "Overview – Looking Forward: 2008 and Beyond" for a discussion of factors impacting the Company's future deposit rates and their impact on net interest margin.

2006 Compared to 2005

Net interest income increased 9.2% to $63.8 million during 2006. During 2005 net interest income was $58.4 million, representing an increase of 18.1% from 2004. On a fully tax equivalent basis, net interest income increased 8.9% and totaled $65.4 million during 2006 compared to $60.1 million for 2005. The increase in net interest income was due to a combination of: (1) growth in average earning assets in 2006; and (2) improvement in the net interest margin.

Net interest income on a tax equivalent basis, expressed as a percentage of average total earning assets, is referred to as the net interest margin. For 2006 the Company's net interest margin was 5.18% compared to 5.12% in 2005. This improvement was due to the continuing residual impact of increases in market interest rates that occurred in mid-2004 through mid-2006.

Loans, generally the Company's highest earning assets, increased $73.7 million as of December 31, 2006, compared to December 31, 2005. On an average balance basis, loans increased by $94.8 million for the year ended December 31, 2006. As a result of this loan growth, the mix of the Company's earning assets improved as loans increased from 77.0% of average earning assets during 2005 to 79% in 2006. Due to increases in market rates from mid- 2004 through mid-2006 the year-to-date yield on the loan portfolio increased 86 basis points to 7.70% for the year ended December 31, 2006, compared to 6.84% for the year ended December 31, 2005. This increase in yield plus the growth in loan balances resulted in interest revenue from loans increasing 24.3% to $76.9 million for 2006.

The investment portfolio is the other main component of the Company's earning assets. The Company invests primarily in mortgage-backed securities, U.S. Government Agencies, and high-grade municipals. Since the risk factor for these types of investments is significantly lower than that of loans, the yield earned on investments is generally less than that of loans.

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Average investment securities decreased $1.0 million in 2006 compared to the average balance during 2005. Interest income on securities increased $1.0 million to $13.1 million for the year ended December 31, 2006 compared to $12.1 million for the year ended December 31, 2005. The average yield, on a tax equivalent basis, in the investment portfolio was 5.0% in 2006 compared to 4.6% in 2005. Net interest income on the Schedule of Year-to-Date Average Balances and Interest Rates shown on a tax equivalent basis, which is higher than net interest income as reflected on the Consolidated Statement of Income because of adjustments that relate to income on securities that are exempt from federal income taxes.

Average interest-bearing sources of funds increased $83.7 million or 9.8% during 2006. Of that increase, average borrowed funds (primarily FHLB Advances) increased $20.8 million, interest-bearing deposits increased $62.9 million, and subordinated debt remained unchanged.

During 2006 the Company was able to grow average interest bearing deposits by $62.9 million. The increase was primarily in time deposits, which grew $73.2 million, as lower cost savings and interest bearing DDA decreased by $10.3 million. Total interest expense on deposit accounts for 2006 was $18.6 million as compared to $9.8 million in 2005. As deposits increased, interest expense on deposits increased 89.6% or $8.8 million in 2006. The average rate paid on interest-bearing deposits was 2.2% in 2006 and 1.3% in 2005. This increase in rates is a result of the lagging impact of increases in market interest rates that occurred in mid-2004 through mid-2006.

Provision and Allowance for Loan Losses

As a financial institution that assumes lending and credit risks as a principal element of its business, credit losses will be experienced in the normal course of business. The allowance for loan losses is maintained at a level considered by management to be adequate to provide for risks inherent in the loan portfolio. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. In determining the adequacy of the allowance for loan losses, management takes into consideration examinations by the Company's supervisory authorities, results of internal credit reviews, financial condition of borrowers, loan concentrations, prior loan loss experience, and general economic conditions. The allowance is based on estimates and ultimate losses may vary from the current estimates. Management reviews these estimates periodically and, when adjustments are necessary, they are reported in the period in which they become known.

The Company has established credit management policies and procedures that govern both the approval of new loans and the monitoring of the existing portfolio. The Company manages and controls credit risk through comprehensive underwriting and approval standards, dollar limits on loans to one borrower and by restricting loans made primarily to its principal market area where management believes it is better able to assess the applicable risk. Additionally, management has established guidelines to ensure the diversification of the Company's credit portfolio such that even within key portfolio sectors such as real estate or agriculture, the portfolio is diversified across factors such as location, building type, crop type, etc. See "Item 7A. Quantitative and Qualitative Disclosures About Market Risk – Credit Risk." Management reports regularly to the Board of Directors regarding trends and conditions in the loan portfolio and regularly conducts credit reviews of individual loans. Loans that are performing but have shown some signs of weakness are subjected to more stringent reporting and oversight.

The provision for loan losses totaled $1.5 million in 2007 compared to $275,000 in 2006 and $425,000 in 2005. Changes in the provision between years were the result of management's evaluation of the adequacy of the allowance for loan losses relative to factors such as the credit quality of the loan portfolio, loan growth, current loan losses and the prevailing economic climate and its effect on borrowers' ability to repay loans in accordance with the terms of the notes. See "Critical Accounting Policies and Estimates – Allowance for Loan Losses" and "Item 7A. Quantitative and Qualitative Disclosures About Market Risk-Credit Risk" and "Overview – Looking Forward: 2008 and Beyond."

As of December 31, 2007, the allowance for loan losses was $18.5 million, which represented 1.6% of the total loan balance. At December 31, 2006, the allowance for loan losses was $18.1 million or 1.7% of the total loan balance. After reviewing all factors above, management concluded that the allowance for loan losses as of December 31, 2007, was adequate.

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The following tables summarize the activity and the allocation of the allowance for losses for the years indicated.

(in thousands)	2007	2006	2005	2004	2003
Allowance for Loan Losses Beginning of Year	$ 18,099	$ 17,860	$ 17,727	$ 17,220	$ 16,684
Provision Charged to Expense	1,495	275	425	1,275	625
Charge Offs:					
Commercial Real Estate	-	-	-	-	1
Real Estate Construction	-	-	-	-	-
Residential 1st Mortgages	-	-	-	-	-
Home Equity Lines and Loans	-	-	-	-	-
Agricultural	254	333	199	5	0
Commercial	722	121	442	700	282
Consumer	52	41	26	7	175
Credit Card	202	284	200	243	239
Other	143	60	-	-	-
Total Charge Offs	1,373	839	867	955	697
Recoveries:					
Commercial Real Estate	-	-	-	-	143
Real Estate Construction	-	-	-	-	-
Residential 1st Mortgages	-	-	-	-	-
Home Equity Lines and Loans	-	-	-	-	-
Agricultural	79	75	376	26	17
Commercial	30	624	134	209	394
Consumer	11	37	19	32	25
Credit Card	42	26	46	31	29
Other	100	41	-	-	-
Total Recoveries	262	803	575	298	608
Net (Charge-Offs) Recoveries	(1,111)	(36)	(292)	(657)	(89)
Less Reclassification Adjustment*	-	-	-	(111)	-
Total Allowance for Loan Losses	$ 18,483	$ 18,099	$ 17,860	$ 17,727	$ 17,220

*As of December 31, 2004, the Company reclassified $111,000 of the Allowance for Loan Losses that pertained to commitments under commercial and standby letters of credit to the “Other Liabilities” section of the Consolidated Balance Sheet.

Ratios:					
Allowance for Loan Losses to:					
Loans at Year End	1.62%	1.72%	1.83%	2.04%	2.13%
Average Loans	1.70%	1.81%	1.98%	2.15%	2.33%
Consolidated Net Charge-Offs to:					
Loans at Year End	0.10%	0.00%	0.03%	0.08%	0.01%
Average Loans	0.10%	0.00%	0.03%	0.08%	0.01%

For a description of the Company’s policy regarding the Allowance for Loan Losses, see Note 1 located in “Item 8. Financial Statements and Supplementary Data.”

Allowance Allocation at December 31,

(in thousands)	2007	2006	2005	2004	2003
Commercial Real Estate	$ 2,527	$ 4,175	$ 3,974	$ 3,989	$ 4,663
Real Estate Construction	2,896	880	1,088	427	1,080
Residential 1st Mortgages	1,652	1,373	1,370	1,147	1,553
Home Equity Lines and Loans	836	436	416	170	471
Agricultural	5,335	3,564	1,786	4,342	4,681
Commercial	3,923	6,007	8,317	5,849	3,957
Consumer	346	92	89	133	104
Other	815	1,199	543	1,312	569
Unallocated	153	373	277	358	142
Total	$ 18,483	$ 18,099	$ 17,860	$ 17,727	$ 17,220

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Non-Interest Income
Non-interest income includes: (1) service charges and fees from deposit accounts; (2) net gains and losses from investment securities; (3) credit card merchant fees; (4) ATM fees; (5) investment gains and losses on non-qualified deferred compensation plans; (6) increases in the cash surrender value of bank owned life insurance; and (7) fees from other miscellaneous business services.

2007 Compared to 2006
Non-interest income totaled $15.4 million, an increase of $3.4 million or 28.1% from non-interest income of $12.1 million for 2006.

Service charges on deposit accounts totaled $7.3 million, an increase of $1.2 million or 20.5% from service charges on deposit accounts of $6.0 million in 2006. This increase was due to fees related to the Company's Overdraft Privilege Service, which was offered to eligible customers with deposit accounts in good standing beginning May 1, 2006.

Net loss on investment securities improved by $461,000 or 21.3% in 2007 and was a loss of $1.7 million compared to a loss of $2.2 million for 2006. During 2006 the Company made the decision to sell some of its investment portfolio at a loss in order to better align the portfolio with its evolving asset/liability management objectives. During 2007 the Company recognized an impairment loss on investment securities. See "Financial Condition-Investment Securities."

ATM fees totaled $1.4 million, an increase of $174,000 or 14.5% over fees in 2006. The increase in these fees is due to the convenience and increased number of ATM's at strategic locations, which benefit both customers and non-customers.

During 2007 the Company received an $869,000 liquidating dividend from the Company's partial ownership in WSBA, a credit card processing company whose operating assets were sold during 2006 and subsequently liquidated in 2007.

Investment gains on non-qualified deferred compensation plan balances increased $505,000 in 2007 to $1.1 million. See Note 11. located in "Item 8. Financial Statements and Supplementary Data" for a description of these plans. Gain/loss on these plans fluctuates depending on the type of investments held and market trends in interest rates and stock prices. All gains/losses are offset by a corresponding impact on salary expense resulting in no effect on the Company's net income.

2006 Compared to 2005
Non-interest income totaled $12.1 million, an increase of $789,000 or 7.0% from non-interest income of $11.3 million for 2005.

Most of the increase in 2006 occurred in service charges on deposit accounts. Service charges totaled $6.0 million, an increase of $1.7 million or 38.5% from service charges on deposit accounts of $4.4 million in 2005. This increase was due to fees related to the Company's Overdraft Privilege Service which was offered to eligible customers with deposit accounts in good standing beginning May 1, 2006.

The increase in service charges was offset by an increase in loss on sale of investment securities, which was a loss of $2.2 million in 2006 as compared to a loss of $953,000 for 2005. During 2006 the Company made the decision to sell some of its investment portfolio at a loss in order to better align the portfolio with its evolving asset/liability management objectives.

ATM fees totaled $1.2 million, an increase of $211,000 or 21.3% over fees in 2005. The increase in these fees is due to the convenience and increased number of ATM's at strategic locations, which benefit both customers and non-customers.

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Non-Interest Expense

Non-interest expense for the Company includes expenses for salaries and employee benefits, occupancy, equipment, supplies, legal fees, professional services, data processing, marketing, deposit insurance, merchant bankcard operations, and other miscellaneous expenses.

2007 Compared to 2006

Overall, non-interest expense totaled $41.9 million, a decrease of $1.2 million or 2.7% for the year ended December 31, 2007.

Salaries and employee benefits decreased $456,000 due to: (1) increased cost deferrals under "FAS 91"as a result of loan growth; and (2) reduced contributions to bonus and retirement plans primarily as a result of a reduction in the number of certain key individuals eligible to participate in the plans. At the end of 2007 the Company had 308 full time equivalent employees compared to 302 at the end of 2006.

Equipment expense in 2007 totaled $2.9 million, a decrease of $343,000 or 10.7% from 2006. During 2007 the Company made fewer equipment repairs/replacements than in 2006.

Marketing expense was $463,000 in 2007, a decrease of $704,000 or 60.3% from $1.2 million in 2006. The majority of this decrease was due to the continued reduction in expenses related to customer direct mail.

2006 Compared to 2005

Overall, non-interest expense totaled $43.1 million, an increase of $2.5 million or 6.2% for the year ended December 31, 2006.

Salaries and employee benefits increased $1.0 million due to: (1) officer salary merit increases which occurred in November 2005; (2) increased contributions to the Company's incentive compensation and supplemental retirement plans; and (3) increased staff related to the three new branches opened during 2006. At the end of 2006 the Company had 302 full time equivalent employees compared to 294 at the end of 2005.

Occupancy and equipment expenses represent the cost of operating and maintaining branch and administrative facilities, including the purchase and maintenance of furniture, fixtures, and office equipment and data processing equipment. Occupancy expense in 2006 totaled $2.5 million, an increase of $382,000 or 18.4% over 2005. This increase was due to: (1) three new branches opened in 2006; (2) increased utilities due to increased gas and electricity prices; (3) increased rents on leased properties; and (4) increased property taxes.

Equipment expense in 2006 totaled $3.2 million, an increase of $709,000 or 28.3% over 2005. This increase was due to: (1) annual computer hardware/software maintenance and upgrades; and (2) increased furniture and equipment depreciation related to remodeling and adding branch locations.

Marketing expense was $1.2 million in 2006 a decrease of $355,000 or 23.3% from $1.5 million in 2005. In 2005 there were significant marketing expenses for a new high performance checking product started in November 2004, including the associated direct mail and other ancillary expenses incurred to promote this product. These same expenses were not required in 2006.

Other operating expense totaled $6.9 million, a 9.7% increase from the prior year. This increase in other operating expense during 2006 was due to: (1) $228,000 early payoff penalties on FHLB advances; (2) operating losses related to non-sufficient funds and electronic funds transactions; and (3) increased stationery and printing expense related to the Company's 90th anniversary logo.

Income Taxes

The provision for income taxes increased $2.1 million during 2007. The effective tax rate in 2007 was 36.2% compared to 36.4% in 2006 and 35.7% in 2005. The effective rates were lower than the statutory rate of 42% due primarily to benefits regarding the cash surrender value of life insurance, California enterprise zone interest income exclusion, and tax-exempt interest income on municipal securities and loans.

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Current tax law causes the Company’s current taxes payable to approximate or exceed the current provision for taxes on the income statement. Three provisions have had a significant effect on the Company’s current income tax liability: the restrictions on the deductibility of loan losses, deductibility of pension and other long-term employee benefits only when paid and the statutory deferral of deductibility of California franchise taxes on the Company’s federal return.

Financial Condition

Investment Securities

The investment portfolio provides the Company with an income alternative to loans. The Company’s investment portfolio at the end of 2007 was $247.6 million, an increase of $3.8 million or 1.6% from 2006. The investment portfolio remained relatively flat in 2007 as the Company deployed funds generated by deposit growth into its loan portfolio.

During 2006 the Company sold $63.3 million in available-for-sale investment securities at a loss of $2.2 million. These securities generally had a remaining life under three years and yields below current market rates. Funds not invested in loans or used to pay down short-term borrowings were reinvested in higher yielding, somewhat longer term (5-7 years) securities which management believes should strengthen the Company’s net interest margin and reduce the Company’s asset sensitivity, thereby better protecting against future declines in market interest rates.

The Company's total investment portfolio represented 16.3% of the Company’s total assets during 2007 and 17.3% of the Company’s total assets during 2006. Not included in the investment portfolio are overnight investments in Federal Funds Sold. In 2007 average Federal Funds Sold on a year to date basis was $10.4 million compared to $1.0 million in 2006.

The Company classifies its investments as held-to-maturity, trading or available-for-sale. Securities are classified as held-to-maturity and are carried at amortized cost when the Company has the intent and ability to hold the securities to maturity. Trading securities are securities acquired for short-term appreciation and are carried at fair value, with unrealized gains and losses recorded in non-interest income. As of December 31, 2007, and 2006 there were no securities in the trading portfolio. Securities classified as available-for-sale include securities which may be sold to effectively manage interest rate risk exposure, prepayment risk, satisfy liquidity demands and other factors. These securities are reported at fair value with aggregate, unrealized gains or losses excluded from income and included as a separate component of shareholders’ equity, net of related income taxes.

The debt securities in the Company’s investment portfolio are comprised primarily of Mortgage-backed securities, U.S. Government Agencies and high grade municipals. All of the Mortgage-backed securities are issued by government-sponsored entities.

During 2007 impairment losses of $1.7 million were recorded on a strategic investment made over time in the equity securities of another bank holding company. Over the past eighteen months the market value of bank stocks in general, and this investment specifically, have declined. In Management’s opinion these industry and company trends may continue for an undetermined period of time, resulting in “other than temporary” impairment.

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Investment Portfolio

The following table summarizes the balances and distributions of the investment securities held on the dates indicated.

December 31: (in thousands)	Available for Sale 2007	Held to Maturity 2007	Available for Sale 2006	Held to Maturity 2006	Available for Sale 2005	Held to Maturity 2005
U. S. Agency	$ -	$ 30,435	$ -	$ 30,539	$ 29,926	$ 30,644
Municipal	9,979	66,375	11,274	69,910	15,576	66,260
Mortgage-backed Securities	126,144	6,731	109,385	8,677	106,433	10,881
Other	5,920	2,053	11,968	2,114	6,094	2,126
Total Book Value	$ 142,043	$ 105,594	$ 132,627	$ 111,240	$ 158,029	$ 109,911
Fair Value	$ 142,043	$ 106,253	$ 132,627	$ 110,132	$ 158,029	$ 108,060

Analysis of Investment Securities Available-for-Sale

The following table is a summary of the relative maturities and yields of the Company's investment securities Available-for-Sale as of December 31, 2007. Non-taxable municipal securities have been calculated on a fully taxable equivalent basis.

December 31, 2007 (in thousands)	Fair Value	Average Yield
Municipal - Non-Taxable		
One year or less	$ 2,440	6.28%
After one year through five years	3,693	7.09%
After ten years	3,846	8.62%
Total Non-Taxable Municipal Securities	9,979	7.48%
Mortgage-backed Securities		
After five years through ten years	1,561	4.70%
After ten years	124,583	5.25%
Total Mortgage-backed Securities	126,144	5.24%
Other		
One year or less	5,920	4.15%
Total Investment Securities Available for Sale	$ 142,043	5.35%

Note: The average yield for floating rate securities is calculated using the current stated yield.

Analysis of Investment Securities Held-to-Maturity

The following table is a summary of the relative maturities and yields of the Company's investment securities Held-to-Maturity as of December 31, 2007. Non-taxable municipal securities have been calculated on a fully taxable equivalent basis.

December 31, 2007 (in thousands)	Book Value	Average Yield
U.S. Agency		
After one year through five years	$ 30,435	4.20%
Municipal - Non-Taxable		
One year or less	5,340	4.81%
After one year through five years	4,148	4.90%
After five years through ten years	16,277	5.52%
After ten years	40,610	6.21%
Total Non-Taxable Municipal Securities	66,375	5.85%

Mortgage-backed Securities		
After one year through five years	6,731	3.89%
Other		
After five years through ten years	72	9.13%
After ten years	1,981	2.55%
Total Other Securities	2,053	2.78%
Total Investment Securities Held-to-Maturity	$ 105,594	5.19%

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Loans

The Company's loan portfolio at December 31, 2007, increased $94.0 million or 9.0% from December 31, 2006. The increase was due to continuing strong loan demand in the Company's market area, along with a focused calling program on selected loan prospects. Most of the current year's growth occurred in Agricultural Loans, Commercial Real Estate Loans (primarily those secured by production agricultural properties) and Commercial Loans, market segments where the Company believes that current market rates and/or credit risks are more reasonable than in the areas of Consumer, Home Equity and Real Estate Construction loans.

Beginning in late 2006 and continuing into 2007 the Company purposely reduced its exposure to Real Estate Construction Loans as the residential housing market softened. Additionally, the Company's Residential 1st Mortgage portfolio is comprised primarily of 15 and 20 year mortgages to local customers. The Company does not originate sub-prime residential mortgage loans, nor does it hold any in its loan portfolio.

On an average balance basis, loans have increased $91.6 million or 9.2%. In 2006 average balances increased 10.5% or $94.8 million from the prior year. The following table sets forth the distribution of the loan portfolio by type and percent as of December 31st of the years indicated.

	2007		2006		2005		2004		2003	
(in thousands)	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Commercial Real Estate	$ 453,815	39.7%	$ 410,458	39.1%	$ 324,609	33.3%	$ 328,012	37.7%	$ 316,708	39.1%
Real Estate Construction	80,651	7.1%	95,378	9.1%	110,235	11.3%	62,446	7.2%	77,115	9.5%
Residential 1st Mortgages	109,764	9.6%	106,148	10.1%	107,769	11.0%	103,734	11.9%	70,027	8.7%
Home Equity Lines and Loans	65,953	5.8%	67,132	6.4%	69,013	7.1%	63,782	7.3%	55,827	6.9%
Agricultural	215,798	18.9%	183,589	17.5%	170,657	17.5%	151,002	17.4%	134,862	16.7%
Commercial	197,108	17.2%	165,412	15.8%	174,530	17.9%	142,133	16.4%	136,955	16.9%
Consumer	12,706	1.1%	13,949	1.3%	12,653	1.3%	11,933	1.4%	11,979	1.5%
Credit Card	5,499	0.5%	5,543	0.5%	5,353	0.5%	5,021	0.6%	4,549	0.6%
Other	1,856	0.2%	1,730	0.2%	952	0.1%	1,019	0.1%	976	0.1%
Total Loans	1,143,150	100.0%	1,049,339	100.0%	975,771	100.0%	869,082	100.0%	808,998	100.0%
Less:										
Unearned Income	2,181		2,427		2,514		2,174		2,092	
Allowance for Loan Losses	18,483		18,099		17,860		17,727		17,220	
Loans, Net	$ 1,122,486		$ 1,028,813		$ 955,397		$ 849,181		$ 789,686	

There were no concentrations of loans exceeding 10% of total loans which were not otherwise disclosed as a category of loans in the above table.

The following table shows the maturity distribution and interest rate sensitivity of the loan portfolio of the Company on December 31, 2007.

(in thousands)	One Year or Less	Over One Year to Five Years	Over Five Years	Total
Commercial Real Estate	$ 30,173	$ 72,321	$ 351,321	$ 453,815
Real Estate Construction	54,299	19,119	7,233	80,651
Residential 1st Mortgages	3,503	3,798	102,463	109,764
Home Equity Lines and Loans	14	195	65,744	65,953
Agricultural	105,889	96,790	13,119	215,798
Commercial	87,785	89,910	19,413	197,108
Consumer, Credit Card & Other	7,610	10,906	1,545	20,061
Total	$ 289,273	$ 293,039	$ 560,838	$ 1,143,150
Rate Sensitivity:				
Predetermined Rate	$ 229,706	$ 181,934	$ 369,617	$ 781,257
Floating Rate	59,567	111,104	191,222	361,893
Total	$ 289,273	$ 293,038	$ 560,839	$ 1,143,150
Percent	25.30%	25.63%	49.06%	100.00%

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In the ordinary course of business, the Company enters into commitments to extend credit to its customers. These commitments are not reflected in the accompanying consolidated financial statements. As of December 31, 2007, the Company had entered into loan commitments amounting to $440.2 million compared to $442.5 million at December 31, 2006. In addition, letters of credit issued by the Company to guarantee the performance of a customer to a third party at December 31, 2007, and December 31, 2006, were $8.4 million and $10.9 million, respectively.

Non-Performing Assets

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is generally discontinued either when: (1) a loan becomes contractually past due by 90 days or more with respect to interest or principal; or (2) the loan is considered by management to be impaired because it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When loans are 90 days past due, but in Management's judgment are well secured and in the process of collection, they may not be classified as non-accrual. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable.

Interest income on non-accrual loans which would have been recognized during the year ended December 31, 2007, if all such loans had been current in accordance with their original terms, totaled $31,000.

Loans where the collateral has been repossessed are classified as other real estate owned ("OREO") or, if the collateral is personal property, the loan is classified as other assets on the Company's financial statements.

The following table sets forth the amount of the Company's non-performing assets as of the dates indicated:

			December 31,		
(in thousands)	2007	2006	2005	2004	2003
Non-Accrual Loans					
Commercial Real Estate	$ -	$ 3	$ 277	$ 214	$ 1,454
Real Estate Construction	-	-	-	-	-
Residential 1st Mortgages	-	-	-	-	-
Home Equity Lines and Loans	-	-	94	-	31
Agricultural	-	-	93	-	185
Commercial	179	36	142	-	516
Consumer	6	-	-	-	181
Credit Card	-	-	-	-	-
Other	1	-	-	-	-
Total Non-Accrual Loans	186	39	606	214	2,367
Accruing Loans Past Due 90 Days or More					
Commercial Real Estate	-	-	66	-	139
Real Estate Construction	-	-	-	-	-
Residential 1st Mortgages	-	-	-	-	-
Home Equity Lines and Loans	-	-	-	-	-
Agricultural	-	-	-	-	-
Commercial	-	-	-	-	41
Consumer	-	-	-	-	-
Credit Card	17	15	22	11	37
Other	-	-	-	-	-
	17	15	88	11	217

Total Accruing Loans Past Due 90 Days or More										
Total Non-Performing Loans	$	203	$	54	$	694	$	225	$	2,584
Other Real Estate Owned	$	251	$	-	$	-	$	-	$	-
Non-Performing Loans as a Percent of Total Loans		0.02%		0.01%		0.07%		0.03%		0.32%
Allowance for Loan Losses as a Percent of Total Non-Performing Loans		9104.93%		33516.67%		2573.49%		7878.67%		666.41%

Although management believes that non-performing loans are generally well-secured and that potential losses are provided for in the Company's allowance for loan losses, there can be no assurance that future deterioration in economic conditions or collateral values will not result in future credit losses.

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Deposits
One of the key sources of funds to support earning assets is the generation of deposits from the Company's customer base. The ability to grow the customer base and subsequently deposits is a significant element in the performance of the Company.

The Company saw an overall increase in deposit growth during 2007 along with a continuing shift in the mix of deposits to higher yielding Time Deposits as customers sought to maximize the interest earned on their deposit balances.

The following table sets forth, by time remaining to maturity, the Company's time deposits in amounts of $100,000 or more at December 31, 2007.

(in thousands)		December 31, 2007
Time Deposits of $100,000 or More		
Three Months or Less	$	211,443
Over Three Months Through Six Months		135,866
Over Six Months Through Twelve Months		36,678
Over Twelve Months		4,304
Total Time Deposits of $100,000 or More	$	388,291

Refer to the Year-to-Date Average Balances and Rate Schedules located on this "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for information on separate deposit categories.

At December 31, 2007, deposits totaled $1.3 billion. This represents an increase of 9.4% or $112.3 million from December 31, 2006. Core deposits (exclusive of Public Time Deposits) increased 8.8% over the same period. Public Time Deposits totaled $144.3 million at December 31, 2007, an increase of $17.7 million since December 31, 2006, primarily because of the Company's decision to increase its use of State of California time deposits for short-term funding needs instead of using FHLB Advances (see "Federal Home Loan Bank Advances").

The primary area of deposit growth in 2007 has been in Time deposits as customers have moved deposit balances from low or non-interest bearing accounts to higher-yielding Time deposits. Overall, Time deposits grew $63.6 million or 12.7% from December 31, 2006. However, as a result of a focused calling program on selected deposit prospects, the Company has also experienced growth in Demand, Interest Bearing Transaction and Savings deposits in the amount of $48.6 million or 6.9% since December 31, 2006.

Federal Home Loan Bank Advances
Advances from the Federal Home Loan Bank are another key source of funds to support earning assets. These advances are also used to manage the Bank's interest rate risk exposure, and as opportunities exist to borrow and invest the proceeds at a positive spread through the investment portfolio. FHLB advances as of December 31, 2007, were $28.9 million compared to $47.5 million as of December 31, 2006. This decrease of $18.6 million in borrowings occurred as a result of the Company's management of its liquidity needs using State of California Time deposits (a strategy which it first implemented in 2006) which generally have rates from 20 to 30 basis points lower than FHLB advances. The average rate on FHLB advances during 2007 was 5.3% compared to 5.2% in 2006.

Subordinated Debentures
On December 17, 2003, the Company raised $10 million through an offering of trust preferred securities. See Note 17 located in "Item 8. Financial Statements and Supplementary Data." Although this amount is reflected as subordinated debt on the Company's balance sheet, under applicable regulatory guidelines, trust preferred securities qualify as regulatory capital. See "Capital." These securities accrue interest at a variable rate based upon 3-month LIBOR plus

2.85%. Interest rates reset quarterly (the next reset is March 16, 2008) and the rate was 7.84% as of December 31, 2007. The average rate paid for these securities in 2007 was 8.42% compared to 8.02% in 2006. Additionally, if the Company decided to defer interest on the subordinated debentures, the Company would be prohibited from paying cash dividends on the Company's common stock.

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Capital

The Company relies primarily on capital generated through the retention of earnings to satisfy its capital requirements. The Company engages in an ongoing assessment of its capital needs in order to support business growth and to insure depositor protection. Shareholders' Equity totaled $143.4 million at December 31, 2007, and $132.3 million at the end of 2006.

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of Total and Tier 1 capital to risk-weighted assets (as defined in the regulations), and of Tier 1 capital to average assets (as defined in the regulations). Management believes, as of December 31, 2007, that the Company and the Bank meet all capital adequacy requirements to which they are subject. For further information on the Company and the Bank's risk-based capital ratios, see Note 10 located in "Item 8. Financial Statements and Supplementary Data."

As previously discussed (see "Subordinated Debentures"), in order to supplement its regulatory capital base, during December 2003 the Company issued $10 million of trust preferred securities. See Note 17 located in "Item 8. Financial Statements and Supplementary Data." On March 1, 2005, the Federal Reserve Board issued its final rule effective April 11, 2005, concerning the regulatory capital treatment of trust preferred securities ("TPS") by bank holding companies ("BHCs"). Under the final rule BHCs may include TPS in Tier 1 capital in an amount equal to 25% of the sum of core capital net of goodwill. The quantitative limitation concerning goodwill will not be effective until March 31, 2009. Any portion of trust preferred securities not qualifying as Tier 1 capital would qualify as Tier 2 capital subject to certain limitations. The Company has received notification from the Federal Reserve Bank of San Francisco that all of the Company's trust preferred securities currently qualify as Tier 1 capital.

In accordance with the provisions of Financial Accounting Standard Board Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), the Company does not consolidate the subsidiary trust which has issued the trust preferred securities.

In 1998, the Board approved the Company's first stock repurchase program. During the second quarter of 2004, the Board approved a second stock repurchase program because it concluded that the Company continued to have more capital than it needed to meet present and anticipated regulatory guidelines for the Bank to be classified as "well capitalized."

On April 4, 2006, the Board unanimously approved expanding the repurchase program to allow the repurchase of up to $15 million of stock through April 30, 2009. Repurchases under the program will continue to be made on the open market or through private transactions. The repurchase program also requires that no purchases may be made if the Bank would not remain "well-capitalized" after the repurchase. All shares repurchased under the repurchase program will be retired. See Part II, "Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities."

During 2007 the Company repurchased 11,821 shares at an average share price of $460 per share. In 2006 the Company repurchased 11,718 shares at an average share price of $507. Since the second share repurchase program was expanded in 2006 the Company has repurchased over 20,000 shares for total consideration of $9.7 million.

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Critical Accounting Policies and Estimates

This "Management's Discussion and Analysis of Financial Condition and Results of Operations," is based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. In preparing the Company's financial statements management makes estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Management believes that the most significant subjective judgments that it makes include the following:

- Allowance for Loan Losses. As a financial institution which assumes lending and credit risks as a principle element in its business, the Company anticipates that credit losses will be experienced in the normal course of business. Accordingly, the allowance for loan losses is maintained at a level considered adequate by management to provide for losses that are inherent in the portfolio. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. Management employs a systematic methodology for determining the allowance for loan losses. On a quarterly basis, management reviews the credit quality of the loan portfolio and considers problem loans, delinquencies, internal credit reviews, current economic conditions, loan loss experience and other factors in determining the adequacy of the allowance balance.

While the Company utilizes a systematic methodology in determining its allowance, the allowance is based on estimates, and ultimate losses may vary from current estimates. The estimates are reviewed periodically and, as adjustments become necessary, are reported in earnings in the periods in which they become known. For additional information, see Note 3 located in "Item 8. Financial Statements and Supplementary Data."

- Fair Value. The Company discloses the fair value of financial instruments and the methods and significant assumptions used to estimate those fair values. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. The use of assumptions and various valuation techniques, as well as the absence of secondary markets for certain financial instruments, will likely reduce the comparability of fair value disclosures between financial institutions. In some cases, book value is a reasonable estimate of fair value due to the relatively short period of time between origination of the instrument and its expected realization. For additional information, see "Item 7A. Quantitative and Qualitative Disclosures About Market Risk – Credit Risk" and Note 12 located in "Item 8. Financial Statements and Supplementary Data."

- Income Taxes. The Company uses the liability method of accounting for income taxes. This method results in the recognition of deferred tax assets and liabilities that are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The deferred provision for income taxes is the result of the net change in the deferred tax asset and deferred tax liability balances during the year. This amount combined with the current taxes payable or refundable results in the income tax expense for the current year.

On January 1, 2007, the Company adopted Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes ("FIN 48")." The adoption of FIN 48 did not have a material impact on the Company's financial position, results of operations or cash flows. For additional information, see Note 1 and Note 7 located in "Item 8. Financial Statements and Supplementary Data."

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations and Commitments

Off-balance sheet arrangements are any contractual arrangement to which an unconsolidated entity is a party, under which the Company has: (1) any obligation under a guarantee contract; (2) a retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets; (3) any obligation under certain derivative instruments; or (4) any obligation under a material variable interest held by us in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the Company, or engages in leasing, hedging or research and development services with the Company.

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Our most significant off-balance sheet arrangements are limited to: (1) the full and unconditional payment guarantee of accrued distributions relating to $10 million of Trust Preferred Securities issued by FMCB Statutory Trust (see Note 17 located in “Item 8. Financial Statements and Supplementary Data”); (2) derivative instruments indexed to the Prime Rate (see Note 13 located in “Item 8. Financial Statements and Supplementary Data”); (3) obligations under guarantee contracts such as financial and performance standby letters of credit for our credit customers (see Note 14 located in “Item 8. Financial Statements and Supplementary Data”); (4) unfunded commitments to lend (see Note 14 located in “Item 8. Financial Statements and Supplementary Data”); and (5) lease contracts (see Note 14 located in “Item 8. Financial Statements and Supplementary Data”). It is our belief that none of these arrangements expose us to any greater risk of loss than is already reflected on our balance sheet. We do not have any off-balance sheet arrangements in which we have any retained or contingent interest (as we do not transfer or sell our assets to entities in which we have a continuing involvement), any exposure to derivative instruments that are indexed to stock indices nor any variable interests in any unconsolidated entity to which we may be a party.

The following table presents, as of December 31, 2007, our significant and determinable contractual obligations by payment date. The payment amounts represent those amounts contractually due to the recipient and do not include any unamortized premiums or discount, hedge basis adjustments or other similar carrying value adjustments. For further information on the nature of each obligation type, see applicable note disclosure located in “Item 8. Financial Statements and Supplementary Data.”

Payments Due By Period
(in thousands)

Contractual Obligations	Total	1 Year or Less	2-3 Years	4-5 Years	More Than 5 Years
Operating Lease Obligations	$ 2,385	$ 447	$ 742	$ 527	$ 669
FHLB Advances	28,954	28,200	-	-	754
Long-Term Subordinated Debentures	10,310	-	-	-	10,310
Deferred Compensation (1)	14,106	503	332	425	12,846
Total	$ 55,755	$ 29,150	$ 1,074	$ 952	$ 24,579

(1) These amounts represent payments to participants under the Company's non-qualified deferred compensation and supplemental retirement plans. See Note 11 located in “Item 8. Financial Statements and Supplementary Data.”

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Risk Management

The Company has adopted a Risk Management Plan, which aims to ensure the proper control and management of all risk factors inherent in the operation of the Company. Specifically, credit risk, interest rate risk, liquidity risk, compliance risk, strategic risk, reputation risk and price risk can all affect the market risk of the Company. These specific risk factors are not mutually exclusive. It is recognized that any product or service offered by the Company may expose the Company to one or more of these risk factors.

Credit Risk

Credit risk is the risk to earnings or capital arising from an obligor’s failure to meet the terms of any contract or otherwise fail to perform as agreed. Credit risk is found in all activities where success depends on counterparty, issuer or borrower performance.

Credit risk in the investment portfolio and correspondent bank accounts is addressed through defined limits in the Company's policy statements. In addition, certain securities carry insurance to enhance credit quality of the bond.

Credit risk in the loan portfolio is controlled by limits on industry concentration, aggregate customer borrowings and geographic boundaries. Standards on loan quality also are designed to reduce loan credit risk. Senior Management, Directors' Committees, and the Board of Directors are regularly provided with information intended to identify, measure, control and monitor the credit risk of the Company.

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The Company's methodology for assessing the appropriateness of the allowance is applied on a regular basis and considers all loans. The systematic methodology consists of two major elements. The first major element includes a detailed analysis of the loan portfolio in two phases. The first phase is conducted in accordance with SFAS No. 114, "Accounting by Creditors for the Impairment of a Loan" as amended by SFAS No. 118, "Accounting by Creditors for Impairment of a Loan — Income Recognition and Disclosures." Individual loans are reviewed to identify loans for impairment. A loan is impaired when principal and interest are deemed uncollectible in accordance with the original contractual terms of the loan. Impairment is measured as either the expected future cash flows discounted at each loan's effective interest rate, the fair value of the loan's collateral if the loan is collateral dependent, or an observable market price of the loan (if one exists). Upon measuring the impairment, the Company will ensure an appropriate level of allowance is present or established.

Central to the first phase and the Company's credit risk management is its loan risk rating system. The originating credit officer assigns borrowers an initial risk rating, which is based primarily on a thorough analysis of each borrower's financial position in conjunction with industry and economic trends. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by senior credit administration personnel. Credits are monitored by credit administration personnel for deterioration in a borrower's financial condition, which would impact the ability of the borrower to perform under the contract. Risk ratings are adjusted as necessary.

Based on the risk rating system, specific allowances are established in cases where management has identified significant conditions or circumstances related to a credit that management believes indicates the possibility of loss. Management performs a detailed analysis of these loans, including, but not limited to, cash flows, appraisals of the collateral, conditions of the marketplace for liquidating the collateral and assessment of the guarantors. Management then determines the inherent loss potential and allocates a portion of the allowance for losses as a specific allowance for each of these credits.

The second phase is conducted by segmenting the loan portfolio by risk rating and into groups of loans with similar characteristics in accordance with SFAS No. 5, "Accounting for Contingencies". In this second phase, groups of loans are reviewed and applied the appropriate allowance percentage to determine a portfolio formula allowance.

The second major element of the analysis, which considers all known relevant internal and external factors that may affect a loan's collectibility, is based upon management's evaluation of various conditions, the effects of which are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments. The conditions evaluated in connection with the second element of the analysis of the allowance include, but are not limited to the following conditions that existed as of the balance sheet date:

- then-existing general economic and business conditions affecting the key lending areas of the Company;
- credit quality trends (including trends in non-performing loans expected to result from existing conditions);
- collateral values;
- loan volumes and concentrations;
- seasoning of the loan portfolio;
- specific industry conditions within portfolio segments;
- recent loss experience within portfolio segments;
- duration of the current business cycle;
- bank regulatory examination results; and
- findings of the Company's internal credit examiners.

Management reviews these conditions in discussion with the Company's senior credit officers. To the extent that any of these conditions are evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management's estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management's evaluation of the inherent loss related to such condition is reflected in the second major element allowance.

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Implicit in lending activities is the risk that losses will and do occur and that the amount of such losses will vary over time. Consequently, the Company maintains an allowance for loan losses by charging a provision for loan losses to earnings. Loans determined to be losses are charged against the allowance for loan losses. The Company's allowance for loan losses is maintained at a level considered by management to be adequate to provide for estimated losses inherent in the existing portfolio.

Management believes that the allowance for loan losses at December 31, 2007, was adequate to provide for both recognized losses and estimated inherent losses in the portfolio. No assurances can be given that future events may not result in increases in delinquencies, non-performing loans or net loan charge-offs that would increase the provision for loan losses and thereby adversely affect the results of operations.

Interest Rate Risk

The mismatch between maturities of interest sensitive assets and liabilities results in uncertainty in the Company's earnings and economic value and is referred to as interest rate risk. The Company does not attempt to predict interest rates and positions the balance sheet in a manner which seeks to minimize, to the extent possible, the effects of changing interest rates.

The Company measures interest rate risk in terms of potential impact on both its economic value and earnings. The methods for governing the amount of interest rate risk include: (1) analysis of asset and liability mismatches (GAP analysis); (2) the utilization of a simulation model; and (3) limits on maturities of investment, loan and deposit products which reduces the market volatility of those instruments.

The Gap analysis measures, at specific time intervals, the divergence between earning assets and interest bearing liabilities for which repricing opportunities will occur. A positive difference, or Gap, indicates that earning assets will reprice faster than interest-bearing liabilities. This will generally produce a greater net interest margin during periods of rising interest rates and a lower net interest margin during periods of declining interest rates. Conversely, a negative Gap will generally produce a lower net interest margin during periods of rising interest rates and a greater net interest margin during periods of decreasing interest rates.

The interest rates paid on deposit accounts do not always move in unison with the rates charged on loans. In addition, the magnitude of changes in the rates charged on loans is not always proportionate to the magnitude of changes in the rate paid for deposits. Consequently, changes in interest rates do not necessarily result in an increase or decrease in the net interest margin solely as a result of the differences between repricing opportunities of earning assets or interest bearing liabilities.

The Company also utilizes the results of a dynamic simulation model to quantify the estimated exposure of net interest income to sustained interest rate changes. The sensitivity of the Company's net interest income is measured over a rolling one-year horizon.

The simulation model estimates the impact of changing interest rates on interest income from all interest earning assets and the interest expense paid on all interest bearing liabilities reflected on the Company's balance sheet. This sensitivity analysis is compared to policy limits, which specify a maximum tolerance level for net interest income exposure over a one-year horizon assuming no balance sheet growth, given a 200 basis point upward and a 200 basis point downward shift in interest rates. A shift in rates over a 12-month period is assumed. Results that exceed policy limits, if any, are analyzed for risk tolerance and reported to the Board with appropriate recommendations. At December 31, 2007, the Company's estimated net interest income sensitivity to changes in interest rates, as a percent of net interest income was a decrease in net interest income of 0.40% if rates increase by 200 basis points and an increase in net interest income of 0.90% if rates decline 200 basis points.

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The estimated sensitivity does not necessarily represent a Company forecast and the results may not be indicative of actual changes to the Company's net interest income. These estimates are based upon a number of assumptions including: the nature and timing of interest rate levels including yield curve shape; prepayments on loans and securities; pricing strategies on loans and deposits; replacement of asset and liability cash flows; and other assumptions. While the assumptions used are based on current economic and local market conditions, there is no assurance as to the predictive nature of these conditions including how customer preferences or competitor influences might change.

Liquidity Risk

Liquidity risk is the risk to earnings or capital resulting from the Company's inability to meet its obligations when they come due without incurring unacceptable losses. It includes the ability to manage unplanned decreases or changes in funding sources and to recognize or address changes in market conditions that affect the Company's ability to liquidate assets or acquire funds quickly and with minimum loss of value. The Company endeavors to maintain a cash flow adequate to fund operations, handle fluctuations in deposit levels, respond to the credit needs of borrowers and to take advantage of investment opportunities as they arise. The principal sources of liquidity include credit facilities from correspondent banks, brokerage firms and the Federal Home Loan Bank, as well as interest and principal payments on loans and investments, proceeds from the maturity or sale of investments, and growth in deposits.

In general, liquidity risk is managed daily by controlling the level of Federal Funds and the use of funds provided by the cash flow from the investment portfolio. The Company maintains overnight investments in Federal Funds as a cushion for temporary liquidity needs. During 2007 Federal Funds Sold averaged $10.4 million. The Company maintains Federal Funds credit lines of $99 million with major banks subject to the customary terms and conditions for such arrangements and $150 million in repurchase lines with major brokers. In addition, the Company has additional borrowing capacity of $196.4 million from the Federal Home Loan Bank.

At December 31, 2007, the Company had available sources of liquidity, which included cash and cash equivalents and unpledged investment securities of approximately $65.9 million, which represents 4.3% of total assets.

Item 8. Financial Statements and Supplementary Data

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
AND FINANCIAL STATEMENT SCHEDULES

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Farmers & Merchants Bancorp

Report of Management on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting at Farmers & Merchants Bancorp ("the Company"). Internal control over financial reporting includes controls over the preparation of financial statements in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C) to comply with the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act ("FDICIA").

Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2007, based on criteria described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that assessment, management concluded that the Company maintained effective internal control over financial reporting as of December 31, 2007.

Perry-Smith LLP, the independent registered public accounting firm that audited the financial statements included in this Annual Report has issued an attestation report on the Company's internal control over financial reporting.

/s/ Kent A. Steinwert	/s/ Stephen W. Haley
Kent A. Steinwert President & Chief Executive Officer	Stephen W. Haley Executive Vice President & Chief Financial Officer

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Shareholders and Board of Directors
Farmers & Merchants Bancorp
Lodi, California

We have audited the accompanying consolidated balance sheet of Farmers & Merchants Bancorp and subsidiaries (the "Company") as of December 31, 2007, and 2006 and the related consolidated statements of income, changes in shareholders' equity, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2007. We also have audited the Company's internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
(Continued)

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Management’s assessment and our audit of internal control over financial reporting included controls over the Company’s preparation of financial statements in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y9C) to comply with the requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA). A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Farmers & Merchants Bancorp and subsidiaries as of December 31, 2007, and 2006 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, Farmers & Merchants Bancorp and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

/s/ Perry-Smith LLP

Sacramento, California
March 4, 2008

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Farmers & Merchants Bancorp
Consolidated Statement of Income

(in thousands except per share data)

	Year Ended December 31, 2007	2006	2005
Interest Income			
Interest and Fees on Loans	$ 84,081	$ 76,872	$ 61,838
Interest on Federal Funds Sold and Securities Purchased Under Agreements to Resell	538	49	188
Interest on Investment Securities:			
Taxable	7,920	8,184	7,217
Exempt from Federal Tax	3,236	3,291	3,215
Total Interest Income	95,775	88,396	72,458
Interest Expense			
Deposits	29,960	18,630	9,828
Borrowed Funds	1,397	5,164	3,561
Subordinated Debentures	868	827	643
Total Interest Expense	32,225	24,621	14,032
Net Interest Income	63,550	63,775	58,426
Provision for Loan Losses	1,495	275	425
Net Interest Income After Provision for Loan Losses	62,055	63,500	58,001
Non-Interest Income			
Service Charges on Deposit Accounts	7,287	6,046	4,364
Net Loss on Investment Securities	(1,707)	(2,168)	(953)
Credit Card Merchant Fees	2,181	2,124	2,039
Increase in Cash Surrender Value of Life Insurance	1,737	1,645	1,563
ATM Fees	1,376	1,202	991
Other	4,581	3,214	3,270
Total Non-Interest Income	15,455	12,063	11,274
Non-Interest Expense			
Salaries and Employee Benefits	27,364	27,820	26,773
Occupancy	2,559	2,455	2,073
Equipment	2,875	3,218	2,509
Credit Card Merchant Expense	1,640	1,569	1,458
Marketing	463	1,167	1,522
Other	7,044	6,892	6,282
Total Non-Interest Expense	41,945	43,121	40,617
Income Before Income Taxes	35,565	32,442	28,658
Provision for Income Taxes	12,870	11,813	10,230
Net Income	$ 22,695	$ 20,629	$ 18,428
Earnings Per Share	$ 28.05	$ 25.25	$ 22.24

The accompanying notes are an integral part of these consolidated financial statements

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Farmers & Merchants Bancorp
Consolidated Balance Sheet

(in thousands except share data)

	December 31, 2007	December 31, 2006
Assets		
Cash and Cash Equivalents:		
Cash and Due from Banks	$ 50,240	$ 47,006
Federal Funds Sold and Securities Purchased Under Agreements to Resell	1,150	-
Total Cash and Cash Equivalents	51,390	47,006
Investment Securities:		
Available-for-Sale	142,043	132,627
Held-to-Maturity	105,594	111,240
Total Investment Securities	247,637	243,867
Loans:	1,140,969	1,046,912
Less: Allowance for Loan Losses	18,483	18,099
Loans, Net	1,122,486	1,028,813
Premises and Equipment, Net	20,188	20,496
Bank Owned Life Insurance	40,180	38,444
Interest Receivable and Other Assets	37,291	32,607
Total Assets	$ 1,519,172	$ 1,411,233
Liabilities		
Deposits:		
Demand	$ 307,299	$ 295,142
Interest-Bearing Transaction	138,665	132,875
Savings	301,678	271,019
Time	563,148	499,492
Total Deposits	1,310,790	1,198,528
Federal Home Loan Bank Advances	28,954	47,532
Subordinated Debentures	10,310	10,310
Interest Payable and Other Liabilities	25,700	22,523
Total Liabilities	1,375,754	1,278,893
Commitments & Contingencies (See Note 14)		
Shareholders' Equity		
Preferred Stock: No Par Value. 1,000,000 Authorized, None Issued or Outstanding	-	-
Common Stock: Par Value $0.01, 20,000,000 Shares Authorized, 800,112 and 811,933 Issued and Outstanding at December 31, 2007 and 2006, respectively	8	8
Additional Paid-In Capital	84,437	89,926
Retained Earnings	57,990	43,126
Accumulated Other Comprehensive Gain (Loss)	983	(720)
Total Shareholders' Equity	143,418	132,340

Total Liabilities and Shareholders' Equity	$ 1,519,172	$ 1,411,233

The accompanying notes are an integral part of these consolidated financial statements

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Farmers & Merchants Bancorp
Consolidated Statement of Changes in Shareholders' Equity

(in thousands except share and per share data)

	Common Shares Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Gain (Loss)	Total Shareholders' Equity
Balance, December 31, 2004	792,722	$ 8	$ 82,237	$ 35,332	$ (1,030)	$ 116,547
Net Income				18,428		18,428
Cash Dividends Declared on Common Stock ($7.68 per share)				(6,366)		(6,366)
5% Stock Dividend	38,995		17,641	(17,641)		-
Cash Paid in Lieu of Fractional Shares Related to Stock Dividend				(290)		(290)
Repurchase of Stock	(8,066)		(4,016)			(4,016)
Change in Net Unrealized Gains on Derivative Instruments					(14)	(14)
Minimum Pension Plan Liability Adjustment					1,018	1,018
Change in Net Unrealized Loss on Securities Available-for-Sale					(1,659)	(1,659)
Balance, December 31, 2005	823,651	8	95,862	29,463	(1,685)	123,648
Net Income				20,629		20,629
Cash Dividends Declared on Common Stock ($8.55 per share)				(6,966)		(6,966)
Repurchase of Stock	(11,718)		(5,936)			(5,936)
Change in Net Unrealized Gains on Derivative Instruments					(7)	(7)
Change in Net Unrealized Loss on Securities Available-for-Sale					972	972
Balance, December 31, 2006	811,933	8	89,926	43,126	(720)	132,340
Net Income				22,695		22,695
Cash Dividends Declared on Common Stock ($9.70 per share)				(7,831)		(7,831)
Repurchase of Stock	(11,821)		(5,489)			(5,489)
Change in Net Unrealized Gains on Derivative Instruments					2	2
					1,701	1,701

Change in Net Unrealized Loss on Securities Available-for-Sale										
Balance, December 31, 2007	800,112	$	8	$	84,437	$	57,990	$	983	$ 143,418

The accompanying notes are an integral part of these consolidated financial statements

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Farmers & Merchants Bancorp
Consolidated Statement of Comprehensive Income

(in thousands)

	Year Ended December 31, 2007	2006	2005
Net Income	$ 22,695	$ 20,629	$ 18,428
Other Comprehensive Income (Loss)			
Unrealized Gains (Losses) on Derivative Instruments:			
Unrealized holding gains arising during the period, net of income tax effects of $0, $0 and $0 for the years ended December 31, 2007, 2006 and 2005, respectively.	-	-	-
Less: Reclassification adjustment for realized gains included in net income, net of related income tax effects of $1, $(6) and $(10) for the years ended December 31, 2007, 2006 and 2005, respectively.	2	(7)	(14)
Unrealized Gains on Minimum Pension Liability Adjustment:			
Unrealized gains arising during the period, net of income tax effects of $738 for the year ended December 31, 2005.	-	-	1,018
Unrealized Gains (Losses) on Securities:			
Unrealized holding gains (losses) arising during the period, net of income tax effects of $517, $(206), and $(1,605) for the years ended December 31, 2007, 2006 and 2005, respectively.	712	(284)	(2,211)
Less: Reclassification adjustment for realized losses included in net income, net of related income tax effects of $718, $912, and $401 for the years ended December 31, 2007, 2006 and 2005, respectively.	989	1,256	552
Total Other Comprehensive Income (Loss)	1,703	965	(655)
Comprehensive Income	$ 24,398	$ 21,594	$ 17,773

The accompanying notes are an integral part of these consolidated financial statements

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Farmers & Merchants Bancorp
Consolidated Statement of Cash Flows

(in thousands)

	Year Ended December 31, 2007	2006	2005
Operating Activities			
Net Income	$ 22,695	$ 20,629	$ 18,428
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Provision for Loan Losses	1,495	275	425
Depreciation and Amortization	1,933	1,892	1,611
Provision for Deferred Income Taxes	(2,316)	(1,169)	(1,874)
Net Amortization (Accretion) of Investment Security Premium & Discounts	213	(166)	602
Net Loss on Investment Securities	1,707	2,168	953
Net Gain on Sale of Property & Equipment	(12)	(6)	(1)
Net Change in Operating Assets & Liabilities:			
Net Increase in Interest Receivable and Other Assets	(5,338)	(9,133)	(2,846)
Net Increase (Decrease) in Interest Payable and Other Liabilities	3,177	6,329	(245)
Net Cash Provided by Operating Activities	23,554	20,819	17,053
Investing Activities			
Securities Available-for-Sale:			
Purchased	(43,577)	(72,910)	(70,058)
Sold, Matured or Called	35,254	98,041	93,179
Securities Held-to-Maturity:			
Purchased	(2,424)	(7,347)	(30,622)
Matured or Called	7,994	5,964	10,583
Net Loans Originated or Acquired	(95,430)	(74,494)	(107,216)
Principal Collected on Loans Previously Charged Off	262	803	575
Net Additions to Premises and Equipment	(1,625)	(4,866)	(4,162)
Proceeds from Sale of Property & Equipment	12	6	1
Net Cash Used by Investing Activities	(99,534)	(54,803)	(107,720)
Financing Activities			
Net Increase (Decrease) in Demand, Interest-Bearing Transaction and Savings Deposits	48,606	(48,256)	64,055
Net Increase in Time Deposits	63,656	143,444	37,175
Net (Decrease) Increase in Federal Funds Purchased	-	(650)	650
Net (Decrease) Increase in Federal Home Loan Bank Advances	(18,578)	(51,315)	17,958
Stock Repurchases	(5,489)	(5,936)	(4,016)
Cash Dividends	(7,831)	(6,966)	(6,656)
Net Cash Provided by Financing Activities	80,364	30,321	109,166
(Decrease) Increase in Cash and Cash Equivalents	4,384	(3,663)	18,499
Cash and Cash Equivalents at Beginning of Year	47,006	50,669	32,170
Cash and Cash Equivalents at End of Year	$ 51,390	$ 47,006	$ 50,669
Supplementary Data			
Cash Payments Made for Income Taxes	$ 14,995	$ 12,138	$ 12,900
Interest Paid	$ 31,287	$ 22,857	$ 13,345

The accompanying notes are an integral part of these consolidated financial statements

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Notes to Consolidated Financial Statements

1. Significant Accounting Policies

Farmers & Merchants Bancorp (the Company) was organized March 10, 1999. Primary operations are related to traditional banking activities through its subsidiary Farmers & Merchants Bank of Central California (the Bank) which was established in 1916. The Bank's wholly owned subsidiaries include Farmers & Merchants Investment Corporation and Farmers/Merchants Corp. Farmers & Merchants Investment Corporation has been dormant since 1991. Farmers/Merchants Corp. acts as trustee on deeds of trust originated by the Bank.

The Company's other subsidiaries include F & M Bancorp, Inc. and FMCB Statutory Trust I. F & M Bancorp, Inc. was created in March 2002 to protect the name F & M Bank. During 2002, the Company completed a fictitious name filing in California to begin using the streamlined name, "F & M Bank" as part of a larger effort to enhance the Company's image and build brand name recognition. In December 2003, the Company formed a wholly owned subsidiary, FMCB Statutory Trust I. FMCB Statutory Trust I is a non-consolidated subsidiary per generally accepted accounting principles (GAAP), and was formed for the sole purpose of issuing Trust Preferred Securities. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and prevailing practice within the banking industry. The following is a summary of the significant accounting and reporting policies used in preparing the consolidated financial statements.

Basis of Presentation

The accompanying consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America for financial information and with the instructions to Form 10-K and Article 9 of Regulation S-X.

The accompanying consolidated financial statements include the accounts of the Company and the Company's wholly owned subsidiaries, F & M Bancorp, Inc. and the Bank, along with the Bank's wholly owned subsidiaries, Farmers & Merchants Investment Corporation and Farmers/Merchants Corp. Significant inter-company transactions have been eliminated in consolidation.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Certain amounts in the prior years' financial statements and related footnote disclosures have been reclassified to conform to the current-year presentation. These reclassifications have no effect on previously reported income.

Cash and Cash Equivalents

For purposes of the Consolidated Statement of Cash Flows, the Company has defined cash and cash equivalents as those amounts included in the balance sheet captions Cash and Due from Banks, Federal Funds Sold and Securities Purchased Under Agreements to Resell. Generally, these transactions are for one-day periods. For these instruments, the carrying amount is a reasonable estimate of fair value.

Investment Securities

Investment securities are classified at the time of purchase as held-to-maturity if it is management's intent and the Company has the ability to hold the securities until maturity. These securities are carried at cost, adjusted for amortization of premium and accretion of discount using a level yield of interest over the estimated remaining period until maturity. Losses, reflecting a decline in value judged by the Company to be other than temporary, are recognized in the period in which they occur.

Securities are classified as available-for-sale if it is management's intent, at the time of purchase, to hold the securities for an indefinite period of time and/or to use the securities as part of the Company's asset/liability management strategy. These securities are reported at fair value with aggregate unrealized gains or losses excluded from income and included as a separate component of shareholders' equity, net of related income taxes. Fair values are based on quoted market prices or broker/dealer price quotations on a specific identification basis. Gains or losses on the sale of these securities are computed using the specific identification method.

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Trading securities, if any, are acquired for short-term appreciation and are recorded in a trading portfolio and are carried at fair value, with unrealized gains and losses recorded in non-interest income.

Investment securities are evaluated for impairment on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Loans

Loans are reported at the principal amount outstanding net of unearned discounts and deferred loan fees and costs. Interest income on loans is accrued daily on the outstanding balances using the simple interest method. Loan origination fees are deferred and recognized over the contractual life of the loan as an adjustment to the yield. Loans are placed on non-accrual status when the collection of principal or interest is in doubt or when they become past due for 90 days or more unless they are both well-secured and in the process of collection. For this purpose a loan is considered well-secured if it is collateralized by property having a net realizable value in excess of the amount of the loan or is guaranteed by a financially capable party. When a loan is placed on non-accrual status, the accrued and unpaid interest receivable is reversed and charged against current income; thereafter, interest income is recognized only as it is collected in cash. Loans placed on non-accrual status are returned to accrual status when the loans are paid current as to principal and interest and future payments are expected to be made in accordance with the contractual terms of the loan.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is impaired, the recorded amount of the loan in the Consolidated Balance Sheet is based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the observable or estimated market price of the loan or on the fair value of the collateral if the loan is collateral dependent. Interest income on impaired loans is reported on a cash basis.

Allowance for Loan Losses

As a financial institution which assumes lending and credit risks as a principal element in its business, the Company anticipates that credit losses will be experienced in the normal course of business. Accordingly, the allowance for loan losses is maintained at a level considered adequate by management to provide for losses that are inherent in the portfolio. The allowance is reduced by charge-offs and increased by provisions charged to operating expense and by recoveries on loans previously charged off. Management employs a systematic methodology for determining the allowance for loan losses. On a quarterly basis, management reviews the credit quality of the loan portfolio and considers many factors in determining the adequacy of the allowance at the balance sheet date.

The factors evaluated in connection with the allowance may include existing general economic and business conditions affecting the key lending areas of the Company, current levels of problem loans and delinquencies, credit quality trends, collateral values, loan volumes and concentration, seasoning of the loan portfolio, specific industry conditions, recent loss experience, duration of the current business cycle, bank regulatory examination results and findings of the Company's internal credit examiners.

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The allowance also incorporates the results of measuring impaired loans as provided in Statement of Financial Accounting Standards (SFAS) No. 114, "Accounting by Creditors for Impairment of a Loan" and SFAS No. 118, "Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures." These accounting standards prescribe the measurement methods, income recognition and disclosures related to impaired loans, which are discussed more fully in Note 3 to these Consolidated Financial Statements.

While the Company utilizes a systematic methodology in determining its allowance, the allowance is based on estimates, and ultimate losses may vary from current estimates. In addition, the Federal Deposit Insurance Corporation and the California Department of Financial Institutions, as an integral part of their examination process, review the allowance for loan losses. These agencies may require additions to the allowance for loan losses based on their judgment about information available at the time of their examinations.

Premises and Equipment

Premises, equipment and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation is computed principally by the straight line method over the estimated useful lives of the assets. Estimated useful lives of buildings range from 30 to 40 years, and for furniture and equipment from 3 to 7 years. Leasehold improvements are amortized over the lesser of the terms of the respective leases, or their useful lives, which are generally 5 to 10 years. Remodeling and capital improvements are capitalized while maintenance and repairs are charged directly to occupancy expense.

Other Real Estate

Other real estate, which is included in other assets, is comprised of properties no longer utilized for business operations and property acquired through foreclosure in satisfaction of indebtedness. These properties are recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Initial losses on properties acquired through full or partial satisfaction of debt are treated as credit losses and charged to the allowance for loan losses at the time of acquisition. Subsequent declines in value from the recorded amounts, routine holding costs, and gains or losses upon disposition, if any, are included in non-interest income or expense as incurred.

Income Taxes

The Company uses the liability method of accounting for income taxes. This method results in the recognition of deferred tax assets and liabilities that are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The deferred provision for income taxes is the result of the net change in the deferred tax asset and deferred tax liability balances during the year. This amount combined with the current taxes payable or refundable results in the income tax expense for the current year.

On January 1, 2007, the Company adopted Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes ("FIN 48")." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The provisions of FIN 48 have been applied to all tax positions of the Company as of January 1, 2007. Only tax provisions that met the more-likely-than-not recognition threshold on January 1, 2007, were recognized or continue to be recognized upon adoption. The Company previously recognized income tax positions based on management's estimate of whether it was reasonably possible that a liability had been incurred for all recognized tax benefits by applying Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies."

The adoption of FIN 48 did not have a material impact on the Company's financial position, results of operations or cash flows.

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When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest expense and penalties associated with unrecognized tax benefits are classified as income tax expense in the consolidated statement of income.

Dividends and Earnings Per Share
Farmers & Merchants Bancorp common stock is not traded on any exchange. The shares are primarily held by local residents and are not actively traded.

No stock dividends were declared during 2007 and 2006. The Board of Directors declared a 5% stock dividend in 2005. Common stock shareholders received one share of common stock for every 20 shares of common stock owned. Fractional shares were not issued. For common stock share lots of less than 20 shares, a cash dividend in the amount of $22.62 was paid in lieu of the stock dividend for the year 2005.

Total cash dividends during 2007 were $7,831,000 or $9.70 per share of common stock, an increase of 13.4% from $6,966,000 or $8.55 per share in 2006. In 2005 cash dividends totaled $6,366,000 or $7.68 per share. Prior periods have been restated where applicable for stock dividends paid.

Earnings per share for the years ending December 31, 2007, 2006 and 2005 were $28.05, $25.25 and $22.24, respectively, and were computed by dividing net income by the weighted average number of common shares outstanding for the period. The weighted average number of shares outstanding for the three years ending December 31, 2007, 2006 and 2005 were 809,057, 817,044 and 828,537, respectively. Prior periods have been restated where applicable for stock dividends paid.

Segment Reporting
Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" requires that public companies report certain information about operating segments. It also requires that public companies report certain information about their products and services, the geographic areas in which they operate, and their major customers. The Company is a holding company for a community bank which offers a wide array of products and services to its customers. Pursuant to its banking strategy, emphasis is placed on building relationships with its customers, as opposed to building specific lines of business. As a result, the Company is not organized around discernable lines of business and prefers to work as an integrated unit to customize solutions for its customers, with business line emphasis and product offerings changing over time as needs and demands change. Therefore, the Company only reports one segment.

Derivative Instruments and Hedging Activities
Statement of Financial Accounting Standards, No. 133, "Accounting for Derivative Instruments and Certain Hedging Activities" as amended by the Statement of Financial Accounting Standards, No. 138, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts,

and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. Changes in the fair value of those derivatives are accounted for depending on the intended use of the derivative and the resulting designation under specified criteria. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, designed to minimize interest rate risk, the effective portions of the change in the fair value of the derivative are recorded in other comprehensive income (loss), net of related income taxes. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings.

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The Company utilizes derivative financial instruments such as interest rate caps, floors, swaps and collars. These instruments are purchased and/or sold to reduce the Company's exposure to changing interest rates. The Company marks to market the value of its derivative financial instruments and reflects gain or loss in earnings in the period of change or in other comprehensive income (loss). The Company was not utilizing any derivative instruments as of December 31, 2007.

Comprehensive Income
Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" establishes standards for the reporting and display of comprehensive income and its components in the financial statements. Other comprehensive income refers to revenues, expenses, gains and losses that generally accepted accounting principles recognize as changes in value to an enterprise but are excluded from net income. For the Company, comprehensive income (loss) includes net income and changes in fair value of its available-for-sale investment securities, minimum pension liability adjustments and cash flow hedges.

2. Investment Securities

The amortized cost, fair values and unrealized gains and losses of the securities available-for-sale are as follows: (in thousands)

	Amortized	Gross Unrealized		Fair/Book
December 31, 2007	Cost	Gains	Losses	Value
Obligations of States and Political Subdivisions	$ 9,957	$ 22	$ -	$ 9,979
Mortgage-backed Securities	124,470	1,778	104	126,144
Other	5,920	-	-	5,920
Total	$ 140,347	$ 1,800	$ 104	$ 142,043

	Amortized	Gross Unrealized		Fair/Book
December 31, 2006	Cost	Gains	Losses	Value
Obligations of States and Political Subdivisions	$ 11,224	$ 59	$ 9	$ 11,274
Mortgage-backed Securities	110,568	109	1,292	109,385
Other	12,075	-	107	11,968
Total	$ 133,867	$ 168	$ 1,408	$ 132,627

Included with the 2007 available-for-sale "Other Securities Fair/Book Value" total of $ 5.9 million was $ 4.8 million of FHLB stock. Included with the 2006 available-for-sale "Other Securities Fair/Book Value" total of $11.9 million was $7.7 million of FHLB stock.

The book values, estimated fair values and unrealized gains and losses of investments classified as held-to-maturity are as follows: (in thousands)

	Book	Gross Unrealized		Fair
December 31, 2007	Value	Gains	Losses	Value
Securities of U.S. Government Agencies	$ 30,435	$ 352	$ 5	$ 30,782
Obligations of States and Political Subdivisions	66,375	460	122	66,713
Mortgage-backed Securities	6,731	-	28	6,703
Other	2,053	2	-	2,055
Total	$ 105,594	$ 814	$ 155	$ 106,253

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December 31, 2006	Book Value		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value	
Securities of U.S. Government Agencies	$	30,539	$	-	$	735	$	29,804
Obligations of States and Political Subdivisions		69,910		319		334		69,895
Mortgage-backed Securities		8,677		-		365		8,312
Other		2,114		7		-		2,121
Total	$	111,240	$	326	$	1,434	$	110,132

Fair values are based on quoted market prices or dealer quotes. If a quoted market price or dealer quote is not available, fair value is estimated using quoted market prices for similar securities.

The remaining principal maturities of debt securities as of December 31, 2007, and 2006 are shown in the following tables. Mortgage-Backed Securities are presented based on expected maturities. Expected maturities may differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Securities Available-for-Sale December 31, 2007 (in thousands)	Within 1 Year		After 1 but Within 5		After 5 but Within 10		Over 10 years		Total Fair Value	
Obligations of States and Political Subdivisions	$	2,440	$	3,693	$	-	$	3,846	$	9,979
Mortgage-backed Securities		-		-		1,561		124,583		126,144
Other		5,920		-		-		-		5,920
Total	$	8,360	$	3,693	$	1,561	$	128,429	$	142,043
2006 Totals	$	14,558	$	6,436	$	-	$	111,633	$	132,627

Securities Held-to-Maturity December 31, 2007 (in thousands)	Within 1 Year		After 1 but Within 5		After 5 but Within 10		Over 10 years		Total Book Value	
Securities of U.S. Government Agencies	$	-	$	30,435	$	-	$	-	$	30,435
Obligations of States and Political Subdivisions		5,340		4,148		16,277		40,610		66,375
Mortgage-backed Securities		-		6,731		-		-		6,731
Other		-		-		72		1,981		2,053
Total	$	5,340	$	41,314	$	16,349	$	42,591	$	105,594
2006 Totals	$	3,769	$	28,468	$	29,628	$	49,375	$	111,240

The following tables show those investments with gross unrealized losses and their market value aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at the dates indicated.

	Less Than 12 Months				12 Months or More				Total			
December 31, 2007 (in thousands)	Fair Value		Unrealized Loss		Fair Value		Unrealized Loss		Fair Value		Unrealized Loss	
Securities of U.S. Government Agencies	$	-	$	-	$	9,995	$	5	$	9,995	$	5
Obligations of States and Political Subdivisions		4,974		33		14,338		89		19,312		122
Mortgage-backed Securities		-		-		19,057		132		19,057		132

Other		-		-		-		-		-		-
Total	$	4,974	$	33	$	43,390	$	226	$	48,364	$	259

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December 31, 2006 (in thousands)	Less Than 12 Months Fair Value	Unrealized Loss	12 Months or More Fair Value	Unrealized Loss	Total Fair Value	Unrealized Loss
Securities of U.S. Government Agencies	$ -	$ -	$ 29,804	$ 735	$ 29,804	$ 735
Obligations of States and Political Subdivisions	10,520	40	19,435	304	29,955	344
Mortgage-backed Securities	66,583	589	32,785	1,067	99,368	1,656
Other	3,893	107	-	-	3,893	107
Total	$ 80,996	$ 736	$ 82,024	$ 2,106	$ 163,020	$ 2,842

As of December 31, 2007, the Company held 187 investment securities of which 9 were in a loss position for less than twelve months and 32 were in a loss position and had been in a loss position for twelve months or more. Management periodically evaluates each investment security for other than temporary impairment relying primarily on industry analyst reports and observations of market conditions and interest rate fluctuations. Management believes it will be able to collect all amounts due according to the contractual terms of the underlying investment securities.

Securities of U.S. Government Agencies and Obligations of States and Political Subdivisions

The unrealized losses on the Company's investments in U.S. government agencies and obligations of states and political subdivisions were caused by interest rate increases. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2007.

Mortgage-backed Securities

The unrealized losses on the Company's investment in mortgage-backed securities were caused by interest rate increases. The contractual cash flows of these investments are guaranteed by an agency of the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2007.

Proceeds from sales of securities available-for-sale were as follows:

(in thousands)	Gross Proceeds	Gross Gains	Gross Losses
2007	$ 2,006	$ 1	$ 11
2006	63,760	1	2,169
2005	64,635	163	1,116

As of December 31, 2007, securities carried at $218,687,000 were pledged to secure public deposits, FHLB borrowings and other government agency deposits as required by law. This amount at December 31, 2006, was $196,459,000.

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3. Loans and Allowance for Loan Losses

Loans as of December 31, consisted of the following:

(in thousands)	2007	2006
Commercial Real Estate	$ 453,815	$ 410,458
Real Estate Construction	80,651	95,378
Residential 1st Mortgages	109,764	106,148
Home Equity Lines and Loans	65,953	67,132
Agricultural	215,798	183,589
Commercial	197,108	165,412
Consumer and Other	20,061	21,222
Subtotal	1,143,150	1,049,339
Deferred Loan Origination Fees, Net	(2,181)	(2,427)
Allowance for Loan Losses	(18,483)	(18,099)
Net Loans	$ 1,122,486	$ 1,028,813

A portion of pledged loans totaling $223,859,000 were used to secure Federal Home Loan Bank advances of $28,200,000 and the unused commitments.

Changes in the allowance for loan losses consisted of the following:

(in thousands)	2007	2006	2005
Balance, January 1	$ 18,099	$ 17,860	$ 17,727
Provision Charged to Operating Expense	1,495	275	425
Recoveries of Loans Previously Charged Off	262	803	575
Loans Charged Off	(1,373)	(839)	(867)
Balance, December 31	$ 18,483	$ 18,099	$ 17,860

All impaired loans have been assigned a related allowance for loan losses. As of December 31, 2007, and 2006 the total recorded investment in impaired loans was $186,000 and $39,000, respectively. The related allowance for impaired loans was $28,000 and $10,000 for the years ended 2007 and 2006, respectively. The average balance of impaired loans was $427,000, $250,000 and $412,000 for the years ended 2007, 2006 and 2005, respectively. There was no interest income reported on impaired loans in 2007, 2006 and 2005. Interest income forgone on loans placed on non-accrual status was $31,000––––, $15,000 and $50,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

4. Premises and Equipment

Premises and equipment as of December 31, consisted of the following:

(in thousands)	2007	2006
Land and Buildings	$ 24,288	$ 24,248
Furniture, Fixtures and Equipment	18,457	16,984
Leasehold Improvements	2,368	2,257
Subtotal	45,113	43,489
Less: Accumulated Depreciation and Amortization	24,925	22,993
Total	$ 20,188	$ 20,496

Depreciation and amortization on premises and equipment included in occupancy and equipment expense amounted to $1,973,000, $1,892,000 and $1,611,000 for the years ended December 31, 2007, 2006 and 2005, respectively. Total rental expense for premises was $496,000, $375,000 and $268,000 for the years ended December 31, 2007, 2006 and 2005, respectively. Rental income was $153,000, $116,000 and $109,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

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5. Other Real Estate

The Bank reported $251,000 in other real estate at December 31, 2007, and none in 2006. Other real estate includes property no longer utilized for business operations and property acquired through foreclosure proceedings. These properties are carried at the lower of cost or fair value less selling costs determined at the date acquired. Losses arising from properties acquired through foreclosure are charged against the allowance for loan losses. Subsequent declines in value, routine holding costs and net gains or losses on disposition are included in other operating expense as incurred.

6. Time Deposits

Time Deposits of $100,000 or more as of December 31, were as follows:
(in thousands)

	2007	2006
Balance	$ 388,291	$ 340,287

At December 31, 2007, the scheduled maturities of time deposits were as follows:

(in thousands)	Scheduled Maturities
2008	$ 548,661
2009	10,752
2010	2,890
2011	716
2012 & Thereafter	129
Total	$ 563,148

7. Income Taxes

Current and deferred income tax expense (benefit) provided for the years ended December 31, consisted of the following:

(in thousands)	2007	2006	2005
Current			
Federal	$ 11,340	$ 9,443	$ 8,826
State	3,984	3,539	3,278
Total Current	15,324	12,982	12,104
Deferred			
Federal	(1,963)	(950)	(1,508)
State	(491)	(219)	(366)
Total Deferred	(2,454)	(1,169)	(1,874)
Total Provision for Taxes	$ 12,870	$ 11,813	$ 10,230

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The total provision for income taxes differs from the federal statutory rate as follows:

(in thousands)

	2007		2006		2005	
	Amount	Rate	Amount	Rate	Amount	Rate
Tax Provision at Federal Statutory Rate	$ 12,448	35.0%	$ 11,355	35.0%	$ 10,030	35.0%
Interest on Obligations of States and Political Subdivisions Exempt from Federal Taxation	(1,014)	(2.9)%	(1,062)	(3.3)%	(1,081)	(3.7)%
State and Local Income Taxes,Net of Federal Income Tax Benefit	2,331	6.6%	2,158	6.7%	1,893	6.6%
Bank Owned Life Insurance	(640)	(1.8)%	(675)	(2.1)%	(636)	(2.2)%
Other, Net	(255)	(0.7)%	37	0.1%	24	0.0%
Total Provision for Taxes	$ 12,870	36.2%	$ 11,813	36.4%	$ 10,230	35.7%

The components of the net deferred tax assets as of December 31 are as follows:

(in thousands)	2007	2006
Deferred Tax Assets		
Allowance for Loan Losses	$ 7,831	$ 7,670
Accrued Liabilities	2,608	2,214
Deferred Compensation	4,299	3,372
State Franchise Tax	1,416	1,249
Unrealized Losses on Securities Available-for-Sale	-	522
Impairment and Capital Loss Carry Forward	352	-
Interest on Non-Accrual Loans	13	6
Total Deferred Tax Assets	$ 16,519	$ 15,033
Deferred Tax Liabilities		
Premises and Equipment	$ (388)	$ (444)
Securities Accretion (zero coupon securities)	(591)	(877)
Unrealized Losses on Securities Available-for-Sale	(713)	-
Other	(406)	(510)
Total Deferred Tax Liabilities	(2,098)	(1,831)
Net Deferred Tax Assets	$ 14,421	$ 13,202

The net deferred tax assets are reported in Interest Receivable and Other Assets on the Company's Consolidated Balance Sheet.

The Company and its subsidiaries file income tax returns in the U.S. federal and California jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2003.

8. Short Term Borrowings

As of December 31, 2007, and 2006 the Company had unused lines of credit available for short term liquidity purposes of $444 million and $405 million, respectively. Federal Funds purchased and advances from the Federal

Reserve Bank are generally issued on an overnight basis. There were no Federal Funds purchased or advances from the Federal Reserve Bank at December 31, 2007 and 2006.

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9. Federal Home Loan Bank Advances

The Company's advances from the Federal Home Loan Bank of San Francisco consist of the following as of December 31,

(in thousands)	2007	2006
5.60% amortizing note, interest and principal payable monthly with final maturity of September 25, 2018.	$ 754	$ 802
5.38% fixed rate credit advance, interest payable at month end and maturity of January 11, 2007	-	25,000
5.34% fixed rate credit advance, interest payable daily with a maturity of January 2, 2007	-	21,730
3.80% fixed rate credit advance, interest payable daily with a maturity of January 2, 2008	20,000	-
3.30% fixed rate credit advance, interest payable daily with a maturity of January 2, 2008	8,200	-
Total	$ 28,954	$ 47,532

In accordance with the Collateral Pledge and Security Agreement, advances are secured by all Federal Home Loan Bank stock held by the Company and by agency and mortgage-backed securities, with carrying values of $1,560,000. A portion of pledged loans totaling $223,859,000 were used to secure Federal Home Loan Bank advances of $28,200,000 and the unused commitments.

10. Shareholders' Equity

From 1975 through 2005 the Company issued an annual 5% stock dividend. In 2006 the stock dividend was discontinued. Earnings and cash dividends per share amounts have been restated where applicable for stock dividends.

During the second quarter of 2004, the Board of Directors of Farmers & Merchants Bancorp approved a resolution authorizing the repurchase, from time to time, of outstanding shares of the common stock of the Company. Repurchases will be made on the open market or through private transactions. When the Company repurchases shares in private transactions the price is determined based upon the most recent transactions that have occurred between third party shareholders. The aggregate price to be paid by the Company for all repurchased stock will not exceed $10 million.

On April 4, 2006, the Board unanimously approved expanding the repurchase program to allow the repurchase of up to $15 million of stock through April 30, 2009. Repurchases under the program will continue to be made on the open market or through private transactions. The repurchase program also requires that no purchases may be made if the Bank would not remain "well-capitalized" after the repurchase. All shares repurchased under the repurchase program will be retired.

Dividends from the Bank constitute the principal source of cash to the Company. The Company is a legal entity separate and distinct from the Bank. Under regulations controlling California state chartered banks, the Bank is, to some extent, limited in the amount of dividends that can be paid to shareholders without prior approval of the California Department of Financial Institutions. These regulations require approval if total dividends declared by a state chartered bank in any calendar year exceed the bank's net profits for that year combined with its retained net profits for the preceding two calendar years. As of December 31, 2007, the Bank could declare dividends of $24,357,000 without approval of the California Department of Financial Institutions.

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company’s and the Bank must meet specific capital guidelines that involve quantitative measures of the Company and the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios set forth in the following table of Total and Tier 1 capital to risk-weighted assets (as defined in the regulations), and of Tier 1 capital to average assets (as defined in the regulations). Management believes, as of December 31, 2007, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

In addition, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since that notification that management believes have changed the Bank's category.

(in thousands)	Actual		Regulatory Capital Requirements		Well Capitalized Under Prompt Corrective Action	
December 31, 2007	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Bank Capital to Risk Weighted Assets	$ 165,398	11.93%	$ 110,917	8.0%	$ 138,646	10.0%
Total Consolidated Capital to Risk Weighted Assets	$ 169,837	12.21%	$ 111,272	8.0%	N/A	N/A
Tier 1 Bank Capital to Risk Weighted Assets	$ 148,052	10.68%	$ 55,458	4.0%	$ 83,188	6.0%
Tier 1 Consolidated Capital to Risk Weighted Assets	$ 152,435	10.96%	$ 55,636	4.0%	N/A	N/A
Tier 1 Bank Capital to Average Assets	$ 148,052	10.07%	$ 58,827	4.0%	$ 73,534	5.0%
Tier 1 Consolidated Capital to Average Assets	$ 152,435	10.34%	$ 58,951	4.0%	N/A	N/A
December 31, 2006	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Bank Capital to Risk Weighted Assets	$ 152,118	11.69%	$ 104,101	8.0%	$ 130,126	10.0%
Total Consolidated Capital to Risk Weighted Assets	$ 159,336	12.17%	$ 104,698	8.0%	N/A	N/A
Tier 1 Bank Capital to Risk Weighted Assets	$ 135,827	10.44%	$ 52,051	4.0%	$ 78,076	6.0%
Tier 1 Consolidated Capital to Risk Weighted Assets	$ 142,954	10.92%	$ 52,349	4.0%	N/A	N/A
Tier 1 Bank Capital to Average Assets	$ 135,827	9.93%	$ 54,736	4.0%	$ 68,420	5.0%
Tier 1 Consolidated Capital to Average Assets	$ 142,954	10.40%	$ 54,979	4.0%	N/A	N/A

11. Employee Benefit Plans

Pension Plan

The Company, through the Bank, sponsored a defined benefit Pension Plan (the Plan) that covered substantially all full-time employees of the Company. Effective June 9, 2001, the Plan was amended to freeze the benefit accruals in the Plan. With the exception of employees who had reached age 55 and who had accumulated 10 years of Plan service, the effect of the amendment was to freeze the participants' monthly pension benefit.

In February 2005 the Board of Directors terminated the Plan. Benefits for those employees who were still accruing benefits under the Plan were frozen on April 30, 2005, when the Plan was amended to halt all future benefit accruals. Those employees now participate in the mandatory contributions to the Company's Profit Sharing Plan.

The Company filed Form 500, Standard Termination Notice for Single Employer Plan, with the Pension Benefit Guaranty Corporation (the "PBGC") on October 21, 2005. The Company did not receive a Notice of Noncompliance from the PBGC within sixty days, so it distributed all benefits to all participants prior to December 31, 2005.

The Company filed Form 5310, Application for Determination of Terminating Plan, with the Internal Revenue Service on September 22, 2005. The Company received a favorable determination letter from the Internal Revenue Service on

June 19, 2006.

Because of the Company’s decision to terminate the Plan in 2005 it elected to accelerate the recognition of gain/loss over a two year amortization period effective January 1, 2004, to match the remaining life of the Plan. This change in amortization period resulted in a cumulative adjustment in the amount of $387,000 ($224,000, net of tax).

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The components of the net periodic benefit costs are as follows:

(in thousands)		2005
Service Cost	$	53
Interest Cost		258
Expected Return on Plan Assets		(114)
Amortization of :		
Unrecognized Prior Service Cost		-
Unrecognized Net Loss		947
Total Net Periodic Benefit Cost	$	1,144
One-Time Charge Due to Plan Termination		1,229
Total Net Periodic Benefit Cost	$	2,373
Decrease in Minimum Liability Included in Other Comprehensive Income	$	(1,756)

Weighted-average assumptions used to determine benefit obligations at December 31, 2005.

	2005
Assumptions Used in the Accounting were:	
Discount Rate (Settlement Rate)	4.89%
Rate of Compensation Increase	4.00%

Weighted-average assumptions used to determine net benefit cost for year ended December 31,

	2005
Assumptions Used in the Accounting were:	
Discount Rate (Settlement Rate)	4.89%
Expected Return on Plan Assets	3.00%
Rate of Compensation Increase	4.00%

The Company’s Pension Plan had no weighted-average assets for the years ended December 31, 2007, and 2006.

Profit Sharing Plan
The Company, through the Bank, sponsors a Profit Sharing Plan for substantially all full-time employees of the Company with one or more years of service. Participants receive up to two annual employer contributions, one is discretionary and the other is mandatory. The discretionary contributions to the Profit Sharing Plan are determined annually by the Board of Directors. The discretionary contributions totaled $780,000, $775,000 and $725,000 for the years ended December 31, 2007, 2006 and 2005, respectively. The mandatory contributions to the Profit Sharing Plan are made according to a predetermined set of criteria. Mandatory contributions totaled $780,000, $727,000 and $693,000 for the years ended December 31, 2007, 2006 and 2005, respectively. Company employees are permitted, within limitations imposed by tax law, to make pretax contributions to the 401(k) feature of the Profit Sharing Plan. The Company does not match employee contributions within the 401(k) feature of the Profit Sharing Plan and the Company can terminate the Profit Sharing Plan at any time. Benefits pursuant to the Profit Sharing Plan vest 0% during the first year of participation, 25% per full year thereafter and after five years such benefits are fully vested.

Indexed Retirement Plan and Life Insurance Arrangements
The Company, through the Bank, sponsors an Indexed Retirement Plan for certain employees. The Indexed Retirement Plan is a defined contribution supplemental executive retirement plan and was developed to supplement the Company’s Profit Sharing Plan which, as a qualified plan, has a ceiling on benefits as set by the Internal Revenue Service.

The Company made contributions to the Indexed Retirement Plan of $829,000, $856,000 and $802,000 for the years ended December 31, 2007, 2006 and 2005, respectively. The Company's total accrued liability under the Indexed Retirement Plan was $3.88 million and $2.83 million as of December 31, 2007, and 2006, respectively. The balance in each participant's account is 0% vested during the first five years of employment and becomes fully vested after five years of employment.

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The Company has purchased single premium life insurance policies on the lives of the Indexed Retirement Plan participants as well as certain other employees of the Company. These policies provide: (1) financial protection to the Company in the event of the death of a key employee and; (2) since the interest earned on the cash surrender value of the policies is tax exempt as long as the policies are used to finance employee benefits, significant income to the Company to offset the expense associated with the Indexed Retirement Plan and other employee benefit plans. As compensation to each employee for agreeing to allow the Company to purchase an insurance policy on his or her life, split dollar agreements have been entered into with those employees. These agreements provide for a division of the life insurance death proceeds between the Company and each employee's designated beneficiary or beneficiaries.

The Company earned tax exempt interest on the life insurance policies of $1.7 million for the year ended December 31, 2007, and $1.6 million for each of the years ended December 31, 2006 and 2005. As of December 31, 2007, and 2006 the total cash surrender value of the insurance policies was $40.2 million and $38.4 million, respectively.

Deferred Bonus and Executive Retention Plans

The Company, through the Bank, sponsors Deferred Bonus and Executive Retention Plans for certain employees. Both plans grant bonuses based on the long-term cumulative profitability and increase in market value of the Company. The Company made contributions to both plans of $732,000, $1.4 million and $966,000 for the years ended December 31, 2007, 2006 and 2005, respectively. Benefits pursuant to the Deferred Bonus Plan vest 0% during the first year of participation, 25% per full year thereafter and after five years such benefits are fully vested. Benefits pursuant to the Executive Retention Plan vest 10% per year beginning in 2005 and after ten years are fully vested. The Company's total accrued liability under the Deferred Bonus and Executive Retention Plans was $4.7 million and $3.6 million as of December 31, 2007, and 2006, respectively.

12. Fair Value of Financial Instruments

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of SFAS No. 107, "Disclosure about Fair Value of Financial Instruments." The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. The use of assumptions and various valuation techniques, as well as the absence of secondary markets for certain financial instruments, will likely reduce the comparability of fair value disclosures between financial institutions. In some cases, book value is a reasonable estimate of fair value due to the relatively short period of time between origination of the instrument and its expected realization.

The following table summarized the book value and estimated fair value of financial instruments as of December 31:

	2007		2006	
ASSETS: (in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Cash and Cash Equivalents	$ 51,390	$ 51,390	$ 47,006	$ 47,006
Investment Securities Held-to-Maturity	105,594	106,253	111,240	110,132
Investment Securities Available-for-Sale	142,043	142,043	132,627	132,627
Loans, Net of Deferred Loan Origination Fees	1,140,969	1,147,264	1,046,912	1,025,363
Cash Surrender Value of Life Insurance Policies	40,180	40,180	38,444	38,444
Accrued Interest Receivable	8,830	8,830	8,537	8,537
LIABILITIES:				
Deposits:				
Non-Interest Bearing	307,299	307,299	295,142	295,142
Interest-Bearing	1,003,491	1,003,303	903,386	902,019
Federal Home Loan Bank Advances	28,954	28,988	47,532	47,555

Subordinated Debentures	10,310	10,184	10,310	10,281
Accrued Interest Payable	4,835	4,835	3,897	3,897

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The methods and assumptions used to estimate the fair value of each class of financial instrument listed in the table above are explained below.

Cash and Cash Equivalents: The carrying amounts reported in the balance sheet for cash and due from banks, federal funds sold and securities purchased under agreements to resell are a reasonable estimate of fair value.

Investment Securities: Fair values for investment securities are based on quoted market prices or dealer quotes, where available. If quoted market prices or dealer quotes are not available, fair values are based on quoted market prices of comparable instruments.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for fixed-rate loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of accrued interest receivable approximates its fair value.

Cash Surrender Value of Life Insurance Policies: The fair value of life insurance policies are based on cash surrender values at each reporting date as provided by the insurers.

Deposit Liabilities: The fair value of demand deposits, interest bearing transaction accounts and savings accounts is the amount payable on demand. The fair value of fixed-maturity certificates of deposit is estimated by discounting expected future cash flows utilizing interest rates currently being offered for deposits of similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

Borrowings: The fair value of federal funds purchased and other short-term borrowings is approximated by the book value. The fair value for Federal Home Loan Bank borrowings is determined using discounted future cash flows.

Subordinated Debentures: Fair values of subordinated debentures were determined based on the current market value of like-kind instruments of a similar maturity and structure.

Limitations: Fair value estimates presented herein are based on pertinent information available to management as of December 31, 2007, and 2006. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date, and therefore, current estimates of fair value may differ significantly from the amounts presented above.

13. Derivative Instruments and Hedging Activities

The Company uses derivative instruments to limit its exposure to changes in interest rates. The Company has developed a Hedging Policy to provide guidelines that address instruments to be used, authority limits, implementation guidelines, guidelines for evaluating hedge alternatives, reporting requirements, and the credit worthiness of the instrument's counterparty.

The Company reviews compliance with these guidelines annually with the ALCO Committee and the Board of Directors. The guidelines may change as the Company's business needs dictate.

As required, the Company records in the balance sheet the interest rate swaps at fair value. Because the transactions meet the criteria for a cash-flow hedge, changes in fair value are reported in other comprehensive income (loss). In the event that a portion of the hedge becomes ineffective, the ineffective portion of the derivative's change in fair value will be immediately recognized in earnings.

The Company recognized a deferred gain on an interest rate swap agreement in the amount of $37,500 in 2005 and 2006 and none in 2007.

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14. Commitments and Contingencies

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These instruments include commitments to extend credit, letters of credit and financial guarantees that are not reflected in the Consolidated Balance Sheet.

The Company's exposure to credit loss in the event of nonperformance by the other party with regard to standby letters of credit, undisbursed loan commitments and financial guarantees is represented by the contractual notional amount of those instruments. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. The Company uses the same credit policies in making commitments and conditional obligations as it does for recorded balance sheet items. The Company may or may not require collateral or other security to support financial instruments with credit risk. Evaluations of each customer's creditworthiness are performed on a case-by-case basis.

Standby letters of credit are conditional commitments issued by the Company to guarantee performance of or payment for a customer to a third party. The Company had standby letters of credit outstanding of $8,409,000 at December 31, 2007, and $10,929,000 at December 31, 2006. Outstanding standby letters of credit had original terms ranging from 1 to 27 months with final expiration in 2010. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Undisbursed loan commitments totaled $440,258,000 and $442,544,000 as of December 31, 2007, and 2006, respectively. Since many of these commitments are expected to expire without fully being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Company is obligated under a number of noncancellable operating leases for premises and equipment used for banking purposes. Minimum future rental commitments under noncancellable operating leases as of December 31, 2007, were $447,000, $393,000, $349,000, $307,000, and $220,000 for the years 2008 through 2012 and $669,000 thereafter.

In the ordinary course of business, the Company becomes involved in litigation arising out of its normal business activities. Management, after consultation with legal counsel, believes that the ultimate liability, if any, resulting from the disposition of such claims would not be material in relation to the financial position of the Company.

The Company may be required to maintain average reserves on deposit with the Federal Reserve Bank primarily based on deposits outstanding. There were no reserve requirements during 2007 or 2006.

15. Recent Accounting Developments

In September 2006 the FASB issued Statement No. 157 (SFAS 157), “Fair Value Measurements.” SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. In this standard, the FASB clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, SFAS 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Management has completed its evaluation of the adoption of SFAS 157 and has determined that it will not have a material impact on the Company’s financial position or results of operations.

In February 2007 the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115.” This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the FASB’s long-term measurement objectives for accounting for financial instruments. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Management has completed its evaluation of the adoption of SFAS 159 and has determined that it will not have a material impact on the Company’s financial position or results of operations.

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In September 2006 the FASB ratified the consensuses reached by the Task Force on Issue No. 06-4 (EITF 06-4) "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." A question arose when an employer enters into an endorsement split-dollar life insurance arrangement related to whether the employer should recognize a liability for the future benefits or premiums to be provided to the employee. EITF 06-4 indicates that an employer should recognize a liability for future benefits and that a liability for the benefit obligation has not been settled through the purchase of an endorsement type policy. An entity should apply the provisions of EITF 06-4 either through a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or a change in accounting principle through retrospective application to all prior periods. The provisions of EITF 06-4 are effective for fiscal years beginning after December 15, 2007. Management has completed its evaluation of the adoption of EITF 06-4 and has determined that it will not have a material impact on the Company's financial position or results of operations.

16. Parent Company Financial Information

The financial information below is presented as of December 31, 2007, and December 31, 2006.

Farmers & Merchants Bancorp
Condensed Balance Sheet

(in thousands)	2007	2006
Cash	$ 174	$ 386
Investment in Farmers & Merchants Bank of Central California	149,035	135,169
Investment Securities	1,059	4,203
Capital Leases	1	826
Other Assets	3,692	2,336
Total Assets	$ 153,961	$ 142,920
Subordinated Debentures	$ 10,310	$ 10,310
Liabilities	233	270
Shareholders' Equity	143,418	132,340
Total Liabilities and Shareholders' Equity	$ 153,961	$ 142,920

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Farmers & Merchants Bancorp
Condensed Income Statements

(in thousands)	Year Ended December 31, 2007	2006	2005
Equity in Undistributed Earnings in Farmers & Merchants Bank of Central California	$ 12,224	$ 2,973	$ 9,160
Dividends from Subsidiary	12,430	18,600	10,000
Interest Income	79	67	59
Other Expenses, Net	(3,459)	(1,695)	(1,327)
Tax Benefit	1,421	684	536
Net Income	$ 22,695	$ 20,629	$ 18,428

Farmers & Merchants Bancorp
Condensed Statement of Cash Flows

(in thousands)	Year Ended December 31, 2007	2006	2005
Cash Flows from Operating Activities:			
Net Income	$ 22,695	$ 20,629	$ 18,428
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Equity in Undistributed Net Earnings from Subsidiary	(12,224)	(2,973)	(9,160)
Net Loss (Gain) on Investment Securities	1,707	-	(143)
Net Increase in Other Assets	(1,402)	(767)	(522)
Net (Decrease) Increase in Other Liabilities	(37)	43	(136)
Net Cash Provided by Operating Activities	10,739	16,932	8,467
Investing Activities:			
Securities Purchased	-	(3,893)	-
Securities Sold or Matured	1,544	-	251
Change in Capital Leases	825	(307)	266
Net Cash Provided (Used) by Investing Activities	2,369	(4,200)	517
Financing Activities:			
Stock Repurchased	(5,489)	(5,936)	(4,016)
Cash Dividends	(7,831)	(6,966)	(6,656)
Net Cash Used by Financing Activities	(13,320)	(12,902)	(10,672)
Increase in Cash and Cash Equivalents	(212)	(170)	(1,688)
Cash and Cash Equivalents at Beginning of Year	386	556	2,244
Cash and Cash Equivalents at End of Year	$ 174	$ 386	$ 556

17. Long-term Subordinated Debentures

In December 2003, the Company formed a wholly owned Connecticut statutory business trust, FMCB Statutory Trust I ("Statutory Trust I"), which issued $10,000,000 of guaranteed preferred beneficial interests in the Company's junior subordinated deferrable interest debentures (the "Trust Preferred Securities"). These debentures qualify as Tier 1 capital under Federal Reserve Board guidelines. All of the common securities of Statutory Trust I are owned by the Company. The proceeds from the issuance of the common securities and the Trust Preferred Securities were used by FMCB Statutory Trust to purchase $10,310,000 of junior subordinated debentures of the Company, which carry a floating rate based on three-month LIBOR plus 2.85%. The debentures represent the sole asset of Statutory Trust I. The Trust Preferred Securities accrue and pay distributions at a floating rate of three-month LIBOR plus 2.85% per annum of the stated liquidation value of $1,000 per capital security. The Company has entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of: (i) accrued and unpaid distributions required to be paid on the Trust Preferred Securities; (ii) the redemption price with respect to any Trust Preferred Securities called for redemption by Statutory Trust I; and (iii) payments due upon a voluntary or involuntary dissolution, winding up or liquidation of Statutory Trust I. The Trust Preferred Securities are mandatorily redeemable upon maturity of the subordinated debentures on December 17, 2033, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the subordinated debentures purchased by Statutory Trust I, in whole or in part, on or after December 17, 2008. As specified in the indenture, if the subordinated debentures are redeemed prior to maturity, the redemption price will be the principal amount and any accrued but unpaid interest. Additionally, if the Company decided to defer interest on the subordinated debentures, the Company would be prohibited from paying cash dividends on the Company's common stock.

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18. Quarterly Financial Information (Unaudited)

2007 (in thousands except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Total Interest Income	$ 23,139	$ 23,970	$ 24,567	$ 24,099	$ 95,775
Total Interest Expense	7,594	8,104	8,542	7,985	32,225
Net Interest Income	15,545	15,866	16,025	16,114	63,550
Provision for Loan Losses	-	250	-	1,245	1,495
Net Interest Income After					
Provision for Loan Losses	15,545	15,616	16,025	14,869	62,055
Total Non-Interest Income	3,752	4,131	3,536	4,036	15,455
Total Non-Interest Expense	11,021	10,939	10,215	9,770	41,945
Income Before Income Taxes	8,276	8,808	9,346	9,135	35,565
Provision for Income Taxes	2,807	3,142	3,471	3,450	12,870
Net Income	$ 5,469	$ 5,666	$ 5,875	$ 5,685	$ 22,695
Earnings Per Share	$ 6.74	$ 6.98	$ 7.26	$ 7.07	$ 28.05

2006 (in thousands except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Total Interest Income	$ 20,703	$ 21,669	$ 22,950	$ 23,074	$ 88,396
Total Interest Expense	4,754	5,773	6,856	7,238	24,621
Net Interest Income	15,949	15,896	16,094	15,836	63,775
Provision for Loan Losses	275	-	-	-	275
Net Interest Income After					
Provision for Loan Losses	15,674	15,896	16,094	15,836	63,500
Total Non-Interest Income	2,604	3,499	3,114	2,846	12,063
Total Non-Interest Expense	10,534	11,376	10,777	10,434	43,121
Income Before Income Taxes	7,744	8,019	8,431	8,248	32,442
Provision for Income Taxes	2,807	2,925	3,098	2,983	11,813
Net Income	$ 4,937	$ 5,094	$ 5,333	$ 5,265	$ 20,629
Earnings Per Share	$ 6.00	$ 6.22	$ 6.54	$ 6.49	$ 25.25

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Farmers & Merchants Bancorp stock is not traded on any exchange. The shares are primarily held by local residents and are not actively traded. Based on information from shareholders and from Company stock transfer records, the prices paid in 2007, 2006 and 2005 ranged from $381.00 to $565.00 per share. Additional information about the Company's common stock is available in Part II, Item 5.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

The Company maintains controls and procedures designed to ensure that all relevant information is recorded and reported in all filings of financial reports. Such information is reported to the Company's management, including its Chief Executive Officer and its Chief Financial Officer to allow timely and accurate disclosure based on the definition of "disclosure controls and procedures" in Rule 13a-15(e). In accordance with Rule 13a-15(b) of the Exchange Act, we carried out an evaluation as of December 31, 2007, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e) under the Exchange Act. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective as of December 31, 2007.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect the internal controls subsequent to the date the Company completed its evaluation.

Management's report on internal control over financial reporting is set forth "Item 8. Financial Statements and Supplementary Data," and is incorporated herein by reference. Perry-Smith LLP, the independent registered public accounting firm that audited the Company's 2007 Consolidated Financial Statements, has issued an attestation report on the Company's internal control over financial reporting, which is set forth in "Item 8. Financial Statements and Supplementary Data," and is incorporated herein by reference.

Item 9B. Other Information

None

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

Set forth below is certain information regarding the Executive Officers of the Company and/or Bank:

Name and Position(s)	Age	Principal Occupation during the Past Five Years
Kent A. Steinwert President & Chief Executive Officer of the Company and Bank	55	President & Chief Executive Officer of the Company and Bank.
Richard S. Erichson Executive Vice President & Senior Credit Officer of the Company and Bank	60	Executive Vice President & Senior Credit Officer of the Company and Bank.
Deborah E. Hodkin Executive Vice President & Chief Administrative Officer of the Company and Bank	45	Executive Vice President & Chief Administrative Officer of the Company and Bank.
Stephen W. Haley Executive Vice President & Chief Financial Officer & Secretary of the Company and Bank	54	Executive Vice President & Chief Financial Officer of the Company and Bank since April 2003, prior thereto, President and Chief Operating Officer of Community West Bancshares.
Kenneth W. Smith Executive Vice President & Head of Business Banking of the Bank	48	Executive Vice President & Head of Business Banking of the Bank since January 2004, prior thereto, Senior Vice President and Credit Administrator of the Bank.

Also, see “Election of Directors” and “Compliance with Section 16(a) of the Exchange Act” in the Company’s definitive proxy statement for the 2008 Annual Meeting of Shareholders which will be filed with the Commission and which is incorporated herein by reference. During 2007 there were no changes in procedures for the election of directors.

The Company has adopted a Code of Conduct which complies with the Code of Ethics requirements of the Securities and Exchange Commission. A copy of the Code of Conduct is posted on the Company’s website. The Company intends to disclose promptly any amendment to, or waiver from any provision of, the Code of Conduct applicable to senior financial officers, and any waiver from any provision of the Code of Conduct applicable to Directors, on its website. The Company’s website address is www.fmbonline.com.

Item 11. Executive Compensation

The information required by Item 11 of Form 10-K is incorporated by reference from the information contained in the Company’s definitive proxy statement for the 2008 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14A.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by Item 12 of Form 10-K is incorporated by reference from the information contained in the Company's definitive proxy statement for the 2008 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14A. The Company does not have any equity compensation plans which require disclosure under Item 201(d) of Regulation S-K.

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Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by Item 13 of Form 10-K is incorporated by reference from the information contained in the Company’s definitive proxy statement for the 2008 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14A.

Item 14. Principal Accounting Fees and Services

The information required by Item 14 of Form 10-K is incorporated by reference from the information contained in the Company’s definitive proxy statement for the 2008 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14A.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) Financial Statements. Incorporated herein by reference, are listed in Item 8 hereof.
(2) Financial Statement Schedules. None

(b) See "Index to Exhibits"

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Farmers & Merchants Bancorp
(Registrant)

By /s/ Stephen W. Haley

Dated: March 7, 2008

Stephen W. Haley
Executive Vice President &
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 7, 2008.

/s/ Kent A. Steinwert

Kent A. Steinwert

President and Chief Executive Officer
(Principal Executive Officer)

/s/ Stephen W. Haley

Stephen W. Haley

Executive Vice President & Chief Financial Officer
(Principal Financial and Accounting Officer)

/s/ Ole R. Mettler

Ole R. Mettler, Chairman

/s/ James E. Podesta

James E. Podesta, Director

/s/ Stewart C. Adams, Jr.

Stewart C. Adams, Jr., Director

/s/ Kevin Sanguinetti

Kevin Sanguinetti, Director

/s/ Ralph Burlington

Ralph Burlington, Director

/s/ Carl Wishek, Jr.

Carl Wishek, Jr., Director

/s/ Edward Corum, Jr.

Edward Corum, Jr., Director

/s/ Calvin Suess

Calvin Suess, Director

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Index to Exhibits

Exhibit No.	Description
3.1	Amended Certificate of Incorporation (incorporated by reference to Appendices 1 and 2 to the Registrant's Definitive Proxy Statement on Schedule 14A for its 2007 Annual Meeting of Stockholders and Exhibit 3(i) to the Registrant's Current Report on Form 8-K dated April 30, 1999).
3.2	Amended By-Laws (incorporated by reference to Appendix 3 to the Registrant's Definitive Proxy Statement on Schedule 14A for its 2007 Annual Meeting of Stockholders, Exhibit 3.1 to the Registrant's Current Report on Form 8-K dated June 7, 2005, and Exhibit 3(ii) to the Registrant's Current Report on Form 8-K dated April 30, 1999).
10.1	Employment Agreement dated January 1, 2005, between Farmers & Merchants Bank of Central California and Kent A. Steinwert, filed on Registrant’s Form 10-K for the year ended December 31, 2004, is incorporated herein by reference.
10.3	Employment Agreement dated January 1, 2005, between Farmers & Merchants Bank of Central California and Deborah E. Hodkin, filed on Registrant’s Form 10-K for the year ended December 31, 2004, is incorporated herein by reference.
10.4	Employment Agreement dated January 1, 2005, between Farmers & Merchants Bank of Central California and Kenneth W. Smith, filed on Registrant’s Form 10-K for the year ended December 31, 2004, is incorporated herein by reference.
10.5	Employment Agreement dated January 1, 2005, between Farmers & Merchants Bank of Central California and Richard S. Erichson, filed on Registrant’s Form 10-K for the year ended December 31, 2004, is incorporated herein by reference.
10.6	Employment Agreement dated January 1, 2005, between Farmers & Merchants Bank of Central California and Stephen W. Haley, filed on Registrant’s Form 10-K for the year ended December 31, 2004, is incorporated herein by reference.
10.15	2005 Deferred Bonus Plan of Farmers & Merchants Bank of Central California executed May 3, 2005, filed on Registrant’s Form 10-Q for the quarter ended March 31, 2005, is incorporated herein by reference.
10.16	Executive Retention Plan of Farmers & Merchants Bank of Central California executed May 3, 2005, filed on Registrant’s Form 10-Q for the quarter ended March 31, 2005, is incorporated herein by reference.
10.17	Amended and Restated Indexed Retirement Plan of Farmers & Merchants Bank of Central California adopted as of March 7, 2006, filed on Registrant’s Form 10-K for the year ended December 31, 2005, is incorporated herein by reference.
10.18	Deferred Compensation Plan of Farmers & Merchants Bank of Central California, executed October 17, 2006, filed on the Registrants Form 10-Q for the quarter ended September 30, 2006, is incorporated herein by reference.
14	Code of Conduct of Farmers & Merchants Bancorp, filed on Registrant’s Form 10-K for the year ended December 31, 2003, is incorporated herein by reference.
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	Subsidiaries of the Registrant, filed on Registrant's Form 10-K for the year ended December 31, 2003, is incorporated herein by reference.
31(a)	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31(b)	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of the 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.

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