

# FIRST NATIONAL BANCORP, INC.

A BANK HOLDING COMPANY FOR



## PROXY STATEMENT ANNUAL MEETING OF SHAREHOLDERS OF FIRST NATIONAL BANCORP, INC.

May 14, 2015

FIRST NATIONAL BANCORP, INC., a Michigan corporation and registered bank holding company, is submitting this Proxy Statement to its shareholders (the “*Shareholders*”) in connection with the solicitation of proxies by the Board of Directors of First National Bancorp, Inc. (the “*Board*”) for use at the 2015 Annual Meeting of Shareholders to be held at the offices of First National Bank of Michigan at 348 West Michigan Avenue, Kalamazoo, Michigan 49007, at 5:00 p.m. on May 14, 2015, and at any adjournments or postponements thereof (the “*Annual Meeting*”).

As indicated in the accompanying Notice of the Annual Meeting, the Shareholders will be asked to consider and vote upon the following proposal (collectively, the “*Proposal*”):

1. Election of Eric V. Brown, Jr., James J. DeKruyter, James S. DeMoss, John M. Dunn, James S. Gunderson, David L. Holmes, Ben Ipema, Larry D. Lueth, Sondra K. Phillips, John M. Schreuder and Joshua T. Weiner as directors of First National Bancorp, Inc. for a one year term expiring at the 2016 annual meeting of shareholders.

We will also transact such other business as may properly come before the meeting or any adjournments thereof.

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*The foregoing introductory information provides only a very brief overview. While this overview may be useful to you as you review the more detailed information in the remainder of this Proxy Statement, you should not rely exclusively upon this overview. Instead, you should carefully review this entire Proxy Statement and the attached Annex A.*

## **GENERAL INFORMATION**

### **Attending in person**

Only the Shareholders, their proxy holders and First National Bancorp, Inc. guests may attend the Annual Meeting.

### **Who may vote**

The Shareholders of First National Bancorp, Inc., as recorded in our stock register on April 14, 2015 (the “**Record Date**”), may vote at the Annual Meeting. As of both the Record Date and the date of this Proxy Statement, First National Bancorp, Inc. had 1,800,900 issued and outstanding shares. Each such share is entitled to one vote on each of the matters presented for shareholder action at the Annual Meeting.

### **How to vote**

You may either vote in person at the Annual Meeting or by proxy. We recommend you vote by proxy even if you plan to attend the Annual Meeting.

### **How proxies work**

Your proxy covers all shares registered in your name. By properly executing and returning your proxy, your shares will be voted at the Annual Meeting according to your instructions unless you revoke the proxy prior to or at the Annual Meeting. You may vote for all, some or none of the director nominees.

If you return your proxy without voting instructions, your shares will be voted FOR the election of all of the director nominees. If you return a properly executed proxy, the persons named as proxy holders will have discretion to vote your shares on any additional matters properly presented for a vote at the Annual Meeting.

**To ensure your proxy is received prior to the Annual Meeting, please return it no later than May 13, 2014.** If your proxy is not received prior to the Annual Meeting, your shares will not be voted at the Annual Meeting unless they are voted in person at the Annual Meeting.

### **Revoking a proxy**

The grant of a proxy on the enclosed form of proxy does not preclude you from voting in person or otherwise revoking a proxy. Attendance at the Annual Meeting will not, in and of itself, constitute revocation of a proxy. You may revoke your proxy before it is voted by:

- submitting a new proxy with a later date;
- notifying First National Bancorp, Inc.’s Secretary in writing before the Annual Meeting; or
- voting in person at the Annual Meeting.

### **Quorum**

In order to carry on the business of the Annual Meeting, we must have a quorum. This means at least a majority of the outstanding shares of First National Bancorp, Inc. eligible to vote at the Annual Meeting must be represented at the Annual Meeting by proxy or in person, including abstentions.

## **Votes needed**

The director nominees who receive a plurality of the votes cast will be elected to fill the 11 seats on the Board. Abstentions will not be included in the vote count.

We do not know of any other matters to be presented at the Annual Meeting. Generally, any other proposal to be voted on at the Annual Meeting would be approved if a majority of shares voted on the proposal are voted in favor of the proposal. Abstentions would not be included in the vote count.

As of the date of this Proxy Statement, directors and officers of First National Bancorp, Inc. and their affiliates were not the beneficial owners of greater than a majority of the outstanding shares.

## **BUSINESS**

First National Bancorp, Inc. is a Michigan corporation that was incorporated on July 7, 2005 to organize and serve as the bank holding company for First National Bank of Michigan (the “**Bank**”), a national bank with branches located at 348 West Michigan Avenue, Kalamazoo, Michigan 49007, 2700 W. Centre Ave., Portage, Michigan 49024, 5313 West Main Street, Kalamazoo, Michigan 49009 and 141 Ionia NW, Grand Rapids, Michigan 49503. First National Bancorp, Inc. received approval from the Federal Reserve Board to become a bank holding company and acquired all of the stock of the Bank. The Bank received regulatory approval to open from the Office of the Comptroller of the Currency and for deposit insurance with the Federal Deposit Insurance Corporation. The Bank focuses on the local community, emphasizing personal service to individuals and businesses in its primary service area.

The Bank offers convenient service, local decision-making and competitively priced deposit and loan products in its primary service area. By focusing its operations on the communities it serves, the Bank should be able to respond to changes in the market more quickly than large non-local institutions.

## **PROPOSAL 1 - ELECTION OF DIRECTORS**

First National Bancorp, Inc.’s Board of Directors currently consists of 11 members who serve one-year terms. The 11 director nominees listed below, all of whom are current directors of First National Bancorp, Inc., were nominated by the Board to fill the 11 Board seats for one year terms expiring at the 2016 annual meeting of shareholders. Biographical information on each of the director nominees is given below. All director nominees have indicated their willingness to serve on the Board if elected. If, prior to the Annual Meeting, a director nominee determines that he or she will be unable to serve on the Board for the upcoming year, your proxy authorizes the proxy holders to vote your shares for a replacement nominee if one is selected.

**ERIC V. BROWN, JR.** Mr. Brown is of counsel to the law firm of Warner, Norcross & Judd LLP. Mr. Brown is a broad-based business counselor. He has served as an advisor and counselor in a substantial number of business transactions for both private and public companies as well as the organization of the Bank, First National Bancorp, Inc. and a venture capital firm. He served on the boards of two other banks and bank holding companies in Michigan for a period in excess of 30 years. He is a member of the board of directors and General Counsel of Kalsec, Inc., a producer of natural colors, flavors, hops and nutritional ingredients for the food and beverage industries. He also is a member of the board of directors of Lafourche Realty Company, Inc., an oil and gas and real estate company. He has been active in the Business Law Section of the American Bar Association for the last 20 years, including participation as a regular member of the Mergers and Acquisitions Committee. As such, he was on the editorial board of a task force which published a Model Stock Purchase Agreement, with commentary, in 1995, and a Model Asset Purchase Agreement, with commentary, in 2000. He has also been active with an American Bar Association task force which has published a Model Joint Venture Agreement. Mr. Brown is listed in the 2003-2015 editions of The Best Lawyers in America under Corporate, Mergers & Acquisitions and Securities Law Sections. Mr. Brown’s extensive experience with the business and banking communities is a great asset to the Board.

**JAMES J. DEKRUYSER.** Mr. DeKruyter currently serves on the board of the Kalamazoo Christian Schools Foundation and the Christian School board, and Gull Lake Ministries. He has served many volunteer organizations including the Kalamazoo YMCA, Sherman Lake YMCA, Open Hearts Ministries, the national board of Youth for

Christ, and the Youth for Christ Foundation. Mr. DeKruyter also served as director of Michigan National Bank – Kalamazoo.

**JAMES S. DEMOSS.** Dr. DeMoss is a practicing Emergency Medicine physician and President of Southwestern Michigan Emergency Services, P.C., which has staffed Bronson Methodist Hospital's Emergency Department for over 40 years. His organization also provides emergency physician staffing of several other hospitals in southwest Michigan. Prior to becoming President of SWMES, P.C., Dr. DeMoss served in several administrative positions within the organization and brings with him a unique knowledge regarding the operations and needs of a midsize professional company providing healthcare in southwest Michigan. An avid outdoor sportsman and enthusiast, Dr. DeMoss supports many wildlife habitat conservation efforts.

**JOHN M. DUNN.** Dr. Dunn is the president of Western Michigan University in Kalamazoo, Michigan. Prior to his appointment in 2007, Dr. Dunn held administrative, research and teaching appointments at Southern Illinois University Carbondale, the University of Utah, Oregon State University and the University of Connecticut. Dr. Dunn is internationally recognized for his efforts to enhance the lives of individuals with disabilities, specifically their long-term health. He is a regular speaker throughout the United States and internationally. In recognition of his efforts, Dr. Dunn has received numerous awards for his scholarship, teaching and leadership and has held offices in several professional organizations. In addition to his professional responsibilities, Dr. Dunn is an active participant in state and community efforts that focus on quality-of-life issues and enhancing economic development. Dr. Dunn serves on several regional boards as well as the governing boards of the Greater Kalamazoo Area United Way, the internationally acclaimed Gilmore Keyboard Festival, Southwest Michigan First, and the W.E. Upjohn Institute. Dr. Dunn began his teaching at the University of Connecticut in 1972, earned bachelor's and master's degrees from Northern Illinois University in 1967 and 1969, respectively. He earned his doctoral degree from Brigham Young University in 1972. Dr. Dunn's diverse experience and leadership provide a valuable resource to the Board.

**JAMES S. GUNDERSON.** Mr. Gunderson was the Founder and President of Engineered Packaging Systems (sold to Alco Standard in 1996). Currently, he is involved in the ownership of a number of small businesses including, Technical Packaging Systems, Gulf States Electric, Your Shower Door, Grand Rapids, and My Shower Door, Tampa. Additionally, he serves on the Board of Bronson Healthcare Group (past Chairman) in Kalamazoo, Michigan. Mr. Gunderson has served numerous community organizations including Kalamazoo County Chamber of Commerce (past Chairman) and the Kalamazoo County Chamber Foundation. Mr. Gunderson's business experience and knowledge of the Kalamazoo business environment are valuable resources for the Bank.

**DAVID L. HOLMES.** Mr. Holmes was an owner and general legal counsel of Phoenix Properties, LLC, a real estate management and development firm in Kalamazoo, Michigan from 1995 to 2010, at which time the business was sold to other partners of the company. Prior to 1995 he was in private practice as a partner in the Kalamazoo office of Howard & Howard Attorneys, P.C. Mr. Holmes remains an active commercial real estate investor. He has been involved as a community volunteer, including having served on the City of Kalamazoo Planning Commission, President of the LIFT Foundation, Chairperson of the Greater Kalamazoo United Way Pacesetter campaign and Vice Chairman of the Finance Council at St. Catherine of Siena Parish. Mr. Holmes brings to the Board extensive experience with the community's real estate market.

**BEN IPEMA.** Mr. Ipema is Managing Director of Operations at Level Data, Inc. a "software as a service" (SaaS) company which provides custom software and data integration services for K-12 Public School Districts throughout the United States. Ben also remains involved in The Exhibit House, which provides trade show exhibit design, build and management services; and, Airpower America, a local company producing the LiquiVac and MaxAir, air powered consumer products. Mr. Ipema's diverse experience provides a unique and valuable resource for the Bank. Mr. Ipema has served many charitable and civic organizations in Kalamazoo, including Bronson Health Foundation, Kalamazoo Deacons Conference, Southern Heights Church, Kalamazoo Christian Schools and various organizations dedicated to education, poverty and housing.

**LARRY D. LUETH.** Mr. Lueth currently serves as CEO and President of the Bank, having served as President and Senior Lender for the Bank since its inception in 2006. Prior to founding the Bank, Mr. Lueth served as Regional President for the Kalamazoo Region of National City Bank, now PNC Bank. Mr. Lueth has served many civic organizations in Kalamazoo including current board member and Treasurer of Borgess Health, board member of Downtown Tomorrow, Inc., and board member of WMU Alumni Association.

**SONDRA K. PHILLIPS.** Ms. Phillips is the sole owner of SKP Design, a firm that she founded in 1996 and Interior Design Schemes, a web based company that offers based pre-packaged interior design schemes. SKP Design offers both commercial and residential interior design services. Ms. Phillips graduated from the University of Michigan in 1989. Prior to starting SKP Design, Sondra held positions with Tilton and Lewis in Chicago, Eckert-Wordell Architects and First of America Bank in Kalamazoo. Her community activities include serving on the Permanent Collection Committee at the Kalamazoo Institute of Arts and the Development Committee at the Kalamazoo Symphony Orchestra. She has two children, and enjoys working with her daughter's Girl Scout troop. Ms. Phillips' passion for marketing, her small business perspective and community connections as a lifelong resident make her an asset to the Bank Board.

**JOHN M. SCHREUDER.** Mr. Schreuder is the Senior Executive and Chairman of the Board of both First National Bancorp, Inc. and First National Bank of Michigan. Mr. Schreuder has been Chairman of the Board since the Bank's inception in April, 2006. He has over 35 years of banking experience in Kalamazoo, Michigan. Mr. Schreuder has served on behalf of many civic and charitable organizations and currently is on the Board of Directors of the Michigan Bankers Association and Heritage Community of Kalamazoo.

**JOSHUA T. WEINER.** Mr. Weiner is the CEO of the Meyer C. Weiner Company, a commercial real estate development firm headquartered in Portage, Michigan. Mr. Weiner is the principal in over 55 income-producing real estate entities; and his primary business interest is in ownership and management for long term asset appreciation. Mr. Weiner's historical experience has provided him with in-depth knowledge of a variety of industries and this background provides the Bank with a valuable resource. Mr. Weiner's familiarity with the Kalamazoo market and the region is another asset for the Bank. Mr. Weiner has extensive experience in the banking industry from prior developmental and regional board positions with National City Bank and Irwin Union Bank and Trust. Mr. Weiner is a Board member of Bronson Health Foundation, and has served numerous charitable and civic causes and organizations, including the Kalamazoo Regional Chamber of Commerce, Western Michigan University Foundation, the United Way, the Jewish Federation of Southwest Michigan, Big Brothers/Big Sisters, Kalamazoo Civic Theatre and Farmers Alley Theatre.

**THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS  
VOTE "FOR" THE ELECTION OF ALL OF THE DIRECTOR NOMINEES.**

**BENEFICIAL\* STOCK OWNERSHIP**

The following table sets forth information as of April 14, 2015 regarding each person (including any group as that term is defined in Section 13(d)(3) of the Securities Exchange Act of 1934) who was known to be the beneficial (the right to vote or dispose of shares) owner of more than 5% of First National Bancorp, Inc.'s common stock as of that date. The table also sets forth the number of shares of common stock beneficially owned by each of our directors (including director nominees) and executive officers as of April 14, 2015.

Name of Beneficial Owner	Common Stock	Rights to Acquire <sup>(1)</sup>	Restricted Stock	Approximate Percent of Common Stock <sup>(2)</sup>
Eric V. Brown, Jr.	30,100	0	0	1.67
James J. DeKruyter	103,358	0	0	5.74
James S. DeMoss	100	0	0	0.01
John M. Dunn	10,100	0	0	0.56
James S. Gunderson	30,000	0	0	1.67
David L. Holmes	20,000	0	0	1.11
Ben Ipema	40,000	0	0	2.22
Larry D. Lueth	10,000	76,000	0	0.56
Sondra K. Phillips	3,000	0	0	0.17
John M. Schreuder	40,000	112,500	0	2.22
Joshua T. Weiner	100,000	0	0	5.55
Michael F. Dimond	5,000	31,000	0	0.28
Matthew J. Morgan	500	750	300	

\* “Beneficial” for the purposes of this table means the right to vote or dispose of shares of First National Bancorp, Inc. and shares held by the beneficial owner’s spouse.

(1) The numbers in the “Rights to Acquire” column represent the shares that may be acquired by exercise of stock options granted under the First National Bancorp, Inc. 2006, 2009 and 2012 Stock Option and Restricted Stock Plans. These numbers are not reflected in the “Approximate Percent of Common Stock” column.

(2) Based on 1,800,900 shares issued and outstanding as of April 14, 2015.

### **EXECUTIVE OFFICERS**

First National Bancorp, Inc.’s current executive officers are as follows:

<b>Name</b>	<b>Position with First National Bancorp, Inc.</b>	<b>Officer Since</b>
John M. Schreuder	Senior Executive and Chairman	March 23, 2006
Larry D. Lueth	President and CEO	March 23, 2006
Michael F. Dimond	CFO	March 23, 2006
Matthew J. Morgan	Secretary / Treasurer	January 1, 2015

### **FINANCIAL INFORMATION**

The Profit and Loss Statement of First National Bancorp, Inc. for fiscal year 2014 and the Balance Sheet as of December 31, 2014 are attached hereto in Annex A.

### **MISCELLANEOUS**

#### **Solicitation of Proxies**

First National Bancorp, Inc. will bear the cost of the solicitation of proxies from Shareholders, including the cost of printing and mailing this Proxy Statement and the accompanying materials. In addition to solicitation by mail, proxies may be solicited in person, or by telephone, facsimile or otherwise in writing or electronic transmission, by directors, officers and regular employees of First National Bancorp, Inc. or the Bank (none of whom will be paid any additional compensation for such services).

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ANNEX A

**FIRST NATIONAL BANCORP, INC. and SUBSIDIARY**  
**Consolidated Financial Report**  
**December 31, 2014**

ANNEX A

**First National Bancorp, Inc. and Subsidiary**

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**Consolidated Financial Report  
December 31, 2014**

**First National Bancorp, Inc. and Subsidiary**

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ANNEX A



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Independent Auditor's Report

To the Board of Directors  
 First National Bancorp, Inc. and Subsidiary

We have audited the accompanying consolidated financial statements of First National Bancorp, Inc. and Subsidiary, which comprise the consolidated balance sheet as of December 31, 2014 and 2013 and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

**Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First National Bancorp, Inc. and Subsidiary as of December 31, 2014 and 2013 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Plante & Moran, PLLC*

January 30, 2015



**First National Bancorp, Inc. and Subsidiary**

**Consolidated Balance Sheet**

	December 31, 2014	December 31, 2013
<b>Assets</b>		
Cash and cash equivalents (Note 2)	\$ 10,061,799	\$ 23,081,234
Investment securities - Available for sale (Note 3)	76,518,143	38,848,090
Other securities (Note 3)	1,067,350	1,084,750
Loans - Net of allowance for loan losses of \$4,716,737 and \$4,534,103 in 2014 and 2013, respectively (Note 4)	260,183,760	242,124,371
Premises and equipment - Net (Note 5)	2,528,540	1,911,902
Accrued interest receivable	1,196,000	853,796
Deferred tax asset (Note 8)	1,617,000	1,873,000
Other assets	2,054,652	1,894,691
Total assets	<b>\$ 355,227,244</b>	<b>\$ 311,671,834</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Deposits (Note 6):		
Noninterest-bearing	\$ 74,264,508	\$ 60,988,148
Interest-bearing	236,712,192	212,438,589
Total deposits	310,976,700	273,426,737
Borrowings (Note 7)	10,700,000	9,500,000
Accrued interest payable	98,687	80,607
Accrued and other liabilities	664,457	443,638
Total liabilities	322,439,844	283,450,982
<b>Stockholders' Equity (Notes 10, 11, and 12)</b>		
Common stock - No par value:		
Authorized - 2,500,000 shares		
Issued and outstanding - 1,801,900 and 1,800,900 shares at December 31, 2014 and 2013, respectively	18,052,225	18,072,904
Additional paid-in capital	1,137,883	1,038,515
Retained earnings	13,140,252	9,107,002
Accumulated other comprehensive income	457,040	2,431
Total stockholders' equity	32,787,400	28,220,852
Total liabilities and stockholders' equity	<b>\$ 355,227,244</b>	<b>\$ 311,671,834</b>

See Notes to Consolidated Financial Statements. 2

ANNEX A

**First National Bancorp, Inc. and Subsidiary**

**Consolidated Statement of Income**

	Year Ended	
	December 31, 2014	December 31, 2013
<b>Interest Income</b>		
Loans - Including fees	\$ 12,258,993	\$ 11,064,747
Debt securities:		
Taxable	581,561	259,830
Tax-exempt	580,078	545,224
Dividends	57,106	46,372
Other	51,874	54,723
Total interest income	13,529,612	11,970,896
<b>Interest Expense</b>	1,288,580	1,236,261
<b>Net Interest Income</b>	12,241,032	10,734,635
<b>Provision for Loan Losses</b> (Note 4)	340,000	808,000
<b>Net Interest Income After Provision for Loan Losses</b>	11,901,032	9,926,635
<b>Noninterest Income</b>		
Service charges and fees	503,842	552,259
Net gain on sale of loans	146,856	359,477
Realized gain on sale of securities	1,872	51,925
Other	483,269	315,469
Total noninterest income	1,135,839	1,279,130
<b>Noninterest Expenses</b>		
Salaries and employee benefits (Note 11)	4,225,028	3,819,416
Occupancy and equipment (Note 5)	856,828	872,710
Data processing	420,836	312,649
FDIC insurance	177,312	181,072
Professional fees	360,230	318,584
Other	1,234,708	1,122,676
Total noninterest expenses	7,274,942	6,627,107
<b>Income - Before income taxes</b>	5,761,929	4,578,658
<b>Income Tax Expense</b> (Note 8)	1,728,679	1,339,568
<b>Net Income</b>	<b>\$ 4,033,250</b>	<b>\$ 3,239,090</b>

See Notes to Consolidated Financial Statements. 3

**First National Bancorp, Inc. and Subsidiary**

**Consolidated Statement of Comprehensive Income**

	Year Ended	
	December 31, 2014	December 31, 2013
<b>Net Income</b>	\$ 4,033,250	\$ 3,239,090
<b>Other Comprehensive Income (Loss)</b> - Unrealized gain (loss) on securities		
Gain (loss) arising during the year	691,481	(970,175)
Reclassification adjustment for realized gain on sale of securities	(1,872)	(51,925)
Income tax impact	(235,000)	348,001
Total other comprehensive income (loss)	454,609	(674,099)
<b>Comprehensive Income</b>	<b>\$ 4,487,859</b>	<b>\$ 2,564,991</b>

See Notes to Consolidated Financial Statements. 4

## First National Bancorp, Inc. and Subsidiary

### Consolidated Statement of Changes in Stockholders' Equity

	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive Income	Total
<b>Balance - January 1, 2013</b>	1,800,900	\$ 18,084,178	\$ 923,065	\$ 5,867,912	\$ 676,530	\$	\$ 25,551,685
Comprehensive income (loss):							
Net income	-	-	-	3,239,090	-	-	3,239,090
Changes in unrealized gain on securities	-	-	-	-	(1,022,100)	-	(1,022,100)
Income tax effect	-	-	-	-	348,001	-	348,001
Total comprehensive income							2,564,991
Stock-based compensation	-	-	142,405	-	-	-	142,405
Stock options exercised	-	(11,274)	(26,955)	-	-	-	(38,229)
<b>Balance - December 31, 2013</b>	1,800,900	18,072,904	1,038,515	9,107,002	2,431	2,431	28,220,852
Comprehensive income (loss):							
Net income	-	-	-	4,033,250	-	-	4,033,250
Changes in unrealized gain on securities	-	-	-	-	689,609	-	689,609
Income tax effect	-	-	-	-	(235,000)	-	(235,000)
Total comprehensive income							4,487,859
Issuance - Common voting	1,000	21,000	-	-	-	-	21,000
Stock-based compensation	-	-	144,794	-	-	-	144,794
Stock options exercised	-	(41,679)	(45,426)	-	-	-	(87,105)
<b>Balance - December 31, 2014</b>	1,801,900	\$ 18,052,225	\$ 1,137,883	\$ 13,140,252	\$ 457,040	\$	\$ 32,787,400

See Notes to Consolidated Financial Statements.

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ANNEX A

## First National Bancorp, Inc. and Subsidiary

### Consolidated Statement of Cash Flows

	Year Ended	
	December 31, 2014	December 31, 2013
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 4,033,250	\$ 3,239,090
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	249,055	256,402
Gain on sale of securities	(1,872)	(51,925)
Provision for loan losses	340,000	808,000
Amortization of securities - Net	426,901	253,273
Deferred income taxes	21,000	(170,410)
Stock-based compensation expense	144,794	142,405
Gain on sale of mortgages	(146,856)	(359,477)
Loans originated for sale	(7,704,403)	(18,585,818)
Proceeds from loan sales	7,851,259	18,945,295
Net change in:		
Accrued interest receivable	(342,204)	(74,616)
Other assets	(159,962)	(843,069)
Accrued interest payable	18,080	(10,620)
Accrued liabilities	220,819	110,665
Net cash provided by operating activities	4,949,861	3,659,195
<b>Cash Flows from Investing Activities</b>		
Purchase of other securities	-	(80,250)
Redemption of other securities	17,400	-
Activity in available-for-sale securities:		
Sales	1,631,115	1,417,393
Maturities, prepayments, and calls	9,244,513	7,629,820
Purchases	(48,281,100)	(16,400,758)
Net increase in loans	(18,399,389)	(38,195,642)
Additions to premises and equipment	(865,693)	(129,162)
Net cash used in investing activities	(56,653,154)	(45,758,599)
<b>Cash Flows from Financing Activities</b>		
Net increase in deposit accounts	37,549,963	57,297,635
Effect of stock options exercised	(87,105)	(38,229)
New advances and other borrowings	8,600,000	2,000,000
Repayment of long-term debt	(7,000,000)	(3,000,000)
Net change in line of credit	(400,000)	2,500,000
Issuance of common stock	21,000	-
Net cash provided by financing activities	38,683,858	58,759,406
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	(13,019,435)	16,660,002
<b>Cash and Cash Equivalents - Beginning of year</b>	23,081,234	6,421,232
<b>Cash and Cash Equivalents - End of year</b>	<b>\$ 10,061,799</b>	<b>\$ 23,081,234</b>
<b>Supplemental Cash Flow Information - Cash paid for</b>		
Interest	\$ 1,270,500	\$ 1,246,881
Income taxes	1,550,000	1,540,000

See Notes to Consolidated Financial Statements. 6

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 1 - Nature of Business and Significant Accounting Policies

**Basis of Presentation and Consolidation** - The consolidated financial statements include the accounts of First National Bancorp, Inc. (the "Corporation") and its wholly owned subsidiary, First National Bank of Michigan (the "Bank"). All significant intercompany balances and transactions have been eliminated in consolidation.

**Use of Estimates** - In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of investment securities. See Notes 13 and 14 for fair value disclosures.

**Nature of Operations** - The Corporation provides a variety of financial services to individuals and small businesses through its two branch locations and main office in Kalamazoo, Michigan and a branch location in Grand Rapids, Michigan. Its primary deposit products are checking, savings, and term certificate accounts and its primary lending products are commercial loans.

**Cash and Cash Equivalents** - For the purpose of the consolidated statement of cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold which mature within 90 days.

**Investment Securities** - Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as available for sale and are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

**Loans Held for Sale** - Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized in a valuation allowance by charges to income.

**Loans** - The Bank grants mortgage, commercial, and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial loans throughout west Michigan. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the effective interest method.

**Allowance for Loan Losses** - The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonimpaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

**Foreclosed Assets** - Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of the foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

**Comprehensive Income** - Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheet, such items, along with net income, are components of comprehensive income. The accumulated other comprehensive income consists solely of the net unrealized gain or loss on investment securities available for sale less the tax effect of approximately \$236,000 and \$1,000 at December 31, 2014 and 2013, respectively.

**Off-balance-sheet Instruments** - In the ordinary course of business, the Corporation has entered into commitments under commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

**Banking Premises and Equipment** - The Bank operates out of owned and leased facilities. Leasehold improvements and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets.

**Income Taxes** - Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. A valuation allowance is recorded against the net deferred tax asset based on the Corporation's estimates of taxable income and the period over which its deferred tax assets will be recoverable. If it is determined by the Corporation that it is more likely than not that future taxable income will not be sufficient to realize such tax benefits, a valuation allowance is recorded against the net deferred tax asset.

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

**Transfers of Financial Assets** - Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of the right) to pledge or exchange the transferred assets, and (3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Subsequent Events** - The consolidated financial statements and related disclosures include evaluation of events up through and including January 30, 2015, which is the date the consolidated financial statements were available to be issued.

**Recent Accounting Pronouncement** - During 2014, the Financial Accounting Standards Board (FASB) released its long-awaited standard addressing revenue recognition. Accounting Standards Update (ASU) 2014-09 (Topic 606), *Revenue From Contracts With Customers*, adopts a standardized approach for revenue recognition and was a joint effort with the International Accounting Standards Board (IASB). The new revenue recognition standard is based on a core principle: "Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services."

This ASU is effective for public companies for annual reporting periods (including interim reporting periods within) beginning after December 15, 2016; early implementation is not allowed. For nonpublic companies, the guidance is effective for annual reporting periods beginning after December 15, 2017, and interim and annual reporting periods thereafter. Early adoption is permitted for nonpublic companies with certain caveats. The Corporation is currently evaluating the impact of adopting the ASU.

In 2014, the FASB issued ASU 2014-01 to permit entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the statement of operations as a component of income tax expense. The new authoritative guidance is effective for public companies in 2014 and will be effective for nonpublic companies for periods after January 1, 2015. The Corporation is evaluating the impact of adopting the ASU.

ANNEX A

**First National Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements  
December 31, 2014 and 2013**

**Note 2 - Restrictions on Cash and Amounts Due from Banks**

The Bank is required to maintain average balances on hand or with the Federal Reserve Bank and other financial institutions. At December 31, 2014 and 2013, these reserve balances amounted to \$2,360,000 and \$1,975,000, respectively.

**Note 3 - Securities**

The amortized cost and fair value of securities, with gross unrealized gains and losses, are as follows:

	2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available-for-sale securities:				
U.S. government and federal agency	\$ 23,337,365	\$ 49,623	\$ (66,096)	\$ 23,320,892
U.S. Treasury	20,352,411	51,185	-	20,403,596
Collateralized mortgage obligations	361,767	8,875	-	370,642
State and municipal	31,773,560	725,243	(75,790)	32,423,013
Total available-for-sale securities	<u>\$ 75,825,103</u>	<u>\$ 834,926</u>	<u>\$ (141,886)</u>	<u>\$ 76,518,143</u>
	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available-for-sale securities:				
U.S. government and federal agency	\$ 13,967,435	\$ 56,538	\$ (258,990)	\$ 13,764,983
Corporate	754,390	5,002	-	759,392
Collateralized mortgage obligations	434,874	193	-	435,067
State and municipal	23,687,960	451,950	(251,262)	23,888,648
Total available-for-sale securities	<u>\$ 38,844,659</u>	<u>\$ 513,683</u>	<u>\$ (510,252)</u>	<u>\$ 38,848,090</u>

At December 31, 2014 and 2013, securities with a carrying value of approximately \$43,000,000 and \$14,000,000, respectively, were pledged to secure borrowings.

**First National Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements  
December 31, 2014 and 2013**

**Note 3 - Securities (Continued)**

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2014 are as follows:

	Available-for-sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 13,701,160	\$ 13,676,978
Due in one through five years	49,952,425	50,372,520
Due after five years through ten years	11,809,751	12,098,003
Total	<u>75,463,336</u>	<u>76,147,501</u>
Collateralized mortgage obligations	<u>361,767</u>	<u>370,642</u>
Total	<u>\$ 75,825,103</u>	<u>\$ 76,518,143</u>

For the years ended December 31, 2014 and 2013, proceeds from sales of securities available for sale amounted to \$1,631,115 and \$1,417,393, resulting in gross realized gains of \$1,872 and \$51,925, respectively.

Information pertaining to securities with gross unrealized losses at December 31, 2014 and 2013, aggregated by investment category and length of time that individual securities have been in a continuous loss position, is as follows:

	2014			
	Less than 12 Months		Over 12 Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. government and federal agency	\$ 14,055	\$ 5,893,056	\$ 52,041	\$ 4,045,043
State and municipal	43,816	4,680,780	31,974	2,525,358
Total available-for-sale securities	<u>\$ 57,871</u>	<u>\$ 10,573,836</u>	<u>\$ 84,015</u>	<u>\$ 6,570,401</u>

**First National Bancorp, Inc. and Subsidiary**
**Notes to Consolidated Financial Statements  
December 31, 2014 and 2013**
**Note 3 - Securities (Continued)**

	2013			
	Less than 12 Months		Over 12 Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. government and federal agency	\$ 258,990	\$ 8,072,309	\$ -	\$ -
State and municipal	177,475	5,775,241	73,787	1,265,155
Total available-for- sale securities	<u>\$ 436,465</u>	<u>\$ 13,847,550</u>	<u>\$ 73,787</u>	<u>\$ 1,265,155</u>

At December 31, 2014 and 2013, there were 33 and 32 securities, respectively, in an unrealized loss position. Unrealized losses on securities have not been recognized into income because the issuers' bonds are of high credit quality, we have the intent and ability to hold the securities for the foreseeable future, and the decline in fair value is primarily due to increased market interest rates. The fair value is expected to recover as the bonds approach the maturity date.

Other securities, totaling \$1,067,350 and \$1,084,750 at December 31, 2014 and 2013, respectively, consist of restricted Federal Home Loan Bank Stock and Federal Reserve Bank Stock. These stocks are carried at cost, which approximates market value.

**First National Bancorp, Inc. and Subsidiary**
**Notes to Consolidated Financial Statements  
December 31, 2014 and 2013**
**Note 4 - Loans**

A summary of the balances of loans is as follows:

	2014	2013
Mortgage loans on real estate:		
Residential	\$ 51,735,469	\$ 52,451,473
Commercial	130,645,086	121,604,820
Construction	29,876,675	24,861,380
Total mortgage loans on real estate	212,257,230	198,917,673
Commercial loans	49,368,240	44,103,456
Consumer installment loans	3,797,411	4,085,126
Total loans	265,422,881	247,106,255
Less:		
Allowance for loan losses	(4,716,737)	(4,534,103)
Net deferred loan fees	(522,384)	(447,781)
Net loans	<u>\$ 260,183,760</u>	<u>\$ 242,124,371</u>

Activity in the allowance for loan losses for 2014 and 2013 is summarized as follows:

	Year Ended December 31, 2014						
	Real Estate - Construction	Real Estate - Residential	Real Estate - Commercial	Commercial and Industrial	Consumer	Unallocated	Total
Beginning balance	\$ 764,487	\$ 980,760	\$ 2,025,560	\$ 464,464	\$ 61,640	\$ 237,192	\$ 4,534,103
Charge-offs	-	-	(164,779)	-	-	-	(164,779)
Recoveries	-	300	-	7,113	-	-	7,413
Provision	(212,815)	98,522	335,121	32,557	(35,059)	121,674	340,000
Ending balance	<u>\$ 551,672</u>	<u>\$ 1,079,582</u>	<u>\$ 2,195,902</u>	<u>\$ 504,134</u>	<u>\$ 26,581</u>	<u>\$ 358,866</u>	<u>\$ 4,716,737</u>
Ending allowance balance attributable to loans - Collectively evaluated for impairment	<u>\$ 551,672</u>	<u>\$ 1,079,582</u>	<u>\$ 2,195,902</u>	<u>\$ 504,134</u>	<u>\$ 26,581</u>	<u>\$ 358,866</u>	<u>\$ 4,716,737</u>
Loans and leases - Collectively evaluated for impairment	<u>\$ 29,876,675</u>	<u>\$ 52,201,374</u>	<u>\$ 130,645,086</u>	<u>\$ 48,902,335</u>	<u>\$ 3,797,411</u>	<u>\$ -</u>	<u>\$ 265,422,881</u>

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 4 - Loans (Continued)

	Year Ended December 31, 2013						Total
	Real Estate - Construction	Real Estate - Residential	Real Estate - Commercial	Commercial and Industrial	Consumer	Unallocated	
Beginning balance	\$ 303,458	\$ 961,601	\$ 1,609,808	\$ 570,631	\$ 69,012	\$ 194,692	\$ 3,709,202
Charge-offs	-	(2,684)	-	-	-	-	(2,684)
Recoveries	900	-	-	18,685	-	-	19,585
Provision	461,029	20,943	415,752	(124,852)	(7,372)	42,500	808,000
Ending balance	\$ 764,487	\$ 980,760	\$ 2,025,560	\$ 464,464	\$ 61,640	\$ 237,192	\$ 4,534,103
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ -	\$ -	\$ 73,348	\$ -	\$ -	\$ -	\$ 73,348
Collectively evaluated for impairment	764,487	980,760	1,952,212	464,464	61,640	237,192	4,460,755
Ending allowance balance	\$ 764,487	\$ 980,760	\$ 2,025,560	\$ 464,464	\$ 61,640	\$ 237,192	\$ 4,534,103
Loans and leases:							
Individually evaluated for impairment	\$ -	\$ 267,533	\$ 1,547,967	\$ 299,123	\$ -	\$ -	\$ 2,114,623
Collectively evaluated for impairment	24,861,380	52,183,940	120,056,853	43,804,333	4,085,126	-	244,991,632
Total loans and leases	\$ 24,861,380	\$ 52,451,473	\$ 121,604,820	\$ 44,103,456	\$ 4,085,126	\$ -	\$ 247,106,255

#### Credit Risk Grading

The Corporation categorized each loan into credit risk categories based on current financial information, overall debt service coverage, comparison against industry averages, collateral coverage, historical payment experience, and current economic trends. The Company uses the following definitions for credit risk ratings:

**Pass** - Credits not covered by the definitions below are pass credits, which are not considered to be adversely rated.

**Special Mention** - Loans classified as special mention, or watch credits, have a potential weakness or weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**Substandard** - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution may sustain some loss if the deficiencies are not corrected.

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 4 - Loans (Continued)

**Doubtful** - Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

The following table is a summary of loans stratified by credit risk grading:

	December 31, 2014				Total
	Pass	Special Mention (5)	Substandard (6)	Doubtful (7)	
Real estate - Residential:					
Revolving lines of credit	\$ 13,332,044	\$ -	\$ 58,152	\$ -	\$ 13,390,196
1-4 family residential	17,154,876	240,049	238,180	-	17,633,105
Multi-family	20,712,168	-	-	-	20,712,168
Total real estate - Residential	51,199,088	240,049	296,332	-	51,735,469
Real estate - Commercial - Nonfarm - Nonresidential	128,180,981	2,464,105	-	-	130,645,086
Real estate - Construction:					
1-4 family residential	10,347,712	77,491	-	-	10,425,203
Other	19,451,472	-	-	-	19,451,472
Total real estate - Construction	29,799,184	77,491	-	-	29,876,675
Commercial and industrial	48,783,147	-	585,093	-	49,368,240
Consumer	3,797,411	-	-	-	3,797,411
Total	\$ 261,759,811	\$ 2,781,645	\$ 881,425	\$ -	\$ 265,422,881

	December 31, 2013				Total
	Pass	Special Mention (5)	Substandard (6)	Doubtful (7)	
Real estate - Construction:					
1-4 family residential	\$ 9,645,362	\$ -	\$ -	\$ -	\$ 9,645,362
Commercial construction and land development	15,216,018	-	-	-	15,216,018
Total real estate - Construction	24,861,380	-	-	-	24,861,380
Real estate - Residential:					
Revolving lines of credit	11,399,303	58,205	-	-	11,457,508
1-4 family residential	17,216,199	323,586	267,533	-	17,807,318
Multi-family	23,186,647	-	-	-	23,186,647
Total real estate - Residential	51,802,149	381,791	267,533	-	52,451,473
Real estate - Commercial - Nonfarm nonresidential	117,487,267	2,569,586	1,547,967	-	121,604,820
Commercial and industrial	43,540,874	263,459	299,123	-	44,103,456
Consumer	4,085,126	-	-	-	4,085,126
Total	\$ 241,776,796	\$ 3,214,836	\$ 2,114,623	\$ -	\$ 247,106,255

At December 31, 2014 and 2013, the SBA and USDA guaranteed \$190,437 and \$1,238,374, respectively, of loan principal on the loans classified as substandard (6).



## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 4 - Loans (Continued)

##### Age Analysis of Past Due Loans

At December 31, 2014, there were no loans over 30 days past due or on nonaccrual. Information pertaining to delinquent loans from 2013 is as follows:

	December 31, 2013						Recorded Investment > 90 Days and Accruing
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Financing Receivables	
Real estate - Construction:							
1-4 family residential	\$ -	\$ -	\$ 267,533	\$ 267,533	\$ 9,377,829	\$ 9,645,362	\$ -
Commercial construction and land development	-	-	-	-	15,216,018	15,216,018	-
Real estate - Residential:							
Resolving lines of credit	-	-	-	-	11,457,508	11,457,508	-
1-4 family residential	-	-	-	-	17,807,318	17,807,318	-
Multi-family	-	-	-	-	23,186,647	23,186,647	-
Real estate - Commercial - Nonfarm residential	-	-	1,547,967	1,547,967	120,056,853	121,604,820	-
Commercial and industrial	-	-	299,123	299,123	43,804,333	44,103,456	-
Consumer	-	-	-	-	4,085,126	4,085,126	-
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 2,114,623</b>	<b>\$ 2,114,623</b>	<b>\$ 244,991,632</b>	<b>\$ 247,106,255</b>	<b>\$ -</b>

##### Impaired Loans

A loan is considered impaired when it is probable that not all principal and interest amounts will be collected according to the loan contract. Individual commercial loans are evaluated for impairment. Impaired loans are written down by the establishment of a specific allowance where necessary.

At December 31, 2014, there no loans considered impaired. Information regarding impaired loans is as follows as of and for the year ended December 31, 2013:

	As of and For the Year Ended December 31, 2013				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment for the Year	Interest Income Recognized for the Year
With no related allowance recorded:					
Real estate - Residential	\$ 267,533	\$ 267,533	\$ -	\$ 268,060	\$ -
Commercial and industrial	299,123	299,123	-	299,153	-
Subtotal	566,656	566,656	-	567,213	-
With an allowance recorded - Real estate - Commercial	1,547,967	1,547,967	73,348	1,551,056	-
<b>Total</b>	<b>\$ 2,114,623</b>	<b>\$ 2,114,623</b>	<b>\$ 73,348</b>	<b>\$ 2,118,269</b>	<b>\$ -</b>

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 4 - Loans (Continued)

##### Nonaccrual Loans

There were no nonaccrual loan balances at December 31, 2014. Nonaccrual loan balances at December 31, 2013 are as follows:

Real estate - Residential - 1-4 family residential	\$ 267,533
Real estate - Commercial - Nonfarm nonresidential	1,547,967
Commercial and industrial	299,123
<b>Subtotal</b>	<b>\$ 2,114,623</b>

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cost-recovery method or cash basis until qualifying for return to accrual.

In the ordinary course of business, the Bank has granted loans to principal officers and directors and their affiliates amounting to approximately \$8,000,000 at December 31, 2014 and \$11,800,000 at December 31, 2013.

#### Note 5 - Bank Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment is as follows:

	2014	2013
Land	\$ 100,000	\$ 100,000
Buildings and building improvements	1,250,000	1,250,000
Leasehold improvements	1,119,275	641,341
Furniture, fixtures, and equipment	1,306,426	1,163,775
Construction in progress	245,108	-
<b>Total cost</b>	<b>4,020,809</b>	<b>3,155,116</b>
Accumulated depreciation	(1,492,269)	(1,243,214)
<b>Net bank premises and equipment</b>	<b>\$ 2,528,540</b>	<b>\$ 1,911,902</b>

The Bank has two leases with a company in which a director is a part owner. The first lease calls for monthly payments of \$10,259 through 2023 and is renewable for two additional five-year terms. The second lease was entered into in September 2010 and calls for minimum monthly payments of \$9,939 through 2025 and is renewable for two additional five-year terms.

Total rent expense for the years ended December 31, 2014 and 2013 amounted to \$313,731 and \$303,965, respectively.

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 5 - Bank Premises and Equipment (Continued)

Pursuant to the terms of noncancelable lease agreements in effect at December 31, 2014 pertaining to banking premises and equipment, future minimum rent commitments under various operating leases are as follows:

Years Ending December 31	Related Party Leases	Other Lease Agreement
2015	\$ 242,386	\$ 73,387
2016	242,386	71,321
2017	242,386	65,921
2018	242,386	65,648
2019	242,386	33,309
Thereafter	1,157,752	-
Total	\$ 2,369,682	\$ 309,586

#### Note 6 - Deposits

The following is a summary of the distribution of deposits at December 31:

	2014	2013
Noninterest-bearing deposits	\$ 74,264,508	\$ 60,988,148
NOW accounts	33,739,129	24,833,663
Savings and money market accounts	114,510,711	94,951,605
Time:		
Under \$100,000	52,291,563	56,370,042
\$100,000 and over	36,170,789	36,283,279
Total	\$ 310,976,700	\$ 273,426,737

At December 31, 2014, the scheduled maturities of time deposits are as follows:

2015	\$ 50,715,291
2016	19,616,246
2017	14,138,612
2018	3,594,275
2019	397,928
Total	\$ 88,462,352

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 7 - Borrowings

The Bank has a formula-based credit facility with the Federal Reserve Bank to meet its short-term borrowing needs. There were no amounts outstanding at December 31, 2014 and 2013. The unused portion of the facility was approximately \$35,500,000 and \$31,700,000 at December 31, 2014 and 2013, respectively. The collateral on the borrowing arrangement consists of commercial, commercial real estate, and consumer loans with a book balance of approximately \$46,600,000 and \$39,600,000 at December 31, 2014 and 2013, respectively.

The Bank has an unsecured fed-funds line of credit with correspondent banks to meet its short-term borrowing needs. Total available borrowings were \$12,000,000 and \$14,500,000 at December 31, 2014 and 2013, respectively. There was no amount outstanding at December 31, 2014 or 2013.

As of December 31, 2014, the Bank had four advances totaling \$8,600,000 from the Federal Home Loan Bank (FHLB) with interest rates ranging from 0.36 percent to 2.17 percent. As of December 31, 2013, the Bank had four advances totaling \$7,000,000 with interest rates ranging from 1.32 to 2.17 percent. Interest is payable monthly. The advances were collateralized by approximately \$91,000,000 and \$70,000,000 of mortgage loans as of December 31, 2014 and 2013, respectively, under a blanket collateral agreement. The advances are also secured by investment securities as described in Note 3. Total advances outstanding (including any overdraft lines of credit or letters of credit) cannot exceed \$50,000,000. The advances are subject to prepayment penalties and the provisions and conditions of the credit policy of the Federal Home Loan Bank.

The Bank during 2014 decided to no longer have an overdraft line of credit agreement with the FHLB. The total available credit outstanding under this agreement was \$1,000,000 as of December 31, 2013.

In addition, the Corporation entered into a line of credit agreement with a bank allowing for available credit up to \$5,000,000. Each quarter, the Corporation may elect the interest rate as either the (1) Wall Street Journal Prime Rate or (2) one-month LIBOR plus 2.75 percent. At December 31, 2014 and 2013, the Corporation selected option 2 and the interest rate was 2.92 percent. Interest is payable monthly with the entire principal balance due on the maturity date of May 10, 2016. The line of credit is secured by all the common stock of the Bank. As of December 31, 2014 and 2013, the total amount outstanding was \$2,100,000 and \$2,500,000, respectively.

ANNEX A

**First National Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements  
December 31, 2014 and 2013**

**Note 7 - Borrowings (Continued)**

The balance of the above borrowings matures as follows:

2015	\$ 4,600,000
2016	4,100,000
2017	<u>2,000,000</u>
Total	<u>\$ 10,700,000</u>

**Note 8 - Income Taxes**

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

	<u>2014</u>	<u>2013</u>
Deferred tax assets:		
Allowance for loan losses	\$ 1,556,000	\$ 1,496,895
Stock options	413,000	349,000
Other	<u>259,000</u>	<u>299,163</u>
Total deferred tax assets	2,228,000	2,145,058
Deferred tax liabilities:		
Net unrealized gain on securities available for sale	236,000	1,000
Net deferred loan fees and other	<u>375,000</u>	<u>271,058</u>
Total deferred tax liabilities	<u>611,000</u>	<u>272,058</u>
Net deferred tax assets	<u>\$ 1,617,000</u>	<u>\$ 1,873,000</u>

Allocation of income taxes between current and deferred portions is as follows:

	<u>2014</u>	<u>2013</u>
Current expense	\$ 1,707,679	\$ 1,509,978
Deferred income tax expense (benefit)	21,000	(170,410)

**First National Bancorp, Inc. and Subsidiary**

**Notes to Consolidated Financial Statements  
December 31, 2014 and 2013**

**Note 8 - Income Taxes (Continued)**

The reasons for the differences between the income tax expense at the federal statutory income tax rate and the recorded income tax benefit are summarized as follows:

	<u>2014</u>	<u>2013</u>
Income before income taxes	\$ 5,761,929	\$ 4,578,658
Income tax expense at federal statutory rate of 34 percent	\$ 1,959,056	\$ 1,556,744
Decreases from nontaxable income - Net of nondeductible expenses	<u>(230,377)</u>	<u>(217,176)</u>
Total income tax expense	<u>\$ 1,728,679</u>	<u>\$ 1,339,568</u>

**Note 9 - Off-balance-sheet Activities**

**Credit-related Financial Instruments** - The Corporation is a party to credit-related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet.

The Corporation's exposure to credit loss is represented by the contractual amount of these commitments. The Corporation follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2014 and 2013, the following financial instruments, whose contract amounts represent credit risk, were outstanding:

	<u>Contract Amount</u>	
	<u>2014</u>	<u>2013</u>
Commitments to grant loans	\$ 18,045,000	\$ 20,812,000
Unfunded commitments under lines of credit	75,539,000	74,286,707
Commercial and standby letters of credit	1,183,907	1,894,302

Commitments to grant loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Corporation, is based on management's credit evaluation of the customer.

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 9 - Off-balance-sheet Activities (Continued)

Unfunded commitments under commercial lines of credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are collateralized and usually contain a specified maturity date; some may not be drawn upon to the total extent to which the Corporation is committed.

Commercial and standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those letters of credit are used primarily to support public and private borrowing arrangements. Essentially, all letters of credit issued have expiration dates within one year. The credit risk involved is extending loan facilities to customers. The Corporation generally holds collateral supporting those commitments if deemed necessary.

**Legal Contingencies** - Various legal claims also arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on the Corporation's consolidated financial statements.

#### Note 10 - Minimum Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2014 and 2013, that the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2014, the most recent notification from the Bank's primary regulator categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category.

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 10 - Minimum Regulatory Capital Requirements (Continued)

In 2013, the federal banking agencies issued revisions to the existing capital rules to incorporate certain changes to the Basel capital framework, including Basel III and other elements. The intent is to strengthen the definition of regulatory capital, increase risk-based capital requirements, and make selected changes to the calculation of risk-weighted assets. Beginning January 1, 2015, banks transitioned to the new rules and will report results with the first call report of 2015. As part of the new rules, there are several provisions affecting the Corporation, such as the implementation of a new common tier ratio, the start of a capital conservation buffer, and increased prompt corrective action capital adequacy thresholds.

The Bank's actual capital amounts and ratios as of December 31, 2014 and 2013 are presented in the table below.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(000s omitted from dollar amounts)						
<b>As of December 31, 2014</b>						
Total capital to risk-weighted assets	\$ 37,582	14.3 %	\$ 21,067	8.0 %	\$ 26,334	10.0 %
Tier I capital to risk-weighted assets	34,283	13.0	10,534	4.0	15,800	6.0
Tier I capital to average assets	34,283	9.7	14,180	4.0	17,725	5.0
<b>As of December 31, 2013</b>						
Total capital to risk-weighted assets	33,228	13.5	19,730	8.0	24,662	10.0
Tier I capital to risk-weighted assets	30,138	12.2	9,865	4.0	14,797	6.0
Tier I capital to average assets	30,138	9.8	12,323	4.0	15,404	5.0

#### Note 11 - Stock Option Plan

At December 31, 2014, the Corporation has a share-based compensation plan, which is described below. The compensation cost that has been charged against income for the plan was \$144,794 and \$142,405 for 2014 and 2013, respectively. There was approximately \$48,000 of deferred income tax benefits recognized in the consolidated statement of income for share-based compensation arrangements for 2014 and 2013.

The Corporation's stock option and restricted stock plan (the "Plan"), which is stockholder-approved and monitored by the board, permits the grant of stock options to its employees for up to 350,000 shares of common stock. The Plan was initially adopted in 2006 and allowed 150,000 option shares. A similar plan was adopted that granted 100,000 additional option shares in both 2009 and 2012. The Corporation believes that such awards better align the interests of its employees with those of its stockholders. Option awards are generally granted with an exercise price equal to the market price of the Corporation's stock at the date of grant; those option awards generally vest over three years of continuous service.

**First National Bancorp, Inc. and Subsidiary**
**Notes to Consolidated Financial Statements  
December 31, 2014 and 2013**
**Note 11 - Stock Option Plan (Continued)**

The calculated value of each option award is estimated on the date of grant using a Black-Scholes option valuation model that uses the weighted average assumptions noted in the following table. Expected volatilities are based on similar volatilities of comparable banks. The Corporation uses comparable bank data to estimate option exercise and employee termination within the valuation model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	2014	2013
Expected volatility	20 %	20 %
Expected dividends	0	0
Expected term (in years)	10	10
Risk-free rate	2.19 %	2.89 %

A summary of option activity under the Plan for the year ended December 31, 2014 is presented below:

Options	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)
Outstanding at January 1, 2013	263,850	\$ 11.29	5.3
Granted	<u>21,550</u>	19.00	9.9
Exercised	(5,150)	10.34	-
Forfeited	(3,000)	14.42	-
Outstanding at January 1, 2014	277,250	11.87	5.7
Granted	18,700	21.00	5.0
Exercised	(10,133)	10.29	-
Forfeited	<u>(817)</u>	17.33	-
Outstanding at December 31, 2014	<u>285,000</u>	11.87	5.0
Exercisable at December 31, 2014	<u>241,567</u>	10.25	4.3

The weighted average grant-date calculated value of options granted during 2014 and 2013 was \$7.03 and \$6.90, respectively.

As of December 31, 2014, there was approximately \$247,000 of total unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized through December 31, 2017.

**First National Bancorp, Inc. and Subsidiary**
**Notes to Consolidated Financial Statements  
December 31, 2014 and 2013**
**Note 11 - Stock Option Plan (Continued)**

Additionally, in 2014, the Corporation awarded 1,500 restricted shares at a value of \$31,500 (\$21.00 per share) which will be recognized over the vesting period, which is five years.

**Note 12 - Restrictions on Dividends, Loans, and Advances**

Banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to the Corporation.

Prior approval of the Bank's federal regulator is required if the total dividends declared by the Bank in a calendar year exceed the sum of the net profits of the Bank for the preceding three years, less any required transfers to surplus. In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum standards. At December 31, 2014, the Bank has approximately \$9,800,000 in retained earnings available for the payment of dividends. Accordingly, approximately \$23,000,000 of the Corporation's investment in the Bank was restricted at December 31, 2014.

Loans or advances made by the Bank to the Corporation are generally limited to 10 percent of the Bank's capital stock and surplus. Accordingly, at December 31, 2014, Bank funds available for loans or advances to the Corporation amounted to \$3,900,000.

Loans made by the Bank to any one customer are generally limited to 15 percent of unconsolidated bank equity, adjusted for the allowance for loan losses. At December 31, 2014, this limits the loans made by the Bank to any one customer to \$5,850,000.

**Note 13 - Fair Value of Financial Instruments**

The carrying amounts and fair values of financial instruments are as follows:

	2014		2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	\$ 10,061,799	\$ 10,061,799	\$ 23,081,234	\$ 23,081,234
Investment securities - Available for sale	76,518,143	76,518,143	38,848,090	38,848,090
Other securities	1,067,350	1,067,350	1,084,750	1,084,750
Loans - Net	260,183,760	266,743,268	242,124,371	247,476,884
Accrued interest receivable	1,196,000	1,196,000	853,796	853,796
Financial liabilities:				
Deposits	310,976,700	310,980,276	273,426,737	273,550,813
Borrowings	10,700,000	10,795,135	9,500,000	9,659,423
Accrued interest payable	98,687	98,687	80,607	80,607

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 13 - Fair Value of Financial Instruments (Continued)

As further discussed in Note 14, the fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts may not necessarily represent the underlying fair value of the Corporation.

A summary of the methods and significant assumptions used to estimate the fair values of financial instruments is as follows:

**Cash and Cash Equivalents** - The carrying amounts of cash and cash equivalents approximate fair values.

**Investment Securities** - Fair values of securities are based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. The carrying value of other securities approximates fair value based on the redemption provisions of the issuers and significant observable inputs.

**Loans Receivable** - For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other 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. Fair values of nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

**Deposit Liabilities** - The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

**Borrowings** - The fair value of the Corporation's borrowings is estimated using fair value of debt based on current rates for similar financing.

**Accrued Interest** - The carrying amounts of accrued interest approximate fair value.

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 13 - Fair Value of Financial Instruments (Continued)

**Other Financial Instruments** - The fair value of other financial instruments, including loan commitments and unfunded letters of credit, based on discounted cash flow analyses, is not material.

#### Note 14 - Fair Value Measurements

Accounting standards require certain assets and liabilities be reported at fair value in the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

The following tables present information about the Corporation's assets measured at fair value on a recurring basis at December 31, 2014 and 2013 and the valuation techniques used by the Corporation to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the Corporation has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals. The Corporation's Level 2 investment securities consisted primarily of U.S. government agency notes, corporate bonds, municipal securities, and collateralized mortgage obligations.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair values are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Corporation's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 14 - Fair Value Measurements (Continued)

During 2014 and 2013, there were no transfers between Levels 1, 2, or 3 in the asset classes.

##### Assets Measured at Fair Value on a Recurring Basis at December 31, 2014

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2014
<b>Assets - Available-for-sale</b>				
investment securities				
U.S. government and federal agency	\$ -	\$ 23,320,892	\$ -	\$ 23,320,892
U.S. Treasury	20,403,596	-	-	20,403,596
Collateralized mortgage obligation	-	370,642	-	370,642
State and municipal	-	28,164,468	4,258,545	32,423,013
<b>Total assets</b>	<b>\$ 20,403,596</b>	<b>\$ 51,856,002</b>	<b>\$ 4,258,545</b>	<b>\$ 76,518,143</b>

##### Assets Measured at Fair Value on a Recurring Basis at December 31, 2013

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2013
<b>Assets - Available-for-sale</b>				
investment securities				
U.S. government and federal agency	\$ -	\$ 13,764,983	\$ -	\$ 13,764,983
Corporate	-	759,392	-	759,392
Collateralized mortgage obligations	-	435,067	-	435,067
State and municipal	-	23,888,648	-	23,888,648
<b>Total assets</b>	<b>\$ -</b>	<b>\$ 38,848,090</b>	<b>\$ -</b>	<b>\$ 38,848,090</b>

There were no significant assets measured at fair value on a nonrecurring basis in which gains or losses were recognized in 2014 or 2013.

## First National Bancorp, Inc. and Subsidiary

### Notes to Consolidated Financial Statements December 31, 2014 and 2013

#### Note 14 - Fair Value Measurements (Continued)

Changes in Level 3 assets measured at fair value on a recurring basis for the year ended December 31, 2014 are as follows:

	Available-for- sale Securities: State and Municipal
Balance at December 31, 2013	\$ -
Purchases	3,494,962
Total unrealized gains	69,898
Transfers into Level 3 from Level 2	693,685
<b>Balance at December 31, 2014</b>	<b>\$ 4,258,545</b>

Available-for-sale investment securities categorized as Level 3 asset consist of bonds issued by local municipalities. The Corporation estimates the fair value of this bond based on the present value of expected future cash flows using management's best estimate of key assumptions, including forecasted interest yield and payment rates, credit quality, and a discount rate commensurate with the current market and other risks involved.

Both observable and unobservable inputs may be used to determine the fair value of positions classified as Level 3 assets and liabilities. As a result, the unrealized gains and losses for these assets and liabilities presented in the table above may include changes in fair value that were attributable to both observable and unobservable inputs.

Transfers into Level 3 from Level 2 were made in 2014 because of the lack of observable market data due to decreased market activity for the securities.