



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

December 31, 2012

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

The First National Bank of Manchester
Charter Number 7605

120 Town Square
Manchester, Kentucky 40962

Office of the Comptroller of the Currency

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Suite 501
Louisville, Kentucky 40223

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

This document is an evaluation of the Community Reinvestment Act (CRA) performance of **First National Bank of Manchester, Manchester, Kentucky** prepared by the Office of the Comptroller of the Currency (OCC), the institution's primary regulator, as of September 30, 2012. The OCC rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR 25.

INSTITUTION'S OVERALL CRA RATING: SATISFACTORY

The First National Bank of Manchester (FNB) has a satisfactory record of meeting the credit needs of its community. This conclusion is based on the following.

- FNB's loan-to-deposit ratio is reasonable.
- A substantial majority of loans were originated to borrowers located in FNB's assessment area (AA).
- FNB's distribution of loans to low- and moderate-income individuals and small businesses with gross revenues less than \$1 million reflects reasonable penetration.
- The overall geographic distribution of loans reflects excellent dispersion in low- and moderate-income census tracts. We noted no conspicuous gaps in lending throughout the AA.

SCOPE OF THE EXAMINATION

This Performance Evaluation assesses FNB's record of meeting the credit needs of the communities in which it operates. FNB was evaluated using the Small Bank Examination Procedures. These procedures include a lending test to evaluate FNB's record of meeting the credit needs of its AA through its lending activities.

The CRA evaluation covers the period between July 1, 2007 and September 30, 2012. The lending test considered a random sample of loans originated by FNB between January 1, 2010 and December 31, 2011. The scope of the lending test included a review of FNB's primary loan products. We identified two primary loan products: residential real estate mortgages and business purpose loans. We determined the primary product lines by reviewing available lending reports for the representative timeframe and through discussions with management. To analyze the two primary loan products, we selected random samples from each of the portfolios, using source documents to collect the data.

The institution's overall rating is the aggregate of conclusions reached in the lending test.

DESCRIPTION OF INSTITUTION

FNB is an intrastate financial institution headquartered in Manchester, Kentucky. FNB is wholly owned by First National Financial Corporation, a one-bank holding company. As of September 30, 2012, FNB reported \$151 million in total assets, \$127 million in total deposits, \$54 million in total loans, and \$21 million in Tier 1 capital. FNB operates out of five full-service offices. Four branches are located in Clay County. Three of the Clay County branches are in the city of Manchester and one is in the town of Garrard. FNB has one office in Laurel County, in the city of London. In addition, FNB has two full-service Automated Teller Machines (ATM). FNB has not opened or closed any offices since the last CRA examination. FNB is accessible to all segments of the community.

FNB is a full-service lender offering traditional banking products and services. As of September 30, 2012, net loans represented 37.8 percent of average total assets. The loan portfolio mix is as follows: one-to-four family residential real estate loans (43.6 percent), business purpose loans (41.6 percent), consumer loans (6.6 percent), commercial and industrial loans (5.8 percent), construction and development loans (1.9 percent), and all other loans (less than one percent).

FNB was rated satisfactory at the last CRA evaluation, dated August 20, 2007. There are no legal or financial circumstances affecting FNB's ability to meet the credit needs of its community.

DESCRIPTION OF THE ASSESSMENT AREA

FNB's AA consists of Clay and Laurel Counties. The AA conforms to the regulatory requirements of the CRA. It is appropriate in relation to the location of FNB's offices and does not arbitrarily exclude any low- and moderate-income areas.

Clay County is located in the southern portion of Kentucky's Eastern Coal Fields Region. The county lies almost entirely within the Daniel Boone National Forest. The largest city in Clay County is Manchester. According to the 2000 United States (U.S.) Census, the population of Clay County was 24,600, which declined to 21,730 as of the 2010 U.S. Census.

The 2000 U.S. Census divides Clay County into six census tracts, with one low-income tract, five moderate-income tracts, and no middle- or upper-income tracts. The 2012 U.S. Census median family income for a non-Metropolitan Statistical Area in Kentucky is \$43,600. However, the median family income for Clay County is \$20,206. Approximately 36.5 percent of people in the county live below the poverty level. As of October 2012, the unemployment rate is 12.1 percent, which is significantly above the Kentucky unemployment rate of 8.4 percent. The Kentucky Cabinet for Economic Development lists the following companies as the largest employers in the county:

- Philips Diversified Manufacturing, Inc. employs 160 individuals and specializes in injection molding and metal fabrication.
- Kentucky Mountain Industries, Inc. employs over 20 individuals and manufactures brass and stainless steel fixtures.
- The Manchester Enterprise employs over 10 individuals and is the local newspaper.

Laurel County is also located in the Eastern Mountain Coal Fields Region and is adjacent to Clay County. The largest city in Laurel County is London. According to the 2000 U.S. Census, the population of Laurel County was 52,700, which increased to 58,849 as of the 2010 U.S. Census.

The 2000 U.S. Census divides the county into eleven census tracts. There are no lower-income tracts, one moderate-income tract, ten middle-income tracts, and no upper-income tracts. The 2012 U.S. Census median family income for Laurel County is \$37,286. Approximately 20.6 percent of people in the county live below the poverty line. As of October 2012, the unemployment rate was 8.8 percent, which was slightly above the Kentucky unemployment rate of 8.4 percent. According to the Kentucky Cabinet for Economic Development, the largest employers in the county are:

- Hearthside Food Solutions, LLC employs 850 individuals and produces baked goods.
- Wal-Mart Stores, Inc. employs 838 individuals at a distribution center.
- Xerox Corporation employs 615 individuals and provides data entry, clerical, scanning, and tracking services.

Competition from other financial institutions in the AA is low in Clay County but significant in Laurel County. According to Federal Deposit Insurance Corporation (FDIC) data, FNB obtained 98 percent of total deposits from the Clay County market and two percent from the Laurel County market. In Clay County, one large national bank operating two offices is the sole competition, allowing FNB a 68 percent market share. In Laurel County, competitors include three large national banks and several regional banks, with deposits ranging from \$494 thousand to \$227 million. FNB has a 0.4 percent market share in the county.

Two community contacts familiar with the Clay County market indicated that the overall credit needs of the community are being met by local banks.

The following table presents demographic information about the AA. We obtained information from 2000 U.S. Census data, unless otherwise noted.

Demographic Information for Full-Scope Area: Clay and Laurel County							
Demographic Characteristics	#	Low % of #	Moderate % of #	Middle % of #	Upper % of #	NA* % of #	
Geographies (Census Tracts)	17	5.88%	35.29%	58.83%	0.00%	0.00%	
Population by Geography	77,271	4.05%	30.83%	65.12%	0.00%	0.00%	
Owner-Occupied Housing by Geography	22,067	4.00%	28.47%	67.53%	0.00%	0.00%	
Businesses by Geography	6,848	1.47%	19.43%	79.10%	0.00%	0.00%	
Farms by Geography	167	0.00%	23.95%	76.05%	0.00%	0.00%	
Families by Income Level	21,861	21.89%	17.54%	18.88%	41.70%	0.00%	
Distribution of Low- and Moderate-Income Families throughout AA Geographies	10,931	6.54%	35.91%	57.55%	0.00%	0.00%	
Median Family Income	\$40,394						
HUD Adjusted Median Family Income for 2012	\$43,600	Median Housing Value				\$56,182	
Households Below the Poverty Level	26.70%	Unemployment Rate				34.11%	

(*) The NA category consists of geographies not assigned an income classification.
 Source: 2000 U.S. Census and 2012 U.S. Department of Housing and Urban Development (HUD) updated Median Family Income. These figures were obtained directly from U.S. Census data and may or may not total exactly 100 percent.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Lending Test

FNB’s performance under the lending test is satisfactory. The net loan-to-deposit ratio is reasonable and a substantial majority of loan originations was inside FNB’s AA. FNB’s borrower distribution reflects reasonable penetration among borrowers of different incomes and businesses of different sizes. In addition, the geographic distribution of loans reflects excellent dispersion. There were no complaints regarding FNB’s performance in meeting the credit needs of the community.

Loan-to-Deposit Ratio

FNB’s loan-to-deposit (LTD) ratio is reasonable given its size and financial condition. The net LTD ratio over the 21 quarters since the previous CRA evaluation is 51 percent. The LTD ratio has decreased since the previous CRA evaluation in 2007. This decrease coincides with a

significant decline in economic activity nationwide and in the local market. Management also cites prudent underwriting, competition with a regional bank for qualified borrowers, and slow economic growth in Clay County as reasons for the decline in the LTD ratio.

We compared FNB to two similarly situated banks. While both banks operate in Laurel and Clay counties, they are headquartered in Laurel County. These banks are comparable to FNB in asset size, number of offices, and major lending products. The table below shows the average LTD ratios of the other banks range from approximately 70 percent to 72 percent.

Institution	Average
First National Bank of Manchester	51.65%
Bank 1	69.96%
Bank 2	72.23%

Lending in the Assessment Area

A substantial majority of FNB’s primary loan products originated between January 1, 2010 and December 31, 2011 were made to borrowers in FNB’s AA. Table 1 shows that 95 percent of the loans and 94 percent of the dollar of loans were made to borrowers in the AA.

Table 1 - Lending in Clay and Laurel Counties										
Loan Type	Number of Loans					Dollars of Loans				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Residential Real Estate Loans	28	93.33%	2	6.67%	30	2,012	50.69%	201	9.08%	2,213
Business Loans	29	96.67%	1	3.33%	30	1,957	49.31%	35	1.76%	1,992
Totals	57	95.00%	3	5.00%	60	3,969	94.39%	236	5.61%	4,205

Source: Random sample of one-to-four family residential real estate and business loans originated between January 1, 2010, and December 31, 2011.

Lending to Borrowers of Different Incomes and to Businesses of Different Sizes

The overall lending to borrowers of different incomes and businesses of different sizes reflects reasonable penetration. We did not note any gaps in lending throughout the AA.

Residential Real Estate Loans

The distribution of residential real estate loans reflects reasonable penetration to borrowers of different income levels, including low- and moderate- income families. Table 2 shows FNB’s distribution of loans to low-income borrowers was lower than the demographic comparator, but loans to moderate- and middle-income borrowers were greater than the demographic comparator. Within our sample, FNB made approximately 10 percent and 19 percent of residential real estate loans to low- and moderate-income borrowers, respectively.

The following table shows the distribution of residential real estate loans among borrowers of different income levels compared to the percent of families in each income category.

Table 2 - Borrower Distribution of Residential Real Estate Loans in Clay and Laurel Counties								
Borrower Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans	% of AA Families	% of Number of Loans
Residential Real Estate Loans	21.89%	10.00%	17.54%	18.33%	18.88%	31.67%	41.70%	40.00%

Source: Percent of AA Families derived from 2000 U.S. Census data. Random sample of one-to-four family residential real estate loans originated between January 1, 2010 and December 31, 2011.

Business Loans

The distribution of business loans reflects excellent penetration to businesses of different revenues. Table 2A indicates the percentage of business loans made to businesses with revenues under \$1 million is approximately 97 percent, which significantly exceeds the demographic comparator of 71 percent. The number of businesses with unreported or unknown revenues is very high at approximately 26 percent. When considering the dollar amount of loans, FNB’s lending performance shows excellent penetration. Ninety-four percent of the dollar amount of loans went to small businesses.

The following table shows the distribution of business loans among different sized businesses in AA.

Table 2A - Borrower Distribution of Loans to Businesses in Clay and Laurel Counties				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/Unknown	Total
% of AA Businesses	71.05%	2.64%	26.31%	100%
% of Bank Loans in AA by #	96.67%	3.33%	N/A	100%
% of Bank Loans in AA by \$	94.94%	5.06%	N/A	100%

Source: Percent of AA Businesses derived from 2000 U.S. Census data. Random sample of business loans originated between January 1, 2010, and December 31, 2011.

Geographic Distribution of Loans

The overall geographic distribution of loans reflects excellent dispersion in low- and moderate-income census tracts. This analysis reflects lending in all census tracts in the AA; we noted no conspicuous gaps in lending throughout the AA.

Residential Real Estate Loans

The distribution of residential real estate loans to borrowers in different census tract income levels reflects excellent dispersion. Table 3 shows FNB’s level of lending to borrowers in low-income census tracts is above the demographic comparator, and lending to moderate-income

census tracts significantly exceeded the demographic comparator. FNB originated approximately seven percent of residential real estate loans to low-income census tracts, and approximately 84 percent of residential real estate loans to moderate-income census tracts.

The following table details FNB’s performance compared to the percentage of owner-occupied housing units in each census tract income level.

Table 3 - Geographic Distribution of Residential Real Estate Loans in Clay and Laurel Counties								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan type	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans	% of AA Owner Occupied Housing	% of Number of Loans
Residential Real Estate Loans	4.00%	6.67%	28.47%	83.33%	67.53%	10.00%	N/A	N/A

Source: Percent of AA Owner-occupied housing derived from 2000 U.S. Census data. Random sample of business loans originated between January 1, 2010, and December 31, 2011.

Business Loans

The distribution of business loans to borrowers in different census tract income levels reflects excellent dispersion. Table 3A shows FNB originated approximately seven percent of business loans to businesses in the AA’s one low-income census tract, which is nearly double the demographic comparator of approximately two percent. In addition, FNB originated nearly 87 percent of business loans to businesses in moderate-income census tracts. This is significantly above the demographic comparator of 25 percent.

The following table details the FNB’s performance compared to the percentage of businesses in each census tract income level.

Table 3A - Geographic Distribution of Loans to Businesses in Clay and Laurel Counties								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
Business Loans	1.87%	6.67%	24.68%	86.67%	73.45%	6.66%	N/A	N/A

Source: Percent of AA Businesses derived from 2000 U.S. Census data. The percentage of AA businesses was obtained directly from U.S. Census data and may or may not total exactly 100 percent. Random sample of business loans originated between January 1, 2010, and December 31, 2011.

Responses to Complaints

FNB has not received any CRA complaints during this evaluation period.

Fair Lending or Other Illegal Credit Practices Review

Pursuant to 12 CFR 25.28(c) or 12 CFR 195.28(c), in determining a national bank's CRA rating, the OCC considers evidence of discriminatory or other illegal credit practices in any geography by FNB or in any AA by an affiliate whose loans have been considered as part of FNB's or FSA's lending performance.

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.