



# FIRST OTTAWA BANCSHARES, INC.

Direct Parent Company of The First National Bank of Ottawa

July 24, 2017

Dear Shareholders,

Through the first two quarters of the year, loan volume continues to be strong, classified assets remain at low levels, and profitability is consistent with the first two quarters of 2016. First Ottawa Bancshares' 2017 pretax operating income and net operating income are virtually identical to the first six months of 2016. As a percentage of average assets, pretax operating income for 2017 is 1.68% as contrasted to 1.63% in 2016, and net operating income in both 2017 and 2016 was 1.05% of average assets.

Loan yields are down marginally, but on greater loan volumes. Total loan and lease yields were 4.89% as of June 30, 2017 as contrasted to 4.94% for the same period in 2016 – while net loan and lease volumes increased to \$217.3 million as of June 30, 2017 compared to \$211.5 million as of June 30, 2016. Investment securities yields increased to 3.31% on a tax-equivalent basis, 2.69% of book yield as of June 30, 2017 as compared to 2.77% and 2.28% respectively as of June 30, 2016, with the portfolio maintaining a similar duration. Overall, total interest income increased from \$5,382,000 as of June 30, 2016 to \$5,458,000 as of June 30, 2017.

Notwithstanding the attention received by the recent 25 basis point overnight rate increases by the Federal Reserve Bank in December, 2016, and March and June of 2017, yields on two to five year maturities have been relatively flat, and longer term yields from seven through thirty years have actually declined during the period. Overall interest expense at First National Bank of Ottawa as a percentage of average earning assets increased to 0.12% as of June 30, 2017, compared to 0.10% as of June 30, 2016 – a twenty percent increase, but nevertheless the low overall interest expense contributed to and helped to maintain a strong net interest margin. We continue to closely monitor general interest rate movements, rate movements among other institutions, and volumes of our transactional and time deposits. Tax equivalent net interest income to average earning assets was 4.16% as of June 30, 2017, and 4.05% as of June 30, 2016.

At the bank level, 2017 non-interest income remained relatively consistent with the first six months of 2016. Comparing year to date 2017 to 2016 we realized increases in Wealth Management fees, \$372 thousand from \$360 thousand; Commercial and Ag loan origination fees increasing to \$136 thousand from \$100 thousand; and Secondary Market Servicing Fees increasing to \$199 thousand from \$165 thousand. Declines comparing the year versus year six month periods occurred in: Service Charges on Deposit Accounts, \$216 thousand from \$235 thousand; Other Income \$409 thousand from \$410 thousand; Mortgage Loan Origination Fees

\$91 thousand from \$126 thousand; and Gain on Sale of Loans \$297 thousand from \$333 thousand. The decline in realized securities gains, which is not an ongoing operational function, \$20 thousand in realized gains to date in 2017, versus \$101 thousand in 2016, accounts for virtually all of the difference between the total non-interest income of \$1.74 million during 2017, and the \$1.83 million generated in 2016.

Non-interest expense at the bank level remained stable increasing by 0.86%, \$4.42 million to date in 2017, versus \$4.38 million in 2016.

Coupled with the foregoing financial performance First National Bank of Ottawa's Tier One Capital Leverage Ratio increased to 10.48% from 9.61% as of June 30, 2016. Total Nonaccrual loans and loans 90 days or more past due were 0.81% of average assets as of June 30, 2017, compared to 0.96% as of June 30, 2016.

We are pleased to be able to present to you this update on our financial performance to date, and to acknowledge the efforts and oversight of our employees and board of directors. We appreciate your support as shareholders, customers, and as advocates for the bank and holding company. Please feel free to contact either myself or bank President and CEO, Steven Gonzalo at any time should you have any questions or comments.

Very truly yours,

A handwritten signature in blue ink, appearing to be 'D. Harris', with a stylized flourish at the end.

Donald J. Harris  
First Ottawa Bancshares, Inc.  
Chairman, CEO and President

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