

PRINCETON NATIONAL BANCORP INC  
Form 10-K  
March 15, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K**

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

**For the Fiscal Year Ended December 31, 2005**

**Commission File Number 0-20050**

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**PRINCETON NATIONAL BANCORP, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**36-32110283**  
(I.R.S. Employer  
Identification No.)

**606 South Main Street**  
**Princeton, Illinois**  
(Address of principal executive offices)

**61356-2080**  
(Zip Code)

Registrant's telephone number, including area code: **(815) 875-4444**

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock	The Nasdaq Stock Market
Preferred Share Purchase Rights	

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Indicate by check mark if the registrant is a well-known season issuer, as defined in Rule 405 of the Securities Act.

YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Sections 13 or 15(d) of the Act.

YES  NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

At February 20, 2006, 3,351,493 shares of Common Stock, \$5.00 Par Value, were outstanding, and the aggregate market value of the common stock (based upon the closing representative bid price of the common stock on June 30, 2005 of \$31.38, the last business day of the Registrant's most recently completed second quarter, as reported by NASDAQ) held by nonaffiliates was approximately \$105,169,850.

Determination of stock ownership by nonaffiliates was made solely for the purpose of responding to this requirement and the registrant is not bound by this determination for any other purpose.

Portions of the following documents are incorporated by reference:

2006 Notice and Proxy Statement for the Annual Meeting of Stockholders April 25, 2006 (the Proxy Statement )  
Part III  
and portions of the Corporation's 2005 Annual Report (the Annual Report ) Part II

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**PART I**

## Item 1. Business

Princeton National Bancorp, Inc. ( PNBC , the Corporation , or the Company ) is a single-bank holding company which operates in one business segment conducting a full-service commercial banking and trust business through its subsidiary bank, Citizens First National Bank ( Citizens Bank , the Bank , or the subsidiary bank ). PNBC was incorporated as a Delaware corporation in 1981 in contemplation of the acquisition of all of the outstanding common stock of Citizens Bank and other future acquisitions. At December 31, 2005, the Corporation had consolidated total assets of \$945,263,000 and stockholders' equity of \$63,144,000.

PNBC operates the Bank as a community bank with offices located for convenience and with professional, highly-motivated, progressive employees who know the Bank's customers and provide individualized, quality service. As part of its community banking approach, officers of the Bank actively participate in community organizations. In addition, within certain credit and rate of return parameters, the subsidiary bank strives to meet the lending needs of the communities in which offices are located and invests in local municipal securities.

Corporate policy, strategy and goals are established by the Board of Directors of PNBC. Pursuant to PNBC's holding company philosophy, operational and administrative policies for the Bank are also established at the holding company level. Within this framework, the Bank focuses on providing personalized services and quality products to its customers to meet the needs of the communities in which its offices are located. In 2005, the majority of the directors of PNBC also served as the directors of Citizens Bank, which further assists PNBC to directly implement its policies at Citizens Bank.

### Acquisition and Expansion Strategy

PNBC seeks to diversify both its market area and asset base and increase profitability through acquisitions and expansion. PNBC's goal, as reflected by its acquisition policy, is to expand through the acquisition of established financial service organizations (primarily commercial banks to the extent suitable candidates may be identified) and by expanding into potential high-growth areas. In integrating acquisitions, PNBC focuses on, among other actions, implementing the policies established at Citizens Bank, improving asset quality, the net interest margin, and encouraging community involvement. In 2005, PNBC acquired Somonauk FSB Bancorp, Inc. and its subsidiary, Farmers State Bank, with branches in Somonauk, Millbrook, Newark and Sandwich (subsequently merged into Citizens Bank).

PNBC will also consider establishing branch facilities as a means of expanding its presence into new market areas. PNBC opened new branch facilities in the Peru/LaSalle/Oglesby area in 1994, in Minooka in 1994, in Hampshire in 1995, in Henry in 1999, in Huntley in 2001, and in Plano in 2005. In early 2006, the construction of a new facility in Aurora, Illinois will be completed. The Company is also planning to construct a new facility in Elburn, Illinois in the next few years. Both of these suburban locations are located in rapidly growing communities that will provide significant loan and deposit growth opportunities, as well as increased revenue potential.

### Citizens First National Bank

Citizens Bank was organized in 1865 as a national banking association under the National Bank Act. Currently in its one hundred and forty-first year, Citizens Bank has nineteen offices in fifteen different communities in north central Illinois: DePue, Genoa, Hampshire, Henry, Huntley, Millbrook, Minooka, Newark, Oglesby, Peru, Plano, Princeton, Sandwich, Somonauk, and Spring Valley.

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Citizens Bank serves individuals, businesses and governmental bodies in Bureau, DeKalb, Grundy, Kane, Kendall, LaSalle, Marshall, McHenry and contiguous counties. Citizens Bank operates a full-service community commercial bank and trust business that offers a broad range of financial services to customers. Citizens Bank's services consist primarily of commercial, real estate and agricultural lending, consumer deposit and financial services, and trust, brokerage, insurance, and farm management services.

### Commercial, Real Estate, and Agricultural Lending

Citizens Bank's commercial loan department provides secured and to a much lesser extent unsecured loans, including real estate loans, to companies and individuals for business purposes and to governmental units within the Bank's market area. As of December 31, 2005, Citizens Bank had commercial loans of \$114.4 million (19.7% of the Bank's total loan portfolio) and commercial real estate loans of \$113.1 million (19.4% of the Bank's total loan portfolio). Citizens Bank does not have a concentration of commercial loans in any single industry or business, except for loans to the agricultural industry as more fully disclosed below.

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Agricultural and agricultural real estate loans are primarily related to ventures within 30 miles of branch locations. As of December 31, 2005, Citizens Bank had agricultural loans of \$73.9 million and agricultural real estate loans of \$56.1 million, which represent approximately 12.7% and 9.6%, respectively, of the Bank's total loan portfolio.

Agricultural loans, many of which are secured by crops, machinery, and real estate, are provided to finance capital improvements and farm operations as well as acquisitions of livestock and machinery. The subsidiary bank's agricultural loan department has the equivalent of five lending officers and works closely with all agricultural customers, including companies and individual farmers, assisting in the preparation of budgets and cash flow projections for the ensuing crop year. These budgets and cash flow projections are monitored closely by the lending officers during the year. In addition, Citizens Bank works closely with governmental agencies, including the Farm Service Agency, to assist agricultural customers in obtaining credit enhancement products, such as loan guaranties.

In accordance with its loan policy, Citizens Bank maintains a diversified loan portfolio. As part of its loan policy and community banking approach, Citizens Bank does not buy loan syndications with other lending institutions. In connection with its credit relationships, Citizens Bank encourages commercial and agricultural borrowers to maintain deposit accounts at the Bank.

### Personal Financial Services

The principal consumer services offered by Citizens Bank are demand, savings and time deposit accounts, home mortgage loans, installment loans, and brokerage services.

One of the strengths of Citizens Bank is the stability of its retail deposit base. This stability is due primarily to the Bank's service oriented competitive strategy and the economically diverse populations of the counties encompassing the nineteen banking offices. These locations provide convenience for customers and visibility for Citizens Bank. A variety of marketing strategies are used to attract and retain stable depositors, the most important of which is the officer call program. Nearly all officers of the Bank call on customers and potential customers of the Bank to maintain and develop relationships.

Citizens Bank is active in consumer and mortgage lending with approximately \$139.0 million in home mortgage loans (23.9% of the Bank's total loan portfolio) and \$48.1 million in consumer installment loans (8.3% of the Bank's total loan portfolio) as of December 31, 2005. To better serve its retail customers, Citizens Bank is active in the secondary residential mortgage market. As a matter of policy, Citizens Bank does not hold, in portfolio, long term, fixed rate, single-family home mortgage loans, however, the servicing of such loans is maintained. As of December 31, 2005, Citizens Bank had \$204.0 million of loans that have been sold, but servicing has been maintained. Management believes customers receive a higher level of quality service with this arrangement.

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Citizens Bank maintains twenty-four automated teller machines. The Bank is a member of NYCE as well as other major nationwide networks such as CIRRUS, PLUS, and STAR. To enhance customer service and convenience, Citizens Bank offers ATM & Debit Cards, which can be used anywhere VISA is accepted, and is viewed as a tremendous benefit to our customers. Citizens Bank also offers an entire host of Internet Banking services including Bill Pay as an additional and convenient alternative delivery mechanism for its product and service line.

Citizens Bank continues to maintain an intensive sales training program, which includes team coaching, setting goals, measuring results, and reward recognition. In 2005, Citizens Bank again achieved record levels of product referrals and product sales.

### Citizens Financial Advisors

Further consolidation of the Trust and Farm Management Services with Investment Services to solidify Citizens Financial Advisors continued in 2005. The integration of these distinct areas improved the number of customer needs that were met by the department through the improved ability to provide the best product, service or the right qualified person to meet with our customers.

**Trust and Farm Management:** Net revenue increased by an impressive 85% in 2005 over that produced in 2004. Commensurately, gross revenues improved to \$1,601,500 from approximately \$1,450,700 during the same period last year. These results represent a 10.4% year over year increase. Trust services contribution to the total increased from \$1,246,700 in 2004 to \$1,343,000 in 2005, an increase of 7.7%. Substantial increases in trading fee income obtained from a new securities trading relationship, as well as new profitable business relationships that developed with the acquisition of Farmers State Bank, were most influential in these positive results. Due to low rain amounts that fell in some areas, fees from farm management declined from \$198,000 in 2004 to \$188,200 in 2005, a decrease of 4.9%. However, fees from farm real

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estate activities exceeded \$70,000 in 2005, from \$6,000 in 2004 representing growth in excess of 1000%.

Trust and Farm assets also eclipsed a company high water mark at the end of 2005 when the assets exceeded \$253,000,000 as of December 31, 2005, marking the first time the total assets have exceeded a quarter of a billion dollars. These results represent more than a \$12,000,000 leap in assets for 2005. Once again, new business relationships generated from the Farmers State Bank acquisition were most instrumental in this growth.

**Investment Services:** There was a 14.9% growth in brokerage gross revenues as the total increased from \$606,900 in 2004 to \$697,300 in 2005. The \$90,000 jump was brought about by the introduction of four new Client Advisors, bringing the total Client Advisors to six from only two at the end of 2004.

### Competition

PNBC is committed to community banking and to providing quality products and services at competitive loan rates and deposit pricing in order to remain competitive in its north central Illinois market. Citizens Bank competes with both small, locally owned banks, as well as regional financial institutions which have numerous offices. The Bank competes with these organizations, as well as with savings and loan associations, credit unions, mortgage companies, insurance companies and other local financial institutions for deposits, loans and other business. The principal methods of competition include loan and deposit pricing, the types and quality of services provided and advertising and marketing programs.

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### Supervision and Regulation

Bank holding companies and banks are extensively regulated under federal and state law. The following information describes certain statutes and regulations affecting PNBC and the Bank, and such discussion is qualified in its entirety by reference to such statutes and regulations. Any change in applicable law or regulations may have a material effect on the business of PNBC and the Bank.

PNBC is registered as a bank holding company with the Board of Governors of the Federal Reserve System (the FRB ), and is subject to supervision by the FRB under the Bank Holding Company Act of 1956, as amended (the BHC Act ). PNBC is required to file with the FRB periodic reports and such additional information as the FRB may require pursuant to the BHC Act. The FRB examines PNBC.

The BHC Act requires prior FRB approval for, among other things, the acquisition by a bank holding company of direct or indirect ownership or control of more than 5% of the voting shares or substantially all the assets of any bank, or for a merger or consolidation of a bank holding company with another bank holding company. With certain exceptions, the BHC Act prohibits a bank holding company from acquiring direct or indirect ownership or control of voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in any activity other than banking or managing or controlling banks or performing services for its authorized subsidiaries. A bank holding company may, however, engage in or acquire an interest in a company that engages in activities which the FRB has determined by regulation or order to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

In November, 1999, the Gramm-Leach-Bliley Act ( GLB Act ) was signed into law. Under the GLB Act, bank holding companies that meet certain standards and elect to become financial holding companies are permitted to engage in a wider range of activities than those permitted for bank holding companies, including securities and insurance activities. Specifically, a bank holding company that elects to become a financial holding company may engage in any activity that the Federal Reserve Board, in consultation with the Secretary of the Treasury, determines is (i) financial in nature or incidental thereto, or (ii) complementary to any such financial-in-nature activity, provided that such complementary activity does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. A bank holding company may elect to become a financial holding company only if each of its depository institution subsidiaries is well-capitalized, well-managed, and has a Community Reinvestment Act rating of satisfactory or better at their most recent examination.

The GLB Act specifies many activities that are financial in nature, including lending, exchanging, transferring, investing for others, or safeguarding money or securities; underwriting and selling insurance; providing financial, investment, or economic advisory services; underwriting, dealing in, or making a market in securities; and those activities currently permitted for bank holding companies that are so closely related to banking or managing or controlling banks, as to be a proper incident thereto.

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The GLB Act changed federal laws to facilitate affiliation between banks and entities engaged in securities and insurance activities. The law also established a system of functional regulation under which banking activities, securities activities, and insurance activities conducted by financial holding companies and their subsidiaries and affiliates will be separately regulated by banking, securities, and insurance regulators, respectively.

PNBC is a legal entity separate and distinct from the Bank. The major source of PNBC's revenue is dividends received from the Bank. The right of PNBC to participate as a stockholder in any distribution of assets of the Bank upon its liquidation or reorganization or otherwise is subject to the prior claims of creditors of the Bank. The Bank is subject to claims by creditors for long-term and short-term debt obligations, including obligations for federal funds purchased and securities sold under repurchase agreements, as well as deposit liabilities. The Bank is subject to regulation and examinations by the Office of Comptroller of the Currency (the OCC).

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The Bank may declare dividends out of undivided profits, except that until the surplus fund of the Bank is equal to its common capital, no dividend can be declared until one-tenth of the Bank's net income for the applicable period has been carried to the surplus fund. The Bank, however, cannot declare or pay a dividend, if after making the dividend, the Bank would be undercapitalized. In addition, prior approval of the OCC is required if dividends declared by the Bank in any calendar year will exceed its net income for that year combined with its retained net income for the preceding two years. Under national banking regulations and capital guidelines, as of December 31, 2005, the Bank was authorized to distribute approximately \$3,492,000 as dividends without prior approval from the OCC, based on net income for 2005 and retained net income for 2003 and 2004. As of January 1, 2006, retained net income for the prior two years was approximately \$2,489,000 and during 2006 the Bank may pay dividends without prior approval from the OCC equal to that amount plus any 2006 net income. Future payments of dividends by the Bank will be dependent on individual regulatory capital requirements and levels of profitability. The ability of the Bank to pay dividends may be further restricted as a result of regulatory policies and guidelines relating to dividend payments and capital adequacy.

Federal laws limit certain transactions between the Bank and its affiliates, including PNBC. Such transactions include loans or extensions of credit by the Bank to PNBC, the purchase of assets or securities of PNBC, the acceptance of PNBC's securities as collateral for loans, and the issuance of a guaranty, acceptance or letter of credit on behalf of PNBC. Transactions of this kind are limited to 10% of the Bank's capital and surplus for transactions with one affiliate, and 20% of the Bank's capital and surplus for transactions with all affiliates. Such transactions are also subject to certain collateral requirements. These transactions, as well as other transactions between the Bank and PNBC, must also be on terms substantially the same as, or at least as favorable as, those prevailing at the time for comparable transactions with nonaffiliated companies or, in the absence of comparable transactions, on terms, or under circumstances, including credit standards, that would be offered to, or would apply to, nonaffiliated companies.

FRB policy requires PNBC to act as a source of financial strength to the Bank and commit resources to support the Bank. The FRB takes the position that in implementing this policy, it may require PNBC to provide such support when PNBC otherwise would not consider itself able to do so.

The various federal bank regulators, including the FRB and the OCC, have adopted risk-based capital requirements for assessing bank holding company and bank capital adequacy. These standards establish minimum capital standards in relation to assets and off-balance sheet exposures, as adjusted for credit risks. Capital is classified into two tiers. For bank holding companies, Tier 1 or core capital consists of common shareholders' equity, perpetual preferred stock (subject to certain limitations) and minority interests in the equity accounts of consolidated subsidiaries, and is reduced by goodwill and certain other intangible assets (Tier 1 Capital). Tier 2 capital consists of (subject to certain conditions and limitations) the allowance for possible credit losses, perpetual preferred stock, hybrid capital instruments, perpetual debt and mandatory convertible debt securities, and term subordinated debt and intermediate-term preferred stock (Tier 2 Capital). Total capital is the sum of Tier 1 Capital and Tier 2 Capital (the latter being limited to 100% of Tier 1 Capital). Components of Tier 1 and Tier 2 Capital for national banks are similar, but not identical, to those for holding companies.

Under the risk-adjusted capital standards, a minimum ratio of qualifying total capital to risk-weighted assets of 8% and of Tier 1 Capital to risk-weighted assets of 4% is required. The FRB and OCC also have adopted a minimum leverage ratio of Tier 1 Capital to total assets of 3% for banks rated 1 under the Uniform Financial Institutions Rating System or bank holding companies rated 1 under the rating system of bank holding companies. All other banks and bank holding companies must maintain a leverage ratio of 4%. In addition, all banks and bank holding companies are expected to have capital commensurate with the level and nature of all risks to which they are exposed.

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At December 31, 2005, PNBC had a total capital to risk-weighted assets ratio of 9.76%, a Tier 1 capital to risk-based assets ratio of 9.26%, and a leverage ratio of 7.83%. PNBC is classified as adequately capitalized for the first ratio and well-capitalized for the last two ratios. The Corporation does intend to be above the 10% requirement to be well-capitalized for the Tier 1 ratio during 2006. At December 31, 2005, the Bank had a total capital to risk-weighted assets ratio of 10.23%, a Tier 1 capital to risk-weighted assets ratio of 9.74%, and a leverage ratio of 8.24%. The Bank is classified as well-capitalized for all three ratios.

Currently, the Bank's deposits are predominantly insured by the Bank Insurance Fund (the BIF) and certain deposits held by the Bank are insured through the Savings Association Insurance Fund (the SAIF). Both the BIF and SAIF are administered by the FDIC. Under the recently adopted Federal Deposit Insurance Reform Act of 2005 (the FDIRA), the BIF will be merged with the SAIF during 2006.

The FDIC has a risk-based assessment system for the deposit insurance provided to depositors at depository institutions whereby assessments to each institution are calculated upon the probability that the insurance fund will incur a loss with respect to the institution, the likely amount of such loss, and the revenue needs of the insurance fund. The system utilizes nine separate assessment classifications based on an entity's capital level and supervisory evaluation. Pursuant to the FDIRA, a new system for assessing insurance premiums based on risk will be adopted.

The BIF and SAIF semi-annual assessment rates currently both range from 0 to 27 cents per \$100 of domestic deposits. Assessments for subsequent periods will depend on the timetable for implementation of the FDIRA and the regulations adopted by the FDIC to implement the FDIRA. In addition to a new system for assessing insurance premiums based on risk, a number of other provisions of the FDIRA and the implementing regulations will impact future assessments. The FDIC will have flexibility to determine the level of reserves it will hold. Currently, the FDIC must hold reserves equal to 1.25 percent of insured deposits, but under the FDIRA, the FDIC will be able to set the reserve ratio annually between 1.15 percent and 1.50 percent. In addition, the FDIC will be required to pay dividends awarded on an historical basis to insured depository institutions whenever the reserve ratio exceeds 1.35 percent, although dividends may be suspended or limited if the FDIC determines there is a significant risk to the deposit insurance fund. Insured depository institutions also will receive a one-time credit which can be applied against the payment of future premiums. An increase in the rates assessed on the Bank could have an adverse effect on the earnings of PNBC and the Bank depending on the amount of the increase. Until FDIRA is fully implemented, it is not possible for the Bank to determine how these changes will impact the amount of deposit premiums it will pay in the future.

All FDIC-insured depository institutions must pay a quarterly assessment to provide funds for the payment of interest on bonds issued by the Financing Corporation, a federal corporation chartered under the authority of the Federal Housing Finance Board. The bonds (commonly referred to as FICO bonds) were issued to capitalize the Federal Savings and Loan Insurance Corporation.

Federal law permits adequately capitalized and adequately managed bank holding companies to acquire banks across state lines, without regard to whether the transaction is prohibited by state law. Any state law relating to the minimum age of target banks (not to exceed five years) or limits on the amount of deposits that may be controlled by a single bank or bank holding company applies. The FRB is not permitted to approve any acquisition if, after the acquisition, the bank holding company would control more than 10% of the deposits of insured depository institutions nationwide or 30% or more of the deposits in the state where the target bank is located. The FRB could approve an acquisition, notwithstanding the 30% limit, if the state waives the limit either by state regulation or order of the appropriate state official.

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Banks are permitted to merge with one another across state lines and thereby create a main bank with branches in separate states. After establishing branches in a state through an interstate merger transaction, a bank can establish and acquire additional branches at any location in the state where any bank involved in the merger could have established or acquired branches under applicable federal or state law. In addition, the laws of some states, including Illinois, permit a bank with its main office in another state to establish de novo branches or to acquire a branch of another bank without acquiring the entire bank. Therefore, if the laws of another state so permit, the Bank could establish a de novo branch or acquire a branch of a bank in such state, even if the laws of such state require a reciprocal provision.

PNBC does not have current plans to acquire banking organizations located outside the state of Illinois.

National banks may establish operating subsidiaries to engage in activities in which the bank could engage directly.

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National banks are also authorized by the GLB Act to engage, through financial subsidiaries, in activities that are permissible for financial holding companies and activities that the Secretary of the Treasury, in consultation with the FRB, determines is financial in nature or incidental to any such financial activity, except (i) insurance underwriting, (ii) real estate development or real estate investment activities (unless otherwise permitted by law), (iii) insurance company portfolio investments, and (iv) merchant banking. A national bank's authority to invest in a financial subsidiary is subject to a number of conditions, including, among other things, requirements that the bank be well-managed and well-capitalized (after deducting from capital the bank's outstanding investment in financial subsidiaries).

The GLB Act affected many other changes to federal law applicable to PNBC and the Bank. One of these changes was a requirement that financial institutions take steps to protect customers' nonpublic personal information.

### **Employees**

PNBC presently has no employees. However, certain of the employees and executive officers of Citizens Bank provide their services to PNBC. A monthly fee for these services is paid by PNBC to Citizens Bank. This fee is computed annually and is based upon an average of the number of hours worked during the year.

As of December 31, 2005, Citizens Bank employed 254 full-time and 72 part-time employees. The Bank offers a variety of employee benefits. Citizens Bank employees are not represented by a union or a collective bargaining agreement, and employee relations are considered to be excellent.

Citizens Bank believes one of its strengths is its ability to attract and retain experienced and well-trained personnel who are knowledgeable of the market areas in which it operates. Management believes that PNBC generally has an easier time attracting and retaining quality employees than other banks in north central Illinois. This is due primarily to its size and management style, which affords greater opportunities to employees for direct participation and development of managerial and banking skills.

In order to implement PNBC's community banking philosophy and to promote itself as a community oriented organization, the Bank has a formal officer call program. Nearly every officer of the Bank calls on existing or potential customers and is expected to become actively involved in leadership positions in community organizations. As of December 31, 2005, employees of the Bank participated in approximately 137 community organizations, providing nearly 9,600 hours of community service.

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### **Available Information**

Our Internet address is [www.citizens1st.com](http://www.citizens1st.com). There we make available, free of charge, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our SEC reports can be accessed through the investor relations section of our Web site. The information found on our Web site is not part of this or any other report we file with or furnish to the SEC.

You may also read and copy materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site ([www.sec.gov](http://www.sec.gov)) that contains reports, proxy statements and other information that we electronically file with the SEC.

### **Item 1A. Risk Factors**

An investment in PNBC's common stock is subject to risks inherent to the Corporation's business. An investor should carefully consider the risks described below and information contained in this Annual Report on Form 10-K together with all of the other information incorporated by reference before deciding to purchase PNBC common stock. The risks and uncertainties described below are not the only ones facing the Corporation. Additional risks and uncertainties that management is not aware of or focused on or deems immaterial may arise or become material in the future and affect PNBC's business. If any of these risks actually occur, PNBC's financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of PNBC common stock could decrease significantly.

*PNBC's concentration of agricultural loans is subject to risks that could adversely affect earnings.*



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PNBC's agricultural and agricultural real estate loan portfolio total \$130.0 million at December 31, 2005, comprising 22.3% of total loans. The primary risks associated with agricultural loans are weather and borrower's management. In the event of catastrophic weather conditions, such as severe drought or flooding, these loans would represent a higher risk due to poor crop sales and reduced cash flow that could impact the borrowers' ability to repay the loan on a timely basis.

### *Changes in interest rates could adversely impact the financial condition and results of operations.*

PNBC's ability to make a profit, like that of most financial institutions, substantially depends upon its net interest income. However, certain assets and liabilities may react differently to changes in market interest rates. In a period of changing rates, interest expense may increase at different rates than the interest earned. Accordingly, changes in interest rates could decrease net interest income.

### *The allowance for loan losses may not be sufficient to cover actual loan losses decreasing earnings.*

In determining the appropriate level of allowance for loan losses, management considers, among other things, the overall composition of the loan portfolio, types of loans, past loss experience, loan delinquencies, potential substandard and doubtful loans, underlying collateral, and other factors that, in management's best judgment, deserve evaluation. Although management monitors the allowance monthly and considers it adequate to absorb probable losses at December 31, 2005, if any of the assumptions are incorrect, the allowance may not be sufficient to cover future loan losses. Future adjustments may be necessary to allow for different economic conditions or adverse developments in the loan portfolio. Consequently, a problem with one or more loans could require the Corporation to significantly increase the level of its provision for loan losses resulting in a reduction of earnings.

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### *The Internal Controls of PNBC may not be effective.*

Management reviews and tests on a quarterly basis its system of internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of internal controls, however well designed, is based on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are actually being met. Any failure or circumvention of these controls could have a material adverse affect on the Corporation's financial condition and results of operations.

### *There is competition within the PNBC market areas which may limit growth and profitability.*

Because the banking business is highly competitive, PNBC faces significant competition both in originating loans and attracting deposits. Competition can not only be effected by the pricing of loans and deposits, but also by the variety of products offered. The ability of the Corporation to continue to grow in the markets served while effectively managing interest rate risk is contingent upon being able to operate in this competitive environment, which ultimately effects the Corporation's profitability.

### *The success of PNBC is dependent on hiring and retaining key personnel.*

PNBC's performance is largely dependent on the talents and efforts of highly skilled individuals. The Corporation relies on key personnel to manage and operate its business and the loss of any of these individuals may adversely affect the Corporation's ability to maintain and/or manage the business effectively. This could have a material adverse affect on the Corporation's financial condition and results of operations.

### *PNBC operates in a highly regulated environment.*

PNBC is subject to extensive regulation, supervision and examination. Any changes in the regulations or applicable laws and the failure of the Corporation to comply with any of the regulations and laws could have a material adverse effect on the Corporation's financial condition and results of operations.

## **Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

PNBC's headquarters and Citizens Bank's principal offices are located at 606 South Main Street, Princeton, Illinois. Also located at this address is an annex completed in 1990 that contains, among others, the trust and farm management departments. The two buildings at this location are owned by Citizens Bank and contain approximately 36,000 square feet of space, all of which is occupied by PNBC and Citizens Bank. Citizens Bank also has two drive-up facilities in Princeton and branch offices in DePue, Genoa, Hampshire, Henry, Huntley, Millbrook, Minooka, Newark, Oglesby, Peru, Plano, Sandwich, Somonauk and Spring Valley. Citizens Bank is the owner of each of these facilities. None of the facilities owned by the Bank are subject to a mortgage. Additionally, the mortgage banking department of the Bank is located in Spring Valley in a separate location from the branch office. This location is not owned by the Bank and is rented by lease agreement. For additional information regarding these properties, see Footnote 6 of Item 8 of this report.

**Item 3. Legal Proceedings**

The Bank is subject to legal proceedings and claims that arise in the ordinary course of business. Although management of the Corporation cannot predict the ultimate outcome of such matters, it believes that the ultimate resolution of these matters will not have a material adverse effect on the Corporation, the Bank, or the Corporation's financial position, liquidity, and results of operations.

**Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of the security holders during the fourth quarter of 2005.

**Supplemental Item Executive Officers**

The following table sets forth information regarding the executive officers:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Tony J. Sorcic	52	President & Chief Executive Officer
James B. Miller	50	Executive Vice President & Commercial Banking Officer
Todd D. Fanning	43	Senior Vice President & Chief Financial Officer
Jacquelyn L. Funderberg	45	Senior Vice President - Consumer Banking
Patrick Murray	53	Senior Vice President - Citizens Financial Advisors
Robert B. Schneider	65	Senior Vice President & Chief Fiduciary Administrative Officer

Tony J. Sorcic has been President and Chief Executive Officer of PNBC since January, 1997, and first became a director of PNBC in 1986. He joined Citizens Bank in 1981 as Assistant Vice President of Operations and became Executive Vice President in 1986. Mr. Sorcic was named President and Chief Executive Officer of Citizens Bank in 1995.

James B. Miller joined Citizens Bank in 1979 as an agricultural loan officer and has been the Executive Vice President of PNBC since 1996. Mr. Miller currently is the Executive Vice President and Commercial Banking Manager of Citizens Bank.

Todd D. Fanning joined Citizens Bank in 1990 as Assistant Vice President and Controller. He became Vice President & Chief Financial Officer in 1997. Mr. Fanning was named Senior Vice-President & Chief Financial Officer in 2005 and remains in that capacity.

Jacquelyn L. Funderberg joined Citizens Bank in 1994 as Assistant Vice President & Branch Manager. Ms. Funderberg became Senior Vice President - Consumer Banking in 2002 and remains in that capacity.

Patrick Murray joined Citizens Bank in 2004 as Senior Vice President in charge of Citizens Financial Advisors and remains in that capacity.

Robert B. Schneider joined Citizens Bank in 1995 as Senior Vice President and Trust Officer, and remains in that capacity.

## PART II

### Item 5. Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) Since May 15, 1992, PNBC's Common Stock has been listed on the NASDAQ National Market, under the symbol PNBC.

The table below indicates the high and low bid prices, and the dividends declared per share for the Common Stock during the periods indicated. The prices shown reflect interdealer prices and do not include retail markups, markdowns, or commissions which may not necessarily represent actual transactions.

	Prices		Cash Dividends Declared
	High	Low	
2005			
Fourth Quarter	\$ 34.00	\$ 32.50	\$ .38
Third Quarter	34.00	30.50	.22
Second Quarter	31.65	29.40	.22
First Quarter	30.99	28.80	.21
2004			
Fourth Quarter	\$ 29.50	\$ 28.30	\$ .40
Third Quarter	29.45	28.75	.19
Second Quarter	29.75	28.15	.19
First Quarter	29.10	26.92	.18

On December 31, 2005, PNBC had 840 registered holders of record of its Common Stock.

The holders of the Common Stock are entitled to receive such dividends as are declared by the Board of Directors of PNBC, which considers payment of dividends quarterly. The ability of PNBC to pay dividends is dependent upon its receipt of dividends from the Bank. In determining cash dividends, the Board of Directors considers the earnings, capital requirements, debt servicing requirements, financial ratio guidelines established by the Board, the financial condition of PNBC and other relevant factors. The Bank's ability to pay dividends to PNBC is subject to regulatory restrictions. See Supervision and Regulation.

PNBC has paid regular cash dividends on the Common Stock since it commenced operations in 1982. PNBC currently anticipates that cash dividends comparable to those that have been paid in the past will continue to be paid in the future. There can be no assurance, however, that any such dividends will be paid by PNBC or that such dividends will not be reduced or eliminated in the future. The timing and amount of dividends will depend upon the earnings, capital requirements, and financial condition of PNBC and the Bank as well as the general economic conditions and other relevant factors affecting PNBC and the Bank. See Management's Discussion and Analysis of Financial Condition and Results of Operations.

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- (c) The following table provides information about purchases of the Corporation's common stock by the Corporation during the quarter ended December 31, 2005:

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of a publicly announced plans or programs (1)	(d) Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs
10/1/05 - 10/31-05	0	\$ 0.00	0	15,400
11/1-05 - 11/30-05	10,000	\$ 33.64	10,000	5,400
12/1-05 - 12/31/05	5,400	\$ 33.40	5,400	0
Total	15,400	\$ 33.56	15,400	0

- (1) Shares purchased under the program announced on January 24, 2005. Program was completed in December, 2006 when all 100,000 shares were purchased under the program.

### Item 6. Selected Financial Data

Information regarding the Corporation's selected financial data is included on page 40 of the Corporation's Annual Report, which information is incorporated by reference herein.

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

Information regarding the Corporation's management's discussion and analysis of financial condition and results of operations is included on pages 29-38 in the Corporation's Annual Report, which information is incorporated by reference herein.

### Item 7A. Quantitative and Qualitative Disclosures about Market Risk

The information required by Item 305 of Regulation S-K is contained in the Corporation's Annual Report on pages 36 and 37, under the headings Asset Liability Management and Contractual Obligations and Off-Balance Sheet Arrangements, which information is incorporated herein by reference.

### Item 8. Consolidated Financial Statements and Supplementary Data

Information regarding the Corporation's consolidated financial statements and supplementary data is included on pages 9-28 and page 39 in the Corporation's Annual Report, which information is incorporated by reference herein.

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

None.

### Item 9A. Controls and Procedures

- (a) Disclosure controls and procedures. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2005. Our disclosure controls and procedures are the controls and other procedures that we designed to ensure that we record, process, summarize and report in a timely manner the information we must disclose in reports that we file with or submit to the SEC. Tony J. Sorcic, President and Chief Executive Officer, and Todd D. Fanning, Senior Vice President and Chief Financial Officer, reviewed and participated in this evaluation. Based on this evaluation, Messrs. Sorcic and Fanning concluded that, as of the date of their evaluation, our disclosure controls were effective.

- (b) Internal controls. There have not been any significant changes in our internal accounting controls or in other factors during the quarter ended December 31, 2005 that could significantly affect those controls.

The reports required by Item 308 of Regulation S-K are attached hereto as Exhibits 99.1 and 99.2 respectively, and are incorporated herein by reference.

## Item 9B. Other Information

None.

## PART III

### Item 10. Directors and Executive Officers of the Registrant

Certain information regarding executive officers of the Corporation is included as a Supplementary Item at the end of Part I of this Form 10-K.

Information regarding executive officers and directors of the Corporation and the Corporation's Audit Committee is included in the Corporation's Definitive Proxy Statement for the Annual Meeting of Stockholders to be held April 25, 2006 (the Proxy Statement) under the caption Proposal 1-Election of Directors, which information is incorporated by reference herein.

Information regarding compliance with Section 16(a) of the Exchange Act is included in the Proxy Statement under the caption Section 16(a) Beneficial Ownership Compliance Reporting, which information is incorporated by reference herein.

Information regarding the Corporation's Code of Ethics is included in the Proxy Statement under the caption Code of Ethics, which information is incorporated by reference herein.

Information regarding an Audit Committee Financial Expert is included in the Proxy Statement under the caption Audit Committee Financial Expert, which information is incorporated by reference herein.

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### Item 11. Executive Compensation

Information regarding executive compensation is included in the Proxy Statement under the captions Board of Directors Meetings and Committees, Compensation of Directors, and Executive Compensation Summary; Summary Compensation Table; and Employment Agreements, which information is incorporated by reference herein.

### Item 12. Security Ownership of Certain Beneficial Owners and Management

Information regarding security ownership is included in the Proxy Statement under the captions Security Ownership of Directors, Nominees for Director, Most Highly Compensated Executive Officers and All Directors and Executive Officers as a Group and Security Ownership of Certain Beneficial Owners, which information is incorporated by reference herein.

## Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities in column (a)) (c)
Equity compensation plans approved by security holders	302,718	\$ 27.52	172,806
Equity compensation plans not approved by security holders	N/A	N/A	20,203(1)
<b>Total</b>	<b>302,718</b>	<b>\$ 27.52</b>	<b>193,009</b>

- (1) Represents shares issuable under the Company's Amended and Restated Employee Stock Purchase Plan (the "ESPP"). The ESPP is a broad-based plan which was originally adopted by the Company in October, 1994 and has been amended and restated to increase the number of shares issuable under the ESPP to the current maximum of 80,000 shares. Under the ESPP, eligible employees and directors may purchase PNBC common stock without incurring any brokerage commissions or service charges using lump sum contributions and/or payroll deductions, in the case of employees.

### Item 13. Certain Relationships and Related Transactions

Information regarding relationships and transactions is included in the Proxy Statement under the caption "Certain Transactions," which information is incorporated by reference herein.

### Item 14. Principal Accountant Fees and Services

Information regarding principal accountant fees and services is included in the Proxy Statement under the caption "Audit Committee Report," which information is incorporated by reference herein.

### Item 15. Exhibits and Financial Statement Schedules

(a)(1) The following is a list of the Financial Statements included in Part II, Item 8 of this report:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2005 and 2004.

Consolidated Statements of Income for the years ended December 31, 2005, 2004 and 2003.

Consolidated Statements of Comprehensive Income for the years ended December 31, 2005, 2004, and 2003.

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2005, 2004, and 2003.

Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004, and 2003.

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Notes to Consolidated Financial Statements.

(a)(2) Financial Statement Schedules

No consolidated financial statement schedules are required to be included in this Report on Form 10-K.

(a)(3) Exhibits

The exhibits filed herewith are listed on the Exhibit Index filed as part of this report on Form 10-K. Each management contract or compensatory plan or arrangement of the Corporation listed on the Exhibit Index is separately identified by an asterisk.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registration has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PRINCETON NATIONAL BANCORP, INC.

By: /s/ Tony J. Sorcic

\_\_\_\_\_  
Tony J. Sorcic, President and Chief Executive Officer

Date: March 13, 2006

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

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/s/ Tony J. Sorcic _____ Tony J. Sorcic	President and Chief Executive Officer and Director (Principal Executive Officer)	March 13, 2006
/s/ Todd D. Fanning _____ Todd D. Fanning	Senior Vice-President & Chief Financial Officer (Principal Accounting and Financial Officer)	March 13, 2006
/s/ Craig O. Wesner _____ Craig O. Wesner	Chairman of the Board	March 13, 2006
/s/ Daryl Becker _____ Daryl Becker	Director	March 13, 2006
/s/ Gary C. Bruce _____ Gary C. Bruce	Director	March 13, 2006

SIGNATURES

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<u>Signature</u>	<u>Title</u>	<u>Date</u>
_____ Gary C. Bruce	Director	
_____ Sharon L. Covert	Director	
_____ John R. Ernat		
_____ /s/ Donald E. Grubb	Director	March 13, 2006
_____ Donald E. Grubb		
_____ /s/ Mark Janko	Director	March 13, 2006
_____ Mark Janko		
_____ Willard Lee	Director	
_____ /s/ Thomas M. Longman	Director	March 13, 2006
_____ Thomas M. Longman		
_____ Ervin I. Pietsch	Director	
_____ /s/ Stephen W. Samet	Director	March 13, 2006
_____ Stephen W. Samet		

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**INDEX TO EXHIBITS**

<u>Exhibit Number</u>	<u>Exhibit</u>
3.1	Amended and Restated Certificate of Incorporation of Princeton National Bancorp, Inc. ( PNBC ) (incorporated by reference to Exhibit 3.1 to the PNBC Registration Statement on Form S-1 (Registration No. 33-46362) (the "S-1 Registration Statement")).
3.2	By-Laws of PNBC (as amended January 27, 2003) (incorporated by reference to Exhibit 3.2 of the 2002 PNBC Annual Report on Form 10-K).
4.1	Certificate of Designation of Series A Junior Participating Preferred Stock (incorporated by reference from Registration Statement on Form 8-A filed by PNBC on August 1, 2003 (File No. 000-20050)) incorporated by reference to Exhibit 4.1 of the



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2004 PNBC Annual Report on Form 10-K).

- 4.2 Trust Preferred Securities Indenture (incorporated by reference to Exhibit 4.1 to PNBC Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
- 10.1\* Employment Agreement, dated as of January 8, 2003 between PNBC and James B. Miller. (incorporated by reference to Exhibit 10.2 of the 2002 PNBC Annual Report on Form 10-K).
- 10.2\* Employment Agreement, dated as of October 23, 2000, between PNBC and Tony J. Sorcic (incorporated by reference to Exhibit 10.2 of the 2000 PNBC Annual Report on Form 10-K).
- 10.3\* Citizens First National Bank Profit Sharing Plan, as amended and restated January 1, 1989 (incorporated by reference to Exhibit 10.4 to the S-1 Registration Statement).
- 10.4\* Citizens First National Bank Defined Contribution Plan and Trust, as amended and restated January 1, 1989 (incorporated by reference to Exhibit 10.5 to the S-1 Registration Statement).
- 10.5\* Princeton National Bancorp, Inc. Stock Option Plan (incorporated by reference from Schedule 14A filed by PNBC on March 6, 1998).
- 10.6\* Princeton National Bancorp, Inc. Deferred Compensation Plan (incorporated by reference to Exhibit 10.6 of the 2001 PNBC Annual Report on Form 10-K).
- 10.7\* Princeton National Bancorp, Inc. Management Incentive Compensation Plan (incorporated by reference to Exhibit 10.7 of the 2001 PNBC Annual Report on Form 10-K).
- 10.8\* Princeton National Bancorp, Inc. 2003 Stock Option Plan (incorporated by reference from Schedule 14A filed by PNBC on March 19, 2003).
- 10.9\* Form of Stock Option Agreement (incorporated by reference to Exhibit 10.9 of the 2004 PNBC Annual Report on Form 10-K).
- 10.10\* Amendment to Stock Option Agreement.

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**Exhibit  
Number**

**Exhibit**

- 10.11 Trust Preferred Securities Purchase Agreement (incorporated by reference to Exhibit 10.1 to PNBC Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
- 10.12 Trust Preferred Securities Declaration of Trust (incorporated by reference to Exhibit 10.2 to PNBC Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
- 10.13 Trust Preferred Securities Guarantee Agreement (incorporated by reference to Exhibit 10.3 to PNBC Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
- 13 Portions of 2005 Annual Report to Shareholders.
- 14 Code of Ethics (incorporated by reference to Exhibit 14 of the 2003 PNBC Annual Report on Form 10-K).
- 21 Subsidiaries of PNBC.

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- 23 Consent of KPMG LLP.
- 31.1 Certification of Tony J. Sorcic required by Rule 13a-14(a).
- 31.2 Certification of Todd D. Fanning required by Rule 13a-14(a).
- 32.1 Certification of Tony J. Sorcic required by Rule 13a-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.
- 32.2 Certification of Todd D. Fanning required by Rule 13a-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.
- 99.1 Report of Management on Internal Control Over Financial Reporting
- 99.2 Report of Independent Registered Public Accounting Firm

\* Management contract or compensatory plan.