

FIRST CITIZENS BANCSHARES INC /TN/  
Form 10-Q  
May 10, 2007

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

(Mark One)

- QUARTERLY REPORT UNDER SECTION 13 or 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED MARCH 31, 2007
- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 2-83542

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First Citizens Bancshares, Inc.

(Exact name of registrant as specified in its charter)

Tennessee  
(State or other jurisdiction of  
incorporation or organization)

62-1180360  
(IRS Employer Identification No.)

P.O. Box 370, One First Citizens Place  
Dyersburg, Tennessee 38024

(Address of principal executive offices including zip code)

(731) 287-4410

(Registrant's telephone number, including area code)

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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 and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

Indicate by a 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. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes  No

Of the registrant's only class of common stock (no par value) there were 3,628,310 shares outstanding as of March 31, 2007.

## PART I - FINANCIAL INFORMATION

### ITEM 1 - FINANCIAL STATEMENTS

#### FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

AS OF MARCH 31, 2007 AND DECEMBER 31, 2006

(Stated in Thousands)

|  | <u>AS OF</u><br><u>March 31, 2007</u> | <u>AS OF</u><br><u>December 31, 2006</u> |
|--|---------------------------------------|--|
| <b>ASSETS</b>  |                                       |  |
| Cash and due from banks  | \$ 18,547                             | \$ 19,597                                |
| Federal funds sold   | 31,387                                | 12,948                                   |
| Cash and cash equivalents  | 49,934                                | 32,545                                   |
| Investment securities  |                                       |  |
| Trading investments-stated at market   | -                                     | -  |
| Held to maturity-amortized cost-fair value of \$291 at March 31, 2007 and \$291 at December 31, 2006 | 290                                   | 290                                      |
| Available for sale-stated at market  | 179,645                               | 177,086                                  |
| Loans (excluding unearned income of \$328 at March 31, 2007 and \$311 at December 31, 2006)          | 550,287                               | 548,834                                  |
| Less: allowance for loan losses  | 6,418                                 | 6,211                                    |
| Net loans  | 543,869                               | 542,623                                  |
| Loans held for sale  | 2,470                                 | 3,449                                    |
| Federal Home Loan Bank and Federal Reserve Bank Stock, at cost                                       | 5,505                                 | 5,505                                    |
| Premises and equipment   | 28,188                                | 28,234                                   |
| Accrued interest receivable  | 6,439                                 | 6,760                                    |
| Goodwill   | 11,825                                | 11,825                                   |
| Other intangible assets  | 437                                   | 458                                      |
| Other real estate  | 1,610                                 | 1,815                                    |
| Bank owned life insurance policies   | 17,386                                | 17,224                                   |
| Other assets   | 3,165                                 | 3,606                                    |
| <b>TOTAL ASSETS</b>  | <b>\$ 850,763</b>                     | <b>\$ 831,420</b>                        |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                                       |  |
| <b>Deposits</b>  |                                       |  |
| Demand   | \$ 97,455                             | \$ 95,048                                |
| Time   | 372,914                               | 370,146                                  |
| Savings  | 209,778                               | 200,869                                  |

|   |                   |                   |
|---|-------------------|-------------------|
| Total deposits  | 680,147           | 666,063           |
| Securities sold under agreements to repurchase  | 35,340            | 31,981            |
| Federal funds purchased and other short-term borrowings   | 1,000             | 1,000             |
| Long-term debt  | 59,199            | 59,538            |
| Other liabilities   | 4,464             | 3,340             |
| Total liabilities   | 780,150           | 761,922           |
| Shareholders' equity:   |                   |                   |
| Common stock, no par value - 10,000,000<br>authorized; 3,717,593 issued and<br>outstanding at March 31, 2007 and 3,717,593<br>issued and outstanding at December 31, 2006 | \$ 3,718          | \$ 3,718          |
| Surplus   | 15,331            | 15,331            |
| Retained earnings   | 53,490            | 52,532            |
| Accumulated other comprehensive income  | 398               | 108               |
| Total common stock and retained earnings  | 72,937            | 71,689            |
| Less-89,283 treasury shares, at cost at<br>March 31, 2007 and 85,500 shares at Cost at<br>December 31, 2006   | 2,324             | 2,191             |
| Total shareholders' equity  | 70,613            | 69,498            |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS'<br/>EQUITY</b>   | <b>\$ 850,763</b> | <b>\$ 831,420</b> |

See accompanying notes to consolidated financial statements.

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**  
**THREE MONTHS ENDED MARCH 31, 2007 AND 2006**  
(Stated in Thousands Except for E.P.S. and Shares Outstanding)

|                                     | <u>Three Months Ended March</u> |             |
|-------------------------------------|---------------------------------|-------------|
|                                     | <u>31,</u>                      |             |
|                                     | <u>2007</u>                     | <u>2006</u> |
| Interest Income:                    |                                 |             |
| Interest and Fees on Loans          | \$ 11,065                       | \$ 10,187   |
| Interest on Investment Securities:  |                                 |             |
| Taxable                             | 1,577                           | 1,306       |
| Tax-Exempt                          | 460                             | 431         |
| Dividends                           | 97                              | 102         |
| Other Interest Income               | 233                             | 318         |
| Total Interest Income               | 13,432                          | 12,344      |
| Interest Expense:                   |                                 |             |
| Interest Expense on Deposits        | 5,296                           | 4,125       |
| Other Interest Expense              | 1,176                           | 1,342       |
| Total Interest Expense              | 6,472                           | 5,467       |
| Net Interest Income                 | 6,960                           | 6,877       |
| Provision for Loan Losses           | 166                             | 233         |
| Net Interest Income after Provision | 6,794                           | 6,644       |
| Other Income                        |                                 |             |

|                                       |       |       |
|---------------------------------------|-------|-------|
| Income from Fiduciary Activities      | 199   | 185   |
| Service Charges on Deposit Accounts   | 1,421 | 1,400 |
| Brokerage Fees                        | 313   | 413   |
| Gain (loss) on Sale of Securities     | (60)  | -     |
| Earnings on bank owned life insurance | 175   | 175   |
| Other Income                          | 350   | 425   |
| Total Other Income                    | 2,398 | 2,598 |

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED) - (CONTINUED)**  
**THREE MONTHS ENDED MARCH 31, 2007 AND 2006**  
(Stated in Thousands Except for E.P.S. and Shares Outstanding)

|   | <b><u>Three Months Ended March</u></b> |                    |
|---|--|--------------------|
|   | <b><u>31,</u></b>                      |                    |
|   | <b><u>2007</u></b>                     | <b><u>2006</u></b> |
| Other Expenses                                |  |                    |
| Salaries and Employee Benefits                | \$ 3,897                               | \$ 3,836           |
| Net Occupancy Expense                         | 420                                    | 445                |
| Depreciation                                  | 526                                    | 482                |
| Data Processing Expense                       | 220                                    | 183                |
| Legal and Professional Fees                   | 60                                     | 27                 |
| Stationary and Office Supplies                | 74                                     | 61                 |
| Amortization of Intangibles                   | 21                                     | 21                 |
| Advertising and promotions                    | 176                                    | 161                |
| Other Expenses                                | 1,259                                  | 1,261              |
| Total Other Expenses                          | 6,653                                  | 6,477              |
| Net Income Before Income Taxes                | 2,539                                  | 2,765              |
| Income Taxes                                  | 528                                    | 596                |
| Net Income                                    | \$ 2,011                               | \$ 2,169           |
| Earning per Share                             | \$ 0.55                                | \$ 0.60            |
| Weighted Average Number of Shares Outstanding | 3,630,169                              | 3,634,621          |

See accompanying notes to consolidated financial statements.

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)**  
**AS OF MARCH 31, 2007 AND 2006**  
(Stated in Thousands)

**Three Months ended**  
**March 31,**  
**2007      2006**

|   |           |           |
|---|-----------|-----------|
| Balance beginning of period               | \$ 69,498 | \$ 63,646 |
| Net income                                | 2,011     | 2,169     |
| Other comprehensive income                |           |           |
| Changes in available for sale investments | 290       | (238)     |
| Changes in derivatives                    | -         | 43        |
| Comprehensive income                      | 2,301     | 1,974     |
| Cash dividend declared                    | (1,054)   | (1,054)   |
| Common stock issued                       |           |           |
| Common stock repurchased, net             | (132)     | (18)      |
| Employee stock obligation                 | -         | -         |
| Balance end of period                     | \$ 70,613 | \$ 64,548 |

See accompanying notes to consolidated financial statements.

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006**  
(Stated In Thousands)

|   | <b>Three Months Ended</b> |                    |
|---|---------------------------|--------------------|
|   | <b>March 31,</b>          |                    |
|   | <b><u>2007</u></b>        | <b><u>2006</u></b> |
| Net cash provided by operating activities               | \$ 3,750                  | \$ 3,399           |
| Investing activities:                                   |                           |                    |
| Proceeds of maturities of held-to-maturity securities   | -                         | -                  |
| Purchase of held-to-maturity investments                | -                         | -                  |
| Proceeds of maturities of available-for-sale securities | 1,707                     | 4,914              |
| Proceeds of sales of available-for-sale securities      | 4,890                     | -                  |
| Purchase of available-for-sale securities               | (7,188)                   | (10,474)           |
| Increase in loans-net                                   | (1,207)                   | (6,891)            |
| Purchases of premises and equipment                     | (480)                     | (1,554)            |
| Net cash (used) by investing activities                 | (2,278)                   | (14,005)           |
| Financing activities:                                   |                           |                    |
| Net increase (decrease) in demand and savings Accounts  | 11,316                    | 9,059              |
| Increase (decrease) in time deposits                    | 2,768                     | 14,022             |
| Increase (decrease) in long-term debt                   | (339)                     | (1,429)            |
| Treasury stock purchases, net                           | (133)                     | (18)               |
| Proceeds from sale of common stock                      | -                         | -                  |
| Cash dividends paid                                     | (1,054)                   | (1,054)            |
| Net increase (decrease) in short-term borrowings        | 3,359                     | (1,329)            |
| Net cash provided by financing activities               | 15,917                    | 19,251             |
| Increase (decrease) in cash and cash equivalents        | 17,389                    | 8,645              |
| Cash and cash equivalents at beginning of period        | 32,545                    | 40,686             |
| Cash and cash equivalents at end of period              | \$ 49,934                 | \$ 49,331          |
| Supplemental cash flow disclosures:                     |                           |                    |
| Interest payments, net                                  | \$ 5,858                  | \$ 5,287           |
| Income taxes paid, net                                  | \$ -                      | \$ -               |

See accompanying notes to consolidated financial statements.

**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**MARCH 31, 2007**  
(Stated in Thousands, except per share data)

**NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS**

The consolidated balance sheet as of March 31, 2007, the consolidated statements of income for the three month periods ended March 31, 2007 and 2006, and the consolidated statements of cash flows for the three-month periods then ended have been prepared by the company without an audit. The accompanying reviewed condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the financial position, results of operations and cash flows at March 31, 2007 and for all periods presented have been made. Operating results for the reporting periods presented are not necessarily indicative of results that may be expected for the year ended December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the company's Annual Report on Form 10-K for the year ended December 31, 2006.

**NOTE 2 - ORGANIZATION**

First Citizens Bancshares, Inc., is a bank holding company chartered on December 14, 1982, under the laws of the State of Tennessee. On September 23, 1983, all of the outstanding shares of common stock of First Citizens National Bank were exchanged for an equal number of shares in First Citizens Bancshares, Inc.

**NOTE 3 - CONTINGENT LIABILITIES**

There is no material pending litigation as of the current reportable date that would result in a liability.

**NOTE 4 - RESERVE FOR LOAN LOSSES**

The Reserve for Loan Losses is evaluated and recorded in accordance with SFAS 5, 114 and 118 as applicable. Accordingly, certain loans have been considered impaired. Approximate investment in impaired loans as of current quarter end is as follows:

|   |               |
|---|---------------|
|   | Balance       |
| Impaired loans with specific reserve allocations    | \$ 1,515,000  |
| Impaired loans without specific reserve allocations | <u>86,000</u> |
|   | \$ 1,601,000  |
|   | =====         |
| Specific reserve for impaired loan losses           | \$ 303,000    |

Interest income recognized on impaired loans has been applied on a cash basis. Interest income recognized on impaired loans is immaterial for all reportable periods presented. Cash receipts are applied as cost recovery first or principal recovery first, consistent with OCC regulations. Management is confident the overall reserves are adequate to cover possible losses within the portfolio in addition to impaired loans.

**NOTE 5 - DERIVATIVE TRANSACTIONS**

FASB 133, 137 and 138 - FASB 133 establishes accounting and reporting standards for derivative instruments, embedded in other contracts, and for hedging activities. It requires derivatives to be reported as either assets or liabilities in the statement of financial position and measures those instruments at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. FASB 137 and 138 amended FASB 133. Bancshares' used the derivative as a cash flow to hedge the "Benchmark Interest Rate." First Citizens designated a Federal Home Loan Bank Variable LIBOR Borrowing to be hedged and effectively locked in a fixed cost on the liability.

In June 2000, First Citizens swapped a fixed investment cash flow for a variable cash flow that is tied to the 90 day LIBOR Rate. The new variable investment cash flow is matched with a variable borrowing cash flow generating a positive spread of 250 basis points with no interest rate risk. The transaction was implemented to increase earnings of First Citizens. Volume used in the transaction was \$1.5 million. Volume and risk associated with the transaction is well within the Funds Management Policy of the bank. Maturity of the hedge is 10 years.

The cash flow hedge has produced negative income because First Citizens swapped a fixed cash flow for a variable cash flow and rates later decreased. The value of the derivative has improved as rates have increased over the last three years, but remains in a negative position as of current quarter end. Value of the derivative was flat during the quarter ended March 31, 2007. Accumulated other comprehensive income reflects a negative value of \$100 thousand, gross and \$62 thousand, net of tax.

#### **NOTE 6 - GOODWILL AND INTANGIBLE ASSETS**

Goodwill and intangible assets are accounted for in accordance with SFAS 142. Thus, goodwill is not amortized and is tested for impairment annually. No impairment has been recognized since SFAS 142 was adopted in 2002.

SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and supercedes APB 17. SFAS 142 adopts a more aggregate view for goodwill and bases the accounting on the units of the combined units of the combined entity into which an acquired entity is integrated (those units are referred to as reporting units in FASB 131). Currently First Citizens' has one reporting unit and does not meet the tests to segment per FASB 131. As of January 2002, First Citizens ceased to amortize goodwill (\$25 thousand per month). Tests are performed annually during first quarter and have resulted in an impairment of zero since adoption of FAS 142 in 2002. Total goodwill as of the reportable date is \$11.8 million or 1.39% of total assets or 16.75% of total capital.

Amortization expense of the other identifiable intangibles for the quarter was \$21 thousand for 2007 and 2006.

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#### **NOTE 7 - LONG TERM OBLIGATIONS**

In March 2002, the Company formed a wholly owned subsidiary First Citizens (TN) Statutory Trust II and issued \$5,000,000 in preferred trust securities. This debt was refinanced in March 2007 through a new trust as detailed below. Therefore, First Citizens (TN) Statutory Trust II was terminated in March 2007. The refinancing results in reduced cost on \$5 million of 185 basis points or \$92,500 annually. This transaction had no incremental impact on total borrowings.

In March 2007, the Company formed a wholly owned subsidiary First Citizens (TN) Statutory Trust IV. The Trust was created under the Business Act of Delaware for the sole purpose of issuing and selling preferred securities and using proceeds from the sale to acquire long term subordinated debentures issued by Bancshares. The debentures are the sole assets of the Trust. First Citizens Bancshares owns 100% of the common stock of the Trust.

In March 2007, the Company through its wholly owned subsidiary, First Citizens (TN) Statutory Trust IV, sold 5,000 of its floating rate Preferred Trust Securities at a liquidation amount of \$1000 per security for an aggregate amount of \$5,000,000. For the period beginning on (and including) the date of original issuance and ending on (but excluding) June 15, 2007 the rate per annum of 7.10%. For each successive period beginning on (and including) June 15, 2007, and each succeeding interest payment date at a rate per annum equal to the 3-month LIBOR plus 1.75%. Interest payment dates are: March 15, June 15, September 15, and December 15 during the 30-year term.

Bancshares' obligation under the debentures and related documents constitute a full and unconditional guarantee by the Company of the Trust issuer's obligations under the Preferred Securities. Although the debentures are treated as debt of the Company, they are treated as Tier I capital subject to a limitation that the securities included as Tier I capital not exceed 25% of the total Tier I capital. The securities are callable by the Company after 5 years.

In March 2005, the Company formed a wholly owned subsidiary First Citizens (TN) Statutory Trust III. The Trust was created under the Business Act of Delaware for the sole purpose of issuing and selling preferred securities and using proceeds from the sale to acquire long term subordinated debentures issued by Bancshares. The debentures are the sole assets of the Trust. First Citizens Bancshares owns 100% of the common stock of the Trust.

On March 17, 2005 the Company through its wholly owned subsidiary, First Citizens (TN) Statutory Trust III, sold 5,000 of its floating rate Preferred Trust Securities at a liquidation amount of \$1,000 per security for an aggregate amount of \$5,000,000. For the period beginning on (and including) the date of original issuance and ending on (but excluding) June 17, 2005 the rate per annum of 4.84%. For each successive period beginning on (and including) June 17, 2005, and each succeeding interest payment date at a rate per annum equal to the 3-month LIBOR plus 1.80%. Interest payment dates are: March 17, June 17, September 17, and December 17 during the 30-year term. The entire \$5 million in proceeds was used to reduce Bancshares' revolving line of credit with First Tennessee discussed in Note 8 below.

The ability of First Citizens to service its long-term debt obligation is dependent upon the future profitability of its banking subsidiaries and their ability to pay dividends to the Company.

#### **NOTE 8 - REVOLVING LINE OF CREDIT**

In 2002, First Citizens Bancshares obtained a two-year line of credit with First Tennessee Bank in the amount of \$13 million. Since its original maturity in 2004, the line has been renewed annually. As of the reportable date, the drawn amount was \$1.4 million. Interest on the outstanding balance is payable quarterly and is based on 100 basis points below the base prime rate of First Tennessee Bank.

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## **ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **GENERAL INFORMATION**

First Citizens Bancshares, Inc. ("Company") headquartered in Dyersburg, Tennessee, the bank holding company for First Citizens National Bank ("Bank"), First Citizens Capital Assets, Inc., First Citizens (TN) Statutory Trust II and First Citizens (TN) Statutory Trust III. First Citizens National Bank is a diversified financial service institution, which provides banking and other financial services to its customers. The Bank operates two wholly owned subsidiaries: First Citizens Financial Plus, Inc. and First Citizens Investments, Inc. The Bank also owns 50% of White and Associates/First Citizens Insurance LLC and 50% of First Citizens/White and Associates Insurance Company, Inc. The two 50% owned insurance subsidiaries are accounted for using the equity method. First Citizens Investments, Inc. owns First Citizens Holdings, Inc. First Citizens Holdings, Inc. owns First Citizens Properties, Inc. These



subsidiary activities consist of: brokerage, investments, insurance related products, credit insurance and investments in real estate mortgage participation interests.

#### EXPANSION

In first quarter 2007, expansion efforts resulted in the opening of two loan production offices. One loan production office was opened in Jackson, Tennessee and the other in Franklin, Tennessee.

#### FORWARD-LOOKING STATEMENTS

Quarterly reports on Form 10-Q, including all documents incorporated by reference, may contain forward-looking statements. Additional written or oral forward-looking statements may be made from time to time in other filings with the Securities Exchange Commission. The discussion of changes in operations may contain words that indicate the company's future plans, goals, and estimates of assets, liabilities or income. Forward-looking statements will express the company's position as of the date the statement is made. These statements are primarily based upon estimates and assumptions that are inherently subject to significant banking, economic, and competitive uncertainties, many of which are beyond management's control. When used in this discussion, the words, "anticipate," "project," "expect," "believe," "should," "intend," "is likely," and other expressions are intended to identify forward-looking statements. The statements are within the meaning and intent of section 27A of the Securities Exchange Act of 1934. Such statements may include, but are not limited to, projections of income or loss, expenses, acquisitions, plans for the future, and others.

#### CRITICAL ACCOUNTING ESTIMATES

The accounting and reporting of First Citizens Bancshares and its subsidiaries conform to accounting principles generally accepted in the United States and follow general practices within its industry. The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The company's estimates are based on historical experience, information supplied from professionals, regulators and others believed to be reasonable under the facts and circumstances. Accounting estimates are considered critical if (1) management is required to make assumptions or judgments about items that are highly uncertain at the time the estimate is made, and (2) different estimates reasonably could have been used during the current period or changes in such estimates are reasonably likely to occur from period to period, that could have a material impact of the presentation of the Consolidated Financial Statements.

The development, selection and disclosure of critical accounting policies are discussed with the Audit Committee of the Board of Directors. Due to the potential impact on the financial condition or results of operations and the required subjective or complex judgments involved, management believes its critical accounting policies to consist of the allowance for loan losses, fair value of financial instruments, and goodwill and assessment of impairment.

#### ALLOWANCE FOR LOAN LOSSES

The allowance for losses on loans represents management's best estimate of inherent losses in the existing loan portfolio. Management's policy is to maintain the allowance for loan losses at a level sufficient to absorb reasonably estimated and probable losses within the portfolio. The company believes the loan loss reserve estimate is a critical accounting estimate because: changes can materially affect bad debt expense on the income statement, changes in the borrower's cash flows can impact the reserve, and management has to make estimates at the balance sheet date and also into the future in reference to the reserve. While management uses the best information available to establish the allowance for loan losses, future adjustments may be necessary if economic or other conditions change materially.

#### FAIR VALUE OF FINANCIAL INSTRUMENTS

Accounting principles generally accepted in the United States require that certain assets and liabilities be carried on the balance sheet at fair value. Furthermore, the fair value of financial instruments is required to be disclosed as a part of the notes to the consolidated financial statements for other assets and liabilities. Fair values are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates, the shape of yield curves and the credit worthiness of counter parties.

Fair values for the majority of First Citizens' available-for-sale investment securities are based on quoted market prices from actively traded markets. In instances where quoted market prices are not available, fair values are based on the quoted prices of similar instruments with adjustment for relevant distinctions (e.g., size of issue, interest rate, etc.).

Fair value of the only derivative held by the company is determined using a combination of quoted market rates for similar instruments and quantitative models based on market inputs including rate, price and index scenarios to generate continuous yield or pricing curves and volatility factors. Third party vendors are used to obtain fair value of available-for-sale securities and the cash flow hedge.

## GOODWILL

The Company's policy is to review goodwill for impairment at the reporting unit level on an annual basis unless an event occurs that would likely impair the goodwill amount. Goodwill represents the excess of the cost of an acquired entity over fair value assigned to assets and liabilities. Management believes accounting estimates associated with determining fair value, as part of the goodwill test is a critical accounting estimate because estimates and assumptions are made based on prevailing market factors, historical earnings and multiples and other contingencies.

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## RESULTS OF OPERATIONS

First quarter 2007 results of operations reflect stable income and strong overall balance sheet growth as Bancshares continues to battle margin and earnings pressure caused by an inverted yield curve, economic factors, competition, and regulatory burdens. As balance sheet growth outpaced earnings growth, decreases are noted in ratios of net income to average assets and average equity as noted in the table below.

|   | AS OF MARCH 31, |             |             |             |             |
|---|-----------------|-------------|-------------|-------------|-------------|
|   | <u>2007</u>     | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
| Percentage of Net Income to:  |                 |             |             |             |             |
| Average Total Assets  | 0.98 %          | 1.06 %      | 1.08 %      | 1.09 %      | 1.15 %      |
| Average Shareholders' Equity  | 11.73 %         | 13.55 %     | 13.43 %     | 13.51 %     | 14.54 %     |
| Percentage of Dividends Declared Per Common Share to Net Income     | 52.41 %         | 48.59 %     | 49.12 %     | 52.00 %     | 49.94 %     |
| *Percentage of Average Shareholders' Equity to Average Total Assets | 9.09 %          | 8.63 %      | 8.86 %      | 8.03 %      | 8.77 %      |

\*Represents primary capital including the allowance for loan losses.

Earnings per share decreased \$0.05 or 8.33% when comparing the first quarters of 2007 and 2006. The decrease in earnings per share is a result of lower non-interest income and higher non-interest expense when comparing first quarter 2007 to first quarter 2006. Non-interest income and non-interest expense components are discussed in detail below.

Net interest income is the principal source of earnings for First Citizens and is defined as the amount of interest generated by earning assets minus interest cost to fund those assets. Net interest income increased \$83 thousand or 1.21%, when comparing first quarter of 2007 to first quarter 2006. The net yield on average earning assets for the first quarters of 2007 and 2006 increased, from 6.64% to 7.35%. Net interest margin for first quarter 2007 was 3.87%, which reflects an increase of 14 basis points above first quarter 2006 and is flat compared to 3.89% for the year ended December 31, 2006. First Citizens has maintained stable net interest margins in the range of 3.7% to 4.0% over the past three years as federal funds rates increased from 1.00% to the current rate of 5.25%.

Per the Uniform Bank Performance Report, net interest income as a percent of average total assets was the below peer at 3.58% compared to peer at 3.94% for the year ended December 31, 2006. Review of individual components of net interest income reveal that the Bank's investment portfolio has higher yields than peer and their cost of deposits are less than peer while peer banks have higher loan yields and lower costs on other borrowed money. Yield on total loans was 7.73% compared to peer at 7.78% at year-end 2006. Investment yields are above peer at 5.02% compared to peer at 4.69%. Cost of deposits was 2.92% compared to peer at 3.27% and cost of other borrowed money was 5.40% compared to peer of 4.71%. Other borrowed money has been higher than peer the last few years due to the Bank's fixed rate advances with the Federal Home Loan Bank. The gap between the Bank's cost of borrowings compared to peer has narrowed over the last three years as the cost of borrowings at peer banks increased while the Bank's other borrowings cost remained fairly flat.

Average earning assets to total average assets is 90% compared to peer of 94% as of December 31, 2006. The dilution is caused by significant investments in fixed assets and Bank-owned life insurance (BOLI) policies, which total approximately \$46 million or 5% of total assets as of March 31, 2007. The statement of cash flows reflects fixed assets purchases of \$1.5 million during first quarter 2007. Earnings on BOLI policies are included in other non-interest income and totaled approximately \$175,000 for first quarter 2007.

The loan loss provision for first quarter 2007 decreased \$67 thousand or 29% compared to first quarter 2006. First quarter 2007 had net recoveries of \$41 thousand compared to net charge offs of \$36 thousand in first quarter 2006. Reserve for losses on loans as a percent of total loans was 1.17% at March 2007 and 1.27% at March 2006. The reserve as a percent of total loans increased 0.04% from 1.13% at year-end 2006. See also Loan section below.

Non-interest income represents fees and other income derived from sources other than interest-earning assets. Non-interest income to average assets outpaced peer over the last few years and was 1.27% compared to peer of 0.83% as of year-end 2006. However, non-interest income has decreased when comparing the first quarters 2007 and 2006. In first quarter of 2007, fee income (non-interest income) contributed 15.15% to total revenue compared to 17.39% for the same period last year.

Non-interest income reflects small increases totaling approximately \$35 in trust fees and service charges on deposits and flat earnings on bank owned life insurance. Brokerage fees decreased approximately \$100,000 from first quarter 2006 to first quarter 2007 primarily from decreased annuity sales.

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The decrease in other non-interest income consists of approximately \$60,000 loss on sale of securities and lower earnings from the 50% owned full insurance agency subsidiary. Approximately \$5 million in securities were sold in March 2007 at a \$60,000 loss which is expected to be recovered in approximately six months through increased yields on new securities purchased with proceeds from the sale. First quarter income from the insurance agency for 2005 and 2006 reflected additional earnings from underwriters due to the agency meeting certain targets for volumes, loss ratios, etc. Such earnings were not duplicated in first quarter 2007 due to higher than usual loss ratios in 2006 caused by tornado damage in markets served. Income from the insurance subsidiary totaled \$138,000, \$207,000 and \$333,000 in first quarters 2007, 2006, and 2005, respectively. First quarter 2005 income of \$333,000 includes approximately \$150,000 on non-recurring income from favorable litigation settlement at the insurance subsidiary.

The following table compares non-interest income for first quarter of 2007, 2006 and 2005:

|                                       | 2007        |               | 2006        |               | 2005        |
|---------------------------------------|-------------|---------------|-------------|---------------|-------------|
|                                       |             | % of          |             | % of          |             |
|                                       | <u>2007</u> | <u>Change</u> | <u>2006</u> | <u>Change</u> | <u>2005</u> |
| Income from Fiduciary Activities      | \$ 199      | 7.57 %        | \$ 185      | 1.09 %        | \$ 183      |
| Service Charges on Deposit Accounts   | 1,421       | 1.50 %        | 1,400       | 4.17 %        | 1344        |
| Brokerage Fees                        | 313         | -24.21 %      | 413         | 11.32 %       | 371         |
| Earnings on bank owned life insurance | 175         | 0.00 %        | 175         | 8.70 %        | 161         |
| Other income                          | 290         | -31.76 %      | 425         | -21.30 %      | 540         |
| Total non-interest income             | \$ 2,398    | -7.70 %       | \$ 2,598    | -0.04 %       | \$ 2,599    |

Non-interest expense represents operating expenses of First Citizens. Non-interest expense increased \$176 thousand, or 2.18%, over first quarter of 2006. Salary and benefits increased approximately \$61 thousand or 1.59%. Average full-time equivalent employees are 268.95 for three months ended March 31, 2007 compared to 266.89 and 257.42 for three months ended March 31, 2006 and 2005, respectively. Bancshares' growth strategies over the last few years also impact certain other sectors of the non-interest expense areas such as data processing and depreciation, which increased approximately 9% and 20%, respectively over prior year's first quarter. Legal and professional fees increased in first quarter 2007 over prior year's first quarter primarily due to consulting fees. The efficiency ratio as of March 31, 2007, 2006 and 2005 was 69.19%, 65.53%, and 63.23%, respectively. Impaired Goodwill expense is \$0 for the current and prior reportable periods. Core deposit intangible expense for the current reportable quarter was flat at \$21,000. Quarter-to-date advertising, community relations, and other forms of marketing expenses were \$176 thousand or 2.65% of other non-interest expense in first quarter 2007 compared to \$161 thousand or 2.5% of total non-interest expense in 2006. All marketing or advertising items are expensed at the time they are incurred.

The following table compares non-interest expense for first quarter of 2007, 2006 and 2005:

|                                | 2007        |               | 2006        |               | 2005        |
|--------------------------------|-------------|---------------|-------------|---------------|-------------|
|                                |             | % of          |             | % of          |             |
|                                | <u>2007</u> | <u>Change</u> | <u>2006</u> | <u>Change</u> | <u>2005</u> |
| Salaries and Employee benefits | \$ 3,897    | 1.59 %        | \$ 3,836    | 7.51 %        | \$ 3,568    |
| Net Occupancy Expense          | 420         | -5.62 %       | 445         | 9.88 %        | 405         |
| Depreciation                   | 526         | 9.13 %        | 482         | 8.80 %        | 443         |
| Data Processing Expense        | 220         | 20.22 %       | 183         | 10.24 %       | 166         |
| Legal and Professional Fees    | 60          | 122.22 %      | 27          | -34.15 %      | 41          |
| Stationary and Office Supplies | 74          | 21.31 %       | 61          | -11.59 %      | 69          |
| Amortization of Intangibles    | 21          | 0.00 %        | 21          | 0.00 %        | 21          |
| Advertising and promotions     | 176         | 9.32 %        | 161         | 37.61 %       | 117         |
| Other Expenses                 | 1,259       | -0.16 %       | 1,261       | 5.70 %        | 1,193       |
| Total Non-Interest Expense     | \$ 6,653    | 2.72 %        | \$ 6,477    | 7.54 %        | \$ 6,023    |

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The following quarterly average balances, interest, and average rates are presented in the following table:

|                                     | QUARTER ENDING MARCH 31, |            |                 |                    |            |                 |                    |           |                 |
|-------------------------------------|--------------------------|------------|-----------------|--------------------|------------|-----------------|--------------------|-----------|-----------------|
|                                     | 2007                     |            |                 | 2006               |            |                 | 2005               |           |                 |
|                                     | Average<br>Balance       | Interest   | Average<br>Rate | Average<br>Balance | Interest   | Average<br>Rate | Average<br>Balance | Interest  | Average<br>Rate |
| <b>ASSETS</b>                       |                          |            |                 |                    |            |                 |                    |           |                 |
| <b>INTEREST EARNING ASSETS:</b>     |                          |            |                 |                    |            |                 |                    |           |                 |
| Loans (1)(2)(3)                     | \$ 547,496               | \$ 11,065  | 8.08 %          | \$ 547,727         | \$ 10,187  | 7.44 %          | \$ 528,272         | \$ 8,713  | 6.60 %          |
| Investment Securities:              |                          |            |                 |                    |            |                 |                    |           |                 |
| Taxable                             | 134,546                  | 1,674      | 4.98 %          | 128,906            | 1,306      | 4.05 %          | 111,103            | 944       | 3.40 %          |
| Tax Exempt (4)                      | 44,243                   | 697        | 6.30 %          | 41,503             | 653        | 6.29 %          | 40,419             | 627       | 6.21 %          |
| Interest Earning                    |                          |            |                 |                    |            |                 |                    |           |                 |
| Deposits                            | 759                      | 9          | 4.74 %          | 726                | 7          | 3.86 %          | 684                | 4         | 2.34 %          |
| Federal Funds Sold                  | <u>17,235</u>            | <u>224</u> | 5.20 %          | <u>32,165</u>      | <u>311</u> | 3.87 %          | <u>17,293</u>      | <u>89</u> | 2.06 %          |
| Total Interest Earning              |                          |            |                 |                    |            |                 |                    |           |                 |
| Assets                              | 744,279                  | 13,669     | 7.35 %          | 751,027            | 12,464     | 6.64 %          | 697,771            | 10,377    | 5.95 %          |
| <b>NON-INTEREST EARNING ASSETS:</b> |                          |            |                 |                    |            |                 |                    |           |                 |
| Cash and due from                   |                          |            |                 |                    |            |                 |                    |           |                 |
| Banks                               | \$ 16,368                |            |                 | \$ 15,670          |            |                 | \$ 18,954          |           |                 |
| Bank Premises                       |                          |            |                 |                    |            |                 |                    |           |                 |
| and Equipment                       | 28,267                   |            |                 | 28,361             |            |                 | 25,065             |           |                 |
| Other Assets                        | <u>45,903</u>            |            |                 | <u>37,774</u>      |            |                 | <u>35,932</u>      |           |                 |
| Total Assets                        | <u>\$ 834,817</u>        |            |                 | <u>\$ 832,832</u>  |            |                 | <u>\$ 777,722</u>  |           |                 |

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|   | QUARTER ENDING MARCH 31, |                     |                 |                    |                     |                 |                    |                     |                 |
|---|--------------------------|---------------------|-----------------|--------------------|---------------------|-----------------|--------------------|---------------------|-----------------|
|   | 2007                     |                     |                 | 2006               |                     |                 | 2005               |                     |                 |
|   | Average<br>Balance       | Average<br>Interest | Average<br>Rate | Average<br>Balance | Average<br>Interest | Average<br>Rate | Average<br>Balance | Average<br>Interest | Average<br>Rate |
| LIABILITIES AND<br>SHAREHOLDERS' EQUITY                                 |                          |                     |                 |                    |                     |                 |                    |                     |                 |
| INTEREST BEARING<br>LIABILITIES:  |                          |                     |                 |                    |                     |                 |                    |                     |                 |
| Interest bearing deposits   | \$ 574,362               | \$ 5,296            | 3.69 %          | \$ 564,796         | \$ 4,125            | 2.92 %          | \$ 520,189         | \$ 2,694            | 2.07 %          |
| Federal funds<br>Purchased and<br>Other Interest<br>Bearing Liabilities | <u>93,405</u>            | <u>1,176</u>        | 5.04 %          | <u>113,645</u>     | <u>1,342</u>        | 4.72 %          | <u>121,901</u>     | <u>1,186</u>        | 3.89 %          |
| Total Interest<br>Bearing Liabilities                                   | 667,767                  | 6,472               | 3.88 %          | 678,441            | 5,467               | 3.22 %          | 642,090            | 3,880               | 2.42 %          |
| NON-INTEREST BEARING<br>LIABILITIES:                                    |                          |                     |                 |                    |                     |                 |                    |                     |                 |
| Demand deposits   | 93,273                   |                     |                 | 85,642             |                     |                 | 68,725             |                     |                 |
| Other liabilities   | <u>4,242</u>             |                     |                 | <u>3,833</u>       |                     |                 | <u>4,391</u>       |                     |                 |
| Total liabilities   | 765,282                  |                     |                 | 767,916            |                     |                 | 715,206            |                     |                 |
| SHAREHOLDERS' EQUITY  | <u>69,535</u>            |                     |                 | <u>64,916</u>      |                     |                 | <u>62,516</u>      |                     |                 |
| TOTAL LIABILITIES AND<br>SHAREHOLDERS' EQUITY                           | <u>\$ 834,817</u>        |                     |                 | <u>\$ 832,832</u>  |                     |                 | <u>\$ 777,722</u>  |                     |                 |
| NET INTEREST<br>INCOME  |                          |                     |                 |                    |                     |                 |                    |                     |                 |
|   |                          | <u>\$ 7,197</u>     |                 |                    | <u>\$ 6,997</u>     |                 |                    | <u>\$ 6,497</u>     |                 |
| NET YIELD ON AVERAGE<br>EARNING ASSETS<br>(ANNUALIZED)                  |                          |                     |                 |                    |                     |                 |                    |                     |                 |
|   |                          |                     | 3.87 %          |                    |                     | 3.73 %          |                    |                     | 3.72 %          |

(1) Loan totals are shown net of interest collected, not earned and Loan Loss Reserve.

(2) Non-accrual loans are included in average total loans.

(3) Loan Fees are included in interest income and the computations of the yield on loans.

(4) Interest and rates on securities which are non-taxable for Federal Income Tax purposes are presented on a taxable equivalent basis.

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## CHANGES IN FINANCIAL CONDITION

Loans grew by \$1.5 million or approximately 0.26% (annualized 1.05%) during first quarter 2007 primarily due to slow overall loan demand in mature Northwest Tennessee markets coupled with slowing loan growth in the Southwest Tennessee markets served by First Citizens. Loan growth rates were approximately 1% and 3% for the years ended December 31, 2006 and 2005, respectively. First Citizens continues its commitment to asset quality by not compromising underwriting standards in order to grow its loan portfolio. Loan growth rates are expected to accelerate in second quarter and the remainder of 2007 due to the addition of two loan production offices. Loan production offices were opened in first quarter 2007 in Jackson, Tennessee and Franklin, Tennessee. These markets are areas experiencing better economic conditions and growth rates than current mature markets of Northwest Tennessee.

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Total deposits increased by \$14 million or 2.11% (annualized 8.45%) during first quarter 2007. Seasonality of municipal deposits contributed to the overall increase of approximately \$9 million in savings deposits. Average interest-bearing deposits in first quarter 2007 compared to the period in 2006 reflect an increase of approximately \$10 million or 1.69 percent. Cost of interest bearing deposits increased 77 basis points from first quarter 2006 to first quarter 2007 primarily due to increased cost of time deposits.

### INVESTMENT SECURITIES

Investment securities are primarily held in the bank's subsidiary, First Citizens Investments, Inc. and in its subsidiary, First Citizens Holdings, Inc. The bank has a portfolio advisory agreement with FTN Financial to manage the investment portfolio. Peer data per the December 31, 2006 Uniform Bank Performance Report indicates that yields on investments exceed peer at 5.02% compared to 4.69% peer. Quarterly average rates for taxable securities for the current quarter end increased 92 basis points while tax exempt securities are flat compared to prior year's first quarter. The investment portfolio is heavily weighted in mortgage-related securities, which account for approximately 50% of total portfolio. Bancshares' goal continues to be to steadily maintain or improve the quality of the investment portfolio without taking on material risk.

Pledged investments reflect a market value of approximately \$122 million as of the current reportable period.

The book value of listed investment securities as of dates indicated are summarized as follows:

|                                | AS OF MARCH 31, |             |             |             |             |
|--------------------------------|-----------------|-------------|-------------|-------------|-------------|
|                                | <u>2007</u>     | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
| U. S. Treasury & Government    |                 |             |             |             |             |
| Agencies                       | \$ 129,290      | \$ 117,202  | \$ 95,449   | \$ 111,510  | \$ 105,561  |
| State & Political Subdivisions | 43,773          | 41,581      | 40,949      | 36,098      | 35,452      |
| All Others                     | 12,377          | 13,505      | 13,333      | 7,988       | 7,893       |
| Totals                         | \$ 185,440      | \$ 172,288  | \$ 149,731  | \$ 155,596  | \$ 148,906  |

\*Includes Federal Home Loan Bank and Federal Reserve Bank stock which are classified separately on the Balance Sheet.

Investments are classified according to intent under generally accepted accounting principles. There are no securities classified in the trading category for any period presented in this report. Amortized cost and fair market value of securities by intent as of March 31, 2007 are as follows:

|   | <u>Held-to Maturity</u> |                   | <u>Available-for-Sale</u> |                   |
|---|-------------------------|-------------------|---------------------------|-------------------|
|   | <u>Amortized Cost</u>   | <u>Fair Value</u> | <u>Amortized Cost</u>     | <u>Fair Value</u> |
| U. S. Treasury Securities   | \$                      | \$                | \$ 1,804                  | \$ 1,797          |
| U. S. Government Agency & Corporate Obligations                   |                         |                   | 128,472                   | 127,493           |
| Securities Issued by States & Political Subdivision in the U. S.: | -                       | -                 | -                         | -                 |
| Taxable Securities  |                         |                   |                           |                   |
| Tax-Exempt Securities   | 290                     | 291               | 41,914                    | 43,483            |
| U. S. Securities:   |                         |                   |                           |                   |
| Debt Securities   |                         |                   | 6,728                     | 6,872             |
| Equity Securities   |                         |                   | 5,505                     | 5,505             |
| Foreign Securities:   |                         |                   |                           |                   |
| Debt Securities   | N/A                     | N/A               | N/A                       | N/A               |
| Equity Securities   | N/A                     | N/A               | N/A                       | N/A               |
| Total   | \$ 290                  | \$ 291            | \$84,423                  | \$85,150          |

\*Includes Federal Home Loan Bank and Federal Reserve Bank stock which are classified separately on the Balance Sheet.

Accumulated other comprehensive income reflects unrealized gain (loss) on securities, net of tax. During first quarter 2007, gross unrealized gain (loss) on securities increased approximately \$468 thousand primarily due to changes in the bond market. The yield curve continues to be inverted but the curve has shifted higher from December 31, 2006 to March 31, 2007. Market value of the investment portfolio is heavily influenced by 10-year Treasury benchmark due to the volumes of U. S. Government Treasury and Agency securities (including mortgage-related investments) that comprise the portfolio. The 10-year Treasury rate was in the range of 4.6% to 4.7% in March 2007 and December 2006. However, 2-year Treasury rates were approximately 4.6% in March 2007 compared to 4.75% at year-end 2006. Thus, the inverted shape of the curve has flattened as of current quarter end resulting in small net unrealized gains in the available-for-sale portfolio. Accumulated other comprehensive income for the current quarter, net of tax, was an unrealized gain of \$460,000. Fluctuations in market value of the portfolio is due entirely to the current interest rate environment and does not appear to relate to quality of issuers or issuers' ability to repay the bonds.

The only derivative transaction of Bancshares or its subsidiaries is an interest rate swap, which is discussed in the derivative transactions footnote.

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## LOANS

One of Bancshares' primary objectives is to seek quality-lending opportunities within its markets. The majority of First Citizens' borrowers lives and conducts business in West Tennessee. First Citizens has recently expanded its footprint in West Tennessee and into Middle Tennessee with the opening of loan production offices in Jackson and Franklin, Tennessee. Overall, loans decreased approximately \$4 million from March 31, 2006 to March 31, 2007 and are flat from December 31, 2006 to March 31, 2007. Real estate loans are flat when comparing March 2007 to March



2006. Slow loan growth is primarily a result of current economic conditions of markets served and interest rate environment. First Citizens remains committed to asset quality and will not sacrifice quality for growth. Loan volumes are expected to increase over the remainder of 2007 primarily from growth in the more metropolitan markets including Shelby, Madison and Williamson Counties of Tennessee. Overall economic factors for Tennessee appear stable including the unemployment rate for Tennessee of 4.7% as of March 2007 compared to 5.4% as of March 2006. The following table sets forth loan totals net of unearned income by category for the past five years:

|   | AS OF MARCH 31, |             |             |             |             |
|---|-----------------|-------------|-------------|-------------|-------------|
|   | <u>2007</u>     | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
| Real estate:                              |                 |             |             |             |             |
| Construction                              | \$ 90,893       | \$ 83,423   | \$ 104,460  | \$ 78,373   | \$ 68,872   |
| Mortgage                                  | 342,224         | 350,230     | 320,675     | 314,409     | 284,051     |
| Commercial, financial<br>and agricultural | 75,650          | 79,156      | 62,754      | 73,118      | 73,079      |
| Consumer installment                      | 37,435          | 37,592      | 37,643      | 37,754      | 38,847      |
| Other                                     | 6,555           | 6,546       | 4,297       | 3,432       | 3,644       |
| Total loans                               | \$ 552,757      | \$ 556,947  | \$ 529,829  | \$ 507,086  | \$ 468,493  |

\*Mortgage loans include loans held for sale in the secondary mortgage market. Balances are \$2.5 million, \$2.9 million, \$2.5 million, \$3.1 million, and \$3.8 million for 2007, 2006, 2005, 2004 and 2003, respectively.

The following table sets forth the balance of non-performing loans as of March 31, for the years indicated:

|                                       | AS OF MARCH 31, |             |             |             |             |
|---------------------------------------|-----------------|-------------|-------------|-------------|-------------|
|                                       | <u>2007</u>     | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
| Non-performing loans:                 |                 |             |             |             |             |
| Non-accrual                           | \$ 385          | \$ 1,386    | \$ 1,310    | \$ 1,015    | \$ 2,065    |
| 90 days past due<br>accruing interest | 703             | 2,213       | 907         | 238         | 1,512       |
| Total                                 | \$ 1,088        | \$ 3,599    | \$ 2,217    | \$ 1,253    | \$ 3,577    |

Non-performing loans at quarter end were 0.20% of total loans. The aggregate amount of loans the company is permitted to make under applicable bank regulations to any one borrower is 15% of unimpaired capital. First Citizens National Bank's legal lending limit at March 31, 2007 was \$11.3 million. Weighted average loan yields increased 64 basis points from first quarter 2006 to first quarter 2007. Loan rates have increased in the rising rate environment over the last three years but the cost of deposits and other funding has also increased resulting in a steady but flat net interest margin.

#### AGRICULTURAL LOANS

First Citizens is one of the largest agriculture lenders in the State of Tennessee and is the only preferred Farm Services Agency community bank lender in Tennessee. Agriculture makes a significant contribution to Dyer County commerce, generating approximately \$75-\$85 million in revenue on an annual basis. Agricultural credits secured by farmland and other types of collateral comprise approximately \$54 million of total loans as of March 31, 2007 and \$55 million as of March 31, 2006. Recoveries, net of charge-offs in this category were \$3 thousand for first quarter 2007.

An analytical model based on historical loss experience, current trends and economic conditions as well as reasonably foreseeable events is used to determine the amount of provision to be recognized and to test the adequacy of the loan loss allowance. The ratio of allowance for loan losses to total loans, net of unearned income, was 1.17% for the current quarter and 1.12% at year-end 2006. A recap of activity posted to the Reserve account in current quarter resulted in the following transactions: (1) loans charged-off (\$66,000) (2) recovery of loans previously charged off \$107,000 and (3) additions to reserve \$166,000. The provision for loan losses decreased \$67,000 when compared to the same time period in 2006.

Recoveries exceeded charged off loans in first quarter 2007 resulting in net recovery of \$41,000 to the allowance for loan losses. Non-performing loans as of current quarter end decreased approximately \$2.6 million from March 2006. Non-performing loans remain in the range of less than 1% of total loans maintained the last five years and are expected to continue at a very manageable level. First Citizens had two significant balance problem loans, which accounted for higher non-performing loans in first quarter 2006. The properties securing these loans were foreclosed and one of the properties accounts for \$1.5 million of the balance in Other Real Estate as of first quarter 2007. See Other Real Estate below. First Citizens does not anticipate any material negative trends in problems loans for 2007. First Citizens had no concentrations of credit of 10 percent or more of total loans in any single industry. There are no material reportable contingencies as of this report date.

## **OTHER REAL ESTATE**

Other real estate is significantly higher at March 31, 2007 and December 31, 2006 compared to prior periods as a result of one foreclosure. In fourth quarter 2006, one residential property was taken into other real estate at its fair market value of approximately \$1.5 million. Management expects this property to be liquidated in second quarter 2007. Fair market values of significant properties are based on independent appraisals.

## **LIQUIDITY**

Liquidity is managed to ensure there is ample funding to satisfy loan demand, investment opportunities, and large deposit withdrawals. Bancshares primary funding sources include customer core deposits, FHLB borrowings, other borrowings, and correspondent borrowings. Customer based sources accounted for 87% of the funding as of the current quarter end and 85% for the same period last year. Borrowed funds from the FHLB amounted to 6.1% of total funding as of March 31, 2007 and 8.3% of total funding as of March 31, 2006. The decrease in FHLB advances is due to deleveraging approximately \$20 million in FHLB advances during 2006. The FHLB line of credit is approximately \$100 million with \$22 million available at current quarter end. The Company has \$23 million in deposit funds from the State of Tennessee. First Citizens National Bank has approximately \$22 million of brokered certificate of deposits comprising 3.3% of total deposits.

The bank's current liquidity position improved since year-end 2006 due to an increase in deposits of approximately \$14 million and slow loan growth. Deposit growth has increased assets primarily in federal funds sold as of first quarter end 2007 compared to year end 2006. The \$339,000 decrease in long-term debt consists of approximately \$200,000 reduction in Bancshares line of credit and approximately \$139 reduction in advances from FHLB.

The bank's liquidity position is strengthened by ready access to a diversified base of wholesale borrowings. These include correspondent borrowings, federal funds purchased, securities sold under agreements to repurchase, Federal Home Loan Bank, Brokered certificates of deposit, and others. First Citizens National Bank has available lines of credit for federal fund purchases totaling \$52.5 million with four correspondent banks as well as additional borrowing capacity of approximately \$22 million with FHLB. Bancshares has a (\$13 million) line of credit established for acquisitions and other holding company needs (see long-term debt and revolving line of credit footnotes). Since the 2002 merger with Munford Union Bank, the focus for growth has been on internally generated growth through new branches. The company has a crisis contingency liquidity plan at the bank and holding company level to defend against any material downturn in our liquidity position.

**CAPITAL RESOURCES**

Management of shareholder equity in a highly regulated environment requires a balance between leveraging and return on equity while maintaining adequate capital amounts and ratios. Total capital on March 31, 2007 was \$70.6 million, up 1.60% from \$69.5 million on December 31, 2006. The increase in capital was primarily from undistributed income from the Bank and its subsidiaries. Bancshares has historically maintained capital in excess of minimum levels established by the Federal Reserve Board. Total risk-based capital ratio as of March 31, 2007 was 12.6%, significantly in excess of the 8% mandated by Regulatory Authorities. Capital as a percentage of total assets for the quarter ending March 31, is presented in the following table for the years indicated (excluding loan loss reserves):

| AS OF MARCH 31, |             |             |             |             |
|-----------------|-------------|-------------|-------------|-------------|
| <u>2007</u>     | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
| 8.30 %          | 7.70 %      | 7.86 %      | 8.06 %      | 7.98 %      |

The dividend payout ratio was 52.41% for the current period versus 48.6% and 49.12% for first quarter 2006 and 2005, respectively. We anticipate the dividend payout ratio to end the year in the range of 48-52%. Dividends per share are from \$0.29 per quarter in 2006 and 2007 compared to \$0.28 for first quarter 2005. Bancshares re-purchased approximately 3,800 shares of its own stock in the open market since December 31, 2006. Stock repurchase average price for first quarter 2007 was \$35.00 per share. Bancshares has no formal plans or programs in place to repurchase common stock as it pursues its current strategy to reduce outstanding debt on the revolving line of credit. Purchases of treasury stock in first quarter 2007 are as follows:

|                           | <u>Shares</u>    | <u>Average</u>         |
|---------------------------|------------------|------------------------|
|                           | <u>Purchased</u> | <u>Price per Share</u> |
| January                   | 1,120            | \$ 35.00               |
| February                  | 804              | \$ 35.00               |
| March                     | 1,859            | \$ 35.00               |
| First Quarter 2007 Totals | 3,783            | \$ 35.00               |

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**RECENTLY ISSUED ACCOUNTING STANDARDS****Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements**

In September 2006, FASB ratified Emerging Issues Task Force (EITF) Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" (EITF 06-4). EITF 06-4 addresses accounting for split-dollar life insurance arrangements after the employer purchases a life insurance policy on the covered employee. This EITF states that an obligation arises as a result of a substantive agreement with an employee to provide future postretirement benefits. Under this issue, the obligation is not settled upon entering into an insurance arrangement. Since the obligation is not settled, a liability should be recognized in accordance with applicable authoritative guidance. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. Bancshares is currently evaluating the impact of adoption of EITF 06-4.

**Fair Value Measurements**

In September 2006, FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This statement was issued to address the need for increased consistency and comparability in fair value measurements and for expanded disclosures about fair value measurements. The statement emphasizes that fair value measurement should be determined based on assumptions that market participants would use in pricing the asset or liability. Also, SFAS 157 establishes a fair value hierarchy that prioritizes information used to develop those assumptions. SFAS is effective for fiscal years beginning after November 15, 2007. Adoption of this statement is not expected to materially impact Bancshares' consolidated financial statements.

#### **The Fair Value Option for Financial Assets and Financial Liabilities**

In February 2007, FASB issued SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities" to permit entities to choose to measure certain financial instruments at fair value. This statement is expected to expand the use of fair value measurement with the intent to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, Fair Value Measurements. Bancshares did not elect early adoption of SFAS 157 and 159. Adoption effective January 1, 2008 is not expected to materially impact consolidated financial statements.

#### **INTEREST RATE RISK**

The bank maintains a formal asset and liability management process to quantify, monitor and control interest rate risk. The Funds Management Committee strives to maintain stability in net interest margin assuming various interest rate cycles. Multiple strategies are utilized to reduce interest rate risk and include but are not limited to the following: use of Federal Home Loan Bank borrowings, shortening or lengthening the re-pricing date of loans and/or time deposits depending on the current rate environment, managing overnight borrowings exposure, use an interest rate swap (see below), and increased mortgage-related investments securities to provide constant cash inflows. Currently, implemented strategies have placed the Company in a slightly liability sensitive position in which the Company would likely experience a small increase in net interest margin should rates begin declining in 2007 or 2008. Interest rate risk exposures are well within policy limits and stable net interest margins are expected to continue in the range of 3.7% to 4.0% experienced over the last three years.

First Citizens swapped a \$1,500,000 fixed investment cash flow for a variable cash flow stream tied to 90 day LIBOR rate June 2000. The new variable investment cash flow is matched with a variable borrowing, resulting in an ongoing positive spread of 250 basis points with no interest rate risk. The transaction was implemented to reduce interest rate risk. The value of the derivative has improved in the rising rate environment over the last three years. See also Footnote 5 Derivative Transactions. The volume and risk associated with this derivative is well within the Funds Management Policy of the bank. There have been no material changes since year-end 2001 applicable to this transaction.

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### **ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

A comprehensive qualitative and quantitative analysis regarding market risk was disclosed in the Company's December 31, 2006 Form 10-K. The Company maintains a fairly neutral interest rate risk position overall which is evidenced by stable net interest margins maintained in a rising rate environment over the last three years. The effects of the current rate environment are discussed throughout Item 2 - Management's Discussion and Analysis including

the following sections: Results of Operations, Loans, Investments, Liquidity, and Interest Rate Risk. The analysis included in the December 31, 2006 Form 10-K included scenarios for a rising rate environment. Actual results for the year ended December 31, 2007 will differ from simulations due to timing, magnitude, and frequency of interest rate changes, market conditions and management strategies.

#### **ITEM 4 - CONTROLS AND PROCEDURES**

##### **Evaluation of Disclosure Controls and Procedures**

An evaluation of the effectiveness of the design and operation of disclosure controls and procedures was performed as of March 31, 2007 under the supervision and with the participation of Management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation, Management including the Chief Executive Officer and Chief Financial Officer, concluded that disclosure controls and procedures were designed and operating effectively as of March 31, 2007.

##### **Changes in Internal Control over Financial Reporting**

There have been no material changes in internal control over financial reporting during the quarter ended March 31, 2007 or subsequently.

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## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

There are no material legal proceedings filed against First Citizens Bancshares or its subsidiaries as of this report date.

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

There is no material change in risk factors from year-end 2006 to first quarter end 2007. See December 31, 2006 Annual Report Form 10-K for in depth discussion of risk factors.

### **Item 2. Changes in Securities**

None.

### **Item 3. Defaults upon Senior Securities**

None.

### **Item 4. Submission of Matters To a Vote of Security Holders**

None.

### **Item 5. Other Information**

None.

**Item 6. Exhibits**

Exhibits 31(a) and 31(b) - Certifications Pursuant to 18 U.S.C. 1350, Section 302

Exhibits 32(a) and 32(b) - Certifications Pursuant to 18 U.S.C. 1350, Section 906

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**SIGNATURES**

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

First Citizens Bancshares, Inc.  
(Registrant)

Date: May 10, 2007

/s/ JEFFREY D. AGEE  
Chief Executive Officer  
First Citizens National Bank  
(Principal Subsidiary)

Date: May 10, 2007

/s/ LAURA BETH BUTLER  
SENIOR VICE PRESIDENT &  
CHIEF FINANCIAL OFFICER  
First Citizens National Bank  
(Principal Subsidiary)

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