

FIRST CITIZENS BANCSHARES INC /TN/  
Form 10-Q  
November 08, 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 SEPTEMBER 30, 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) 285-4410

(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 3,624,944 shares outstanding as of September 30, 2007.

## PART I - FINANCIAL INFORMATION

### ITEM 1 - FINANCIAL STATEMENTS

**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**AS OF SEPTEMBER 30, 2007 AND DECEMBER 31, 2006**  
(Stated in Thousands)

	<b>AS OF</b>		<b>AS OF</b>
	<b><u>September 30, 2007</u></b>		<b><u>December 31, 2006</u></b>
<b>ASSETS</b>			
Cash and due from banks	\$ 17,653	\$	19,597
Federal funds sold	5,929		12,948
Cash and cash equivalents	23,582		32,545
Investment securities			
Trading investments-stated at market	-		-
Held to maturity-amortized cost-fair value of \$291 at September 30, 2007 and \$291 at December 31, 2006	290		290
Available for sale-stated at market	184,516		177,086
Loans (excluding unearned income of \$475 at September 30, 2007 and \$311 at December 31, 2006)	581,641		548,834
Less: allowance for loan losses	6,318		6,211
Net loans	575,323		542,623
Loans held for sale	3,210		3,449
Federal Home Loan Bank and Federal Reserve Bank Stock, at cost	5,505		5,505
Premises and equipment	28,746		28,234
Accrued interest receivable	7,811		6,760
Goodwill	11,825		11,825
Other intangible assets	394		458
Other real estate	2,521		1,815
Bank owned life insurance policies	17,669		17,224
Other assets	3,982		3,606
<b>TOTAL ASSETS</b>	<b>\$ 865,374</b>	<b>\$</b>	<b>831,420</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Deposits</b>			
Demand	\$ 94,044	\$	95,048
Time	369,734		370,146
Savings	198,937		200,869
Total deposits	662,715		666,063
Securities sold under agreements to repurchase	38,811		31,981
Federal funds purchased and other short-term borrowings	22,400		1,000
Long-term debt	63,509		59,538
Other liabilities	5,203		3,340
Total liabilities	792,638		761,922
Shareholders' equity:			

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Common stock, no par value - 10,000,000 authorized; 3,717,593 issued and outstanding at September 30, 2007 and 3,717,593 issued and outstanding at December 31, 2006	\$	3,718	\$	3,718
Surplus		15,331		15,331
Retained earnings		56,136		52,532
Accumulated other comprehensive income		(7)		108
Total common stock and retained earnings		75,178		71,689
Less-92,649 treasury shares, at cost at September 30, 2007 and 85,500 shares at cost at December 31, 2006		2,442		2,191
Total shareholders' equity		72,736		69,498
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$	865,374	\$	831,420

See accompanying notes to consolidated financial statements.

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**  
**THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006**  
(Stated in Thousands Except for E.P.S. and Shares Outstanding)

	<u>Three Months Ended Sept 30,</u>		<u>Nine Months Ended Sept 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Interest income:				
Interest and fees on loans	\$ 11,826	\$ 11,431	\$ 34,240	\$ 32,523
Interest on investment securities:				-
Taxable	1,725	1,520	4,970	4,205
Tax-exempt	506	429	1,444	1,339
Dividends	103	52	299	260
Other interest income	-	-	-	-
Fed funds sold	40	32	409	504
Interest-bearing deposits in banks	14	11	34	29
Total interest income	14,214	13,475	41,396	38,860
Interest expense:				
Interest expense on deposits	5,517	4,989	16,209	13,631
Other interest expense	1,450	1,394	3,813	4,089
Total interest expense	6,967	6,383	20,022	17,720
Net interest income	7,247	7,092	21,374	21,140
Provision for loan losses	250	225	583	683
Net interest income after provision	6,997	6,867	20,791	20,457
Other non-interest income:				
Income from fiduciary activities	214	202	613	566
Service charges on deposit accounts	1,913	1,580	5,042	4,512
Brokerage fees	421	342	1,180	1,070
Earnings on bank owned life insurance	172	136	517	462
Gain (loss) on sale of securities	(43)	-	(103)	-
Other non-interest income	426	350	1,183	1,170
Total other non-interest income	3,103	2,610	8,432	7,780

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FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED) - (CONTINUED)  
 THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006  
 (Stated in Thousands Except for E.P.S. and Shares Outstanding)

	<u>Three Months Ended Sept 30,</u>		<u>Nine Months Ended Sept 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Other non-interest expense:				
Salaries and employee benefits	\$ 3,972	\$ 3,796	\$ 11,802	\$ 11,486
Net occupancy expense	415	400	1,261	1,260
Depreciation expense	521	533	1,563	1,510
Data processing expense	240	219	658	580
Legal and professional fees	54	42	148	96
Stationary and office supplies	73	71	217	208
Amortization of intangibles	21	21	63	63
Advertising and promotions	181	137	556	480
Other non-interest expense	1,502	1,262	4,137	3,828
Total other non-interest expense	6,979	6,481	20,405	19,511
Net income before income taxes	3,121	2,996	8,818	8,726
Income taxes	617	572	2,058	1,888
Net income	\$ 2,504	\$ 2,424	\$ 6,760	\$ 6,838
Earnings per share	\$ 0.69	\$ 0.67	\$ 1.86	\$ 1.88
Weighted average number of shares outstanding	3,624,951	3,633,271	3,627,038	3,633,878

See accompanying notes to consolidated financial statements.

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FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)  
 THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006  
 (Stated in Thousands)

	<u>Three Months Ended</u> <u>September 30</u>		<u>Nine Months Ended</u> <u>September 30</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Balance at beginning of period	\$ 69,870	\$ 64,491	\$ 69,498	\$ 63,646
Net income	2,504	2,424	6,760	6,838
Other comprehensive income due to:				
Changes in available-for-sale investments	1,424	1,788	(116)	317
Changes in cash flow hedge derivative	(10)	(19)	-	42
Comprehensive income	3,918	4,193	6,644	7,197
Cash dividends declared	(1,049)	(1,053)	(3,156)	(3,161)
Common stock repurchased, net	(3)	(32)	(250)	(83)
Balance at end of period	\$ 72,736	\$ 67,599	\$ 72,736	\$ 67,599

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 NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006  
 (Stated In Thousands)

	<u>Nine Months Ended Sept 30,</u>	
	<u>2007</u>	<u>2006</u>
Net cash provided by operating activities	\$ 8,535	\$ 4,502
Investing activities:		
Proceeds of maturities of held-to-maturity securities	-	-

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Purchase of held-to-maturity investments	-	-
Proceeds of maturities of available-for-sale securities	15,851	17,490
Proceeds of sales of available-for-sale securities	11,378	-
Purchase of available-for-sale securities	(34,370)	(27,097)
(Increase) in loans-net	(33,728)	(13,214)
Purchases of premises and equipment	(2,075)	(2,463)
Net cash (used) by investing activities	(42,944)	(25,284)
Financing activities:		
Net increase (decrease) in demand and savings accounts	(2,936)	(8,287)
Increase (decrease) in time deposits	(412)	17,103
Increase (Decrease) in long-term debt	3,971	(10,203)
Treasury stock purchases, net	(251)	(83)
Cash dividends paid	(3,156)	(3,161)
Net increase in short-term borrowings	28,230	4,035
Net cash provided by financing activities	25,446	(596)
Increase (decrease) in cash and cash equivalents	(8,963)	(21,378)
Cash and cash equivalents at beginning of period	32,545	40,686
Cash and cash equivalents at end of period	\$ 23,582	\$ 19,308
Supplemental cash flow disclosures:		
Interest payments, net	\$ 19,982	\$ 17,147
Income taxes paid, net	\$ 2,004	\$ 2,004

See accompanying notes to consolidated financial statements.

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**SEPTEMBER 30, 2007**  
(Stated in Thousands, except per share data)

**NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS**

The consolidated balance sheet as of September 30, 2007, the consolidated statements of income for the three month and nine month periods ended September 30, 2007 and 2006, and the consolidated statements of cash flows for the nine 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 September 30, 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., (Bancshares) 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 (First Citizens) were exchanged for an equal number of shares in First Citizens Bancshares, Inc.

**NOTE 3 - CONTINGENT LIABILITIES**

There is no material pending or threatened 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	\$ 2,863,000
Impaired loans without specific reserve allocations	<u>97,000</u>
	\$ 2,960,000
	=====
Specific reserve for impaired loan losses	\$ 530,000

Interest income recognized on impaired loans has been applied on a cash basis. Interest income recognized on impaired loans is approximately \$126,000 and \$80,000 for the nine months ended September 30, 2007 and 2006, respectively. 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 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 improved as rates increased over the last three years, but remains in a negative position as of current quarter end. Value of the derivative decreased approximately \$28,000 during the quarter ended September 30, 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 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 1.37% of total assets or 16.3% of total capital.

Amortization expense of the other identifiable intangibles for the current 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 \$961,000. 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 (TN) Statutory Trust III and First Citizens (TN) Statutory Trust IV. 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 is located in Jackson, Tennessee and the other in Franklin, Tennessee. In September 2007, the Bank purchased a lot at 2575 Christmasville Cove in Jackson, Tennessee for future development into a full service branch location. In October 2007, the Bank purchased a building and lot at 1304 Murfreesboro Road in Franklin, Tennessee, which will be renovated into a full service branch location in the next six to nine months.

### **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.

Third quarter 2007 results of operations continue to reflect stable earnings in a challenging banking environment. Moderate asset and capital growth and steady earnings yield slightly lower returns on assets and equity for third quarter 2007 compared to third quarter results from prior year. The following key performance ratios for third quarter over the past five years are noted in the following table:

	<u>2007</u>	<u>2006</u>	AS OF SEPT 30, <u>2005</u>	<u>2004</u>	<u>2003</u>
Percentage of Net Income to:					
Average Total Assets	1.07 %	1.10 %	1.12 %	1.07 %	1.14 %
Average Shareholders' Equity	12.76 %	14.03 %	14.04 %	13.53 %	14.32 %
Percentage of Dividends Declared Per Common Share to Net Income	46.77 %	46.28 %	46.41 %	51.53 %	48.21 %
*Percentage of Average Shareholders' Equity to Average Total Assets	9.15 %	8.68 %	8.81 %	8.81 %	7.97 %

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

It would be unrealistic to make light of current economic issues that dominate financial markets. At the same time, we refuse to accept an attitude of doom and gloom, keeping in mind that there have been many economic cycles since First Citizens National Bank was first chartered in 1889. We will use this opportunity to identify bold and exciting objectives and to implement strategies that expand the First Citizens brand into new and more distant markets. When considering the combined strengths of Shareholders, the Board of Directors, a broad based management team and quality staff, we have every reason to be optimistic about the future direction of this Company.

Earnings for third quarter 2007 increased a modest 3% compared to third quarter 2006 as a result of increased net interest income and offsetting increases and decreases in non-interest income and expense. 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 2% as the increase in interest expense outpaced the increase in interest income. The yield on average earning assets increased from 7.41% in September 2006 to 7.62% in September 2007. The net cost of interest bearing liabilities increased from 3.83% in September 2006 to 4.07% in September 2007. Net interest margin for third quarter 2007 was 3.95%, which reflects an increase of 6 basis points above the margin for the year ended December 31, 2006 and is flat compared to 3.96% for third quarter 2006. First Citizens has maintained very stable net interest margins in the range of 3.7% to 4.0% over the past three years.

Per the Uniform Bank Performance Report, net interest income as a percent of average total assets was below peer at 3.60% compared to peer at 3.79% as of June 30, 2007 (most recent peer data available). Review of individual components of net interest income reveal that the Bank's investment portfolio and loans have slightly higher yields than peer and their cost of deposits are less than peer while peer banks have lower costs on other borrowed money. Yield on total loans was 8.06% compared to peer at 7.95% at second quarter end 2007. Investment yields are above peer at 5.05% compared to peer at 5.00%. Cost of interest bearing deposits was 3.24% compared to peer at 3.73%, and cost of other borrowed money was 5.56% compared to peer of 4.89%. 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.

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

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	QUARTER ENDING SEPTEMBER 30,								
	2007			2006			2005		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>ASSETS</b>									
<b>INTEREST EARNING ASSETS:</b>									
Loans (1)(2)(3)	\$ 571,192	\$ 11,826	8.28 %	\$ 565,480	\$ 11,431	8.09 %	\$ 548,440	\$ 9,884	7.21 %
Investment Securities:									
Taxable	138,974	1,828	5.26 %	125,866	1,572	5.00 %	122,270	1,242	4.06 %
Tax Exempt (4)	45,994	767	6.67 %	43,904	650	5.92 %	40,305	623	6.18 %
Interest Earning									
Deposits	803	14	5.50 %	771	11	5.71 %	785	3	1.53 %
Federal Funds Sold	<u>2,570</u>	<u>40</u>	6.23 %	<u>3,057</u>	<u>32</u>	4.19 %	<u>2,422</u>	<u>23</u>	3.80 %
Lease Financing									
Total Interest Earning Assets	759,533	14,475	7.62 %	739,078	13,696	7.41 %	714,222	11,775	6.59 %
<b>NON-INTEREST EARNING ASSETS:</b>									
Cash and due from									
Banks	\$ 17,101			\$ 13,373			\$ 16,954		
Bank Premises and Equipment	28,208			28,715			25,933		
Other Assets	<u>48,421</u>			<u>46,579</u>			<u>36,226</u>		
Total Assets	<u>\$ 853,263</u>			<u>\$ 827,745</u>			<u>\$ 793,335</u>		

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	QUARTER ENDING SEPTEMBER 30,								
	2007			2006			2005		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>									
<b>INTEREST BEARING LIABILITIES:</b>									
Interest bearing deposits	\$ 568,609	\$ 5,517	3.88 %	\$ 557,918	\$ 4,989	3.58 %	\$ 515,935	\$ 2,938	2.28 %
Federal funds									
Purchased and Other Interest Bearing Liabilities	<u>115,563</u>	<u>1,450</u>	5.02 %	<u>108,839</u>	<u>1,394</u>	5.12 %	<u>130,235</u>	<u>1,680</u>	5.16 %
Total Interest Bearing Liabilities	684,172	6,967	4.07 %	666,757	6,383	3.83 %	646,170	4,618	2.86 %
<b>NON-INTEREST BEARING LIABILITIES:</b>									
Demand deposits	92,949			89,694			78,496		
Other liabilities	<u>4,906</u>			<u>5,664</u>			<u>5,185</u>		
Total liabilities	782,027			764,121			729,851		
SHAREHOLDERS' EQUITY	<u>71,236</u>			<u>65,630</u>			<u>63,484</u>		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 853,263</u>			<u>\$ 829,751</u>			<u>\$ 793,335</u>		
<b>NET INTEREST INCOME</b>									
		<u>\$ 7,508</u>			<u>\$ 7,313</u>			<u>\$ 7,157</u>	
<b>NET YIELD ON AVERAGE EARNING ASSETS (ANNUALIZED)</b>									
			3.95 %			3.96 %			4.01 %

- (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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Average earning assets to total average assets is 91% compared to peer of 94% as of June 30, 2007. 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 September 30, 2007. The statement of cash flows reflects fixed assets purchases of \$2.1 million during nine months ended September 30, 2007. The \$2.1 million includes approximately \$1 million for a lot in Jackson, Tennessee to be developed into a full service branch in the next three to five years. In October 2007, an additional \$1.86 million was invested in building and lot in Franklin, Tennessee. Renovations are scheduled to begin in fourth quarter 2007 to convert the building into a full service branch expected to be opened in 2008. Earnings on BOLI policies are included in other non-interest income and totaled approximately \$517,000 for nine months ended September 30, 2007.

The loan loss provision for third quarter 2007 decreased \$25 thousand or 11% compared to third quarter 2006. Net charge offs were \$168 thousand for third quarter 2007 compared to net charge offs of \$108 thousand in third quarter 2006. Reserve for losses on loans as a percent of total loans was 1.09% at September 30, 2007 and 1.13% at December 31, 2006. The level of reserve for loan losses is considered adequate and is evaluated quarterly in accordance with generally accepted accounting principles. 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 1.29% compared to peer of 0.81% for second quarter 2007. Non-interest income increased approximately 19% from third quarter 2006 to third quarter 2007 as each major category increased at least five percent. Service charges on deposit accounts increased approximately \$332,000 or 21%. This increase in fees has offsetting increases in other non-interest expenses in the form of increased provision for charged off demand deposit accounts. Earnings from BOLI consist of increases on accumulated cash surrender values in the current rate environment. In third quarter 2007, fee income (non-interest income) contributed 17.92% to total revenue compared to 16.23% for the same period last year. Brokerage fees increased approximately \$79,000 in third quarter 2007 compared to third quarter 2006 primarily due to increased sales of annuities and other brokerage services.

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

	QUARTER ENDING SEPT 30,					
	2007		2006		2005	
		% of		% of		
	<u>2007</u>	<u>Change</u>	<u>2006</u>	<u>Change</u>	<u>2005</u>	
Income from Fiduciary Activities	\$ 214	5.94 %	\$ 202	-14.41 %	\$ 236	
Service Charges on Deposit Accounts	1,913	21.08 %	1,580	0.13 %	1578	
Brokerage Fees	421	23.10 %	342	12.87 %	303	
Earnings from Bank Owned Life Insurance	172	26.47 %	136	-3.55 %	141	
Other income	383	9.43 %	350	-15.87 %	416	
Total non-interest income	\$ 3,103	18.89 %	\$ 2,610	-2.39 %	\$ 2,674	

The largest component of other income for third quarter 2007 consists of income from 50% owned full-service insurance agency, White & Associates/First Citizens Insurance, LLC. Income from this subsidiary for third quarter 2007, 2006 and 2005 was \$165,000, \$97,000 and \$123,000, respectively.

Non-interest expense represents operating expenses of First Citizens. Non-interest expense for the current quarter increased approximately \$500 thousand, or 7.68%, over third quarter 2006. The primary contributors to this increase are salaries and benefits, other real estate expenses, provision for charged off demand deposit accounts, and advertising expenses. Salary and benefits increased approximately \$176 thousand or 4.64%. Average full-time equivalent employees for the Bank are 266.62 for three months ended September 30, 2007 compared to 266.12 and

263.65 for three months ended September 30, 2006 and 2005, respectively. The efficiency ratio as of September 30, 2007, 2006 and 2005 was 66.7%, 65.3%, and 63.6%, respectively. Impaired Goodwill expense is \$0 for the current and prior reportable periods. Core deposit intangible expense for the current reportable quarter is flat at \$21,000. Quarter-to-date advertising, community relations, and other forms of marketing expenses were \$181 thousand or 2.6% of other non-interest expense in third quarter 2007 compared to \$137 thousand or 2.1% of total non-interest expense in 2006. All marketing or advertising items are expensed at the time they are incurred. Marketing expenses increased primarily due to marketing efforts for the new loan production offices in Jackson and Franklin, Tennessee. Increases in legal and professional fees are a result of consulting fees incurred for various projects including but not limited to information technology risk assessments, cost segregation studies, and strategic planning. Provision for charged off demand deposit accounts was \$219,000 for third quarter 2007 compared to \$69,000 in third quarter 2006. The increase in this provision is offset by increased service charge income from deposit accounts as noted in section above. Write-downs and expenses on other real estate owned increased approximately \$60,000 from third quarter 2006 to third quarter 2007. See additional discussion below regarding other real estate.

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

	QUARTER ENDING SEPT. 30,					
	<u>2007</u>	<u>% of</u> <u>Change</u>	<u>2006</u>	<u>% of</u> <u>Change</u>	<u>2005</u>	
Salaries and Employee benefits	\$ 3,972	4.64 %	\$ 3,796	5.18 %	\$ 3,609	
Net Occupancy Expense	415	3.75 %	400	-9.30 %	441	
Depreciation	521	-2.25 %	533	12.45 %	474	
Data Processing Expense	240	9.59 %	219	24.43 %	176	
Legal and Professional Fees	54	28.57 %	42	31.25 %	32	
Stationary and Office Supplies	73	2.82 %	71	-7.79 %	77	
Amortization of Intangibles	21	0.00 %	21	0.00 %	21	
Advertising and promotions	181	32.12 %	137	-19.88 %	171	
Other Expenses	1,502	19.02 %	1,262	0.64 %	1,254	
Total Non-Interest Expense	\$ 6,979	7.68 %	\$ 6,481	3.61 %	\$ 6,255	

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## CHANGES IN FINANCIAL CONDITION

Loans grew by \$32.7 million or approximately 6.0% during the first three quarters of 2007. Overall, loan demand continues to be slow in mature Northwest Tennessee markets and at a slower pace in the Southwest Tennessee markets served by First Citizens compared to growth rates experienced in prior years. Current year growth has been achieved through the opening of loan production offices in Jackson and Franklin, Tennessee, loan growth of approximately 10% in the Southwest Tennessee markets and modest growth of approximately 3% in core Northwest Tennessee markets. Loan growth rates were approximately 1% and 3% for the years ended December 31, 2006 and 2005, respectively. While pursuing strategies to expand its footprint and increase market share, First Citizens maintains a strong commitment to asset quality by not compromising underwriting standards in order to grow its loan portfolio.

Total deposits decreased by \$3.3 million or 0.5% from year-end 2006 to current quarter end. Average interest-bearing deposits in third quarter 2007 compared to third quarter 2006 reflect an increase of approximately \$11 million or 2 percent. Cost of interest bearing deposits increased 30 basis points from third quarter 2006 to third quarter 2007. Cost of time and savings deposits increased approximately 50 and 15 basis points, respectively when comparing the quarter ended September 30, 2007 and 2006.

As deposits have decreased slightly in the current quarter partially due to typical seasonality in savings accounts, borrowings have been used to fund loan growth. Short-term borrowings increased \$21.4 million and long-term

borrowings have increased \$4 million. Growth of \$6 million in securities sold under repurchase agreements or sweep accounts has also served to fund loan growth.

Capital growth of approximately 4.6% is from undistributed earnings for the nine months ended September 30, 2007. Accumulated other comprehensive income decreased approximately \$115,000 since year-end 2006. Net treasury stock purchases total approximately \$250,000 through September 30, 2007.

## 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 June 30, 2007 (most recent available) Uniform Bank Performance Report indicates that yields on investments exceed peer at 5.05% compared to 5.00% peer. Quarterly average rates for taxable securities for the current quarter end increased 26 basis points while tax-exempt securities increased 75 basis points compared to prior year's third quarter. The investment portfolio is heavily weighted in mortgage-related securities, which account for approximately 50% of total portfolio. Mortgage-related securities consist of high quality U. S. Government Agency and mortgage-backed securities. Thus, there has been no impact to the quality of our portfolio as a result of the recent fallout in the sub-prime mortgage industry. 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 \$125 million as of the current reportable period.

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

	AS OF SEPT 30,				
	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
U. S. Treasury & Government Agencies	\$ 129,629	\$ 120,687	\$ 109,468	\$ 101,693	\$ 97,804
State & Political Subdivisions	48,475	44,379	40,594	39,726	38,971
All Others*	12,207	12,240	13,411	13,440	8,853
Totals	\$ 190,311	\$ 177,306	\$ 163,473	\$ 154,859	\$ 145,628

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

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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 September 30, 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	\$	\$	\$ -	\$ -
U. S. Government Agency & Corporate Obligations			130,556	129,629
Securities Issued by States & Political Subdivision in the U. S.:	-	-	-	-
Taxable Securities				
Tax-Exempt Securities	290	291	47,129	48,185
U. S. Securities:				

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Debt Securities			6,741	6,702
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	\$ 189,931	\$ 190,021

\*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 third quarter 2007, gross unrealized gain (loss) on securities increased approximately \$2.3 million primarily due to fluctuations in the bond market. 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. In September 2007, bond market movement resulted in lower yields on both the 2-year and 10-year treasuries compared to last quarter. The 10-year Treasury rate was in the range of 4.5% to 4.6% in September 2007 compared to 5.0% to 5.1% in June 2007 to 4.6% to 4.7% in December 2006. The 2-year Treasury rates were approximately 3.9% to 4.0% compared to 4.9% in June 2007 and 4.75% at year-end 2006. Thus, the shape and position of the curve has shifted this year resulting in immaterial unrealized gain on available-for-sale portfolio as of current quarter end. Accumulated other comprehensive income for the current quarter, net of tax, was an unrealized loss of \$55,000. Fluctuations in market value of the portfolio are 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. First Citizens does not participate in sub-prime lending and has had no impact from the recent fallout in sub-prime loans. The majority of First Citizens' borrowers lives and conducts business in West Tennessee. First Citizens has recently expanded its market area in West and Middle Tennessee with the opening of loan production offices in Jackson and Franklin, Tennessee. Overall, loans increased approximately \$20 million from September 30, 2006 to September 30, 2007 and increased approximately \$32 million from December 31, 2006 to September 30, 2007. Real estate loans increased \$24 million when comparing September 2007 to September 2006.

In 2006, First Citizens experienced unusual loan growth trends compared to prior years in that loan growth was strong in first and second quarter 2006 and then slowed to less than one percent growth for the year ended December 31, 2006. First Citizens remains committed to asset quality and will not sacrifice quality for growth. Loan growth rates are expected to be in the range of 5% to 7% for the year ended December 31, 2007 primarily from growth in more metropolitan markets including Shelby, Madison and Williamson Counties of Tennessee. The unemployment rate for Tennessee is 4.7% as of September 2007, an increase from 4.1% in June 2007. This increase is consistent with mild declines in overall economic conditions throughout the state. The following table sets forth loan totals net of unearned income by category for the past five years:

	AS OF SEPT 30				
	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Real Estate:					
Construction	\$ 101,023	\$ 84,457	\$ 75,991	\$ 91,621	\$ 54,547
Mortgage	357,504	349,539	359,267	319,249	282,927
Commercial, Financial					

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and Agricultural	82,443	89,388	82,773	73,159	71,598
Consumer Installment	37,289	36,744	39,576	39,101	39,980
Other	6,592	4,931	3,533	7,458	4,376

Total Loans \$ 584,851 \$ 565,059 \$ 561,140 \$ 530,588 \$ 453,428

\*Mortgage loans include loans held for sale in the secondary mortgage market. Balances are \$3.2 million, \$3.9 million, \$3.1 million, \$1.0 million, and \$2.2 million for September 30, 2007, 2006, 2005, 2004 and 2003, respectively.

The following table sets forth the balance of non-performing loans as of September 30, for the years indicated:

	AS OF SEPT 30				
	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Non-Performing Loans:					
Non-accrual	\$ 920	\$ 476	\$ 761	\$ 1,129	\$ 931
90 Days Past Due					
Accruing Interest	802	6,196	151	1,112	596
Total	\$ 1,722	\$ 6,672	\$ 912	\$ 2,241	\$ 1,527

Non-performing loans at quarter end were 0.29% of total loans. Non-performing loans decreased \$5 million since third quarter end 2006 primarily due to a small volume of larger balance loans being foreclosed and recorded as other real estate at appraised market value. Of the \$920,000 on non-accrual status, approximately \$365,000 carries a Small Business Administration (SBA) guarantee. See also Other Real Estate section discussed below.

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 September 30, 2007 was \$11.6 million. Weighted average loan yields increased 19 basis points from third quarter 2006 to third quarter 2007. Loan rates steadily increased in the current rate environment over the last three years but the cost of deposits and other funding also increased resulting in steady but flat net interest margins.

## AGRICULTURAL LOANS

First Citizens is one of the largest agriculture lenders in the State of Tennessee and is the only community bank with Farm Services Agency (FSA) Preferred Lender status in Tennessee. Agriculture makes a significant contribution to Dyer County commerce, generating approximately over \$60 million in revenue on an annual basis. Agricultural credits secured by farmland and other types of collateral comprise approximately \$62 million of total loans as of September 30, 2007 and \$67 million as of September 30, 2006. Recoveries, net of charge-offs in this category were \$3 thousand for first nine months of 2007.

Agricultural producers in our markets were adversely affected by the spring freeze and summer drought. Due to these conditions, we expect approximately 40% of the agricultural portfolio to require various levels of refinancing. Equity positions and use of FSA guarantees should minimize the impact to our portfolio.

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## LOAN LOSS EXPERIENCE AND RESERVES FOR LOAN LOSSES

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 1.09% for the current quarter and 1.13% 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 (\$267,000) (2) recovery of loans previously charged off \$99,000 and (3) additions to reserve \$250,000. The provision for loan losses increased \$25,000 when compared to the same time period in 2006.



Non-performing loans as of current quarter end decreased approximately \$5 million from September 2006 to September 2007. 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 experienced an increase in past due loans as expected in current economic conditions but does not anticipate any material negative trends in problems loans for the remainder of 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 (ORE) is significantly higher at September 30, 2007 and December 31, 2006 compared to prior periods as a result of foreclosures on a small volume of significant balance loans. Fair market values of significant properties are based on independent appraisals. Management continues efforts to liquidate ORE. Approximately \$1.4 million of the \$2.5 million balance in ORE as of current quarter end is one residential property in Shelby County. Capital improvements for the \$1.4 million Shelby County home are in process and the property is expected to be sold in 2008 once such improvements are completed. This property is requiring modifications and additional construction to reach a point of marketability and sold at or near its market value.

#### **LIQUIDITY**

Liquidity is managed to ensure 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 84% and 85% of funding in third quarter 2007 and 2006, respectively. Borrowed funds from the FHLB amounted to 6.6% of total funding as of September 30, 2007 and 7.4% of total funding as of September 30, 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 \$90 million with \$8 million available at current quarter end. The Company has a \$25 million standby letter of credit with FHLB used to collateralize public deposits that reduces borrowing capacity with FHLB. The Company has \$23 million in deposit funds from the State of Tennessee. First Citizens National Bank has approximately \$24.5 million of brokered certificate of deposits comprising 3.7% of total deposits as of current quarter end. The current quarter total of brokered deposits is \$5 million less than total as of September 2006.

The bank's liquidity position has tightened in the current quarter due to loan growth and increasing federal funds purchased balances. Securities sold under agreements to repurchase balances increased approximately \$6 million from year-end 2006 to end of third quarter 2007. Investments increased approximately \$7 million and long-term debt increased \$4 million.

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 \$8 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 September 30, 2007 was \$72.7 million, up 4.66% from \$69.5 million on December 31, 2006. The increase in capital was primarily from

undistributed income from the Bank and its subsidiaries. Such increase was offset by decrease in accumulated other comprehensive income as a result of temporary declines in current market value of available-for-sale securities. Bancshares has historically maintained capital in excess of minimum levels established by the Federal Reserve Board. Total risk-based capital ratio as of September 30, 2007 was 12.35%, significantly in excess of the 8% mandated by Regulatory Authorities. Capital growth outpaced asset growth in 2006 and 2007 resulting in higher capital to asset ratio for the current period. Capital as a percentage of total assets for the quarter ending September 30, is presented in the following table for the years indicated (excluding loan loss reserves):

AS OF SEPT 30				
<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
8.41%	8.20%	7.99%	8.06%	7.87%

The dividend payout ratio was 46.8% for the current period versus 46.3% and 46.4% for third quarter 2006 and 2005, respectively. We anticipate the dividend payout ratio to end the year in the range of 45-50%. Dividends per share are \$0.29 per quarter in 2006 and 2007 compared to \$0.28 per quarter in 2005. Bancshares has re-purchased approximately 7,150 shares of its stock in the open market since December 31, 2006. Stock repurchase average price for third quarter 2007 was \$36.45 per share. Bancshares has no formal plans or programs in place to repurchase common stock. Purchases of treasury stock in third quarter 2007 are as follows:

	<u>Shares</u>	<u>Price Paid</u>
	<u>Purchased</u>	<u>Per Share</u>
July	-	-
August	82	36.45
September	-	-
Total	82	\$ 36.45

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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.

First Citizens has endorsement split dollar life insurance policies that will require accruals upon adoption of this pronouncement effective January 1, 2008. The Company anticipates the effect of adoption to have a cumulative effect adjustment to retained earnings of approximately \$1.8 million as of January 1, 2008 and related accrual expense of approximately \$225,000 for the year ended December 31, 2008.

### *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 liability sensitive position in which the Company would likely experience a small increase in net interest margin should rates decline 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 September 30, 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 September 30, 2007.

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

There have been no material changes in internal control over financial reporting during the quarter ended September 30, 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 third 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

The Fair Value Option for Financial Assets and Financial Liabilities

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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: November 8, 2007

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

Date: November 8, 2007

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