

FIRST CITIZENS BANCSHARES INC /TN/
Form 10-Q
May 08, 2009

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

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, 2009
- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 0-11709

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)

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 has submitted electronically and posted on its corporate Web site, if

any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such file). 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 3,624,999 shares outstanding as of April 30, 2009.

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS AS OF MARCH 31, 2009 AND DECEMBER 31, 2008 (In Thousands)

	<u>March 31, 2009</u> (UNAUDITED)	<u>December 31, 2008</u> (1)
ASSETS		
Cash and due from banks	\$ 13,354	\$ 17,888
Federal funds sold	25,509	22,816
Cash and cash equivalents	38,863	40,704
Investment securities:		
Held-to-Maturity, at amortized cost, fair value of \$0 at March 31, 2009 and \$115 at December 31, 2008	-	115
Available-for-Sale, at fair value	208,351	210,385
Loans (excluding unearned income of \$479 at March 31, 2009 and \$506 at December 31, 2008)	591,162	596,758
Less: allowance for loan losses	8,430	7,300
Net loans	582,732	589,458
Loans held-for-sale	3,343	2,632
Federal Home Loan Bank and Federal Reserve Bank stocks, at cost	5,684	5,684
Premises and equipment	31,480	31,746
Accrued interest receivable	5,201	5,581
Goodwill	11,825	11,825
Other intangible assets	268	289
Other real estate	5,557	5,424
Bank owned life insurance policies	20,795	20,627
Other assets	10,480	3,032
TOTAL ASSETS	\$ 924,579	\$ 927,502

LIABILITIES AND SHAREHOLDERS' EQUITY

Deposits			
Demand	\$	86,672	\$ 108,762
Time		378,218	392,840
Savings		256,586	233,313
Total deposits		721,476	734,915
Securities sold under agreements to repurchase		39,834	32,765
Federal funds purchased and other short term borrowings		1,000	1,000
Long-term debt		75,700	73,843
Other liabilities		7,608	7,971
Total liabilities		845,618	850,494

See accompanying notes to consolidated financial statements.

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FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (Continued)
AS OF MARCH 31, 2009 AND DECEMBER 31, 2008
(In Thousands)

	<u>March 31, 2009</u>		<u>December 31, 2008</u>
	(UNAUDITED)		(1)
Shareholders' equity:			
Common stock, no par value - 10,000,000 authorized; 3,717,593 issued and outstanding at March 31, 2009 and 3,717,593 issued and outstanding at December 31, 2008	\$	3,718	\$ 3,718
Surplus		15,331	15,331
Retained earnings		59,618	58,890
Accumulated other comprehensive income		2,735	1,526
Total common stock and retained earnings		81,402	79,465
Less-92,594 treasury shares, at cost as of March 31, 2009 and 93,094 shares at cost at December 31, 2008		2,441	2,457
Total shareholders' equity		78,961	77,008
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$	924,579	\$ 927,502

(1) Derived from audited financial statements.

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, 2009 AND 2008

(Dollars in Thousands Except for Per Share Amounts)

	<u>Three Months Ended</u>	
	<u>March 31, 2009</u>	<u>March 31, 2008</u>
Interest income:		
Interest and fees on loans	\$ 9,489	\$ 10,952
Interest on investment securities:		
Taxable	1,948	1,728
Tax-exempt	694	557
Dividends	55	88
Other interest income	21	59
Total interest income	12,207	13,384
Interest expense:		
Interest expense on deposits	3,553	4,956
Other interest expense	1,045	1,336
Total interest expense	4,598	6,292
Net interest income	7,609	7,092
Provision for loan losses	2,400	367
Net interest income after provision	5,209	6,725
Other income		
Mortgage banking income	302	311
Income from fiduciary activities	166	191
Service charges on deposit accounts	1,577	1,735
Brokerage fees	277	387
Gain on sale of securities	724	63
Earnings on bank owned life insurance	202	213
Other income	453	401
Total other income	3,701	3,301

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FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED) - (CONTINUED)

THREE MONTHS ENDED MARCH 31, 2009 AND 2008

(Dollars in Thousands Except for Per Share Amounts)

	<u>Three Months Ended</u>	
	<u>March 31, 2009</u>	<u>March 31, 2008</u>
Other expenses		
Salaries and employee benefits	\$ 3,647	\$ 4,582
Net occupancy expense	438	440
Depreciation	449	445
Data processing expense	282	200
Legal and professional fees	31	60
Stationary and office supplies	68	58
Amortization of intangibles	21	21
Advertising and promotions	134	175
FDIC insurance premium expense	255	19
Other real estate expense	203	138
Other expenses	1,135	1,191
Total other expenses	6,663	7,329

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Net income before income taxes		2,247		2,697
Income taxes		468		566
Net income	\$	1,779	\$	2,131
Earnings per share	\$	0.49	\$	0.59
Weighted average number of shares outstanding		3,625,257		3,624,806

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, 2009 AND 2008
(In Thousands)

	<u>Three Months Ended</u>	
	<u>March 31, 2009</u>	<u>March 31, 2008</u>
Balance beginning of period	\$ 77,008	\$ 75,031
Net income	1,779	2,131
Other comprehensive income		
Changes in available for sale investments	1,177	1,772
Changes in derivatives	32	(2)
Comprehensive income	2,988	3,901
Cash dividend declared	(1,051)	(1,051)
Common stock issued	-	-
Sale of common stock held in treasury	16	-
Cumulative effect for change in accounting principle (adoption of EITF 06-04)	-	(1,919)
Balance end of period	\$ 78,961	\$ 75,962

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, 2009 AND 2008
(Dollars In Thousands)

	<u>Three Months Ended</u>	
	<u>March 31, 2009</u>	<u>March 31, 2008</u>
Net cash provided by operating activities	\$ 2,732	\$ 6,555
Investing activities:		
Proceeds of maturities of held-to-maturity securities	115	-
Purchase of held-to-maturity investments	-	-
Proceeds of maturities of available-for-sale securities	9,332	14,062
Proceeds of sales of available-for-sale securities	16,276	14,851
Purchase of available-for-sale securities	(28,512)	(35,133)
Decrease (Increase) in loans-net	3,323	(14,647)
Proceeds from sale of other real estate	624	449
Purchases of premises and equipment	(183)	(1,433)
Net cash provided (used) by investing activities	975	(21,851)
Financing activities:		
Net increase in demand and savings accounts	1,183	443
Decrease in time deposits	14,622	5,995

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Increase in long-term debt	1,857		6,655
Treasury stock sold, net	16		-
Proceeds from sale of common stock	-		-
Cash dividends paid	(1,051)		(1,051)
Net increase in short-term borrowings	7,069		11,965
Net cash provided (used) by financing activities	(5,548)		12,017
Decrease in cash and cash equivalents	1,841		3,279
Cash and cash equivalents at beginning of period	40,704		25,242
Cash and cash equivalents at end of period	\$ 38,863	\$	21,963
Supplemental cash flow disclosures:			
Interest payments, net	\$ 4,560	\$	5,986
Income taxes paid, net	350		-
Transfers from loans to foreclosed assets	1,760		704
Transfers from foreclosed assets to loans	757		-

See accompanying notes to consolidated financial statements.

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FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
MARCH 31, 2009

NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS

The consolidated balance sheet as of March 31, 2009, the consolidated statements of income for the three month periods ended March 31, 2009 and 2008, 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, 2009 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 ending December 31, 2009. 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, 2008.

Certain prior year balances have been reclassified to conform with current year presentation. The consolidated financial statements include all accounts of First Citizens Bancshares, Inc. (the "Company"), and its subsidiary, First Citizens National Bank (the "Bank"). First Citizens (TN) Statutory Trusts III and IV are reported under the equity method in accordance with generally accepted accounting principles for Variable Interest Entities for all periods presented. These investments are included in other assets and the proportionate share of income (loss) is included in other non-interest income. The Bank also has two wholly owned subsidiaries, First Citizens Financial Plus and First Citizens Investments, Inc., which are consolidated into its financial statements.

The Bank has a 50% ownership interest in two insurance subsidiaries both of which are accounted for using the equity method. One is White and Associates/First Citizens Insurance, LLC, which is a general insurance agency offering a full line of insurance products. The other is First Citizens/White and Associates Insurance Company whose principal activity is credit insurance. The investment in these subsidiaries is included in Other Assets on the Balance Sheets presented in this report and earnings from these subsidiaries are recorded in Other Income on the Income Statements presented in this report.

NOTE 2 - ORGANIZATION

First Citizens Bancshares, Inc., is a bank holding company chartered December 14, 1982, under the laws of the State of Tennessee. On September 23, 1983, all 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 or threatened litigation as of the current reportable date that would result in a liability.

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES

In conformity with Statement of Financial Accounting Standard (SFAS) No. 114, the Company recognized loans as impaired with carrying values of approximately \$14.8 million as of March 31, 2009 and \$12.2 million as of December 31, 2008. Specific allocations in the reserve for loan losses related to impaired loans totaled \$2.8 million as of March 31, 2009 and \$2.0 million at December 31, 2008. Average investment in impaired loans in first quarter 2009 was \$13.5 million compared to \$10.0 million during year ended December 31, 2008, respectively. Interest income recognized on impaired loans on an accrual basis is approximately \$208,000 for first quarter 2009 compared to approximately \$150,000 for first quarter 2008.

NOTE 5 - INVESTMENT SECURITIES AND DERIVATIVE TRANSACTIONS

The amortized cost and fair value of securities as of March 31, 2009 and December 31, 2008 were as follows:

	Amortized <u>Cost</u>	Gross Unrealized <u>Gains</u>	Gross Unrealized <u>Losses</u>	Fair <u>Value</u>
As of March 31, 2009 (in thousands):				
<u>Securities Held-to-Maturity:</u>				
Obligations of States and Political Subdivisions	\$ -	\$ -	\$ -	\$ -
<u>Securities Available-for-Sale:</u>				
U. S. Treasury Securities and Obligations of U. S. Government Agencies and Corporations	\$ 133,537	\$ 4,822	\$ (2)	\$ 138,356
Obligations of States and Political Subdivisions	66,313	2,355	(433)	68,236
All Others	3,939	5	(2,185)	1,759
	\$ 203,789	\$ 7,182	\$ (2,620)	\$ 208,351
As of December 31, 2008 (in thousands):				
<u>Securities Held-to-Maturity:</u>				
Obligations of States and Political Subdivisions	\$ 115	\$ -	\$ -	\$ 115
<u>Securities Available-for-Sale:</u>				
U. S. Treasury Securities and Obligations of U. S. Government Agencies and Corporations	\$ 144,596	\$ 3,688	\$ (14)	\$ 148,269
Obligations of States and Political Subdivisions	59,196	1,065	(788)	59,474
All Others	3,939	7	(1,304)	2,642
	\$ 207,731	\$ 4,760	\$ (2,106)	\$ 210,385

In reviewing the investment portfolio for other-than-temporary impairment of individual securities, consideration is given but not limited to (1) the length of time in which fair value has been less than cost and the extent of the unrealized loss, (2) the financial condition of the issuer, and (3) the positive intent and ability of the Company to maintain its investment in the issuer for a time that would provide for any anticipated recovery in the fair value. With respect to unrealized losses on securities noted and the analysis performed relating to the securities, management currently believes that declines in market value are not other-than-temporary and asserts positive intent and ability to hold such investments until anticipated recovery.

Generally accepted accounting principles have established accounting and reporting standards for derivative financial instruments, including certain derivative instruments embedded in other contracts and for hedging activities. These

standards require that derivatives be reported either as assets or liabilities on the balance sheets and be reflected at fair value. The accounting for changes in the fair value of a derivative instrument depends on the intended use of the derivative and the resulting designation. The Company has one derivative transaction, which is an interest rate swap that was purchased in June 2000. Since a Federal Home Loan Bank Variable LIBOR Borrowing has been designated as the hedged item and in doing so, the Company has effectively fixed the cost of this liability. As a floating rate liability was hedged, there are no significant fluctuations in its market value but there are fluctuations in the cash flows. Thus, the swap is designated as a cash flow hedge, hedging the "benchmark interest rate." The market value gain or loss of the swap is adjusted through other comprehensive income. The purpose of the transaction was to reduce exposure to interest rate risk. Volume of the transaction is \$1.5 million and the term 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 fluctuated since inception, as have rates, but remains in a negative position as of current quarter end. Value of the derivative improved modestly during the quarter ended March 31, 2009. Accumulated other comprehensive income reflects a negative value of approximately \$129,000, gross and \$80,000, net of tax. See Note 10 regarding determination of fair value of the derivative.

NOTE 6 - GOODWILL AND INTANGIBLE ASSETS

Goodwill is not amortized and is tested for impairment annually or more frequently if events and circumstances indicate that the asset might be impaired. The goodwill impairment test is conducted in first quarter annually and is a two-step test. The first step, used to identify potential impairment, involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. Currently the Company has one reporting unit and does not meet the tests to segment per SFAS No. 131. If the estimated fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment.

If required, the second step involves calculating an implied fair value of goodwill which is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill.

Our stock price has historically traded above its book value per common share and tangible book value per common share and was trading above its book value per common share and tangible book value per common share as of March 31, 2009. In the event our stock price were to trade below its book value per common share and tangible book value per common share, an evaluation of the carrying value of goodwill would be performed as of the reporting date. Such a circumstance would be one factor in our evaluation that could result in an eventual goodwill impairment charge. Additionally, should our future earnings and cash flows decline and/or discount rates increase, an impairment charge to goodwill and other intangible assets may also be required.

No impairment of goodwill is recorded in the current or prior reportable periods. Total goodwill as of the reportable date is \$11.8 million or 1.28% of total assets or 15.01% of total capital.

Amortization expense of the other identifiable intangibles for the quarter was approximately \$21,000 for 2009 and approximately \$21,000 for 2008.

NOTE 7 - LONG TERM OBLIGATIONS

In March 2002, the Company formed a wholly owned subsidiary, First Citizens (TN) Statutory Trust as a Delaware statutory trust. The subsidiary was formed for the purpose of issuing preferred securities and conveying the proceeds to the Company in exchange for long-term, subordinated debentures issued by the Company. The debentures are the sole assets of the trust. The Company owns 100% of the common stock of the trust.

On March 26, 2002, the Company, through its Trust subsidiary, issued 5,000 floating rate Trust Preferred Securities in denominations of \$1,000 for a total of \$5,000,000, which mature thirty (30) years from the date of issuance. Interest is payable on March 26, June 26, September 26 and December 26 of each year during the term. The interest rate is calculated quarterly equal to the three-month LIBOR interest rate plus 3.6%. Responsibilities of the Company concerning the debentures and related documents constitute a full and unconditional guarantee by the Company of the Trust issuer's preferred securities. In March 2007, First Citizens (TN) Statutory Trust II was terminated and the related debt was refinanced through First Citizens (TN) Statutory Trust IV, which is discussed below.

In March 2005, the Company formed a wholly owned subsidiary First Citizens (TN) Statutory Trust III. The trust is a Delaware statutory trust for the sole purpose of issuing and selling preferred securities and using proceeds from the sale to acquire long term subordinated debentures issued by the Company. Debentures are the sole assets of the trust. The Company 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 was 4.84%. For each successive three-month 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 a revolving line of credit with First Tennessee Bank. The Company's 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.

In March 2007, the Company formed a wholly owned subsidiary First Citizens (TN) Statutory Trust IV. The trust is a Delaware statutory trust for the sole purpose of issuing and selling preferred securities and using proceeds from the sale to acquire long term subordinated debentures issued by the Company. Debentures are the sole assets of the trust. The Company 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 Trust Preferred 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. The purpose of sale of preferred securities was to refinance debt issued through First Citizens (TN) Statutory Trust II (discussed above) at a lower spread to LIBOR and results in savings of \$92,500 annually. The Company's obligation under the debentures and related documents constitute a full and unconditional guarantee by the Company of the Trust issuer's obligations under the Trust Preferred Securities.

Although for accounting presentation, the Preferred Trust Securities are treated as debt, the outstanding balance qualifies as Tier I capital subject to the provision that the amount of the securities included in Tier I Capital cannot exceed twenty-five percent (25%) of total Tier I capital.

The Company is dependent on the profitability of the Bank and its subsidiaries and their ability to pay dividends in order to service its long-term debt.

The Bank has long-term advances from the FHLB totaling approximately \$65 million as of March 31, 2009 and \$63 million as of December 31, 2008. These advances bear interest at rates which vary from 1.89% to 6.55% with a weighted average rate of 4.85% as of March 31, 2009. Most of the FHLB borrowings have quarterly call features and maturities range from 2009 to 2017. If a convertible advance is called, the Company has the option to pay off the advance without penalty or to have the advance reprice at a variable rate tied to the 90-day LIBOR. If a puttable advance is called, the Company is required to re-pay the obligation. Collateral for the FHLB advances consists of the Bank's entire portfolio of fully disbursed, one-to-four family residential mortgages and multi-family residential mortgages as well as the commercial loan portfolio, agriculture portfolio and second mortgages on 1-4 family residential properties. The Bank had additional borrowing capacity of approximately \$36 million as of March 31, 2009.

NOTE 8 - REVOLVING LINE OF CREDIT

The Company has a \$5 million one-year line of credit with First Tennessee Bank that is renewed annually. As of current quarter end, there is no outstanding balance drawn on this line. Interest on the outstanding balance is payable quarterly and is based on 100 basis points below the base prime rate of First Tennessee Bank.

NOTE 9 - ADOPTION OF EITF 06-04 ACCOUNTING FOR ENDORSEMENT SPLIT DOLLAR LIFE INSURANCE PLANS WITH POSTRETIREMENT BENEFITS

The Company adopted EITF 06-4 effective January 1, 2008. The cumulative adjustment to retained earnings for this change in accounting principle is \$1.9 million to accrue the postretirement death benefits for endorsement split dollar life insurance plans. Expense related to these accruals is estimated at \$165,000 for the year ended December 31, 2009. Expense related to these plans for first quarter 2009 is approximately \$41,000 compared to approximately \$66,000 in first quarter 2008. This expense is included in the Salaries and Benefits Expense on the Consolidated Statement of Income.

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NOTE 10 - FAIR VALUE MEASUREMENTS

Fair value measurements are used to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company adopted SFAS No. 157, "Fair Value Measurements" ("SFAS 157") effective January 1, 2008 for all applicable financial and non-financial assets and liabilities. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure requirements regarding fair value measurements. This standard does not expand the use of fair value in any new circumstances but clarifies the principle that fair value should be based on assumptions that market participants would use when pricing the asset or liability. The standard outlines the following three acceptable valuation techniques that may be used to measure fair value:

- a. **Market approach**-The market approach uses prices and other relevant information generated by market transactions involving identical or similar assets or liabilities. This technique includes matrix pricing that is a mathematical technique used principally to value debt securities without relying solely on quoted prices for specific securities but rather by relying on securities' relationship to other benchmark quoted securities.
- b. **Income approach**-The income approach uses valuation techniques to convert future amounts such as earnings or cash flows to a single present discounted amount. The measurement is based on the value indicated by current market expectations about those future amounts. Such valuation techniques include present value techniques, option-pricing models (such as Black-Scholes-Merton formula and a binomial model), and multi-period excess earnings method (used to measure fair value of certain intangible assets).

c. Cost approach-The cost approach is based on current replacement cost which is the amount that would currently be required to replace the service capacity of an asset.

Valuation techniques are selected as appropriate for the circumstances and for which sufficient data is available. Valuation techniques are to be consistently applied but a change in valuation techniques or its application may be made if the change results in a measurement that is equally or more representative of fair value in the circumstances. Revisions resulting from a change in valuation technique or its application are accounting for as a change in accounting estimate (in accordance with SFAS No. 154, "Accounting Changes and Error Corrections") which does not require the change in accounting estimate to be accounted for by restating or retrospectively adjusting amounts reported in financial statements of prior periods or by reporting pro forma amounts for prior periods.

SFAS 157 also establishes a hierarchy that prioritizes information used to develop those assumptions. The level in the hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company considers an input to be significant if it drives more than 10% of the total fair value of a particular asset or liability. The hierarchy is as follows:

Level 1 Inputs (Highest ranking): Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 Inputs: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Such inputs may include quoted prices for similar assets or liabilities in active markets, and inputs other than quoted market prices that are observable for the assets and liabilities such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 Inputs (Lowest ranking): Unobservable inputs for determining fair values of assets and liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets and liabilities.

Assets and liabilities may be measured for fair value on a recurring basis (daily, weekly, monthly or quarterly) or on a non-recurring basis in periods subsequent to initial recognition. Recurring valuations are measured regularly for investment securities and the cash flow hedge. Loans held for sale, other real estate and impaired loans are measured at fair value on a non-recurring basis and do not necessarily result in a change in the amount recorded on the balance sheet. Generally, these assets have non-recurring valuations that are the result of application of other accounting pronouncements that require the assets be assessed for impairment or at the lower of cost or fair value. Fair values of loans held for sale are considered Level 2. Fair values for other real estate and impaired loans are considered Level 3.

The Company obtains fair value measurements for securities and the cash flow hedge from a third party vendor. The cash flow hedge and the majority of the available-for-sale securities are valued using Level 2 inputs. Collateralized debt obligation securities that are backed by trust preferred securities and account for less than 2% of the available-for-sale securities portfolio are valued using Level 3 inputs. The fair value measurements reported in Level 2 are primarily matrix pricing that considers observable data (such as dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and terms and conditions of bonds, and other factors). Fair value measurements for trust-preferred securities are obtained through the use of valuation models that include unobservable inputs which are considered Level 3.

Effective January 1, 2008, the Company adopted provisions of SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of SFAS No. 115" ("SFAS 159"). SFAS 159 permits the Company to choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value measurement option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with certain exceptions enabling the

Company to record identical financial assets and liabilities at fair value or by another measurement basis permitted under generally accepted accounting principles, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to portions of instruments. Adoption of SFAS 159 on January 1, 2008 did not have a material impact on the financial statements of the Company.

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Recurring Basis

Fair value measurements are determined in accordance with SFAS 157. The following are descriptions of valuation methodologies used for assets and liabilities measured at fair value on a recurring basis:

Available for Sale Securities

Fair values for available-for-sale securities are obtained from a third party vendor and are valued using Level 2 inputs, except for trust preferred collateralized debt obligations ("TRUP CDOs") which are accounted for using Level 3 inputs. TRUP CDOs accounted for less than 2% of the portfolio at March 31, 2009.

The markets for TRUP CDOs and other similar securities were not active at March 31, 2009. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which these securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also relatively inactive.

The market values for these securities (and other securities other than those issued or guaranteed by the U.S. Treasury) are very depressed relative to historical levels. For example, the yield spreads for the broad market of investment grade and high yield corporate bonds reached all time wide levels versus Treasuries at the end of November 2008 and remained near those levels at March 31, 2009. Therefore, in the current market, a low market price for a particular bond may only provide evidence of stress in credit markets in general rather than being an indicator of credit problems with a particular issuer.

Given conditions in current debt markets and the relative inactivity in the secondary and new issue markets, the Company determined:

- Few observable transactions and market quotations that were available are not reliable for purposes of determining fair value as of March 31, 2009;
- An income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs will be equally or more representative of fair value than the market approach valuation technique used at prior measurement dates; and
- The Company's TRUP CDOs will be classified within Level 3 of the fair value hierarchy because significant adjustments are required to determine fair value at the measurement date.

The Company's TRUP CDO valuations were prepared by an independent third party. Their approach to determining fair value involved these steps:

- The credit quality of the collateral was estimated using average risk-neutral probability of default values for each industry (i.e., banks and insurance companies are evaluated separately);
- Asset defaults were generated taking into account both the probability of default of the asset and an assumed level of correlation among the assets;

- A higher level of correlation was assumed among assets from the same industry (e.g., banks with other banks) than among those from different industries;
- The loss given a default was assumed to be 95% (i.e., a 5 % recovery);
- The cash flows were forecast for the underlying collateral and applied to each TRUP CDO tranche to determine the resulting distribution among the securities;
- The calculations were modeled in several thousand scenarios using a Monte Carlo engine;
- The expected cash flows for each scenario were discounted at the risk-free rate plus 200 basis points (for illiquidity) to calculate the present value of the security; and
- The average price was used for valuation purposes.

The Company recalculated the overall effective discount rates for these valuations. The overall discount rates for the current quarter end range from 10% to 28% and were highly dependent upon the credit quality of the collateral, the relative position of the tranche in the capital structure of the TRUP CDO and the prepayment assumptions.

Cash Flow Hedge

The Company's cash flow hedge is valued by a third party vendor and based on matrix pricing using Level 2 inputs as noted in Note 1.

A summary of assets and liabilities as of March 31, 2009 measured at estimated fair value on a recurring basis is as follows (in thousands):

	Level 1 <u>Inputs</u>	Level 2 <u>Inputs</u>	Level 3 <u>Inputs</u>	Total Fair <u>Value</u>
Assets:				
Securities available-for-sale	\$ -	\$ 206,872	\$ 1,479	\$ 208,351
Liabilities:				
Cash Flow Hedge	\$ -	\$ 164		\$ 164

The following table presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the quarter ended March 31, 2009 (in thousands):

	Available <u>for Sale</u>
Balance at December 31, 2008	\$ 2,342
Total unrealized gains (losses) included in:	
Net income	-
Other comprehensive income	(863)
Purchases, sales, issuances and settlements, net	
Transfers in and (out) of Level 3	-
Balance at March 31, 2009	\$ 1,479

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Non-Recurring Basis

Certain assets are measured at fair value on a non-recurring basis as described below.

Impaired Loans

Impaired loans are evaluated and valued at the time the loan is identified as impaired at the lower of cost or fair value. Fair value is measured based on the value of the collateral securing these loans. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable. Independent appraisals for collateral are obtained and may be discounted by management based on historical experience, changes in market conditions from

time of valuation and/or management's knowledge of the borrower and the borrower's business. As such discounts may be significant, these inputs are considered Level 3 in the hierarchy for determining fair value. Values of impaired loans are reviewed on at least a quarterly basis to determine if specific allocations in the reserve for loan losses are adequate.

Loans Held for Sale

Loans held for sale are recorded at the lower of cost or fair value. Fair value of loans held for sale are based upon binding contracts and quotes from third party investors that qualify as Level 2 inputs for determining fair value. Loans held for sale did not have an impairment charge in first quarter 2009 or during the year ended December 31, 2008.

Other Real Estate

Other real estate is recorded at the lower of cost or fair value. Fair value is measured based on independent appraisals and may be discounted by management based on historical experience and knowledge and changes in market conditions from time of valuation. As such discounts may be significant, these inputs are considered Level 3 in the hierarchy for determining fair value. Values of other real estate are reviewed at least annually or more often if circumstances require more frequent evaluations.

A summary of assets and liabilities as of March 31, 2009 measured at estimated fair value on a non-recurring basis were as follows:

	<u>Level 1</u> <u>Inputs</u>	<u>Level 2</u> <u>Inputs</u>	<u>Level 3</u> <u>Inputs</u>	<u>Total Fair</u> <u>Value</u>
Assets:				
Impaired Loans	\$ -	\$ -	\$ 14,778	\$ 14,778
Loans held for sale	-	3,343	-	3,343
Other real estate			5,557	5,557

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

OVERVIEW

Results of operations for first quarter 2009 reflect stable core income streams, improving net interest margins, and reductions in non-interest expense. In spite of this, earnings per share decreased \$0.10 or 16% when comparing the first quarters of 2009 and 2008. Decreased earnings are attributable to recording provision for loan losses of \$2.4 million for first quarter 2009 compared to a provision of \$367 thousand first quarter 2008. Provision of this magnitude was recorded as a proactive measure to address not only net charge-offs for first quarter 2009 but also to increase the allowance for loan losses as a percent of total loans given the adverse economic conditions and continued deterioration in real estate markets. Net loan charge-offs for first quarter 2009 totaled \$1.3 million compared to \$353 thousand in first quarter 2008. Reserve for losses on loans as a percent of total loans was 1.43% as of March 2009, 1.22% as of December 2008 and 1.06% as of March 2008.

Total assets by design remained flat in first quarter 2009 compared to year-end 2008 as a result of strategic efforts to grow cautiously during the current economic recession and a lack of loan demand. Strategic efforts are currently focused on preservation of capital and maintaining prudent liquidity position rather than aggressive growth until economic and market conditions improve. Loan totals decreased by \$5.5 million or approximately 0.9% (annualized 3.8%) during first quarter 2009.

EXPANSION

There are no immediate plans for expansion in the near term. Construction of a full service branch facility in Jackson, Tennessee originally scheduled for 2009 has been temporarily put on hold due to the current conditions of the economy and financial markets.

FORWARD-LOOKING STATEMENTS

Information contained herein includes forward-looking statements with respect to the beliefs, plans, risks, goals and estimates of First Citizens Bancshares, Inc. Forward-looking statements are necessarily 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," "will," "intend," "is likely," "going forward" and other expressions are intended to identify forward-looking statements. These forward-looking statements are within the meaning of section 27A of the Securities Act of 1933, as amended, and section 21E of the Securities Exchange Act of 1934, as amended. 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 the Company and its subsidiaries conform to accounting principles generally accepted in the United States and follow general practices within its industry. The preparation of financial statements requires management to make estimates and assumptions that affect 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 that 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. Third party vendors are used to obtain fair value of available-for-sale securities and the cash flow hedge. See also Note 10 to the Company's Consolidated Financial Statements included elsewhere in this Quarterly Report on 10-Q.

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

Results of operations for first quarter 2009 reflect stable core income streams, improving net interest margins, and reductions in non-interest expenses offset by increased provision for loan losses. Key performance metrics for the Company reflect the negative impact of increased provision for loan losses recorded in first quarter 2009 compared to first quarter of prior years and are as follows:

	AS OF MARCH 31,				
	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Percentage of Net Income to:					
Average Total Assets	0.78%	0.97%	0.98%	1.06%	1.08%
Average Shareholders' Equity	9.14%	11.65%	11.73%	13.55%	13.43%
Percentage of Dividends Declared Per Common Share to Net Income	59.08%	49.32%	52.41%	48.59%	49.12%
*Percentage of Average Shareholders' Equity to Average Total Assets	9.30%	9.07%	9.09%	8.63%	8.86%

*Represents primary capital including the allowance for loan losses.

Earnings per share decreased \$0.10 or 16.5% when comparing the first quarters of 2009 and 2008. The decrease in earnings per share is a result of increase in provision for loan losses that is partially offset by increased net interest income, gain on sale of available-for-sale securities, and reductions in other non-interest expenses. Non-interest income and non-interest expense components are discussed in detail below.

Net interest income is the principal source of earnings for the Company and is defined as the amount of interest generated by earning assets minus interest cost to fund those assets. Net interest income increased approximately \$517,000 or 7.3%, when comparing first quarter of 2009 to first quarter 2008. The net yield on average earning assets for the first quarters of 2009 and 2008 decreased, from 7.01% to 6.10%. Net interest margin for first quarter 2009 was 3.87%, which reflects an increase of 8 basis points above first quarter 2008 and is flat compared to 3.84% for the year ended December 31, 2008. First quarter 2009 net interest margin improved as cost of interest-bearing liabilities decreased more than the decreased yield on interest-earning assets. The Company has maintained stable net interest margins in the range of 3.50% to 4.00% over the past four years as federal funds rates fluctuated between 0.00% and 5.25%.

Per the most recent Uniform Bank Performance Report (UBPR), net interest income as a percent of average total assets was above peer at 3.50% compared to peer at 3.46% for the year ended December 31, 2008. Review of individual components of net interest income reveal that both the Bank's investment and loan portfolios have higher

yields than peer and the cost of deposits is less than peer while peer banks have lower costs on other borrowed money. Yield on total loans was 6.90% compared to peer at 6.77% at year-end 2008. Investment yields (on a tax equivalent basis) are above peer at 5.47% compared to peer at 5.03%. Cost of interest-bearing deposits was 2.53% compared to peer at 2.87% and cost of other borrowed money was 4.89% compared to peer of 3.67%. 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.

Average earning assets to total average assets is 90% compared to peer of 94% as of December 31, 2008. The dilution is caused by significant investments in fixed assets and Bank-owned life insurance (BOLI) policies, which total \$52 million or 5.7% of total assets as of March 31, 2009. The statement of cash flows reflects fixed assets purchases of approximately \$183,000 during first quarter 2009. Earnings on BOLI policies are included in other non-interest income and totaled approximately \$202,000 in first quarter 2009 compared to approximately \$213,000 for first quarter 2008.

Average interest-bearing deposits in first quarter 2009 compared to the same period in 2008 reflect an increase of approximately \$42 million or 7.2%. Cost of interest bearing deposits decreased 111 basis points from first quarter 2008 to first quarter 2009. While the cost of deposits has decreased, competitive factors and liquidity pressures in the industry kept the cost of deposits from declining significantly compared to the steep rate cuts by the FOMC.

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The following quarterly average balances, interest, and average rates are presented in the following table (dollars in thousands):

	QUARTER ENDING MARCH 31,								
	2009			2008			2007		
	Avg. Balance	Interest	Avg. Rate	Avg. Balance	Interest	Avg. Rate	Avg. Balance	Interest	Avg. Rate
ASSETS									
INTEREST EARNING ASSETS:									
Loans (1)(2)(3)	\$ 586,378	\$ 9,489	6.47 %	\$ 585,576	\$ 10,952	7.48 %	\$ 545,171	\$ 10,783	7.91 %
Investment Securities:									
Taxable	149,563	2,005	5.36 %	137,517	1,816	5.28 %	134,546	1,674	4.98 %
Tax Exempt (4)	65,128	1,056	6.46 %	52,380	844	6.45 %	44,243	697	6.30 %
Interest Earning									
Deposits	900	6	6.67 %	848	13	6.13 %	759	9	4.74 %
Federal Funds Sold	<u>22,176</u>	<u>130</u>	<u>2.27 %</u>	<u>3,385</u>	<u>46</u>	<u>5.44 %</u>	<u>17,235</u>	<u>224</u>	<u>5.20 %</u>
Total Interest Earning Assets	824,145	12,566	6.10 %	779,706	13,671	7.01 %	741,954	13,387	7.22 %
NON-INTEREST EARNING ASSETS:									
Cash and due from Banks	\$ 15,610			\$ 17,676			\$ 16,368		
Bank Premises and Equipment	31,691			30,972			28,267		
Other Assets	<u>54,539</u>			<u>51,663</u>			<u>48,228</u>		
Total Assets	\$ 925,985			\$ 880,017			\$ 834,817		
	=====			=====			=====		

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	QUARTER ENDING MARCH 31,								
	2009			2008			2007		
	Avg. Balance	Interest	Avg. Rate	Avg. Balance	Interest	Avg. Rate	Avg. Balance	Interest	Avg. Rate
LIABILITIES AND SHAREHOLDERS' EQUITY									
INTEREST BEARING LIABILITIES:									
Interest bearing deposits	\$ 633,040	\$ 3,553	2.25 %	\$ 590,483	\$ 4,956	3.36 %	\$ 574,362	\$ 5,296	3.69 %
Federal funds Purchased and Other Interest Bearing Liabilities	<u>113,850</u>	<u>1,045</u>	3.67 %	<u>119,798</u>	<u>1,336</u>	4.46 %	<u>93,405</u>	<u>1,176</u>	5.04 %
Total Interest Bearing Liabilities	746,890	4,598	2.46 %	710,281	6,292	3.54 %	667,767	6,472	3.88 %
NON-INTEREST BEARING LIABILITIES:									
Demand deposits	91,880			89,500			93,273		
Other liabilities	<u>8,244</u>			<u>6,684</u>			<u>4,242</u>		
Total liabilities	847,014			806,465			765,282		
SHAREHOLDERS' EQUITY	<u>78,971</u>			<u>73,552</u>			<u>69,535</u>		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 925,985			\$ 880,017			\$ 834,817		
	=====			=====			=====		
NET INTEREST INCOME		\$ 7,967			\$ 7,379			\$ 6,915	
		=====			=====			=====	
NET YIELD ON AVERAGE EARNING ASSETS (ANNUALIZED)			3.87 %			3.79 %			3.73 %

- (1) Loan totals are loans held for investments and net of unearned income and loan loss reserves
- (2) Fee Income on loans held for investment is included in interest income and the computations of the yield. However, loans held for sale and related mortgage banking income are reported in other assets and other income and therefore, are excluded.
- (3) Includes loans on non-accrual status.
- (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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Provision for loan losses for first quarter 2009 increased \$2 million compared to first quarter 2008. Net charge-offs for first quarter 2009 totaled \$1.3 million compared to net charge-offs of approximately \$353,000 in first quarter 2008. Reserve for losses on loans as a percent of total loans was 1.43% as of March 2009 compared to 1.22% as of December 2008 and 1.06% as of March 2008. See also Nonperforming Loans and Allowance for Loan Losses 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 1.43% compared to peer of 0.78% as of year-end 2008. Non-interest income increased 12% when comparing first quarters 2009 and 2008. In first quarter of 2009, fee income (non-interest income) contributed 23.3% to total revenue compared to 19.8% for the same period last year.

The increase in non-interest income in first quarter 2009 is due to gain on sale of available-for-sale securities totaling approximately \$724,000 in first quarter 2009 compared to approximately \$63,000 in first quarter 2008. See additional information in Investment Securities section below. Income from fiduciary activities and brokerage fees decreased in

first quarter 2009 approximately \$25,000 and \$110,000, respectively, as compared to first quarter 2008. These fees have trended lower as market values of assets under management have declined during the current economic recession and due to lack of consumer confidence in the economy and financial markets. Service charges on deposits decreased approximately \$110,000 due to lower overdraft fee income in first quarter 2009 compared to first quarter 2008.

The increase of approximately \$52,000 in other non-interest income primarily relates to an increase of approximately \$80,000 in income from White & Associates/First Citizens Insurance LLC in first quarter 2009 compared to first quarter 2008. Income from the insurance subsidiary totaled approximately \$283,000, \$201,000, and \$138,000, in first quarters of 2009, 2008, and 2007, respectively. The following table compares non-interest income for first quarter of 2009, 2008 and 2007 (dollars in thousands):

	QUARTER ENDING MARCH 31,					
	<u>2009</u>	<u>Change</u>	<u>2008</u>	<u>Change</u>	<u>2007</u>	
Mortgage banking income	\$ 302	-2.89 %	\$ 311	10.28 %	\$ 282	
Income from fiduciary activities	166	-13.09 %	191	-4.02 %	199	
Service charges on deposits	1,577	-9.11 %	1,735	22.10 %	1,421	
Brokerage fees	277	-28.42 %	387	23.64 %	313	
Earnings on bank owned life insurance	202	-5.16 %	213	21.71 %	175	
Gain (loss) on sale of securities	724	1031.25 %	64	-206.67 %	(60)	
Other income	453	13.25 %	400	14.29 %	350	
Total non-interest income	\$ 3,701	12.12 %	\$ 3,301	23.17 %	\$ 2,680	

Non-interest expense represents operating expenses of the Company and many strategic action plans have centered around reduction in operating expenses in 2009. As a result, non-interest expense for first quarter 2009 decreased approximately \$666,000, or 9.1%, over first quarter of 2008. Salary and benefits expense is the largest component of non-interest expense and decreased approximately \$935,000 or 20.4% over first quarter 2008 due primarily to reduction in employee benefit expenses. Employee benefit expense accruals for incentive compensation and retirement contributions were reduced approximately \$475,000 in first quarter 2009 compared to first quarter 2008. Expense related to imputed income tax reimbursement agreements and post-retirement bank owned life insurance benefits decreased approximately \$370,000 in first quarter 2009 compared to first quarter 2008. Average full-time equivalent employees for the Bank were 255 for three months ended March 31, 2009 compared to 271 for three months ended March 31, 2008.

Depreciation expense in first quarter 2009 was flat compared to first quarter 2008. Purchases of fixed assets in first quarter 2009 totaled approximately \$183,000 compared to \$1.4 million in first quarter 2009. Data processing expense increased approximately \$80,000 due to increased processing and maintenance fees on new and enhanced programs and systems including products related to customer relationship management, our core processor, and online banking. Data processing expense also includes fees for outsourced processing and services including payroll processing and some network administration, which increased in 2009.

FDIC insurance premium expense increased approximately \$235,000 in first quarter 2009 compared to 2008 as the result of an increase in assessment rates and depletion of a one-time assessment credit that served to reduce premiums due in 2007 and 2008. An additional one time assessment against all banks by FDIC to help offset costs incurred by the fund in dealing with failed banks is projected to increase FDIC premiums in 2009 to a level in excess of \$2 million compared to approximately \$100,000 for the year ended December 31, 2008. The one-time special assessment will be made as of the end of second quarter 2009 and will be paid in third quarter 2009.

Other real estate expense for first quarter 2009 was approximately \$203,000 compared to \$136,000 in first quarter 2008. See Other Real Estate section below for additional information.

No impairment of goodwill has been recorded for the current and prior reportable periods. Core deposit intangible expense for the current reportable quarter was flat at approximately \$21,000. Quarter-to-date advertising, community relations, and other forms of marketing expenses were approximately \$134,000 or 2.01% of other non-interest

expense in first quarter 2009 compared to approximately \$175,000 or 2.39% of total non-interest expense in first quarter 2008. All marketing or advertising items are expensed at the time they are incurred. Reduced marketing and promotional expenses are due to strategic efforts to control non-interest expense during first quarter 2009.

The following table compares non-interest expense for first quarter of 2009, 2008 and 2007 (dollars in thousands):

	QUARTER ENDING MARCH 31,					
	2009	% of Change	2008	% of Change	2007	
Salaries and Employee benefits	\$ 3,647	-20.41 %	\$ 4,582	14.98 %	\$ 3,985	
Net Occupancy Expense	438	-0.45 %	440	4.76 %	420	
Depreciation	449	0.90 %	445	-15.40 %	526	
Data Processing Expense	282	41.00 %	200	-9.09 %	220	
Legal and Professional Fees	31	-48.33 %	60	0.00 %	60	
Stationary and Office Supplies	68	17.24 %	58	-21.62 %	74	
Amortization of Intangibles	21	0.00 %	21	0.00 %	21	
Advertising and promotions	134	-23.43 %	175	-0.57 %	176	
FDIC insurance premium expense	255	1242.11 %	19	-5.00 %	20	
Other real estate expenses	203	49.26 %	136	615.79 %	19	
Other Expenses	1,135	-4.86 %	1,193	5.39 %	1,132	
Total Non-Interest Expense	\$ 6,663	-9.09 %	\$ 7,329	10.16 %	\$ 6,653	

The efficiency ratio measures total non-interest expenses as a percentage of the sum of net interest income (on a tax equivalent basis) and non-interest income. The Company's efficiency ratio as of March 31, 2009, and 2008 was 57.0% and 68.5%, respectively. The lower ratio in March 2009 compared to March 2008 was due to the combination of increased non-interest income and lower non-interest expense which are described above.

CHANGES IN FINANCIAL CONDITION

Total assets were flat in first quarter 2009 compared to year-end 2008 due to slow loan demand and strategic efforts to grow cautiously during the current economic recession. Loans decreased by \$5.5 million or approximately 0.9% (annualized 3.8%) during first quarter 2009. Loan growth was approximately 2.1% for the year ended December 31, 2008. The Company continues to fund loans and looks forward to the time when a stronger economy encourages customers to once again move forward with a more aggressive business agenda. The Company remains steadfast in its commitment to asset quality by not compromising underwriting standards in order to grow its loan portfolio.

Total deposits decreased by approximately \$13.4 million or 1.8% (annualized 7.2%) during first quarter 2009. Demand deposits decreased approximately \$22 million in first quarter 2009. Demand deposits have fluctuated in recent months in the range of \$80 million to \$110 million but overall monthly average demand balances have remained in the range of \$85 million to \$95 million, which is consistent with historical trends. Time deposits decreased approximately \$15 million due to de-leveraging of brokered certificates of deposits. Savings deposits increased \$23 million during first quarter 2009. Seasonality of municipal deposits contributed to the overall increase of approximately \$23 million in savings deposits.

Securities sold under agreements to repurchase increased \$7.1 million or 21.6% since year-end 2008. Long-term debt increased \$1.9 million or 2.5% in first quarter 2009 as a result of one new FHLB advance totaling \$2 million offset by debt reductions totaling approximately \$100,000 on amortizing FHLB advances.

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 a third party vendor to manage the investment portfolio. Peer data per the December 31, 2008 Uniform Bank Performance Report indicates that tax equivalent yields on investments exceed peer at 5.47% compared to 5.03% peer. Quarterly average rates for taxable

Total deposits decreased by approximately \$13.4 million or 1.8% (annualized 7.2%) during first quarter 2009. Dem

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securities for the first quarter end increased 7 basis points while tax exempt securities are flat compared to prior year's first quarter. The investment portfolio is heavily weighted in agency mortgage-related securities, which accounted for approximately 60% of total portfolio. The Company's 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 \$137 million as of March 31, 2009.

The carrying value of listed investment securities as of dates indicated were summarized as follows (in thousands):

	AS OF MARCH 31,				
	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
U. S. Treasury & government agencies	\$ 138,356	\$ 137,241	\$ 129,290	\$ 117,202	\$ 95,449
State & political subdivisions	68,236	53,806	43,773	41,581	40,949
All others	1,759	4,599	12,377	13,505	13,333
Totals	\$ 208,351	\$ 195,646	\$ 185,440	\$ 172,288	\$ 149,731

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, 2009 were as follows (in thousands):

	<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	-	-	133,537	138,356
Securities issued by states & Political subdivision in the U. S.:				
Taxable securities	-	-	-	-
Tax-exempt securities	-	-	66,313	68,236
U. S. securities:				
Debt securities	-	-	3,908	1,754
Equity securities	-	-	10	5
Foreign securities:				
Debt securities	N/A	N/A	N/A	N/A
Equity securities	N/A	N/A	N/A	N/A
Total	\$ -	\$ -	\$ 203,768	\$ 208,351

Accumulated other comprehensive income reflects \$2.8 million net unrealized gain on securities, net of tax. During first quarter 2009, gross unrealized gain on securities increased approximately \$1.9 million from year end 2008 primarily due to increases in market value of agency mortgage-backed securities (MBS) and collateralized mortgage obligations (CMOs) held in the portfolio. Market values of the bonds increased in first quarter 2008 as a result of the Federal Reserve's quantitative easing plan to improve stability and liquidity in financial markets and promote recovery in housing sector. The Federal Reserve's purchase of mortgage-backed securities similar to those held in the Company's portfolio drove re-investment yields lower and market values of current holdings higher. Market value of the investment portfolio was also heavily influenced by U. S. Treasury curve. The 10-year Treasury rate was 2.71% as of March 2009 compared to 2.49% as of December 2008 and 4.07% in March 2008. The two-year Treasury rates were approximately 0.81% in March 2009 compared to 1.46% at year-end 2008 and 2.46% as of March 2008.

In first quarter 2009, the Company implemented a strategy to realize a portion of the unrealized gain on the investment portfolio. Investments totaling approximately \$23.5 million were sold in first quarter 2009 at a realized gain of approximately \$724,000. The sales were recorded on a trade date basis in accordance with generally accepted accounting principles. Although the transactions were executed prior to March 31, 2009, settlement for a portion of

Total deposits decreased by approximately \$13.4 million or 1.8% (annualized 7.2%) during first quarter 2009. Dem

the sales did not occur until April 2009 and resulted in a receivable of approximately \$7 million reported in Other Assets on the Consolidated Balance Sheet as of March 31, 2009. Proceeds from the sale of investments were reinvested into securities consisting of agency MBS and CMO as well as municipal securities. Investment strategies for new purchases took a slightly more defensive position in the taxable securities portion of the portfolio in preparation for a rise rate environment in the future. The Company is also allocating approximately 25% to 30% of new purchases into tax-exempt municipal securities. The Company continues to employ a strong due diligence process on securities purchases and factors considered include but are not limited to type of security, diversification among and within portfolio sectors, internal policy limits, credit quality of issuer and/or underlying collateral, ratings, yield, duration, expected life, maturity date, etc.

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

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LOANS

The following table sets forth total loans held for investment net of unearned income by category for the past five years (in thousands):

	AS OF MARCH 31,				
	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Real estate:					
construction	\$ 93,927	\$ 109,394	\$ 90,893	\$ 83,423	\$ 104,460
mortgage	379,727	358,969	339,754	347,345	318,173
Commercial, financial and agricultural	78,059	85,635	75,650	79,156	62,754
Consumer installment	34,733	36,450	37,435	37,592	37,643
Other	4,716	8,642	6,555	6,546	4,297
Total loans	\$ 591,162	\$ 599,090	\$ 550,287	\$ 554,062	\$ 527,327

Loans decreased \$5.6 million from December 31, 2008 to March 31, 2009 and decreased \$8 million from March 31, 2008 to March 31, 2009. Real estate loans increased \$5 million from March 31, 2008 to March 31, 2009.

Commercial, financial and agricultural loans combined decreased \$7.5 million when comparing March 31, 2008 to March 31, 2009. Loan demand was slow during the first quarter of 2009 and the Company has been strategically cautious with its growth strategies under the current economic conditions.

The loan portfolio was heavily weighted in real estate loans, which accounted for approximately \$473 million or 80% of total portfolio. Commercial and residential construction loans comprised \$94 million or 16% of the total loan portfolio. Although the portfolio was heavily weighted in real estate, the Bank did not and does not invest in sub-prime or non-traditional mortgages. The Bank monitors concentrations in commercial real estate in accordance with regulatory guidelines.

The aggregate amount of loans the company is permitted to make under applicable bank regulations to any one borrower is 15% of unimpaired capital. The Bank's legal lending limit at March 31, 2009 was \$12.4 million. Although the Bank's legal lending limit has been in excess of \$10 million for several years, the Bank rarely extends credit in excess of \$5 million to one borrower. There were no material reportable contingencies as of March 31, 2009.

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 including

Total deposits decreased by approximately \$13.4 million or 1.8% (annualized 7.2%) during first quarter 2009. Dem

loans secured by farmland and loans to finance agricultural production comprise \$67 million of total loans as of March 31, 2009 and \$63 million as of March 31, 2008. Recoveries, net of charge-offs in this category were approximately \$10,000 for first quarter 2009 compared to net charge-offs of approximately \$23,000 for first quarter 2008.

NON-PERFORMING LOANS AND ALLOWANCE FOR LOAN LOSSES

Overall economic factors for Tennessee deteriorated in recent months as commercial and individual customers battled declining home values and rising unemployment rates. While conditions have deteriorated, the impact in our markets appears to have been less severe overall than at the national level and was primarily concentrated in residential construction and land development loans in and around Shelby County. Credit quality deterioration in this sector of the portfolio was reflected in net loans charged off in first quarter 2009 and increases in non-performing loans and increase in other real estate owned. In response, the Company increased the allowance for loan losses as a percentage of total loans from 1.22% as of December 2008 to 1.43% as of March 2009.

Non-performing loans at quarter end were 1.75% of total loans. Non-performing loans and other real estate trended upward over the last twelve months. Per the most recent UBPR (as of December 31, 2008), the ratio of non-current loans to gross loans (as of December 31, 2008) was 0.74% compared to peer at 2.04%. Non-performing loans have historically been in the range of less than 1% of total loans during the last five years. The recent increase was attributed to a small volume of loans with balances in excess of a \$1 million. The following table sets forth the balance of non-performing loans as of March 31, for the years indicated (in thousands):

	AS OF MARCH 31,				
	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Non-performing loans:					
Non-accrual	\$ 7,579	\$ 998	\$ 385	\$ 1,386	\$ 1,310
90 days past due accruing interest	2,788	1,087	703	2,213	907
Total	\$ 10,367	\$ 2,085	\$ 1,088	\$ 3,599	\$ 2,217

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 1.43% for the current quarter and 1.22% at year-end 2008. The following table recaps activity in the allowance for loan losses in first quarter for the past five years and the ratio of net charge offs for the quarter as a percentage of average loans outstanding (dollars in thousands):

	QUARTER ENDED MARCH 31,				
	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Average net loans outstanding	\$ 586,378	\$ 585,576	\$ 545,171	\$ 547,727	\$ 528,272
Balance of reserve for loan losses at beginning of period	\$ 7,300	\$ 6,328	\$ 6,211	\$ 6,830	\$ 6,239
Loan charge-offs	(1,330)	(453)	(66)	(123)	(131)
Recovery of loans previously charged- off	60	100	107	87	44
Net recoveries (charge offs)	(1,270)	(353)	41	(36)	(87)

Total deposits decreased by approximately \$13.4 million or 1.8% (annualized 7.2%) during first quarter 2009. Dem

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Addition to reserve charged to operating expense		2,400		367		166		233		251
Balance at end of period	\$	8,430	\$	6,342	\$	6,418	\$	7,027	\$	6,403
Ratio of net charge-offs during the quarter to average net loans outstanding		0.22 %		0.01 %		0.01 %		0.01 %		0.01 %

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Net loans charged off in first quarter for each of last five years by category were as follows (dollars in thousands):

	QUARTER ENDED MARCH 31,				
	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Charge-offs:	-	-	-	-	-
Domestic:					
Commercial, financial and agricultural	(\$428)	(\$54)	(\$7)	(\$49)	(\$55)
Real estate-construction	(503)	(76)			

Total deposits decreased by approximately \$13.4 million or 1.8% (annualized 7.2%) during first quarter 2009. Dem