

FIRST CITIZENS BANCSHARES INC /TN/
Form 10-Q
May 09, 2006

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, 2006
- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 2-83542

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 3 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 [X] 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 [x].

Of the registrant's only class of common stock (no par value) there were 3,634,468 shares outstanding as of March 31, 2006.

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

FIRST CITIZENS BANCSHARES, INC. & SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF MARCH 31, 2006 AND DECEMBER 31, 2005
(Stated in Thousands)

| | <u>AS OF</u> <u>March 31, 2006</u> | <u>AS OF</u> <u>December 31, 2005</u> |
|--|---------------------------------------|--|
| ASSETS | | |
| Cash and due from banks | \$ 16,311 | \$ 15,808 |
| Federal funds sold | <u>33,020</u> | <u>24,878</u> |
| Cash and cash equivalents | 49,331 | 40,686 |
| Investment securities | | |
| Trading investments - stated at market | - | - |
| Held to maturity - amortized cost - fair value of \$294 at March 31, 2006 and \$296 at December 31, 2005 | 290 | 290 |
| Available for sale, stated at market | 166,186 | 160,878 |
| Loans (excluding unearned income of \$438 at March 31, 2006 and \$462 at December 31, 2005) | 554,072 | 547,217 |
| Less: allowance for loan losses | <u>7,027</u> | <u>6,830</u> |
| Net loans | 547,045 | 540,387 |
| Loans held for sale | 2,885 | 3,043 |
| Federal Home Loan Bank and Federal Reserve Bank Stock, at cost | 5,317 | 5,258 |
| Premises and equipment | 28,714 | 27,642 |
| Accrued interest receivable | 5,354 | 5,478 |
| Goodwill | 11,825 | 11,825 |
| Other intangible assets | 521 | 542 |

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| | | |
|------------------------------------|--------------|--------------|
| Other real estate | 169 | 129 |
| Bank owned life insurance policies | 16,161 | 16,013 |
| Other assets | <u>4,239</u> | <u>3,578</u> |
| TOTAL ASSETS | | |

\$ 838,037

\$ 815,749

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LIABILITIES AND SHAREHOLDERS' EQUITY

Liabilities:

Deposits

Demand

\$ 87,117

\$ 83,970

Time

362,542

348,520

Savings

208,931

203,019

Total deposits

658,590

635,509

Securities sold under agreements to repurchase

33,727

34,753

Federal funds purchased and other short term borrowings

| | |
|--|----------------|
| | 697 |
| | 1,000 |
| Long- term debt | |
| | 76,699 |
| | 78,128 |
| Other liabilities | |
| | <u>3,776</u> |
| | <u>2,713</u> |
| TOTAL LIABILITIES | |
| | 773,489 |
| | 752,103 |
| Shareholders' equity: | |
| Common stock, no par value - 10,000,000 authorized; 3,717,593 issued and outstanding at March 31, 2006 and 3,717,593 issued and outstanding at December 31, 2005 | |
| | 3,718 |
| | 3,718 |
| Surplus | |
| | 15,331 |
| | 15,331 |
| Retained earnings | |
| | 48,706 |
| | 47,591 |
| Accumulated other comprehensive income | |
| | <u>(1,095)</u> |
| | <u>(900)</u> |

Total common stock and retained earnings

66,660

65,740

Less - 83,125 treasury shares, at cost at March 31, 2006 and 82,585
shares at cost at December 31, 2005

2,112

2,094

TOTAL SHAREHOLDERS' EQUITY

64,548

63,646

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY

\$ 838,037

\$ 815,749

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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, 2006 AND 2005
(Stated in Thousands Except for E.P.S. and Shares Outstanding)**

| | Three Months Ended March 31, | |
|------------------------------------|---------------------------------|---------------|
| | <u>2006</u> | <u>2005</u> |
| Interest income: | | |
| Interest and fees on loans | \$ 10,187 | \$ 8,713 |
| Interest on investment securities: | | |
| Taxable | 1,306 | 944 |
| Tax-exempt | 431 | 414 |
| Dividends | 102 | 78 |
| Other interest income | | |
| Fed funds sold | 311 | 89 |
| Checking | <u>7</u> | <u>4</u> |
| Total interest income | <u>12,344</u> | <u>10,242</u> |
| Interest expense: | | |

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| | | |
|---|--------------|--------------|
| Interest expense on deposits | 4,125 | 2,694 |
| Other interest expense | <u>1,342</u> | <u>1,186</u> |
| Total interest expense | <u>5,467</u> | <u>3,880</u> |
| Net interest income | 6,877 | 6,362 |
| Provision for loan losses | <u>233</u> | <u>251</u> |
| Net interest income after provision | <u>6,644</u> | <u>6,111</u> |
| Other income: | | |
| Income from fiduciary activities | 185 | 183 |
| Service charges on deposit accounts | 1,400 | 1,344 |
| Brokerage fees | 413 | 371 |
| Gain (loss) on sale of securities | - | (27) |
| Earnings on bank owned life insurance | 175 | 161 |
| Other income | <u>425</u> | <u>567</u> |
| Total other income | <u>2,598</u> | <u>2,599</u> |
| Other expenses: | | |
| Salaries and employee benefits | 3,836 | 3,568 |
| Net occupancy expense | 445 | 405 |
| Depreciation | 482 | 443 |
| Data processing expense | 183 | 166 |
| Legal and professional fees | 27 | 41 |
| Stationary and office supplies | 61 | 69 |
| Amortization of intangibles | 21 | 21 |
| Advertising and promotions | 161 | 117 |
| Other expenses | <u>1,261</u> | <u>1,193</u> |
| Total other expenses | <u>6,477</u> | <u>6,023</u> |
| Net income before income taxes | \$ 2,765 | \$ 2,687 |
| Income taxes | <u>596</u> | <u>617</u> |
| Net income | \$ 2,169 | \$ 2,070 |
| | ===== | ===== |
| Earning Per Share | \$ 0.60 | \$ 0.57 |
| | ===== | ===== |
| Weighted average number of shares outstanding | 3,634,621 | 3,645,217 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements.

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FIRST CITIZENS BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)
AS OF MARCH 31, 2006 AND 2005
(Stated in Thousands)

| | Three Months ended March 31, | |
|---|---------------------------------|--------------|
| | <u>2006</u> | <u>2005</u> |
| Balance at beginning of period | \$ 63,646 | \$ 61,208 |
| Net income | 2,169 | 2,070 |
| Other comprehensive income: | | |
| Changes in available for sale investments | (238) | (1,061) |
| Changes in derivatives | <u>43</u> | <u>50</u> |
| Comprehensive income | 1,974 | 1,059 |
| Cash dividend declared | (1,054) | (1,020) |
| Common stock issued | -- | -- |
| Common stock repurchased, net | <u>(18)</u> | <u>(246)</u> |
| Balance at end of period | \$ 64,548 | \$ 61,001 |
| | ===== | ===== |

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, 2006 AND 2005
(Stated in Thousands)

| | Three Months Ended | |
|---|---------------------------|--------------------|
| | March 31, | |
| | <u>2006</u> | <u>2005</u> |
| Net cash provided by operating activities | \$ 3,399 | \$ 3,969 |
| Investing activities: | | |
| Proceeds of maturities of held-to-maturity securities | - | - |
| Purchase of held-to-maturity investments | - | - |
| Proceeds of maturities of available-for-sale securities | 4,914 | 11,386 |
| Proceeds of sales of available-for-sale securities | - | 10,343 |
| Purchase of available-for-sale securities | (10,474) | (20,925) |
| Increase in loans-net | (6,891) | (1,511) |
| Purchases of premises and equipment | (1,554) | (2,133) |
| Net cash (used) by investing activities | (14,005) | (2,840) |
| Financing activities: | | |
| Net increase (decrease) in demand and savings accounts | 9,059 | (4,076) |
| Increase (decrease) in time deposits | 14,022 | 1,447 |
| Increase (decrease) in long-term debt | (1,429) | (119) |
| Treasury stock purchases, net | (18) | (246) |
| Proceeds from sale of common stock | - | - |
| Cash dividends paid | (1,054) | (1,020) |
| Net increase (decrease) in short-term borrowings | (1,329) | 6,085 |
| Net cash provided by financing activities | 19,251 | 2,071 |
| Increase (decrease) in cash and cash equivalents | 8,645 | 3,200 |
| Cash and cash equivalents at beginning of period | 40,686 | 33,386 |
| Cash and cash equivalents at end of period | \$ 49,331 | \$ 36,586 |
| Supplemental cash flow disclosures: | | |
| Interest payments, net | \$ 5,287 | \$ 10,025 |

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, 2006
(Stated in Thousands)

NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS

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The consolidated balance sheet as of March 31, 2006, the consolidated statements of income for the three month periods ended March 31, 2006 and 2005, and the consolidated statements of cash flows and equity 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, 2006 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, 2006. 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, 2005.

NOTE 2 - ORGANIZATION

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

NOTE 3 - CONTINGENT LIABILITIES

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

NOTE 4 - RESERVE FOR LOAN LOSSES

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

| | |
|---|----------------|
| Impaired loans with specific reserve allocations | \$ 1,156,000 |
| Impaired loans without specific reserve allocations | <u>638,000</u> |
| | \$ 1,794,000 |
| | ===== |
| Specific reserve for impaired loan losses | \$ 612,000 |

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

NOTE 5 - DERIVATIVE TRANSACTIONS

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

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

The cash flow hedge has produced negative income because First Citizens swapped a fixed cash flow for a variable cash flow and rates later decreased. The value of the derivative has improved as rates have increased over the last year, but remains in a negative position as of current quarter end. Value of the derivative increased \$43 thousand, net of tax, for the current reportable period. Accumulated other comprehensive income reflects a negative value of \$107 thousand, gross and \$66 thousand, net of tax.

NOTE 6 - GOODWILL AND INTANGIBLE ASSETS

SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and supercedes APB 17. Goodwill is no longer amortized. This statement adopts a more aggregate view for goodwill and bases the accounting on the units of the combined units of the combined entity into which an acquired entity is integrated (those units are referred to as reporting units in FASB 131). Currently First Citizens' has one reporting unit and does not meet the tests to segment per FASB 131. As of January 2002, First Citizens ceased to amortize goodwill (\$25 thousand per month). Tests are performed annually during first quarter and have resulted in an impairment of zero since adoption of FAS 142 in 2002. Total goodwill as of the reportable date is \$11.8 million or 1.41% of total assets or 18.32% of total capital.

Amortization expense of the other identifiable intangibles for the quarter was \$21 thousand for 2006 and 2005.

NOTE 7 - LONG TERM OBLIGATIONS

In March 2002, the Company formed a wholly owned subsidiary First Citizens (TN) Statutory Trust II. 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 26, 2002 the Company through its wholly owned subsidiary, First Citizens (TN) Statutory Trust II, 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 26, 2002 the rate per annum of 5.59%. For each successive period beginning on (and including) June 26, 2002, and each succeeding interest payment date at a rate per annum equal to the 3-month LIBOR plus 3.60%; provided however, that prior to March 26, 2007, this interest rate shall not exceed 11%. Interest payment dates are: March 26, June 26, September 26, and December 26 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. These funds are a partial source for the acquisition of Munford Union Bank, along with a line of credit and capital infusion from First Citizens National Bank.

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 \$2.3 million. Interest on the outstanding balance is payable quarterly and is based on 100 basis points below the base prime rate of First Tennessee Bank.

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

GENERAL INFORMATION

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

BRANCH OPERATIONS

In second quarter 2006, the East branch facility of the Union City branch will be converted from a full-service location to a drive-thru only location. The East branch facility is located at 1509 East Reelfoot Avenue in Union City, Tennessee.

The annex building of the Main Bank is being converted into a new Information Technology and Operations Center and is expected to be completed and opened during second quarter 2006.

FORWARD-LOOKING STATEMENTS

Quarterly reports on Form 10-Q (and 10-Q/A), 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 loan 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

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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 that are 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.

RESULTS OF OPERATIONS

In first quarter 2006, Bancshares continues the trend of strong and stable financial performance and asset growth. Such success is reflected in key performance ratios for the past five years are as follows:

| | <u>AS OF MARCH 31,</u> | | | | |
|--|------------------------|-------------|-------------|-------------|-------------|
| | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> |
| Percentage of Net Income to: | | | | | |
| Average Total Assets | 1.06% | 1.08% | 1.09% | 1.15% | 1.28% |
| Average Shareholders' Equity | 13.55% | 13.43% | 13.51% | 14.54% | 14.08% |
| Percentage of Dividends Declared Per Common Share to Net | | | | | |
| Income | 48.59% | 49.12% | 52.00% | 49.94% | 54.04% |
| *Percentage of Average Shareholders' Equity to Average | | | | | |
| Total Assets | 8.63% | 8.86% | 8.03% | 8.77% | 9.34% |

* Represents primary capital including the allowance for loan losses.

Earnings per share increased \$0.03 or 5.26% when comparing the first quarters of 2006 and 2005. 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 \$515 thousand or 8.09%, when comparing first quarter of 2006 to first quarter 2005. The net yield on average earning assets for the first quarters of 2006 and 2005 is flat. The flat net interest margin is a result of the current rate environment, the bank's slightly asset sensitive interest rate risk position and higher growth rate in deposits over loans when comparing first quarters 2006 and 2005.

Beginning in late June 2004, the Federal Open Market Committee (FOMC) began removing accommodative monetary conditions through consistent 25 basis point increases in federal funds rates. From June 2004 to March 2005, federal funds rates increased fifteen straight times from 1.00% to 4.75%. In response to these increases, the behavior of the yield curve negatively impacted net interest margins. During this rising rate environment, markets demanded higher rates for deposits and short-term funding compared to lagging increases in loan and investment yields. From first quarter 2005 to first quarter 2006, cost of total interest bearing liabilities increased 80 basis points while the yield on interest-earning assets increased 69 basis points. Although the yield curve remains relatively flat as of first quarter end 2006, the yields on the 2-year and 10-year treasury notes increased approximately 50 basis points from year end 2005. The impact of the increase in 10-year yields is positively impacting the Bank's taxable investment yields, which

are up about 65 basis points compared to first quarter 2005.

The current rising rate environment coupled with competition slowed annual loan growth in 2005 to approximately three percent compared to loan growth rates of eight to ten percent enjoyed in years 2003 and 2004. Loans grew by \$7 million or approximately 1.2% (annualized 5%) during first quarter 2006, which is improved from the 2005 loan growth rate but is somewhat below the anticipated growth range of 6% to 8%. Loan growth is expected to increase primarily in second and third quarters due to funding of construction and agriculture loans.

Total deposits increased by \$23 million or 3.63% (annualized 14.5%) during first quarter 2006. Approximately 60 percent or \$14 million of this growth was in time deposits and is attributable to successful strategies to attract depositors in the new Collierville market. Seasonality of municipal deposits also contributed to the overall increase. Average interest-bearing deposits in first quarter 2006 compared to the period in 2005 reflect an increase of approximately \$45 million or 8 percent.

Per the Uniform Bank Performance Report, net interest income as a percent of average total assets was 3.61% compared to peer at 3.96% for the year ended December 31, 2005. Review of individual components of net interest income reveal that the Bank's investment portfolio has higher yields than peer and their cost of deposits are less than peer while peer banks have higher loan yields and lower costs on other borrowed money. Yield on total loans was 6.83% compared to peer at 6.92% at year-end 2005. Investment yields are above peer at 4.64% compared to peer at 4.21%. Cost of deposits was 2.17% compared to peer at 2.26% and cost of other borrowed money was 4.99% compared to 3.41%. 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 each quarter in 2005 as the cost of borrowings at peer banks increased while the Bank's other borrowings cost remained flat.

Another major factor impacting peer comparisons of net interest margins is the dilution caused by significant investments in fixed assets and Bank-owned life insurance (BOLI) policies, which total approximately \$45 million or 5% of total assets as of March 31, 2006. The statement of cash flows reflects fixed assets purchases of \$1.5 million during first quarter 2006. Earnings on BOLI policies are included in other non-interest income and totaled approximately \$175,000 for first quarter 2006.

The loan loss provision for first quarter 2006 decreased \$18 thousand or 7% compared to first quarter 2005. First quarter net charge-offs for 2006 and 2005 were \$36 thousand and \$87 thousand, respectively. Reserve for losses on loans as a percent of total loans was 1.27% at March 2006 and 1.20% at March 2005. The reserve as a percent of total loans increased 0.02% from 1.25% at year-end 2005. See also Loan section below.

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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 1.38% compared to peer of 0.88% as of year-end 2005. Non-interest income was flat when comparing the first quarters 2006 and 2005. In first quarter of 2006, fee income (non-interest income) contributed 17.39% to total revenue compared to 20.24% for the same period last year. Brokerage fees and service charges on deposits combined are approximately \$100,000 more than prior year. Also, losses of approximately \$30, which occurred in first quarter 2005, were not duplicated in first quarter 2006. These positive variances are almost completely offset by negative variance in other income related to the litigation settlement that occurred in first quarter 2005 at the 50% owned full service insurance subsidiary. In 2004, First Citizens/White and Associates Insurance Company, LLC brought suit to protect certain rights and earnings in 2004 were down due to related legal fees incurred. Settlement of the subsidiary's litigation occurred early in 2005 in favor of the subsidiary. First Citizens' portion of the gain of approximately \$150,000 was recorded in first quarter of 2005. Excluding settlement of the litigation, income received from White and Associates/First Citizens insurance subsidiary for first quarter 2006 increased \$25,000 from first quarter 2005. The following table compares non-interest

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income for first quarter of 2006, 2005 and 2004:

QUARTER ENDING MARCH 31,
% of % of

| | <u>2006</u> |
|-------------------------------------|-------------|
| <u>Change</u> | |
| | <u>2005</u> |
| <u>Change</u> | |
| | <u>2004</u> |
| Income from fiduciary activities | \$ 185 |
| | 1.09% |
| | \$ 183 |
| | -3.17% |
| | \$ 189 |
| Service charges on deposit accounts | 1,400 |

| | |
|---------------------------------------|--------|
| | 4.17% |
| | 1,344 |
| | 9.98% |
| | 1,222 |
| Brokerage fees | |
| | 413 |
| | 11.32% |
| | 371 |
| | 20.45% |
| | 308 |
| Earnings on bank owned life insurance | |
| | 175 |
| | 8.70% |
| | 161 |
| | -1.23% |
| | 14 |

| | |
|---------------------------|----------|
| | 163 |
| Other income | |
| | 425 |
| | -21.30% |
| | 540 |
| | -4.42% |
| | 565 |
| Total non-interest income | |
| | \$ 2,598 |
| | -0.04% |
| | \$ 2,599 |
| | 6.21% |
| | \$ 2,447 |

Non-interest expenses represent the operating expenses of First Citizens. Non-interest expense increased \$454 thousand, or 7.54%, over first quarter of 2005. Salary and benefits increased approximately \$268 thousand or 7.51%. Average full-time equivalent employees are 266.89 for three months ended March 31, 2006 compared to 257.42 and 250.72 for three months ended March 31, 2005 and 2004, respectively. Bancshares' growth strategies over the last few years also impact certain other sectors of the non-interest expense areas such as net occupancy and depreciation, which increased approximately 10% over prior year's first quarter. The efficiency ratio as of March 31, 2006, 2005 and 2004 was 66.67%, 65.53%, and 63.23%, respectively. Impaired Goodwill expense is \$0 for the current and prior

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reportable periods. The core deposit intangible expense for the current reportable quarter was flat at \$21,000. Quarter-to-date advertising, community relations, and other forms of marketing expenses were \$161 thousand or 2.5% of other non-interest expense in first quarter 2006 compared to \$117 thousand or 1.94% of total non-interest expense in 2005. The majority of this increase is due to increased advertising and promotional efforts in the Collierville market. All marketing or advertising items are expensed at the time they are incurred.

The following table compares non-interest expense for first quarter of 2006, 2005 and 2004:

| | QUARTER ENDING MARCH 31, | |
|--------------------------------|--------------------------|-------------|
| | % of | % of |
| | | <u>2006</u> |
| | <u>Change</u> | |
| | | <u>2005</u> |
| | <u>Change</u> | |
| | | <u>2004</u> |
| Salaries and employee benefits | | \$ 3,836 |
| | | 7.51% |
| | | \$ 3,568 |
| | | 7.96% |
| | | \$ 3,305 |
| Net occupancy expense | | |

| | |
|-------------------------|--------|
| | 445 |
| | 9.88% |
| | 405 |
| | 2.53% |
| | 395 |
| Depreciation | 482 |
| | 8.80% |
| | 443 |
| | 18.45% |
| | 374 |
| Data processing expense | 183 |
| | 10.24% |
| | 166 |
| | 17 |

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| | |
|--------------------------------|---------|
| | 0.61% |
| | 165 |
| Legal and professional fees | 27 |
| | -34.15% |
| | 41 |
| | 64.00% |
| | 25 |
| Stationary and office supplies | 61 |
| | -11.59% |
| | 69 |
| | -12.66% |
| | 79 |
| Amortization of intangibles | 21 |
| | 18 |

| | |
|----------------------------|--------|
| | 0.00% |
| | 21 |
| | -4.55% |
| | 22 |
| Advertising and promotions | 161 |
| | 37.61% |
| | 117 |
| | 1.74% |
| | 115 |
| Other expenses | 1,261 |
| | 5.70% |
| | 1,193 |
| | 5.11% |
| | 19 |

1,135

Total non-interest expense

\$ 6,477

7.54%

\$ 6,023

7.27%

\$ 5,615

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

| | QUARTER ENDING MARCH | | | | | | | | |
|-----------------------------|----------------------|------------|-----------------|--------------------|-----------|-----------------|--------------------|-----------|-----------------|
| | 31. | | | 31. | | | 31. | | |
| | 2006 | | | 2005 | | | 2004 | | |
| | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate |
| ASSETS | | | | | | | | | |
| INTEREST EARNING | | | | | | | | | |
| ASSETS: | | | | | | | | | |
| Loans (1) (2) (3) | \$ 547,727 | \$ 10,187 | 7.44% | \$ 528,272 | \$ 8,713 | 6.60% | \$ 491,475 | \$ 8,063 | 6.56% |
| Investment Securities: | | | | | | | | | |
| Taxable | 128,906 | 1,306 | 4.05% | 111,103 | 944 | 3.40% | 118,132 | 940 | 3.18% |
| Tax Exempt (4) | 41,503 | 653 | 6.29% | 40,419 | 627 | 6.21% | 37,753 | 490 | 5.19% |
| Interest Earning Deposits | 726 | 7 | 3.86% | 684 | 4 | 2.34% | 609 | 1 | 0.66% |
| Federal Funds Sold | <u>32,165</u> | <u>311</u> | <u>3.87%</u> | <u>17,293</u> | <u>89</u> | <u>2.06%</u> | <u>6,098</u> | <u>25</u> | <u>1.64%</u> |
| Total Interest Earning | \$ 751,027 | \$ 12,464 | 6.64% | \$ 697,771 | \$ 10,377 | 5.95% | \$ 654,067 | \$ 9,519 | 5.82% |
| Assets | | | | | | | | | |
| NON-INTEREST EARNING | | | | | | | | | |
| ASSETS: | | | | | | | | | |
| Cash and Due From Banks | \$ 15,670 | | | \$ 18,954 | | | \$ 15,825 | | |
| Bank Premises and Equipment | 28,361 | | | 25,065 | | | 21,909 | | |
| Other Assets | <u>37,774</u> | | | <u>35,932</u> | | | <u>37,043</u> | | |
| TOTAL ASSETS | <u>\$ 832,832</u> | | | <u>\$ 777,722</u> | | | <u>\$ 728,844</u> | | |
| ===== | | | | | | | | | |
| LIABILITIES AND | | | | | | | | | |
| SHAREHOLDERS' EQUITY | | | | | | | | | |
| INTEREST BEARING | | | | | | | | | |
| LIABILITIES: | | | | | | | | | |
| Interest bearing deposits | \$ 564,796 | \$ 4,125 | 2.92% | \$ 520,189 | \$ 2,694 | 2.07% | \$ 490,919 | \$ 2,069 | 1.69% |

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| | | | | | | | | | |
|-----------------------------|----------------|--------------|--------------|----------------|--------------|--------------|----------------|--------------|--------------|
| Federal Funds Purchased and | | | | | | | | | |
| Other Interest Bearing | <u>113,645</u> | <u>1,342</u> | <u>4.72%</u> | <u>121,901</u> | <u>1,186</u> | <u>3.89%</u> | <u>105,801</u> | <u>1,082</u> | <u>4.09%</u> |
| Liabilities | | | | | | | | | |
| TOTAL INTEREST BEARING | 678,441 | 5,467 | 3.22% | 642,090 | 3,880 | 2.42% | 596,720 | 3,151 | 2.11% |
| LIABILITIES | | | | | | | | | |
| NON-INTEREST BEARING | | | | | | | | | |
| LIABILITIES: | | | | | | | | | |
| Demand Deposits | 85,642 | | | 68,725 | | | 68,808 | | |
| Other Liabilities | <u>3,833</u> | | | <u>4,391</u> | | | <u>4,760</u> | | |
| TOTAL LIABILITIES | 767,916 | | | 715,206 | | | 670,288 | | |
| SHAREHOLDERS' EQUITY | <u>64,916</u> | | | <u>62,516</u> | | | <u>58,556</u> | | |
| TOTAL LIABILITIES AND | | | | | | | | | |
| SHAREHOLDERS' EQUITY | \$ 832,832 | | | \$ 777,722 | | | \$ 728,844 | | |
| | ===== | | | ===== | | | ===== | | |
| NET INTEREST INCOME | | \$ 6,997 | | | \$ 6,497 | | | \$ 6,368 | |
| | | ===== | | | ===== | | | ===== | |
| NET YIELD ON AVERAGE | | | | | | | | | |
| EARNING | | | 3.73% | | | 3.72% | | | 3.89% |
| ASSETS (ANNUALIZED) | | | | | | | | | |

(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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LOANS

The following table sets forth loan totals net of unearned income by category for the past five years:

| | <u>AS OF MARCH 31,</u> | | | | |
|--|------------------------|--------------|--------------|--------------|--------------|
| | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> |
| Real Estate: | | | | | |
| Construction | \$ 83,423 | \$ 104,460 | \$ 78,373 | \$ 68,872 | \$ 36,167 |
| Mortgage* | 350,230 | 320,675 | 314,409 | 284,051 | 229,665 |
| Commercial, financial and agricultural | 79,156 | 62,754 | 73,118 | 73,079 | 59,468 |
| Consumer installment | 37,592 | 37,643 | 37,754 | 38,847 | 39,440 |
| Other | <u>6,546</u> | <u>4,297</u> | <u>3,432</u> | <u>3,644</u> | <u>1,452</u> |
| Total loans | \$ 556,947 | \$ 529,829 | \$ 507,086 | \$ 468,493 | \$ 366,192 |
| | ===== | ===== | ===== | ===== | ===== |

*Mortgage loans include loans held for sale in the secondary mortgage market. Balances are \$2.9 million, \$2.5 million, \$3.1 million, \$3.8 million, and \$1.3 million for 2006, 2005, 2004, 2003 and 2002, respectively.

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

| | <u>AS OF MARCH 31,</u> | | | | |
|-----------------------------------|------------------------|-------------|-------------|--------------|--------------|
| | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> |
| Non-performing loans: | | | | | |
| Non-accrual | \$ 1,386 | \$ 1,310 | \$ 1,015 | \$ 2,065 | \$ 407 |
| 90 day past due accruing interest | <u>2,213</u> | <u>907</u> | <u>238</u> | <u>1,512</u> | <u>2,070</u> |
| Total loans | \$ 3,599 | \$ 2,217 | \$ 1,253 | \$ 3,577 | \$ 2,477 |

One of Bancshares' primary objectives is to seek quality-lending opportunities in West Tennessee. The majority of First Citizens' borrowers lives and conducts business in West Tennessee. Total loans increased approximately 1.2% during first quarter of 2006. Volume is expected to grow during second quarter and third quarters 2006 due to advances on agricultural production lines and construction loans. Real estate loans grew 2.0% or \$8.5 million when comparing March 2006 to March 2005 and the growth is primarily due to the Southwest market consisting of Shelby, Tipton and Fayette Counties, Tennessee. The unemployment rate for Tennessee is 5.4% as of March 2006 compared to 5.9% as of March 2005 and 5.4% as of December 2005. Cash flows reflect moderate loan growth at \$6.9 million versus \$1.5 million in first quarter 2005. The aggregate amount of loans the company is permitted to make under applicable bank regulations to any one borrower is 15% of unimpaired capital. First Citizens National Bank's legal lending limit at March 31, 2006 was \$10.8 million. Non-performing loans at quarter end were 0.65% of total loans. Weighted average loan yields increased 84 basis points from first quarter 2005 to first quarter 2006. Loan rates have increased in the rising rate environment over the last 24 months but the cost of deposits and other short-term funding has also increased resulting in a steady but flat net interest margin.

AGRICULTURAL LOANS

First Citizens is one of the largest agriculture lenders in the State of Tennessee and is an approved Farm Credit Services lender. Agriculture makes a significant contribution to Dyer County commerce, generating approximately \$75-\$85 million in revenue on an annual basis. Agricultural credits secured by farmland and other types of collateral comprise approximately \$55 million of total loans as of March 31, 2006 and \$47 million as of March 31, 2005. Recoveries, net of charge-offs in this category were \$10 thousand for first quarter of 2006.

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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 1.27% for the current quarter and 1.25% at year-end 2005. A recap of activity posted to the Reserve account in current quarter resulted in the following transactions: (1) loans charged-off (\$124,000) (2) recovery of loans previously charged off \$88,000 and (3) additions to reserve \$233,000. The provision for loan losses decreased \$18,000 when compared to the same time period in 2005.

The ratio of net charged off loans to average net loans outstanding was 0.01% during first quarters 2005 and 2006. Non-performing loans as of current quarter end have increased approximately \$1.3 million from March 2005. Despite an increase from prior year and slightly above the non-performing averages over the last few years, 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. Although historical experience suggests that an increase in non-performing assets and charge-offs would be likely given that interest rates have increased continuously over the last two years and given the current increases in fuel and energy costs, First Citizens does not expect a material negative trend in non-performing assets especially given that non-performing assets and charge-offs have been extremely low the last three years coupled with the current level of reserve at 1.27% of loans as of current quarter end. 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.

LIQUIDITY

Liquidity is managed to ensure there is ample funding to satisfy loan demand, investment opportunities, and large deposit withdrawals. Bancshares primary funding sources include customer core deposits, FHLB Borrowings, other

borrowings, and correspondent borrowings. Customer based sources accounted for 85% of the funding as of the current quarter end and 83% for the same period last year. Borrowed funds from the FHLB amounted to 8.3% of total funding as of March 31, 2006 and 9.9% of total funding as of March 31, 2005. The FHLB line of credit was \$100 million with \$11 million available at current quarter end. The Company has \$23 million in deposit funds from the State of Tennessee. First Citizens National Bank has approximately \$30 million of brokered certificate of deposits comprising 4.6% of total deposits.

The bank's current liquidity position has improved since year-end 2005 due to increase of deposits totaling approximately \$23 million. Increases in assets resulting from deposit growth consist of \$8 million increase in federal funds sold, \$5 million additional investment in available-for-sale securities, \$7 million net increase in loans and \$1.5 million investment in premises and equipment. Long-term debt has also been reduced by \$1.4 million and consists primarily of a call on \$1 million FHLB advance and \$300,000 reduction in Bancshares' line of credit at First Tennessee Bank.

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 \$11 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.

INVESTMENT SECURITIES

Investment securities are primarily held in the bank's subsidiary, First Citizens Investments, Inc. and in its subsidiary, First Citizens Holdings, Inc. The bank has a portfolio advisory agreement with FTN Financial to manage the investment portfolio. Peer data per the December 31, 2005 Uniform Bank Performance Report indicates that our yields on investments exceed peer at 4.64% compared to 4.21% peer. Quarterly average rates for taxable and tax-exempt securities for the current quarter end have increased 65 and 9 basis points, respectively, over prior year's first quarter. The investment portfolio is heavily weighted in mortgage-related securities, which account for approximately 50% of the total portfolio. Bancshares' goal is to steadily improve the investment portfolio without taking on material risk.

Pledged investments reflect a market value of approximately \$120 million as of the current reportable period.

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

| | <u>AS OF MARCH 31,</u> | | | | |
|-------------------------------------|------------------------|---------------|--------------|--------------|--------------|
| | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> |
| U.S. Treasury & Government Agencies | \$ 117,202 | \$ 95,449 | \$ 111,510 | \$ 105,561 | \$ 77,409 |
| State & Political Subdivisions | 41,581 | 40,949 | 36,098 | 35,452 | 18,863 |
| All Others* | <u>13,505</u> | <u>13,333</u> | <u>7,988</u> | <u>7,893</u> | <u>9,274</u> |
| TOTALS | \$ 172,288 | \$ 149,731 | \$ 155,596 | \$ 148,906 | \$ 105,546 |
| | ===== | ===== | ===== | ===== | ===== |

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

Investments are classified according to intent under generally accepted accounting principles. There are no securities classified in the trading category for any period presented in this report. Amortized cost and fair market value of securities by intent as of March 31, 2006 are as follows:

| | <u>Held to Maturity</u> | | <u>Available for Sale</u> | |
|--|-------------------------|---------------|---------------------------|-------------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| U.S. Treasury Securities | \$ 0 | \$ 0 | \$ 2,696 | \$ 2,669 |
| U.S. Government agency & Corporation Obligations | 0 | 0 | 117,543 | 114,533 |
| Securities Issued by States & Political Subdivision in the U.S.: | | | | |
| Taxable Securities | 0 | 0 | 0 | 0 |
| Tax-Exempt Securities | 785 | 804 | 39,490 | 40,796 |
| U.S. Securities: | | | | |
| Debt Securities | 0 | 0 | 6,331 | 6,519 |
| Equity Securities* | 0 | 0 | 7,146 | 6,986 |
| Foreign Securities: | | | | |
| Debt Securities | N/A | N/A | N/A | N/A |
| Equity Securities | N/A | N/A | N/A | N/A |
| Total | \$ 785 | \$ 804 | \$ 173,206 | \$ 171,503 |
| | ===== | ===== | ===== | ===== |

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

Accumulated other comprehensive income reflects unrealized gain (loss) on securities, net of tax. During first quarter 2006, gross unrealized gain (loss) on securities decreased approximately \$430 thousand due to the current rising interest rate environment and flattened yield curve and its impact on 10-year Treasury rate. Market value of the investment portfolio is heavily influenced by 10-year Treasury benchmark due to the volumes of U. S. Government Treasury and Agency securities (including mortgage-related investments) that comprise the portfolio. The 10-year Treasury rate was in the range of 4.8% to 4.9% as of March 31, 2006 compared to 4.5 - 4.6% in March 2005. Accumulated other comprehensive income for the current quarter, net of tax, was a loss of approximately \$1 million. The decrease in market value of the portfolio is due entirely to the current interest rate environment and does not relate to quality of the issuer or the issuer's 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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CAPITAL RESOURCES

Management of the equity section in a highly regulated environment requires a balance between leveraging and return on equity while maintaining adequate capital amounts and ratios. Total capital on March 31, 2006 was \$64.5 million, up 1.42% from \$63.6 million on December 31, 2005. The increase in capital was from undistributed income from the Bank and its subsidiaries. Bancshares has historically maintained capital in excess of minimum levels established by the Federal Reserve Board. Total risk-based capital ratio as of March 31, 2006 was 12.35%, significantly in excess of the 8% mandated by Regulatory Authorities. Capital as a percentage of total assets for the quarter ending March 31, is presented in the following table for the years indicated (excluding loan loss reserves):

| | <u>AS OF MARCH</u> | | | |
|-------------|--------------------|-------------|-------------|-------------|
| | <u>31,</u> | | | |
| <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> |

7.70%

7.86%

8.06%

7.98%

9.30%

The dividend payout ratio was 48.6% for the current period versus 49.12% and 51.95% for first quarter 2005 and 2004, respectively. We anticipate the dividend payout ratio to end the year in the range of 48-50%. Dividends per share were increased from \$0.28 per quarter in 2004 and 2005 to \$0.29 for first quarter 2006. Bancshares has re-purchased approximately 500 shares of its own stock in the open market since December 31, 2005. Stock repurchase average price for first quarter 2006 was \$33.00 per share. Bancshares has no formal plans or programs in place to repurchase common stock as it pursues its current strategy to reduce outstanding debt on the revolving line of credit.

RECENTLY ISSUED ACCOUNTING STANDARDS

During first quarter 2006, the Financial Accounting Standards Board (FASB) issued the following Statements of Financial Accounting Standards (SFAS):

- ◆ SFAS No. 155 Accounting for Certain Hybrid Financial Instruments-an amendment of SFAS No. 133 and 140
- ◆ SFAS No. 156 Accounting for Servicing of Financial Assets-an amendment of SFAS No. 140

Both statements become effective at the beginning of the first fiscal year that begins after September 15, 2006. These two statements will not materially affect the consolidated financial statements of Bancshares or its subsidiaries.

INTEREST RATE RISK

The bank maintains a formal asset and liability management process to quantify, monitor and control interest rate risk. The Asset/Liability 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.

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 increase earnings and reduce interest rate risk. The cash flow hedge has produced a positive income, but because the bank swapped a fixed cash flow for a variable cash flow and rates have declined the value of the derivative has decreased since inception through 2004. The value of the derivative has improved in the rising rate environment over the last two 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.

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, 2005 Form 10-K. The trend of increasing interest rates that began in late June 2004 continues into 2006 with Federal Funds rate of 4.75% as of current quarter end compared to 1.00% as of June 30, 2004. The effects of the rising rate environment are discussed throughout Item 2 - Management's Discussion and Analysis including the following sections: Results of Operations, Loans, Liquidity, and Interest Rate Risk. The analysis included in the December 31, 2005 Form 10-K included scenarios for a rising rate environment. Actual results for the year ended December 31, 2006 will differ from simulations due to timing, magnitude, and frequency of interest rate changes, market conditions and management strategies.

ITEM 4 - CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

An evaluation of the effectiveness of the design and operation of disclosure controls and procedures was performed as of March 31, 2006 under the supervision and with the participation of Management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation, Management including the Chief Executive Officer and Chief Financial Officer, concluded that disclosure controls and procedures were designed and operating effectively as of March 31, 2006.

Changes in Internal Control over Financial Reporting

There have been no material changes in internal control over financial reporting during the quarter ended March 31, 2006 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 2005 to first quarter end 2006. See December 31, 2005 Annual Report Form 10-K for in depth discussion on 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

SIGNATURES

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

First Citizens Bancshares, Inc.
(Registrant)

Date: May 9, 2006

/s/ KATIE WINCHESTER
Chief Executive Officer & Chairman
First Citizens National Bank
(Principal Subsidiary)

Date: May 9, 2006

/s/ LAURA BETH BUTLER
Senior Vice President &
Chief Financial Officer
First Citizens National Bank
(Principal Subsidiary)