

FIRST CITIZENS BANCSHARES INC /TN/
Form 10-Q
November 12, 2003

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 SEPTEMBER 30, 2003
- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 2-83542 CIK Number 0000719264

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.)

One First Citizens Place
Dyersburg, Tennessee 38024
www.firstcitizens-bank.com

(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 check mark whether the registrant is an accelerated filer (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 3,655,768 shares outstanding as of September 30, 2003 (Net of Treasury).

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

FIRST CITIZENS BANCSHARES, INC.
AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET
(Stated in Thousands)

	September 30 2003	December 31 2002 (unaudited)	September 30 2002
ASSETS			
Cash and due from banks	\$ 17,058	\$ 21,290	\$ 19,168
Federal funds sold	9,726	26,393	15,826
Investment securities			
Trading investments - stated at market	--	--	--
Held to maturity - amortized cost - fair value of \$1,083 at			
September 30, 2003, \$1,473 at	1,045	1,190	2,502
December 31, 2002 and \$2,567 at			
September 30, 2002.			
Available-for-sale, stated at market	144,583	141,682	141,939
Loans (excluding unearned income of \$140 at September 30, 2003, \$1,473 at December 31, 2002 and \$1,539 at September 30, 2002)	491,404	453,480	453,428
Less: Allowance for loan losses	<u>6,107</u>	<u>5,653</u>	<u>5,435</u>
Net Loans	485,297	447,827	447,993
Premises and equipment	20,790	17,866	17,847
Goodwill	12,218	12,417	12,545
Other Intangible Assets	732	844	866
Other real estate	1,125	1,781	2,289
Other assets	<u>25,304</u>	<u>22,908</u>	<u>18,326</u>
TOTAL ASSETS	\$ 717,878 =====	\$ 694,198 =====	\$ 679,301 =====
LIABILITIES AND STOCKHOLDERS EQUITY			
Deposits			
Demand	\$ 65,350	\$ 61,535	\$ 56,501

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Time	316,096	312,885	219,876
Savings	172,265	157,222	230,095
Total Deposits	553,711	531,642	506,472
Securities sold under agreements to repurchase	18,553	18,444	18,578
Federal funds purchased & other short-term borrowings	--	--	10,300
Long term debt	83,655	83,881	83,894
Notes payable of Employee Stock Ownership Plan	--	--	--
Other liabilities	<u>5,415</u>	<u>5,630</u>	<u>6,137</u>
TOTAL LIABILITIES	<u>\$ 661,334</u>	<u>\$ 639,597</u>	<u>\$ 625,381</u>

Stockholders' Equity

Common stock, No par value - 10,000,000 authorized; 3,717,593 issued and outstanding at September 30, 2003, 3,717,593 issued and outstanding at December 31, 2002, and 3,717,593 at September 30, 2002.	3,718	3,718	3,718
Surplus	15,331	15,299	15,300
Retained earnings	37,881	35,174	33,930
Obligation of Employee Stock Ownership Plan	--	--	--
Accumulated other comprehensive income	<u>1,068</u>	<u>1,681</u>	<u>2,198</u>
Total Common Stock and Retained Earnings	57,998	55,872	55,146
Less: 61,825 treasury shares, at cost at September 30, 2003, 56,357 shares at cost at December 31, 2002, and 54,653 at September 30, 2002.	(1,454)	(1,271)	(1,226)
TOTAL STOCKHOLDERS' EQUITY	<u>\$ 56,544</u>	<u>\$ 54,601</u>	<u>\$ 53,920</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 717,878</u>	<u>\$ 694,198</u>	<u>\$ 679,301</u>

See accompanying notes to consolidated financial statements.

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FIRST CITIZENS BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(STATED IN THOUSANDS)

	<u>Three Months Ended September 30</u>		<u>Nine Months Ended September 30</u>	
	2003	2002	2003	2002
Balance January 1	\$ 56,326	\$ 52,553	\$ 54,601	\$ 49,809
Net Income	2,047	2,129	5,668	5,639
Other comprehensive income:				
Changes in Available for Sale Investments	(884)	528	(636)	1,779
Changes in Derivatives	<u>94</u>	<u>(140)</u>	<u>23</u>	<u>(143)</u>

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Comprehensive Income	1,257	2,517	5,055	7,275
Cash dividend declared	(987)	(953)	(2,962)	(2,862)
Common stock issued	--	--	--	--
Common stock repurchased	(52)	(197)	(150)	(302)
Employee stock obligation	--	--	--	--
Balance Ending Period	\$ 56,544	\$ 53,920	\$ 56,544	\$ 53,920
	=====	=====	=====	=====

FIRST CITIZENS BANCSHARES, INC.
AND SUBSIDIARY
CONSOLIDATED STATEMENT OF INCOME (UNAUDITED)
(STATED IN THOUSANDS EXCEPT E.P.S. AND SHARES OUTSTANDING)

	<u>Three Months Ended September 30</u>		<u>Nine Months Ended September 30</u>	
	2003	2002	2003	2002
INTEREST INCOME				
Interest and fees on loans	\$ 8,606	\$ 8,757	\$ 25,885	\$ 23,960
Interest and dividend on investment securities:				
Taxable	672	1,217	2,508	3,385
Tax-exempt	409	438	1,218	914
Dividends	68	64	205	189
Other interest income - Federal funds sold	21	49	109	167
Other interest income - Checking	1	4	5	22
Lease financing income	--	--	--	--
Total Interest Income	<u>9,777</u>	<u>10,529</u>	<u>29,930</u>	<u>28,637</u>
INTEREST EXPENSE				
Interest on deposits	2,301	2,791	7,423	7,623
Other interest expense	<u>1,111</u>	<u>1,279</u>	<u>3,430</u>	<u>3,130</u>
Total Interest Expense	<u>3,412</u>	<u>4,070</u>	<u>10,853</u>	<u>10,753</u>
Net Interest Income	6,365	6,459	19,077	17,884
Provision for Loan Losses	<u>280</u>	<u>404</u>	<u>859</u>	<u>1,150</u>
Net Interest Income after Provision	6,085	6,055	18,218	16,734
OTHER INCOME				
Income from fiduciary activities	201	172	510	494
Service charges on deposit accounts	1,298	1,001	3,601	2,510
Brokerage fees	281	217	619	657
Securities gains (losses)	--	27	20	128
Other income	<u>668</u>	<u>431</u>	<u>1,679</u>	<u>1,481</u>
Total Other Income	2,448	1,848	6,429	5,270
OTHER EXPENSES				
Salaries and employee benefits	3,119	2,844	9,217	7,801
Net occupancy expense	350	295	1,194	851
Depreciation	345	339	1,032	985
Data processing expense	237	160	630	487
Legal and professional expense	19	40	42	142
Stationery and office supplies	84	66	253	181
Amortization of intangibles	29	10	66	20
Executive payouts	--	--	--	--
Other expenses	<u>1,467</u>	<u>1,125</u>	<u>4,066</u>	<u>3,449</u>
Total Other Expenses	5,650	4,879	16,500	13,916
Net income before income taxes	2,883	3,024	8,147	8,088
Taxes	<u>836</u>	<u>895</u>	<u>2,479</u>	<u>2,449</u>
Net income	\$ 2,047	\$ 2,129	\$ 5,668	\$ 5,639
	=====	=====	=====	=====
Earnings per share	\$ 0.56	\$ 0.58	\$ 1.55	\$ 1.54
	3,657,608	3,665,664	3,659,727	3,669,800

Weighted average number of shares
outstanding

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PERIODS PRESENTED FIRST CITIZENS
BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
STATED IN (\$000) EXCEPT EPS AND SHARES OUTSTANDING

	<u>Three Months Ended September 30</u>		<u>Nine Months Ended September 30</u>	
	2003	2002	2003	2002
INTEREST INCOME				
Interest and fees on loans	\$ 8,606	\$ 8,757	\$ 25,885	\$ 26,150
Interest and dividend on investment securities:				
Taxable	672	1,217	2,508	3,795
Tax-exempt	409	438	1,218	1,234
Dividends	68	64	205	189
Other interest income - Federal funds sold	21	49	109	217
Interest Bearing Checking	1	4	5	22
Lease financing income	<u> --</u>	<u> --</u>	<u> --</u>	<u> --</u>
Total Interest Income	9,777	10,529	29,930	31,607
INTEREST EXPENSE				
Interest on deposits	2,301	2,791	7,423	8,658
Other interest expense	<u>1,111</u>	<u>1,279</u>	<u>3,430</u>	<u>3,449</u>
Total Interest Expense	<u>3,412</u>	<u>4,070</u>	<u>10,853</u>	<u>12,107</u>
Net Interest Income	6,365	6,459	19,077	19,500
Provision for Loan Losses	<u>280</u>	<u>404</u>	<u>859</u>	<u>1,150</u>
Net Interest Income after Provision	6,085	6,055	18,218	18,350
Total Other Income	2,448	1,848	6,429	5,630
Total Other Expenses	5,650	4,879	16,500	15,231
Net income before income taxes	2,883	3,024	8,147	8,749
Taxes	<u>836</u>	<u>895</u>	<u>2,479</u>	<u>2,714</u>
Net income	\$ 2,047	\$ 2,129	\$ 5,668	\$ 6,035
	=====	=====	=====	=====
Earnings per share	\$ 0.56	\$ 0.58	\$ 1.55	\$ 1.64
Weighted average number of shares outstanding	3,657,608	3,665,664	3,659,727	3,669,800

See accompanying notes to consolidated financial statements.

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FIRST CITIZENS BANCSHARES, INC.
AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED, STATED IN THOUSANDS)

	<u>Nine Months Ended September 30,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
OPERATING ACTIVITIES			
Net cash provided by operating activities	\$ 6,328	\$ 8,924	\$ 5,941

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INVESTING ACTIVITIES

Proceeds of maturities of held to maturity securities	145	113	13,059
Purchase of held to maturity securities	--	--	--
Proceeds from maturities of available for sale securities	60,923	46,923	70,708
Proceeds from sales of available for sale securities	1,477	10,482	5,500
Purchase of available for sale securities	(66,323)	(64,029)	(82,132)
Increase in loans - net	(38,329)	(12,984)	(32,414)
Payment for purchase of Bank of Troy - net of cash acquired	--	(10,283)	--
Purchase of premises and equipment	(3,959)	(973)	(1,667)
Net Cash provided by investing activities	(46,066)	(30,751)	(26,946)

FINANCING ACTIVITIES

Net Increase (Decrease) in Demand and Savings Accounts	18,858	6,267	3,138
Increase (Decrease) in Time Accounts	3,211	(4,245)	21,090
Increase (Decrease) in Long term Debt	(226)	16,161	11,736
Treasury Stock Transactions	(151)	(305)	(459)
Proceeds from Sale of Common Stock	--	--	--
Cash Dividends Paid	(2,962)	(2,862)	(2,782)
Net Increase (Decrease) in Short Term Borrowings	109	10,622	(9,929)
Net Cash provided (used) by Financing Activities	18,839	25,638	22,794
Increase (Decrease) in Cash and Cash Equivalents	(20,899)	3,811	1,789
Cash and Cash Equivalents at beginning of year	47,683	31,183	23,927
Cash and Cash Equivalents at end of year	26,784	34,994	25,716

Cash Payments made for interest and income taxes during the years presented are as follows:

<u>2003</u>	<u>2002</u>	<u>2001</u>
-------------	-------------	-------------

Interest	11,634	11,798	15,627
Income Taxes	3,748	2,277	1,284
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FIRST CITIZENS BANCSHARES, INC.,
AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED, STATED IN THOUSANDS)
SEPTEMBER 30, 2003

NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS

The consolidated balance sheet as of September 30, 2003, the consolidated statements of income for the nine month periods ended September 30, 2003, 2002 and 2001, and the consolidated statements of cash flows for the nine months 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 generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the financial position, results of operations and cash flows at September 30, 2003 and for all periods presented have been made. Operating results for the reporting periods presented are not necessarily indicative of the results that may be expected for the year ended December 31, 2003. 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, 2002.

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

FASB 114 and 118 were implemented during first quarter of 1995. This new FASB requires companies to set aside reserves for impaired loans.

The following data reflects impaired and probable loss loan totals:

	Balance
Amount of recorded balance with a related allowance	\$ 1,029
Amount of recorded balance with no related allowance	<u>971</u>
Impaired loan balance or recorded balance	\$ 1,999
	=====

Interest income recognized on impaired loans has been applied on a cash basis. Cash receipts are applied as cost recovery first or principal recovery first, consistent with OCC regulations. An analysis of the loan loss reserve indicates that overall reserves are adequate to cover possible losses within the portfolio in addition to impaired loans.

NOTE 5 - DERIVATIVES ORIGINATION DATE: 06/2000

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.

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. Value of the derivative increased \$94 thousand net of tax for the current reportable period and \$311 thousand cumulative to date. Other comprehensive income reflects fair market value of the derivative at \$518 thousand gross and \$311 thousand net of tax.

NOTE 6 - FASB 141

FASB 141 - This statement addresses financial accounting and reporting for business combinations and supersedes APB Opinion 16. FASB 141 eliminated pooling of interests. Bancshares implemented purchase accounting effective June 30, 2001. Bancshares purchased Munford Union Bank on June 1, 2002. Munford Union has 5 branches (including the main) for a total asset base at the time of purchase of \$115 million. Munford Union Bank, a state chartered bank established in 1925, serves the counties of Tipton and Shelby in Tennessee. Purchase accounting method was used for the acquisition. Total acquisition price was \$19.3 million funded partially through a dividend paid by First Citizens National Bank (The Bank) to First Citizens Bancshares, Inc (The Company). Balance of funding for the purchase was accomplished through Trust Preferred debt and a line of Credit. Bancshares stock was not issued for the purchase. Dollar cost of purchased research and development assets as well as pre-acquisition contingencies was \$0 and dollar amount written off was not applicable. Results of Operations for Munford Union stated in this report include all nine months for the ending period September 30, 2003. Munford Union Bank was merged as a branch of First Citizens National Bank the second quarter of 2003.

All assets and liabilities were valued to the current fair market value. Goodwill included in the acquisition totaled \$8.8 million and will only be amortized if impairment occurs as directed by FASB 142. Core deposits intangible accumulated to \$845 thousand and is being amortized over a ten year period using straight line method. Goodwill on the books of Bancshares will not be tax deductible if impairment according to FASB 142 occurs.

The following condensed balance sheet shows the **initial** values assigned to each balance sheet item:

	Old Value	Adjustment	New Value
Cash and Due from	\$ 3,855	\$ 0	\$ 3,855
Fed Funds Sold	5,295	0	5,295
Investments	31,860	17	31,877
Net Loans	68,452	1,456	69,998
Premises and Equipment	3,535	-198	3,337
Goodwill	0	8,808	8,808
Core Deposit Intangible	0	845	845
Other Assets	2,012	0	2,012

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Total Assets	\$ 115,099	\$ 10,928	\$ 126,027
Deposits	\$ 99,723	\$ 1,219	\$ 100,942
Other Liabilities	5,635	21	5,762
Capital	9,635	9,688	19,323
Total Liabilities and Capital	\$ 115,099	\$ 10,928	\$ 126,027

Debt issued to fund the Munford purchase will be repaid from accumulated earnings of Munford Union with First Citizens National Bank subsidizing a small fraction of the debt for the first two years and thereafter funded 100% by Munford Union Bank.

NOTE 7 - FASB 142

This statement addresses financial accounting and reporting for acquired goodwill and other intangible assets and supercedes APB 17. Goodwill and some intangible assets will no longer be 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 implemented first quarter 2002 and 2003 to establish a goodwill benchmark resulted in an impairment of zero. Total goodwill as of the reportable date is \$12 million or less than 2% of total assets or less than 22% of total capital. The Charter of the Munford Union Bank was sold second quarter for a net price of \$200 thousand, causing a decrease to goodwill of the same amount. Munford Union Bank merged with First Citizens National Bank June 13, 2003.

Amortization expense of the other identifiable intangibles for the quarter was \$29 thousand for 2003.

NOTE 8 - 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.

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 9 - REVOLVING LINE OF CREDIT

First Citizens Bancshares has an approved two year renewable line of credit with First Tennessee Bank in the amount of \$13 million. As of the reportable date, the drawn amount was \$9.1 million.

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

GENERAL INFORMATION

First Citizens Bancshares, Inc. (the "company") headquartered in Dyersburg, Tennessee, the bank holding company for First Citizens National Bank ("the Bank"), First Citizens Capital Assets and First Citizens (TN) Statutory Trust II. First Citizens National Bank is a diversified financial service institution, which provides banking and other financial services to its customers. The bank operates four wholly owned subsidiaries: Financial Plus, Inc., Delta Finance, Inc., Nevada Investments I, Inc., and Nevada Investments II, Inc. The bank also owns 50% of White and Associates/First Citizens Insurance LLC and First Citizens/White and Associates Insurance Company, Inc. These subsidiary activities consist of: brokerage, personal finance, investments, insurance related products and credit insurance. The Munford Union Bank and its two wholly owned subsidiaries (Nevada Investments III and IV) were merged into First Citizens National Bank and Nevada Investments during second quarter 2003.

BRANCH OPERATIONS

Construction of a full service branch facility located at 200 University Avenue, Martin, TN. was completed in October 2003. The Martin branch opened for business in mid October. A second facility currently under construction, located at 5845 Airline Road, Arlington, TN, 38002 will serve as a full service branch bank and should be opened for business 4th quarter 2003. Market data analysis reflects more than adequate market share growth available within these geographic areas to support the bank's long-term financial projections. Future population and household income growth within the geographic regions are projected to be positive. First Citizens will continue to search for expansion opportunities that will result in a positive deployment of the Company's capital.

FORWARD-LOOKING STATEMENTS

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

CRITICAL ACCOUNTING POLICIES

The accounting and reporting of First Citizens Bancshares and its subsidiaries conform to accounting principles generally accepted in the United States. 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. Actual results could differ from those estimates. First Citizens considers its more critical accounting policies to consist of the allowance for loan losses and the estimation of fair market value.

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 for First Citizens' available for sale investments are based on quoted market prices supplied by a third party. In situations where quoted market prices are not available, fair values are based on quoted prices of similar instruments.

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 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 values 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.

Management has discussed these critical accounting policies with the Audit Committee, and the Audit Committee has reviewed the Company's disclosure relating to them in the discussion and analysis of operations for the quarter just ended.

RESULTS OF OPERATIONS

Results of operations for the first three quarters of 2003 revealed strong growth in both loans and deposits, coming primarily from newly acquired markets. Net loans were up 8.33%, increasing in excess of \$37 million to end the quarter at \$485,297,000. This increase was primarily in the commercial and residential real estate sector of the portfolio, and was driven by the low interest rate environment. Deposits grew at an annual rate of 5.54%, increasing \$22 million to \$553,711,000 at quarter-end. While all categories of deposits reflected an increase, the most significant growth occurred in the Wall Street Account, an interest bearing checking account. Total assets increased 3.41% over the first three quarters of 2003. Year-to-date earnings for 2003 increased in spite of a change in interpretation of Tennessee Excise Tax Law. The ruling, approved second quarter and retroactive to January 1, 2003, resulted in a YTD excise tax impact in 2003 that was not applicable to earnings of \$270,000. Excluding this increase to the tax liability, earnings for third quarter would have exceeded this same period in 2002. Earnings projections for 2003 are expected to exceed YTD budget projections. Earnings per share for the most recent five quarters respectively are as follows: \$.56, \$.45, \$.54, \$.60, and \$.58. Return on average assets was 1.14% for 2003 compared to 1.29%, and 1.14% for the