FIRST CITIZENS BANCSHARES INC /TN/
Form 10-Q
November 08, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

[**X**] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURTIES EXCHANGE ACT OF 1934

For the quarterly period ended **September 30, 2011**

Or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______ to ________.

Commission File Number**: 0-11709**

FIRST CITIZENS BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Tennessee	**62-1180360**
(State of Incorporation)	(IRS Employer Id. No.)

P. O. Box 370, One First Citizens Place

Dyersburg, TN 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 [X] No [ ].

Indicate by 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 files). Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]	Accelerated filer [X]

Non-accelerated filer[ ] (Do not check if a smaller reporting company) Smaller reporting company [ ]

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 3,607,852 shares outstanding as of October 31, 2011.

PART I-FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST CITIZENS BANCSHARES, INC. & SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF SEPTEMBER 30, 2011 AND DECEMBER 31, 2010

(In Thousands)

ASSETS	September 30, 2011 (UNAUDITED)	December 31, 2010 (1)
Cash and due from banks	$ 13,082	$ 15,628
Federal funds sold	5,131	18,063
Cash and cash equivalents	18,213	33,691
Interest-bearing deposits in other banks	35,802	6,271
Investment securities:		
Available-for-Sale, stated at market	335,014	294,823
Loans (excluding unearned income of $343 at September 30, 2011		
and $352 at December 31, 2010)	554,039	547,703
Less: allowance for loan losses	8,095	8,028
Net loans	545,944	539,675
Loans held-for-sale	2,101	2,777
Federal Home Loan Bank and Federal Reserve Bank stocks, at cost	5,684	5,684
Premises and equipment	29,437	30,268
Accrued interest receivable	6,294	5,215
Goodwill	11,825	11,825
Other intangible assets	56	120
Other real estate owned	12,595	14,734

Bank owned life insurance policies	21,250	21,656
Other assets	7,178	7,639
TOTAL ASSETS	$1,031,393	$974,378
LIABILITIES AND EQUITY		
Non-interest bearing demand deposits	$114,239	$100,130
Interest bearing time deposits	353,399	368,636
Interest bearing savings deposits	357,865	323,079
Total deposits	825,503	791,845
Securities sold under agreements to		
repurchase	40,004	34,309
Short term borrowings	5,000	1,000
Other borrowings	47,432	52,259
Other liabilities	10,207	5,686
Total liabilities	928,146	885,099

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FIRST CITIZENS BANCSHARES, INC. & SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (cont d)

AS OF SEPTEMBER 30, 2011 AND DECEMBER 31, 2010

(In Thousands)

	September 30, 2011 (UNAUDITED)	December 31, 2010 (1)
Equity		
Common stock, no par value - 10,000,000		
authorized; 3,717,593 issued and		
outstanding at September 30, 2011 and 3,717,593		
issued and outstanding at December 31, 2010	$3,718	$3,718
Surplus	15,331	15,331
Retained earnings	75,613	68,696
Accumulated other comprehensive income	9,553	1,896
Total common stock and retained earnings	104,215	89,641
Less-109,741 treasury shares, at cost as of September 30, 2011		
and 91,767 treasury shares, at cost as of December 31, 2010	3,023	2,417
Total shareholders' equity	101,192	87,224
Noncontrolling (minority) interest in consolidated subsidiary	2,055	2,055
Total equity	103,247	89,279
TOTAL LIABILITIES AND EQUITY	$1,031,393	$974,378

(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 AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

(Dollars in Thousands Except for Per Share Amounts)

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2011	Sept 30, 2010	Sept. 30, 2011	Sept 30, 2010
Interest income:				
Interest and fees on loans	$ 8,706	$ 9,018	$ 25,904	$ 27,273
Interest on investment securities:				
Taxable	1,725	1,374	4,983	4,571
Tax-exempt	1,122	977	3,297	2,929
Dividends	50	58	161	175
Other interest income	16	12	58	38
Total interest income	11,619	11,439	34,403	34,986
Interest expense:				
Interest expense on deposits	1,881	2,160	5,906	6,590
Other interest expense	415	827	1,278	2,679
Total interest expense	2,296	2,987	7,184	9,269
Net interest income	9,323	8,452	27,219	25,717
Provision for loan losses	700	950	1,925	6,000
Net interest income after provision	8,623	7,502	25,294	19,717
Non-interest income				
Mortgage banking income	259	361	543	826
Income from fiduciary activities	181	189	559	546
Service charges on deposit accounts	1,686	1,761	4,944	5,166
Brokerage fees	362	219	1,004	774

Earnings on bank owned life insurance	175	190	528	510
Gain (loss) on sale of securities	0	413	943	1,881
Loss on sale of foreclosed property	(172)	(63)	(977)	(882)
Gain on disposition of property	0	0	273	0
Other non-interest income	393	372	1,079	1,174
Total non-interest income	2,884	3,442	8,896	9,995
Total other-than temporary impairment losses	(348)	(216)	(348)	(273)
Portion of loss recognized in other comprehensive income (before taxes)	(300)	147	(300)	261
Net impairment losses recognized in earnings	(48)	(363)	(48)	(534)

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FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED) (cont d)

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

(Dollars in Thousands Except for Per Share Amounts)

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2011	Sept 30, 2010	Sept. 30, 2011	Sept 30, 2010
Non-interest expense				
Salaries and employee benefits	$4,009	$4,241	$12,288	$11,242
Net occupancy expense	449	435	1,286	1,301
Depreciation expense	445	456	1,318	1,322
Data processing expense	441	398	1,316	1,148
Legal and professional fees	131	66	304	188
Stationary and office supplies	53	51	164	166
Amortization of intangibles	21	21	63	63
Advertising and promotions	154	194	469	546
FDIC Insurance Premium expense	206	300	643	900
Other real estate expense	284	367	692	691
Other non-interest expense	1,353	1,254	3,917	3,611
Total non-interest expense	7,546	7,783	22,460	21,178
Net income before income taxes	3,913	2,798	11,682	8,000
Income taxes	695	564	2,596	1,576
Net income	$3,218	$2,234	$9,086	$6,424
Earnings per share	$0.89	$0.62	$2.51	$1.77
Weighted average number of shares outstanding	3,608,507	3,625,818	3,616,540	3,625,733

See accompanying notes to consolidated financial statements.

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FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (UNAUDITED)

NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

(In Thousands)

	Common Stock Shares (#)	Common Stock Amount ($)	Surplus ($)	Retained Earnings ($)	Accum. Other Compre. Income ($)	Treasury Stock ($)	Non-Controlling Interests ($)	Total ($)
ance January 1, 2010	3,718	$ 3,718	$15,331	$ 84,312	$ 4,256	$(2,441)	$ 55	$84,36
nprehensive income:								
et income, nine months ended Sept 30, 2010				6,424				6,424
djustment of unrealized gain (loss) on								
ecurities available-for-sale, net of tax					3,458			3,458
djustment of unrealized gain (loss) on								
ash flow hedge, net of tax					69			69
Total comprehensive income				6,424	3,527			9,951
n dividends paid - $0.45 per share				(1,632)				(1,632)
asury stock transactions- net						26		26
of subsidiary preferred shares to non-								
ntrolling interest							2,000	2,000
ance September 30, 2010	3,718	$ 3,718	$ 15,331	$ 89,104	$ 7,783	$ (2,415)	$ 2,055	$ 94,
ance January 1, 2011	3,718	$ 3,718	$ 15,331	$ 68,696	$ 1,896	$ (2,417)	$ 2,055	$ 89,
nprehensive income:								
income, nine months ended Sept 30, 2011				9,086				9,086
ustment of unrealized gain (loss) on								
curities available-for-sale, net of tax					7,657			7,657
Total comprehensive income				9,086	7,657			16,743
n dividends paid - $0.60 per share				(2,169)				(2,169)
asury stock purchases						(606)		(606)
ance September 30, 2011	3,718	$ 3,718	$ 15,331	$ 75,613	$ 9,553	$ (3,023)	$ 2,055	$ 103,

See accompanying notes to consolidated financial statements.

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

(Dollars in Thousands)

	Nine months ended September 30, 2011	September 30, 2010
Net cash provided by operating activities	$ 11,980	$ 7,820
Investing activities:		
Decrease (increase) in interest bearing deposits in banks	(29,531)	(1,208)
Proceeds of maturities of available-for-sale securities	34,265	56,364
Proceeds of sales of available-for-sale securities	37,865	47,377
Purchase of available-for-sale securities	(100,393)	(110,353)
Decrease (increase) in loans-net	(9,087)	6,646
Proceeds from sale of other real estate	4,159	2,987
Proceeds from disposition of property	328	0
Purchases of premises and equipment	(815)	(1,302)
Net cash provided (used) by investing activities	(63,209)	511
Financing activities:		
Net increase (decrease) in demand deposits	14,109	(5,782)
Net increase (decrease) in savings deposits	34,786	11,999
Increase (decrease) in time deposits	(15,237)	11,112
Net increase (decrease) in short-term borrowings	9,695	578
Increase (decrease) in other borrowings	(4,827)	(8,892)
Treasury stock transactions, net	(606)	26
Cash dividends paid	(2,169)	(1,632)
Sale of subsidiary preferred shares to noncontrolling interest	0	2,000
Net cash provided by financing activities	35,751	9,409
Increase (decrease) in cash and cash equivalents	(15,478)	17,740
Cash and cash equivalents at beginning of period	33,691	32,347
Cash and cash equivalents at end of period	$ 18,213	$ 50,087
Supplemental cash flow disclosures:		
Interest payments, net	$ 2,579	$ 6,567

Income taxes paid, net	4,800	1,150
Transfers from loans to foreclosed assets	3,292	6,683
Transfers from foreclosed assets to loans	541	1,209

See accompanying notes to consolidated financial statements.

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FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

SEPTEMBER 30, 2011

Note 1 - Consolidated Financial Statements

The consolidated balance sheet as of September 30, 2011, the consolidated statements of income for the three and nine months ended September 30, 2011 and 2010, and the consolidated statements of equity and cash flows for the six-month periods then ended have been prepared by the Company without an audit. The accompanying reviewed condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the financial position, results of operations and cash flows at September 30, 2011 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, 2011. 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, 2010.

Certain prior year balances have been reclassified to conform to 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, Inc. and First Citizens Investments, Inc., which are consolidated into its financial statements. First Citizens Holdings, Inc., a wholly owned subsidiary of First Citizens Investments, Inc., and First Citizens Properties, Inc. are also consolidated into the financial statements. First Citizens Holdings, Inc. owns approximately 60% of preferred stock and 100% of common stock of First Citizens Properties, Inc. Directors, executive officers and certain employees and affiliates of the Bank own approximately 40% of the preferred stock which is reported as Noncontrolling Interest in Consolidated Subsidiaries in the Consolidated Balance Sheets of the Company.

The Bank has a 50% ownership interest in two insurance subsidiaries both of which are accounted for using the equity method. The first 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 investments in these subsidiaries are included in Other Assets on the Balance Sheets presented in this report and earnings from these subsidiaries are recorded in Other Non-Interest 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 recognition of a liability.

Note 4 -- Cash Reserves and Interest-Bearing Deposits in Other Banks

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The Bank maintains cash reserve balances as required by the Federal Reserve Bank. Average required balances during nine months ended September 30, 2011 and the year ended December 31, 2010 were approximately $500,000. Amounts above the required minimum balance are reported as Interest-Bearing Deposits in Other Banks on the Consolidated Balance Sheets. Balances in excess of required reserves held at the Federal Reserve Bank as of September 30, 2011 and December 31, 2010 were $34.1 million and $5.3 million, respectively. Interest-bearing deposits in other banks also include short-term certificates of deposit held in increments that are within FDIC insurance limits and totaled $1.7 million and approximately $975,000 as of September 30, 2011 and December 31, 2010, respectively.

Note 5 Investment Securities and Derivative Transactions

The amortized cost and fair value of available-for-sale securities as of September 30, 2011 and December 31, 2010 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of September 30, 2011:				
U. S. Treasury securities and obligations of U. S. government agencies and corporations	$213,187	$ 8,359	$ -	$221,546
Obligations of states and political subdivisions	104,158	8,757	-	112,915
All others	2,189	15	(1,651)	553
Total available-for-sale securities	$319,534	$17,131	$ (1,651)	$335,014
As of December 31, 2010:				
U. S. Treasury securities and obligations of U. S. government agencies and corporations	$189,280	$3,721	$ (1,558)	$191,443
Obligations of states and political subdivisions	99,774	3,073	(397)	102,450
All others	2,698	22	(1,790)	930
Total available-for-sale securities	$291,752	$6,816	$ (3,745)	$294,823

There were no securities classified as held-to-maturity or trading as of September 30, 2011 or December 31, 2010.

The following table summarizes contractual maturities of debt securities available-for-sale as of September 30, 2011 (in thousands):

	Available-for-Sale Securities	
	Amortized Cost	Fair Value
Amounts maturing In:		
One year or less	$ 2,196	$ 2,219
After one year through five years	7,758	8,237
After five years through ten years	44,105	47,302
After ten years*	265,452	277,218
	319,511	334,976
Equity securities	23	38
Total securities	$319,534	$335,014

*This table includes agency mortgage-backed securities (MBS) and collateralized mortgage obligations (CMO) based on contractual maturities (primarily in the After ten years category). However, the remaining lives of such securities is expected to be much shorter

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Gross sales and realized gains (losses) on sale of available-for-sale securities are presented as follows (in thousands):

Nine months ended September 30:	Gross Sales	Gains	Losses	Net
2011 - Securities available-for-sale	$ 37,865	$ 943	$ -	$ 943
2010 - Securities available-for-sale	$ 62,839	$ 1,881	$ -	$ 1,881

The following table presents information on securities with gross unrealized losses at September 30, 2011, aggregated by investment category and the length of time that the individual securities have been in a continuous loss position (in thousands):

	Less than twelve months		*Over twelve months*		*Total*	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ -	$ -	$ -	$ -	$ -	$ -
Obligations of states and political subdivisions	-	-	-	-	-	-
Other debt securities	-	-	(1,651)	515	(1,651)	515
Total	$ -	$ -	$ (1,651)	$ 515	$ (1,651)	$ 515

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.

As of September 30, 2011, the Company had three debt securities with unrealized losses and all three have been in an unrealized loss position for greater than 12 months. The Company did not intend to sell any such securities in unrealized loss position and it was more likely than not that the Company would not be required to sell the securities prior to recovery of costs. The three corporate debt securities are pooled collateralized debt obligation securities that are backed by trust-preferred securities (TRUP CDOs) issued by banks, thrifts and insurance companies. These three bonds were rated below investment grade (BBB) by Moody s and/or S&P as of September 30, 2011.

The three TRUP CDOs have an aggregate book value of $2.2 million, fair market value of approximately $515,000 and each of the three are the mezzanine or B class tranches. The unrealized losses totaling $1.7 million as of September 30, 2011 are reflected in accumulated other comprehensive income, net of tax. The following table provides the book and market values of each security as well as information regarding the levels of excess subordination in the securities as of September 30, 2011 (dollars in thousands):

Description	Class	Book Value		Market Value	Actual Over Collateral Ratio (2)	Required Over Collateral Ratio (3)	Actual Over (Under)
Pretsl I	Mezzanine	$862	(1)	$313	76.4%	103.0%	-32.5%
Pretsl X	B-2	304	(1)	5	59.1%	N/A(4)	N/A
I-Prestsl IV	B-1	1,000		197	105.2%	106.0%	5.0%

(1) Book values reflect principal only and do not include interest capitalized or payment-in-kind (PIK) to the bond according to contractual terms of the bond if applicable. The Company does not recognize PIK interest for book purposes and has these bonds on non-accrual status.

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(2) The Over Collateral (OC) Ratio reflects the ratio of performing collateral to a given class of notes and is calculated by dividing the performing collateral by the sum of the current balance of a given class of notes plus all senior classes.

(3) The Required OC Ratio for a particular class of bonds reflects the required overcollateralization ratio such that cash distributions may be made to lower classes of bonds. If the OC Ratio is less than the Required OC ratio, cash is diverted from the lower classes of bonds to the senior bond classes.

(4) The Required OC Ratio is not applicable in this case, as interest on Pretsl X for B-2 class is capitalized to the bond or PIK.

Security-specific collateral is used in the assumptions to project cash flows each quarter. Issuers in default are assumed at zero recovery. Issuers in deferral are assumed at a 15% recovery beginning two years from deferral date. Forward interest rates are used to project future principal and interest payments allowing the model to indicate impact of over or undercollateralization for each transaction. Higher interest rates generally increase credit stress on undercollateralized transactions by reducing excess interest (calculated as the difference between interest received from underlying collateral and interest paid on the bonds). The discount rate is based on the original discount margin calculated at the time of purchase based on the purchase price. The original discount margin is then added to the three-month LIBOR to determine the discount rate. The discount rate is then used to calculate the present value for the then-current quarter s projected cash flows. If the present value of the then-current quarter s projected cash flows is less than the prior quarter or less than the then-current book value of the security, that difference is recorded against earnings as the credit component of other-than-temporary impairment. Additional credit losses totaled approximately $48,000 during the quarter ended September 30, 2011 were recognized against earnings during third quarter 2011.

The following is a tabular rollforward of the amount related to the pre-tax credit loss component recognized in earnings on debt securities for three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Balance of credit losses on available-for-sale securities	$ -	$ 171	$ -	$ -
Additions for credit losses for which an OTTI loss was not previously recognized	-	-	-	-
Additions for credit losses for which an OTTI loss was previously recognized	48	363	48	534
Balance of credit losses on available-for-sale securities	$ 48	$ 534	$ 48	$ 534

See also discussion of valuation techniques and hierarchy for determining fair value of these securities at Note 11.

Note 6 Loans

Performing and non-performing loans by category were as follows as of September 30, 2011 and December 31, 2010 (in thousands):

	Performing	Non-Performing*	Total
September 30, 2011:			
Commercial, financial and agricultural	$ 81,882	$ 839	$ 82,721
Real estate construction	39,682	1,236	40,918
Real estate mortgage	391,009	6,673	397,682
Installment loans to individuals	28,761	298	29,059
All other loans	3,627	32	3,659
Total	$544,961	$9,078	$554,039
December 31, 2010:			
Commercial, financial and agricultural	$ 65,428	$869	$66,297
Real estate construction	48,259	889	49,148
Real estate mortgage	391,270	3,986	395,256
Installment loans to individuals	31,334	259	31,593
All other loans	5,278	131	5,409
Total	$541,569	$6,134	$547,703

*Non-Performing loans consist of loans that are on non-accrual status and loans 90 days past due and still accruing interest.

An aging analysis of loans outstanding by category as of September 30, 2011 and December 31, 2010 was as follows (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
As of September 30, 2011:							
Commercial, financial and agricultural	$ 358	$23	$574	$955	$81,766	$82,721	$535
Real estate construction	366	11	549	926	39,992	40,918	0
Real estate mortgage	1,543	778	2,970	5,291	392,391	397,682	1,642
Installment loans to individuals	133	46	87	266	28,793	29,059	24
All other loans	0	0	0	0	3,659	3,659	0
Total	$2,400	$858	$4,180	$7,438	$546,601	$554,039	$2,201
As of December 31, 2010:							
Commercial, financial and agricultural	$ 405	$167	$ 716	$ 1,288	$ 65,009	$ 66,297	$ 500
Real estate construction	368	117	35	520	48,628	49,148	35
Real estate mortgage	1,093	349	2,238	3,680	391,576	395,256	1,441
Installment loans to individuals	210	81	13	304	31,289	31,593	10
All other loans	-	-	-	-	5,409	5,409	-
Total	$ 2,076	$714	$3,002	$5,792	$541,911	$547,703	$1,986

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Loans on non-accrual status as of September 30, 2011 and December 31, 2010 by category were as follows (in thousands):

	September 30, 2011	December 31, 2010
Commercial, financial and agricultural	$ 304	$ 369
Real estate construction	1,236	854
Real estate mortgage	5,031	2,545
Installment loans to individuals	274	249
All other loans	32	131
Total	$ 6,877	$4,148

Credit risk management procedures include assessment of loan quality through use of an internal loan rating system. Each loan is assigned a rating upon origination and the rating may be revised over the life of the loan as circumstances warrant. The rating system utilizes eight major classification types based on risk of loss with Grade 1 being the lowest level of risk and Grade 8 being the highest level of risk. Loans internally rated Grade 1 to Grade 4 are considered Pass grade loans with low to average level of risk of credit losses. Loans rated Grade 5 are considered Special Mention and generally have one or more circumstances that require additional monitoring but do not necessarily indicate a higher level of probable credit losses. Loans rated Grade 6 or higher are loans with circumstances that generally indicate an above average level of risk for credit losses. Loans by internal risk rating by category as of September 30, 2011 and December 31, 2010 were as follows:

	Grades 1-4	Grade 5	Grades 6-8	Total
September 30, 2011:				
Commercial, financial and agricultural	$ 80,418	$ 726	$ 1,577	$ 82,721
Real estate construction	37,396	1,422	2,100	40,918
Real estate mortgage	375,288	6,190	16,204	397,682
Installment loans to individuals	28,706	10	343	29,059
All other loans	3,659	0	0	3,659
Total	$525,467	$8,348	$20,224	$554,039
December 31, 2010:				
Commercial, financial and agricultural	$ 64,297	$ 71	$ 1,929	$ 66,297
Real estate construction	45,931	820	2,397	49,148
Real estate mortgage	373,025	4,912	17,319	395,256
Installment loans to individuals	31,136	14	443	31,593
All other loans	5,278	-	131	5,409
Total	$519,667	$5,817	$22,219	$547,703

Information regarding the Company s impaired loans for the quarter ended September 30, 2011 and 2010 is as follows (in thousands):

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	Recorded Investment	Unpaid Principal Balance	Specific Allowance	Average Recorded Investment	Interest Income Recognized
September 30, 2011:					
With no specific allocation recorded:					
Commercial, financial and agricultural	$-	$-	N/A	$ 5	$-
Real estate construction	-	-	N/A	210	-
Real estate mortgage	-	-	N/A	2,097	-
Installment loans to individuals	-	-	N/A	-	-
All other loans	-	-	N/A	-	-
With allocation recorded:					
Commercial, financial and agricultural	$ 500	$ 500	$ 50	$ 548	$23
Real estate construction(1)	1,236	1,236	572	1,131	0
Real estate mortgage(2)	5,707	5,707	653	5,384	50
Installment loans to individuals(3)	166	166	36	188	-
All other loans	-	-	-	-	-
Total:					
Commercial, financial and agricultural	$ 500	$ 500	$ 50	$ 553	$23
Real estate construction	1,236	1,236	572	1,341	-
Real estate mortgage	5,707	5,707	653	7,481	50
Installment loans to individuals	166	166	36	188	-
All other loans	-	-	-	-	-
September 30, 2010:					
With no specific allocation recorded:					
Commercial, financial and agricultural	$ -	$ -	N/A	$ 138	$-
Real estate construction	2,644	2,644	N/A	887	-
Real estate mortgage	5,018	5,018	N/A	1,627	-
Installment loans to individuals	-	-	N/A	14	-
All other loans	-	-	N/A	58	-
With allocation recorded:					
Commercial, financial and agricultural	$ 500	$ 500	$ 50	$ 421	$ 18
Real estate construction	1,209	1,209	635	5,107	206
Real estate mortgage	4,000	4,000	586	7,770	229
Installment loans to individuals	202	202	34	181	2
All other loans	-	-	-	251	-
Total:					
Commercial, financial and agricultural	$ 500	$ 500	$ 50	$ 559	$ 18
Real estate construction	3,853	3,853	635	5,993	206
Real estate mortgage	9,018	9,018	586	9,397	229
Installment loans to individuals	202	202	34	194	2
All other loans	-	-	-	309	-

(1) Impaired total for this category includes troubled debt restructurings with recorded investment totaling approximately $148,000 and a specific allowance of approximately $148,000.

(2) Impaired total for this category includes troubled debt restructurings with recorded investment totaling $2.6 million and specific allowance of approximately $255,000.

(3) Impaired total for this category includes troubled debt restructurings with recorded investment totaling approximately $8,000 and a specific allowance of less than $1,000.

The Company adopted amendments in Accounting Standards Update No. 2011-01 as of September 30, 2011. As a result, the Company reviewed loans classified as troubled debt restructurings (TDRs) that had been restructured during the nine months ended September 30, 2011 and confirmed that TDRs with a balance greater than or equal to $250,000 deemed to be impaired were properly identified as such and reviewed individually for impairment as reported in the impaired loan table above. Loans meeting the criteria to be classified as TDRs with a balance less than $250,000 have historically been reviewed on a collective basis by risk code and loan category. Reassessment of these loans on an individual basis upon adoption of the ASU No. 2011-01 for impairment did not result in a significant difference in the required allowance as the aggregate balance of loans reviewed was less than $20,000.

Generally, loans are appropriately risk rated and identified for individual impairment review prior to when the restructure occurs. Thus, in the normal life cycle of a loan, specific allocations if any are usually prior to a formal restructuring or at least at the time of restructuring rather than subsequent to modification. Therefore, adoption of these amendments did not have a material impact on the volume of loans classified as TDRs or the related allowance for loan losses associated with TDRs. Also, TDRs are included in non-accrual loans as reported in the above tables unless the loan has performed according to the modified terms for a length of time sufficient to support placing the loan on accrual status (generally six months). Loans that have been restructured during the nine months ended September 30, 2011 consist of the following:

	As of September 30, 2011		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial, financial and agricultural	0	$ -	$ -
Real estate construction	1	155	148
Real estate mortgage	4	2,577	2,554
Installment loans to individuals	2	9	8

All other loans	0	-	-
Total	7	$2,741	$2,710

Modification of the terms of the TDRs reported in the above table did not have a material impact to the consolidated financial statements or to the overall risk profile of the loan portfolio. There were no TDRs that were modified during the year ended December 31, 2010 that re-defaulted in the nine months ended September 30, 2011. The allowance for loan losses associated with the TDRs totaled approximately $407,000 as of September 30, 2011.

Note 7 Allowance for Loan Losses

The following table presents the breakdown of the allowance for loan losses by category and the percentage of each category in the loan portfolio to total loans as of September 30, 2011 and December 31, 2010 (dollars in thousands):

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	September 30, 2011		December 31, 2010	
	Amount	% to Total Loans	Amount	% to Total Loans
Commercial, financial and agricultural	$1,461	14.93%	$ 944	12.10%
Real estate construction	1,771	7.39%	1,295	8.97%
Real estate mortgage	4,439	71.78%	5,299	72.17%
Installment loans to individuals	378	5.24%	462	5.77%
All other loans	46	0.66%	28	0.99%
Total allowance for loan losses	$8,095	100.00%	$8,028	100.00%

An analysis of the allowance for loan losses by loan category for the nine months ended September 30, 2011 is as follows (in thousands):

	Beginning balance	Charge-offs	Recoveries	Provision	Ending balance
Allowance for loan losses					
Commercial, financial and agricultural	$ 944	($809)	$63	$1,263	$1,461
Real estate construction	1,295	(378)	51	803	1,771
Real estate mortgage	5,299	(755)	61	(166)	4,439
Installment loans to individuals	462	(144)	53	7	378
All other loans	28	0	0	18	46
Total	$8,028	($2,086)	$228	$1,925	$8,095

The allowance for loan losses is comprised of allocations for loans evaluated individually and loans evaluated collectively for impairment. The allocations of the allowance for loan losses for outstanding loans by category evaluated individually and collectively were as follows as of September 30, 2011 and December 31, 2010 (in thousands):

	Evaluated Individually	Evaluated Collectively	Total
As of September 30, 2011:			
Allowance for loan losses			
Commercial, financial and agricultural	$ 50	$1,411	$1,461
Real estate construction	572	1,199	1,771
Real estate mortgage	653	3,786	4,439
Installment loans to individuals	36	342	378
All other loans	0	46	46

Total	$1,311	$6,784	$8,095
Loans			
Commercial, financial and agricultural	$ 500	$ 82,221	$ 82,721
Real estate construction	1,236	39,682	40,918
Real estate mortgage	5,707	391,975	397,682
Installment loans to individuals	166	28,893	29,059
All other loans	0	3,659	3,659
Total	$7,609	$546,430	$554,039

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	Evaluated Individually	Evaluated Collectively	Total
As of December 31, 2010:			
Allowance for loan losses			
Commercial, financial and agricultural	$ 50	$ 894	$ 944
Real estate construction	375	920	1,295
Real estate mortgage	853	4,446	5,299
Installment loans to individuals	37	425	462
All other loans	-	28	28
Total	$1,315	$6,713	$8,028
Loans			
Commercial, financial and agricultural	$ 500	$ 65,797	$ 66,297
Real estate construction	1,583	47,565	49,148
Real estate mortgage	7,056	388,200	395,256
Installment loans to individuals	200	31,393	31,593
All other loans	-	5,409	5,409
Total	$9,339	$538,364	$547,703

Note 8 Bank Owned Life Insurance

The Bank has a significant investment in bank-owned life insurance policies (BOLI) and provides the associated fringe benefit to certain employees in the position of Vice President and higher after one year of service. The cash surrender values of BOLI were $21.3 million and $21.7 million as of September 30, 2011 and December 31, 2010, respectively. BOLI are initially recorded at the amount of premiums paid and are adjusted to current cash surrender values. Changes in cash surrender values are recorded in other non-interest income and are based on premiums paid less expenses plus accreted interest income. Earnings on BOLI resulted in non-interest income of approximately $175,000 and $190,000 for the quarters ended September 30, 2011 and 2010, respectively.

The Company adopted guidance in ASC 715-60 effective January 1, 2008. The cumulative effect adjustment to retained earnings for change in accounting principle was recorded January 1, 2008 in the amount of $1.9 million to accrue the post-retirement death benefits for endorsement split dollar life insurance plans. Expense related to these accruals is reflected in Salaries and Employee Benefits on the Consolidated Income Statements. Expense for this benefit totaled $15,000 for the nine months ended September 30, 2011 compared to $133,000 for the nine months ended September 30, 2010. The decrease in expense in 2011 is attributable to a reduction in the liability associated with death benefit that was paid from policy proceeds. The accrual for the post-retirement death benefits is included in Other Liabilities on the Consolidated Balance Sheet and totaled $2.4 million as of September 30, 2011 and $2.4 million as of December 31, 2010.

Note 9 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 under generally accepted accounting standards. 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, thesre 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 September 30, 2011. 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 September 30, 2011 was $11.8 million or 1.15% of total assets or 11.69% of total equity.

Amortization expense of the other identifiable intangibles was approximately $21,000 per quarter during the nine months ended September 30, 2011 and 2010.

Note 10   Borrowings

The Bank has three sources of short-term borrowings, which consist of cash management advances from the FHLB, Treasury, Tax and Loan (TT&L   ) option note, and federal funds purchased from correspondent banks. Short-term borrowings are used to manage seasonal fluctuations in liquidity.

Cash management advances from FHLB are secured by one-to-four family first mortgages under the blanket collateral pledge agreement that also collateralizes long-term advances from FHLB and have maturities of 90 days or less. There were no short-term borrowings outstanding against this line as of December 31, 2010 and totaled $4 million as of September 30, 2011. The one $4 million short-term advance matures in October 2011.

The Bank is an Option B bank in regards to TT&L and up to $1 million in TT&L payments collected can be retained as a short-term option note. This option note is callable upon demand by the TT&L. The balance of this line was $1 million as of September 30, 2011 and as of December 31, 2010 and is reported in Short Term Borrowings in the Consolidated Balance Sheets.

The Bank has four correspondent bank federal fund lines of credit available totaling $54.5 million. There were no federal funds purchased as of September 30, 2011 or December 31, 2010.

The Bank had secured long-term advances from the FHLB totaling $37.1 million as of September 30, 2011 and $41.9 million as of December 31, 2010 that are reported in Other Borrowings on the Consolidated Balance Sheets. FHLB borrowings are comprised primarily of fixed rate positions with principal due at call date or maturity date with interest rates ranging from 1.15% to 5.09%. Most of these FHLB borrowings have quarterly call features and maturities range from 2011 to 2019. Advances totaling $16 million require repayment if the call feature is exercised. Under the existing and forecasted rate environments, borrowings with call features in place are not likely to be called in the next 12 months. The Bank has one LIBOR based variable rate advance totaling $2.5 million with a rate of 0.24% as of September 30, 2011. Also included in the FHLB borrowings total reported above is a pool of smaller balance amortizing advances that total $1.1 million as of September 30, 2011 and $1.4 million as of year-end 2010. These smaller balance advances have rates ranging from 3.34% to 7.05% and maturities range from 2012 to 2019. Obligations are secured by loans totaling $375 million consisting of the Bank s entire portfolio of fully disbursed, one-to-four family residential mortgages, commercial mortgages, farm mortgages, second mortgages and multi-family residential mortgages. The Bank had additional borrowing capacity of $114 million as of September 30, 2011. Of the $37.1 million long-term advances as of September 30, 2011, principal due in twelve months totals $3.4 million.

In March 2005, the Company formed a wholly owned subsidiary -- First Citizens (TN) Statutory Trust III. The trust was created as a Delaware statutory trust for the sole purpose of issuing and selling trust preferred securities and using proceeds from the sale to acquire 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 17, 2005, the Company, through First Citizens (TN) Statutory Trust III, sold 5,000 of its floating rate trust preferred securities at a liquidation amount of $1,000 per security for an aggregate amount of $5.0 million. 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 period beginning on (and including) June 17, 2005, and each succeeding interest payment date, interest accrues at a rate per annum equal to the three-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 $5.0 million in proceeds was used to reduce other debt at the Company. 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.

In March 2007, the Company formed a wholly owned subsidiary -- First Citizens (TN) Statutory Trust IV. The trust was created as a Delaware statutory trust for the sole purpose of issuing and selling trust preferred securities and using proceeds from the sale to acquire 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.

In March 2007, the Company, through First Citizens (TN) Statutory Trust IV, sold 5,000 of its floating rate trust preferred securities at a liquidation amount of $1,000 per security for an aggregate amount of $5.0 million. For the period beginning on (and including) the date of original issuance and ending on (but excluding) June 15, 2007, the rate per annum was 7.10%. For each successive period beginning on (and including) June 15, 2007, and each succeeding interest payment date, interest accrues at a rate per annum equal to the three-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 proceeds was to refinance the debt issued through First Citizens (TN) Statutory Trust II at a lower spread to LIBOR and results in savings of approximately $92,500 annually. First Citizens (TN) Statutory Trust II was dissolved as a result of this transaction. 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 trust preferred securities are presented as debt (and reported in Other Borrowings on the Consolidated Balance Sheets), the outstanding balance qualifies as Tier I capital for regulatory reporting purposes subject to the limitation that the amount of the securities included in Tier I Capital cannot exceed 25% of total Tier I capital.

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

Note 11 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 measures fair value under guidance provided by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 820, Fair Value Measurements and Disclosures (AS 820), and was effective January 1, 2008 for all applicable financial and non-financial assets and liabilities. ASC 820 defines fair value, establishes a framework for measuring fair value and expands disclosure requirements regarding fair value measurements. ASC 820 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. ASC 820 outlines the following three acceptable valuation techniques 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 the Black-Scholes-Merton formula or 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 technique or its application may be made if the change results in a measurement that is equally or more representative of fair value under the circumstances. Revisions resulting from a change in valuation technique or its application are accounted for as a change in accounting estimate 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.

ASC 820 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. 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 Consolidated Balance Sheets. 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 from a third party vendor. 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 1% 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 pooled trust-preferred securities are obtained through the use of valuation models that include unobservable inputs which are considered Level 3.

Certain non-financial assets and non-financial liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Certain non-financial assets measured at fair value on a non-recurring basis include non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, as well as intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment.

Effective January 1, 2008, the Company adopted ASC 820, which 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 ASC 820 on January 1, 2008 did not have a material impact on the Company s financial condition or results of operation.

Recurring Basis

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 TRUP CDOs which are accounted for using Level 3 inputs. TRUP CDOs accounted for less than 1% of the portfolio at September 30, 2011 and December 31, 2010.

The markets for TRUP CDOs and other similar securities were not active at September 30, 2011 or December 31, 2010. 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 has also been relatively inactive.

The market values for TRUP CDOs and other securities except for those issued or guaranteed by the U.S. Treasury have been 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 levels versus Treasuries at the end of November 2008 and remained close to those levels at September 30, 2011. Therefore, low market prices for a particular bond may only have provided evidence of stress in credit markets in general rather than being an indicator of credit problems with a particular issuer over the past three years.

Given conditions in debt markets for this type of security at September 30, 2011 and December 31, 2010 and the relative inactivity in the secondary and new issue markets, the Company determined:

- Few observable transactions existed and market quotations that were available were not reliable for purposes of determining fair value as of September 30, 2011 or December 31, 2010;

- An income valuation approach technique (present value technique) that maximized the use of relevant observable inputs and minimized the use of unobservable inputs were equally or more representative of fair value than the market approach valuation technique used at prior measurement dates; and

- The Company s TRUP CDOs should be classified within Level 3 of the fair value hierarchy because significant adjustments were required to determine fair value at the measurement date.

The Company s TRUP CDO valuations were prepared by an independent third party. The third party s approach to determining fair value involved these steps as of September 30, 2011 and December 31, 2010:

- The credit quality of the collateral was calibrated by assigning default probabilities to each issuer;
- 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 50% level of correlation was assumed among assets from the same industry (e.g., banks with other banks) while a lower (30%) correlation level is assumed among those from different industries;
- The loss given default was assumed to be 100% (i.e., no 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 10,000 scenarios using a Monte Carlo engine;
- The expected cash flows for each scenario were discounted using a discount rate that the third party calculates for each bond that represents an estimate of the yield that would be required in today s market for a bond with a similar credit profile as the bond in question; and
- The prices were aggregated and the average price was used for valuation purposes.

The Company recalculated the overall effective discount rates for these valuations. The overall discount rates ranged from 19% to 45% 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.

A summary of assets and liabilities as of September 30, 2011 and December 31, 2010 measured at estimated fair value on a recurring basis is as follows (in thousands):

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
September 30, 2011:				
Financial assets:				
Securities available-for-sale	$ -	$334,499	$ 515	$335,014
December 31, 2010:	-	-	-	-
Financial assets:				
Securities available-for-sale	$ -	$294,384	$ 439	$294,823

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 quarters ended September 30, 2011 and 2010 (in thousands):

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	Three months ended September 30, 2011	2010	Nine months ended September 30, 2011	2010
Available-for-sale securities:				
Beginning balance	$ 563	$1,509	$ 439	$ 1,727
Total unrealized gains (losses) included in:				
Net income	(48)	(356)	(48)	(527)
Other comprehensive income	5	107	129	60
Purchases, sales, issuances and settlements, net	(5)	-	(5)	-
Transfers in and (out) of Level 3	-	-	-	-
Ending balance	$515	$ 1,260	$ 515	$ 1,260

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 allowance 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 for three or nine months ended September 30, 2011 or 2010.

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 as of September 30, 2011 and December 31, 2010 measured at estimated fair value on a non-recurring basis were as follows:

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
September 30, 2011:				
Assets:				
Impaired Loans	$ -	$ -	$ 7,609	$ 7,609
Loans held for sale	-	2,101	-	2,101
Other real estate			12,595	12,595
December 31, 2010:				
Assets:				
Impaired Loans	$ -	$ -	$ 3,687	$ 3,687
Loans held for sale	-	2,777	-	2,777
Other real estate	-	-	14,734	14,734

Fair Value Estimates

ASC 820 requires disclosure of the estimated fair value of financial instruments for interim and annual periods. The following assumptions were made and methods applied to estimate the fair value of each class of financial instruments not measured at fair value on the Consolidated Balance Sheets:

Cash and Cash Equivalents

For instruments that qualify as cash equivalents, as described in Note 1, the carrying amount is assumed to be fair value.

Loans

Fair value of variable-rate loans with no significant change in credit risk subsequent to loan origination is based on carrying amounts. For other loans, such as fixed rate loans, fair values are estimated utilizing discounted cash flow analyses, applying interest rates currently offered for new loans with similar terms to borrowers of similar credit quality. Fair values of loans that have experienced significant changes in credit risk have been adjusted to reflect such changes.

Accrued Interest Receivable

The fair values of accrued interest receivable and other assets are assumed to be the carrying value.

Federal Home Loan Bank and Federal Reserve Bank Stock

Carrying amounts of capital stock of the FHLB of Cincinnati and Federal Reserve Bank of St. Louis approximate fair value.

Bank-Owned Life Insurance

Carrying amount of bank-owned life insurance is the cash surrender value as of the end of the periods presented and approximates fair value.

Deposit Liabilities

Demand Deposits

The fair values of deposits which are payable on demand, such as interest-bearing and non-interest-bearing checking accounts, passbook savings, and certain money market accounts are equal to the carrying amount of the deposits.

Variable-Rate Deposits

The fair value of variable-rate money market accounts and certificates of deposit approximate their carrying value at the balance sheet date.

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Fixed-Rate Deposits

For fixed-rate certificates of deposit, fair values are estimated utilizing discounted cash flow analyses, which apply interest rates currently being offered on certificates of deposits to a schedule of aggregated monthly maturities on time deposits.

Other Borrowings

For securities sold under repurchase agreements payable upon demand, the carrying amount is a reasonable estimate of fair value. For securities sold under repurchase agreements for a fixed term, fair values are estimated using the same methodology as fixed rate time deposits discussed above. The fair value of the advances from the FHLB and other long-term borrowings are estimated by discounting the future cash outflows using the current market rates.

Other Liabilities

Fair value of other liabilities is assumed to be the carrying values.

The carrying amount and fair value of assets and liabilities as of September 30, 2011 and December 31, 2010 were as follows (in thousands):

	As of September 30, 2011		As of December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	$ 18,213	$ 18,213	$ 33,691	$ 33,691
Interest bearing deposits in banks	35,802	35,802	6,271	6,271
Investment securities	335,014	335,014	294,823	294,823

Loans	554,039		547,703	
Less: Allowance for loan losses	(8,095)		(8,028)	
Net loans	545,944	546,666	539,675	540,479
Loans held for sale	2,101	2,101	2,777	2,777
Accrued interest receivable	6,294	6,294	5,215	5,215
Federal Reserve Bank and Federal				
Home Loan Bank stock	5,684	5,684	5,684	5,684
Other real estate	12,595	12,595	14,734	14,734
Bank owned life insurance	21,250	21,250	21,656	21,656
Financial liabilities				
Deposits	825,503	827,346	791,845	793,978
Short-term borrowings	45,004	45,070	35,309	35,402
Other borrowings	47,432	49,403	52,259	52,359
Other liabilities	10,207	10,207	5,686	5,686
Unrecognized Financial Instruments				
Commitments to extend credit	73,454	73,454	78,107	78,107
Standby letters of credit	1,430	1,430	2,752	2,752

Note 12 Accumulated Other Comprehensive Income

Accumulated Other Comprehensive Income as of September 30, 2011 and December 31, 2010 was as follows (in thousands):

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	September 30, 2011	December 31, 2010
Unrealized gains (losses) on available-for-sale securities without other-than-temporary impairment, net of tax	$10,113	$2,501
Unrealized gains (losses) on available-for-sale securities with other-than-temporary impairment, net of tax	(560)	(605)
Accumulated other comprehensive income	$9,553	$1,896

The components of comprehensive income, net of related tax, for the three and nine months ended September 30, 2011 and 2010 were as follows (in thousands):

	Three months ended September 30, 2011	Three months ended September 30, 2010	Nine months ended September 30, 2011	Nine months ended September 30, 2010
Net income	$3,218	$2,234	$9,086	$6,424
Other comprehensive income, net of tax:				
Net change in unrealized gains (losses) on cash flow hedge*	0	38	0	69
Net change in unrealized gains (losses) on available-for-sale securities	3,689	2,107	7,657	3,458
Total other comprehensive income	3,689	2,145	7,657	3,527
Total comprehensive income	$6,907	$4,379	$16,743	$9,951

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*The Company s only derivative transaction matured in June 2010. There are no derivative transactions as of September 30, 2011 or December 31, 2010.

Related tax effects allocated to each component of other comprehensive income for the periods presented are as follows (in thousands):

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	Before-tax Amount	Tax (Expense) or Benefit	Net-of-tax Amount
Nine months ended September 30, 2011:			
Unrealized gains (losses) on cash flow hedge	$ -	$ -	$ -
Unrealized gains (losses) on available-for-sale securities:			
Unrealized gains (losses) arising during the period	13,350	(5,112)	8,209
Reclassification adjustments for net gains included in net income	(895)	343	(552)
Unrealized gains (losses) on available-for-sale securities, net	12,455	(4,769)	7,657
Net unrealized gains (losses)	$ 12,455	$ (4,769)	$ 7,657
Nine months ended September 30, 2010:			
Unrealized gains (losses) on cash flow hedge	$ 112	$ (43)	$ 69
Unrealized gains (losses) on available-for-sale securities:			
Unrealized gains (losses) arising during the period	7,461	(2,847)	4,289
Reclassification adjustments for net gains included in net income	(1,347)	516	(831)
Unrealized gains (losses) on available-for-sale securities, net	6,114	(2,331)	3,458
Net unrealized gains (losses)	$ 6,226	$ (2,374)	$ 3,527
Three months ended September 30, 2011:			
Unrealized gains (losses) on cash flow hedge	$ -	$ -	$ -
Unrealized gains (losses) on available-for-sale securities:			
Unrealized gains (losses) arising during the period	5,978	(2,289)	3,659
Reclassification adjustments for net gains included in net income	48	(18)	30
Unrealized gains (losses) on available-for-sale securities, net	6,026	(2,307)	3,689
Net unrealized gains (losses)	$ 6,026	$ (2,307)	$ 3,689
Three months ended September 30, 2010:			
Unrealized gains (losses) on cash flow hedge	$ 62	$ (24)	$ 38
Unrealized gains (losses) on available-for-sale securities:			
Unrealized gains (losses) arising during the period	3,974	(1,512)	2,462
Reclassification adjustments for net gains included in net income	(50)	19	(355)
Unrealized gains (losses) on available-for-sale securities, net	3,924	(1,493)	2,107
Net unrealized gains (losses)	$ 3,986	$ (1,517)	$ 2,145

Note 13 Subsequent Events

The Company has reviewed subsequent events through November 1, 2011, the date the financial statements were available to be issued.

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

Overview

As of September 30, 2011, total assets were $1.03 billion which was an increase of $57 million or 5.9% since year-end 2010. Growth in 2011 was driven primarily by 4.3% growth in deposits since year end 2010. Asset growth consists of $30 million increase in interest bearing deposits in other banks, $40 million increase in available-for-sale securities, and $6 million increase in loans. Growth in these asset categories was offset by $15 million decrease in cash and cash equivalents and $2 million decrease in other real estate owned (OREO). During first nine months of 2011, total liabilities increased $43 million driven by $34 million increase in deposits, $5 million increase in borrowings and $4 million increase in other liabilities. Total equity increased $14 million or 15.7% in first nine months of 2011 due to undistributed net income and increased appreciation on available-for-sale securities reflected in accumulated other comprehensive income.

Net income for first nine months of 2011 totals $9.1 million compared to $6.4 million for nine months ended September 30, 2010. Earnings per share were $2.51 for the nine months ended September 30, 2011 compared to $1.77 for the nine months ended September 30, 2010. The 40% increases in net income and earnings per share during the nine months ended September 30, 2011 compared to the same period last year are attributable to $4.1 million decrease in provision for loan losses and $1.5 million increase in net interest income. Increased net interest income was driven by lower interest expense of $2.1 million that more than offset the approximate $583,000 decrease in interest income. Non-interest income decreased $1.1 million in first nine months of 2011 compared to first nine months of 2010. The largest component of decrease non-interest income is approximately $938,000 decrease in gain on sale of available-for-sale securities. The Company recognized net other-than-temporary impairment charges in earnings totaling approximately $48,000 for the nine months ended September 30, 2011 compared to approximately $534,000 for the nine months ended September 30, 2010. Non-interest expense increased $1.3 million in nine months ended September 30, 2011 compared to September 30, 2010 due primarily to increased employee benefit accruals for incentives and retirement contributions.

Provision for loan losses totaled $1.9 million for first three quarters 2011 compared to a provision of $6.0 million first three quarters of 2010. Net loans charged off for first nine months of 2011 totaled $1.9 million compared to $6.7 million in first nine months of 2010. Reserve for losses on loans as a percent of total loans was 1.46% as of September 30, 2011 compared to 1.42% as of September 30, 2010 and 1.47% as of December 31, 2010.

Net income for third quarter 2011 was approximately $984,000 more than third quarter 2010. Provision for loan losses decreased approximately $250,000 when comparing third quarter 2011 to third quarter 2010. In comparing results of operations for third quarter 2011 to third quarter 2010, net interest income increased approximately $871,000, non-interest income decreased approximately $558,000, other-than temporary impairment charges improved by approximately $315,000 and non-interest expense decreased approximately $237,000.

The efficiency ratio is a measure of non-interest expense as a percentage of total revenue. The Company computes the efficiency ratio by dividing non-interest expense by the sum of net interest income on a tax equivalent basis and non-interest income. This is a non-GAAP financial measure, which we believe provides investors with important information regarding our operational efficiency. Comparison of our efficiency ratio with those of other companies may not be possible because other companies may calculate the efficiency ratio differently. The efficiency ratio for the quarter ended September 30, 2011, 2010 and 2009 was 59.47%, 64.99%, and 58.98%, respectively.

The tangible common equity ratio is a non-GAAP measure used by management to evaluate capital adequacy. Tangible common equity is total equity less net accumulated other comprehensive income ("OCI"), goodwill and deposit-based intangibles. Tangible assets are total assets less goodwill and deposit-based intangibles. The tangible common equity ratio is 8.02% as of the quarter ended September 30, 2011 compared to 7.55% and 7.29% as of the quarters ended September 30, 2010 and 2009, respectively.

A reconciliation of non-GAAP measures of efficiency ratio and tangible common equity is provided as follows for the quarter ended September 30, 2011, 2010 and 2009:

	2011	2010	2009
Efficiency ratio:			
Net interest income[1]	$9,852	$8,897	$9,078
Non-interest income[2]	2,836	3,079	3,449
Total revenue	$12,688	$11,976	$12,527
Non-interest expense	$7,546	$7,783	$7,388
Efficiency ratio	59.47%	64.99%	58.98%
Tangible common equity ratio:			
Total equity capital	$103,247	$92,657	$84,377
Less:			
Accumulated other comprehensive income	9,553	7,783	4,535
Goodwill	11,825	11,825	11,825
Other intangible assets	56	141	225
Tangible common equity	$81,813	$72,908	$67,792
Total assets	$1,031,393	$977,038	$942,567
Less:			
Goodwill	11,825	11,825	11,825
Other intangible assets	56	141	225
Tangible assets	$1,019,512	$965,072	$930,517
Tangible common equity ratio	8.02%	7.55%	7.29%

(1) Net interest income includes interest and rates on securities that are non-taxable for federal income tax purposes that are presented on a taxable equivalent basis based on federal statutory rate of 34%.

(2) Non-interest income is presented net of any credit component of other-than-temporary impairment on available-for-sale securities recognized against earnings for the years presented.

Expansion

The Company, through its strategic planning process, intends to seek profitable opportunities that utilize excess capital and maximize income in Tennessee. If the Company decides to acquire other banking institutions, its objective would be for asset growth and diversification into other market areas. Acquisitions and de novo branches might afford the Company increased economies of scale within the operation functions and better utilization of human resources. The Company would only pursue an acquisition or de novo branch if the board of directors determines it to be in the best interest of the Company and its shareholders. The Company does not currently have formal plans to acquire other banking institutions.

The Company owns two lots in Jackson, Tennessee, that are intended for construction of full service branches but construction is temporarily on hold because of current economic conditions. Construction of these facilities is expected to commence in the next two to five years.

Forward-Looking Statements

Information contained herein includes forward-looking statements with respect to the beliefs, plans, risks, goals and estimates of the Company. 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, w intend, is likely, going forward, may and other expressions are intended to identify forward-looking statements. Th 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, capital resources, strategic planning, acquisitions or de novo branching, ability to meet capital guidelines, governmental regulations, construction of new branch locations, dividends, critical accounting policies, allowance for loan losses, fair value estimates, goodwill, occupancy and depreciation expense, held-to-maturity securities, available-for-sale securities, trading securities, cash flows, diversification in the real estate loan portfolio, interest income, maturity of loans, loan impairment, loan ratings, maturity and re-pricing of deposits, borrowings with call features, dividend payout ratio, off-balance sheet arrangements, the impact of recently issued accounting standards, changes in funding sources, liquidity, interest rate sensitivity, net interest margins, payment status of corporate debt securities, non-accrual status of loans, contractual maturities of mortgage-backed securities and collateralized mortgage obligations, other-than-temporary impairment of securities, amortization expense, deferred tax assets, independent appraisals for collateral, property enhancement or additions, efficiency ratio, ratio of assets to employees, net income, changes in interest rates, loan policies, categorization of loans, maturity of FHLB borrowings and the effectiveness of internal control over financial reporting.

Forward-looking statements are based upon information currently available and represent management s expectations or predictions of the future. As a result of risks and uncertainties involved, actual results could differ materially from such forward-looking statements. The potential factors that could affect the Company s results include but are not limited to:

- Changes in general economic and business conditions;
- Changes in market rates and prices of securities, loans, deposits and other financial instruments;
- Changes in legislative or regulatory developments affecting financial institutions in general, including changes in tax, banking, insurance, securities or other financial service related laws;
- Changes in government fiscal and monetary policies;
- The ability of the Company to provide and market competitive products and services;
- Concentrations within our loan portfolio;
- Fluctuations in prevailing interest rates and the effectiveness of the Company s interest rate hedging strategies;
- The Company s ability to maintain credit quality;
- The effectiveness of the Company s risk monitoring systems;
- The ability of the Company s borrowers to repay loans;
- The availability of and costs associated with maintaining and/or obtaining adequate and timely sources of liquidity;
- Geographic concentration of the Company s assets and susceptibility to economic downturns in that area;

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