FIRST CITIZENS BANCSHARES INC /TN/
Form 10-Q
November 12, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 or 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED SEPTEMBER 30, 2004

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 2-83542

First Citizens Bancshares, Inc.

(Exact name of registrant as specified in its charter)

Tennessee	62-1180360
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

P.O. Box 370, One First Citizens Place
Dyersburg, Tennessee 38024

(Address of principal executive offices including zip code)

(731) 285-4410

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 3 months and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ].

Of the registrant's only class of common stock (no par value) there were 3,651,681 shares outstanding as of September 30, 2004 (Net of Treasury).

PART I -FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2004 AND DECEMBER 31, 2003
(UNAUDITED)
(Stated in thousands)

	AS OF September 30 2004	AS OF December 31 2003
ASSETS		
Cash and Due From Banks	$ 16,672	$ 17,500
Federal Funds Sold	1,450	16,777
Investment Securities		
Trading Investments - Stated at Market	--	--
Held-to-Maturity - amortized cost - Fair Value of $820 at September 30, 2004 and $861 at December 31, 2003.	795	825
Available-for-Sale, Stated at Market	148,907	148,855
Loans (Including Unearned Income of $266 at September 30, 2004 and $120 at December 31, 2003)	530,588	488,107
Less: Allowance for Loan Losses	6,358	6,124
Net Loans	524,230	481,983
Premises and Equipment	22,384	21,738
Goodwill	11,825	12,218
Other Intangible Assets	648	711
Other Real Estate	257	535
Other Assets	26,567	24,962
TOTAL ASSETS	$ 753,735	$ 726,104
	========	========
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Demand	$ 73,557	$ 68,031
Time	312,259	313,531
Savings	176,762	179,048
Total Deposits	562,578	560,610

Securities Sold Under Agreements to Repurchase	26,197	19,681
Federal Funds Purchased and Other Short-Term Borrowings	14,850	--
Long Term Debt	84,628	83,314
Notes Payable of Employee Stock Ownership Plan	--	--
Other Liabilities	4,749	4,553
TOTAL LIABILITIES	$ 693,002	$ 668,158
Shareholders' Equity:		
Common Stock, No Par Value - 10,000,000 Authorized; 3,717,593 Issued and Outstanding at September 30, 2004 and 3,717,593 Issued and Outstanding at December 31, 2003.	3,718	3,718
Surplus	15,332	15,331
Retained Earnings	41,927	39,043
Obligation of Employee Stock Ownership Plan	--	--
Accumulated Other Comprehensive Income	1,326	1,308
Total Common Stock and Retained Earnings	62,303	59,400
Less: 65,912 Treasury Shares, at Cost at September 30, 2004 and 61,825 Shares at Cost at December 31, 2003.	1,570	1,454
TOTAL SHAREHOLDERS' EQUITY	$ 60,733	$ 57,946
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 753,735	$ 726,104
	==========	==========

See accompanying notes to consolidated financial statements.

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(UNAUDITED)
(Stated in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Balance Beginning of Period	$ 58,033	$ 56,326	$ 57,946	$ 54,601
Net Income	1,966	2,047	5,954	5,668
Other Comprehensive Income:				
Changes in Available-for-Sale Investments	1,691	(881)	(141)	(636)
Changes in Derivatives	96	92	158	23
Comprehensive Income	3,753	1,258	5,971	5,055
Cash Dividend Declared	(1,022)	(988)	(3,068)	(2,962)
Common Stock Issued	--	--	--	--
Common Stock Repurchased	(31)	(52)	(116)	(150)
Employee Stock Obligation	--	--	--	--

Balance End of Period	$ 60,733	$ 56,544	$ 60,733	$ 56,544
	=====	=====	=====	=====

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(Stated in thousands)

	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2004	2003	2004	2003
Interest Income:				
Interest and Fees on Loans	$ 8,379	$ 8,606	$ 24,674	$ 25,885
Interest and Dividends on Investment Securities:				
Taxable	967	672	2,909	2,508
Tax-Exempt	345	409	1,010	1,218
Dividends	76	68	220	205
Other Interest Income :				
Federal Funds Sold	10	21	42	109
Checking	2	1	2	5
Lease Financing Income	--	--	--	--
Total Interest Income	9,779	9,777	28,857	29,930
Interest Expense:				
Interest on Deposits	2,126	2,301	6,203	7,423
Other Interest Expense	1,202	1,111	3,420	3,430
Total Interest Expense	3,328	3,412	9,623	10,853
Net Interest Income	6,451	6,365	19,234	19,077
Provision for Loan Losses	285	280	835	859
Net Interest Income after Provision	6,166	6,085	18,399	18,218
Other Income:				
Income from Fiduciary Activities	180	201	569	510
Service Charges on Deposit Accounts	1,479	1,298	4,107	3,601
Brokerage Fees	258	281	839	619
Gain (loss) on Sale of Securities	4	--	210	20
Other Income	366	668	1,244	1,679
Total Other Income	2,287	2,448	6,969	6,429
Other Expenses:				
Salaries and Employee Benefits	3,320	3,119	9,919	9,217
Net Occupancy Expense	397	350	1,154	1,194
Depreciation	421	345	1,192	1,032
Data Processing Expense	170	237	531	630
Legal and Professional Fees	89	19	171	42
Stationary and Office Supplies	69	84	212	253
Amortization of Intangibles	21	29	63	66
Other Expenses	1,219	1,467	3,798	4,066
Total Other Expenses	5,706	5,650	17,040	16,500
Net Income Before Income Taxes	2,747	2,883	8,328	8,147
Income Taxes	781	836	2,374	2,479
Net Income	$ 1,966	$ 2,047	$ 5,954	$ 5,668
	=====	=====	=====	=====
Earnings per Share	$ 0.54	$ 0.56	$ 1.63	$ 1.55
Weighted Average Number of Shares Outstanding	3,651,859	3,657,608	3,652,869	3,659,727

See accompanying notes to consolidated financial statements.

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(UNAUDITED)
(stated in thousands)

	Nine Months Ended Sept. 30,	
	2004	**2003**
Net Cash Provided by Operating Activities	$ 7,627	$ 6,328
Investing Activities:		
Proceeds of Maturities of Held-to-Maturity Securities	30	145
Purchase of Held-to-Maturity Investments	--	--
Proceeds of Maturities of Available-for-Sale Securities	25,773	60,923
Proceeds of Sales of Available-for-Sale Securities	14,190	1,477
Purchase of Available-for-Sale Securities	(40,319)	(66,323)
Increase in Loans - Net	(43,082)	(38,329)
Purchases of Premises and Equipment	(1,838)	(3,959)
Net Cash Provided by Investing Activities	(45,246)	(46,066)
Financing Activities:		
Net Increase in Demand and Savings Accounts	3,240	18,858
Increase (Decrease) in Time Deposits	(1,272)	3,211
Increase (Decrease) in Long-Term Debt	1,314	(226)
Treasury Stock Purchases	(116)	(151)
Proceeds from Sale of Common Stock	--	--
Cash Dividends Paid	(3,068)	(2,962)
Net Increase in Short Term Borrowings	21,366	109
Net Cash provided by Financing Activities	21,464	18,839
Increase (Decrease) in Cash and Cash Equivalents	(16,155)	(20,899)
Cash and Cash Equivalents at Beginning of Period	34,277	47,683
Cash and Cash Equivalents at End of Period	$ 18,122	$ 26,784
	=======	=======

Supplemental Cash Flow Disclosures:

	2004	2003
Interest Payments, Net	$ 10,025	$ 11,634
Income Taxes Paid, Net	$ 2,142	$ 3,748

FIRST CITIZENS BANCSHARES, INC.,
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)
(IN THOUSANDS)
September 30, 2004

NOTE 1 - CONSOLIDATED FINANCIAL STATEMENTS

The consolidated balance sheet as of September 30, 2004, the consolidated statements of income for the three month and nine month periods ended September 30, 2004 and 2003, and the consolidated statements of cash flows for the nine months 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 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 accounting principles generally accepted in the United States 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, 2004 and for all periods presented have been made. Operating results for the reporting periods presented are not necessarily indicative of results that may be expected for the year ended December 31, 2004. 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, 2003.

NOTE 2 - ORGANIZATION

First Citizens Bancshares, Inc., (the "Company") 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 (the "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

Loans are evaluated for impairment under the guidelines set forth in FASB 114 and 118.

The following data reflects impaired and probable loss loan totals:

	AS OF SEPT. 30
Amount of recorded balance with a related allowance	$ 1,569
Amount of recorded balance with no related allowance	776
Impaired loan balance or recorded balance	$ 2,345
	=======

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. Management is confident the 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. The Company used the derivative as a cash flow to hedge the "Benchmark Interest Rate." The Company designated a Federal Home Loan Bank Variable Libor Borrowing to be hedged and effectively locked in a fixed cost on the liability.

The Company 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 September 15, 2010.

The cash flow hedge has produced negative income because the Company swapped a fixed cash flow for a variable cash flow and rates later decreased. Accumulated Other Comprehensive Income, a component of total capital, includes a negative $151 thousand for the cash flow hedge as of the current quarter end.

NOTE 6 - FASB 142

This statement addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB 17. Goodwill is no longer amortized. This statement adopts a more aggregate view for goodwill and bases the accounting on the units of the combined units of the combined entity into which an acquired entity is integrated (those units are referred to as reporting units in FASB 131). Currently the Company has one reporting unit and does not meet the tests to segment per FASB 131. As of January 2002, the Company ceased to amortize goodwill ($25 thousand per month). Tests implemented first quarter 2003 and 2004 to establish a goodwill benchmark resulted in an impairment of zero. During the third quarter 2004, goodwill totaling $392,000 was reclassified as a deferred tax asset to correct an error made on the accounting for the Munford Union Bank acquisition in 2002. The acquisition accounting did not include an amount for deferred taxes related to Munford Union Bank being an S Corporation prior to acquisition. As this entry was a reclassification on the balance sheet, there was no impact on total assets, equity or net income for the periods presented. Total goodwill as of the reportable date is $11.8 million or 1.57% of total assets or 19.47% of total capital.

Amortization expense of the other identifiable intangibles for the first three quarters was $63 thousand for 2004 and $66 thousand for 2003.

NOTE 7 - LONG TERM OBLIGATIONS

In March 2002, the Company formed a wholly owned subsidiary First Citizens (TN) Statutory Trust II (Trust). 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 is 5.59%. For each successive period beginning on (and including) June 26, 2002, and each succeeding interest payment date at a rate per annum is 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.

The Company's obligation under the debentures and related documents, constitute a full and unconditional guarantee by the Company of the Trust issuer's obligations under the Preferred Securities. 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 the Company to service its long-term debt obligation is dependent upon the future profitability of its banking subsidiary d its ability to pay dividends to the Company.

NOTE 8 - 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 $8.705 million.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS

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 two wholly owned subsidiaries: Financial Plus, Inc. and Nevada Investments II, Inc. Through a corporate charter amendment, Nevada Investments II, Inc. changed its name to First Citizens Investments, Inc. as of September 21, 2004. First Citizens Investments, Inc. formed a wholly owned subsidiary, First Citizens Holdings, Inc. as of September 17, 2004. First Citizens Properties, Inc. is a wholly owned subsidiary of First Citizens Holdings, Inc., which was also formed September 17, 2004. The formation of these entities had no material impact on the consolidated financial statements of First

Citizens Bancshares, Inc. The bank also owns 50% of White and Associates/First Citizens Insurance LLC which provides various insurance products to its customers and First Citizens/White and Associates Insurance Company, Inc., which is a provider of credit insurance. The activities of the Bank's subsidiaries consist of: brokerage, investments, insurance related products, credit insurance and real estate participation interests.

BRANCH OPERATIONS

Land has been acquired in Oakland, Tennessee for the location of a new branch facility. A temporary banking facility opened June 7, 2004. Construction of a permanent banking facility on this site is in process and is expected to be completed by March 2005. Market data analysis for Fayette County reflects more than adequate market share growth available to support the Bank's long-term financial projections. Future population and household income growth within the area are projected to be positive. The Company 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," and other expressions are intended to identify forward-looking statements. The statements are within the meaning and intent of section 27A of the Securities Exchange Act of 1934. Such statements may include, but are not limited to, projections of income or loss, expenses, acquisitions, plans for the future, and others.

FINANCIAL SUMMARY

The accounting and reporting of the Company and its subsidiaries conform with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. The Company's estimates are based on historical experience, information supplied from professionals, regulators, and others believed to be reasonable under the facts and circumstances. Actual results could differ from estimates. The Company considers its more critical accounting policies to consist of the allowance for loan losses and the estimation of fair market value.

The allowance for losses on loans represents management's best estimate of inherent losses in the existing loan portfolio. Management's policy is to maintain the allowance for loan losses at a level sufficient to absorb reasonably estimated and probable losses within the portfolio. The Company believes the loan loss reserve estimate is a critical accounting estimate because: changes can materially affect bad debt expense on the income statement, changes in the borrower's cash flows can impact the reserve, and management must 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 values for the Company's 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 the fair value assigned to the assets and liabilities. Management believes accounting estimates associated with determining fair value, as part of the goodwill test is a critical accounting estimate because estimates and assumptions are made based on prevailing market factors, historical earnings and multiples and other contingencies.

Management has discussed critical accounting policies with the Audit Committee, and the Audit Committee has reviewed the Company's disclosure relating to these policies in this Management's Discussion and Analysis.

Net interest income is the principal source of earnings for the Company and is defined as the amount of interest generated by earning assets minus the interest cost to fund those assets. Net interest income has increased 2.63% when comparing third quarter of 2004 to the third quarter 2003, but the net yield on average earning assets is flat. Quarterly average cost of total interest bearing liabilities decreased 14 basis points while yields on interest-earning assets decreased 17 basis points from third quarter 2003 to third quarter 2004. Demands for re-financing, competition, and current market rate continued to drive loan yields downward 68 basis points when comparing third quarters 2004 and 2003. Federal Home Loan Bank fixed rate borrowings of $64.5 million carries a yield of 5.11%, resulting in a quarterly dilution to net interest income of $477 thousand when compared to average cost of funds of 2.11%. Federal Home Loan Borrowings were used to fund balance sheet and reduce exposure to rising interest rates. As rates rise, these borrowings will be fixed, causing a reduction to interest rate risk. Net interest margins have been challenged over the past two years as the Federal Reserve lowered interest rates in an effort to stimulate the national economy. Low interest rates resulted in substantial prepayments, higher premium amortization, and in-house loan refinancing. In the third quarter 2004, the Federal Reserve began raising interest rates to return to a neutral level of interest rates. The impact of raising the fed fund rate from 1.00% to 1.75% over the third quarter of 2004 has resulted in incremental increases in yields of variable rate loans and the cost of interest-bearing deposits and variable rate borrowings. The overall cost of interest bearing liabilities has increased 10 basis points from the end of second quarter to the end of third quarter 2004. Although rates have begun to rise during the third quarter 2004, a large volume of fixed rates loans have re-priced below rates in effect at the time of origination. As the volume of fixed rate loans is greater than the daily variable rate loans, the yield on total interest bearing assets dropped six basis points from the end of June to the end of September 2004. Net yield on average earning assets for the third quarter of 2004, 2003, and 2002 are 3.92%, 3.92%, and 4.59%, respectively. Mortgage fee income has begun to drop after two years of strong fee income as a result of low interest rate environment in the market up until the most recent quarter. A review of mortgage fee income from the last eight quarters starting with the most recent reflects the following: $227 thousand, $278 thousand, $296 thousand, $506 thousand, $498 thousand, $422 thousand, $336 thousand, and $239 thousand. Mortgage fee income posted in prior quarters is not anticipated to continue at these high levels and is evidenced by the decrease of approximately $50 in the third quarter 2004 compared to second quarter 2004.

The year-to-date and quarterly loan loss provisions are fairly flat from 2003 to 2004. Net charge-offs are $601 thousand for the first three quarters 2004 compared to $311 thousand, $713 thousand, and $826 thousand for the same three quarters of 2003, 2002, and 2001, respectively. The Bank continues to outperform peer in credit quality as evidenced by net charge-offs to total loans, non-performing loans to total loans, and earning coverage for net losses on loans as noted in the June 30, 2004 Uniform Bank Performance Report. Reserve for losses on loans as a percent of total loans has remained flat the past four quarters at 1.24% to 1.26%. Credit quality remains strong, as our provision for loan losses was $835,000 compared to net charge-offs of $601,000 for the first three quarters of 2004. Due to low net charge-offs through September 30, 2004, fourth quarter earnings will be enhanced as the allocation for loan losses is discontinued for the last quarter of 2004.

Non-interest income represents fees and other income derived from sources other than interest-earning assets. Non-interest income decreased $161 thousand, or 6.58% below the prior year's third quarter. In third quarter of 2004, non-interest income contributed 18.95% to total revenue compared to 20.02% for the same quarter last year. The decrease in third quarter non-interest income from prior year is primarily due to a one-time gain of $141,000 on a bank owned life insurance policy recognized in the third quarter 2003. On the positive side, service charges on deposit accounts have increased as a strategic result of implementing a new overdraft privilege product in new markets. Brokerage fees are down 8.19% when comparing third quarter of 2004 to 2003 but are up 35.5% overall for the nine months ended September 30, 2004 compared to the nine months ended September 30, 2003. The year-to-date increase is a result of implementing brokerage services in our new markets. The following table compares non-interest income for **third quarter** of 2004, 2003 and 2002:

	QUARTER ENDING SEPTEMBER 30,				
	2004	% of Change	2003	% of Change	2002
Income from Fiduciary Activities	$ 180	-10.45%	$ 201	16.86%	$ 172
Service Charges on Deposit Accounts	1,479	13.94%	1,298	29.67%	1,001
Brokerage Fees	258	-8.19%	281	29.49%	217
Other income	370	-44.61%	668	45.85%	458
Total non-interest income	$ 2,287	-6.58%	$ 2,448	32.47%	$ 1,848

Non-interest expense represents the operating expenses of the Bank. Non-interest expense increased $56 thousand, or 0.99%, over the third quarter of 2004. Increases in non-interest expense in the areas of salaries and benefits, occupancy costs and depreciation are reflective of those normally attributed to growth. As we continue to seek out and branch into new markets, First Citizens will experience earnings pressures associated with start up costs, increased staffing, marketing and other costs. Once the branch is established and a revenue stream developed, a return on investment will be realized. The year-to-date average for full time equivalent (FTE) employees has increased from 224.64 to 258.27 or 14.97% from September 2003 to 2004 while the total salaries and employee benefits year-to-date have increased $702 thousand or 7.62% year-to-date. Year-to-date average FTE per average total assets is $2.87 million assets per FTE as of September 30, 2004 compared to $3.15 million per FTE as of September 30, 2003. Tight budget controls and budget-based incentives stabilize the growth of the controllable expenses as shown in the stationary and office expense decrease of (17.86%) and other expense decrease of (16.91%). The efficiency ratios as of September 30, 2004 and 2003 were 64.00% and 62.61%. Executive management is committed to continued improvement in the efficiency ratio to meet or exceed peer group ratios. Expenses related to other real estate totaled $51 thousand for first three quarters in 2004 compared to $146 thousand for first three quarters in 2003. Other real estate continues to decrease from $1.1 million as of September 2003 to $257 thousand as of September 2004. Based on impairment testing in accordance with FASB 142, no impairment or expense of goodwill has been recorded in 2003 or 2004. The core deposit intangible expense for the current reportable quarter is $21,000. Quarter-to-date advertising, community relations, and other forms of marketing expenses were $129 thousand or 2.26% of total non-interest expense. All marketing or advertising items are expensed at the time they are incurred.

The following table compares non-interest expense for the **third quarter** of 2004, 2003, and 2002:

	QUARTER ENDING SEPTEMBER 30,				
	2004	% of Change	2003	% of Change	2002
Salaries and Employee Benefits	$ 3,320	6.44%	$ 3,119	9.67%	$ 2,844
Net Occupancy Expense	397	13.43%	350	18.64%	295
Depreciation	421	22.03%	345	1.77%	339
Data Processing Expense	170	-28.27%	237	48.13%	160
Legal and Professional Fees	89	368.42%	19	-52.50%	40
Stationary and Office Supplies	69	-17.86%	84	27.27%	66
Amortization of Intangibles	21	-27.59%	29	190.00%	10
Other Expenses	1,219	-16.91%	1,467	30.40%	1,125
Total Non-Interest Expense	$ 5,706	0.99%	$ 5,650	15.80%	$ 4,879

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

	QUARTER ENDING SEPTEMBER 30,								
	2004			2003			2002		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS									
INTEREST EARNING ASSETS:									
Loans (1) (2) (3)	$ 525,396	$ 8,379	6.38%	$ 487,869	$ 8,606	7.06%	$ 444,724	$ 8,757	7.87%
Investment Securities:									
Taxable	114,052	1,043	3.66%	106,704	672	2.52%	97,121	1,281	5.27%
Tax Exempt (4)	37,829	570	6.03%	38,623	409	4.24%	29,415	663	9.01%
Interest Earning Deposits	881	2	0.91%	425	1	0.94%	467	4	3.42%
Federal Funds Sold	1,949	10	2.05%	8,131	21	1.03%	10,299	49	1.90%
Lease Financing	-	-	-%	-	-	-%	-	-	-%
Total Interest Earning Assets	$ 680,107	$ 10,004	5.88%	$ 641,752	$ 9,709	6.05%	$ 582,026	$ 10,754	7.39%
NON-INTEREST EARNING ASSETS:									
Cash and due from Banks	14,964	0	0.00%	16,067	0	0.00%	14,904	0	0.00%
Bank Premises and Equipment	22,204	0	0.00%	20,208	0	0.00%	17,810	0	0.00%
Other Assets	33,329	0	0.00%	38,471	0	0.00%	50,471	0	0.00%
Total Assets	$ 750,604	$ 10,004	0.00%	$ 716,498	$ 9,709	0.00%	$ 665,211	$ 10,754	0.00%
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LIABILITIES AND SHAREHOLDERS' EQUITY									
INTEREST BEARING LIABILITIES:									
Interest bearing deposits	482,827	2,126	1.76%	487,559	2,301	1.89%	447,746	2,791	2.49%
Federal Funds Purchased and Other Interest Bearing Liabilities	131,223	1,202	3.66%	102,580	1,111	4.33%	106,663	1,279	4.79%

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