FIRST CITIZENS BANCSHARES INC /TN/
Form 10-K
March 31, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2014

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 or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
One First Citizens Place Dyersburg, Tennessee	38024
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (731) 285 - 4410

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
None.	N/A

Securities registered pursuant to Section 12(g) of the Act:

None.

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No þ

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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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. (Check One):

Large accelerated filer	Accelerated filer
Non-accelerated filer þ	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant on June 30, 2014 was approximately $129,315,510 based upon the last known sale price prior to such date**.**

As of February 27, 2015, the registrant had 3,836,721 outstanding shares of common stock and 140,202 outstanding shares of Class A common stock.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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PART I

ITEM 1. BUSINESS.

General

First Citizens Bancshares, Inc. (First Citizens or the Company) is a financial holding company incorporated in Tennessee in 1982. Through its principal bank subsidiary, First Citizens National Bank (FCNB), First Citizens conducts commercial banking and financial services operations primarily in West and Middle Tennessee. On October 1, 2014, First Citizens acquired Southern Heritage Bank which continues to operate as a separate depository institution. At December 31, 2014, First Citizens and its subsidiaries had total assets of $1.48 billion and total deposits of $1.21 billion. First Citizens principal executive offices are located at One First Citizens Place, Dyersburg, Tennessee 38024 and its telephone number is (731) 285-4410.

First Citizens, headquartered in Dyersburg, Tennessee, is the holding company for FCNB, Southern Heritage Bank (SHB and together with FCNB, the Banks), First Citizens (TN) Statutory Trusts III and IV and Southern Heritage Bancshares Statutory Trust I. The trusts hold the Banks trust preferred debt and are not consolidated but are accounted for under the equity method in accordance with generally accepted accounting principles (GAAP).

FCNB is a diversified financial services institution that provides banking and other financial services to its customers. FCNB provides customary banking services, such as checking and savings accounts, fund transfers, various types of time deposits, safe deposit facilities, financing of commercial transactions and making and servicing both secured and unsecured loans to individuals, firms and corporations. FCNB is the only community bank in Tennessee recognized as a preferred lender for the Farm Service Agency of the U.S. Department of Agriculture (FSA), which provides emergency farm loans to help producers recover from production and physical losses caused by natural disasters or quarantine. FCNB s agricultural services include operating loans as well as financing for the purchase of equipment and farmland. FCNB s consumer lending department makes direct loans to individuals for personal, automobile, real estate, home improvement, business and collateral needs. FCNB typically sells long-term residential mortgages that it originates to the secondary market without retaining servicing rights. FCNB s commercial lending operations include various types of credit services for customers.

FCNB has the following subsidiaries:

- First Citizens Financial Plus, Inc., a Tennessee bank service corporation wholly owned by FCNB, provides licensed brokerage services that allow FCNB to compete on a limited basis with numerous non-bank entities that provide such services to First Citizens customer base. The brokerage firm operates three locations in West Tennessee.
- White and Associates/First Citizens Insurance, LLC was chartered in the State of Tennessee and is a general insurance agency offering a full line of insurance products including casualty, life and health, and crop insurance. FCNB holds a 50% ownership interest in the agency, which is accounted for using the equity method. The insurance agency operates nine offices in Northwest Tennessee.
- First Citizens/White and Associates Insurance Company was organized and existed under the laws of the State

of Arizona. Its principal activity is credit insurance. FCNB held a 50% ownership in the agency, which was accounted for using the equity method until the entity was liquidated and dissolved as of September 29, 2014. The dissolution and liquidation of assets did not have a material impact to the Consolidated Financial Statements for the year ended December 31, 2014 included in Item 8 of this Annual Report on Form 10-K.

- First Citizens Investments, Inc. was organized and exists under laws of the State of Nevada. The principal activities of this entity are to acquire and sell investment securities and to collect income from its portfolio. First Citizens Investments, Inc. has the following subsidiaries:

  - ♦ First Citizens Holdings, Inc., a Nevada corporation and wholly-owned subsidiary of First Citizens Investments, Inc., acquires and sells certain investment securities, collects income from its portfolio, and owns the following subsidiary:

- ♦ First Citizens Properties, Inc. is a real estate investment trust organized and existing under the laws of the State of Maryland, the principal activity of which is to invest in participation interests in real estate loans made by FCNB and provide FCNB with an alternative vehicle for raising capital. First Citizens Holdings, Inc. owns 100% of the outstanding common stock and 60% of the outstanding preferred stock of First Citizens Properties, Inc. Directors, executive officers and certain employees and affiliates of FCNB own approximately 40% of the preferred stock which is reported as Noncontrolling Interest in Consolidated Subsidiaries in the Consolidated Balance Sheets of First Citizens included in Item 8 of this Annual Report on Form 10-K.

Southern Heritage Bank is a financial services institution that provides banking services to its customers. Southern Heritage Bank conducts commercial banking operations primarily in Bradley County in East Tennessee. Southern Heritage Bank provides customary banking services, such as checking and savings accounts, fund transfers, various types of time deposits, safe deposit facilities, financing of commercial transactions and making and servicing both secured and unsecured loans to individuals, firms and corporations. Southern Heritage Bank s consumer lending department makes direct loans to individuals for personal, automobile, real estate, home improvement, business and collateral needs. Southern Heritage Bank typically sells long-term residential mortgages that it originates to the secondary market without retaining servicing rights. Southern Heritage Bank s commercial lending operations include various types of credit services for customers.

The following table sets forth a comparative analysis of key balance sheet metrics of First Citizens as of December 31, for the years indicated (in thousands):

	2014	2013	2012
Total assets	$1,481,438	$1,174,472	$1,178,325
Total deposits	1,211,506	968,530	964,839
Total net loans	703,682	572,418	541,497
Total equity capital	144,510	112,606	114,140

The table below provides a comparison of First Citizens performance to industry standards based on information provided by the Federal Reserve. According to the Bank Holding Company Performance Report as of December 31, 2014 (the most recent report available as of the date of this Annual Report on Form 10-K), First Citizens peer group consisted of 343 bank holding companies with assets totaling $1 billion to $3 billion. The following table presents comparisons of First Citizens with its peers as indicated in Bank Holding Company Performance (BHCP) Reports for the years ended December 31 for each of the years indicated:

	2014		2013		2012	
	First Citizens	Peer(1)	First Citizens	Peer(2)	First Citizens	Peer(2)
Net interest income to average assets	3.46%	3.37%	3.41%	3.33%	3.69%	3.38%
Net operating income to average assets	1.08%	0.91%	1.19%	0.88%	1.27%	0.79%
Net loan losses to average total loans	0.16%	0.15%	0.16%	0.25%	0.14%	0.59%
Tier 1 capital to average assets(3)	8.92%	10.11%	9.40%	9.94%	9.17%	9.74%
Cash dividends to net income	36.17%	23.68%	33.94%	23.12%	32.00%	25.78%

(1) Peer information is provided for December 31, 2014, which is the most recent information available.
(2) For the years ended December 31, 2013 and 2012, First Citizens peer group consisted of approximately 350 bank holding companies with total asset size of $1 to $3 billion.
(3) Tier 1 capital to average assets is the ratio of core equity capital components to average total assets.

First Citizens and its subsidiaries employed a total of 348 full-time equivalent employees as of December 31, 2014. First Citizens and its subsidiaries are committed to hiring and retaining high quality employees to execute First Citizens strategic plan.

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First Citizens website address is www.FirstCNB.com. First Citizens makes its Annual Reports and all amendments to those reports available free of charge by link on its website on the About Investor Relations webpage as soon as reasonably practicable. Shareholders may request a copy of the annual report without charge by contacting Laura Beth Butler, Secretary, First Citizens Bancshares, Inc., P. O. Box 370, Dyersburg, Tennessee 38025-0370.

First Citizens is an emerging growth company as defined in the Jumpstart Our Business Startups Act of 2012 and, as such, may elect to comply with certain reduced public company reporting requirements.

Recapitalization

During a special meeting on July 16, 2014, First Citizens shareholders voted on and approved the First Citizens Charter Amendment authorizing an additional class of common stock (Class A common stock) to be issued to certain shareholders of First Citizens. Upon the filing of the First Citizens Charter Amendment, each share of First Citizens common stock outstanding immediately prior to such filing owned by a shareholder of record who owned less than 300 shares of such common stock, was, by virtue of the filing of the First Citizens Charter Amendment and without any action on the part of the holders, reclassified as Class A common stock, on the basis of one share of Class A common stock per each share of common stock so reclassified. Each share of First Citizens common stock outstanding immediately prior to the filing of the First Citizens Charter Amendment owned by a shareholder of record who owned 300 or more shares of such common stock was not reclassified and continued to be classified as common stock. The First Citizens common stock continues to have unlimited voting rights. Each outstanding share of First Citizens Class A common stock has no voting rights except as may be required by law.

Merger

On October 1, 2014, the Company completed its previously announced acquisition of Southern Heritage pursuant to the terms of the Merger Agreement. In accordance with the Merger Agreement, Southern Heritage merged with and into the Company, with the Company continuing as the surviving corporation.

Expansion

First Citizens, through its strategic planning process, intends to seek profitable opportunities that utilize excess capital and maximize income in Tennessee. In determining whether to acquire other banking institutions, First Citizens objective is asset growth and diversification into other market areas. Management believes acquisitions and de novo branches afford First Citizens increased economies of scale within operation functions and better utilization of human resources. First Citizens only pursues an acquisition or opens a de novo branch if First Citizens board of directors determines it to be in the best interest of First Citizens and its shareholders.

Competition

The business of providing financial services is highly competitive. In addition to competing with other commercial banks in the service area, both FCNB and SHB compete with savings and loan associations, insurance companies, savings banks, small loan companies, finance companies, mortgage companies, real estate investment trusts, certain governmental agencies, credit card organizations, credit unions and other enterprises. In 1998, federal legislation allowed credit unions to expand their membership criteria. Expanded membership criteria coupled with existing tax-exempt status give credit unions a competitive advantage compared to banks.

Both Banks build and implement strategic plans and commitments to address competitive factors in the various markets served. The primary strategic focus is on obtaining and maintaining profitable customer relationships in all markets the Banks serve. The markets demand competitive pricing, but the Banks compete on high quality customer service that will attract and enhance loyal, profitable customers. Industry surveys have consistently revealed that 65-70% of customers leave banks because of customer service issues. Accordingly, the Banks are committed to providing excellent customer service in all markets that they serve as a means of branding and distinguishing from other financial institutions. The Banks utilize advertising, including both newspaper and radio, and promotional activities to support strategic plans.

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The Banks offer a typical mix of interest-bearing transaction, savings and time deposit products, as well as traditional non-interest bearing deposit accounts. FCNB is a leader in deposit market share compared to competitors in the Counties of Dyer, Fayette, Lauderdale, Obion, Tipton and Weakley in Tennessee. FCNB has consistently been a leader in market share of deposits in its markets for several years. FCNB s market share has been 19% to 20% in Dyer, Fayette, Lauderdale, Obion, Tipton and Weakley Counties combined and in excess of 62% in Dyer County for the last three years. The following market share information for these counties (banks only, deposits inside of market) is from the Deposit Market Share Report, as of June 30, 2014, prepared annually by the Federal Deposit Insurance Corporation (the FDIC) (dollars in thousands):

Bank Name	# of Offices	Total Deposits	Market Share %
First State Bank	15	$ 864,395	24.29%
First Citizens National Bank	13	714,865	20.09%
Bank of Fayette County	6	255,155	7.17%
Regions Bank	9	207,414	5.83%
Trustmark National Bank	5	181,734	5.11%
Bank of Ripley	4	171,166	4.81%
BancorpSouth Bank	5	147,728	4.15%
Commercial Bank & Trust	2	127,915	3.59%
Security Bank	6	109,772	3.08%
Patriot Bank	2	102,465	2.88%
Reelfoot Bank	4	97,995	2.75%
INSOUTH Bank	2	89,817	2.52%
First South Bank	2	75,456	2.12%
Clayton Bank & Trust	4	75,049	2.11%
Bank of Gleason	1	66,832	1.88%
Bank of Halls	2	58,930	1.66%
The Lauderdale County Bank	2	45,454	1.28%
Greenfield Banking Co.	2	39,533	1.11%
Gates Banking & Trust Co.	1	37,756	1.06%
Brighton Bank	1	33,695	0.95%
Bank Tennessee	2	17,294	0.49%
All others	7	38,165	1.07%
Total	97	$3,558,585	100.00%

FCNB also competes in the Shelby County and Williamson County markets. Because the size and composition of these two markets is much larger and more diverse than the other markets in which FCNB operates, Shelby and Williamson Counties are excluded from the above table. FCNB s market share in Shelby County was 1.05% and 1.02% as of June 30, 2014 and 2013, respectively. FCNB s market share in Williamson County was 0.97% and 1.25% as of June 30, 2014 and 2013, respectively.

SHB competes in Bradley County and has been 13% to 14% for the last three years. The following market share information for this county (banks only, deposits inside of market) is from the Deposit Market Share Report, as of June 30, 2014, prepared annually by the FDIC (dollars in thousands):

Bank Name	# of Offices	Total Deposits	Market Share %
First Tennessee Bank	4	$ 265,848	18.90%
Southern Heritage Bank	3	209,024	14.86%
Regions Bank	4	200,879	14.28%
Bank of Cleveland	5	188,792	13.42%
Branch Banking & Trust Co.	3	172,150	12.24%
SunTrust Bank	2	91,726	6.52%
CapitalMark Bank & Trust	1	79,108	5.62%
United Community Bank	2	68,511	4.87%
FSGBANK	2	35,341	2.51%
SouthEast Bank	1	31,284	2.22%
All others	4	64,237	4.56%
Total	31	$1,406,900	100.00%

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Regulation and Supervision

The following discussion sets forth certain material elements of the regulatory framework applicable to the Corporation and the Banks. This discussion is a brief summary of the regulatory environment in which the Corporation and its subsidiaries operate and is not designed to be a complete discussion of all statutes and regulations affecting such operations. Regulation of financial institutions is intended primarily for the protection of depositors, the deposit insurance fund and the banking system, and generally is not intended for the protection of shareholders. Changes in applicable laws, and their application by regulatory agencies, cannot necessarily be predicted, but could have a material effect on the business and results of the Corporation and its subsidiaries.

General

The Corporation is subject to regulation and supervision by the Board of Governors of the Federal Reserve System (the Federal Reserve). The Corporation is required to file annual reports with the Federal Reserve and such other information as the Federal Reserve may require. The Federal Reserve also conducts examinations of the Corporation. The Banks are subject to regulation and supervision by the Office of the Comptroller of the Currency (the OCC). The Banks are required to file annual reports with the OCC and such other information as the OCC may require. The OCC also conducts examinations of the Banks.

The Bank Holding Corporation Act requires every bank holding company to obtain the prior approval of the Federal Reserve before:

- it may acquire direct or indirect ownership or control of any voting shares of any other bank holding company if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the voting shares of the other bank holding company;
- it may acquire direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the voting shares of the bank;
- it or any of its subsidiaries, other than a bank, may acquire all or substantially all of the assets of any bank; or
- it may merge or consolidate with any other bank holding company.

The Bank Holding Company Act further provides that the Federal Reserve may not approve any transaction that would result in a monopoly or that would substantially lessen competition in the banking business, unless the public interest in meeting the needs of the communities to be served outweighs the anticompetitive effects. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks involved and the convenience and needs of the communities to be served. Consideration of financial resources generally focuses on capital adequacy, and consideration of convenience and needs issues focuses, in part, on the performance under the Community Reinvestment Act of 1977, both of which are discussed below in more detail.

Subject to various exceptions, the Bank Holding Company Act and the Change in Bank Control Act, together with related regulations, require Federal Reserve approval prior to any person or company acquiring control of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of a bank holding company. Control is also presumed to exist, although rebuttable, if a person or company acquires 10% or more, but less than 25%, of any class of voting securities and either:

- the bank holding company has registered securities under Section 12 of the Exchange Act of 1934, as amended (Exchange Act); or
- no other person owns a greater percentage of that class of voting securities immediately after the transaction.

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The Corporation s common stock is registered under Section 12 of the Exchange Act. The regulations provide a procedure for challenging rebuttable presumptions of control.

The Bank Holding Company Act generally prohibits a bank holding company from engaging in activities other than banking, managing or controlling banks or other permissible subsidiaries and acquiring or retaining direct or indirect control of any company engaged in any activities other than activities closely related to banking or managing or controlling banks. In determining whether a particular activity is permissible, the Federal Reserve considers whether performing the activity can be expected to produce benefits to the public that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The Federal Reserve has the power to order a bank holding company or its subsidiaries to terminate any activity or control of any subsidiary when the continuation of the activity or control constitutes a serious risk to the financial safety, soundness or stability of any bank subsidiary of that bank holding company.

The Banks are incorporated under the laws of the United States and is subject to the applicable provisions of the National Bank Act and regulations promulgated by the OCC. The Banks are subject to the supervision of the OCC and to regular examinations by that department. Deposits in the Banks are insured by FDIC and, therefore, the Banks are subject to the provisions of the Federal Deposit Insurance Act.

Federal Reserve policy historically has required bank holding companies to act as a source of strength to their bank subsidiaries and to commit capital and financial resources to support those subsidiaries. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) codifies this policy as a statutory requirement. This support may be required by the Federal Reserve at times when the Corporation might otherwise determine not to provide it. In addition, if a bank holding company commits to a federal bank regulator that it will maintain the capital of its bank subsidiary, whether in response to the Federal Reserve s invoking its source-of-strength authority or in response to other regulatory measures, that commitment will be assumed by the bankruptcy trustee and the bank will be entitled to priority payment in respect of that commitment, ahead of other creditors of the bank holding company.

In addition, the Corporation is required to file certain reports with, and otherwise comply with the rules and regulations of, the U.S. Securities and Exchange Commission (the SEC) under federal securities laws.

The Dodd-Frank Act

The Dodd-Frank Act, enacted in 2010, significantly restructured financial regulation in the United States, including through the creation of a new resolution authority, mandating higher capital and liquidity requirements, requiring banks to pay increased fees to regulatory agencies, and through numerous other provisions intended to strengthen the financial services sector.

The Dodd-Frank Act established the Consumer Financial Protection Bureau (CFPB), which has extensive regulatory and enforcement powers over consumer financial products and services, and the Financial Stability Oversight Council, which has oversight authority for monitoring and regulating systemic risk. In addition, the Dodd-Frank Act altered the authority and duties of the federal banking and securities regulatory agencies, implemented certain corporate governance requirements for all public companies, including financial institutions, with regard to executive compensation, proxy access by shareholders, and certain whistleblower provisions, and restricted certain proprietary trading and hedge fund and private equity activities of banks and their affiliates. The Dodd-Frank Act also required the issuance of numerous implementing regulations, many of which have not yet been issued.

In January 2013, the CFPB issued final regulations governing mainly consumer mortgage lending. One rule imposes additional requirements on lenders, including rules designed to require lenders to ensure borrowers ability to repay their mortgage. The CFPB also finalized a rule on escrow accounts for higher priced mortgage loans and a rule expanding the scope of the high-cost mortgage provision in the Truth in Lending Act. The CFPB also issued final rules implementing provisions of the Dodd-Frank Act that relate to mortgage servicing. In November 2013, the CFPB issued a final rule on integrated mortgage disclosures under the Truth in Lending Act and the Real Estate Settlement Procedures Act, compliance with which is required by August 1, 2015.

The Dodd-Frank Act authorizes national and state banks to establish de novo branches in other states to the same extent as a bank chartered by that state would be so permitted. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks are now able to enter new markets more freely.

Recently, the CFPB and banking regulatory agencies have increasingly used a general consumer protection statute to address unethical or otherwise bad business practices that may not necessarily fall directly under the purview of a specific banking or consumer finance law. Prior to the Dodd-Frank Act, there was little formal guidance to provide insight to the parameters for compliance with the unfair or deceptive acts or practices (UDAP) law. However, the UDAP provisions have been expanded under the Dodd-Frank Act to apply to unfair, deceptive or abusive acts or practices, which has been delegated to the CFPB for supervision.

Many aspects of the Dodd-Frank Act are subject to further rulemaking and will take effect over several years. The overall financial impact on the Corporation and its subsidiaries or the financial services industry generally cannot be anticipated at this time.

Dividends

The Corporation is a legal entity that is separate and distinct from its subsidiaries. The primary source of funds for dividends paid to the Corporation s shareholders are dividends paid to the Corporation by the Banks. Federal law limits the amount of dividends that the Banks may pay to the Corporation without regulatory approval. The Banks are required by to obtain the prior approval of the OCC for payments of dividends if the total of all dividends declared by its board of directors in any calendar year will exceed (i) the total of the Banks retained net income for that year, plus (ii) the Banks retained net income for the preceding two years. The OCC also has the authority to prohibit the Banks from engaging in business practices that the OCC considers to be unsafe or unsound, which, depending on the financial condition of the Banks, could include the payment of dividends.

In addition, the Federal Reserve has the authority to prohibit the payment of dividends by a bank holding company if its actions constitute unsafe or unsound practices. The Federal Reserve has issued a policy statement, Supervisory Release 09-4, on the payment of cash dividends by bank holding companies, which outlines the Federal Reserve s view that a bank holding company that is experiencing earnings weaknesses or other financial pressures should not pay cash dividends that exceed its net income, that are inconsistent with its capital position, or that could only be funded in ways that weaken its financial health, such as by borrowing or selling assets. The Federal Reserve has indicated that, in some instances, it may be appropriate for a bank holding company to eliminate its dividends.

Capital

The Federal Reserve has issued risk-based capital ratio and leverage ratio guidelines for bank holding companies. The risk-based capital ratio guidelines establish a systematic analytical framework that:

- ♦ makes regulatory capital requirements sensitive to differences in risk profiles among banking organizations;
- ♦ takes off-balance sheet exposures into explicit account in assessing capital adequacy; and
- ♦ minimizes disincentives to holding liquid, low-risk assets.

Under the guidelines and related policies, banks and bank holding companies must maintain capital sufficient to meet both a risk-based asset ratio test and a leverage ratio test on a consolidated basis. The risk-based ratio is determined by allocating assets and specified off-balance sheet commitments into four weighted categories, with higher weighting assigned to categories perceived as representing greater risk. The risk-based ratio represents capital divided by total risk-weighted assets. The leverage ratio is core capital divided by total assets adjusted as specified in the guidelines.

Generally, under the applicable guidelines, a financial institution s capital is divided into two tiers. Total capital is Tier 1 plus Tier 2 capital. These two tiers are:

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- ♦ Tier 1, or core capital, that includes total equity plus qualifying capital securities and minority interests, excluding unrealized gains and losses accumulated in other comprehensive income, and non-qualifying intangible and servicing assets; and
- ♦ Tier 2, or supplementary capital, includes, among other things, cumulative and limited-life preferred stock, mandatory convertible securities, qualifying subordinated debt, and the allowance for credit losses, up to 1.25% of risk-weighted assets.

The Federal Reserve and the other federal banking regulators require that all intangible assets (net of deferred tax), except originated or purchased mortgage-servicing rights, non-mortgage servicing assets, and purchased credit card relationships, be deducted from Tier 1 capital. However, the total amount of these items included in Total capital cannot exceed 100% of an institution s Tier 1 capital.

Under the risk-based capital guidelines existing prior to January 1, 2015, financial institutions were required to maintain a risk-based ratio of 8%, with 4% being Tier 1 capital. The appropriate regulatory authority may set higher capital requirements when they believe an institution s circumstances warrant.

Under the leverage guidelines existing prior to January 1, 2015, financial institutions are required to maintain a leverage ratio of at least 3%. The minimum ratio is applicable only to financial institutions that meet certain specified criteria, including excellent asset quality, high liquidity, low interest rate risk exposure, and the highest regulatory rating. Financial institutions not meeting these criteria are required to maintain a minimum Tier 1 leverage ratio of 4%.

The guidelines also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the Federal Reserve has indicated that it will consider a tangible Tier 1 capital leverage ratio (deducting all intangibles) and other indicators of capital strength in evaluating proposals for expansion or new activities.

Failure to meet applicable capital guidelines could subject the financial institution to a variety of enforcement remedies available to the federal regulatory authorities. These include limitations on the ability to pay dividends, the issuance of a capital directive to increase capital, and the termination of deposit insurance by the FDIC. In addition, the financial institution could be subject to the measures described below under Prompt Corrective Action as applicable to under-capitalized institutions.

New Capital Rules

On July 2, 2013, the Federal Reserve approved the final rule for BASEL III capital requirements for all bank holding companies chartered in the United States and banks that are members of the Federal Reserve System. The rule implements in the United States certain of the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. The major provisions of the new rule applicable to the Corporation and the Banks are:

- ♦ The new rule implements higher minimum capital requirements, includes a new common equity Tier 1 capital requirement, and establishes criteria that instruments must meet in order to be considered common equity Tier 1 capital, additional Tier 1 capital, or Tier 2 capital. These enhancements both improve the quality and increase the quantity of capital required to be held by banking organizations, better equipping the United States banking system to deal with adverse economic conditions.

- ♦ The new minimum capital to risk-weighted assets requirements are a common equity Tier 1 capital ratio of 4.5% and a Tier 1 capital ratio of 6.0% which is an increase from 4.0%, and a total capital ratio that remains at 8.0%. The minimum leverage ratio (Tier 1 capital to total assets) is 4.0%.
- ♦ The new rule improves the quality of capital by implementing changes to the definition of capital. Among the most important changes are stricter eligibility criteria for regulatory capital instruments that would disallow the inclusion of instruments such as trust preferred securities in Tier 1 capital going forward, and new constraints on the inclusion of minority interests, mortgage-servicing assets, deferred tax assets, and certain investments in the capital of unconsolidated financial institutions. In addition, the new rule requires that most regulatory capital deductions be made from common equity Tier 1 capital.

- Under the new rule, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of common equity Tier 1 capital above its minimum risk-based capital requirements. This buffer will help to ensure that banking organizations conserve capital when it is most needed, allowing them to better weather periods of economic stress. The buffer is measured relative to risk weighted assets. Phase-in of the capital conservation buffer requirements will begin on January 1, 2016. A banking organization with a buffer greater than 2.5% would not be subject to limits on capital distributions or discretionary bonus payments; however, a banking organization with a buffer of less than 2.5% would be subject to increasingly stringent limitations as the buffer approaches zero. The new rule also prohibits a banking organization from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5% at the beginning of the quarter. When the new rule is fully phased in, the minimum capital requirements plus the capital conservation buffer will exceed the prompt corrective action well-capitalized thresholds.
- The new rule also increases the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors.

The transition period for implementation of Basel III is January 1, 2015, through December 31, 2018.

Prompt Corrective Action

The Federal Deposit Insurance Corporation Improvement Act of 1991, known as FDICIA, requires federal banking regulatory authorities to take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. For these purposes, FDICIA establishes five capital tiers: well-capitalized, adequately-capitalized, under-capitalized, significantly under-capitalized, and critically under-capitalized.

An institution is deemed to be:

- well-capitalized if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 6% or greater (8% after January 1, 2015), a Tier 1 leverage ratio of 5% or greater, and, after January 1, 2015, a common equity Tier 1 capital ratio of 6.5% or greater, and is not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure;
- adequately-capitalized if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 4% or greater (6% after January 1, 2015), generally, a Tier 1 leverage ratio of 4% or greater, and, after January 1, 2015, a common equity Tier 1 capital ratio of 4.5% or greater, and the institution does not meet the definition of a well-capitalized institution;
- under-capitalized if it does not meet one or more of the adequately-capitalized tests;
- significantly under-capitalized if it has a total risk-based capital ratio that is less than 6%, a Tier 1 risk-based capital ratio that is less than 3% (less than 4% after January 1, 2015), a Tier

1 leverage ratio that is less than 3%, and, after January 1, 2015, a common equity Tier 1 capital ratio that is less than 3%; and

- critically under-capitalized if it has a ratio of tangible equity, as defined in the regulations, to total assets that is equal to or less than 2%.

Throughout 2014, the Banks regulatory capital ratios were in excess of the levels established for well-capitalized institutions.

FDICIA generally prohibits a depository institution from making any capital distribution, including payment of a cash dividend or paying any management fee to its holding company, if the depository institution would be under-capitalized after such payment. Under-capitalized institutions are subject to growth limitations and are required by the appropriate federal banking agency to submit a capital restoration plan. If any depository institution subsidiary of a holding company is required to submit a capital restoration plan, the holding company would be required to provide a limited guarantee regarding compliance with the plan as a condition of approval of such plan.

If an under-capitalized institution fails to submit an acceptable plan, it is treated as if it is significantly under-capitalized. Significantly under-capitalized institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately-capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks.

Critically under-capitalized institutions may not, beginning 60 days after becoming critically under-capitalized, make any payment of principal or interest on their subordinated debt. In addition, critically under-capitalized institutions are subject to appointment of a receiver or conservator within 90 days of becoming so classified.

Under FDICIA, a depository institution that is not well-capitalized is generally prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market. As previously stated, the Banks are well-capitalized and the FDICIA brokered deposit rule did not adversely affect its ability to accept brokered deposits. The Banks had approximately $4.9 million of such brokered deposits at December 31, 2014.

Interstate Banking and Branching Legislation

Federal law allows banks to establish and operate a de novo branch in a state other than the bank s home state if the law of the state where the branch is to be located would permit establishment of the branch if the bank were chartered by that state, subject to standard regulatory review and approval requirements. Federal law also allows the Banks to acquire an existing branch in a state in which the banks are not headquartered and does not maintain a branch if the OCC approves the branch or acquisition, and if the law of the state in which the branch is located or to be located would permit the establishment of the branch if the banks were chartered by that state.

Once a bank has established branches in a state through an interstate merger transaction or through de novo branching, the bank may then establish and acquire additional branches within that state to the same extent that a state chartered bank is allowed to establish or acquire branches within the state.

Under the Bank Holding Company Act, a bank holding company may not directly or indirectly acquire ownership or control of more than 5% of the voting shares or substantially all of the assets of any bank holding company or bank or merge or consolidate with another bank holding company without the prior approval of the Federal Reserve. Current federal law authorizes interstate acquisitions of banks and bank holding companies without geographic limitation. Furthermore, a bank headquartered in one state is authorized to merge with a bank headquartered in another state, as long as neither of the states have opted out of such interstate merger authority prior to such date, and subject to any state requirement that the target bank shall have been in existence and operating for a minimum period of time, not to exceed five years, and subject to certain deposit market-share limitations.

FDIC Insurance

The deposits of the Banks are insured by the Deposit Insurance Fund (the DIF), which the FDIC administers. The Dodd-Frank Act permanently increased deposit insurance on most accounts to $250,000. To fund the DIF, FDIC-insured banks are required to pay deposit insurance assessments to the FDIC. For institutions like the Banks with less than $10 billion in assets, the amount of the assessment is based on its risk classification. The higher an institution s risk classification, the higher its rate of assessments (on the assumption that such institutions pose a greater risk of loss to the DIF). An institution s risk classification is assigned based on its capital levels and the level of supervisory concern that the institution poses to the regulators. In addition, the FDIC can impose special assessments in certain instances.

In addition, all institutions with deposits insured by the FDIC must pay assessments to fund interest payments on bonds issued by the Financing Corporation, a mixed-ownership government corporation established as a financing vehicle for the Federal Savings & Loan Insurance Corporation. The assessment rate for the first quarter of fiscal 2015 is 1.28% of insured deposits and is adjusted quarterly. These assessments will continue until the bonds mature in 2019.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Banks, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. If the FDIC terminates an institution s deposit insurance, accounts insured at the time of the termination, less withdrawals, will continue to be insured for a period of six months to two years, as determined by the FDIC.

Affiliate Transactions

The Banks are subject to Regulation W, which comprehensively implements statutory restrictions on transactions between a bank and its affiliates. Regulation W combines the Federal Reserve s interpretations and exemptions relating to Sections 23A and 23B of the Federal Reserve Act. Regulation W and Section 23A place limits on the amount of loans or extensions of credit to, investments in, or certain other transactions with affiliates, and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. In general, the Banks affiliates are the Corporation and its non-bank subsidiaries.

Regulation W and Section 23B prohibit, among other things, a bank from engaging in certain transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with non-affiliated companies.

The Banks are also subject to certain restrictions on extensions of credit to executive officers, directors, certain principal shareholders and their related interests. Such extensions of credit must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties and must not involve more than the normal risk of repayment or present other unfavorable features.

The Community Reinvestment Act

The Community Reinvestment Act of 1977 (CRA) and its implementing regulations provide an incentive for regulated financial institutions to meet the credit needs of their local community or communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of such financial institutions. The regulations provide that the appropriate regulatory authority will assess reports under CRA in connection with applications for establishment of domestic branches, acquisitions of banks or mergers involving bank holding companies. An unsatisfactory rating under CRA may serve as a basis to deny an application to acquire or establish a new bank, to establish a new branch or to expand banking services. As of December 31, 2014, the Banks had a satisfactory rating under the CRA.

Patriot Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, as extended and revised by the PATRIOT Improvement and Reauthorization Act of 2005 (the Patriot Act), requires each financial institution to: (i) establish an anti-money laundering program; (ii) establish due diligence policies, procedures and controls with respect to its private banking accounts and correspondent banking accounts involving foreign individuals and certain foreign financial institutions; and (iii) avoid establishing, maintaining, administering or managing correspondent accounts in the United States for, or on behalf of, foreign financial institutions that do not have a physical presence in any country. The Patriot Act also requires that financial institutions follow certain minimum standards to verify the identity of customers, both foreign and domestic, when a customer opens an account. In addition, the Patriot Act contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. Federal banking regulators are required, when reviewing bank holding company acquisition and bank merger applications, to take into account the effectiveness of the anti-money laundering activities of the applicants.

Consumer Privacy and Other Consumer Protection Laws

The Banks, like all other financial institutions, are required to maintain the privacy of its customers non-public, personal information. Such privacy requirements direct financial institutions to:

- ♦ provide notice to customers regarding privacy policies and practices;
- ♦ inform customers regarding the conditions under which their non-public personal information may be disclosed to non-affiliated third parties; and
- ♦ give customers an option to prevent disclosure of such information to non-affiliated third parties.

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Under the Fair and Accurate Credit Transactions Act of 2003, the Banks customers may also opt out of information sharing between and among the Banks and its affiliates.

The Banks are also subject, in connection with its deposit, lending and leasing activities, to numerous federal and state laws aimed at protecting consumers, including the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act, the Truth in Lending Act, the Truth-in-Savings Act, the Fair Housing Act, the Fair Credit Reporting Act, the Electronic Funds Transfer Act, the Currency and Foreign Transactions Reporting Act, the National Flood Insurance Act, the Flood Protection Act, the Bank Secrecy Act, laws and regulations governing unfair, deceptive, and/or abuse acts and practices, the Servicemembers Civil Relief Act, the Housing and Economic Recovery Act, and the Credit Card Accountability Act, among others, as well as various state laws.

Incentive Compensation

In 2010, the Federal Reserve issued guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization s incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization s ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization s board of directors.

Any deficiencies in compensation practices that are identified may be incorporated into the organization s supervisory ratings, which can affect its ability to make acquisitions or perform other actions. The guidance also provides that enforcement actions may be taken against a banking organization if its incentive compensation arrangements or related risk-management control or governance processes pose a risk to the organization s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

The federal banking agencies have proposed rule-making implementing provisions of the Dodd-Frank Act to prohibit incentive-based compensation plans that expose covered financial institutions to inappropriate risks. Covered financial institutions are institutions that have over $1 billion in assets and offer incentive-based compensation programs. If adopted, the proposed rules would require incentive-based compensation plans:

- to provide incentives that do not encourage risk-taking beyond the organization s ability to effectively identify and manage risks;
- be compatible with effective internal controls and risk management, and
- be supported by strong corporate governance, including active and effective oversight by the organization s board of directors and appropriate policies, procedures and monitoring.

The scope and content of banking regulators policies on executive compensation are continuing to develop and are likely to continue evolving in the near future. It cannot be determined at this time whether compliance with such policies will adversely affect the Corporation s ability to hire, retain and motivate its key employees.

Sarbanes-Oxley

The Sarbanes-Oxley Act of 2002 is applicable to all companies with equity or debt securities registered under the Exchange. In particular, the Sarbanes-Oxley Act established: (i) requirements for audit committees, including independence, expertise and responsibilities; (ii) certification and related responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting Corporation; (iii) standards for auditors and regulation of audits; (iv) disclosure and reporting obligations for the reporting Corporation and its directors and executive officers; and (v) civil and criminal penalties for violation of the securities laws.

Effect of Governmental Policies

The Corporation and the Banks are affected by the policies of regulatory authorities, including the Federal Reserve, the FDIC, and the OCC. An important function of the Federal Reserve is to regulate the national money supply. Among the instruments of monetary policy used by the Federal Reserve are: (i) purchases and sales of U.S. government and other securities in the marketplace; (ii) changes in the discount rate, which is the rate any depository institution must pay to borrow from the Federal Reserve; (iii) changes in the reserve requirements of depository institutions; and (iv) indirectly, changes in the federal funds rate, which is the rate at which depository institutions lend money to each other overnight. These instruments are intended to influence economic and monetary growth, interest rate levels, and inflation.

The monetary policies of the Federal Reserve and other governmental policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. Because of changing conditions in the national and international economy and in the money markets, as well as the result of actions by monetary and fiscal authorities, it is not possible to predict with certainty future changes in interest rates, deposit levels, loan demand, or the business and results of operations of the Corporation and the Banks, or whether changing economic conditions will have a positive or negative effect on operations and earnings.

Other Proposals

Bills occasionally are introduced in the United States Congress, and regulations occasionally are proposed by regulatory agencies, any of which could affect the Company s businesses, financial results, and financial condition. Generally it cannot be predicted whether or in what form any particular proposals will be adopted or the extent to which the Corporation and the Banks may be affected.

ITEM 1A. RISK FACTORS.

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, could, may and other expressions are intended to identify forward-looking statements. These forward-looking statements are within the meaning of section 27A of the Securities Act of 1933, as amended (the Securities Act), and section 21E of the Exchange Act. Such statements may include, but are not limited to, capital resources, strategic planning, acquisitions or de novo branching, ability to meet capital guidelines, legislation and governmental regulations affecting financial services companies, 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, core deposit intangibles, diversification in the real estate loan portfolio, interest income, maturity of loans, loan impairment, loan ratings, charge-offs, other real estate owned, 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, 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 Federal Home Loan Bank (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 the 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;
- The ability of the Company to attract, train and retain qualified personnel;
- Changes in consumer preferences; and
- Other factors generally understood to affect financial results of financial services companies.

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The Company undertakes no obligation to update its forward-looking statements to reflect events or circumstances that occur after the date of this Annual Report on Form 10-K.

Changes in interest rates could have an adverse effect on First Citizens earnings.

First Citizens profitability is in part a function of interest rate spread, or the difference between interest rates earned on investments, loans and other interest-earning assets and the interest rates paid on deposits and other interest-bearing liabilities. Interest rates are largely driven by monetary policies set by the Federal Open Market Committee (FOMC) and trends in the prevailing market rate of interest embodied by the yield curve. The FOMC establishes target rates of interest to influence the cost and availability of capital and promote national economic goals. Rates remained at a historical low range of 0.00% to 0.25% through the end of 2014. In March 2015, the FOMC indicated that rates of 0.00% to 0.25% remain appropriate. The yield curve is a representation of the relationship between short-term interest rates to longer-term debt maturity rates. Currently, the yield curve is fairly steep as short-term rates continue at historic lows. As of December 31, 2014, FCNB was liability sensitive in terms of interest rate risk exposure, meaning that FCNB will likely experience margin compression when federal funds rates increase. In other words, upward pressure on deposit interest rates will outpace increases in the interest rates on interest-earning assets. Deposits are currently priced at historically low levels and are likely to reprice at a faster pace than interest-earning assets when the rate environment begins rising. The majority of variable-rate loans are priced at floors that will require significant increases in federal fund and prime rates before loan yields increase.

If the rate of interest paid on deposits and other borrowings increases more than the rate of interest earned on loans and other investments, First Citizens net interest income and, therefore, earnings could be adversely affected. Earnings could also be adversely affected if the rates on loans and other investments fall more quickly than those on deposits and other borrowings. While management takes measures to guard against interest rate risk, there can be no assurance that such measures will be effective in minimizing the exposure to interest rate risk. A sudden and significant increase in the market rate of interest could have a material adverse effect on the First Citizens financial condition and earnings.

First Citizens is subject to credit quality risks and First Citizens credit policies may not be sufficient to avoid losses.

First Citizens is subject to the risk of losses resulting from the failure of borrowers, guarantors and related parties to pay interest and principal amounts on loans. Although First Citizens maintains credit policies and credit underwriting, monitoring and collection procedures that management believes are sufficient to manage this risk, these policies and procedures may not prevent losses, particularly during periods in which the local, regional or national economy suffers a general decline. If a large number of borrowers fail to repay their loans, First Citizens financial condition and results of operations may be adversely affected.

If First Citizens allowance for loan losses becomes inadequate, First Citizens financial condition and results of operations could be adversely affected.

First Citizens maintains an allowance for loan losses that management believes is a reasonable estimate of known and inherent potential losses in its loan portfolio. Management uses various assumptions and judgments to evaluate on a quarterly basis the adequacy of the allowance for loan losses in accordance with GAAP as well as regulatory guidelines. The amount of future losses is susceptible to changes in economic, operating and other conditions, as well as changes in interest rates, most of which are beyond First Citizens control, and these losses may exceed current estimates. Although First Citizens believes the allowance for loan losses is a reasonable estimate of known and inherent potential losses in its loan portfolio, First Citizens cannot fully predict such potential losses or that its loan loss allowance will be adequate in the future. Excessive loan losses could have an adverse effect on First Citizens financial performance.

Federal and state regulators periodically review First Citizens allowance for loan losses and may require First Citizens to increase its provision for loan losses or recognize further loan charge-offs, based on judgments different than those of its management. Any increase in the amount of First Citizens provision or loans charged-off as required by these regulatory agencies could have an adverse effect on First Citizens results of operations.

First Citizens no longer has reporting obligations pursuant to the Exchange Act and it cannot be certain if the less publicly available information will make First Citizens stock trade less frequently and be less attractive to investors.

First Citizens no longer has reporting obligations pursuant to the Exchange Act, which will result in less publicly available information about First Citizens and could cause its stock to trade less frequently and be less attractive to investors.

First Citizens is geographically concentrated in West Tennessee, and changes in local economic conditions may impact its profitability.

First Citizens operates primarily in West Tennessee and the majority of all loan customers and most deposit and other customers live or have operations in this area. Accordingly, First Citizens success depends significantly upon growth in population, income levels, deposits, housing starts and continued attraction of business ventures to this area. First Citizens profitability is impacted by changes in general economic conditions in this market. First Citizens management remains concerned about unemployment levels and economic conditions in its rural markets. Additionally, unfavorable local or national economic conditions could reduce First Citizens growth rate, affect the ability of its customers to repay their loans and generally affect First Citizens financial condition and results of operations.

First Citizens is less able than larger institutions to spread the risks of unfavorable local economic conditions across a large number of diversified economies. Moreover, First Citizens is unable to give assurance that it will benefit from any market growth or favorable economic conditions in its primary market areas if they do occur.

Earnings could be adversely affected if values of other real estate owned decline.

First Citizens is subject to the risk of losses from the liquidation and/or valuation adjustments on other real estate owned. First Citizens owns approximately 74 properties totaling $5.7 million in other real estate owned as of December 31, 2014. Other real estate owned is valued at the lower of cost or fair market value less cost to sell. Fair market values are based on independent appraisals for properties valued at $50,000 or greater and appraisals are updated annually. First Citizens may incur future losses on these properties if economic and real estate market conditions result in declines in the fair market value of these properties.

If financial market conditions worsen or First Citizens loan demand increases significantly, First Citizens liquidity position could be adversely affected. First Citizens may be required to rely on secondary sources of liquidity to meet withdrawal needs or fund operations, and there can be no assurance that these sources will be sufficient to meet future liquidity demands.

First Citizens relies on dividends from the Banks as its primary source of funds. The Banks primary sources of funds are client deposits, loan repayments and proceeds from the sale or maturity of securities. While scheduled loan repayments have historically been a relatively stable source of funds, they are susceptible to the inability of borrowers to repay the loans. The ability of borrowers to repay loans can be adversely affected by a number of factors, including changes in economic conditions, adverse trends or events affecting business industry groups, reductions in real estate values or markets, business closings or lay-offs, natural disasters and national or international instability. Additionally, deposit levels may be affected by a number of factors, including rates paid by competitors, general interest rate levels, regulatory capital requirements, returns available to clients on alternative investments and general economic conditions. Accordingly, First Citizens may be required from time to time to rely on secondary sources of liquidity to meet withdrawal demands or otherwise fund operations. Such sources include FHLB advances, sales of securities and loans, and federal funds lines of credit from correspondent banks, as well as out-of-market time deposits. While First Citizens believes that these sources are currently adequate, there can be no assurance they will be sufficient to meet future liquidity demands, particularly if First Citizens continues to grow and experience increasing loan demand. First Citizens may be required to slow or discontinue loan growth, capital expenditures or other investments or liquidate assets should such sources not be adequate.

Market conditions could adversely affect First Citizens ability to obtain additional capital on favorable terms should it need it.

First Citizens business strategy calls for continued growth. First Citizens anticipates that it will be able to support this growth through the generation of additional deposits at new branch locations, as well as through returns realized as a result of investment opportunities. However, First Citizens may need to raise additional capital in the future to support continued growth and maintain adequate capital levels. First Citizens may not be able to obtain additional capital in the amounts or on terms satisfactory to it. Growth may be constrained if First Citizens is unable to raise additional capital as needed.

Failure to remain competitive in an increasingly competitive industry may adversely affect results of operations and financial condition.

First Citizens encounters strong competition from other financial institutions in its market areas. In addition, established financial institutions not already operating in First Citizens market areas may open branches in its market areas at future dates or may compete via the internet. Certain aspects of First Citizens banking business also compete with savings institutions, credit unions, mortgage banking companies, consumer finance companies, insurance companies and other institutions, some of which are not subject to the same degree of regulation or restrictions imposed on First Citizens. Many of these competitors have substantially greater resources and lending limits and are able to offer services that First Citizens does not provide. While First Citizens believes that it competes effectively with these other financial institutions in its market areas, First Citizens may face a competitive disadvantage as a result of its smaller size, smaller asset base, lack of geographic diversification and inability to spread its marketing costs across a broader market. If First Citizens has to raise interest rates paid on deposits or lower interest rates charged on loans to compete effectively, First Citizens net interest margin and income could be negatively affected. Failure to compete effectively to attract new or to retain existing clients may reduce or limit First Citizens margins and its market share and may adversely affect First Citizens results of operations and financial condition.

First Citizens and its subsidiaries are subject to extensive government regulation and supervision. Changes in laws, government regulation and monetary policy may have a material adverse effect on our results of operations.

First Citizens and its subsidiaries are subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors funds, federal deposit insurance funds and the banking system as a whole, not First Citizens shareholders. These regulations affect First Citizens lending practices, capital structure, investment practices and dividend policy and growth, among other things. Future changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect First Citizens in substantial and unpredictable ways. Such changes could subject First Citizens to additional costs, limit the types of financial services and products First Citizens may offer and/or increase the ability of non-banks to offer competing financial services and products, or decrease the flexibility in pricing certain products and services by the Banks, among other things. Failure to comply with laws, regulations or policies could result in sanctions imposed by regulatory agencies, civil money penalties, civil liability and/or reputation damage, which could have a material adverse effect on First Citizens financial condition and results of operations. While First Citizens policies and procedures are designed to deter and detect any such violations, there can be no assurance that such violations will not occur.

First Citizens stock is not listed or traded on any established securities market and is less liquid than most securities traded in those markets; First Citizens has filed to revert to non-reporting status following the filing of this Annual Report on Form 10-K.

First Citizens stock is not listed or traded on any established securities exchange or market and First Citizens has no plans to seek to list its stock on any recognized exchange or qualify it for trading in any market. Accordingly, First Citizens stock has substantially fewer trades than the average securities listed on any national securities exchange. Most transactions in First Citizens stock are privately negotiated trades and its stock is very thinly traded. There is no dealer for First Citizens stock and no market maker. First Citizens shares do not have a trading symbol. The lack of a liquid market can produce downward pressure on First Citizens stock price and can reduce the marketability of First Citizens stock. On January 5, 2015, First Citizens filed a Form 15 with the SEC terminating First Citizens reporting obligations pursuant to Section 15(d) of the Exchange Act, which will result in less publicly available information about First Citizens and could cause its stock to trade less frequently.

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First Citizens ability to pay dividends may be limited.

As a holding company, First Citizens is a separate legal entity from the Banks and does not conduct significant income-generating operations of its own. It currently depends upon the Banks cash and liquidity to pay dividends to its shareholders. First Citizens cannot provide assurance that the Banks will have the capacity to pay dividends to First Citizens in the future. Various statutes and regulations limit the availability of dividends from the Banks. It is possible that, depending upon the Banks respective financial condition and other factors, the Banks regulators could assert that payment of dividends by the Banks to First Citizens is an unsafe or unsound practice. In the event that the Banks are unable to pay dividends to First Citizens, First Citizens may not be able to pay dividends to its shareholders.

A failure or breach of First Citizens operational or security systems or infrastructure, or those of First Citizens third party vendors and other service providers or other third parties, including as a result of cyber-attacks, could disrupt First Citizens businesses, result in the disclosure or misuse of confidential or proprietary information, damage its reputation, increase its costs, and cause losses.

First Citizens relies heavily on communications and information systems to conduct its business. Information security risks for financial institutions such as First Citizens have generally increased in recent years in part because of the proliferation of new technologies, the use of the internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists, and other external parties. As customer, public, and regulatory expectations regarding operational and information security have increased, First Citizens operating systems and infrastructure must continue to be safeguarded and monitored for potential failures, disruptions, and breakdowns. First Citizens business, financial, accounting, and data processing systems, or other operating systems and facilities, may stop operating properly or become disabled or damaged as a result of a number of factors, including events that are wholly or partially beyond First Citizens control. For example, there could be electrical or telecommunication outages; natural disasters such as earthquakes, tornadoes, and hurricanes; disease pandemics; events arising from local or larger scale political or social matters, including terrorist acts; and, as described below, cyber-attacks.

As noted above, First Citizens business relies on its digital technologies, computer and email systems, software and networks to conduct its operations. Although First Citizens has information security procedures and controls in place, First Citizens technologies, systems and networks and its customers devices may become the target of cyber-attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss, or destruction of First Citizens or its customers or other third parties confidential information. Third parties with whom First Citizens does business or that facilitate First Citizens business activities, including financial intermediaries, or vendors that provide service or security solutions for First Citizens operations, and other unaffiliated third parties, could also be sources of operational and information security risk to First Citizens, including from breakdowns or failures of their own systems or capacity constraints.

While First Citizens has disaster recovery and other policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. First Citizens risk and exposure to these matters remain heightened because of the evolving nature of these threats. As a result, cyber security and the continued development and enhancement of First Citizens controls, processes, and practices designed to protect its systems, computers, software, data, and networks from attack, damage or unauthorized access remain a focus for First Citizens. As threats continue to evolve, First Citizens may be required to expend additional resources to continue to modify or enhance its protective measures or to investigate and remediate information security vulnerabilities. Disruptions or failures in the physical infrastructure or operating systems that support First Citizens businesses and clients, or cyber-attacks or security breaches of the networks, systems or devices that First Citizens clients use to access First Citizens products and services could result in client attrition, regulatory fines, penalties or intervention, reputation damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could have a material effect on First Citizens results of operations or financial condition.

Shares of First Citizens stock are not insured.

Shares of First Citizens stock are not deposits and are not insured by the FDIC or any other entity.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

Properties

First Citizens National Bank Properties

FCNB has 17 full-service bank financial centers, two drive-through only branches and 28 ATMs spread over eight Tennessee counties. A list of available banking locations and hours is maintained on FCNB s website (www.firstCNB.com) under the Locations section. FCNB owns and occupies the following properties:

- FCNB s main branch and executive offices are located in a six-story building at One First Citizens Place (formerly 200 West Court), Dyersburg, Dyer County, Tennessee. This property also includes the Banking Annex, which has an address of 215-219 Masonic Street. The Banking Annex houses FCNB s operations, information technology, call center, bank security and mail departments;
- FCNB s downtown drive-through branch is located at 117 South Church Street, Dyersburg, Dyer County, Tennessee, and is a remote motor bank with six drive-through lanes and a drive-up ATM lane;
- The Green Village Financial Center, located at 710 U.S. 51 Bypass adjacent to the Green Village Shopping Center in Dyersburg, Dyer County, Tennessee, is a full-service banking facility;
- The Newbern Financial Center, a full-service facility, is located at 104 North Monroe Street, Newbern, Dyer County, Tennessee;
- The Industrial Park Financial Center located at 2211 St. John Avenue, Dyersburg, Dyer County, Tennessee is a full-service banking facility;
- The Ripley Financial Center is a full-service facility located at 316 Cleveland Street in Ripley, Lauderdale County, Tennessee;
- The Troy Financial Center is a full-service banking facility located at 220 East Harper Street in Troy, Obion County, Tennessee;
- The Union City Financial Center, a full-service banking facility, is located 215 W. Lee Street, Union City, Tennessee.
- The Martin Financial Center is a full-service facility located at 200 University Avenue, Martin, Weakley County, Tennessee;

- The Munford Financial Center is a full-service facility located at 1426 Munford Avenue in Munford, Tipton County, Tennessee. In addition, a drive-through facility is located at 1483 Munford Avenue, also in Munford;
- The Atoka Financial Center is a full-service facility located at 123 Atoka-Munford Avenue, Atoka, Tipton County, Tennessee;
- The Millington Financial Center is a full-service branch facility located at 8170 Highway 51 N., Millington, Shelby County, Tennessee;
- The Bartlett Financial Center is a full-service facility located at 7580 Highway 70, Bartlett, Shelby County, Tennessee;

- The Arlington Financial Center is a full-service facility located at 5845 Airline Road, Arlington, Shelby County, Tennessee;
- The Oakland Financial Center is a full-service facility located at 7285 Highway 64, Oakland, Fayette County, Tennessee;
- The Collierville Financial Center is a full-service facility located at 3668 South Houston Levee in Collierville, Shelby County, Tennessee;
- The Franklin Financial Center is a full-service facility located at 1304 Murfreesboro Road in Franklin, Williamson County, Tennessee;
- The Cool Springs Financial Center is a full-service facility located at 9045 Carothers Parkway, Franklin, Williamson County, Tennessee;
- The Jackson Financial Center is a full-service facility located at 381 Walker Road in Jackson, Tennessee which was opened October 1, 2014. The lot for this financial center is located on the corner of Walker Road and Union University Drive and was originally reported in prior filings as located on Union University Drive in Jackson, Madison County, Tennessee. However, after construction, the address assigned by 911 Authorities was 381 Walker Road rather than Union University Drive; and
- A lot located on Christmasville Cove in Jackson, Madison County, Tennessee, that was purchased in 2007 on which First Citizens expects to construct a full-service facility in the next three to five years.

FCNB owns all properties and there are no liens or encumbrances against any properties owned by FCNB. All facilities described above are adequate and appropriate to provide banking services as noted and are adequate to handle growth expected in the foreseeable future. As growth continues or needs change, individual property enhancements or additional properties will be evaluated as necessary, including, among other things, licensing and marketing and sales practices.

Southern Heritage Bank Properties

Southern Heritage Bank has three full-service bank financial centers and ATMs spread over two Tennessee counties. A list of available banking locations and hours is maintained on Southern Heritage Bank s website (www.southernheritagebank.com) under the Locations & Hours section. Southern Heritage Bank owns and occupies the following properties:

- Southern Heritage Bank s main branch and executive offices are located in a two-story building at 3020 Keith Street, Cleveland, Bradley County, Tennessee 37312. This property also houses Southern Heritage Bank s operations, information technology, call center, bank security and mail departments;
- Southern Heritage Bank s Waterville Springs office is located at 2530 Dalton Pike, Cleveland, Bradley County, Tennessee 37323, and is a full-service banking facility with 3 drive-through lanes and a drive-up ATM lane;
- The Georgetown Road office is located at 3795 Georgetown Road, Cleveland, Bradley County, Tennessee 37312, and is a full-service banking facility with 3 drive-through lanes

and a drive-up ATM lane; and

- Southern Heritage Bank s stand-alone ATM location is located at the corner of Hwy 64 and 411, 116 White Water Drive, Ocoee, Polk County, Tennessee 37361.

Southern Heritage Bank owns all branch properties and there are no liens or encumbrances against any properties owned by Southern Heritage Bank; the ATM location in Polk County is leased. All facilities described above are adequate and appropriate to provide banking services as noted and are adequate to handle growth expected in the foreseeable future. As growth continues or needs change, individual property enhancements or additional properties will be evaluated as necessary.

ITEM 3. LEGAL PROCEEDINGS.

The Company and its subsidiaries are defendants in various lawsuits arising out of the normal course of business. In the opinion of management, the ultimate resolution of such matters should not have a material adverse effect on the Company s consolidated financial condition or results of operations. Litigation is, however, inherently uncertain, and the Company cannot make assurances that it will prevail in any of these actions, nor can it estimate with reasonable certainty the amount of damages that it might incur.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Holders and Market Information

As of February 27, 2015, there were 786 shareholders of the Company s common stock and 792 holders of the Company s Class A Common Stock. The Company s common stock and Class A common stock are not listed or traded on any established public trading market. The table below shows the quarterly range of high and low sale prices for the Company s common stock and Class A common stock during the fiscal years 2014 and 2013. These sale prices represent known transactions reported to the Company and do not necessarily represent all trading transactions for the periods.

Year	Quarter	High	Low
2014	First	$44.00	$44.00
	Second	45.00	44.00

	Third	45.00	45.00
	Fourth	47.00	45.00
2013	First	39.00	39.00
	Second	42.60	39.00
	Third	42.60	42.60
	Fourth	42.60	42.60

Dividends

The Company paid aggregate dividends per share of the Company s common stock of $1.30 in 2014, $1.30 in 2013 an $1.20 per share in 2012. The following quarterly dividends per share of common stock were paid for 2014, 2013 and 2012:

Quarter	2014	2013	2012
First Quarter	$0.25	$0.25	$0.25
Second Quarter	0.25	0.25	0.25
Third Quarter	0.25	0.25	0.25
Fourth Quarter	0.55	0.55	0.45
Total	$1.30	$1.30	$1.20

Future dividends will depend on the Company s earnings, financial condition, regulatory capital levels and other factors, which the Company s Board of Directors considers relevant. See the section above entitled Item 1. Business Regulation and Supervision and Note 17 to the Company s Consolidated Financial Statements included in Item 8 of this Annual Report on 10-K for more information on restrictions and limitations on the Company s ability to pay dividends.

Issuer Purchases of Equity Securities

The Company had no publicly announced plans or programs to purchase the Company s stock during 2014. There were no shares of Company common stock or Class A common stock repurchased during the quarter ended December 31, 2014.

Unregistered Sale of Securities

None.

ITEM 6. SELECTED FINANCIAL DATA.

The following table presents selected financial data of the Company for the 12 months ended December 31, for the years indicated (dollars in thousands, except per share data):

	2014	2013	2012	2011	2010
Net interest income	$40,665	$37,133	$36,084	$36,150	$34,377
Gross interest income	46,934	44,122	44,111	45,506	46,347
Income from continuing operations	13,545	13,808	13,515	11,862	8,875
Net income per common share	$3.72	$3.83	$3.75	$3.28	$2.45
Cash dividends declared per common share	1.30	1.20	1.30	1.10	1.00
Total assets at year-end	$1,483,186	$1,174,472	$1,178,325	$1,053,549	$974,378
Long-term obligations (1)	59,326	46,362	32,594	43,976	42,296
Allowances for loan losses as a % of total loans	1.06%	1.35%	1.45%	1.52%	1.47%
Allowances for loan losses as a % of non-performing loans	96.40%	91.63%	89.25%	98.49%	76.40%
Loans 90 days past due as a % of total loans	0.51%	0.60%	0.54%	1.39%	1.12%

(1) Long-term obligations consist of FHLB advances that mature after December 31, 2015, and trust-preferred securities.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Executive Overview

For the year ended December 31, 2014, the Company s financial condition, results of operations and key performance metrics were significantly impacted by the acquisition of Southern Heritage Bancshares, Inc. and its subsidiary Southern Heritage Bank which occurred on October 1, 2014. Southern Heritage Bancshares, Inc. was merged into the Company as of the acquisition date and Southern Heritage Bank (a wholly owned subsidiary) continues to operate as a separate financial institution and has not yet been merged into FCNB. Significant areas of impact from the acquisition are summarized as follows:

- ♦ Total assets increased approximately $250 million.
- ♦ Total equity increased $17 million due to new equity issued as merger consideration.
- ♦ Total long-term debt increased due to $12 million correspondent loan to finance cash portion of merger consideration.
- ♦ Results of Operations for 2014 include three months (October to December 2014) of net income from Southern Heritage Bank.
- ♦ Results of Operations include transaction expenses of approximately $1 million (pre-tax) charged to earnings related to investment banker advisory, legal, accounting and other non-recurring expenses related to the acquisition.

For the year ended December 31, 2014, net income of $13.5 million resulted in a return on equity (ROE) of 10.7% compared to ROE of 12.1% and net income of $13.8 million for 2013. Return on equity declined due to capital growth outpacing earnings growth during 2014. Capital growth of 28.3% in 2014 consists primarily of $17.0 million in new equity issued as merger consideration in the acquisition of Southern Heritage Bancshares, Inc. Return on assets (ROA) was 1.08%, 1.19% and 1.25% for 2014, 2013 and 2012, respectively. For 2014, ROE of 10.7% and ROA of 1.08% exceeded the same measures for the Southeast Public Bank Peer Report, as produced by Mercer Capital s Financial Institutions Group (the Peer Report), which reported an average ROE of 7.9% and average ROA of 0.88% for 2014. The Peer Report provides market pricing and performance data on publicly traded banks in Alabama, Arkansas, Georgia, Kentucky, Louisiana, Mississippi, Missouri, and Tennessee.

Earnings per share were $3.72 for the year ended December 31, 2014, compared to $3.83 and $3.75 for the years ended December 31, 2013 and 2012, respectively. Dividends per common share were flat at $1.30 annually in 2014 and 2013. Dividends were held flat in 2014 as part of overall capital growth and preservation strategy after the recent acquisition. In 2014, the Company s dividend payout ratio was 35% compared to 34% in 2013. The dividend payout ratio has trended in the range of 30-40% the past three years. Dividend yield for 2014 was 3.05% compared to 3.33% in 2013 and consistent with historical dividend yields in the range of 3% to 3.4%. The Peer Report reported an average dividend yield of 1.68% for 2014.

During 2014, asset growth totaled $307 million or 26.1% with the acquisition accounting for $250 million in total asset growth. Capital growth was greater than asset growth at $31.9 million or 28.3% was attributable not only to new equity of $17.0 million but also to a $8.6 million increase in retained earnings and a $6.3 million increase in accumulated other comprehensive income. Retained earnings increased 9.1% in 2014 as a result of undistributed net income and conservative dividend payout ratio of 35%. Accumulated other comprehensive income increased due to increase of $6.3 million in unrealized appreciation (net of tax) on the available-for-sale securities portfolio compared to prior year.

Maintaining stable and strong net interest margins is a top priority for the Company. The Company s net interest margin had been stable at 3.83% in 2014 and 2013. As of December 31, 2014, the Company s interest rate risk position was liability sensitive. For more information, see Item 7A of this Annual Report on Form 10-K.

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 management believes provides investors with important information regarding the Company s operational efficiency. Comparison of the Company s 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 years ended December 31, 2014, 2013 and 2012 was 64.3%, 61.3%, and 60.2%, 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, goodwill and deposit-based intangibles. Tangible assets are total assets less goodwill and deposit-based intangibles. The tangible common equity ratio was 7.85% as of year-end 2014 compared to 8.53% at year-end 2013 and 7.71% at year-end 2012.

A reconciliation of non-GAAP measures of efficiency ratio and tangible common equity is provided as follows (dollars in thousands):

	At or for the Year Ended December 31,		
	2014	2013	2012
Efficiency ratio:			
Net interest income[1]	$ 43,676	$ 40,332	$ 39,047
Non-interest income[2]	14,421	14,030	12,454
Total revenue	58,097	54,362	51,501
Non-interest expense	37,352	33,341	31,017
Efficiency ratio	64.29%	61.33%	60.23%
Tangible common equity ratio:			
Total equity capital	$ 144,510	$ 112,606	$ 114,140
Less:			
Accumulated other comprehensive income	5,955	(361)	10,291
Goodwill	22,340	13,651	13,651
Other intangible assets	1,800	384	426
Tangible common equity	$ 114,415	$ 98,932	$ 89,772
Total assets	$ 1,481,438	$ 1,174,472	$ 1,178,325
Less:			
Goodwill	22,340	13,651	13,651
Other intangible assets	1,800	384	426
Tangible assets	$ 1,457,298	$ 1,160,437	$ 1,164,248
Tangible common equity ratio	7.85%	8.53%	7.71%

(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 a federal statutory rate of 34%.

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

Critical Accounting Policies

The accounting and reporting of the Company and its subsidiaries conform to GAAP and follow general practices within the industry. Preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Management believes that the Company s estimates are reasonable under the facts and circumstances based on past experience and information supplied from professionals, regulators and others. Accounting estimates are considered critical if (i) management is required to make assumptions or judgments about items that are highly uncertain at the time estimates are made and (ii) different estimates reasonably could have been used during the current period, or changes in such estimates are reasonably likely to occur from period to period, that could have a material impact on presentation of the Company s Consolidated Financial Statements.

The development, selection and disclosure of critical accounting policies are discussed and approved by the Audit Committee of the Banks Boards of Directors. Because of the potential impact on the financial condition or results of operations and the required subjective or complex judgments involved, management believes its critical accounting policies consist of the allowance for loan losses, fair value of financial instruments and goodwill.

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Allowance for Loan Losses

The allowance for losses on loans represents management s best estimate of inherent losses in the existing loan portfolio. Management s policy is to maintain the allowance for loan losses at a level sufficient to absorb reasonably estimated and probable losses within the portfolio. Management believes the allowance for loan loss estimate is a critical accounting estimate because: (i) changes can materially affect provision for loan loss expense on the income statement, (ii) changes in the borrower s cash flows can impact the reserve, and (iii) management makes 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. In addition, as a part of their examination process, federal regulatory agencies periodically review the Banks loans and allowances for loan losses and may require the Banks to recognize adjustments based on their judgment about information available to them at the time of their examination. See Note 1 of the Company s Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K for more information.

Fair Value of Financial Instruments

Certain assets and liabilities are required to be carried on the balance sheet at fair value. Further, the fair value of financial instruments must be disclosed as a part of the notes to the consolidated financial statements for other assets and liabilities. Fair values are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates, the shape of yield curves and the credit worthiness of counterparties.

Fair values for the majority of the Banks available-for-sale investment securities are based on observable market prices obtained from independent asset pricing services that are based on observable transactions but not quoted market prices.

Fair value of derivatives (if any) held by the Company is determined using a combination of quoted market rates for similar instruments and quantitative models based on market inputs including rate, price and index scenarios to generate continuous yield or pricing curves and volatility factors. Third party vendors are used to obtain fair value of available-for-sale securities and derivatives (if any). For more information, see Notes 1 and 21 in the Company s Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Goodwill

The Company s policy is to review goodwill for impairment at the reporting unit level on an annual basis unless an event occurs that could potentially impair the goodwill amount. Goodwill represents the excess of the cost of an acquired entity over fair value assigned to assets and liabilities. Management believes accounting estimates associated with determining fair value as part of the goodwill test are critical because estimates and assumptions are made based on prevailing market factors, historical earnings and multiples and other contingencies. For more information, see Notes 1 and 9 in the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Financial Condition

Changes in the statement of financial condition for the year ended December 31, 2014 reflect the Company s acquisition of Southern Heritage Bancshares, Inc. as well as modest organic growth. Asset growth in 2014 totaled $307 million or 26.1% and $58 million of the $307 million was attributable to organic growth. In 2014, loan growth of 22% was outpaced by growth of 31.4% in cash and cash equivalents, 87.5% in interest bearing deposits in banks and 27.8% in investments. Total deposit growth of 25.1% was driven by 27.0% growth in non-interest bearing deposits and 24.5% growth in interest-bearing deposits. Other borrowings increased 30.6% in 2014 in relation to new debt associated with the acquisition of Southern Heritage Bancshares, Inc.

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Investment Securities Analysis

The following table presents the composition of total investment securities as of December 31 for the last five years (in thousands):

	2014	2013	2012	2011	2010
U.S. Treasury and government agencies	$384,990	$321,703	$ 346,452	$249,240	$191,443
State and political subdivisions	198,302	134,751	119,143	115,634	102,450
All other	54	71	824	591	930
Total investment securities	$583,346	$456,525	$ 466,419	$365,465	$294,823

In 2014, total investment securities portfolio growth of $126.8 million consisted of a $63.3 million increase in agency mortgage-backed securities (MBS) and collateralized mortgage obligations (CMO) and a $63.6 million increase in municipal securities. Growth in the overall portfolio of $77 million was attributable to the acquisition of Southern Heritage Bancshares, Inc.

The allocation to tax-exempt municipal securities as a percent of the total portfolio was 34% as of December 31, 2014 compared to 30% and 25% as of December 31, 2013 and 2012, respectively. This range of ratios is consistent with recent allocations, as the Company typically strategically targets 25-35% of its portfolio in the tax-exempt municipal sector.

Maturity and Yield on Securities

Contractual maturities on investment securities are generally over ten years. However, the expected remaining lives of such bonds are expected to be much shorter due to anticipated payments from U. S. Treasury and government agency securities. These securities comprised 66% of the portfolio at December 31, 2014 and are primarily amortizing payments that provide stable monthly cash inflows of principal and interest payments. The following table presents contractual maturities and yields by category for debt securities as of December 31, 2014 (dollars in thousands):

	Maturing Within One Year		Maturing After One Year Within Five Years		Maturing After Five Years Within Ten Years		Maturing After Ten Years		
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total
U. S. Treasury and government agencies[1]	$ -	-%	$ 2,804	2.48%	$ 6,807	3.87%	$375,376	2.27%	$384,987
State and political subdivisions[2]	2,724	6.58%	15,141	6.12%	96,332	4.87%	84,108	5.35%	198,305
All other	-		-		-		-	-	-
Total debt securities	2,724		17,945		103,139		459,484		583,292
Equity securities	-		-		-		54	1.25%	54
Total	$2,724		$ 17,945		$ 103,139		$459,538		$ 583,346

(1) Of this category, 99% of the total consisted of MBS and CMO which are presented based on contractual maturities (with 98% of the total for this category in the Maturing After Ten Years category). However, the remaining lives of such securities are expected to be much shorter due to anticipated payments.

(2) Yields are presented on a tax-equivalent basis using a federal statutory rate of 34%.

Held-To-Maturity and Available-For-Sale Securities

The Company held no securities in the held-to-maturity or trading categories as of December 31, 2014 or 2013. The following table presents amortized cost and fair value of available-for-sale securities as of December 31, 2014 (in thousands):

	Amortized Cost	Fair Value
U.S. government agencies and corporate obligations	$384,456	$384,990
Obligations of states and political subdivisions	189,264	198,302
U.S. securities:		
Equity securities	10	54
Total	$573,730	$583,346

In addition to amounts presented above, the Banks had $5.7 million in FHLB and Federal Reserve Bank stock at both December 31, 2014 and 2013, recorded at cost.

Objectives of the Company s investment portfolio management are to provide safety of principal, provide adequate liquidity, insulate GAAP capital against excessive changes in market value, insulate earnings from excessive change and optimize investment performance. Investments also serve as collateral for government, public funds and large deposit accounts that exceed FDIC-insured limits. Pledged investments at December 31, 2014 and 2013 had a fair market value of $250 million and $204 million, respectively. The average expected life of the investment securities portfolio was 4.6 years as of December 31, 2014 and 2013. Portfolio yields (on a tax equivalent basis) were 3.25% as of December 31, 2014 compared to 3.35% as of December 31, 2013.

The Company classifies investments, based on intent, into trading, available-for-sale and held-to-maturity categories in accordance with GAAP. The Company held no securities in the trading or held-to-maturity categories for any of the periods presented in this Annual Report on Form 10-K and does not expect to hold any such securities in 2014. The Company s investment strategy is to classify most of the securities portfolio as available-for-sale, which are carried on the balance sheet at fair market value. Classification of available-for-sale investments allows flexibility to actively manage the portfolio under various market conditions.

U.S. Treasury securities and government agencies and corporate obligations consisted primarily of MBSs and CMOs and accounted for 66.0% and 70.5% of the investment portfolio for years ended December 31, 2014 and 2013, respectively. The credit quality of the overall MBS and CMO portfolio was considered stable and reflected a net unrealized gain (pre-tax) of approximately $534,000 as of December 31, 2014. The unrealized loss positions are attributable to market factors as values are heavily influenced by market rates and the yield curve, including but not limited to the 10-year Treasury rates, which decreased approximately 87 basis points from December 31, 2013 to December 31, 2014. Credit quality factors on the bonds and related underlying mortgages are evaluated at the time of purchase and on a periodic basis thereafter. These factors typically include, but are not limited to, average loan-to-value ratios, average FICO credit scores, payment seasoning (how many months of payment history), geographic dispersion, average maturity and average duration. Management believes that this level of amortizing securities provides steady cash flows. Principal cash flows for 2015 are projected to be $70 million to $75 million.

As of December 31, 2014, approximately 34% of the investment portfolio was invested in municipal securities, which were geographically diversified, compared to 30% as of December 31, 2013. The fair value of municipal securities totaled $198.3 million ($196.9 million tax-exempt and $1.4 million taxable) at December 30, 2014. Approximately 66% of municipal securities were general obligation municipal bonds and the remaining 34% were revenue bonds at December 31, 2014. The revenue bonds are primarily essential services bonds such as for water and sewer, school systems and other public improvement projects. Overall credit quality of the municipal portfolio was considered strong and reflected a net unrealized gain of $9.0 million as of year-end 2014.

The following table indicates by category gross unrealized gains and losses within the available-for-sale portfolio as of December 31, 2014 (in thousands):

	Unrealized Gains	Unrealized Losses	Net
U.S. Treasury securities and obligations of U.S. government agencies and corporations	$ 4,065	$(3,531)	$ 534
Obligations of states and political subdivisions	9,273	(235)	9,038
All other	44	-	44
Total	$13,382	$(3,766)	$9,616

Unrealized gains and losses noted above were included in Accumulated Other Comprehensive Income, net of tax.

Loan Portfolio Analysis

The following table compares the portfolio mix of loans held for investment as of December 31 for each of the last five years (in thousands):

	2014	2013	2012	2011	2010
Commercial, financial and agricultural	$ 112,529	$ 81,757	$ 74,014	$ 72,174	$ 66,297
Real estate-construction	63,461	46,959	40,498	39,964	49,148
Real estate-mortgage	491,471	413,235	397,638	383,934	395,256
Installment loans to individuals	25,733	24,807	25,428	28,027	31,593
Other loans	18,029	13,477	11,874	3,600	5,409
Total loans	$711,223	$580,235	$549,452	$527,699	$547,703

For purposes of the table above, loans do not include loans that are sold in the secondary mortgage market. The Company classifies loans to be sold in the secondary mortgage market separately in its consolidated financial statements. Secondary market mortgages totaled $4.3 million, $3.1 million and $4.7 million as of December 31, 2014, 2013 and 2012, respectively. For more information, see Notes 4, 5 and 6 in the Company s Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K. Interest and fees earned on secondary mortgage loans were included in mortgage banking income as reported in other non-interest income in the Company s Consolidated Financial Statements.

Changes In Loan Categories

Total loans at December 31, 2014 were $711 million compared to $580 million at December 31, 2013 and $587 million at December 31, 2012. Loan growth in 2014 was primarily as result of the acquisition but also includes modest organic loan growth of $10 million. The following table details the breakdown of changes by category for the year ended December 31, 2014 (dollars in thousands):

	Increase (Decrease)	Percent Change
Commercial, financial and agricultural	$30,772	37.64%
Real estate-construction	16,502	35.14%
Real estate-mortgage	78,236	18.93%
Installment loans to individuals	926	3.73%
Other loans	4,552	33.78%
Net change in loans	$130,988	22.57%

The loan portfolio remains heavily weighted in real estate loans, which accounted for $555 million or 78% of total loans as of December 31, 2014 compared to $460 million or 79% of total loans as of December 31, 2013. Commercial and residential construction loans accounted for $63 million of the $555 million invested in real estate loans. Within real estate loans, residential mortgage loans (including residential construction) was the largest category, comprising 30% of total loans as of December 31, 2014 and December 31, 2013. Diversification of the real estate portfolio is a necessary and desirable goal of the Company s real estate loan policy. In order to achieve and maintain a prudent degree of diversity, given the composition of the market area and the general economic state of the market area, the Company strives to maintain real estate loan portfolio diversification. Risk monitoring of commercial real estate concentrations is performed in accordance with regulatory guidelines and includes assessment of risk levels of various types of commercial real estate and review of ratios of various concentrations of commercial real estate as a percentage of capital. The following table presents real estate loans as a percent of total risk based capital as of December 31 for each of the last five years:

	2014	2013	2012	2011	2010
As a percent of total risk based capital*:					
Construction and development	46.54%	40.49%	37.79%	40.06%	53.05%
Residential (one-to-four family)	141.53%	147.13%	163.16%	163.40%	184.50%
Other real estate loans	218.87%	209.14%	207.93%	224.04%	245.15%
Total real estate loans	406.94%	396.75%	408.89%	427.50%	482.70%

* Total risk based capital is a non-GAAP measure used by regulatory authorities and reported on quarterly regulatory filings. Total risk based capital for the Banks was $136.3 million, $116.0 million, $107.2 million, $99.8 million and $92.6 million as of December 31, 2014, 2013, 2012, 2011 and 2010, respectively.

Average Loan Yields

The average yield on loans of the Banks has trended downward over the past five years, as loans have repriced during the historically low interest rate environment. Average yield on loans for the years indicated were as follows:

2014 - 5.45%
2013 - 5.67%
2012 - 6.11%
2011 - 6.32%
2010 - 6.42%

The aggregate amount of unused guarantees, commitments to extend credit and standby letters of credit was $101.2 million at year-end 2014. For more information regarding commitments and standby letters of credit, see Note 18 in the Company s Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Loan Maturities

As of December 31, 2014, contractual maturities of loans were as follows (in thousands):

	Due in One Year or Less	Due After One Year but Within Five Years	Due After Five Years
Real estate	$114,581	$175,283	$265,068
Commercial, financial and agricultural	62,258	42,465	7,806
All other loans	14,724	25,190	3,848
Total	$191,563	$242,938	$276,772

As of December 31, 2014, loans with a remaining maturity of more than one year consisted of the following (in thousands):

Loans with maturities after one year for which:	
Interest rates are fixed or predetermined	$433,124
Interest rates are floating or adjustable	278,149

The degree of interest rate risk to which a bank is subjected can be controlled through a well-defined funds management program. The Company controls interest rate risk by matching interest sensitive assets and liabilities. At December 31, 2014, the Company was liability-sensitive, meaning that liabilities reprice at a faster rate than assets. Therefore, in a rising rate environment (with a normal yield curve) net interest income would decline. The majority of the Company s loan portfolio will reprice or mature in less than five years. Approximately $255 million or 36% of total loans will either reprice or mature over the next 12 months, while $165 million or 23.0% of total loans will mature or reprice after one year but less than three years. Approximately $230 million or 32% of total loans will mature or reprice after three years but in less than five years. The remaining 9% or $61 million reprices or matures in greater than five years.

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Loan Policy Guidelines

Management has established policies approved by the Company s Board of Directors regarding portfolio diversification and underwriting standards. Loan policy also includes Board-approved guidelines for collateralization, loans in excess of loan to value (LTV) limits, maximum loan amount and maximum maturity and amortization period for each loan type. Policy guidelines for LTV ratios and maturities related to various types of collateral at December 31, 2014, were as follows:

Collateral	Maximum Amortization	Maximum LTV
Real estate	Various (see discussion below)	Various (see discussion below)
Equipment*	5 Years	75%
Inventory	5 Years	50%
Accounts receivable	5 Years	75%
Livestock	5 Years	75%
Crops	1 Year	50%
Securities**	10 Years	75% (Listed), 50% (Unlisted)

* New farm equipment can be amortized over seven years with a guaranty by the FSA. Farm irrigation systems may be amortized over seven years without an FSA guaranty.

** When proceeds are used to purchase or carry securities not listed on a national exchange, maximum LTV shall be 50%.

The Company s policy manages risk in the real estate portfolio by adherence to regulatory limits in regards to LTV percentages, as designated by the following categories:

Loan Category	Maximum LTV
Raw land	65%
Farmland	80%
Real estate-construction:	
Commercial acquisition and development	70%
Commercial, multi-family* and other non-residential	80%
One-to-four family residential owner occupied	80%
One-to-four family residential non-owner occupied	75%

Commercial (existing property):	
Owner occupied improved property	85%
Non-owner occupied improved property	80%
Residential (existing property):	
Home equity lines	80%
Owner occupied one-to-four family residential	90%
Non-owner occupied one-to-four family residential	75%

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* Multi-family construction loans include loans secured by cooperatives and condominiums.

Loans may be approved in excess of the LTV limits, provided that they are approved on a case by case basis pursuant to the Banks loan policy as follows:

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- The request is fully documented to support the fact that other credit factors justify the approval of that particular loan as an exception to the LTV limit;
- The loan, if approved, is designated in the Banks records and reported as an aggregate number with all other such loans approved by the full Board of Directors on at least a quarterly basis;
- The aggregate total of all loans so approved, including the extension of credit then under consideration, shall not exceed 65% of the Banks total capital; and
- The aggregate portion of these loans in excess of the LTV limits that are classified as commercial, agricultural, multi-family or non-one-to-four family residential property shall not exceed 30% of the Banks total capital.

The Banks loan policies additionally require every loan to have a documented repayment arrangement. While reasonable flexibility is necessary to meet credit needs of customers, in general, real estate loans are to be repaid within the following time frames:

Loan Category	Amortization Period
Raw land	10 years
Real estate- construction	1.5 years
Real estate-commercial, multi-family, and other non-residential	20 years
Real estate-one-to-four family residential	25-30 years
Home equity	10 years
Farmland	20 years

Credit Risk Management and Allowance for Loan Losses

Loan portfolio quality was stable in 2014 compared to 2013 and 2012 and remains very stable relative to prevailing market conditions, as is evidenced through improving trends in impaired loans and changes to the allowance for loan losses. The ratio of net charge-offs to average net loans outstanding was 0.16%, 0.16% and 0.14% for the years ended December 31, 2014, 2013 and 2012, respectively. Management believes that the Company s strong credit risk management practices continue to provide a means for timely identification and assessment of problem credits in order to minimize losses. For additional information regarding the Company s credit risk management procedures and practices and allowance for loan losses, refer to Notes 1 and 5 in the Consolidated Financial Statements in Item 8 of this Annual Report on Form 10-K.

Non-Performing Assets

Non-performing assets consist of non-performing loans, Other Real Estate Owned (OREO) and non-accrual debt securities. Non-performing loans consist of non-accrual loans, loans 90 days or more past due and still accruing interest and restructured loans. Interest income on loans is recorded on an accrual basis. The accrual of interest is discontinued on all loans, except consumer loans, which become 90 days past due, unless the loan is well secured and in the process of collection. Consumer loans which become past due 90 to 120 days are charged to the allowance for loan losses. The aggregate of non-performing loans and OREO as a percent of total loans plus OREO at December 31, 2014 totaled 2.03% compared to 2.62% at December 31, 2013 and 3.14% at December 31, 2012. The gross interest income that would have been recorded for the 12 months ended December 31, 2014 if all loans reported as non-accrual had been current in accordance with their original terms and had been outstanding throughout the period was approximately $349,000 compared to approximately $473,000 and $596,000, for the 12 months ended December 31, 2013 and 2012, respectively. Loans on which terms have been modified to provide for a reduction of either principal or interest as a result of deterioration in the financial position of the borrower are considered to be restructured loans, or troubled debt restructurings (TDRs). First Citizens had TDRs totaling $8.0 million of December 31, 2014, compared to $4.8 million as of December 31, 2013. For additional discussion regarding non-performing assets, see Note 4 in the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Other Real Estate Owned

The book value of OREO was $5.7 million as of December 31, 2014, compared to $6.8 million and $8.6 million as of December 31, 2013 and 2012, respectively. As of December 31, 2014, there were approximately 74 properties accounted for as OREO consisting of vacant land, residential lots and other residential and commercial properties. Approximately 83% of the $5.7 million accounted for as OREO as of December 31, 2014, was located in Shelby County, Tennessee and surrounding counties. Management continues efforts to market and liquidate OREO.

Activity in OREO for the years ended December 31, 2014, 2013, and 2012 was as follows (in thousands):

	2014	2013	2012
Beginning balance	$6,826	$8,580	$11,073
Acquisitions	2,847	541	1,261
Capitalized costs	19	-	159
Dispositions	(3,639)	(1,702)	(2,751)
Valuation adjustments through earnings	(336)	(593)	(1,162)
Ending balance	$5,717	$6,826	$ 8,580

Capitalized costs consist of costs to complete construction of homes partially complete at the time of foreclosure, significant repairs or renovations or include costs to complete certain phases of a development project for raw land. Capitalized costs were incurred in order to improve marketability of certain properties. Valuation adjustments through earnings reflected above includes write down of properties subsequent to foreclosure and realized gains and losses on sale of OREO.

OREO is recorded at the time of foreclosure at the lesser of its appraised value (less cost to sell) or the loan balance. Any reduction in value at the time of foreclosure is charged to the allowance for loan losses. All other real estate parcels are appraised at least annually and carrying values adjusted to reflect the decline, if any, in their realizable value. Such adjustments made subsequent to foreclosure are charged against earnings.

Other non-interest expenses for property taxes, maintenance and other costs related to acquisition or maintenance of OREO totaled approximately $333,000, $415,000, and $455,000 for the years ended December 31, 2014, 2013 and 2012, respectively. The positive trend in other non-interest expense and losses related to OREO from 2011 through 2013 was attributable to the declining trend in OREO volume.

Composition of Deposits

The average balance of deposits and average interest rates paid on such deposits are summarized in the following table for the years ended December 31, 2014, 2013 and 2012 (dollars in thousands):

	2014		2013		2012	
	Balance	Rate	Balance	Rate	Balance	Rate
Non-interest bearing demand deposits	$147,174	%	$ 133,019	%	$ 125,364	%
Savings deposits	522,539	0.47%	465,847	0.48%	409,576	0.61%
Time deposits	358,624	0.67%	348,454	0.74%	341,005	1.01%
Total deposits	$1,028,337	0.47%	$947,320	0.51%	$875,945	0.68%

The decrease in average cost of deposits for the year ended December 31, 2014 compared to the prior two years was a result of the continued historically low interest rate environment and a result of the impact of the FOMC decision to maintain low federal funds rates during that timeframe. It is expected that federal fund rates will remain at the current range of 0.00% to 0.25% through mid-2015. During 2014, the prevailing market and competitive environment continued to yield strong competition in the pricing of interest-bearing deposit products, but overall pricing remained very low compared to long-term historical trends. The Company does not compete solely on price, as strategies are focused more on customer relationships that attract and retain core deposit customers rather than time deposits.

Total deposits grew 25% from December 31, 2013 to December 31, 2014. Savings deposit growth was $141.5 million or 29.0% and demand deposit balances grew $38.9 million or 27.2% during 2014, largely due to acquisition of Southern Heritage Bank. Time deposit growth was 20.2%, or $66.4 million.

FCNB participates in the Certificate of Deposit Account Registry Service (CDARS), a deposit placement service that allows FCNB to accept very large denomination (up to $50 million) certificates of deposit (CDs) from customers and ensures that 100% of those CDs are FDIC-insured. Participating in this network enhances FCNB s ability to attract and retain large-denomination depositors without having to place funds in a sweep or repurchase agreement. The CDARS network provides a means to place reciprocal deposits for FCNB s customers, purchase time deposits (referred to as one-way buy deposits) or to sell excess deposits (referred to as one-way sell deposits). One-way buy deposits are structured similarly to traditional brokered deposits. FCNB held reciprocal deposits and one-way buy deposits in the CDARS program totaling $4.9 million at year-end 2014 compared to $8.4 million at year-end 2013. CDARS accounts are classified as brokered time deposits for regulatory reporting purposes.

Time deposits over $100,000 (including brokered time deposits) comprised 58.6% of total time deposits as of December 31, 2014 compared to 58.7% as of year-end 2013. As of December 31, 2014, 75.3% of time deposits, including brokered time deposits, will mature or reprice over the next 12 months as the prevailing competitive market and rate environment continued to exhibit strong demand for shorter terms during 2014.

Other Borrowings

In addition to deposits, First Citizens uses a combination of short-term and long-term borrowings to supplement its funding needs. Short-term borrowings are used to manage fluctuations in liquidity based on seasonality of agricultural production loans and other factors. Short-term borrowings were used on a very limited basis during the most recent two fiscal years because of First Citizens strategic efforts to maintain a strong liquidity position, modest loan demand, and steady growth in core deposits. In 2014, other borrowings increased $15.7 million due to assumption of trust preferred debt totaling $3.6 million and a new $12 million credit facility from a correspondent bank associated with the acquisition. For more information about short-term and long-term borrowings, see Notes 13 and 14 in the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

The Company s junior subordinated debentures commonly referred to as trust preferred debt totaled $13.9 million as of December 31, 2014 compared to $10.3 million as of December 31, 2013. These debentures have 30-year terms and variable rates with rates in the range of 1.99% to 2.29% as of December 31, 2014.

The Company s $12 million credit facility with a correspondent bank was obtained as of October 1, 2014 as funding for cash consideration in the acquisition of Southern Heritage Bancshares, Inc. The credit facility consists of $6 million at a fixed rate of 3.76% for five years and $6 million at variable rate based on 90-day LIBOR plus 2% that reprices quarterly. Principal and interest payments are due quarterly based on a ten-year amortization.

FCNB s other borrowings consist of advances from the FHLB. The average volume of FHLB advances for 2014 was $41.8 million at an average rate of 1.82% compared to $46.1 million at an average rate of 1.93% in 2013. The average remaining maturity for FHLB long-term borrowings was approximately three years at December 31, 2014. As of December 31, 2014, FHLB borrowings were comprised primarily of fixed rate positions ranging from 0.31% to 7.05% and maturities from 2015 to 2023. Approximately 15% of total other borrowings or $6.4 million will mature on or before December 31, 2015. As of December 31, 2014, advances totaling $16 million require repayment if call features are 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 and, therefore, were not included in current liabilities. For more information about liquidity, see the section below entitled Liquidity.

Aggregate Contractual Obligations

At December 31, 2014, contractual obligations were due as follows (in thousands):

	Total	Less than One Year	One-Three Years	Three-Five Years	Greater than Five Years
Unfunded loan commitments	$119,669	$119,669	$ -	$ -	$ -
Standby letters of credit	2,902	2,902	-	-	-
Other borrowings*	66,831	7,505	19,936	22,970	16,420
Capital lease obligations	-	-	-	-	-
Operating lease obligations	41	18	23	-	-
Purchase obligations	-	-	-	-	-
Other long-term liabilities	-	-	-	-	-
Total	$189,443	$130,094	$19,959	$22,970	$16,420

* Other borrowings presented as principal only, excluding interest.

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For more information about long-term obligations, see Notes 14 and 19 in the Company s Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Off-Balance Sheet Arrangements

Except for unfunded loan commitments and standby letters of credit, the Banks do not materially engage in off-balance sheet activities and does not anticipate material changes in volume going forward.

For more information about off-balance sheet risk, see Note 19 in the Company s Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Results of Operations

The Company reported consolidated net income of $13.5 million for the year ended December 31, 2014, compared to $13.8 million for the year ended December 31, 2013 and $13.5 million in 2012. Results of operations include three months of net income from Southern Heritage Bank (which continues to operate as a separate entity but is reported on a consolidated basis from the acquisition date forward). The 1.9% decrease in net income from 2013 to 2014 was attributed to a 12.0% increase in non-interest expense which was mostly offset by favorable variances in net interest income, provision for loan losses, and total non-interest income. Earnings per share were $3.72 for 2014 compared to $3.83 for 2013 and $3.75 for 2012. Return on average assets was 1.08%, 1.19% and 1.25% for the years ended December 31, 2014, 2013 and 2012, respectively. Return on average equity was 10.7%, 12.1% and 12.2% for 2014, 2013 and 2012, respectively.

Net yield on average earning assets was 3.83% for both 2014 and 2013 and 4.01% for 2012. Stability in net interest margin during 2014 and 2013 was attributable to the Company s ability to maintain stable to slightly declining cost of interest bearing liabilities while yields on loans and tax exempt-securities continued to decline. The Banks are liability sensitive as of December 31, 2014 and are expected to face margin compression in a rising rate environment. For more information about the Company s interest rate sensitivity, see Item 7A of this Annual Report on Form 10-K.

Total non-interest income for the year ended December 31, 2014 increased approximately $390,000 compared to the year ended December 31, 2013. The net increase was primarily attributable to reduced losses recognized on OREO totaling approximately $336,000 in 2014 compared to approximately $593,000 in 2013. Other contributors to increased earnings were increased income from ATM and debit card transactions of approximately $295,000 and increase in brokerage fees of approximately $135,000.

There were no other-than-temporary credit impairment losses on available-for-sale securities for the years ended December 31, 2014, 2013 or 2012. Also, no impairment of goodwill was recognized in any of the periods presented in this report.

The Company s effective tax rates were in the range of 20% to 23% over the past three years. Effective tax rates were impacted by fluctuations in certain factors including, but not limited to, the volume of and related earnings on tax-free investments within the Banks investment portfolios, tax-exempt earnings and expenses on bank-owned life insurance (BOLI), certain tax benefits that result from dividends and payouts under the Banks Employee Stock Ownership Plan (ESOP), and other factors incidental to the financial services business. Fluctuations in the deduction related to the ESOP dividends and payouts and tax-exempt interest earned in the investment portfolio were the largest contributors to the various effective rates for the past three years.

Interest earning assets in 2014 averaged $1.14 billion at an average rate of 4.37% compared to $1.05 billion at an average rate of 4.42% in 2013 and $973 million at an average rate of 4.77% in 2012. Interest bearing liabilities at December 31, 2014 averaged $981 million at an average cost of 0.64% compared to $912 million at an average cost of 0.68% at December 31, 2013 and $836 million at an average cost of 0.88% at December 31, 2012. The declining asset yields and cost of funds are attributed to the continued historical low rate environment.

The following table presents the annual average balance sheet and net interest income analysis for the years ended December 31, 2014, 2013 and 2012 (dollars in thousands):

	AVERAGE BALANCES AND RATES								
	2014			2013			2012		
	Balance	Interest	Rate	Balance	Interest	Rate	Balance	Interest	Rate
Assets									
Interest earning assets:									
Loans (1)(2)(3)	$623,760	$ 34,005	5.45%	$567,414	$ 32,156	5.67%	$528,024	$ 32,277	6.11%
Investment securities:									
Taxable	319,832	7,229	2.26%	328,016	7,160	2.18%	283,244	7,222	2.55%
Tax exempt (4)	157,116	8,603	5.48%	124,922	7,129	5.71%	116,142	6,802	5.86%
Interest earning deposits	33,157	80	0.24%	29,657	85	0.29%	34,330	89	0.26%
Federal funds sold	7,977	28	0.35%	3,348	16	0.48%	10,841	34	0.31%
Total interest earning assets	1,141,842	49,945	4.37%	1,053,357	46,546	4.42%	972,581	46,424	4.77%
Non-interest earning assets:									
Cash and due from banks	21,476			14,087			15,288		
Premises and equipment	35,596			34,271			29,574		
Other assets	62,889			63,500			65,739		
Total assets	$1,271,149			$1,165,215			$1,083,182		
Liabilities and shareholders equity									
Interest bearing liabilities									
Savings deposits	$522,539	$ 2,447	0.47%	$465,847	$ 2,250	0.48%	$409,576	$ 2,491	0.61%
Time deposits	358,624	2,415	0.67%	348,454	2,576	0.74%	341,005	3,428	1.01%
Federal funds purchased and other interest bearing liabilities	99,485	1,407	1.41%	97,241	1,385	1.42%	85,432	1,458	1.71%

Total interest bearing liabilities	980,648	6,269	0.64%	911,542	6,214	0.68%	836,013	7,377	0.88%
Non-interest bearing liabilities									
Demand deposits	147,174			133,019			125,364		
Other liabilities	7,585			6,165			11,149		
Total liabilities	1,135,406			1,050,726			972,526		
Total shareholders equity	126,396			114,489			110,656		
Total liabilities and shareholders equity	$1,271,149			$1,165,215			$ 1,083,182		
Net interest income		$ 43,676			$ 40,332			$ 39,047	
Net yield on average earning assets			3.83%			3.83%			4.01%

(1) Loan totals are loans held for investments and net of unearned income and loan loss reserves.

(2) Fee income on loans held for investment is included in interest income and computations of the yield.

(3) Includes loans on non-accrual status.

(4) Interest and rates on securities that are non-taxable for federal income tax purposes are presented on a taxable equivalent basis based on the Company s statutory federal tax rate of 34%.

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Volume/Rate Analysis

The following table provides an analysis of the impact of changes in balances and rates on interest income and interest expense changes from 2014 to 2013 and 2013 to 2012 (in thousands):

	2014 Compared to 2013 Due to Changes in			2013 Compared to 2012 Due to Changes in		
	Average Volume	Average Rate	Total Increase (Decrease)	Average Volume	Average Rate	Total Increase (Decrease)
Interest earned on:						
Loans	$3,071	$(1,222)	$1,849	$2,233	$(2,354)	$ (121)
Taxable securities	(185)	254	69	976	(1,038)	(62)
Tax-exempt securities	1,764	(290)	1,474	501	(174)	327
Interest bearing deposits with other banks	8	(13)	(5)	(14)	10	(4)
Federal funds sold and securities purchased under agreements to sell	16	(4)	12	(36)	18	(18)
Total interest earning assets	4,674	(1,275)	3,399	3,660	(3,538)	122
Interest expense on:						
Savings deposits	266	(69)	197	270	(511)	(241)
Time deposits	68	(232)	(164)	55	(904)	(849)
Federal funds purchased and securities sold under agreements to repurchase and other borrowings	32	(10)	22	168	(241)	(73)
Total interest bearing liabilities	366	(311)	55	493	(1,656)	(1,163)
Net interest earnings	$4,308	$(964)	$3,344	$3,167	$(1,882)	$1,285

Non-Interest Income

The following table compares non-interest income for the years ended December 31, 2014, 2013 and 2012 (dollars in thousands):

	Total	Increase (Decrease)		Total	Increase (Decrease)		Total
	2014	Amount	%	2013	Amount	%	2012
Mortgage banking income	$ 1,405	$ (40)	(2.77%)	$ 1,445	$ (52)	(3.47%)	$ 1,497

Income from fiduciary activities	915	11	1.22%	904	68	8.13%	836
Service charges on deposit accounts	4,680	(118)	(2.46%)	4,798	(98)	(2.00%)	4,896
Income from ATM and debit cards	2,788	295	11.83%	2,493	102	4.27%	2,391
Brokerage fees	1,506	135	9.85%	1,371	111	8.81%	1,260
Earnings on bank owned life insurance	621	(11)	(1.74%)	632	26	4.29%	606
Gain (loss) on sale of foreclosed property	(336)	257	(43.34%)	(593)	569	(48.97%)	(1,162)
Gain on sale of available-for-sale securities	1,294	38	3.03%	1,256	576	84.71%	680
Income from insurance activities	867	9	1.05%	858	106	14.10%	752
Other non-interest income	681	(185)	(21.36%)	866	168	24.07%	698
Total non-interest income	$14,421	$391	2.79%	$14,030	$1,576	12.65%	$12,454

In 2014, total non-interest income contributed 23.5% of total revenue in 2014 compared to 24.1% and 22.0% for 2013 and 2012, respectively. Total non-interest income increased 2.7% in 2014 compared to 2013. Income from ATM and debit cards increased 11.83% or approximately $295,000 in 2014 compared to 2013, largely due to increased transaction volume. Brokerage fees increased 9.85% or approximately $135,000 in 2014 compared to 2013 also driven by increased volume. Mortgage banking income and service charges on deposit accounts each declined less than 3% in 2014. Mortgage banking income declined as the volume of mortgages originated and sold on the secondary market was negatively impacted by the increased regulatory and compliance burdens. Service charges on deposits decreased in 2014 primarily due to declining trend in overdraft fee income.

Loss on sale of foreclosed property includes write downs of OREO subsequent to foreclosure and has had a favorable trend over the past three years due to declining volumes of OREO and stabilization of real estate values. For more information regarding OREO, see the section below entitled Financial Condition Other Real Estate Owned and Note 10 in the Company s Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Gain on sale of available-for-sale securities totaled approximately $1.3 million per year in 2014 and 2013 as a result of specific strategies designed to realize appreciation in the investment portfolio. See additional information regarding sale of securities in Note 4 of the Company s Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Other non-interest income decreased approximately $185,000 due to the aggregate effect of several small balance non-interest income streams that declined in 2014 such as service charges on letters of credit, check revenue, and other fees.

Income from Insurance Activities in the Consolidated Statements of Income totaled $867,000 and $858,000 in 2014 and 2013, respectively and includes income from White and Associates/First Citizens Insurance, LLC, a full-service insurance agency (WAFCI), accounted for under the equity method. Non-interest income generated by WAFCI for 2014, 2013 and 2012 totaled approximately $874,000, $859,000 and $730,000, respectively. Income from insurance activities also includes commissions from sale of credit life policies and the Company s proportionate share of income from FCNB s other 50% owned insurance agency, First Citizens/White and Associates Insurance Company which was dissolved in late 2014.

Non-Interest Expense

The following table compares non-interest expense for the years ended December 31, 2014, 2013 and 2012 (dollars in thousands):

	Total	Increase (Decrease)		Total	Increase (Decrease)		Total
	2014	Amount	%	2013	Amount	%	2012
Salaries and Employee Benefits	$20,973	$2,067	10.93%	$18,906	$1,474	8.46%	$17,432
Net Occupancy Expense	1,900	204	12.03%	1,696	24	1.44%	1,672
Depreciation	2,073	88	4.43%	1,985	163	8.95%	1,822
Data Processing Expense	2,180	524	31.64%	1,656	(184)	(10.00%)	1,840
Legal and Professional Fees	1,153	686	146.90%	467	(239)	(33.85%)	706
Stationary and Office Supplies	266	42	18.75%	224	4	1.82%	220
Amortization of Intangibles	80	38	90.48%	42	7	20.00%	35
Advertising and Promotions	1,013	(105)	(9.39%)	1,118	404	56.58%	714
Premiums for FDIC insurance	679	(125)	(15.55%)	804	234	41.05%	570

Expenses related to other real estate owned	333	(82)	(19.76%)	415	(40)	(8.79%)	455
ATM and debit card related fees and expenses	1,390	(106)	(7.09%)	1,496	391	35.38%	1,105
Other Expenses	5,312	780	17.21%	4,532	86	1.93%	4,446
Total non-interest expense	$37,352	$4,011	12.03%	$33,341	$2,324	7.49%	$31,017

Total non-interest expense increased 12.0% in 2014 compared to 2013. Total non-interest expense includes three months of non-interest expense of Southern Heritage Bank as well as approximately $1 million of costs associated with the acquisition such as but not limited to legal, accounting, and investment banker fees. The most significant component of non-interest expense was salaries and employee benefits expense, which comprised 56.1% of total non-interest expense in 2014 compared to 56.8% in 2013 and 56.2% in 2012. Salary and employee benefits expense increased 10.9% or $2.1 million in 2014 compared to 2013. Significant expense associated with salaries and benefits is consistent with First Citizens strategic plan to hire and retain high quality employees to provide outstanding customer service and strive for exceptional shareholder returns. Increased expense in 2014 is attributable to a combination of increased total number of employees (including three months of expense associated with approximately 65 employees from the acquisition of Southern Heritage Bank), pay increases to existing employees, increased cost of employee benefits, including health insurance, and contributions to retirement plans and incentive plans. Over the past two years, First Citizens also incurred additional salaries and benefits expense for investments in new hires necessary to achieve expansion and growth goals, absorb regulatory burdens and plan for succession. Personnel expense to average assets was 1.67% compared to peer at 1.69% per the BHCP Report for the year ended December 31, 2014.

From 2013 to 2014, net occupancy expense increased approximately $204,000 and depreciation expense increased approximately $88,000. Increased net occupancy and depreciation expense are consistent with expanded Depreciation expense increased 8.95% in 2013 primarily due to the Cool Springs branch, which was purchased in December 2012. Data processing expense decreased 10.0% in 2013 primarily due to effective contract management of expenses for core systems and outsourced portions of the information technology functions of FCNB. First Citizens continues to strive for efficiencies in the areas of expansion, data integrity/security and customer service. However, strategies adopted by First Citizens board of directors to provide superior customer service will continue to exert pressure on occupancy, depreciation and other non-interest expenses going forward.

Legal and professional fees increased significantly in 2014 compared to 2013 as a result of legal and other professional consulting and advisory expenses related to the acquisition of Southern Heritage Bank. Increased expense in stationary and supplies, amortization of intangibles, and other non-interest expenses are also primarily attributable to the acquisition.

Advertising and promotions expense decreased approximately $105,000 in 2014 compared to 2013. Advertising and promotion costs are expensed as incurred and totaled $1.0 million in 2014, $1.1 million in 2013 and approximately $714,000 in 2012.

FDIC insurance premiums totaled $679,000, $804,000, and $570,000 for the years ended December 31, 2014, 2013 and 2012, respectively. Fluctuations in this expense are primarily attributable to fluctuations in deposit balances used to calculate premiums.

Expenses related to OREO totaled approximately $333,000 in 2014 compared to approximately $415,000 in 2013 and approximately $455,000 in 2012. The reduction in expense is consistent with the declining trend in volume of OREO over the past three years. For more information regarding OREO, see the section below entitled Financial Condition Other Real Estate Owned and Note 10 in the Company s Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Expenses associated with the Company s ATM and debit card program totaled approximately $1.4 million in 2014 compared to $1.5 million in 2013. Decreased expense for the ATM and debit card program in 2014 compared to 2013 is a result of reduced expense related to the debit card usage rewards program.

Capital Resources

The following table presents key capital and earnings ratios for the years ended December 31:

	2014	2013	2012	2011	2010
Net income to average total assets	1.08%	1.19%	1.25%	1.18%	0.92%
Net income to average shareholders equity	10.72%	12.06%	12.21%	12.22%	9.80%
Dividends declared to net income	34.95%	33.94%	32.00%	33.54%	40.86%
Average equity to average total assets	9.94%	9.83%	10.22%	9.62%	9.38%
Total equity to total assets	9.75%	9.58%	9.69%	9.82%	9.16%

In 2014, capital growth of $31.9 million or 28.3% was achieved through new equity of $17.0 million, $8.6 million increase in retained earnings and a $6.3 million increase in accumulated other comprehensive income. Retained earnings increased 9.1% in 2014 as a result of undistributed net income and conservative dividend payout ratio of 35%. Accumulated other comprehensive income increased due to increase of $6.3 million in unrealized appreciation (net of tax) on the available-for-sale securities portfolio compared to prior year. Total capital as a percentage of total assets has been maintained in the range of 9.0% to 10.0% for each of the past five years.

Risk-based capital focuses primarily on broad categories of credit risk and incorporates elements of transfer, interest rate and market risks. The calculation of risk-based capital ratio is accomplished by dividing qualifying capital by weighted risk assets in accordance with financial institution regulatory guidelines. The minimum risk-based capital ratio is 8.00%. At least one-half of this ratio or 4.00% must consist of core capital (Tier I), and the remaining 4.00% may be in the form of core (Tier I) or supplemental capital (Tier II). Tier I capital or core capital consists of common shareholders equity, qualified perpetual preferred stock and minority interests in consolidated subsidiaries. Tier II capital or supplementary capital may consist of the allowance for loan and lease losses, perpetual preferred stock, term-subordinated debt and other debt and stock instruments. The Company has historically maintained capital in excess of minimum levels established by regulation. The total risk-based capital ratio was 16.5% as of December 31, 2014 and 17.6% as of December 31, 2013 were significantly in excess of the 8% mandated by regulation. This ratio decreased during 2014 as a result of the acquisition of Southern Heritage Bancshares, Inc.

Dividend payments totaled $1.30 per share in 2014 compared to $1.30 per share in 2013 and $1.20 per share in 2012. The Company s strategy continues to be to pay dividends at a level that provides dividend payout ratio and dividend yield in excess of average for peers as reported in the Peer Report. The dividend payout ratio was 34.95% in 2014 compared to 33.94% in 2013 and 32.00% in 2012. The projected payout ratio for 2015 is in the range of 30% to 40%. The Company s dividend yield in 2014 was 3.05% compared to 3.33% per year in 2013 and 2012.

As of year-end 2014, there were approximately $21.7 million of retained earnings available for the payment of future dividends from the subsidiary banks to the Company. Banking regulations require certain capital levels to be maintained and may limit dividends paid by a bank to its holding company or by the Company to its shareholders. Historically, these restrictions have posed no practical limit on the ability of the Company to receive dividends from its subsidiaries or to pay dividends to shareholders.

As of December 31, 2014, the Company had repurchased approximately 111,001 shares of its common stock; reported as treasury stock on the Consolidated Balance Sheets at weighted average cost basis of $27.73 per share at December 31, 2014. During 2014, the Company repurchased 1,958 shares of its own common stock for an aggregate cost of $86,592 and weighted average per share cost of $44.22. The Company sold 795 shares of its common stock in 2014 at a weighted average per share price of $44.45 per share for an aggregate price of $35,338. During 2013, the Company did not repurchase or sell any shares of its common stock. There are currently no publicly announced plans or programs to repurchase shares in place.

Liquidity

The Company manages liquidity in a manner to ensure the availability of ample funding to satisfy loan demand, fund investment opportunities and fund large deposit withdrawals. Primary funding sources for the Company include customer core deposits, and FHLB borrowings as well as correspondent bank and other borrowings. The Company s liquidity position is further strengthened by ready access to a diversified base of wholesale borrowings, which includes lines of credit with the FHLB, federal funds purchased, securities sold under agreements to repurchase, brokered CDs and others.

The turmoil and events in financial markets and across the banking industry during the recent economic recession serve as proof that adequate liquidity is critical to the Company s success and survival, especially during times of market turbulence. Therefore, management maintains and regularly updates its strategic action plans related to liquidity, including crisis and contingency liquidity plans to defend against any material downturn in the liquidity position of the Company or any of its subsidiaries.

As of December 31, 2014 and 2013, deposits accounted for 91% of total liabilities. Borrowed funds from the FHLB totaled 3.1% ($41 million) of total liabilities as of December 31, 2014 compared to 3.8% ($41 million) as of December 31, 2013 and 3.6% ($38 million) at December 31, 2012. As of December 31, 2014, FCNB had additional borrowing capacity of $100.4 million with the FHLB and Southern Heritage Bank had borrowing capacity of $4.7 million.   The Company and its subsidiaries also had eight correspondent bank federal fund lines of credit totaling $72.0 million as of December 31, 2014.

In each of the years ended December 31, 2014 and 2013, FCNB held $23 million in short-term CDs with the State of Tennessee. Brokered time deposits account for less than one percent of total funding as of December 31, 2014 and 2013. Brokered deposits include reciprocal and one-way buy deposits in the CDARS program. For more information about CDARS, see the section above entitled Financial Condition Composition of Deposits.

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When evaluating liquidity, funding needs are compared against the current level of liquidity, plus liquidity that would likely be available from other sources. This comparison provides a means for determining whether funds management practices are adequate. Management should be able to manage unplanned changes in funding sources, as well as react to changes in market conditions that could hinder the Banks ability to quickly liquidate assets with minimal loss. Funds management practices are designed and implemented to ensure that the Company does not maintain liquidity by paying above market prices for funds or by relying unduly on wholesale or credit-sensitive funding sources. The OCC has established benchmarks to be used as guidelines in managing liquidity. The following areas are considered liquidity red flags:

- Significant increases in reliance on wholesale funding;
- Significant increases in large CDs, brokered deposits or deposits with interest rates higher than the market;
- Mismatched funding funding long-term assets with short-term liabilities or short-term assets with long-term liabilities;
- Significant increases in borrowings;
- Significant increases in dependence on funding sources other than core deposits;
- Reduction in borrowing lines by correspondent banks;
- Increases in cost of funds;
- Declines in levels of core deposits; and
- Significant decreases in short-term investments.

Although the Company s liquidity position remained strong during the periods presented and is forecasted to remain strong, liquidity remains a critical component of the overall strategic plan, which strives to maintain diverse funding sources conducive to net interest margin strategies. The following table reflects key liquidity metrics of the Company compared to the BHCP Report of December 31, 2014, 2013 and 2012:

	2014		2013		2012	
	First Citizens	Peer(1)	First Citizens	Peer(2)	First Citizens	Peer(2)
Noncore funding to total assets	3.46%	3.37%	3.41%	3.33%	3.69%	3.38%
Net noncore funding dependence	1.08%	0.91%	1.19%	0.81%	1.27%	0.79%
Net loans and leases to total deposits	0.16%	0.15%	0.16%	0.25%	0.14%	0.59%
Available-for-sale securities appreciation (depreciation) to Tier 1 Capital(3)	8.92%	10.11%	9.40%	9.94%	9.17%	9.74%
Pledged securities to total investment securities	36.17%	23.68%	33.94%	23.13%	22.00%	25.78%

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(1) Peer information is provided for December 31, 2014, which is the most recent information available.
(2) For the years ended December 31, 2013 and 2012, First Citizens peer group consisted of approximately 350 bank holding companies with total asset size of $1 to $3 billion.
(3) Tier 1 capital to average assets is the ratio of core equity capital components to average total assets.

The above comparison is one quantitative means of monitoring liquidity levels. However, other quantitative and qualitative factors are considered in the overall risk management process for liquidity. Such other factors evaluated by management include, but are not limited to, forecasting and stress testing capital levels, diversification of funding sources, degree of reliance on short-term volatile funding sources, deposit volume trends and stability of deposits. There are no known trends or uncertainties that are likely to have a material effect on the Company s liquidity or capital resources. There currently exist no recommendations by regulatory authorities, which, if implemented, would have such an effect.

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Recently Issued Accounting Standards

ASU 2014-01, Investments - Equity Method and Joint Ventures (Topic 323) - Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force).

ASU 2014-01 allows for use of the proportional amortization method for qualified affordable housing projects if certain conditions are met. Under the proportional amortization method, the initial cost of the investment is amortized in proportion to the tax credits and other tax benefits received and the net investment performance is recognized in the income statement as a component of income tax expense. ASU 2014-01 provides for a practical expedient, which allows for amortization of only expected tax credits over the period tax credits are expected to be received. This method is permitted if it produces a measurement that is substantially similar to the measurement that would result from using both tax credits and other tax benefits. ASU 2014-01 is effective for fiscal years and interim periods beginning after December 15, 2014 and is applied retrospectively to all periods presented. The adoption of ASU 2014-01 did not have a material impact on the Company s Consolidated Financial Statements.

ASU 2014-04, Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force).

ASU 2014-04 clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. ASU 2014-04 is effective for fiscal years and interim periods beginning after December 15, 2014 and may be applied prospectively or through a modified retrospective approach. The adoption of ASU 2014-04 did not have a material impact on the Company's Consolidated Financial Statements.

ASU 2014-09, Revenue from Contracts with Customers.

ASU 2014-09 does not change revenue recognition for leases, insurance contracts or financial instruments. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The newly established recognition principle is accomplished through a five-step framework involving 1) the identification of contracts with customers, 2) identification of performance obligations, 3) determination of the transaction price, 4) allocation of the transaction price to the performance obligations and 5) recognition of revenue as performance obligations are satisfied. Additionally, qualitative and quantitative information is required for disclosure regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. Transition to the new requirements may be made by retroactively revising prior financial statements or by a cumulative effect through retained earnings. The adoption of ASU 2014-09 is not expected to have a material impact on the Company's Consolidated Financial Statements.

ASU 2014-14, Receivables Troubled Debt Restructurings by Creditors: Classification of Certain Government-Guaranteed Residential Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force).

Issued in August 2014, ASU 2014-14 requires that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if (1) the loan has a government guarantee that is not separable from the loan before foreclosure; (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under the claim; and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. ASU 2014-14 also provides that upon foreclosure, the separate other receivable would be measured based on the current amount of the loan balance (principal and interest) expected to be recovered under the guarantee. The amendments of ASU 2014-14 are effective for interim and annual periods beginning after December 15, 2014, and may be applied using either a modified retrospective transition method or a prospective transition method as described in ASU 2014-14. The adoption of ASU 2014-14 is not expected to have a material impact on the Company's Consolidated Financial Statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Interest Rate Sensitivity

Interest rate sensitivity varies with different types of interest-earning assets and interest-bearing liabilities. Overnight federal funds, on which rates change daily, and loans which are tied to the prime rate are much more sensitive than long-term investment securities and fixed rate loans. The shorter-term interest sensitive assets and liabilities are key to measurement of the interest sensitivity gap. Minimizing this gap is a continual challenge and a primary objective of the asset/liability management program.

The Company monitors and employs multiple strategies to manage interest rate risk and liquidity continuously at acceptable levels. Such strategies include but are not limited to use of FHLB borrowings, floors on variable rate loans, use of interest rate swaps and investments in mortgage-backed investments that enable the Company to have steady cash inflows.

Overall, the Company maintained net interest margins at 3.83% in 2013 and 2014. Margins declined from 2012 to 2013 and stabilized in 2013 and 2014. The ability to maintain a strong net interest margin over the past three years has been challenged by the historical low rate environment and weak loan demand resulting in a declining loan-to-deposit trend. The impact of deposit growth primarily being used for increased lower yielding cash balances and increased allocations to investment securities purchases over the past three years will continue to place pressure on net interest margins going forward.

Interest rate risk is separated and analyzed according to the following categories of risk: (1) re-pricing; (2) yield curve; (3) option risk; (4) price risk; and (5) basis risk. Trading assets are utilized infrequently and are addressed in the investment policy. Asset/liability strategies are reviewed and adjusted perpetually in order to achieve or maintain a stable net interest margin without taking on material risk in other key risk areas such as credit risk or liquidity risk. The data schedule below reflects a summary of the Company s interest rate risk using simulations. The projected 12-month exposure is based on various rate scenarios which are primarily focused on rising rates given the historically low current rate environment.

The following condensed gap reports provide an analysis of interest rate sensitivity of earning assets and costing liabilities in a flat rate environment at December 31, 2014 and 2013 (dollars in thousands):

CONDENSED GAP REPORT

CURRENT BALANCES

DECEMBER 31, 2014

	Year 1	Year 2	Year 3	Year 4	Year 5	Over 5	Total
Assets:							
Total investments	$112,680	$69,615	$65,355	$61,385	$69,989	$204,322	$583,346
Total net loans	379,266	112,790	85,723	61,217	40,127	24,559	703,682
Other earnings assets	54,203	0	0	0	0	33,098	87,301
Non-earning assets	-	-	-	-	-	107,109	107,109
Total assets	$546,149	$182,405	$151,078	$122,602	$110,116	$369,088	$1,481,438
Liabilities:							
Non-maturity deposits	309,766	16,936	16,348	15,781	15,236	436,557	810,624
Time deposits	309,424	44,321	22,832	14,670	9,559	76	400,882
Total deposits	619,190	61,257	39,180	30,451	24,795	436,633	1,211,506
Total borrowings	70,079	8,355	12,764	8,394	12,269	4,287	116,148
Other liabilities	0	0	0	0	0	9,274	9,274
Equity	-	-	-	-	-	144,510	144,510
Total liabilities and equity	$689,269	$69,612	$51,944	$38,845	$37,064	$594,704	$1,481,438
Period gap	($143,120)	$112,793	$99,134	$83,757	$73,052	($225,616)	-
Cumulative gap	-143,120	-30,327	68,807	152,564	225,616	-	-
% of Total Assets	-9.66%	-2.05%	4.64%	10.30%	15.23%	0.00%	0.00%

CONDENSED GAP REPORT

CURRENT BALANCES

DECEMBER 31, 2013

	Year 1	Year 2	Year 3	Year 4	Year 5	Over 5	Total
Assets:							
Total investments	$ 73,545	$ 50,835	$ 49,323	$47,477	$50,001	$185,344	$ 456,525
Total net loans	360,235	77,486	59,411	38,496	13,227	23,563	572,418
Other earnings assets	33,017	-	-	-	-	22,466	55,483
Non-earning assets	-	-	-	-	-	90,046	90,046
Total assets	$466,797	$128,321	$108,734	$85,973	$63,228	$321,419	$1,174,472
Liabilities:							
Non-maturity deposits	248,313	12,319	11,872	11,443	11,032	335,761	630,740
Time deposits	280,659	31,051	11,316	11,875	2,822	67	337,790
Total deposits	528,972	43,370	23,188	23,318	13,854	335,828	968,530
Total borrowings	49,159	2,009	7,010	7,010	7,119	15,668	87,975
Other liabilities	-	-	-	-	-	5,361	5,361
Equity	-	-	-	-	-	112,606	112,606
Total liabilities and equity	$578,131	$45,379	$30,198	$30,328	$20,973	$469,463	$1,174,472
Period gap	$(111,334)	$82,942	$78,536	$55,645	$ 42,255	$(148,044)	$ -
Cumulative gap	(111,334)	(28,392)	50,144	105,789	148,044	-	-
% of Total Assets	-9.5%	-2.4%	4.3%	9.0%	12.6%	0.0%	-%

Notes to the Gap Reports:

1. The gap report reflects the interest sensitivity positions during a flat rate environment. Time frames could change depending on whether rates rise or fall.
2. Re-pricing overrides maturities in various time frames.
3. Other earning assets consist of bank owned life insurance, interest bearing deposits in banks, fed funds sold, and FHLB and Federal Reserve Bank stock.
4. Non-maturity deposits include both non-interest bearing demand deposits and interest bearing savings and transaction accounts. Non-maturity deposits are considered to be core and are spread among the one-year, two-year, three-year and greater than five-year categories for gap analysis based on characteristics of the various accounts and pricing strategies related to those accounts. Regular savings accounts are the least sensitive type of interest bearing account. First Rate, e-Solutions and Wall Street deposit products are more sensitive to rate changes and, therefore, are repriced more aggressively than regular savings and other less sensitive type deposit accounts.

5. Simulations are utilized to reflect the impact of multiple rate scenarios on net interest income at risk, net income at risk and economic value of equity at risk. Strategies are implemented to increase net interest income, while always considering the impact on interest rate risk. Overall, the Company manages the gap between interest rate sensitive liabilities to expand and contract with the rate cycle phase and to keep exposures within policy limits. The Company s Funds Management Committee is responsible for implementing and monitoring procedures to improve net interest income through volume increases and efficient pricing techniques.

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First Citizens interest rate risk position is currently and has been liability sensitive for the past three years. Therefore, net interest margins would be diluted slightly by increases in rates over the next 12 months under a normal interest rate environment. As of December 2014, federal funds rates remain at historical low ranges of 0.00% to 0.25%. Federal funds rates at this level do not have the capacity to decrease even 100 basis points. Therefore, in the interest rate risk models, the rates on federal funds and prime hit a floor of zero and 3.0%, respectively. The prime rate floor of 3% assumes that the normal spread between federal funds rates and prime is maintained and remains fixed at 300 basis points. While prime rate in the model reaches a floor of 3%, FCNB s variable rate loan pricing carries an average floor in the range of 4.0% to 5.0%. As rates in the model are shocked, loans will decrease only until the floor position is reached while some liabilities continue to reprice downward. However, the variance between the flat rate scenario and the down rate shocks are negative as the current pricing of liabilities is historically low and has little room to trend downward beyond its current position. With federal funds rates currently between 0.00% to 0.25%, the down 100 basis points and down 200 basis point scenarios are the most unlikely scenarios. Scenarios for exposure in the up 100 basis points and up 200 basis points are considered more realistic. However, recent statements by the FOMC indicate that federal funds rates will mostly remain flat or increase gradually over the next one to two years.

These rate shock scenarios also indicate a negative variance because the upward scenarios indicate that deposits will reprice faster than loans and investments, especially given that most of the loans are currently at a floor and will require a more than 200-basis point increase in federal funds rates and prime rate before loan floors will increase.

The Company s exposure to interest rate risk is within established policy limits. The following table presents net interest income at risk as of December 31, 2014 projected over a 12-month exposure period and compared to the Company s internal policy limits (dollars in thousands):

Scenarios:	Rate Moves in Basis Points	Current Position	Possible Results	Variance	As % of Net Interest Income*	Policy Limit
Declining 1%	-100	45,064	43,252	-1,812	-4.02%	-15.00%
Most Likely-Base		**45,064**	**45,064**	**0**	**0**	%
Rising 1%	100	45,064	43,909	-1,155	-2.56%	-7.00%
Rising 2%	200	45,064	42,651	-2,413	-5.35%	-15.00%
Rising 3%	300	45,064	41,177	-3,887	-8.63%	-20.00%
Rising 4%	400	45,064	39,565	-5,499	-12.20%	-25.00%

* Net interest income assumes that interest rates would change immediately within the total portfolio, a scenario which would reflect a worst case position and is unlikely to happen.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Management s Annual Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company s internal control system is designed to provide reasonable assurance to management and the Company s Board of Directors regarding the preparation and fair presentation of the Company s annual financial statements in accordance with generally accepted accounting principles.

Inherent limitations exist in the effectiveness of any internal control structure, including the possibility of human error and circumvention of controls. Accordingly, even effective internal control can only provide reasonable assurance with respect to financial statement preparation.

Management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2014, based on criteria for effective internal control over financial reporting described in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. As permitted, management excluded from its assessment the operations of Southern Heritage Bancshares, Inc. during 2014 which is more fully described in Note 2 to the Consolidated Financial Statements. The assets acquired in this transaction consist primarily of cash, investment securities, loans and fixed assets which comprised approximately 17% of total consolidated assets at December 31, 2014. Based on this assessment, management believes that, as of December 31, 2014, the Company s internal control over financial reporting was effective.

Alexander Thompson Arnold, PLLC, the Company s independent registered public accounting firm, has audited the Company s consolidated financial statements and issued an attestation report on the Company s internal control over financial reporting. The reports appear beginning on the next page.

Members of:
American Institute of Certified Public Accountants
AICPA Center for Public Company Audit Firms
AICPA Governmental Audit Quality Center
AICPA Employee Benefit Plan Audit Quality Center
Tennessee Society of Certified Public Accountants
Kentucky Society of Certified Public Accountants

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Offices in Tennessee & Kentucky

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders of

First Citizens Bancshares, Inc. and Subsidiaries

Dyersburg, Tennessee 38024

We have audited First Citizens Bancshares, Inc. and subsidiaries internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As permitted by regulations we have excluded Southern Heritage Bancshares, Inc. from the audit of internal control over financial reporting. First Citizens Bancshares, Inc. and subsidiaries management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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In our opinion, First Citizens Bancshares Inc. and subsidiaries excluding Southern Heritage Bancshares Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets and the related statements of income, comprehensive income, stockholders equity, and cash flows of First Citizens Bancshares Inc. and subsidiaries, and our report dated March 3, 2015, expressed an unqualified opinion.

Alexander Thompson Arnold, PLLC

Dyersburg, Tennessee

March 3, 2015

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Members of:
American Institute of Certified Public Accountants
AICPA Center for Public Company Audit Firms
AICPA Governmental Audit Quality Center
AICPA Employee Benefit Plan Audit Quality Center
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders of
First Citizens Bancshares, Inc. and Subsidiaries

Dyersburg, Tennessee 38024

We have audited the accompanying consolidated balance sheets of First Citizens Bancshares, Inc., and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, stockholders equity, and cash flows for each of the years in the three- year period ended December 31, 2014. First Citizens Bancshares, Inc. and subsidiaries management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of First Citizens Bancshares, Inc. and subsidiaries as of December 31, 2014 and 2013, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), First Citizens Bancshares, Inc. and subsidiaries internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 3, 2015, expressed an unqualified opinion.

Alexander Thompson Arnold PLLC

Dyersburg, Tennessee
March 3, 2015

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2014 AND 2013
(Dollars in thousands)

	2014	2013
ASSETS		
Cash and due from banks	$18,932	$19,780
Federal funds sold	14,250	5,469
Cash and cash equivalents	33,182	25,249
Interest-bearing deposits in other banks	40,993	21,865
Investment securities:		
Available-for-Sale, stated at market	583,346	456,525
Loans (excluding unearned income of $423 at December 31, 2014 and $434 at December 31, 2013)	711,223	580,236
Less: Allowance for loan losses	7,541	7,818
Net loans	703,682	572,418
Loans held-for-sale	4,339	3,098
Federal Home Loan Bank and Federal Reserve Bank stocks, at cost	6,134	5,684
Premises and equipment	41,006	34,152
Accrued interest receivable	6,260	5,011
Goodwill	22,340	13,651
Other intangible assets	1,800	384
Other real estate owned	5,717	6,826
Bank-owned life insurance policies	25,924	22,466
Other assets	6,715	7,143
TOTAL ASSETS	$1,481,438	$1,174,472
LIABILITIES AND EQUITY		
Non-interest bearing deposits	$181,195	$142,673
Interest-bearing deposits	1,030,311	825,857
Total deposits	1,211,506	968,530
Securities sold under agreements to repurchase	49,317	36,808
Long-term debt	66,831	51,167
Other liabilities	9,274	5,361
Total liabilities	1,336,928	1,061,866

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (cont'd)
DECEMBER 31, 2014 AND 2013
(Dollars in thousands)

	2014	2013
Equity		
Class A common stock, no par value – 1,000,000 authorized; 145,728 issued and outstanding at December 31, 2014 and no shares authorized, issued or outstanding at December 31, 2013	$146	$-
Common stock, no par value - 10,000,000 authorized; 3,986,895 issued and 3,838,522 outstanding at December 31, 2014 and 10,000,000 authorized, 3,717,593 issued and 3,607,754 outstanding at December 31, 2013	3,950	3,718
Surplus	31,946	15,331
Retained earnings	103,536	94,889
Accumulated other comprehensive income (loss)	5,955	(361)
Total common stock and retained earnings	145,533	113,577
Less-111,001 treasury shares, at cost as of December 31, 2014 and 109,839 treasury shares, at cost as of December 31, 2013	3,078	3,026
Total shareholders' equity	142,455	110,551
Non-controlling (minority) interest in consolidated subsidiary	2,055	2,055
Total equity	144,510	112,606
TOTAL LIABILITIES AND EQUITY	$1,481,438	$1,174,472

Note: See accompanying notes to consolidated financial statements.

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012
(In thousands, except per share data)

	2014	2013	2012
Interest income			
Interest and fees on loans	$34,005	$32,156	$32,277
Interest and dividends on investment securities:			
Taxable	7,031	6,962	7,004
Tax-exempt	5,592	4,705	4,489
Dividends	198	198	218
Other interest income	108	101	123
Total interest income	46,934	44,122	44,111
Interest expense			
Interest on deposits	4,862	4,829	5,919
Interest on borrowings	1,164	1,102	1,126
Other interest expense	243	283	332
Total interest expense	6,269	6,214	7,377
Net interest income	40,665	37,908	36,734
Provision for loan losses	751	775	650
Net interest income after provision for loan losses	39,914	37,133	36,084
Non-interest income			
Service charges on deposit accounts	4,680	4,798	4,896
Income from ATM and debit cards	2,788	2,493	2,391
Brokerage fees	1,506	1,371	1,260
Mortgage banking income	1,405	1,445	1,497
Income from fiduciary activities	915	904	836
Income from insurance activities	867	858	752
Earnings on bank owned life insurance	621	632	606
Loss on sale or write down of other real estate owned	(336)	(593)	(1,162)
Gain on sale or call of available-for-sale securities	1,294	1,256	680
Other non-interest income	681	866	698
Total non-interest income	14,421	14,030	12,454
Total other-than temporary impairment losses	–	–	–
Portion of loss recognized in other comprehensive income (before taxes)	–	–	–
Net impairment losses recognized in earnings	–	–	–

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (cont'd)
YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012
(In thousands, except per share data)

	2014	2013	2012
Other non-interest expense:			
Salaries and employee benefits	$20,973	$18,906	$17,432
Net occupancy expense	1,900	1,696	1,672
Depreciation	2,073	1,985	1,822
Data processing expense	2,180	1,656	1,840
ATM and debit card fees and expenses	1,390	1,496	1,105
Advertising and promotions	1,013	1,118	714
Legal and professional fees	1,153	467	706
Premiums for FDIC insurance	679	804	570
Expenses related to other real estate owned	333	415	455
Stationary and office supplies	266	224	220
Amortization of intangibles	80	42	35
Other non-interest expense	5,312	4,532	4,446
Total other non-interest expense	37,352	33,341	31,017
Net income before income taxes	16,983	17,822	17,521
Provision for income tax expense	3,438	4,014	4,006
Net income	$13,545	$13,808	$13,515
Earnings per common share:			
Net income per common share	$3.72	$3.83	$3.75
Weighted average common shares outstanding	3,644	3,607	3,607

Note: See accompanying notes to consolidated financial statements.

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

(In thousands)

	2014	2013	2012
Net income	$13,545	$13,808	$13,515
Other comprehensive income, net of tax:			
Net change in unrealized gains (losses) on available-for-sale securities	6,316	(10,652)	1,490
Total other comprehensive income (loss), net of tax	6,316	(10,652)	1,490
Total comprehensive income	$19,861	$3,156	$15,005

Related tax effects allocated to each component of other comprehensive income were as follows:

	Before-tax Amount	Tax Expense Or Benefit	Net-of-tax Amount
Year ended December 31, 2014:			
Unrealized gains on available-for-sale securities:			
Unrealized gains arising during the period	$10,830	$(4,147)	$6,683
Reclassification adjustments for net gains included in net income	(595)	228	(367)
Net unrealized gains (losses)	$10,235	$(3,919)	$6,316
Year ended December 31, 2013:			
Unrealized gains (losses) on available-for-sale securities:			
Unrealized losses arising during the period	$(16,006)	$6,129	$(9,877)
Reclassification adjustments for net gains included in net income	(1,256)	481	(775)
Net unrealized gains (losses)	$(17,262)	$6,610	$(10,652)
Year ended December 31, 2012:			
Unrealized gains (losses) on available-for-sale securities:			
Unrealized gains arising during the period	$3,095	$(1,185)	$1,910
Reclassification adjustments for net gains included in net income	(680)	260	(420)
Net unrealized gains (losses)	$2,415	$(925)	$1,490

Note: See accompanying notes to consolidated financial statements.

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

(In thousands)

	Class A Common Stock Shares (#)	Class A Common Stock Amount ($)	Common Stock Shares (#)	Common Stock Amount ($)	Surplus ($)	Retained Earnings ($)	Accumulated. Other Comprehensive Income ($)	Treasury Stock ($)	Non-Controlling Minority Interests ($)	Total ($)
Balance January 1, 2012	-	$ -	3,718	$ 3,718	$ 15,331	$ 76,586	$ 8,801	$ (3,023)	$ 2,055	$ 103,468
Comprehensive income:										
Net income, year ended December 31, 2012						13,515				13,515
Adjustment of unrealized gains on securities available-for-sale, net of tax							1,490			1,490
Total comprehensive income						13,515	1,490			15,005
Cash dividends paid - $1.20 per common share						(4,330)				(4,330)
Treasury stock purchases – net								(3)		(3)
Balance December 31, 2012	-	$ -	3,718	$ 3,718	$ 15,331	$ 85,771	$ 10,291	$ (3,026)	$ 2,055	$ 114,140
Comprehensive income:										
Net income, year ended December 31, 2013						13,808				13,808
Adjustment of unrealized losses on securities available-for-sale,							(10,652)			(10,652)

net of tax										
Total comprehensive income						13,808	(10,652)			3,156
Cash dividends paid - $1.30 per common share						(4,690)				(4,690)
Balance December 31, 2013	-	$ -	3,718	$ 3,718	$ 15,331	$ 94,889	$ (361)	$ (3,026)	$ 2,055	$ 112,606
Comprehensive income:										
Net income, year ended December 31, 2014						13,545				13,545
Adjustment of unrealized gains on securities available-for-sale, net of tax							6,316			6,316
Total comprehensive income						13,545	6,316			19,861
Cash dividends paid - $1.30 per common share						(4,898)				(4,898)
Reclassification of certain common shares to Class A Common Stock	37	37	(37)	(37)						-
Issuance of common stock and Class A common stock in connection with acquisition of Southern Heritage Bancshares, Inc.	109	109	269	269	16,615					16,993
Treasury stock purchases – net								(52)		(52)
Balance December 31, 2014	146	$ 146	3,950	$ 3,950	$ 31,946	$ 103,536	$ 5,955	$ (3,078)	$ 2,055	$ 144,510

Note: See accompanying notes to consolidated financial statements.

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FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

(In thousands)

	2014	2013	2012
Operating activities			
Net income	$13,545	$13,808	$13,515
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	751	775	650
Provision for depreciation	2,073	1,985	1,822
Provision for amortization of intangibles	80	42	35
Deferred income taxes	400	(637)	(102)
Net gains on sale or call of available-for-sale securities	(1,294)	(1,256)	(680)
Net losses on sale or write down of other real estate owned	336	593	1,162
Net (increase) decrease in loans held-for-sale	1,611	1,580	(2,062)
(Increase) decrease in accrued interest receivable	(243)	10	285
Decrease in accrued interest payable	(163)	(144)	(35)
Increase in cash surrender value of bank-owned life insurance policies	(458)	(508)	(520)
Net (increase) decrease in other assets	1,720	522	(2,502)
Net increase in other liabilities	1,473	331	1,747
NET CASH PROVIDED BY OPERATING ACTIVITIES	19,831	17,101	13,315
Investing activities			
(Increase) decrease in interest-bearing deposits in other banks	(10,495)	19,984	(1,711)
Proceeds of paydowns and maturities of available-for-sale investment securities	53,413	73,428	69,546
Proceeds of sales of available-for-sale investment securities	30,152	41,861	34,615
Purchases of available-for-sale investment securities	(118,535)	(122,382)	(203,237)
Increase in loans – net	(7,204)	(31,769)	(22,306)
Net cash paid in acquisition	(5,593)	-	-
Premiums paid for bank owned life insurance	(3,000)	-	-
Proceeds from sale of other real estate owned	1,973	1,235	1,309
Purchase of premises and equipment	(3,653)	(1,821)	(6,063)
NET CASH USED BY INVESTING ACTIVITIES	(62,942)	(19,464)	(127,847)
Financing activities			
Net increase in noninterest-bearing deposits	3,338	3,027	19,957
Net increase in interest bearing deposits	28,124	664	89,210
Net increase (decrease) in short-term borrowings	12,509	(2,036)	2,373
Issuance of long-term debt	17,000	19,000	10,000
Payment of principal on long-term debt	(4,977)	(16,552)	(8,609)
Cash dividends paid	(4,898)	(4,690)	(4,330)
Treasury stock transactions – net	(52)	-	(3)
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	51,044	(587)	108,598

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS (cont'd)

YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

(In thousands)

	2014	2013	2012
Increase (decrease) in cash and cash equivalents	7,933	($2,950)	($5,934)
Cash and cash equivalents at beginning of year	25,249	28,199	34,133
Cash and cash equivalents at end of year	$33,182	$ 25,249	$ 28,199
Supplemental cash flow information:			
Interest paid	$6,280	$ 6,358	$ 7,412
Income taxes paid	4,475	4,412	4,250
Supplemental noncash disclosures:			
Transfers from loans to other real estate owned	2,301	541	1,261
Transfers from other real estate owned to loans	1,666	468	1,442

Note: See accompanying notes to consolidated financial statements.

FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2014 AND 2013

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

The accounting and reporting policies of First Citizens Bancshares, Inc., and subsidiaries (the "Company") conform to generally accepted accounting principles ("GAAP"). The significant policies are described as follows:

Basis of Presentation

The Consolidated Financial Statements include all accounts of the Company and its wholly owned subsidiary depository financial institutions, First Citizens National Bank ("FCNB") and Southern Heritage Bank ("SHB" or collectively referred to the "Banks"). The Company's investment in these subsidiaries is reflected on the Company's condensed balance sheets. See Notes 2 and 24 for more information.

FCNB has two wholly-owned subsidiaries, First Citizens Financial Plus, Inc. and First Citizens Investments, Inc., which are consolidated into its financial statements. The principal activity of First Citizens Investments, Inc. is to acquire and sell investment securities and collect income from the securities portfolio. First Citizens Holdings, Inc., a wholly owned subsidiary of First Citizens Investments, Inc., acquires and sells certain investment securities, collects income from its portfolio, and owns First Citizens Properties, Inc., a real estate investment trust. First Citizens Properties, Inc. is a real estate investment trust organized and existing under the laws of the state of Maryland, the principal activity of which is to invest in participation interests in real estate loans made by the FCNB and provide the FCNB with an alternative vehicle for raising capital. First Citizens Holdings, Inc. owns 100% of the outstanding common stock and 60% of the outstanding preferred stock of First Citizens Properties, Inc. Directors, executive officers and certain employees and affiliates of the FCNB own approximately 40% of the preferred stock which is reported as Noncontrolling Interest in Consolidated Subsidiary in the Consolidated Financial Statements of the Company. Net income attributable to the non-controlling interest is included in Other Non-Interest Expense on the Consolidated Statements of Income and is not material for any of the periods presented.

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

The Company has three additional wholly owned subsidiaries, First Citizens (TN) Statutory Trusts III and IV and Southern Heritage Bancshares Statutory Trust I. These three subsidiaries are reported under the equity method in accordance with GAAP for Variable Interest Entities for the periods presented. These investments are reported in Other Assets and the proportionate share of income (loss) is reported in other non-interest income.

All significant inter-company balances and transactions are eliminated in consolidation. Certain balances have been reclassified to conform to current year presentation.

Nature of Operations

The Company and its subsidiaries provide a wide variety of commercial banking services to individuals and corporate customers in the mid-southern United States with a concentration in West Tennessee. The Company’s primary products are checking and savings deposits and residential, commercial and consumer lending.

Basis of Accounting

The Consolidated Financial Statements are presented using the accrual method of accounting.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the fair value of investment securities, determination of the allowance for losses on loans, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, and determination of fair values associated with impairment testing of goodwill. In connection with the determination of the allowances for losses on loans and foreclosed real estate, management obtains independent appraisals for significant properties. Estimates and assumptions used in goodwill impairment testing are made based on prevailing market factors, historical earnings and multiples and other factors.

Business Combinations

Business combinations are accounted for by applying the acquisition method in accordance with ASC 805, “Business Combinations” (“ASC 805”). Under the acquisition method, identifiable assets acquired and liabilities assumed are measured at fair value as of the acquisition date and are recognized separately from goodwill. Results of operations of the acquired entities are included in the Consolidated Statements of Income from the date of acquisition.

Loans acquired in business combinations with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Acquired credit-impaired loans are accounted for under the accounting guidance for loan and debt securities acquired with deteriorated credit quality, in accordance with ASC 310-30, “Loans and Debt Securities Acquired with Deteriorated Credit Quality” (“ASC 310-30”), and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Increases in expected cash flows to be collected on these loans are recognized as an adjustment to the loan’s yield over its remaining life, while decreases in expected cash flows are recognized as an impairment. Loans acquired through business combinations that do not meet the specific criteria of ASC 310-30 but for which a discount is attributable, at least in part to credit quality, are also accounted for under this guidance. As a result, related discounts are recognized subsequently through accretion based on expected cash flow of the acquired loans.

Cash Equivalents

Cash equivalents include cash on hand, cash items, clearings and exchanges as well as amounts due from correspondent banks which do not bear interest and federal funds sold. Generally, federal funds are purchased or sold for one-day periods.

Interest-Bearing Deposits in Other Banks

Interest-bearing deposits in other banks consist of excess balances above the minimum required balance at the Federal Reserve Bank and short-term certificates of deposits ("CDs") held at other banks. The CDs at other banks are held in increments of less than $250,000 and, therefore, are covered by FDIC insurance. Interest income on deposits in banks is reported as Other Interest Income on the Consolidated Statements of Income.

Securities

Investment securities are classified as follows:

Held-to-maturity, which includes those investment securities which the Company has the intent and the ability to hold until maturity;

Trading securities, which include those investments that are held for short-term resale; and

Available-for-sale, which includes all other investment securities.

Held-to-maturity securities are reflected at cost, adjusted for amortization of premiums and accretion of discounts using methods which approximate the interest method. Available-for-sale securities are carried at fair value, and unrealized gains and losses are recognized as direct increases or decreases to accumulated other comprehensive income except for other-than-temporary impairment losses that are required to be charged against earnings. The credit portion of other-than-temporary impairment losses is recorded against earnings and is separately stated on the Consolidated Statements of Income. Trading securities, where applicable, are carried at fair value, and unrealized gains and losses on these securities are included in net income.

Realized gains and losses on sale or call of investment securities transactions are determined based on the specific identification method and are included in net income.

Loans Held-for-Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or market, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Servicing rights are not retained when mortgage loans are sold. Income from loans held for sale is reported in Mortgage Banking Income, which is included in Non-Interest Income in the Consolidated Financial Statements.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reflected on the Consolidated Balance Sheets at the unpaid principal amount less the allowance for loan losses and unearned interest and fees. Interest on loans is recorded on an accrual basis unless it meets criteria to be placed on non-accrual status. The Company's policy is to not accrue interest or discount on (i) any asset which is maintained on a cash basis because of deterioration in the financial position of the borrower, (ii) any asset for which payment in full of interest or principal is not expected or (iii) any asset upon which principal or interest has been in default for a period of 90 days or more unless it is both well-secured and in the process of collection. For purposes of applying the 90 days past due test for non-accrual of interest, the date on which an asset reaches non-accrual status is determined by its contractual term. A debt is deemed well-secured if it is secured by collateral in the form of liens or pledges of real or personal property, including securities that have a realizable value sufficient to discharge the debt (including accrued interest) in full, considered to be proceeding in due course either through legal action, including judgment enforcement procedures or, in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status. Unpaid interest on loans placed on non-accrual status is reversed from income and further accruals of income are not usually recognized. Subsequent collections related to impaired loans are usually credited first to principal and then to previously uncollected interest.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans evaluated on an individual basis for impairment. For each loan evaluated individually that is determined to be impaired, a specific allocation to the allowance is established when the discounted cash flows (or collateral value or observable market price) of the loan is lower than the carrying value of that loan. The general component of the allowance is determined based on loans evaluated on a pooled basis which consist of non-impaired loans and pools of loans with similar characteristics that are not evaluated individually for impairment.

Loans that meet the criteria for individual impairment analysis are those loans or borrowing relationships with current outstanding principal balance greater than or equal to $250,000 at the measurement date and have an internal rating of "Grade 6" or higher (generally characterized as "Substandard" or worse). Once identified for individual analysis, then a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect scheduled payments of principal or interest when due according to contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all circumstances surrounding the loan and the borrower, including the length of delay, reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or fair value of the collateral if the loan is collateral dependent. The majority of the Company's impaired loans is secured by real estate and considered collateral-dependent. Therefore, impairment losses are primarily based on the fair value of the underlying collateral (usually real estate).

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors. Loans are pooled together based on the type of loans and internal risk ratings. Risk factors for each pool are developed using historical charge-offs for the past three years. The risk factors are then adjusted based on current conditions of the loan portfolio and lending environment that may result in future losses differing from historical patterns. Such factors include, but are not limited to:

- Changes in underlying collateral securing the loans;

Changes in lending policies and procedures including changes in underwriting, collection, charge-off and recovery practices;

Changes in economic and business conditions that affect the collectability of the portfolio;

Changes in the nature and volume of the portfolio;

Changes in the experience, ability and depth of lending management and other related staff;

Changes in the volume and severity of past due loans, volume of non-accruals, and/or problem loans;

Changes in the quality of the Company's loan review system;

Existence and effects of any concentration of credit and changes in the level of concentrations; and

The effects of other external factors such as competition, legal or regulatory requirements.

The risk factors for loans evaluated collectively are also adjusted based on the level of risk associated with the internal risk ratings of the loans. Loans rated Grade 1 are considered low risk and have the lowest risk factors applied. Loans rated Grades 2 and 3 have an average level of risk. Loans rated Grade 4 and 5 have a marginal level of risk slightly higher than Grades 2 and 3. Loans rated Grade 6 or higher have above average risk and therefore have higher risk factors applied to that portion of the portfolio.

Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. The provision for depreciation is computed using straight-line and accelerated methods for both financial reporting and income tax purposes. Expenditures for maintenance and repairs are charged against income as incurred. Cost of major additions and improvements are capitalized and depreciated over the estimated useful life of the addition or improvement.

Other Real Estate Owned

Real estate acquired through foreclosure is separately stated on the Consolidated Balance Sheets as Other Real Estate Owned and recorded at the lower of cost or fair value less cost to sell. Adjustments made at the date of foreclosure are charged to the allowance for loan losses. Expenses incurred in connection with ownership, subsequent adjustments to book value, and gains and losses upon disposition are included in other non-interest expenses. Adjustments to net realizable value subsequent to acquisition are made at least annually if necessary based on appraisal.

Securities Sold under Agreements to Repurchase

Securities sold under agreements to repurchase are accounted for as collateralized financing transactions, represent the purchase of interests in securities by banking customers and are recorded at the amount of cash received in connection with the transaction. Daily repurchase agreements are settled on the following business day and fixed repurchase agreements have various fixed terms. All securities sold under agreements to repurchase are collateralized by certain pledged securities, generally U.S. government and federal agency securities, and are held in safekeeping by the purchasing financial institution. These transactions are not deposits and, therefore, are not covered by FDIC insurance. Securities sold under agreements to repurchase are reported separately on the Company’s Consolidated Balance Sheets and interest expense related to these transactions is reported on the Company’s Consolidated Statements of Income as Other Interest Expense.

Income Taxes

The Company uses the accrual method of accounting for federal and state income tax reporting. Deferred tax assets or liabilities are computed for significant differences in financial statement and tax bases of assets and liabilities, which result from temporary differences in financial statement and tax accounting. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. Provision for income taxes is made on a separate income tax return basis for each entity included in the Consolidated Financial Statements.

Interest Income and Fees on Loans

Interest income on commercial and real estate loans is computed on the basis of daily principal balance outstanding using the accrual method. Interest on installment loans is credited to operations by the level-yield method. Interest income on loans is discontinued at the time the loan is 90 days delinquent unless the loan is well secured and in process of collection. Loans may be placed on non-accrual status at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not received for loans placed on non-accrual status is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method until qualifying to return to accrual status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Fees on loans are generally recognized in earnings at the time of origination as they are generally offset by related expenses also incurred at origination. Certain fees such as commitment fees are deferred and amortized over the life of the loan using the interest method.

Net Income per Share of Common Stock

Net income per share of common stock is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period, after giving retroactive effect to stock dividends and stock splits.

Income from Fiduciary Activities

Income from fiduciary activities is recorded on an accrual basis.

Advertising and Promotions

The Company's policy is to charge advertising and promotions to expenses as incurred.

Fair Value

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" ("ASC 820"). 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:

1. 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.

2. 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 formula or a binomial model), and multi-period excess earnings method (used to measure fair value of certain intangible assets).

3. 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 a 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 and derivatives (if any). Loans held for sale, OREO 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 OREO and impaired loans are considered Level 3. See Note 21 for more information.

The Company obtains fair value measurements for securities and derivatives (if any) from a third party vendor. The Company's cash flow hedge and the majority of the available-for-sale securities are valued using Level 2 inputs. Collateralized debt obligation securities that are backed by trust preferred securities and account for less than 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. See additional discussion of valuation techniques and inputs in Note 21.

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.

The Company utilizes 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 GAAP, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to portions of instruments.

Subsequent Events

The Company has evaluated subsequent events for recognition and disclosure through March 3, 2015, which is the date the financial statements were available to be issued.

NOTE 2 – MERGERS AND ACQUISITIONS

Southern Heritage Bancshares, Inc.

On October 1, 2014, the Company completed its acquisition by merger of Southern Heritage Bancshares, Inc. (“SH Bancshares”), a bank holding company headquartered in Cleveland, Tennessee, and parent of Southern Heritage Bank (“SHB”), a Tennessee chartered bank. SHB continues to operate as a Tennessee-chartered bank and has not been merged into FCNB. The operations of SHB have been included in the consolidated financial statements since October 1, 2014. SHB operates three full-service financial centers in Cleveland, Bradley County, Tennessee. The acquisition of SH Bancshares and SHB allowed the Company to further its strategic objectives by expanding its geographic footprint across the State of Tennessee. The Company issued 269,302 shares of common stock and 108,356 shares of Class A common stock and paid $16.1 million in cash or $33.1 million in aggregate consideration for 100% of the equity interests in SH Bancshares.

The Company recorded intangible assets totaling $10.2 million which consist of $8.7 of goodwill and $1.5 million of core deposit intangible. Goodwill resulted from a combination of revenue enhancements from expansion into new markets and efficiencies to be gained from operational synergies. The fair value of the core deposit intangible is being amortized on a straight line basis over the estimated useful life, currently expected to be approximately 10 years. The intangible assets are not deductible for income tax purposes.

The Company assumed $5.155 million in floating rate junior subordinated deferrable interest debentures payable to Southern Heritage Statutory Trust I that must be redeemed by December 2034. The acquired subordinated debentures require interest to be paid quarterly at a rate of 90-day LIBOR plus 2.05%. The fair value adjustment on the junior subordinated debentures of $1.55 million will be amortized on a straight line basis over the remaining expected life of 10 years which is when the securities are intended to be repaid.

At the acquisition date of October 1, 2014, supplemental executive retirement plan (“SERP”) agreements became effective with certain key executives of SHB as part of the Company’s long-term retention strategy. The SERPs provide for a nonqualified defined lifetime post-retirement benefit. Vesting for the benefit occurs 50% after three years, 75% after four years and 100% after five years from the effective date of the agreements. Expense for accrual of such benefits is reflected in Salaries and Employee Benefits on the Statement of Income and totaled approximately $43,000 for the year ended December 31, 2014. The accrual liability for SERP benefits is included in other liabilities on the Balance Sheet and totaled $43,000 as of December 31, 2014. No benefit payments are expected to be paid over the next five years and benefit payments totaling approximately $82,000 annually are expected to be paid thereafter.

The following table summarizes the allocation of purchase price to assets and liabilities acquired in connection with the Company's acquisition of SH Bancshares and SHB based on their fair values on October 1, 2014 (dollars in thousands except per share amounts).

Purchase Price:		
Total shares of SH Bancshares outstanding as of October 1, 2014	1,313,135	
Fixed exchange ratio	0.2876	
Company common shares issued for SH Bancshares common shares	269,302	
Company Class A common shares issued for SH Bancshares Class A, Class B or Series A preferred shares	108,356	
Price per share based on Company shares as of October 1, 2014	$45.00	
Aggregate value of Company stock issued	$16,995	
Aggregate cash consideration at $12.25 per SH Bancshares share	16,087	
Total purchase price		$33,082
Net assets acquired:		
Cash and cash equivalents	10,493	
Interest bearing deposits in banks	8,633	
Available-for-sale investment securities	80,869	
Loans, net of unearned income	126,850	
Mortgage loans held for sale	2,852	
Premises and equipment	5,274	
Other real estate owned	546	
Other intangible assets	1,496	
Other assets	3,482	
Total assets	240,495	
Non-interest bearing deposits	35,275	
Interest bearing deposits	176,330	
Total deposits	211,605	
Borrowings	3,602	
Other liabilities	895	
Total liabilities	216,102	
Net assets acquired		24,393
Goodwill		$8,689

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Cool Springs Financial Center

On December 7, 2012, FCNB acquired one full-service financial center branch located at 9045 Carothers Parkway in Franklin, Tennessee from Community First Bank & Trust. Through the acquisition, FCNB assumed $55 million in deposit liabilities and purchased $5 million in real and personal property and $20 million in loans. Goodwill totaling $1.8 million and a core deposit intangible of approximately $426,000 was recorded in relation to the deposit premium paid and fair value adjustments recorded at the time of acquisition. The core deposit intangible will be amortized over a ten-year period and goodwill will continue to be evaluated for impairment annually as noted in Note 9 below.

NOTE 3 – CASH AND INTEREST-BEARING DEPOSITS IN OTHER BANKS

Cash and cash equivalents include deposit balances due from correspondent banks. Balances due from correspondent banks above FDIC insurance limits totaled approximately $1.0 million and $863,000 as of December 31, 2014 and 2013, respectively.

The Company maintains cash reserve balances as required by the Federal Reserve Bank. Average required balances during 2014 and 2013 were $1.1 million and approximately $500,000, respectively. Balances held at the Federal Reserve Bank 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 December 31, 2014 and 2013 were $38.8 million and $19.8 million, respectively. Interest-bearing deposits in other banks also include short-term CDs held in increments that are within FDIC insurance limits and totaled $2.2 million as of December 31, 2014 and $2.1 million as of December 31, 2013.

NOTE 4 – INVESTMENT SECURITIES

The following tables reflect amortized cost, unrealized gains, unrealized losses and fair value of available-for-sale investment securities for the dates presented (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of December 31, 2014:				
U.S. Treasury securities and obligations of U.S. government agencies and corporations	$ 384,456	$ 4,065	$ (3,531)	$ 384,990
Obligations of states and political subdivisions	189,264	9,273	(235)	198,302
All Other	10	44	-	54

Total investment securities	$573,730	$ 13,382	$ (3,766)	$583,346
As of December 31, 2013:				
U.S. Treasury securities and obligations of U.S. government agencies and corporations	$326,272	$ 2,927	$ (7,496)	$321,703
Obligations of states and political subdivisions	130,813	5,338	(1,400)	134,751
All other	23	48	-	71
Total investment securities	$457,108	$ 8,313	$ (8,896)	$456,525

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There were no securities categorized as trading or held-to-maturity as of December 31, 2014 or 2013. At December 31, 2014 and 2013, investment securities were pledged to secure government, public and trust deposits as follows (in thousands):

	Amortized Cost	Fair Value
2014	$ 248,221	$250,363
2013	205,374	205,900

The following table summarizes contractual maturities of available-for-sale securities as of December 31, 2014 (in thousands):

	Amortized Cost	Fair Value
Amounts maturing in:		
One year or less	$2,680	$2,724
After one year through five years	17,082	17,945
After five years through ten years	98,875	103,139
After ten years*	455,083	459,484
Total debt securities	573,720	583,292
Equity securities	10	54
Total securities	$573,730	$583,346

* Of the $574 million (amortized cost) in this category, $375 million (amortized cost) consisted of mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMO"), which are presented based on contractual maturities. However, the remaining lives of such securities are expected to be much shorter due to anticipated payments.

Sales and realized gains on sales of available-for-sale securities for the years ended December 31, 2014, 2013 and 2012 are presented as follows (in thousands):

	Gross Sales	Gross Gains	Gross Losses	Net Gains
2014	$30,152	$1,345	($51)	$1,294
2013	41,861	1,489*	(233)	1,256
2012	34,615	680	-	680

* Gross gains for 2013 also include approximately $12,000 in gains on called debt securities.

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The following table presents information on available-for-sale securities with gross unrealized losses at December 31, 2014 and 2013, aggregated by investment category and the length of time that the individual securities have been in a continuous loss position (in thousands):

	Less Than 12 Months		Over 12 Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
December 31, 2014:						
U.S. Treasury securities and obligations of U.S. Government agencies and corporations	$(171)	$50,186	$(3,360)	$113,216	$(3,531)	$163,402
Obligations of states and political subdivisions	(74)	6,684	(161)	8,675	(235)	15,359
Total securities with unrealized losses	$(245)	$56,870	$(3,521)	$121,891	$(3,766)	$178,761
December 31, 2013:						
U.S. Treasury securities and obligations of U.S. Government agencies and corporations	$(5,464)	$167,616	$(2,032)	$33,863	$(7,496)	$201,479
Obligations of states and political subdivisions	(1,336)	29,953	(64)	561	(1,400)	30,514
Total securities with unrealized losses	$(6,800)	$197,569	$(2,096)	$34,424	$(8,896)	$231,993

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 December 31, 2014, the Company had 80 debt securities with unrealized losses. The Company did not intend to sell any such securities in an unrealized loss position and it was more likely than not that the Company would not be required to sell the debt securities prior to recovery of costs. Of the 80 debt securities, 43 are obligations of state and political subdivisions and 37 are U.S. government agency collateralized mortgage obligations (CMOs) or mortgage-backed securities (MBS). The securities in an unrealized loss position as of December 31, 2014, were evaluated for other-than-temporary impairment. In analyzing reasons for the unrealized losses, management reviews any applicable industry analysts' reports and considers various factors including, but not limited to, whether the securities are issued by the federal government or its agencies, and whether downgrades of bond ratings have occurred. With respect to unrealized losses on municipal and agency securities and the analysis performed relating to the securities, management believes that declines in market value were not other-than-temporary at December 31, 2014. The unrealized losses on the agency and municipal securities have not been recognized for other-than-temporary impairment. No impairment charges were recognized on these securities in 2014, 2013 or 2012.

GAAP includes accounting and reporting standards for derivative financial instruments, including certain derivative instruments embedded in other contracts and for hedging activities. These standards require that derivatives be reported either as assets or liabilities on the Consolidated Balance Sheets and be reflected at fair value. The accounting for changes in the fair value of a derivative instrument depends on the intended use of the derivative and the resulting designation.

NOTE 5 – LOANS

The following is a summary of loans at December 31:

	2014	2013
Commercial, financial and agricultural	$112,529	$81,757
Real estate – construction	63,461	46,959
Real estate – mortgage	491,471	413,235
Installment loans to individuals	25,733	24,807
All other loans	18,029	13,478
Total	$711,223	$580,236

Credit Quality

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 December 31, 2014 and 2013 were as follows (in thousands):

	Pass	Special Mention	Substandard	Total
December 31, 2014:				
Commercial, financial and agricultural	$111,724	$ 147	$ 658	$112,529
Real estate – construction	60,867	-	2,594	63,461
Real estate – mortgage	476,098	711	14,662	491,471
Installment loans to individuals	25,635	-	98	25,733
All other loans	18,029	-	-	18,029
Total	$692,353	$ 858	$ 18,012	$711,223
December 31, 2013:				
Commercial, financial and agricultural	$80,639	$ 267	$ 851	$81,757
Real estate – construction	42,486	611	3,862	46,959
Real estate – mortgage	394,749	1,645	16,841	413,235
Installment loans to individuals	24,662	-	145	24,807
All other loans	13,478	-	-	13,478

Total	$556,014	$ 2,523	$ 21,699	$580,236

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Past Due and Non-Performing Loans

An aging analysis of loans outstanding by category as of December 31, 2014 and 2013 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 December 31, 2014:							
Commercial, financial and agricultural	$305	$476	$81	$862	$111,667	$112,529	$ -
Real estate – construction	11	-	170	181	63,280	63,461	-
Real estate – mortgage	3,610	227	3,369	7,206	484,265	491,471	385
Installment loans to individuals	172	97	33	302	25,431	25,733	33
All other loans	234	-	-	234	17,795	18,029	-
Total	$4,332	$800	$3,653	$8,785	$702,438	$711,223	$ 418
As of December 31, 2013:							
Commercial, financial and agricultural	$305	$117	$596	$1,018	$80,739	$81,757	$ -
Real estate – construction	263	25	53	341	46,618	46,959	53
Real estate – mortgage	3,157	2,116	2,845	8,118	405,117	413,235	88
Installment loans to individuals	99	3	13	115	24,692	24,807	8
All other loans	-	-	-	-	13,478	13,478	-
Total	$3,824	$2,261	$3,507	$9,592	$570,644	$580,236	$ 149

Performing and non-performing loans by category were as follows as of December 31, 2014 and 2013 (in thousands):

	Performing	Non- Performing*	Total
December 31, 2014:			
Commercial, financial and agricultural	$ 112,294	$ 235	$112,529
Real estate – construction	62,960	501	63,461
Real estate – mortgage	484,454	7,017	491,471
Installment loans to individuals	25,673	60	25,733
All other loans	18,029	-	18,029
Total	$ 703,410	$ 7,813	$711,223
December 31, 2013:			
Commercial, financial and agricultural	$ 81,089	$ 668	$81,757
Real estate – construction	46,313	646	46,959
Real estate – mortgage	406,082	7,153	413,235
Installment loans to individuals	24,743	64	24,807

All other loans	13,478	-	13,478
Total	$ 571,705	$ 8,531	$580,236

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

Non-accrual loans as of December 31, 2014 and 2013 by category were as follows (in thousands):

	2014	2013
Commercial, financial and agricultural	$235	$668
Real estate – construction	501	593
Real estate – mortgage	6,632	7,065
Installment loans to individuals	27	56
All other loans	-	-
Total	$7,395	$8,382

Troubled Debt Restructurings

Loans that were restructured during the year ended December 31, 2014 consisted of the following (dollars in thousands):

	2014 Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial, financial and agricultural	6	$ 294	$ 144
Real estate – construction	10	1,196	1,027
Real estate – mortgage	36	6,360	5,474
Installment loans to individuals	15	132	55
All other loans	-	-	-
Total	67	$ 7,982	$ 6,700

Modification of the terms of the TDRs reported in the above table did not have a material impact on the consolidated financial statements or to the overall risk profile of the loan portfolio. TDRs modified that re-defaulted in the year ended December 31, 2014 consisted of the following (dollars in thousands):

	Number of Contracts	Recorded Investment
Commercial, financial and agricultural	2	$ 120
Real estate – construction	-	-
Real estate – mortgage	2	381

Installment loans to individuals	1		1
All other loans	-		-
Total	5	$	502

The allowance for loan losses associated with the TDRs totaled approximately $244,000 and $402,000 as of December 31, 2014 and 2013, respectively.

Impaired Loans

Information regarding the Company's impaired loans for the years ended December 31, 2014 and 2013 is as follows (in thousands):

	Recorded Investment	Unpaid Principal Balance	Specific Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2014:					
With no specific allocation recorded:					
Commercial, financial and agricultural	$ 62	$ 203	N/A	$ 74	$ 3
Real estate – construction	165	273	N/A	168	3
Real estate – mortgage	2,975	3,363	N/A	2,995	55
Installment loans to individuals	-	-	N/A	-	-
All other loans	-	-	N/A	-	-
With allocation recorded:					
Commercial, financial and agricultural	$ 81	$ 81	$ 15	$ 81	$ 7
Real estate – construction(1)	187	187	19	187	12
Real estate – mortgage(2)	1,895	1,949	232	1,895	18
Installment loans to individuals	-	-	-	-	-
All other loans	-	-	-	-	-
Total:					
Commercial, financial and agricultural	$ 143	$ 284	$ 15	$ 155	$ 10
Real estate – construction	352	460	19	355	15
Real estate – mortgage	4,870	5,312	232	4,890	73
Installment loans to individuals	-	-	-	-	-
All other loans	-	-	-	-	-
December 31, 2013:					
With no specific allocation recorded:					
Commercial, financial and agricultural	$ -	$ -	N/A	$ 28	$ -
Real estate – construction	430	430	N/A	592	12
Real estate – mortgage	1,361	1,361	N/A	2,275	8
Installment loans to individuals	15	15	N/A	7	1
All other loans	-	-	N/A	-	-
With allocation recorded:					
Commercial, financial and agricultural	$ 500	$ 500	$ 50	$ 757	$ -
Real estate – construction	88	88	90	222	-
Real estate – mortgage	5,105	5,105	847	5,548	-
Installment loans to individuals	-	-	-	30	-
All other loans	-	-	-	-	-
Total:					
Commercial, financial and agricultural	$ 500	$ 500	$ 50	$ 785	$ -
Real estate – construction	518	518	90	814	12
Real estate – mortgage	6,466	6,466	847	7,823	8

Installment loans to individuals	15	15	-	37	1
All other loans	-	-	-	-	-

(1) Impaired total for this category includes troubled debt restructurings with recorded investment totaling approximately $87,000 and a specific allowance of approximately $4,000.

(2) Impaired total for this category includes troubled debt restructurings with recorded investment totaling approximately $1.3 million and a specific allowance of approximately $208,000.

Acquired Loans with Evidence of Credit Deterioration

Loans acquired in business combinations that exhibited, at date of acquisition, evidence of credit deterioration since origination, such that it was probable that all contractually required payments would not be collected, were as follows:

	Impaired Loans	Other Loans	Total
December 31, 2014:			
Commercial, financial and agricultural	$ 45	$ 2,171	$ 2,216
Real estate – construction	121	43	164
Real estate – mortgage	1,733	9,456	11,189
Installment loans to individuals	-	14	14
All other loans	-	-	-
Total	$ 1,899	$ 11,684	$ 13,583

The following table presents the fair value of loans determined to have evidence of credit deterioration at the time of acquisition as of the date presented:

December 31, 2014	
Contractually-required principal	$ 16,533
Nonaccretable difference	(2,532)
Cash flows expected to be collected	14,001
Accretable yield	(418)
Fair Value	$ 13,583

Changes in the accretable yield of loans acquired with deteriorated credit quality were as follows:

Balance at January 1, 2014	$ -
Additions through acquisition	(471)
Reclasses from nonaccretable difference	-
Accretion	53
Balance at December 31, 2014	$ (418)

NOTE 6 – 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 at December 31 for the years indicated (dollars in thousands):

	2014		2013		2012	
	Amount	% to Total Loans	Amount	% to Total Loans	Amount	% to Total Loans
Commercial, financial and agricultural	$999	15.82 %	$1,221	14.09 %	$1,588	13.47 %
Real estate – construction	1,281	8.92 %	1,521	8.09 %	1,563	7.37 %
Real estate – mortgage	4,679	69.10 %	4,752	71.22 %	4,486	72.37 %
Installment loans to individuals	274	3.62 %	243	4.28 %	285	4.63 %
All other loans	308	2.54 %	81	2.32 %	33	2.16 %
Total	$7,541	100.0 %	$7,818	100.0 %	$7,955	100.0 %

An analysis of the allowance for loan losses during the years ended December 31 is as follows (in thousands):

	2014	2013	2012
Balance - beginning of year	$7,818	$7,955	$8,039
Provision for loan losses	751	775	650
Loans charged to allowance	(1,681)	(1,211)	(1,560)
Recovery of loans previously charged off	653	299	826
Net charge-offs	(1,028)	(912)	(734)
Balance - end of year	$7,541	$7,818	$7,955

An analysis of the activity in the allowance for loan losses by category for the years ended December 31, 2014 and 2013 is as follows:

	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance
Year ended December 31, 2014:					
Commercial, financial and agricultural	$ 1,221	$ (260)	$ 114	$ (76)	$ 999
Real estate – construction	1,521	(40)	133	(333)	1,281
Real estate – mortgage	4,752	(912)	107	732	4,679
Installment loans to individuals	243	(105)	55	81	274
All other loans	81	(364)	244	347	308
Total	$ 7,818	$ (1,681)	$ 653	$ 751	$ 7,541
Year ended December 31, 2013:					
Commercial, financial and agricultural	$ 1,588	$ (636)	$ 46	$ 223	$ 1,221
Real estate – construction	1,563	(38)	142	(146)	1,521
Real estate – mortgage	4,486	(408)	57	617	4,752
Installment loans to individuals	285	(129)	54	33	243
All other loans	33	-	-	48	81
Total	$ 7,955	$ (1,211)	$ 299	$ 775	$ 7,818

The allowance for loan losses is comprised of allocations for loans evaluated individually and loans evaluated collectively for impairment. In addition, specific acquired loans were evaluated at time of acquisition and determined to have evidence of credit deterioration. The allocations of the allowance for loan losses for outstanding loans by category evaluated individually and collectively were as follows as of December 31, 2014 and 2013 (in thousands):

	Evaluated Individually	Evaluated Collectively	Acquired Loans with Evidence of Credit Deterioration	Total
As of December 31, 2014:				
Allowance for loan losses				
Commercial, financial and agricultural	$ 15	$ 984	$ -	$999
Real estate – construction	19	1,262	-	1,281
Real estate – mortgage	232	4,447	-	4,679
Installment loans to individuals	-	274	-	274
All other loans	-	308	-	308
Total	$ 266	$ 7,275	$ -	$7,541
Loans				
Commercial, financial and agricultural	$ 98	$ 112,431	$ 2,216	$112,529
Real estate – construction	231	63,230	164	63,461
Real estate – mortgage	3,137	488,334	11,189	491,471
Installment loans to individuals	-	25,733	14	25,733
All other loans	-	18,029	-	18,029
Total	$ 3,466	$ 707,757	$ 13,583	$711,223
As of December 31, 2013:				
Allowance for loan losses				
Commercial, financial and agricultural	$ 50	$ 1,171	N/A	$1,221
Real estate – construction	90	1,431	N/A	1,521
Real estate – mortgage	847	3,905	N/A	4,752
Installment loans to individuals	-	243	N/A	243
All other loans	-	81	N/A	81
Total	$ 987	$ 6,831	N/A	$7,818
Loans				
Commercial, financial and agricultural	$ 500	$ 81,257	N/A	$81,757
Real estate – construction	518	46,441	N/A	46,959
Real estate – mortgage	6,466	406,769	N/A	413,235
Installment loans to individuals	15	24,792	N/A	24,807
All other loans	-	13,478	N/A	13,478
Total	$ 7,499	$ 572,737	N/A	$580,236

NOTE 7 – SECONDARY MORTGAGE MARKET ACTIVITIES

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or market, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. There were no such losses for any of the years ended December 31, 2014, 2013 or 2012. There have been no material differences between cost and fair market values of loans held-for-sale for any of the periods presented.

Servicing rights are not retained on any mortgage loans held for sale. Mortgage banking income included in non-interest income was approximately $1.4 million, $1.4 million, and $1.5 million for the years ended December 31, 2014, 2013 and 2012, respectively.

NOTE 8 – PREMISES AND EQUIPMENT

Premises and equipment used in the ordinary course of business at December 31 are summarized as follows (dollars in thousands):

	Useful Lives in Years	2014	2013
Land		$11,809	$9,748
Buildings	5 to 50	39,500	32,947
Furniture and equipment	3 to 20	21,674	17,560
Total premises and equipment		72,983	60,255
Less: accumulated depreciation		31,977	26,103
Net premises and equipment		$41,006	$34,152

NOTE 9 – GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill is not amortized but tested at least annually for impairment. No impairment charges were recorded for any periods presented in the Consolidated Financial Statements. Total goodwill as of December 31, 2014 was $22.3 million or 1.51% of total assets and 15.46% of total capital. Total goodwill as of December 31, 2013 was $13.7 million or 1.16% of total assets and 12.12% of total capital. Goodwill of $8.7 million was recorded in 2014 as a result of the acquisition of SHB. See also Note 2.

Other identifiable intangibles consisted of core deposit intangibles being amortized over ten-year periods as of December 31 as follows (in thousands):

	2014	2013
Core deposit intangible	$1,922	$426
Accumulated amortization	(122)	(42)
Net core deposit intangible	$1,800	$384

Amortization expense was approximately $80,000 in 2014 and $42,000 in 2013 and $35,000 in 2012. Amortization expense is expected to be approximately $192,000 per year for each of the next five years. See also Note 2.

NOTE 10 – OTHER REAL ESTATE OWNED

The carrying value of other real estate owned on the Consolidated Balance Sheets was $5.7 million as of December 31, 2014 compared to $6.8 million as of December 31, 2013. The value of OREO is based on the lower of cost or fair value less cost to sell. Fair value is based on independent appraisals for significant properties and may be adjusted by management as discussed in Note 21.

NOTE 11 – BANK-OWNED LIFE INSURANCE AND IMPUTED INCOME TAX REIMBURSEMENT AGREEMENTS

The Company has a significant investment in bank-owned life insurance policies (“BOLI”) and provides endorsement split dollar life insurance to certain employees in the position of Vice President and higher after one year of service. The cash surrender values of BOLI were $25.9 million and $22.5 million as of December 31, 2014 and 2013, 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 $621,000, $632,000, and $606,000, for the years ended December 31, 2014, 2013 and 2012, respectively.

Post-retirement death benefits for endorsement split dollar life insurance plans are accounted for in accordance with FASB ASC Subtopic 715-60, "Compensation – Retirement Benefits – Defined Benefit Plans – Postretirement." Expense for accrual of such benefits is reflected in Salaries and Employee Benefits on the Consolidated Statements of Income and was approximately $224,000, $143,000, and $169,000, for the years ended December 31, 2014, 2013 and 2012, respectively. The accrued liability for post-retirement death benefits is included in Other Liabilities on the Consolidated Balance Sheet and totaled $2.8 million and $2.6 million as of December 31, 2014 and 2013, respectively.

Because endorsement split dollar life insurance plans create imputed income to each applicable participant without generating cash to pay the tax expense associated with imputed income, the FCNB entered into Imputed Income Tax Reimbursement Agreements with certain officers. The Imputed Income Tax Reimbursement Agreements provide for annual cash payments to the participants until death for the previous tax year in amounts equal to a portion of federal income taxes attributable to (i) the income imputed to the applicable participant on the benefit under the Amended and Restated Split Dollar Agreement and (ii) the additional cash payments under the Imputed Income Tax Reimbursement Agreement. Each participant was 100% vested in benefits provided under Imputed Income Tax Reimbursement Agreements as of January 1, 2008. Service costs are based on the net present value of the sum of payments in accordance with each participant's agreement. Interest accrues monthly at a rate of 7.0%.

Net other post-retirement benefits expense for Imputed Income Tax Reimbursement Agreements was as follows for the years ended December 31 (in thousands):

	2014	2013
Service cost	$ -	$ -
Interest cost	27	27
Net other post-retirement benefits expense	$ 27	$ 27

The accumulated post-retirement defined benefit obligation for Imputed Income Tax Reimbursement Agreements was as follows for the years ended December 31 (in thousands):

Accumulated other post-retirement benefit obligation:	2014	2013
Beginning balance	$418	$410
Service cost	-	-
Interest cost	27	27
Benefit payments	(25)	(19)
Ending balance	$420	$418

The accumulated post-retirement benefit obligation was included in Other Liabilities as of December 31, 2014 and 2013 and was equal to the funded status of the plan as of each applicable year-end, as there were no related assets recognized on the Consolidated Balance Sheet for the Imputed Income Tax Reimbursement Agreements.

NOTE 12 – DEPOSITS

Included in interest-bearing deposits shown at December 31 were the following time and savings deposits in denominations of $100,000 to $250,000 and greater than $250,000 (in thousands):

	2014	2013
Time deposits		
$100,000 or greater but less than $250,000	$110,577	$96,465
Greater than $250,000	124,444	101,734
Savings deposits		
$100,000 or greater but less than $250,000	$122,933	$114,570
Greater than $250,000	287,735	254,535

NOW accounts, included in interest bearing deposits on the Consolidated Balance Sheets, totaled $135.8 million as of December 31, 2014 and $72.5 million as of December 31, 2013. Demand deposit balances reclassified as loans consisted of overdrafts totaling approximately $470,000 and $520,000 as of December 31, 2014 and 2013, respectively.

Time deposits were maturing as follows at December 31, 2014 (in thousands):

On or before December 31, 2015	$301,674
On or during year ended December 31, 2016	43,346
On or during year ended December 31, 2017	25,086
On or during year ended December 31, 2018	17,256
During or after year ended December 31, 2019	13,520
	$400,882

NOTE 13 – FEDERAL FUNDS PURCHASED AND OTHER SHORT-TERM BORROWINGS

The Company has various sources of short-term borrowings, which consist primarily of cash management advances from the Federal Home Loan Bank (“FHLB”) 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. See Note 14 for more information about maximum borrowing capacity with FHLB. There were no short-term borrowings outstanding against this line as of December 31, 2014 or 2013.

The Company has eight federal fund lines of credit available with various correspondent banks totaling $72.0 million as of December 31, 2014. There were no federal funds purchased as of December 31, 2014 or 2013.

The following tabular analysis presents short-term borrowing year-end balance, maximum month-end balance, annual average and weighted average interest rates for the years ended December 31, 2014, 2013 and 2012 (dollars in thousands):

	2014	2013	2012

Amount outstanding at end of year	$-	$ -	$-
Weighted average interest rate at end of year	– %	– %	– %
Maximum outstanding at any month end	$5,000	$ -	$5,000
Average outstanding during year	2,477	$ 11	$1,230
Weighted average interest rate during year	0.19 %	– %	– %

NOTE 14 – LONG TERM DEBT

Long-term debt as of December 31, 2014 and 2013 is summarized as follows (in thousands):

	2014	2013
FHLB advances	$41,164	$40,857
Junior subordinated debentures	13,951	10,310
Promissory notes	11,716	-
Total long-term debt	$66,831	$51,167

FHLB advances

FCNB had secured advances from FHLB totaling $41.2 million as of December 31, 2014 and $40.9 million as of December 31, 2013. FHLB borrowings are comprised primarily of advances with principal due at call date or maturity date with fixed interest rates ranging from 0.31% to 7.05%. Some FHLB borrowings have quarterly call features and maturities ranging from 2015 to 2023. 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. Obligations are secured by loans totaling $385 million consisting of the FCNB's entire portfolio of fully disbursed, one-to-four family residential mortgages, commercial mortgages, farm mortgages, second mortgages and multi-family residential mortgages. FCNB had additional borrowing capacity with the FHLB of $100.4 million as of December 31, 2014.

SHB had no outstanding secured or unsecured advances from FHLB as of December 31, 2014 or during the period from acquisition date of October 1, 2014 to December 31, 2014. SHB has one-to-four family residential mortgages totaling $19.6 million pledged and borrowing capacity of $4.7 million with FHLB as of December 31, 2014.

Junior subordinated debentures

The Company owns 100% of the outstanding common securities of three business trusts that issued corporation-obligated mandatorily redeemable preferred capital securities to third-party investors. The trusts used the proceeds from the issuance of their preferred capital securities and common securities (collectively referred to as "capital securities" to buy floating rate junior subordinated debentures issued by the Company. The debentures are the trusts' only assets and interest payments from the debentures finance the distributions paid on the capital securities. Distributions are payable quarterly at a rate per annum equal to the interest rate being earned by the trusts on the debentures held by the trusts. The capital securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. The Company has entered into agreement which fully and unconditionally guarantees the capital securities subject to terms of the guarantee. Although for accounting presentation the trust preferred securities are presented as long-term debt, the outstanding balance qualifies as Tier I capital subject to the limitation that the amount of the securities included in Tier I Capital cannot exceed 25% of total Tier I capital. The following table provides details on the debentures as of December 31, 2014:

	Principal Amount	Interest Rate		Year of Maturity	Amount included in Tier I Capital
First Citizens (TN) Statutory Trust III	$ 5,155	2.04	%	2035	$ 5,155
First Citizens (TN) Statutory Trust IV	5,155	1.99	%	2037	5,155
Southern Heritage Statutory Trust I	5,155	2.29	%	2034	3,951

In March 2005, the Company formed First Citizens (TN) Statutory Trust III, 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. Proceeds were used to reduce other debt at the Company. For the period beginning on (and including) the date of original issuance and ending on (but excluding) June 17, 2005, the rate per annum equals 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.

In March 2007, the Company formed First Citizens (TN) Statutory Trust IV, 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. Proceeds were used to refinance other debt at the Company at a lower interest rate. For the period beginning on (and including) the date of original issuance and ending on (but excluding) June 15, 2007, the rate per annum equals 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.

Pursuant to the merger with SH Bancshares on October 1, 2014, the Company assumed the debentures issued to Southern Heritage Statutory Trust I. The discount associated with the Company's assumption of the debentures issued to Southern Heritage Statutory Trust I had a carrying value of $1.5 million as of December 31, 2014 and is being amortized through September 2024. Interest for Southern Heritage Statutory Trust I reprices quarterly equal to the three-month LIBOR plus 2.05%.

Promissory Notes

On October 1, 2014, the Company entered into a Loan Agreement, Pledge and Security Agreement, Promissory Note (Fixed Rate) and Promissory Note (Floating Rate) (collectively, the "Promissory Notes") with First Tennessee Bank, National Association (the "Lender"), pursuant to which the Lender has agreed to extend to the Company two five-year term loans in the aggregate maximum principal amount of $12,000,000 (the "Credit Facilities"). The Promissory Notes provide that the Credit Facilities will be repaid in quarterly installments of principal and interest based on a ten-year amortization schedule consisting of a $6.0 million five-year fixed rate loan at a fixed rate of 3.76% and a $6.0 million five-year floating rate loan at the 90 day rounded LIBOR plus 2% that reprices quarterly. The current principal balance on the Promissory Notes is $11.7 million as of December 31, 2014.

The Credit Facilities are secured by a pledge of 51% of the stock of FCNB, the Company's wholly owned subsidiary. The Loan Documents also contain a number of affirmative and negative covenants, including limitations on the incurrence of additional debt, liens on property, guarantees, mergers, consolidations, liquidations and dissolutions, asset sales, dividends and other payments in respect of our capital stock, relocation of the Company's principal office, principal banking office, or principal registered office, and transactions with affiliates. The Company has used the proceeds of the Credit Facilities to finance part of the cash consideration in the merger with SH Bancshares.

Annual average volume, rates and maturities of long-term debt for the years ended December 31, 2014 and 2013 were as follows (dollars in thousands):

	Average Volume	Interest Rate	Maturity
2014[(1)]			
First Citizens Bancshares, Inc.	$14,233	2.63 %	18 years
First Citizens National Bank	46,096	1.82 %	3 years
2013			
First Citizens Bancshares, Inc.	$10,310	2.08 %	22 years
First Citizens National Bank	46,096	1.93 %	4 years

(1) SHB had no borrowings during the periods presented therefore is not included in the table above.

Maturities of principal of long-term debt for the following five years were as follows as of December 31, 2014 (in thousands):

2015	$7,505
2016	10,095
2017	9,841
2018	9,620
2019	13,350
Thereafter	16,420
	$66,831

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 15 – INCOME TAXES

Provision for income taxes was comprised of the following for the years ended December 31 (in thousands):

	2014	2013	2012
Income tax expense (benefit):			
Current	$3,089	$4,651	$4,108
Deferred	349	(637)	(102)
State income tax expense (benefit of operating loss carryforwards)	66	313	84
Change in valuation allowance	(66)	(313)	(251)
	$3,438	$4,014	$4,006

Effective tax rates for the years ended December 31, 2014, 2013 and 2012 differed from federal statutory rate of 34% applied to income before income taxes as a result of the following (in thousands):

	2014	2013	2012
Tax expenses at statutory rate	$5,774	$6,060	$5,957
(Decrease) increase resulting from:			
Tax exempt interest income	(1,949)	(1,638)	(1,582)
Net earnings on bank-owned life insurance	(211)	(148)	(132)
ESOP dividend	(305)	(314)	(296)
Other items	129	54	59
	$3,438	$4,014	$4,006

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefit of these deductible differences. However, the amount of deferred tax assets considered realizable could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced. Deferred tax assets and liabilities were comprised of the following as of December 31 for the years indicated (in thousands):

	2014	2013	2012
Deferred tax assets:			
Allowance for loan losses	$2,613	$2,659	$2,706
Unrealized loss on other real estate owned	1,076	999	1,050
State income tax benefit for net operating loss carryforwards	845	911	1,224
Alternative Minimum Tax Credit	659	-	-
Purchase accounting adjustments	185	-	-
Net unrealized losses on available-for-sale debt securities	-	224	-
Deferred loan fees	138	136	91
Imputed income tax reimbursement plan	139	142	139
Impairment loss on equity securities	-	618	618
Impairment loss on debt securities	-	-	436
Other	126	146	203
Total deferred tax assets	5,781	5,835	6,467
Deferred tax liabilities:			
Depreciation	(3,210)	(2,692)	(2,473)
FHLB stock dividends	(770)	(742)	(742)
Net unrealized gains on available-for-sale debt securities	(3,660)	-	(6,385)
Prepaid expenses	(207)	(152)	(117)
Other	(116)	(132)	(252)
Total deferred tax liabilities	(7,963)	(3,718)	(9,969)
Valuation allowance for state income tax benefit	(845)	(911)	(1,224)
Net deferred tax assets (liabilities)	$(3,027)	$1,206	$(4,726)

As of December 31, 2014, the Company had a net operating loss carryforward for state tax purposes of $7.3 million expiring in 2022, $3.4 million expiring in 2023 and $2.3 million expiring in 2025. As of December 31, 2014 and 2013, the Company had no unrecognized tax benefits. The Company’s policy is to recognize penalties and interest on unrecognized tax benefits in Provision for Income Tax Expense in the Consolidated Statements of Income. There were no amounts related to interest and penalties recognized for each of the years ended December 31, 2014, 2013 and 2012. The tax years subject to examination by federal and state taxing authorities are the years ended December 31, 2014, 2013, 2012 and 2011.

NOTE 16 – REGULATORY MATTERS

The Company is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company and the Consolidated Financial Statements. Regulations require FCNB and SHB to meet specific capital adequacy guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Capital classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require banks to maintain minimum amounts and ratios (set forth in the table below) of Tier I capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier I and total risk-based capital (as defined) to risk-weighted assets (as defined). To be considered adequately capitalized (as defined) under the regulatory framework for prompt corrective action, the minimums must be maintained for Tier I leverage, Tier I risk-based and total risk-based ratios as set forth in the table. Actual capital amounts and ratios are presented in the table below.

As of December 31, 2014, the most recent notifications from primary regulatory authorities categorized FCNB, SHB and the Company as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Banks must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the table below. There are no conditions or events since notification that management believes have changed the institution's category.

Actual and minimum capital amounts and ratios are presented in the following table (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2014:	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk weighted assets:						
First Citizens Bancshares, Inc.	$135,107	16.3 %	$66,473	8.0 %	N/A	10.0 %
First Citizens National Bank	119,132	17.6 %	54,028	8.0 %	$67,535	10.0 %
Southern Heritage Bank	26,632	17.3 %	12,301	8.0 %	15,376	10.0 %
Tier I capital to risk weighted assets:						
First Citizens Bancshares, Inc.	127,546	15.4 %	33,237	4.0 %	N/A	6.0 %
First Citizens National Bank	111,629	16.5 %	27,012	4.0 %	40,519	6.0 %
Southern Heritage Bank	26,574	17.3 %	6,148	4.0 %	9,222	6.0 %
Tier I capital to average assets:						
First Citizens Bancshares, Inc.	127,546	8.8 %	57,778	4.0 %	N/A	5.0 %
First Citizens National Bank	111,629	9.3 %	48,220	4.0 %	60,275	5.0 %
Southern Heritage Bank	26,574	11.1 %	9,550	4.0 %	11,938	5.0 %
December 31, 2013:						
Total capital to risk weighted assets:						
First Citizens Bancshares, Inc.	117,027	17.6 %	53,255	8.0 %	N/A	10.0 %
First Citizens National Bank	115,990	17.4 %	53,206	8.0 %	66,508	10.0 %
Tier I capital to risk weighted assets:						
First Citizens Bancshares, Inc.	109,187	16.4 %	26,615	4.0 %	N/A	6.0 %
First Citizens National Bank	108,150	16.3 %	26,605	4.0 %	39,908	6.0 %
Tier I capital to average assets:						
First Citizens Bancshares, Inc.	109,187	9.4 %	46,463	4.0 %	N/A	5.0 %
First Citizens National Bank	108,150	9.3 %	46,416	4.0 %	58,080	5.0 %

NOTE 17 – CAPITAL

The Company is subject to capital adequacy requirements imposed by the Federal Reserve. In addition, the Banks are restricted by regulation from paying dividends in an amount in excess of the net earnings of the current year plus retained profits of the preceding two years. As of December 31, 2014, $21.7 million of retained earnings were available for future dividends from FCNB and SHB to the Company.

During a special meeting on July 16, 2014, First Citizens' shareholders voted on and approved the First Citizens Charter Amendment authorizing 1,000,000 shares in an additional class of common stock (Class A common stock) and a reclassification of First Citizens' outstanding common stock. Upon the filing of the First Citizens Charter Amendment on July 17, 2014, each share of First Citizens common stock outstanding immediately prior to such filing owned by a shareholder of record who owned between one and 299 shares of such common stock was, by virtue of the filing of the First Citizens Charter Amendment and without any action on the part of the holders, reclassified as Class A common stock, on the basis of one share of Class A common stock per each share of common stock so reclassified. In aggregate, 37,372 shares of common stock were reclassified to Class A common stock. Each share of First Citizens common stock outstanding immediately prior to the filing of the First Citizens Charter Amendment owned by a shareholder of record who owned 300 or more shares of such common stock was not reclassified and continued to be classified as common stock. The First Citizens common stock continues to have unlimited voting rights. The First Citizens Class A common stock has no voting rights, except as may be required by law.

Accumulated Other Comprehensive Income (Loss) as of December 31, 2014 and 2013 was as follows (in thousands):

	2014	2013
Unrealized gains (losses) on available-for-sale securities without other-than-temporary impairment, net of tax	$5,955	$(361)
Unrealized losses on available-for-sale securities with other-than-temporary impairment, net of tax	-	-
Total accumulated other comprehensive income (loss)	$5,955	$(361)

See also Note 2 regarding changes to capital that occurred during the year ended December 31, 2014.

NOTE 18 – RELATED PARTY TRANSACTIONS

The Company has loans and deposits with certain executive officers, directors and their affiliates. The Company also enters into contracts with certain related parties from time to time such as for construction of a branch. All related party transactions are entered into under substantially the same terms as unrelated third-party transactions. All material contracts are awarded based on competitive bids.

In 2013, the Bank contracted with a related party for the construction of a new full service branch facility in Jackson, Tennessee. The contract is for $1.6 million and was awarded on a competitive bid basis. Contract payments paid totaled approximately $1.6 million and $60,000 in the years ended December 31, 2014 and 2013, respectively.

In 2014, the Company also paid approximately $111,000 to another related party on a competitive bid basis for various renovations and repairs to the Martin and Union City, Tennessee financial centers.

Activity in loans to executive officers, directors and their affiliates was as follows for the years ended December 31, 2014 and 2013 (in thousands):

	2014	2013
Balance at beginning of period	$6,892	$5,689
New loans[1]	16,925	4,664
Repayments	(10,947)	(3,461)
Balance at end of period	$12,870	$6,892

(1) The new loan total for 2014 includes $7,141 of related party loans acquired pursuant to the merger with SH Bancshares, Inc.

There were no charged-off, restructured or non-current loans to related parties for any of the periods presented. Loans to related parties are made on substantially the same terms as third-party transactions.

Indebtedness shown represents amounts owed by directors and executive officers of the Company and the Bank and by entities in which such persons are general partners or have at least 10% or greater interest and trust and estates in which they have a substantial beneficial interest. All loans have been made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others and do not involve other than normal risks of collectability.

The Bank routinely enters into deposit relationships with its directors, officers and employees in the normal course of business. These deposits bear the same terms and conditions as those prevailing at the time for comparable transactions with unrelated parties. Balances of executive officers and directors on deposit as of December 31, 2014 and 2013 were $22.6 million and $19.3 million, respectively.

NOTE 19 – FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk not recognized in the statement of financial position.

The Company's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The same policies are utilized in making commitments and conditional obligations as are used for creating on-balance sheet instruments. Ordinarily, collateral or other security is not required to support financial instruments with off-balance sheet risk.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Loan commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many commitments are expected to expire without being drawn upon, total commitment amounts do not necessarily represent future cash requirements. Each customer's credit-worthiness is evaluated on a case-by-case basis, including the collateral required, if deemed necessary by the Bank upon extension of credit, and is based on management's credit evaluation of the counter party. At December 31, 2014 and 2013, the Company had outstanding loan commitments of $119.6 million and $87.7 million, respectively. As of year-end 2014, variable rate commitments were $78.7 million and fixed rate commitments were $40.9 million. As of year-end 2013, variable rate commitments were $56.5 million and fixed rate commitments were $31.2 million. Of these commitments, none had an original maturity in excess of one year.

Standby letters of credit and financial guarantees are conditional commitments issued by the Company to guarantee performance of a customer to a third party. Those guarantees are issued primarily to support public and private borrowing arrangements, and the credit risk involved is essentially the same as that involved in extending loans to customers. The Company requires collateral to secure these commitments when deemed necessary. At December 31, 2014 and 2013, outstanding standby letters of credit totaled $2.9 million and $4.3 million, respectively.

In the normal course of business, the Company extends loans, which are subsequently sold to other lenders, including agencies of the U.S. government. Certain of these loans are conveyed with recourse creating off-balance sheet risk with regard to the collectibility of the loan. At December 31, 2014 and 2013, the Company had no loans sold with recourse.

NOTE 20 – SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

The Company grants agribusiness, commercial, residential and personal loans to customers throughout a wide area of the mid-southern United States. A large majority of the Company's loans, however, are concentrated in the immediate vicinity of the Company, primarily in West Tennessee. Although the Company has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their obligations is dependent upon the agribusiness and industrial economic sectors of that geographic area.

NOTE 21 – FAIR VALUE MEASUREMENTS

Recurring Basis

The following are descriptions of valuation methodologies used for assets measured at fair value on a recurring basis. There are no liabilities measured for fair value on a recurring basis for any of the periods presented.

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.

Assets as of December 31, 2014 and 2013 measured at estimated fair value on a recurring basis were as follows (in thousands):

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
December 31, 2014:				
Financial assets:				
Securities available-for-sale	$ -	$583,346	$ -	$583,346
December 31, 2013:				
Financial assets:				
Securities available-for-sale	$ -	$456,525	$ -	$456,525

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

Loans Held-for-Sale

Loans held-for-sale are recorded at the lower of cost or fair value. Fair value of loans held-for-sale are based upon binding contracts and quotes from third party investors that qualify as Level 2 inputs for determining fair value. Loans held for sale did not have an impairment charge in 2014 or 2013.

Other Real Estate Owned

OREO 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 OREO are reviewed at least annually or more often if circumstances require more frequent evaluations.

Assets as of December 31, 2014 and 2013 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
December 31, 2014:				
Assets:				
Impaired loans	$ -	$-	$7,395	$7,395
Loans held-for-sale	-	4,339	-	4,339
Other real estate owned	-	-	5,717	5,717
December 31, 2013:				
Assets:				
Impaired loans	$ -	$-	$7,499	$7,499
Loans held-for-sale	-	3,098	-	3,098
Other real estate owned	-	-	6,826	6,826

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.

Interest-Bearing Deposits in Other Banks

Interest-bearing deposits in other banks consist of excess balances held at the Federal Reserve Bank and short term CDs and 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 CDs approximate their carrying value at the balance sheet date.

Fixed-Rate Deposits

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

Long-term debt

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 December 31, 2014 and 2013 were as follows (in thousands):

	Carrying Amount	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Fair Value
As of December 31, 2014:					
Financial assets:					
Cash and cash equivalents	$33,182	$33,182	$-	$-	$33,182
Interest-bearing deposits in other banks	40,993	40,993	-	-	40,993
Investment securities	583,346	-	583,346	-	583,346
Loans, net of allowance	703,682	-	715,163	7,395	722,558
Loans held-for-sale	4,339	-	4,339	-	4,339
Accrued interest receivable	6,260	-	6,260	-	6,260
Federal Reserve Bank and Federal Home Loan Bank Stock	6,134	-	6,134	-	6,134
Other real estate owned	5,717	-	-	5,717	5,717
Bank owned life insurance	25,924	-	25,924	-	25,924
Financial liabilities:					