



# **FIRST CITIZENS BANCSHARES, INC.**

**AUDITED FINANCIAL STATEMENTS**

**DECEMBER 31, 2016**

**FIRST CITIZENS BANCSHARES, INC.**

One First Citizens Place  
Dyersburg, TN 38024



**First Citizens Bancshares, Inc.**

**Management's Annual Report on Internal Control Over Financial Reporting**

**December 31, 2016**

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, 2016, based on criteria for effective internal control over financial reporting described in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2016, 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.



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## Independent Auditor's Report

Board of Directors and Shareholders of  
First Citizens Bancshares, Inc. and subsidiaries  
Dyersburg, Tennessee 38024

We have audited the accompanying consolidated financial statements of First Citizens Bancshares, Inc., and subsidiaries, which comprise the balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016 and the related notes to the financial statements. We also have audited First Citizens Bancshares, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

### Management's Responsibility for the Consolidated Financial Statements and Internal Control over Financial Reporting

First Citizens Bancshares, Inc. and subsidiaries' management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of effective internal control over financial reporting relevant to the preparation and fair presentation of these consolidated financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Institution's internal control over financial reporting based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

An audit of the financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the institution's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists. The procedures selected depend on the auditor's judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also involves obtaining and understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances.

We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

### **Definition and Inherent Limitations of Internal Control over Financial Reporting**

An institution's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An institution'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 entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity'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 and correct 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.

### **Opinions**

In our opinion, the consolidated financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of First Citizens Bancshares, Inc., and subsidiaries as of December 31, 2016, and 2015, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2016, in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, First Citizens Bancshares, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

*Alexander Thompson Arnold PLLC*

Dyersburg, Tennessee  
March 7, 2017

**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31, 2016 AND 2015**  
*(Dollars in thousands)*

	2016	2015
<b>ASSETS</b>		
Cash and due from banks	\$ 25,472	\$ 19,758
Federal funds sold	7,983	14,146
Cash and cash equivalents	33,455	33,904
Interest-bearing deposits in other banks	27,690	35,098
Investment securities:		
Available-for-Sale, stated at market	581,532	560,430
Loans (excluding unearned income of \$869 at December 31, 2016 and \$628 at December 31, 2015)	841,586	790,279
Less: Allowance for loan losses	8,791	7,993
Net loans	832,795	782,286
Loans held-for-sale	6,737	5,778
Federal Home Loan Bank and Federal Reserve Bank stocks, at cost	6,134	6,134
Premises and equipment	41,256	40,776
Accrued interest receivable	7,226	6,958
Goodwill	22,340	22,340
Other intangible assets	1,416	1,608
Other real estate owned	3,708	4,041
Bank-owned life insurance policies	25,402	25,896
Other assets	9,309	7,688
<b>TOTAL ASSETS</b>	<b>\$1,599,000</b>	<b>\$1,532,937</b>
<b>LIABILITIES AND EQUITY</b>		
Non-interest bearing deposits	\$ 211,173	\$ 195,693
Interest-bearing deposits	1,128,454	1,078,420
Total deposits	1,339,627	1,274,113
Securities sold under agreements to repurchase	29,303	34,322
Long-term debt	64,135	59,084
Other liabilities	9,115	11,342
Total liabilities	1,442,180	1,378,861

**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS (cont'd)**  
**DECEMBER 31, 2016 AND 2015**  
*(Dollars in thousands)*

	<u>2016</u>	<u>2015</u>
Equity		
Class A common stock, no par value – 1,000,000 authorized; 145,728 issued and 141,220 outstanding at December 31, 2016 and 1,000,000 authorized; 145,728 issued and 143,772 outstanding at December 31, 2015	\$ 146	\$ 146
Common stock, no par value - 10,000,000 authorized; 3,986,895 issued and 3,834,203 outstanding at December 31, 2016 and 10,000,000 authorized; 3,986,895 issued and 3,837,030 outstanding at December 31, 2015	3,950	3,950
Surplus	31,946	31,946
Retained earnings	123,791	113,585
Accumulated other comprehensive income (loss)	(1,551)	5,639
Total common stock and retained earnings	158,282	155,266
Less-119,829 treasury shares, at cost as of December 31, 2016 and 114,450 treasury shares, at cost as of December 31, 2015	3,517	3,245
Total shareholders' equity	154,765	152,021
Non-controlling (minority) interest in consolidated subsidiary	2,055	2,055
Total equity	156,820	154,076
<b>TOTAL LIABILITIES AND EQUITY</b>	<b><u>\$1,599,000</u></b>	<b><u>\$1,532,937</u></b>

*Note: See accompanying notes to consolidated financial statements.*

**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014**  
*(In thousands, except per share data)*

	2016	2015	2014
Interest income			
Interest and fees on loans	\$42,319	\$39,931	\$34,005
Interest and dividends on investment securities:			
Taxable	7,122	7,486	7,031
Tax-exempt	7,495	6,925	5,592
Dividends	200	212	198
Other interest income	322	161	108
Total interest income	57,458	54,715	46,934
Interest expense			
Interest on deposits	5,667	5,616	4,862
Interest on borrowings	1,645	1,549	1,164
Other interest expense	161	186	243
Total interest expense	7,473	7,351	6,269
Net interest income	49,985	47,364	40,665
Provision for loan losses	2,003	1,526	751
Net interest income after provision for loan losses	47,982	45,838	39,914
Non-interest income			
Service charges on deposit accounts	5,719	4,981	4,680
Income from ATM and debit cards	3,505	3,301	2,788
Brokerage fees	197	1,608	1,506
Mortgage banking income	3,209	3,094	1,405
Income from fiduciary activities	883	806	915
Income from insurance activities	1,067	1,093	867
Earnings on bank owned life insurance	579	530	621
Loss on sale or write down of other real estate owned	(113)	(826)	(336)
Gain on sale or call of available-for-sale securities	651	1,354	1,294
Other non-interest income	836	712	681
Total non-interest income	16,533	16,653	14,421
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, 2016, 2015 AND 2014**  
*(In thousands, except per share data)*

	2016	2015	2014
Other non-interest expense:			
Salaries and employee benefits	\$25,353	\$25,363	\$20,973
Net occupancy expense	2,272	2,119	1,900
Depreciation	2,548	2,382	2,073
Data processing expense	3,867	2,807	2,180
ATM and debit card fees and expenses	1,666	1,437	1,390
Advertising and promotions	1,226	959	1,013
Legal and professional fees	638	885	1,153
Premiums for FDIC insurance	746	759	679
Expenses related to other real estate owned	229	248	333
Stationary and office supplies	271	306	266
Amortization of intangibles	192	192	80
Other non-interest expense	6,127	5,622	5,312
Total other non-interest expense	45,135	43,079	37,352
Net income before income taxes	19,380	19,412	16,983
Provision for income tax expense	3,602	3,783	3,438
Net income	<u>\$15,778</u>	<u>\$15,629</u>	<u>\$13,545</u>
Earnings per common share:			
Net income per common share	<u>\$3.97</u>	<u>\$3.92</u>	<u>\$3.72</u>
Weighted average common shares outstanding	<u>3,977</u>	<u>3,984</u>	<u>3,644</u>

*Note: See accompanying notes to consolidated financial statements.*

**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014**  
*(In thousands)*

	2016	2015	2014
Net income	\$15,778	\$15,629	\$13,545
Other comprehensive income, net of tax:			
Net change in unrealized gains (losses) on available-for-sale securities	(7,190)	(316)	6,316
Total other comprehensive income (loss), net of tax	(7,190)	(316)	6,316
Total comprehensive income	<u>\$8,588</u>	<u>\$15,313</u>	<u>\$19,861</u>

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
<b><u>Year ended December 31, 2016:</u></b>			
Unrealized gains on available-for-sale securities:			
Unrealized gains arising during the period	\$(11,000)	4,212	\$(6,788)
Reclassification adjustments for net gains included in net income	(651)	249	(402)
Net unrealized gains (losses)	<u>\$ (11,651)</u>	<u>\$4,461</u>	<u>\$(7,190)</u>
<b><u>Year ended December 31, 2015:</u></b>			
Unrealized gains on available-for-sale securities:			
Unrealized gains arising during the period	\$ 843	\$(323)	\$ 520
Reclassification adjustments for net gains included in net income	(1,354)	518	(836)
Net unrealized gains (losses)	<u>\$ (511)</u>	<u>\$ 195</u>	<u>\$(316)</u>
<b><u>Year ended December 31, 2014:</u></b>			
Unrealized gains (losses) on available-for-sale securities:			
Unrealized losses 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)	<u>\$10,235</u>	<u>\$(3,919)</u>	<u>\$6,316</u>

*Note: See accompanying notes to consolidated financial statements.*

**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014**

(In thousands)

	Class A Common Stock		Common Stock		Retained	Accumulated, Other Comprehensive	Treasury	Non- Controlling		
	Shares	Amount	Shares	Amount	Earnings	Income	Stock	Interests	Total	
	(#)	(\$)	(#)	(\$)	(\$)	(\$)	(\$)	(\$)	(\$)	
<b>Balance January 1, 2014</b>	-	\$ -	3,608	\$3,718	\$15,331		\$(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			(1)				\$(52)			\$(52)
<b>Balance December 31, 2014</b>	146	\$146	3,839	\$3,950	\$31,946	\$103,536	\$5,955	\$\$(3,078)	\$2,055	\$144,510
Comprehensive income:										
Net income, year ended December 31, 2015					15,629					15,629
Adjustment of unrealized gains on securities available-for-sale, net of tax						(316)				(316)
Total comprehensive income					15,629	(316)				15,313
Cash dividends paid - \$1.40 per common share					(5,580)					(5,580)
Treasury stock purchases – net	(2)		(2)				\$(167)			\$(167)
<b>Balance December 31, 2015</b>	144	\$146	3,937	\$3,950	\$31,946	\$113,585	\$5,639	\$\$(3,245)	\$2,055	\$154,076
Comprehensive income:										
Net income, year ended December 31, 2016					15,778					15,778
Adjustment of unrealized gains on securities available-for-sale, net of tax						(7,190)				(7,190)
Total comprehensive income					15,778	(7,190)				8,588
Cash dividends paid - \$1.40 per common share	(3)		(3)		(5,572)		\$(272)			(5,572)
Treasury stock purchases – net	141	\$146	3,834	\$3,950	\$31,946	\$123,791	\$(1,551)	\$\$(3,517)	\$2,055	\$156,820
<b>Balance December 31, 2016</b>										

Note: See accompanying notes to consolidated financial statements.

**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014**  
*(In thousands)*

	2016	2015	2014
<b>Operating activities</b>			
Net income	\$15,778	\$15,629	\$13,545
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	2,003	1,526	751
Provision for depreciation	2,548	2,382	2,073
Provision for amortization of intangibles	192	192	80
Deferred income taxes	(801)	178	400
Net gains on sale or call of available-for-sale securities	(651)	(1,354)	(1,294)
Net losses on sale or write down of other real estate owned	113	826	336
Net (increase) decrease in loans held-for-sale	(959)	(1,439)	1,611
(Increase) decrease in accrued interest receivable	(268)	(698)	(243)
Increase (decrease) in accrued interest payable	59	(35)	(163)
(Increase) decrease in cash surrender value of bank-owned life insurance policies	494	28	(458)
Net decrease in other assets	2,110	334	1,720
Net increase in other liabilities	2,156	2,324	1,473
NET CASH PROVIDED BY OPERATING ACTIVITIES	22,774	19,893	19,831
<b>Investing activities</b>			
(Increase) decrease in interest-bearing deposits in other banks	7,408	5,895	(10,495)
Proceeds of paydowns and maturities of available-for-sale investment securities	70,705	71,625	53,413
Proceeds of sales of available-for-sale investment securities	77,733	77,078	30,152
Purchases of available-for-sale investment securities	(183,360)	(126,391)	(118,535)
Increase in loans – net	(54,729)	(80,094)	(7,204)
Net cash paid in acquisition	-	-	(5,593)
Premiums paid for bank owned life insurance	-	-	(3,000)
Proceeds from sale of other real estate owned	2,501	750	1,973
Purchase of premises and equipment	(3,028)	(2,152)	(3,653)
NET CASH USED BY INVESTING ACTIVITIES	(82,770)	(53,289)	(62,942)
<b>Financing activities</b>			
Net increase in noninterest-bearing deposits	15,480	14,498	3,338
Net increase in interest bearing deposits	50,034	48,109	28,124
Net increase (decrease) in short-term borrowings	(5,019)	(14,995)	12,509
Issuance of long-term debt	20,000	-	17,000
Payment of principal on long-term debt	(15,104)	(7,747)	(4,977)
Cash dividends paid	(5,572)	(5,580)	(4,898)
Treasury stock transactions – net	(272)	(167)	(52)
NET CASH PROVIDED BY FINANCING ACTIVITIES	59,547	34,118	51,044

**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CASH FLOWS (cont'd)**  
**YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014**  
*(In thousands)*

	2016	2015	2014
Increase (decrease) in cash and cash equivalents	\$ (449)	\$ 722	\$ 7,933
Cash and cash equivalents at beginning of year	33,904	33,182	25,249
Cash and cash equivalents at end of year	<u>\$33,455</u>	<u>\$33,904</u>	<u>\$33,182</u>
Supplemental cash flow information:			
Interest paid	\$7,414	\$7,199	\$6,280
Income taxes paid	4,744	5,145	4,475
Supplemental noncash disclosures:			
Transfers from loans to other real estate owned	2,360	1,300	2,301
Transfers from other real estate owned to loans	79	1,400	1,666

*Note: See accompanying notes to consolidated financial statements.*

**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016 AND 2015**

**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 institution, First Citizens National Bank (“FirstCNB” or the “Bank”). Its wholly owned subsidiary depository financial institution, Southern Heritage Bank (“SHB”) was merged into FirstCNB on September 30, 2016. The Company’s investment in subsidiaries is reflected on the Company’s condensed balance sheets. See Notes 2 and 24 for more information.

FirstCNB has one wholly-owned subsidiary, First Citizens Investments, Inc., which is consolidated into its financial statements. First Citizens Financial Plus, Inc. (“Financial Plus”) was a formerly wholly owned subsidiary brokerage subsidiary. Financial Plus filed to withdraw its broker dealer status with the Securities and Exchange Commission on November 23, 2015 as the Company entered into agreement with a third party vendor to offer brokerage services going forward. The broker dealer status terminated on January 23, 2016 and the subsidiary was dissolved and liquidated in April 2016. Dissolution and liquidation of this subsidiary did not have a material impact on the consolidated financial statements of the Company.

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 FirstCNB and provide the FirstCNB 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 FirstCNB 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.

FirstCNB has a 50% ownership in an insurance subsidiary which is 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. The investment in this insurance subsidiary 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 intercompany 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 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:

- a. Market approach—The market approach uses prices and other relevant information generated by market transactions involving identical or similar assets or liabilities. This technique includes matrix pricing that is a mathematical technique used principally to value debt securities without relying solely on quoted prices for specific securities but rather by relying on securities' relationship to other benchmark quoted securities.
- b. Income approach—The income approach uses valuation techniques to convert future amounts such as earnings or cash flows to a single present discounted amount. The measurement is based on the value indicated by current market expectations about those future amounts. Such valuation techniques include present value techniques, option-pricing models (such as the Black-Scholes formula or a binomial model), and multi-period excess earnings method (used to measure fair value of certain intangible assets).
- c. Cost approach—The cost approach is based on current replacement cost which is the amount that would currently be required to replace the service capacity of an asset.

Valuation techniques are selected as appropriate for the circumstances and for which sufficient data is available. Valuation techniques are to be consistently applied, but a change in 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. 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). 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.

### **Subsequent Events**

The Company has evaluated subsequent events for recognition and disclosure through March 7, 2017, 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. The operations of SHB have been included in the consolidated financial statements since October 1, 2014. From acquisition on October 1 2014 until September 29, 2016, SHB continued to operate as a separate depository institution. Then, Company merged SHB into FirstCNB on September 30, 2016. The merger of SHB into FirstCNB on September 30, 2016 did not have a material impact on the consolidated financial statements for the year ended December 31, 2016. SHB has 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 \$184,000, \$175,000 and \$43,000 for the years ended December 31, 2016, 2015 and 2014, respectively. The accrual liability for SERP benefits is included in other liabilities on the Balance Sheet and totaled \$304,000 and \$218,000 as of December 31, 2016 and 2015, respectively. Benefit payments are expected to total approximately \$82,000 annually beginning in 2019.

The following 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

<i>Net assets acquired:</i>	
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

### *Cool Springs Financial Center*

On December 7, 2012, FirstCNB acquired one full-service financial center branch located at 9045 Carothers Parkway in Franklin, Tennessee from Community First Bank & Trust. Through the acquisition, FirstCNB 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 federal funds sold and deposit balances due from correspondent banks. Federal funds sold and balances due from correspondent banks above FDIC insurance limits totaled approximately \$8.4 million and \$14.7 million as of December 31, 2016 and 2015, respectively.

The Company maintains cash reserve balances as required by the Federal Reserve Bank. Average required balances during 2016 and 2015 were \$500,000 and \$2.9 million, 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, 2016 and 2015 were \$27.5 million and \$33.3 million, respectively. Interest-bearing deposits in other banks also include short-term CDs held in increments that are within FDIC insurance limits and totaled approximately \$222,000 as of December 31, 2016 and \$1.8 million as of December 31, 2015.

### **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, 2016:				
U.S. Treasury securities and obligations of U.S. government agencies and corporations	348,120	1,125	(6,547)	342,698
Obligations of states and political subdivisions	235,916	5,280	(2,462)	238,734
All Other	10	90	-	100
Total investment securities	584,046	6,495	(9,009)	581,532

As of December 31, 2015:				
U.S. Treasury securities and obligations of U.S. government agencies and corporations	\$343,446	\$ 2,376	\$(3,224)	\$342,598
Obligations of states and political subdivisions	207,895	9,922	(47)	217,770
All other	10	52	-	62
Total investment securities	\$551,351	\$12,350	\$(3,271)	\$560,430

There were no securities categorized as trading or held-to-maturity as of December 31, 2016 or 2015. At December 31, 2016 and 2015, investment securities were pledged to secure government, public and trust deposits as follows (in thousands):

	Amortized Cost	Fair Value
2016	269,634	266,657
2015	\$261,503	\$261,509

The following table summarizes contractual maturities of available-for-sale securities as of December 31, 2016 (in thousands):

	Amortized Cost	Fair Value
Amounts maturing in:		
One year or less	\$ 9,721	\$ 9,868
After one year through five years	32,149	33,674
After five years through ten years	108,002	110,531
After ten years*	434,164	427,359
Total debt securities	584,036	581,432
Equity securities	10	100
Total securities	\$584,046	\$581,532

\* Of the \$434 million (amortized cost) in this category, \$340 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, 2016, 2015 and 2014 are presented as follows (in thousands):

	Gross Sales	Gross Gains	Gross Losses	Net Gains
2016	\$77,733	\$ 682	(\$ 31)	\$ 651
2015	77,078	1,537	(183)	1,354
2014	30,152	1,345	(51)	1,294



The following table presents information on available-for-sale securities with gross unrealized losses at December 31, 2016 and 2015, 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
<b>December 31, 2016:</b>						
U.S. Treasury securities and obligations of U.S. Government agencies and corporations	(\$5,605)	\$249,603	(\$942)	\$27,931	(\$6,547)	\$277,534
Obligations of states and political subdivisions	(2,446)	92,997	(16)	363	(2,462)	93,360
Total securities with unrealized losses	(\$8,051)	\$342,600	(\$958)	\$28,294	(\$9,009)	\$370,894
<b>December 31, 2015:</b>						
U.S. Treasury securities and obligations of U.S. Government agencies and corporations	\$(1,069)	\$147,504	\$(2,155)	\$80,917	\$(3,224)	\$228,421
Obligations of states and political subdivisions	(32)	3,667	(15)	1,444	(47)	5,111
Total securities with unrealized losses	\$(1,101)	\$151,171	\$(2,170)	\$82,361	\$(3,271)	\$233,532

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, 2016, the Company had 308 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 308 debt securities, 221 are obligations of state and political subdivisions and 87 are obligations of U.S. government agencies consisting of collateralized mortgage obligations (CMOs) or mortgage-backed securities (MBS). The securities in an unrealized loss position as of December 31, 2016, 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, 2016. The unrealized losses on the agency and municipal securities have not been recognized for other-than-temporary impairment through earnings during the year ended December 31, 2016.

As of December 31, 2015, the Company had 75 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 75 debt securities, 13 are obligations of state and political subdivisions and 62 are obligations of U.S. government agencies consisting of collateralized mortgage obligations (CMOs) or mortgage-backed securities (MBS). The securities in an unrealized loss position as of December 31, 2015, 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, 2015. The unrealized losses on the agency and municipal securities have not been recognized for other-than-temporary impairment through earnings during the year ended December 31, 2015. No impairment charges were recognized on available-for-sale securities in 2016, 2015 or 2014.



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:

	2016	2015
Commercial, financial and agricultural	\$124,424	\$115,585
Real estate – construction	104,390	99,367
Real estate – mortgage	574,001	533,163
Installment loans to individuals	22,103	24,658
All other loans	16,668	17,506
Total	<u>\$841,586</u>	<u>\$790,279</u>

### *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, 2016 and 2015 were as follows (in thousands):

	Pass	Special Mention	Substandard	Total
December 31, 2016:				
Commercial, financial and agricultural	\$114,216	\$ 2,548	\$ 7,660	\$124,424
Real estate – construction	104,075	-	315	104,390
Real estate – mortgage	552,877	2,613	18,511	574,001
Installment loans to individuals	21,930	9	164	22,103
All other loans	16,667	-	1	16,668
Total	<u>\$809,765</u>	<u>\$5,170</u>	<u>\$26,651</u>	<u>\$841,586</u>

December 31, 2015:

Commercial, financial and agricultural	\$110,160	\$ 704	\$ 4,721	\$115,585
Real estate – construction	98,682	-	685	99,367
Real estate – mortgage	513,690	2,433	17,040	533,163
Installment loans to individuals	24,449	-	209	24,658
All other loans	17,506	-	-	17,506
Total	<u>\$764,487</u>	<u>\$3,137</u>	<u>\$22,655</u>	<u>\$790,279</u>

*Past Due and Non-Performing Loans*

An aging analysis of loans outstanding by category as of December 31, 2016 and 2015 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
<b>As of December 31, 2016:</b>							
Commercial, financial and agricultural	\$ 1,145	\$94	\$ 355	\$ 1,594	\$122,830	\$124,424	\$ 215
Real estate – construction	4	0	14	18	104,372	104,390	14
Real estate – mortgage	1,128	683	873	2,684	571,317	574,001	235
Installment loans to individuals	181	74	25	280	21,823	22,103	20
All other loans	-	-	-	-	16,668	16,668	-
<b>Total</b>	<b>\$2,458</b>	<b>\$851</b>	<b>\$1,267</b>	<b>\$4,576</b>	<b>\$837,010</b>	<b>\$841,586</b>	<b>\$484</b>
<b>As of December 31, 2015:</b>							
Commercial, financial and agricultural	\$ 431	\$125	\$ -	\$ 556	\$115,029	\$115,585	\$ -
Real estate – construction	96	40	20	156	99,211	99,367	-
Real estate – mortgage	2,119	195	3,936	6,250	526,913	533,163	10
Installment loans to individuals	119	95	70	284	24,374	24,658	13
All other loans	-	-	-	-	17,506	17,506	-
<b>Total</b>	<b>\$2,765</b>	<b>\$455</b>	<b>\$4,026</b>	<b>\$7,246</b>	<b>\$783,033</b>	<b>\$790,279</b>	<b>\$23</b>

Performing and non-performing loans by category were as follows as of December 31, 2016 and 2015 (in thousands):

	Performing	Non- Performing*	Total
<u>December 31, 2016:</u>			
Commercial, financial and agricultural	\$123,564	\$ 860	\$124,424
Real estate – construction	104,296	94	104,390
Real estate – mortgage	570,832	3,169	574,001
Installment loans to individuals	21,991	112	22,103
All other loans	16,667	1	16,668
Total	<u>\$837,350</u>	<u>\$4,236</u>	<u>\$841,586</u>

December 31, 2015:

Commercial, financial and agricultural	\$115,292	\$ 293	\$115,585
Real estate – construction	99,245	122	99,367
Real estate – mortgage	527,857	5,306	533,163
Installment loans to individuals	24,485	173	24,658
All other loans	17,506	-	17,506
Total	<u>\$784,385</u>	<u>\$5,894</u>	<u>\$790,279</u>

\* 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, 2016 and 2015 by category were as follows (in thousands):

	2016	2015
Commercial, financial and agricultural	\$ 645	\$ 293
Real estate – construction	80	122
Real estate – mortgage	2,934	5,296
Installment loans to individuals	92	160
All other loans	1	-
Total	<u>\$3,752</u>	<u>\$5,871</u>

### *Troubled Debt Restructurings*

Loans that were restructured during the year ended December 31, 2016 consisted of the following (dollars in thousands):

	2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
<u>Troubled debt restructurings:</u>			
Commercial, financial and agricultural	13	\$ 2,277	\$ 2,005
Real estate – construction	8	758	507
Real estate – mortgage	38	7,210	5,605
Installment loans to individuals	12	112	80
All other loans	-	-	-
Total	<u>71</u>	<u>\$10,357</u>	<u>\$8,197</u>

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, 2016 consisted of the following (dollars in thousands):

	Number of Contracts	Recorded Investment
Commercial, financial and agricultural	5	\$128
Real estate – construction	-	-
Real estate – mortgage	6	223
Installment loans to individuals	1	8
All other loans	-	-
Total	12	\$359

The allowance for loan losses associated with the TDRs totaled approximately \$392,000 and \$436,000 as of December 31, 2016 and 2015, respectively.

#### *Impaired Loans*

Information regarding the Company's impaired loans for the years ended December 31, 2016 and 2015 is as follows (in thousands):

	Recorded Investment	Unpaid Principal Balance	Specific Allowance	Average Recorded Investment	Interest Income Recognized
<u>December 31, 2016:</u>					
<u>With no specific allocation recorded:</u>					
Commercial, financial and agricultural	\$ 1,303	\$ 1,323	N/A	\$ 1,303	\$ 77
Real estate – construction	19	19	N/A	19	2
Real estate – mortgage	3,095	3,293	N/A	3,095	205
Installment loans to individuals	11	11	N/A	11	1
All other loans	-	-	N/A	-	-
<u>With allocation recorded:</u>					
Commercial, financial and agricultural	\$1,630	\$1,675	\$140	\$ 1,630	\$114
Real estate – construction	-	-	-	-	-
Real estate – mortgage	594	639	78	594	59
Installment loans to individuals	-	-	-	-	-
All other loans	-	-	-	-	-
<u>Total:</u>					
Commercial, financial and agricultural	\$2,933	\$2,998	\$140	\$ 2,933	\$191
Real estate – construction	19	19	-	19	2
Real estate – mortgage <sup>(1)</sup>	3,689	3,932	78	3,689	264
Installment loans to individuals	11	11	-	11	1
All other loans	-	-	-	-	-
<u>December 31, 2015:</u>					
<u>With no specific allocation recorded:</u>					
Commercial, financial and agricultural	\$ 26	\$ 280	N/A	\$ 54	\$ -
Real estate – construction	43	68	N/A	81	-
Real estate – mortgage	3,481	3,875	N/A	3,923	76
Installment loans to individuals	10	10	N/A	8	1
All other loans	-	-	N/A	-	-
<u>With allocation recorded:</u>					
Commercial, financial and agricultural	\$624	\$662	\$284	\$ 868	\$57
Real estate – construction	188	188	27	188	11
Real estate – mortgage	2,295	2,344	217	2,295	19
Installment loans to individuals	32	34	5	32	-
All other loans	-	-	-	-	-
<u>Total:</u>					
Commercial, financial and agricultural	\$650	\$942	\$284	\$ 922	\$57
Real estate – construction <sup>(2)</sup>	231	256	27	269	11
Real estate – mortgage <sup>(1)</sup>	5,776	6,219	217	6,218	95
Installment loans to individuals	42	44	5	40	1
All other loans	-	-	-	-	-

(1) Impaired total for this category includes troubled debt restructurings with recorded investment totaling approximately \$594,000 and a specific allowance of approximately \$78,000 as of December 31, 2016 and recorded investment totaling approximately \$2.3 million and a specific allowance of approximately \$207,000 as of December 31, 2015.

(2) Impaired total for this category includes troubled debt restructurings with recorded investment totaling approximately \$71,000 and a specific allowance of approximately \$4,000 as of December 31, 2015.

### *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
<u>December 31, 2016:</u>			
Commercial, financial and agricultural	\$ 825	\$ 220	\$ 1,045
Real estate – construction	-	130	130
Real estate – mortgage	1,652	6,793	8,445
Installment loans to individuals	-	-	-
All other loans	-	-	-
Total	<u>\$2,477</u>	<u>\$7,143</u>	<u>\$9,620</u>
<u>December 31, 2015:</u>			
Commercial, financial and agricultural	\$ 26	\$ 1,618	\$ 1,644
Real estate – construction	23	131	154
Real estate – mortgage	1,323	8,837	10,160
Installment loans to individuals	-	10	10
All other loans	-	-	-
Total	<u>\$1,372</u>	<u>\$10,596</u>	<u>\$11,968</u>

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:

<u>December 31, 2016:</u>	
Contractually-required principal	\$11,544
Nonaccretable difference	(1,924)
Cash flows expected to be collected	9,620
Accretable yield	-
Fair Value	<u>\$9,620</u>
<u>December 31, 2015:</u>	
Contractually-required principal	\$14,667
Nonaccretable difference	(2,454)
Cash flows expected to be collected	12,213
Accretable yield	(245)
Fair Value	<u>\$11,968</u>

Changes in the accretable yield of loans acquired with deteriorated credit quality were as follows for the years ended December 31, 2016 and 2015:

	2016	2015
Beginning balance	\$(245)	\$(418)
Additions through acquisition	-	-
Reclasses from nonaccretable difference	(242)	(78)
Accretion	487	251
Ending balance	<u>\$ -</u>	<u>\$(245)</u>

## 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):

	2016		2015		2014	
	Amount	% to Total Loans	Amount	% to Total Loans	Amount	% to Total Loans
Commercial, financial and agricultural	\$1,546	14.78%	\$1,477	14.63%	\$ 999	15.82%
Real estate – construction	1,116	12.40%	1,191	12.58%	1,281	8.92%
Real estate – mortgage	5,588	68.21%	4,749	67.45%	4,679	69.10%
Installment loans to individuals	249	2.63%	272	3.12%	274	3.62%
All other loans	292	1.98%	304	2.22%	308	2.54%
Total	<u>\$8,791</u>	100.00%	<u>\$7,993</u>	100.00%	<u>\$7,541</u>	100.00%

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

	2016	2015	2014
Balance - beginning of year	\$7,993	\$7,541	\$7,818
Provision for loan losses	2,003	1,526	751
Loans charged to allowance	(1,814)	(2,027)	(1,681)
Recovery of loans previously charged off	609	953	653
Net charge-offs	(1,205)	(1,074)	(1,028)
Balance - end of year	<u>\$8,791</u>	<u>\$7,993</u>	<u>\$7,541</u>

An analysis of the activity in the allowance for loan losses by category for the years ended December 31, 2016 and 2015 is as follows:

	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance
<b>Year ended December 31, 2016:</b>					
Commercial, financial and agricultural	\$1,477	\$(463)	\$123	\$409	\$1,546
Real estate – construction	1,191	(23)	70	(122)	1,116
Real estate – mortgage	4,749	(745)	157	1,427	5,588
Installment loans to individuals	272	(218)	72	123	249
All other loans	304	(365)	187	166	292
Total	<u>\$7,993</u>	<u>\$(1,814)</u>	<u>\$609</u>	<u>\$2,003</u>	<u>\$8,791</u>
<b>Year ended December 31, 2015:</b>					
Commercial, financial and agricultural	\$ 999	\$(396)	\$210	\$ 664	\$1,477
Real estate – construction	1,281	(120)	319	(289)	1,191
Real estate – mortgage	4,679	(1,057)	177	950	4,749
Installment loans to individuals	274	(144)	51	91	272
All other loans	308	(310)	196	110	304
Total	<u>\$7,541</u>	<u>\$(2,027)</u>	<u>\$953</u>	<u>\$1,526</u>	<u>\$7,993</u>

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, 2016 and 2015 (in thousands):

	Evaluated Individually	Evaluated Collectively	Acquired Loans with Evidence of Credit Deterioration	Total
As of December 31, 2016:				
<b>Allowance for loan losses</b>				
Commercial, financial and agricultural	\$135	\$1,698	\$5	\$1,838
Real estate – construction	-	1,116	-	1,116
Real estate – mortgage	78	5,510	-	5,588
Installment loans to individuals	-	249	-	249
All other loans	-	-	-	-
Total	\$213	\$8,573	\$5	\$8,791
<b>Loans</b>				
Commercial, financial and agricultural	\$2,108	\$137,939	\$1,045	\$141,092
Real estate – construction	19	104,241	130	104,390
Real estate – mortgage	2,037	563,519	8,445	574,001
Installment loans to individuals	11	22,092	-	22,103
All other loans	-	-	-	-
Total	\$4,175	\$827,791	\$9,620	\$841,586
As of December 31, 2015:				
<b>Allowance for loan losses</b>				
Commercial, financial and agricultural	\$284	\$1,193	\$-	\$1,477
Real estate – construction	27	1,164	-	1,191
Real estate – mortgage	231	4,518	-	4,749
Installment loans to individuals	5	267	-	272
All other loans	-	304	-	304
Total	\$547	\$7,446	\$-	\$7,993
<b>Loans</b>				
Commercial, financial and agricultural	\$1,074	\$112,867	\$ 1,644	\$115,585
Real estate – construction	209	99,004	154	99,367
Real estate – mortgage	4,457	518,546	10,160	533,163
Installment loans to individuals	41	24,607	10	24,658
All other loans	-	17,506	-	17,506
Total	\$5,781	\$772,530	\$11,968	\$790,279

## 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, 2016, 2015 or 2014. 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 \$3.2 million, \$3.1 million, and \$1.4 million for the years ended December 31, 2016, 2015 and 2014, 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	2016	2015
Land		\$12,031	\$11,787
Buildings	5 to 50	41,622	40,483
Furniture and equipment	3 to 20	22,524	21,272
Total premises and equipment		76,177	73,542
Less: accumulated depreciation		34,921	32,766
Net premises and equipment		<u>\$41,256</u>	<u>\$40,776</u>

## 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, 2016 was \$22.3 million or 1.40% of total assets and 14.25% of total capital. Total goodwill as of December 31, 2015 was \$22.3 million or 1.46% of total assets and 14.50% of total capital. 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):

	2016	2015
Core deposit intangible	\$1,922	\$1,922
Accumulated amortization	(506)	(314)
Net core deposit intangible	<u>\$1,416</u>	<u>\$1,608</u>

Amortization expense was approximately \$192,000 per year in 2016 and 2015 and approximately \$80,000 in 2014. 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 \$3.7 million as of December 31, 2016 compared to \$4.0 million as of December 31, 2015. 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.

At December 31, 2016 and 2015, the balance of real estate owned includes \$1.5 million and \$165,000, respectively of foreclosed residential real estate properties. At December 31, 2015, the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceeds are in process is \$243,000. No loans had formal foreclosure proceeds in process at December 31, 2016.

## 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 value of BOLI was \$25.4 million as of December 31, 2016 and \$25.9 million as of December 31, 2015. BOLI policies 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 \$579,000, \$530,000, and \$621,000, for the years ended December 31, 2016, 2015 and 2014, 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 \$33,000, \$42,000, and \$224,000, for the years ended December 31, 2016, 2015 and 2014, respectively. The accrued liability for post-retirement death benefits is included in Other Liabilities on the Consolidated Balance Sheet and totaled \$2.6 million and \$2.7 million as of December 31, 2016 and 2015, 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 FirstCNB 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):

	2016	2015
Service cost*	\$ -	\$(127)
Interest cost	18	25
Net other post-retirement benefits expense	<u>\$18</u>	<u>\$(102)</u>

\*Service cost for 2015 was negative due to reversal of accrual balance due to death of participant.

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:	2016	2015
Beginning balance	\$285	\$418
Service cost	-	(127)
Interest cost	18	25
Benefit payments	<u>(18)</u>	<u>(31)</u>
Ending balance	<u>\$285</u>	<u>\$285</u>

The accumulated post-retirement benefit obligation was included in Other Liabilities as of December 31, 2016 and 2015 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 deposits in denominations of \$250,000 or greater (in thousands):

	2016	2015
Time deposits	\$134,827	\$122,947
Non-maturity transaction and savings deposits	375,397	314,488

NOW accounts, included in interest bearing deposits on the Consolidated Balance Sheets, totaled \$101.1 million as of December 31, 2016 and \$167.5 million as of December 31, 2015. Demand deposit balances reclassified as loans consisted of overdrafts totaling approximately \$608,000 and \$459,000 as of December 31, 2016 and 2015, respectively. Maturities of time deposits were as follows as of December 31, 2016 (in thousands):

On or before December 31, 2017	\$298,512
On or during year ended December 31, 2018	43,184
On or during year ended December 31, 2019	13,390
On or during year ended December 31, 2020	12,823
During or after year ended December 31, 2021	13,082
	<u>\$380,991</u>

## 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, 2016 or 2015.

The Company has four federal fund lines of credit available with various correspondent banks totaling \$49.5 million as of December 31, 2016. There were no federal funds purchased as of December 31, 2016 or 2015.

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, 2016, 2015 and 2014 (dollars in thousands):

	2016	2015	2014
Amount outstanding at end of year	\$ -	\$ -	\$ -
Weighted average interest rate at end of year	—%	—%	—%
Maximum outstanding at any month end	\$-	\$-	\$5,000
Average outstanding during year	10	7	2,477
Weighted average interest rate during year	—%	—%	0.19%

## NOTE 14 – LONG TERM DEBT

Long-term debt as of December 31, 2016 and 2015 is summarized as follows (in thousands):

	2016	2015
FHLB advances	\$40,889	\$34,868
Junior subordinated debentures	14,261	14,106
Promissory notes	8,985	10,110
Total long-term debt	\$64,135	\$59,084

### *FHLB advances*

FirstCNB had secured advances from FHLB totaling \$40.9 million as of December 31, 2016 and \$34.9 million as of December 31, 2015. FHLB borrowings are comprised primarily of advances with principal due at call date or maturity date with fixed interest rates ranging from 0.86% to 7.05%. Some FHLB borrowings have quarterly call features and maturities range from 2017 to 2023. Advances totaling \$14 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 \$544 million consisting of the FirstCNB's entire portfolio of fully disbursed, one-to-four family residential mortgages, commercial mortgages, farm mortgages, second mortgages and multi-family residential mortgages. FirstCNB had additional borrowing capacity with the FHLB of \$119 million as of December 31, 2016.

SHB had no outstanding secured or unsecured advances from FHLB as of or during the year ended December 31, 2015.

### *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 additional Tier I capital subject to certain limitations. The following table provides details on the debentures as of December 31, 2016 and 2015:

	Principal Amount	Interest Rate	Year of Maturity	Amount included in Additional Tier I Capital
<b>As of December 31, 2016:</b>				
First Citizens (TN) Statutory Trust III	\$5,155	2.66%	2035	\$5,155
First Citizens (TN) Statutory Trust IV	5,155	2.60%	2037	5,155
Southern Heritage Statutory Trust I	5,155	2.90%	2035	5,155
<b>As of December 31, 2015:</b>				
First Citizens (TN) Statutory Trust III	\$5,155	2.33%	2035	\$5,155
First Citizens (TN) Statutory Trust IV	5,155	2.26%	2037	5,155
Southern Heritage Statutory Trust I	5,155	2.56%	2037	5,155

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 \$1.2 million and \$1.4 million as of December 31, 2016 and 2015, respectively, 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 \$9.0 million as of December 31, 2016 and \$10.1 million as of December 31, 2015.

The Credit Facilities are secured by a pledge of 51% of the stock of FirstCNB, 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, 2016 and 2015 were as follows (dollars in thousands):

	Average		
	Volume	Interest Rate	Maturity
<u>2016<sup>(1)</sup></u>			
First Citizens Bancshares, Inc.	\$23,819	3.67%	12 years
First Citizens National Bank	40,735	1.96%	2 years
<u>2015<sup>(1)</sup></u>			
First Citizens Bancshares, Inc.	\$25,274	3.37%	13 years
First Citizens National Bank	37,681	1.91%	2 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, 2016 (in thousands):

2017	\$ 9,936
2018	9,620
2019	17,850
2020	10,959
2021	800
Thereafter	14,970
	<u>\$64,135</u>

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):

	2016	2015	2014
Income tax expense (benefit):			
Current	\$4,403	\$3,605	\$3,089
Deferred	(801)	178	349
State income tax expense (benefit of operating loss carryforwards)	343	397	66
Change in valuation allowance	(343)	(397)	(66)
	<u>\$3,602</u>	<u>\$3,783</u>	<u>\$3,438</u>

Effective tax rates for the years ended December 31, 2016, 2015 and 2014 differed from federal statutory rate of 34% applied to income before income taxes as a result of the following (in thousands):

	2016	2015	2014
Tax expenses at statutory rate	\$6,683	\$6,600	\$5,774
(Decrease) increase resulting from:			
Tax exempt interest income	(2,585)	(2,384)	(1,949)
Net earnings on bank-owned life insurance	(200)	(180)	(211)
ESOP dividend	(321)	(234)	(305)
Other items	25	(19)	129
	<u>\$3,602</u>	<u>\$3,783</u>	<u>\$3,438</u>

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):

	2016	2015	2014
Deferred tax assets:			
Allowance for loan losses	\$2,990	\$2,737	\$2,613
Unrealized loss on other real estate owned	757	1,061	1,076
State income tax benefit for net operating loss carryforwards	105	448	845
Alternative Minimum Tax Credit	659	659	659
Purchase accounting adjustments, net	18	-	185
Net unrealized losses on available-for-sale debt securities	963	-	-
Deferred loan fees	294	211	138
Imputed income tax reimbursement plan	97	97	139
Supplemental executive retirement plan	137	62	16
Other	72	71	110
Total deferred tax assets	6,092	5,346	5,781
Deferred tax liabilities:			
Depreciation	(2,652)	(3,122)	(3,210)
Net unrealized gains on available-for-sale debt securities	-	(3,439)	(3,660)
FHLB stock dividends	(770)	(770)	(770)
Purchase accounting adjustments, net.	-	(183)	-
Prepaid expenses	(214)	(199)	(207)
Other	(132)	(169)	(116)
Total deferred tax liabilities	(3,768)	(7,882)	(7,963)
Valuation allowance for state income tax benefit	(105)	(448)	(845)
Net deferred tax assets (liabilities)	<u>\$2,219</u>	<u>\$(2,984)</u>	<u>\$(3,027)</u>

As of December 31, 2016, the Company had a net operating loss carryforward for state tax purposes of \$1.8 million expiring in 2025. As of December 31, 2016 and 2015, 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, 2016, 2015 and 2014.

#### 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 banks 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 Common Equity Tier I, Tier I and total risk-based capital (as defined) to risk-weighted assets (as defined). The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U. S. bank (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule and fully phased in by January 1, 2019. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019 and is 0.625% for 2016. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. To be considered adequately capitalized (as defined) under the regulatory framework for prompt corrective action, the minimums must be maintained for Tier I leverage, Common Equity Tier I risk-based, Tier I risk-based and total risk-based ratios as set forth in the table. Management believes



as of December 31, 2016, the Company and FirstCNB meet all capital adequacy requirements to which they are subject. Actual capital amounts and ratios are presented in the table below.

As of December 31, 2016 and 2015, the most recent notifications from primary regulatory authorities categorized the Company and its subsidiary bank(s) as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank(s) must maintain minimum total risk-based, Common Equity Tier I 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 its categories.

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

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
<u>December 31, 2016:</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
Total capital to risk weighted assets:						
First Citizens Bancshares, Inc.	\$157,411	15.9%	\$79,352	8.0%	N/A	10.0%
First Citizens National Bank	164,583	16.6%	79,402	8.0%	\$99,252	10.0%
Tier I capital to risk weighted assets:						
First Citizens Bancshares, Inc.	148,579	15.0%	59,514	6.0%	N/A	8.0%
First Citizens National Bank	155,751	15.7%	59,551	6.0%	79,401	8.0%
Common Equity Tier I capital to risk weighted assets:						
First Citizens Bancshares, Inc.	133,414	13.5%	44,636	4.5%	N/A	6.5%
First Citizens National Bank	154,847	15.6%	44,663	4.5%	64,514	6.5%
Tier I capital to average assets:						
First Citizens Bancshares, Inc.	148,579	9.5%	62,882	4.0%	N/A	5.0%
First Citizens National Bank	155,751	9.9%	62,988	4.0%	78,734	5.0%
<u>December 31, 2015:</u>						
Total capital to risk weighted assets:						
First Citizens Bancshares, Inc.	\$146,999	15.5%	\$75,968	8.0%	N/A	10.0%
First Citizens National Bank	125,783	16.0%	62,774	8.0%	\$78,467	10.0%
Southern Heritage Bank	29,567	17.9%	13,192	8.0%	16,490	10.0%
Tier I capital to risk weighted assets:						
First Citizens Bancshares, Inc.	138,984	14.6%	56,961	6.0%	N/A	8.0%
First Citizens National Bank	118,198	15.1%	47,060	6.0%	62,746	8.0%
Southern Heritage Bank	29,137	17.7%	9,894	6.0%	13,192	8.0%
Common Equity Tier I capital to risk weighted assets:						
First Citizens Bancshares, Inc.	123,609	13.0%	42,722	4.5%	N/A	6.5%
First Citizens National Bank	116,929	14.9%	35,290	4.5%	50,975	6.5%
Southern Heritage Bank	29,137	17.7%	7,420	4.5%	10,718	6.5%
Tier I capital to average assets:						
First Citizens Bancshares, Inc.	138,984	9.2%	60,231	4.0%	N/A	5.0%
First Citizens National Bank	118,198	9.5%	50,031	4.0%	62,539	5.0%
Southern Heritage Bank	29,137	11.4%	10,224	4.0%	12,779	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, 2016, \$19.2 million of retained earnings were available for future dividends from FirstCNB 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, 2016 and 2015 was as follows (in thousands):

	2016	2015
Unrealized gains (losses) on available-for-sale securities without other-than-temporary impairment, net of tax	\$(1,551)	\$5,639
Unrealized losses on available-for-sale securities with other-than-temporary impairment, net of tax	-	-
Total accumulated other comprehensive income (loss)	<u>\$(1,551)</u>	<u>\$5,639</u>

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 2015, FirstCNB contracted with a related party for the construction of a new full service branch facility in Union City, Tennessee. The contract is for \$1.7 million and was awarded on a competitive bid basis. Contract payments paid totaled approximately \$980,000 in the year ended December 31, 2015 and the remainder of the contract was paid in 2016.

Activity in loans to executive officers, directors and their affiliates was as follows for the years ended December 31, 2016 and 2015 (in thousands):

	2016	2015
Balance at beginning of period	\$14,019	\$12,870
New loans	3,340	9,015
Effect of changes in composition of related parties	(10,512)	(1,865)
Repayments	(1,655)	(6,001)
Balance at end of period	<u>\$ 5,192</u>	<u>\$14,019</u>

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 Banks 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 Banks 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, 2016 and 2015 were \$12.8 million and \$15.5 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 Banks upon extension of credit, and is based on management's credit evaluation of the counter party. At December 31, 2016 and 2015, the Company had outstanding loan commitments of \$157.9 million and \$142.2 million, respectively. As of year-end 2016, variable rate commitments were \$50.7 million and fixed rate commitments were \$107.2 million. As of year-end 2015, variable rate commitments were \$67.8 million and fixed rate commitments were \$74.4 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, 2016 and 2015, outstanding standby letters of credit totaled \$2.6 million and \$3.0 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, 2016 and 2015, 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, 2016 and 2015 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, 2016:				
Financial assets:				
Securities available-for-sale	\$ -	\$581,532	\$ -	\$581,532
December 31, 2015:				
Financial assets:				
Securities available-for-sale	\$ -	\$560,430	\$ -	\$560,430

### 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 vary are determined on case-by-case basis, 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 2016 or 2015.

#### *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, 2016 and 2015 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
<u>December 31, 2016:</u>				
Assets:				
Impaired loans	\$ -	\$ -	\$6,652	\$6,652
Loans held-for-sale	-	6,737	-	6,737
Other real estate owned	-	-	3,708	3,708
<u>December 31, 2015:</u>				
Assets:				
Impaired loans	\$ -	\$ -	\$6,699	\$6,699
Loans held-for-sale	-	5,778	-	5,778
Other real estate owned	-	-	4,041	4,041

### **Other Fair Value Estimates**

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 not measured at fair value on the Balance Sheets as of December 31, 2016 and 2015 were as follows (in thousands):

	<u>Carrying Amount</u>	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Fair Value</u>
<u>As of December 31, 2016:</u>					
Financial assets:					
Cash and cash equivalents	\$ 33,455	\$33,455	\$ -	\$ -	\$ 33,455
Interest-bearing deposits in other banks	27,690	27,690	-	-	27,690
Loans, net of allowance	826,143	-	829,287	-	829,287
Accrued interest receivable	7,226	-	7,226	-	7,226
Federal Reserve Bank and Federal Home Loan Bank Stock	6,134	-	6,134	-	6,134
Bank owned life insurance	25,402	-	25,402	-	25,402
Financial liabilities:					
Deposits	1,339,627	-	1,338,157	-	1,338,157
Short-term borrowings	29,303	-	29,303	-	29,303
Other borrowings	64,135	-	63,995	-	63,995
Other liabilities	8,867	-	8,867	-	8,867
Off-balance sheet arrangements					
Commitments to extend credit	157,890	-	157,890	-	157,890
Standby letters of credit	2,612	-	2,612	-	2,612
<u>As of December 31, 2015:</u>					
Financial assets					

	<u>Carrying Amount</u>	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Fair Value</u>
Cash and cash equivalents	\$ 33,904	\$33,904	\$ -	\$ -	\$ 33,904
Interest bearing deposits in other banks	35,098	35,098	-	-	35,098
Loans, net of allowance	774,796	-	777,105	-	784,595
Accrued interest receivable	6,958	-	6,958	-	6,958
Federal Reserve Bank and Federal Home Loan Bank Stock	6,134	-	6,134	-	6,134
Bank owned life insurance	25,896	-	25,896	-	25,896
Financial liabilities				-	
Deposits	1,274,113	-	1,273,499	-	1,273,499
Short-term borrowings	34,322	-	34,322	-	34,322
Other borrowings	59,084	-	58,812	-	58,812
Other liabilities	11,342	-	11,342	-	11,342
Off-balance sheet arrangements				-	
Commitments to extend credit	142,232	-	142,232	-	142,232
Standby letters of credit	2,983	-	2,983	-	2,983

## NOTE 22 – EMPLOYEE STOCK OWNERSHIP AND 401(k) PLANS

The Company maintains the First Citizens National Bank of Dyersburg Employee Stock Ownership Plan (the “ESOP”) and the First Citizens National Bank 401(k) Plan (the “401(k) Plan”) as employee benefits. The plans provide for a contribution annually not to exceed 25% of the total compensation of all participants and afford eligibility for participation to all full-time employees who have completed at least one year of service and are age 21 or older.

The Company annually contributes amounts equal to 3% of total eligible compensation to the 401(k) Plan and a discretionary percentage of total eligible compensation to the ESOP. The annual discretionary percentage of total eligible compensation was 7% for 2016 and 2015. Total eligible compensation for both plans consists of total compensation subject to income tax. Total eligible compensation includes any salary deferrals made through the 401(k) Plan and Section 125 Cafeteria Plan and is subject to maximum limits set annually by the IRS. Each participant may also elect to defer up to 75% of his or her pay into the 401(k) Plan, subject to dollar limitations imposed by law.

Employer cash contributions to the 401(k) Plan totaled approximately \$542,000 in 2016, \$539,000 in 2015, and \$421,000 in 2014. Employer cash contributions to the ESOP totaled approximately \$1.3 million in 2016, \$1.3 million in 2015, and \$989,000 in 2014. Cash contributions to the 401(k) Plan and ESOP are reported in Salaries and Employee Benefits in Non-Interest Expenses on the Consolidated Statements of Income.

The ESOP is a non-leveraged plan and all shares of Company common stock owned by the ESOP were allocated to participants as of December 31, 2016 and 2015. Cash dividends paid by the Company on common stock held by the ESOP are charged to retained earnings. All shares owned by the ESOP are considered outstanding for earnings per share computations. In the event a terminated or retired ESOP participant desires to sell his or her shares of Company common stock, or if certain employees elect to diversify their account balances, the Company may be required to purchase the shares from the participant at their fair market value. The ESOP owned 631,272 shares of Company common stock with an estimated fair value of \$32.2 million as of December 31, 2016 and 662,347 shares of Company common stock with an estimated fair value of \$32.1 million as of December 31, 2015.

SHB had a 401(k) profit sharing plan covering employees meeting certain age and service requirements. Employees of SHB may contribute up to a certain dollar amount which is set by law. Participants vest immediately in their contributions plus the actual earnings thereon. SHB contributions vested 20% per year over 5 years. Discretionary contributions from the acquisition date through December 31, 2014 totaled approximately \$23,000. This plan was terminated as of December 31, 2014 and employees of SHB meeting eligibility requirements were enrolled in the Company’s 401(k) Plan and/or EOSP on January 1, 2015.

**NOTE 23 – QUARTERLY SELECTED FINANCIAL DATA (UNAUDITED)**

The following table presents quarterly selected financial data (unaudited) for 2016 and 2015 (in thousands, except per share data):

	<u>Interest Income</u>	<u>Net Interest Income</u>	<u>Net Income</u>	<u>EPS Basic</u>	<u>EPS Diluted</u>
2016					
First Quarter	\$13,973	\$12,149	\$3,983	\$1.00	\$1.00
Second Quarter	14,168	12,310	3,891	0.98	0.98
Third Quarter	14,625	12,724	3,891	0.98	0.98
Fourth Quarter	14,692	12,802	4,013	1.01	1.01
Total	<u>\$57,458</u>	<u>\$49,985</u>	<u>\$15,778</u>	<u>\$3.97</u>	<u>\$3.97</u>
2015					
First Quarter	\$13,217	\$11,373	\$3,711	\$0.93	\$0.93
Second Quarter	13,678	11,843	3,960	1.00	1.00
Third Quarter	13,837	11,991	4,021	1.00	1.00
Fourth Quarter	13,983	12,157	3,937	0.99	0.99
Total	<u>\$54,715</u>	<u>\$47,364</u>	<u>\$15,629</u>	<u>\$3.92</u>	<u>\$3.92</u>

**NOTE 24 – CONDENSED FINANCIAL INFORMATION**

**FIRST CITIZENS BANCSHARES, INC.**  
**(Parent Company Only)**  
**Balance Sheets**  
**December 31, 2016 and 2015**  
*(In thousands)*

	2016	2015
<b>Assets</b>		
Cash	\$ 1,570	\$ 1,481
Investment in subsidiaries	176,661	175,153
Other assets	328	209
<b>Total assets</b>	<b>\$178,559</b>	<b>\$176,843</b>
<b>Liabilities and shareholders' equity</b>		
<b>Liabilities</b>		
Long term debt	\$ 23,246	\$ 24,216
Accrued expenses	548	606
<b>Total liabilities</b>	<b>23,794</b>	<b>24,822</b>
<b>Shareholders' equity</b>	<b>154,765</b>	<b>152,021</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$178,559</b>	<b>\$176,843</b>

**FIRST CITIZENS BANCSHARES, INC.**  
**(Parent Company Only)**  
**Condensed Statements of Income**  
**Years Ended December 31, 2016 and 2015**  
*(In thousands)*

	2016	2015
<b>Income</b>		
Dividends from bank subsidiaries	\$7,700	\$7,800
Other income	12	10
<b>Total income</b>	<b>7,712</b>	<b>7,810</b>
<b>Expenses</b>		
Interest expense	874	851
Other expenses	243	281
<b>Total expenses</b>	<b>1,117</b>	<b>1,132</b>
<b>Income before income taxes and equity in undistributed net income of bank subsidiary</b>	<b>6,595</b>	<b>6,678</b>
<b>Income tax benefit</b>	<b>(485)</b>	<b>(514)</b>
<b>Equity in undistributed net income of bank subsidiary</b>	<b>7,080</b>	<b>7,192</b>
<b>Net income</b>	<b>\$15,778</b>	<b>\$15,629</b>



**FIRST CITIZENS BANCSHARES, INC.**  
**(Parent Company Only)**  
**Condensed Statements of Cash Flows**  
**Years ended December 31, 2016 and 2015**  
*(In thousands)*

	2016	2015
<i>Operating activities</i>		
Net income	\$15,778	\$15,629
Adjustments to reconcile net income to net cash provided by operating activities:		
Undistributed income of subsidiary	(8,698)	(8,437)
(Increase) decrease in other assets	(119)	429
Increase in other liabilities	97	98
Net cash provided by operating activities	7,058	7,719
<i>Investing activities</i>		
Outlay for business acquisitions-net	0	0
Net cash used by investing activities	-	-
<i>Financing activities</i>		
Dividend payments to shareholders	(5,572)	(5,580)
Principal reductions on long-term debt	(1,125)	(1,606)
Treasury stock transactions -net	(272)	(167)
Net cash used by financing activities	(6,969)	(7,353)
Increase in cash	89	366
Cash at beginning of year	1,481	1,115
Cash at end of year	\$1,570	\$1,481





